DRAFTING TO EFFECTUATE GRANTOR'S RETENTION DESIRES WITH RESPECT TO PUBLICLY HELD SECURITIES[1]

Trent S. Kiziah and Lori J. Campbell*

Editors' Synopsis: For a variety of reasons and despite the economic risk, many grantors instruct their legal counsel to create trusts that retain concentrations in particular investments. These wishes, however, often conflict with a trustee's duties to diversify and invest with care, skill, and caution. Although courts generally uphold a boilerplate waiver of the duty to diversify, this Article discusses recent cases that suggest a boilerplate waiver may not always be sufficient. As a result, the authors suggest that these waivers should specifically reference the concentration and explain the grantor's wishes regarding the retention.

Despite including a waiver of the duty to diversify, additional duties often cause the trustee to sell a concentration. The Article examines the effectiveness of various drafting options that are designed to prevent these additional duties from inhibiting the grantor's wishes. The authors propose an alternative that gives beneficiaries the power to determine whether a concentration should be sold but places legal title with an independent trustee. The Article concludes by discussing the conflict between honoring the grantor's desire to retain a concentration and managing the trust for the benefit of the beneficiaries.

*Trent S. Kiziah and Lori J. Campbell are Senior Vice-Presidents at U.S. Trust, Bank of America Private Wealth Management.

[1] This material is intended for educational purposes only. The conclusions expressed are those of the authors and do not necessarily reflect the views of U. S. Trust, Bank of America Private Wealth Management, or any of its affiliates.

I. INTRODUCTION

Notwithstanding the age old maxim against placing all of one's eggs in a single basket,[2] some investors hold concentrations in publicly-held companies actively traded on established markets and direct their legal counsel to prepare investment provisions that prohibit or discourage diversification.[3] This Article reviews the various drafting options that grantors use to effectuate their retention desires, examines the success of those drafting options,

[2] This maxim has long roots in the law dating back at least to 1934 when the phrase appears in *First National Bank of Boston v. Truesdale Hospital*, 192 N.E. 150, 152 (Mass. 1934).

[3] *See* Ashvin B. Chhabra, *Beyond Markowitz: A Comprehensive Wealth Allocation Framework for Individual Investors*, J. OF WEALTH MGMT., Spring 2005, at 8 (referencing Goetzmann and Kumar's 2001 study of 40,000 stock accounts at a brokerage firm, which reveals that the mean number of stocks in a portfolio in the 1991-1996 period was four and that the median number was three).

and offers other drafting alternatives that grantors may wish to consider. Because waiving the duty to diversify is crucial to any successful retention provision, the Article begins with an examination of the trustee's duty to diversify and the trustee's duties to invest with care, skill, and caution as set forth in the Uniform Prudent Investor Act (UPIA) as enacted by a majority of the states.[4]

II. THE DUTY TO DIVERSIFY

Under the UPIA, a trustee must diversify unless special circumstances justify retention or unless the operative document waives the duty to diversify.[5] The duty to diversify is central to investing prudently.[6] If the trust does not waive the duty to diversify, the trustee may retain a concentration only if special circumstances exist.[7] To effectuate a grantor's desire that a concentration be retained, the drafter must be cognizant of the special circumstances that justify retention and what language is necessary to waive

---

[4] As of February 3, 2011, forty-six states have adopted the UPIA in part or whole. *See* Uniform Law Commissioners, Uniform Prudent Investor Act, http://www.nccusl.org/Update/uniformact_factsheet/uniformacts_fs_upria.asp (last visited February 3, 2011). This Article does not address the peculiarity of each state's adopted UPIA. For an excellent discussion of how state specific adoptions of the UPIA bear on the duty to diversify, see *Diversification and Retention of Inception Assets*, 2002 PRAC. DRAFTING, 7026, 7026-58.

[5] UPIA section 3 provides: "[a] trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying." UNIF. PRUDENT INVESTOR ACT § 3, 7B U.L.A. 29 (2006). UPIA section 1(b) provides: "[t]he prudent investor rule, a default rule, may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust." UNIF. PRUDENT INVESTOR ACT § 1(b), 7B U.L.A. 15 (2006). For ease of reference, the operative document will be referred to as a trust and is meant to encompass a trust created by will, inter vivos agreement, court order, or by any other method.

[6] Section 90 to the *Restatement (Third) of Trusts* states as follows:

> The rationale of the trust law's requirement of diversification is more than conservatism or a duty of caution. . . . The general duty to diversify further expresses a warning to trustees, predicated on the duty to exercise care and skill, against taking bad risks—ones in which there is unwarranted danger of loss, or volatility that is not compensated by commensurate opportunities for gain. A central feature of such prudence ordinarily is the reduction of uncompensated risk through diversification.

RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. g (2003). According to one commentator, "[t]he duty to diversify in order to eliminate non-market risk is the centerpiece of the prudent investor rule." Jerold I. Horn, *Prudent Investor Rule, Modern Portfolio Theory and Private Trusts: Drafting and Administration Including the "Give-Me-Five" Unitrusts*, 33 REAL PROP. PROB. & TR. J. 1, 16 (1998).

[7] *See* UNIF. PRUDENT INVESTOR ACT § 3, 7B U.L.A. 29 (2006); *see also infra* Part II.B (discussing the special circumstances that may justify retention of a concentration).

the duty to diversify.[8] Initially, defining diversification and understanding when a concentration exists are necessary.

A. Defining Diversification

The surrogate in *In re Will of Dumont*[9] aptly states the following:

> Diversification is the receipt of a concentrated portfolio, and selling off the majority of the concentration before any hint of problems with the company or stock is received. Diversification is a sale which is done even when the subject company's value is climbing. Conversely, a sale to preserve the value of a trust corpus and ideally to remedy a suffered loss is not the same. Although such a sale could *result* in a diversified portfolio, diversification would not be the *reason* for sale . . . .[10]

The duty to diversify requires a trustee to sell a concentration even if analysts are predicting that the concentration will outperform similar assets. Diversification does not focus on future anticipated performance; rather, diversification focuses on the fact that the trustee has too many identical eggs.

1. Defining What Constitutes a Concentration

The UPIA does not define what constitutes an investment concentration nor does it address how many investments are necessary to achieve diversification.[11] "There is no automatic rule for identifying how much diversification is enough."[12] According to the *Restatement (Third) of Trusts* (*Restatement*), "[s]ignificant diversification advantages can be achieved with a modest number of well-selected securities representing different industries

[8] *See* UNIF. PRUDENT INVESTOR ACT § 1(b), 7B U.L.A. 15 (2006); UNIF. PRUDENT INVESTOR ACT § 3, 7B U.L.A. 29 (2006).

[9] No. 1956TT443, 2004 WL 1468746 (N.Y. Sur. Ct. June 25, 2004), *rev'd sub nom. In re* Chase Manhattan Bank, 809 N.Y.S.2d 360 (App. Div. 2006); *see also infra* Parts II.B.(2)(a), III, V (discussing the case further).

[10] *Id.* at *8.

[11] *See Diversification and Retention of Inception Assets*, 2002 PRAC. DRAFTING 7026, 7057-58. ("The Act [UPIA] and the Restatement provide little guidance regarding the nuts and bolts of the duty to diversify. For example, is there a percentage limit on the holding of a single stock or multiple holding in a single industry?").

[12] UNIF. PRUDENT INVESTOR ACT § 3 cmts., 7B U.L.A. 30 (2006).

and having other differences in their qualities. Broader diversification, however, is usually preferred in trust investing."[13]

2. Diversification in the Equity Market

Several empirical studies have shown that as few as ten to fifteen securities can significantly reduce "diversifiable risk."[14] Other studies have shown that twenty stocks are necessary for optimal diversification.[15] One recent study has concluded that reaching an optimal level of diversification now requires 120 stocks.[16] Unquestionably, a trust that only owns stock in a single company is not diversified. A court recently held that a trustee breached the duty to diversify when the trustee invested one-third of the trust in a publicly held security.[17] Unfortunately, the court does not discuss how it reached its conclusion that a concentration existed.

B. Special Circumstances

"The duty to diversify . . . is not absolute."[18] Diversification is not required if "the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying."[19] The UPIA does not elaborate on the phrase "special circumstances;" however, the comments to the UPIA provide insight.

1. Income Tax Considerations

According to the comments to UPIA section 3, "[c]ircumstances can, however, overcome the duty to diversify. For example, if a tax-sensitive trust owns an under[]diversified block of low-basis securities, the tax costs of recognizing the gain may outweigh the advantages of diversifying the holding."[20] The broader investment provision of UPIA section 2(c)(3) also

---

[13] RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. g (2007).

[14] *See* HERBERT B. MAYO, INVESTMENTS: AN INTRODUCTION 153 (9th ed. 2008).

[15] *See* Ted Bloomfield, Richard Leftwich & John Long, *Portfolio Strategies and Performance*, 5 J. FIN. ECON. 201-18 (1977).

[16] *See* Meir Statman, How Much Diversification Is Enough? (Oct. 2002) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=365241.

[17] *See* Uzyel v. Kadisha, 116 Cal. Rptr. 3d 244, 283-84 (Ct. App. 2010).

[18] RESTATEMENT (THIRD) OF TRUSTS § 92 cmt. d(2) (2007).

[19] UNIF. PRUDENT INVESTOR ACT § 3, 7B U.L.A. 29 (2006).

[20] UNIF. PRUDENT INVESTOR ACT § 3 cmt., 7B U.L.A. 29 (2006) "What 'tax-sensitive' means is unclear." *Diversification and Retention of Inception Assets*, 2002 PRAC. DRAFTING, 7026, 7028. Presumably, a tax-exempt trust is not tax sensitive. A charitable remainder trust is not subject to income tax, but it may be a tax-sensitive trust because gains may flow out to

directs a trustee to consider the expected tax consequences of investment decisions or strategies.[21] Comments to UPIA section 2 provide the following:

> Tax considerations, such as preserving the stepped up basis on death under Internal Revenue Code § 1014 for low-basis assets, have traditionally been exceptionally important in estate planning for affluent persons. Under the present recognition rules of the federal income tax, taxable investors, including trust beneficiaries, are in general best served by an investment strategy that minimizes the taxation incident to portfolio turnover.[22]

A trustee of a "tax-sensitive trust" may be justified in holding an asset concentration if the stock has a low income tax basis.[23] The exception cannot be open ended.[24] Nearly all asset concentrations involve assets that have appreciated in value from their income tax basis.[25] If an asset has not appreciated in value from the time of its purchase, few investors and few beneficiaries would demand its retention. Mere income tax exposure cannot justify asset retention, or the exception would consume the rule.

---

noncharitable beneficiaries. Most trusts are tax sensitive because they and their beneficiaries are subject to income tax.

[21] *See* Robert H. Jeffrey & Robert D. Arnott, *Is Your Alpha Big Enough to Cover Its Taxes?* J. OF PORTFOLIO MGMT., Spring 1993, at 15 (noting that in most cases, the income taxes generated by frequent portfolio turnover is not large enough to be justified for taxable investors).

[22] UNIF. PRUDENT INVESTOR ACT § 2 cmt., 7B U.L.A. 21 (2006).

[23] *See* UNIF. PRUDENT INVESTOR ACT § 2(c)(3), 7B U.L.A. 20 (2006); *see also* UNIF. PRUDENT INVESTOR ACT §§ 2-3 cmts., 7B U.L.A. 20-33 (2006). Comment (a) to *Restatement* section 92 provides: "[i]n some circumstances, for example, tax considerations (looking to the tax positions of both the trust and the beneficiaries) may tend to suggest retention of inception assets, and in others these considerations may tend to suggest that conversion be made promptly." RESTATEMENT (THIRD) OF TRUSTS § 92 cmt. a (2007).

[24] In *Rhodehamel v. Rhodehamel*, No. C07-0081z, 2008 WL 249042 (W.D. Wash. 2008), the trustee defendants of a revocable trust asserted that retention of the concentration was justified because an adjustment to basis would occur upon the death of the grantor, who was 82. The Court noted in footnote 3: "Given the overall decrease in Eli Lilly & Company share prices over the life of the trust, the . . . Defendants' analysis appears a bit simplistic, and the question whether a prudent investor would have sold the stock and invested the Trust assets differently seems to be a factual dispute." *Id.* at *12, n.3.

[25] A notable exception occurs if the trust has recently received an adjustment to its income tax basis due to inclusion in an individual's federal gross estate.

A trustee may be justified in retaining a concentration if an adjustment to basis will occur in the near future. The sooner the basis adjustment is likely to occur, the greater the reason for retaining the concentration. For example, the trustee of a revocable trust created by a grantor currently ninety-eight years old may be prudent in retaining a concentration with a low income tax basis because the asset's income tax basis will be adjusted in the near future. While the portfolio has much greater risk by retaining the concentration, reducing risk involves substantial tax cost. Given the life expectancy of a ninety-eight year old, the trust does not have sufficient time to make up the tax cost.[26] If the trust continues for a lengthy period of time without inclusion in a beneficiary or grantor's federal gross estate, less justification exists for allowing the inherent income tax to weigh too heavily on the investment decision.

No reported cases exist that squarely address how much reliance a trustee should place on the income tax exposure when determining whether to sell a concentration. Is it possible that inherent income tax is a factor only if a basis adjustment will occur in the near future, but an insignificant factor if an adjustment will not occur during the term of the trust or until an event that is not likely to occur until many years into the future, given life expectancies? Until this question is answered, trustees should bear in mind that protection may exist only if basis adjustment is likely to occur in the near future. Exactly how far into the future is uncertain.

2. Special Relationship

When investing, UPIA section 2(c)(8) requires a trustee to consider "an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries."[27] Even if the trust does not expressly waive the duty to diversify, a concentration with a "special relationship" or "special value" to the purpose of the trust may be retained because it constitutes a "special circumstance" under UPIA section 3.[28] The comments to UPIA section 3 references the desire to retain a family business as a circumstance in which the trust's purposes override the duty to diversify.[29] Because the family business has a special relationship to the trust's pur-

---

[26] Even in this situation, the trustee should monitor the concentration as illustrated in *Rhodehamel*, 2008 WL 249042.

[27] UNIF. PRUDENT INVESTOR ACT § 2(c)(8), 7B U.L.A. 20 (2006).

[28] UNIF. PRUDENT INVESTOR ACT § 3, 7B U.L.A. 29 (2006).

[29] *See* UNIF. PRUDENT INVESTOR ACT § 3 cmts., 7B U.L.A. 29 (2006). ("The wish to retain a family business is another situation in which the purposes of the trust sometimes override the conventional duty to diversify.")

poses, the business can be retained notwithstanding the fact that it represents a concentration and notwithstanding the absence of a waiver of the duty to diversify in the trust. Two illustrative cases concerning family controlled entities are *In re Hyde*[30] and *Lichtenfels v. North Carolina National Bank*.[31]

In *In re Hyde*, the daughters of the founder of Finch Pruyn, a large manufacturer in Glens Falls, New York, established three trusts and funded them with stock in this closely held company. The beneficiaries asserted that the trustees should be surcharged for their failure to diversify during the twenty-year tenure of the trusts. The trusts did not waive diversification nor make any reference to the stock.[32] According to the court, there was some indication that "the settlors of the trust[s] wanted the ownership of Finch Pruyn to remain in the family and the trusts were used as vehicles to achieve such a result."[33] The trustees considered liquidating the stock several times and met with financial advisors, including investment bankers and brokerage houses. Because no market for the stock existed and the company had little interest in purchasing its own stock except at a substantially reduced value, the trustees concluded that only a sale of the entire company could obtain a fair price.[34] The court noted that the trustees did not diversify because of the lack of a market for the stock, the expected tax consequences, and the special relationship the business had to the trust purpose.[35] The court held the trustees fulfilled their fiduciary investment duties.[36]

In *Lichtenfels v. North Carolina National Bank*, upon funding, approximately 90% of the trust consisted of stock in Cone Mills, the fifth largest textile company in the United States at the time. The grantor was a member of the Cone family. The stock was closely held by the family until it was listed on the New York Stock Exchange.[37] The court noted:

> [W]here a decedent leaves an estate which is not diversified in a prudent manner, as where the principal asset of the estate is stock in a family corporation, and he authorizes the retention of investments, the trustee is not

---

[30] 845 N.Y.S.2d 833 (App. Div. 2007).
[31] 151 S.E.2d 78 (N.C. 1966).
[32] *See* 845 N.Y.S.2d at 835.
[33] *Id.* at 838.
[34] *See id.* at 837.
[35] *See id.* at 838.
[36] *See id.* at 839.
[37] *See* 151 S.E.2d 78, 80 (N.C. 1966).

> obliged to sell part of the assets merely to obtain diversification.[38]

The court held that the trustee was justified in retaining the family corporation's stock. The court continued to refer to the stock as a family corporation even though it was publicly traded. Whether the family still maintained control after the stock was listed on the exchange is not clear from the opinion.

Hyde and *Lichtenfels* involved securities that were initially closely held. Notably, in *Lichtenfels* the court held the trustees were justified in retaining the stock even after the company went public.[39] Notwithstanding the fact that the trusts in both cases did not specifically waive the duty to diversify, special circumstances justified the retention of the stock. The stocks had a special relationship to the beneficiaries, and retention effectuated a trust purpose. Notwithstanding the absence of an expressed waiver of the duty to diversify, a trustee may be justified in holding a concentration in a family controlled entity if retention is consistent with trust purposes and prudent in light of the trustee's duty of care and caution.

a. *Publicly Held Companies*

Would a court extend the special asset exception to a concentration in a publicly held stock held by millions of investors? For example, would a trustee be justified in retaining United Parcel Service (UPS) stock in a revocable trust because the now incompetent elderly grantor had worked for the company and had continually refused to sell the asset concentration?[40] Continuing this example, does the sentimental attachment to a particular stock extend after the testator's death because the family made its fortune in that stock? These questions arose in *Wood v. U.S. Bank, N.A.*[41] concerning a concentration in Firstar, a publicly held company. The court noted:

> The "special circumstances" language [in UPIA section 3] generally refers to holdings that are important to a family or a trust. For example, in *Brackett v. Tremaine*, the Nebraska Supreme Court recently held that there was no duty to diversify where the asset in question was a piece

---

[38] *Id.* at 85-86.

[39] *See id.* at 86.

[40] The answer may be yes, but the conclusion primarily rests on the fact that retaining the stock is prudent given the fact that the income tax basis will be adjusted upon the grantor's demise.

[41] 828 N.E.2d 1072 (Ohio Ct. App. 2005).

> of farmland that had a special meaning to the family. We realize that Firstar stock is not farmland. But perhaps it had a special relationship to the family or to the trust. Or perhaps it did not. Further, this was not the case of a controlling interest in a family business—which might normally be an example of special circumstances. Either way, this question was for the jury.[42]

The appellate court remanded the case to the trial court with instructions to have the jury consider whether the beneficiary had a special relationship to Firstar.[43] The court noted that the trust officer had testified that the decedent "had made all of his money from . . . [Firstar] and had insisted for years that it never be sold."[44] Note that the court did not rule as a matter of law on the issue. Rather, the court determined that the jury should decide whether special circumstances were present.[45] How much reliance a trustee should place on *Wood* is unknown. No available record exists on how the jury ruled when the case was remanded. In *Wood,* the trust did not waive the duty to diversify.[46] As a result, the trustee would be protected in holding the concentration only if the stock had a special relationship to the beneficiaries or to the trust.[47] The court punted the crucial question to the jury.[48]

In *In re Will of Dumont*,[49]the will contained a clause that expressly waived the duty to diversify and expressed the testator's affinity for the stock.[50] The surrogate mentioned the following in footnote one:

> It was established that Charles Dumont had a family history with the Kodak company, and it was Kodak which had created the family's wealth to begin with. Directions to retain are looked upon more favorably by courts when the

---

[42] *Id.* at 1079.

[43] *See id.* at 1080.

[44] *Id.*

[45] *See id.*

[46] The decision centered primarily on whether a general retention clause was sufficient to waive the duty to diversify as opposed to whether the grantor had a special relationship to the stock.

[47] *See id.* at 1078.

[48] *See id.* at 1080.

[49] No. 1956TT443, 2004 WL 1468746 (N.Y. Sur. Ct. June 25, 2004), *rev'd sub nom. In re* Chase Manhattan Bank 809 N.Y.S.2d 360 (N.Y. App. Div. 2006); *see* discussion *supra* Part II.A, *infra* Parts III, V.

[50] *See infra* note 104 (quoting the actual language contained in the trust).

> stock was held by the testator . . . and as such would be even more so here with a long-standing intimate family connection to the company.[51]

The surrogate's mention of the testator's affinity for Kodak apparently does impact the analysis but provides no further insight into the issue.[52] Presumably, the testator's affinity for the stock did not weigh heavily because the court awarded $21 million in damages against the trustee.[53]

One commentator opined that a grantor should be able to elect into the special relationship exception by stating that the concentration has a special relationship to the grantor, the trust, and its beneficiaries.[54] This direction would constitute a written waiver of the duty to diversify.[55] Thus, the duty to diversify would be waived by the trust stating the grantor's affinity to the stock.

In light of the current state of case law, trustees should be cautious about retaining a concentration in a publicly held company based solely on the special relationship exception to the duty to diversify.

3. Impossibility of Sale

Section 231 comment c of the *Restatement (Second) of Trusts* provides the following:

> The trustee is not liable for delaying to sell because he cannot obtain a fair price for the property. Thus, in the case of real estate or other property which does not have a ready market he can properly delay selling until he can obtain an offer to buy at a price which he reasonably thinks represents a fair value for the property.[56]

Generally, publicly held securities are readily marketable. However, in some cases security restrictions may prohibit the sale of the stock during

---

51 *In re* Will of Dumont, 2004 WL 1468746 at *6.

52 *See id.* at *7.

53 *See id.* at *23

54 *See Follow up on April 1983, October 1995, October 1997 and October 2002 Issues*, 2004 PRAC. DRAFTING, 7818, 7832.

55 *See infra* Part II.C.

56 RESTATEMENT (SECOND) OF TRUSTS § 231 cmt. c (1959).

certain periods. In those cases, the inability to sell the stock likely will justify its retention.[57]

4. *Summary of Special Circumstances*

If the concentration has a special relationship to the beneficiaries or to the trust or if significant tax gains are present with adjustment to basis in the foreseeable future, the trustee may be justified in retaining the concentration notwithstanding the absence of language in the trust waiving the duty to diversify. Of course, the better approach is for the trust to mention the concentration specifically, waive the duty to diversify, and explain the grantor's rationale for encouraging the retention of the concentration.

C. Waiving the Duty to Diversify[58]

If a grantor desires a particular stock be retained, the grantor should waive the duty to diversify rather than rely on the special circumstances exception. A trustee is required to effectuate the grantor's intention as expressed in the terms of the trust.[59] The duty to diversify "may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust."[60] Because diversification is fundamental to investing prudently, a waiver of

---

[57] The trustee should consider the possible use of derivatives to reduce risk when holding any concentrations and especially when the concentration cannot be sold. *See* Robert J. Aalberts & Percy S. Poon, *Derivatives and the Modern Prudent Investor Rule: Too Risky or Too Necessary?*, 67 OHIO L. J. 525 (2006); Thomas J. Boczar, *An Introduction to Options and Other Financial Derivative Strategies*, 136 TRUSTS & ESTATES 43 (Feb. 1997); Michael D. Cohn, *Using Options as a Tool to Protect Assets, Increase Investment Income, and Improve Risk Reward Rations*, 31 ACTEC J. 74 (2005).

[58] The following discussion assumes the UPIA has been enacted in the applicable jurisdiction. Six states have not enacted the UPIA, and others have done so but have modified some of its provisions. For example, in Pennsylvania and Washington the trustee may retain inception assets even though the asset represents a concentration. *See* 20 PA. CONS. STAT. § 7205 (2005); WASH. REV. CODE § 11.100.060 (2006). In these states, the asset may be retained even though special circumstances are not present and even though the trust does not waive the duty to diversify. *See supra* note 4.

[59] *See* RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. b (2007) ("Trustees have a general fiduciary duty to comply with the terms of their trusts . . . . The nature and extent of a trustee's duties and powers are primarily determined by the terms of the trust."); *see also* UNIF. TRUST CODE § 801, 7C U.L.A. 587 (2006) ("Upon acceptance of a trusteeship, the trustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries, and in accordance with this [Code].").

[60] UNIF. PRUDENT INVESTOR ACT § 1(b), 7B U.L.A. 15 (2006). The comments to UPIA section 1 state, "[a]lmost all of the rules of trust law are default rules, that is, rules that the settlor may alter or abrogate. Subsection (b) carries forward this traditional attribute of trust law." *Id.*

the duty to diversify should be unequivocal. According to the comments to the *Restatement*, "because diversification is fundamental to prudent risk management, trust provisions are strictly construed against dispensing with that requirement altogether."[61] Courts have not imposed such a strict standard. Even waivers contained in the boilerplate powers provisions of a trust have been deemed sufficient to waive the duty to diversify. In all of the following cases, the courts held that the duty to diversify was waived.

Americans for the Arts v. Ruth Lilly Charitable Remainder Annuity Trust[62] involved two charitable remainder annuity trusts (CRATs) solely funded with shares in Eli Lilly & Company (a publicly traded company at the time) valued at approximately $286 million upon funding.[63] After receipt, the corporate trustee began selling the stock and had sold all of the stock within ten months of funding.[64] The charitable remainder beneficiaries asserted that the trustee had failed to diversify within a reasonable period of time.[65] Each trust granted the trustee the power "to retain indefinitely any property received by the trustee" and provided "any investment made or retained by the trustee in good faith shall be proper despite any resulting risk or lack of diversification or marketability and although not of a kind considered by law suitable for trust investments."[66] Other than this provision buried in the powers provision of the CRATs, the trust was silent as to the grantor's attachment to the $286 million concentration.[67] The court concluded that "the general Retention Clause in the CRATs combined with the clause explicitly lessening the trustee's duty to diversify is sufficient to except National City [the corporate trustee] from the default duty to diversify trust assets."[68] The court rendered judgment in the corporate trustee's favor.[69]

In *Nelson v. First National Bank and Trust Company of Williston*,[70] the revocable trust was funded primarily with Medtronic stock, a publicly

---

[61] RESTATEMENT (THIRD) OF TRUSTS § 91 cmt. f (2007).

[62] 855 N.E.2d 592 (Ind. Ct. App. 2006); *see infra* Part IV.G.2 (discussing this case further).

[63] *See* 855 N.E.2d at 595.

[64] The court notes the stock had significantly declined in value during the ten month period but does not state by how much.

[65] *See* 855 N.E.2d at 602.

[66] *Id.* at 595.

[67] *See id.* at 599-602.

[68] *Id.* at 601-02.

[69] *See id.* at 603.

[70] 543 F.3d 432 (8th Cir. 2008); *see infra* Part IV.H (discussing this case further).

traded company. The corporate trustee took no action to sell the stock until five months after the grantor's death, by which time the value of the stock had decreased by over $4 million. The beneficiaries asserted the trustee should have sold the stock within two weeks of the grantor's death.[71] The trust agreement granted the trustee the power to retain any property received by the trustee and provided "any investment made or retained by the trustee in good faith shall be proper despite any resulting risk of lack of diversification or marketability and although not of a kind considered by law suitable for trust investments."[72] The court held that this language waived the duty to diversify. The court noted that the trustee monitored the concentration daily to ensure that the price of the stock did not fall so low as to interfere with the trust's ability to pay the estate taxes. The court held in favor of the corporate trustee.[73]

In *Atwood v. Atwood*,[74] the grantor funded the trust primarily with stock in AMP Company, a publicly traded company.[75] The trust permitted the trustee to do the following: "To invest and reinvest in, or exchange assets for, any securities and properties they deem advisable, including without limiting the generality of the foregoing, common and preferred stocks, *without being limited in the selection of investments by any statutes, rules of law, custom or usage*."[76]

The beneficiaries asserted the trust was damaged due to the trustee's failure to diversify. The court held the quoted language conveyed an unequivocal message that the grantors intended that the trustee not be constrained by the prudent investor rule.[77] Notably, the quoted provision does not explicitly reference the duty to diversify.[78] The court held for the trustees.[79]

In *Donato v. BankBoston, N.A.*,[80] the bank served as trustee of a trust primarily consisting of stock in CML Group, Inc., a publicly traded compa-

[71] *See* 543 F.3d at 434.
[72] *Id.*
[73] *See id.* at 437.
[74] 25 P.3d 936 (Okla. Ct. App. 2001).
[75] *See id.* at 940.
[76] *Id.* at 943.
[77] *See id.* at 944.
[78] *See id.* at 943-44.
[79] *See id.* at 945.
[80] 110 F. Supp. 2d 42 (D.R.I. 2000); *see infra* Part III (discussing this case further).

ny and the maker of NordicTrack equipment.[81] The beneficiary asserted that the trustee breached the duty to diversify and the duty of care, skill, and caution.[82] The trust provided the following:

> I specifically authorize the trustees to hold and retain any property delivered to them by me or subsequently acquired by them pursuant to my written instructions, notwithstanding any lack of diversification in the investment of such property or any disproportionate investment thereof in common stock or other equities and the trustee shall not be liable for any loss or depreciation occasioned by such retention.[83]

The court held for the trustee and noted that the trust relieved the trustee from any absolute duty to diversify the trust assets.[84]

In these four cases,[85] a simple clause expressly waiving the duty to diversify buried in the boilerplate powers provisions waived the duty to diversify.[86]

Bucking the trend, however, the court in *Fifth Third Bank v. Firstar Bank, N.A.*[87] held that a general waiver of the duty to diversify was insufficient to waive the duty.[88] The grantor funded a charitable remainder unitrust for her life with $2 million of Proctor & Gamble stock, a publicly traded company. Selecting a corporate trustee, the bank's portfolio manager im-

---

[81] *See* 110 F. Supp. 2d at 43.

[82] *See id.* at 44-45.

[83] *Id.* at 48.

[84] *See id.* at 49.

[85] *See* Trent S. Kiziah, *The Trustee's Duty to Diversify: An Examination of the Developing Case Law*, 36 ACTEC J. 357, 383 (2010) (providing additional cases addressing waiver of the duty to diversify).

[86] A general authorization in a trust permitting the trustee to retain investments received as part of a trust is insufficient to waive the trustee's duty to diversify. *See, e.g.*, Wood v. U.S. Bank, N.A., 828 N.E.2d 1072, 1078 (Ohio App. 2005); *see also* M. L. Cross, Annotation, *Construction and Effect of Instrument Authorizing or Directing Trustee or Executor to Retain Investments Received Under Such Instrument*, 47 A.L.R.2d 187. Comment d to *Restatement* section 92 provides that "[a] general authorization in an applicable statute or in the terms of the trust to retain investments received as a part of a trust estate does not ordinarily abrogate the trustee's duty with respect to diversification or the trustee's general duty to act with prudence in investment matters." RESTATEMENT (THIRD) OF TRUSTS § 92 cmt. d (2007).

[87] No. C-050518, 2006 WL 2520329 (Ohio Ct. App. Sept. 1, 2006).

[88] *See id.* at *4.

mediately started liquidating the stock. However, when the price of the stock dropped, the portfolio manager postponed any additional sales. When the price increased, the portfolio manager resumed diversification. By the end of the first year, the trust had dropped in value by half.[89] The trust agreement granted the trustee the following power: "to retain, without liability for loss or depreciation resulting from such retention, original property, real or personal, received from Grantor or from any other source, although it may represent a disproportionate part of the trust."[90]

The court held "this language did not clearly indicate the intention to abrogate the duty to diversify."[91] The court held that the duty to diversify can be waived only "'if the instrument creating the trust clearly indicates an intention to abrogate the common-law, now statutory, duty to diversify.'"[92] The court apparently concluded that the trust provision that referenced "disproportionate part" was not sufficiently clear.[93]

Notwithstanding the general leniency of the courts to permit a waiver of the duty to diversify by boilerplate provisions, in light of *Fifth Third Bank*, the better approach is to specifically mention the concentration to be retained, specifically waive the duty to diversify as to that particular concentration, and explain why the grantor does not want to diversify the investment.[94]

III. DUTY TO INVEST WITH CARE, SKILL, AND CAUTION

A trustee has a duty to "invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements,

---

[89] *See id.* at *1.

[90] *Id.* at *3.

[91] *Id.* at *4.

[92] *Id.* (quoting Wood v. U.S. Bank, N.A., 828 N.E.2d 1072, 1074 (Ohio Ct. App. 2005)).

[93] *See id.*

[94] Christopher P. Cline opines that "mere boilerplate language is largely unhelpful if the trustor intends for the trustee to hold large undiversified concentrations of anything. Rather, the lawyer drafting the instrument should include very specific language, worded very strongly, if this is the testator's intent." Christopher P. Cline, *The Uniform Prudent Investor and Principal and Income Acts: Changing the Trust Landscape*, 42 REAL PROP. PROB. & TR. J. 611, 622 (2008); *see also* Michael L. Graham, 100 Years Is A Long Time – New Concepts and Practical Planning Ideas, at E-17-MLG/HCIII (2007) (presentation at the 2007 annual ACTEC meeting), *available at* http://www.actec.org/Documents/CLEMaterials/SemE GrahamChristensen100years.pdf.

and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution."[95]

"The duty of care requires the trustee to exercise reasonable effort and diligence in making and monitoring investments for the trust, with attention to the trust's objectives."[96]

The trustee must also use the skill of an individual of ordinary intelligence.[97] A trustee who has special skills or expertise has a duty to use those special skills or expertise.[98]

In addition to the duty to use care and skill, the trustee must exercise caution when investing.[99] "In the absence of contrary provisions in the terms of the trust, this requirement of caution requires the trustee to invest with a view both to safety of the capital and to securing a reasonable return."[100] Preserving the safety of the capital includes the duty to invest in a manner that preserves the purchasing power of the assets; in other words, the trustee must invest bearing in mind the effects of inflation.[101] Because all investments are risky, the duty of caution "does not call for avoidance of risk by trustees but for their prudent management of risk."[102] The trustee has a duty to minimize risk.[103]

In *In Re Will of Dumont*, the will provided the following:

> It is my desire and hope that said stock will be held by my said Executors and by my said trustee to be distributed to the ultimate beneficiaries under this Will, and neither my Executors nor my said trustee shall dispose of such stock for the purpose of diversification of investment and neither they or it shall be held liable for any diminution in the value of such stock. . . .

---

[95] UNIF. PRUDENT INVESTOR ACT § 2(a), 7B U.L.A. 20 (2006).

[96] RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. d (2007).

[97] *See id.*

[98] *See* UNIF. PRUDENT INVESTOR ACT § 2(f), 7B U.L.A. 20 (2006); *see also* UNIF. TRUST CODE § 806, 7C U.L.A. 602 (2006).

[99] *See* RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. e (2007).

[100] *Id.*

[101] *See id.* Likewise, UPIA section 2(c)(2) requires the trustee to invest considering the possible effects of inflation or deflation. *See* UNIF. PRUDENT INVESTOR ACT § 2(C)(2), 7B U.L.A. 20 (2006).

[102] RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. e(1) (2007).

[103] *See id.*

> The foregoing provisions shall not prevent my said Executors or my said Trustee from disposing of all or part of the stock of Eastman Kodak Company in case there shall be some compelling reason other than diversification of investment for doing so.[104]

The surrogate noted the will clearly waived the duty to diversify but pointed out that a waiver of the duty to diversify does not waive the trustee's duty to prudently manage the concentration. According to the surrogate, a trustee has a duty to preserve the corpus of the trust. The trustees erroneously assumed that a waiver of the duty to diversify excused them from properly monitoring the trust portfolio.[105] The surrogate noted:

> Where a fiduciary is administering an estate under directives of a retention clause, it is incumbent upon that fiduciary to develop a uniform understanding of the testator's words, basing such a definition on the input of an experienced team of industry professionals, preferably under the guidance of in-house legal advice. It is also critical that the fiduciary's actions reflect an understanding that a retention clause does not exculpate itself from poor judgment and laziness, but instead that a retention clause almost requires a greater level of diligence and work, as prudent management of the estate will demand a delicate balancing act.[106]

The surrogate held that the trustee had a duty to sell the Kodak stock because the stock's low dividend yield was insufficient to provide the beneficiary sufficient income.[107] A factor beyond diversification required the sale of the Kodak stock. In addition, the surrogate held that the trustee should have sold the Kodak stock when the January 11, 1974 Valueline report expressed less praise for the stock than an earlier report.[108] In other

---

[104] *In re* Will of Dumont, No. 1956TT443, 2004 WL 1468746, at *1-2 (N.Y. Sur. Ct. June 25, 2004), *rev'd sub nom. In re* Chase Manhattan Bank, 809 N.Y.S.2d 360 (App. Div. 2006); *see also supra* Parts II.A, II.B.2.a, *infra* Part V (discussing the case further).

[105] *See Dumont*, 2004 WL 1468746, at *19.

[106] *Id.* at *17.

[107] *See id.* at *22.

[108] *See id.* at *20.

words, the trustee should have sold the stock because of the stock's poor investment outlook. The surrogate awarded $21 million in damages.[109]

In *First Alabama Bank of Huntsville, N.A. v. Spragins*,[110] the trust waived the duty to diversify.[111] The court pointed out that the waiver of the duty to diversify did not relieve the trustee from the duty to determine whether holding the concentration was prudent in light of the beneficiaries' needs.[112] According to the court, even eight years after stepping in as trustee, the bank had failed to determine the needs of the beneficiaries.[113] The court surcharged the trustee for its failure to prudently manage the assets.[114]

In *Donato v. BankBoston*,[115] the trust waived the duty to diversify.[116] The trustee argued it could be held liable only for retaining the concentration if it abused its discretion because it was relieved of any duty to diversify.[117] The court noted the following:

> "[T]he fact that an investment is permitted does not relieve the trustee of the fundamental duty to act with prudence." Thus, standing alone, a permissive provision does not relieve trustees from scrutiny under a "prudence" standard for their investment decisions; it means only that a trustee cannot be found to have acted imprudently *per se* for

---

[109] The appellate court in *Dumont* overturned the judgment against the trustee. *See In re* Chase Manhattan Bank, 809 N.Y.S.2d 360 (App. Div. 2006). The appellate court concluded that the trustee was not remiss in holding onto a concentration with low yield because the income beneficiary was not in need of funds because she had inherited $12 million from another decedent. *See id.* In addition, the appellate court held that a trustee does not act imprudently because a Valueline report includes less praise than an earlier report. *See id.* Notably, the appellate court did not disagree with the surrogate's position on the applicable law. *See id.* A waiver of the duty to diversify does not waive the duty to manage prudently. *See id.*

[110] 515 So.2d 962 (Ala. 1987).

[111] *See id.* at 963. The trustee was empowered to invest in a manner "as it may seem necessary or desirable, regardless of any lack of diversification." *Id.* at 963.

[112] *See id.* at 964.

[113] *See id.*

[114] *See id.* at 967.

[115] 110 F. Supp. 2d 42 (D.R.I. 2000).

[116] *See id.* at 48; *see also* discussion *supra* Part II.C.

[117] *See* 110 F. Supp. 2d at 48.

> holding a particular type of investment or for holding a disproportionately large amount of one investment.[118]

The *Dumont*, *Spragins*, and *Donato* decisions illustrate that a waiver of the duty to diversify simply relieves the trustee of the duty to sell a concentration solely for diversification reasons. *Practical Drafting* aptly states, "The elimination of the requirement to diversify provides a trustee with more flexibility; it does not remove the requirement of prudence. . . . Eliminating the duty to diversify does not, in itself, relax the other aspects of the standard of prudence applicable to retention of an asset."[119]

A waiver of the duty to diversify does not waive the trustee's duty to prudently invest in light of the purposes, terms, distribution requirements, and other circumstances of the trust.[120] Nor does a waiver of the duty to diversify waive the trustee's duties to invest with care, skill, and caution.[121]

IV. DRAFTING RETENTION PROVISIONS

Grantors desiring to retain a concentration are faced with a myriad of drafting choices. None of these choices guarantee that the concentration will be retained. All of the choices have limitations.

A. Mandatory Retention Provisions

On occasion, grantors will include a mandatory retention provision, which mandates that a trustee retain a concentration and prohibits the trustee from selling the asset. Mandatory retention provisions operate to waive the duty to diversify because the trustee cannot sell the concentration.[122] For example, the will of Joseph Pulitzer, of the famous Pulitzer Prize, contained the following provision:

> This power of sale, however, is limited to the said stock of the Pulitzer Publishing Company of St. Louis, and shall not be taken to authorize or empower the sale or

---

[118] *Id.* at 49 (quoting RESTATEMENT (THIRD) OF TRUSTS § 228 cmt. f (1992) (now contained in RESTATEMENT (THIRD) OF TRUSTS § 91 cmt. f (2007))).

[119] *Followup on April 1983, October 1995, October 1997 and October 2002 Issues*, 2004 PRAC. DRAFTING, 7818, 7830-31.

[120] *See id.*

[121] *See id.*; *see also* Durden v. Citicorp Trust Bank, FSB, No. 3:07-cv-974-J-34JRK, 2009 WL 6499365, at *14 (M.D. Fla. Aug. 21, 2009) (citing RESTATEMENT (THIRD) OF TRUSTS § 91 (2007)) (noting "mere authorization with regard to an investment or type of investment [does not] constitute an exculpatory clause.").

[122] *See supra* Part II.C.

> disposition under any circumstances whatever, by the Trustees of any stock of the Press Publishing Company, publisher of 'The World' newspaper. I particularly enjoin upon my sons and my descendants the duty of preserving, perfecting and perpetuating 'The World' newspaper (to the maintenance and upbuilding of which I have sacrificed my health and strength) in the same spirit in which I have striven to create and conduct it as a public institution, from motives higher than mere gain, it having been my desire that it should be at all times conducted in a spirit of independence and with a view to inculcating high standards and public spirit among the people and their official representatives, and it is my earnest wish that said newspaper shall hereafter be conducted upon the same principles.[123]

The stock in the company passed into trusts for two of his youngest sons for their lifetime with eventual distribution to their descendants.[124] The trustees were the decedent's three sons.[125] They petitioned the court and sought to be relieved of this prohibition on sale.[126] The trustees pointed out that the company had operated at a loss from 1926 to 1930 and, given the substantial decrease in advertising revenues, would continue to suffer a loss.[127] They argued that an emergency existed, and if the company were not sold, the trust would continue to decline in value and become worthless.[128] The court stated that it "will be guided by the policy of protection of the trust funds rather than blind obedience by the trustee to the language used by the testator."[129] The court read into the will an implied power to sell based on changed circumstances.[130] The court based its decision on the changed circumstances doctrine.[131]

---

[123] *In re* Pulitzer's Estate, 249 N.Y.S. 87, 92 (Sur. Ct. 1931), *supplemented by* 251 N.Y.S. 549 (Sur. Ct. 1931), *aff'd mem.*, 260 N.Y.S. 975 (App. Div. 1932).

[124] *See id.* at 91.

[125] *See id.* at 92.

[126] *See id.* at 90.

[127] *See id.* at 97.

[128] *See id.*

[129] *Id* at 95.

[130] *See id.* at 98.

[131] The doctrine of changed circumstances is set forth in *Restatement* section 66(1), which provides that "the court may modify an administrative or distributive provision of a

In *In Re Trusteeship Under Agreement with Mayo*,[132] the court addressed an investment restriction that prohibited equity investments.[133] Therein the two irrevocable trusts both permitted the trustees to "invest and reinvest the same in real estate mortgages, municipal bonds or any other form of income bearing property (but not real estate nor corporate stock)."[134] In 1940, one trust had a value of $957,000. Eighteen years later the trust had appreciated to a value of only $968,000. Given inflation, the buying power of the trust had been reduced nearly in half. The beneficiary sought deviation from the restrictive investment language.[135] She argued that the primary purpose of the trust was to preserve the value of the trust corpus and that this purpose was circumvented because of the restrictive investment language.[136] She argued that, since the grantor's demise, inflation had become a substantial factor.[137] The trustees asserted that inflation had in fact been present during the grantor's life and that he restricted the investments due to the stock market crash of 1929.[138] The court began by noting that its highest duty was to give effect to the donor's intent.[139] The court noted that in exceptional circumstances, a court will permit a deviation from the terms of a trust but only if "it is reasonably certain that the purposes of the trust would otherwise be defeated or impaired in carrying out the donor's dominant intention."[140] The court felt compelled to allow a deviation from the terms of the trust to give effect to the grantor's dominant intention to benefit the beneficiaries.[141]

---

trust, or direct or permit the trustee to deviate from an administrative or distributive provision, if because of circumstances not anticipated by the settlor the modification or deviation will further the purposes of the trust." RESTATEMENT (THIRD) OF TRUSTS § 66(1) (2003).

[132] 105 N.W.2d 900 (Minn. 1960).

[133] *See id.* at 901.

[134] *Id.* at 902.

[135] *See id.*

[136] *See id.* at 904.

[137] *See id.* at 902.

[138] *See id.* at 903.

[139] *See id.*

[140] *Id.* at 904.

[141] *See id.* at 906. The Mayo decision does not involve a mandatory retention provision; rather, it involves a restrictive investment provision.

To benefit the beneficiaries, the courts in *Pulitzer* and *Mayo* relieved the trustee from mandatory provisions that failed.[142]

Mandatory retention provisions are discouraged because they may result in substantial erosion of the value of the trust.[143] Such clauses may be void because they usurp the duty of prudence.[144] As illustrated in *Pulitzer* and *Mayo,* even if not void *ab initio*, the courts likely will find sufficient changed circumstances to remove the prohibition on sale. However, a trustee cannot ignore a mandatory retention provision.[145] A trustee may have a duty to seek judicial relief from a mandatory retention provision if selling the concentration is prudent to prevent harm to the trust.[146] When prudence dictates a sale, the trustee will be forced to seek judicial relief. Unfortunately, the trust may be substantially harmed by the delay in seeking such relief. Because mandatory retention provisions may cause harm to the beneficiaries if the company changes or market conditions change, mandatory retention provisions should rarely, if ever, be used.

---

[142] Worth noting is that in *Pulitzer* the mandatory retention provision was honored from the time of Mr. Pulitzer's demise in 1911 until entry of the court order in 1931, a period of twenty years. In *Mayo*, the grantor died in 1939, and the court's decision was not issued until 1960. Thus, the provision operated for twenty-one years.

[143] *See* Jeffrey A. Cooper, *Speak Clearly and Listen Well: Negating the Duty to Diversify Trust Investments*, 33 OHIO N.U. L. REV. 903, 922 (2007).

[144] "Where prudence dictates sale, a retention clause is superseded," according to the surrogate in *In re Will of Dumont*, No. 1956TT443, 2004 WL 1468746, at *19 (N.Y. Sur. Ct., June 25, 2004), *rev'd sub nom. In re* Chase Manhattan Bank, 809 N.Y.S.2d 824 (App. Div. 2006). *See supra*, text at notes 9, 49, and 104 (discussing this case further).

[145] RESTATEMENT (THIRD) OF TRUSTS § 91 cmt. e (2007) ("Unless violative of some public policy . . . such directions and restrictions are legally permissible and are ordinarily binding on the trustee in managing the trust assets, thus often displacing the normal duty of prudence.").

[146] *Restatement* section 66 provides:

> (1) The court may modify an administrative or distributive provision of a trust, or direct or permit the trustee to deviate from an administrative or distributive provision, if because of circumstances not anticipated by the settlor the modification or deviation will further the purposes of the trust.
>
> (2) If a trustee knows or should know of circumstances that justify judicial action under Subsection (1) with respect to an administrative provision, and of the potential of those circumstances to cause substantial harm to the trust or its beneficiaries, the trustee has a duty to petition the court for appropriate modification of or deviation from the terms of the trust.

RESTATEMENT (THIRD) OF TRUSTS § 66 (2003).

B. Permissive Retention Provisions

A permissive retention provision expresses the grantor's desire that the trust retain a concentration but does not mandate retention.[147] A trustee is required to give consideration to the grantor's request but is not prohibited from selling the concentration if prudence dictates a sale.[148] It has been lamented that the grantors' wishes expressed in permissive retention provisions are too often thwarted by trustees and judges.[149] For example, in *Holder v First Tennessee Bank, N.A., Memphis*,[150] the trust provided the following:

> Only for the most compelling reason is the Trustee to make any change in the stocks put in this trust. However, change is to be permitted if the need for change appears to the Trustee to be clearly in the best interests of the beneficiaries of this trust. . . . The Grantor intends for the Trustee to act primarily in a custodial capacity with regard to the stocks in this trust, and he expressly relieves the Trustee of responsibility for any unfavorable results that may arise from lack of diversification, or from these restrictions on its normal investment freedom.[151]

The trust held a concentration in Coca-Cola stock, a publicly traded company. The trustee sold some of the stock and filed a declaratory judgment seeking construction of the trust language. The beneficiaries asserted that the trustee should not have sold any of the Coca-Cola stock. The trustee testified that it sold shares in Coca-Cola because the trustee felt that diversifying the risk associated with holding stock in only one company was in the best interest of the beneficiaries.[152] The trial court held that compelling reasons for selling the stock did not exist because the trust waived the duty to diversify.[153] The appellate court reversed, noting that the trust specifically authorized the trustee to sell if the trustee felt selling was in the best interest

---

[147] RESTATEMENT (THIRD) OF TRUSTS § 91, cmt. f (2007) ("[a] trustee is not under a duty to make or retain investments that are made merely permissive by trust provision.").

[148] *See id.*

[149] *See* Cooper, *supra* note 143, at 905.

[150] No. W1998-00890-COA-R3-CV, 2000 WL 349727 (Tenn. Ct. App. Mar. 31, 2000).

[151] *Id.* at *1.

[152] *See id.* at *2.

[153] *See id.* at *1.

of the beneficiaries.[154] Both courts held that the quoted trust provision waived the duty to diversify. Even though the trust waived the duty to diversify, the trustee felt compelled to diversify to reduce the risk associated with holding a concentration.[155] The trustee did not offer any reason for selling the stock other than to reduce the risk associated with holding a concentration. The grantor's wishes were thwarted.

Properly drafted permissive provisions, which waive the duty to diversify by specific reference to the concentration, will alleviate the duty to sell merely for diversification reasons.[156] Even when diversification has been waived, however, the trustee must sell if it is prudent to do so for reasons other than diversification.[157] As illustrated in *Holder*, some trustees and courts give little regard to permissive provisions.[158] In light of their continuing investment duties, trustees are inclined to sell a concentration even though the trust agreement clearly waives the duty to diversify.[159] A grantor who waives the duty to diversify by specific reference to the concentration and expresses a preference for retention, however, is presumably attempting to do more than waive the duty to diversify.[160] The grantor expresses an opinion that the asset is a prudent investment that will benefit the beneficiaries if it is retained.[161] The grantor may have created the trust with the primary purpose of retaining the concentration.[162] Wisdom weighs, however, too heavily in favor of diversification unless special circumstances are present, and even then, the trustee faces additional risk by retaining a concentration. A court may hold that the trustee foolishly waited to sell because the trustee placed too much reliance on a permissive retention provision. As long as the trustee has discretion of any kind with respect to a concentration, the trustee faces risk and will be inclined to sell.[163]

[154] *See id.* at *5.

[155] *See id.* at *2.

[156] *See supra* Part II.C.

[157] *See supra* Part III.

[158] *See Holder*, 2000 WL 349727.

[159] *See* David M. Stein, Andrew F. Siegel, Premkumar Narasimhan & Charles E. Appeadu, *Diversification in the Presence of Taxes*, J. OF PORTFOLIO MGMT., Fall 2000, at 61, 61-71.

[160] *Followup on April 1983, October 1995, October 1997 and October 2002 Issues*, 2004 PRAC. DRAFTING, 7818, 7831.

[161] *See id.*

[162] *See id.*

[163] In some states, the trustee has no duty to diversify inception assets. *See supra* note 58.

C. Objective Retention Provisions

Because courts have not been inclined to honor mandatory provisions and trustees have often ignored permissive provisions, Professor Jeffrey A. Cooper recommends trust provisions that forbid the trustee from selling an asset until an objective event occurs.[164] For example, he proffers a clause that prohibits a sale unless the company's earnings per share decline for three years in a row.[165] Cooper asserts such a provision takes the middle road between a permissive retention provision and a mandatory retention provision on sale.[166] While such a provision would operate effectively in many situations, Cooper readily admits cases will arise in which the more prudent approach is for a trustee to quickly act to changing economic developments.[167] A single event may necessitate the sale of the stock. Waiting three years may result in total depletion of the trust. No formula, no matter how intricate, will operate under all circumstances, especially in an ever-changing economic playing field. The trustee may have a duty to seek judicial relief from a mandatory retention provision or a formulaic retention provision if retention of the concentration will serve to harm the beneficiaries.[168] A court will not exonerate a trustee who idly sits by while the value of the trust is depleted. The trustee cannot find protection behind a mandatory or formulaic retention provision.

D. Individual Trustees

Fearing that corporate trustees will diversify a concentration, some grantors assume that selecting an individual to serve as trustee will increase the possibility that their retention desires will be honored. To a certain extent, the grantors are correct. Individuals owning few assets or with creditor protected assets may display more boldness than a corporate fiduciary. Individuals may also place more reliance on the grantor's orally expressed retention desires. Individuals may also be less familiar with their obligations as trustees. However, none of these reasons support the selection of an individual trustee as a viable alternative to proper drafting. Individuals serving as trustees have the same duty to diversify trust concentrations and invest

---

[164] *See* Cooper, *supra* note 143, at 923.

[165] *See id.*

[166] *See id.*

[167] *See id.*, at 923 n.104.

[168] *See* RESTATEMENT (THIRD) OF TRUSTS § 66(2) (2007).

with care, skill, and caution as corporate trustees have.[169] Because the individual trustee has the same duty to comply with the UPIA, selecting an individual trustee merely shifts the investment risk from the deep pockets of a corporate trustee to the shallow pockets of an individual trustee rather than solving the underlying issues surrounding concentrations.

E. Shifting Investment Responsibility

1. Delegation of Investment Responsibility

Under the UPIA, a trustee may delegate investment functions to an investment agent.[170] The trustee is not liable to the beneficiaries or the trust for the decisions or actions of the investment agent if the trustee used reasonable care, skill, and caution in selecting the agent, properly established the scope and terms of the delegation, and periodically reviewed the agent's actions to monitor the agent's performance and compliance with the terms of the delegation.[171] Can the trustee absolve itself from liability for an asset concentration by delegating investment functions to an investment agent? Has an investment agent fallen below the required standard of care if a concentration is retained? In such event, is the breach clear enough to give rise to a breach by the trustee for failure to monitor? A trustee's delegation of investment function may be insufficient to shift the trustee's duty to diversify, and even if it does, it merely shifts the duty to the investment agent.[172] Delegation of investment function, thus, does not effectively resolve the diversification issues arising with respect to concentrations in trust accounts.

2. Trust Advisor/Directed Trustee

A trust can shift the duties to monitor and manage a concentration to a trust advisor.[173] A trust could provide that the directed trustee has no investment duties over the concentration. The directed trustee would take di-

---

[169] "The prudent investor standard applies to a range of fiduciaries, from the most sophisticated professional investment management firms and corporate fiduciaries, to family members of minimal experience." UNIF. PRUDENT INVESTOR ACT § 2, 7B U.L.A. 22 (2006).

[170] *See* UNIF. PRUDENT INVESTOR ACT § 9, 7B U.L.A. 39 (1994).

[171] *See* UNIF. PRUDENT INVESTOR ACT § 9(a), 7B U.L.A. 39 (2006).

[172] *See* UNIF. PRUDENT INVESTOR ACT § 9(b), 7B U.L.A. 40 (2006).

[173] Alexander A. Bove, Jr. argues that the terms *trust advisor*, *trust consultant*, *trust director*, and *trust protector* are all interchangeable. *See* Alexander A. Bove, Jr., The Protector: Trust(y) Watchdog or Expensive Exotic Pet?, at SII-3-AAB (2003) (presentation at the 2003 annual ACTEC meeting) *available at* http://www.actec.org/Documents/CLE Materials/ProtectorBove.pdf.

rection from the trust advisor for all matters concerning the concentration.[174] The duties that a directed trustee has under these circumstances depend on the characterization of the trust advisor's power.[175] Under the Uniform Trust Code (UTC), a trust advisor is presumptively a fiduciary.[176] The directed trustee has a duty to follow the direction of the trust advisor unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust.[177] If the trust does not waive the duty to diversify and the trust advisor retains the concentration, has a serious breach of trust occurred? If the trust waives the duty to diversify and the trust advisor retains the concentration even after several analysts downgrade the stock, has a serious breach of trust occurred? If the answer to these questions is yes, then under the UTC, the directed trustee will not be protected from exposure.[178]

If the trust advisor's power is personal, the directed trustee has no duty to review the exercise of the power in some jurisdictions.[179] However, the

---

[174] *See* Dennis I. Belcher, *Not My Fault – The Devil Made Me Do It! Responsibilities and Duties of a Delegating or Directed Trustee*, 41 HECKERLING INST. ON EST. PLAN. 13-1 (2007) (providing an excellent discussion of the law concerning the directed trustee); *see also* Henry Christensen, III, The Use of Trust Protectors or Boards of Advisors in Long-Term Irrevocable Trusts, (2007) at E-23-MLG/HCIII (seminar at the 2007 annual ACTEC meeting), *available at* http://www.actec.org/Documents/CLEMaterials/SemEGraham Christensen100years.pdf.

[175] *See* Belcher, *supra* note 174, at 13-30; *see also* Alexander A. Bove, Jr., *The Protector: Trust(y) Watchdog or Expensive Exotic Pet?* 30 EST. PLAN. 390, 391 (2003) (reproducing Bove, *supra* note 173, at SII-8-AAB).

[176] *See* UNIF. TRUST CODE § 808(d), 7C U.L.A. 604 (2000). Bove asserts "[i]f the protector is someone in an advisory capacity to the settlor or someone the settlor would be unlikely, under normal circumstances, to name as a beneficiary, the power will most likely be a fiduciary one," Bove, *supra* note 175, at 392 (reproducing Bove, *supra* note 173, at SII-10-AAB to SII-11-AAB).

[177] *See* UNIF. TRUST CODE § 808(b), 7C U.L.A. 604 (2000). *Restatement* section 75 requires the trustee to follow the directions of the trust advisor "unless the attempted exercise is contrary to the terms of the trust or power or the trustee knows or has reason to believe that the attempted exercise violates a fiduciary duty that the power holder owes to the beneficiaries." RESTATEMENT (THIRD) OF TRUSTS § 75 (2005).

[178] *See* Bove, *supra* note 173, at SII-8-AAB; *see* RESTATEMENT (THIRD) OF TRUSTS § 75 cmt. d (2007) (indicating that even if the trust advisor's power is personal, the trustee has a duty not to comply with the direction if the trustee knows or has reason to believe that an attempted exercise exceeds the scope of the advisor's power or constitutes an abuse of power).

[179] *See* Belcher, *supra* note 174, at 13-30. Bove notes that, if the trust advisor "is a beneficiary or a person who would likely be an object of the settlor's bounty," the power

directed trustee may have other duties that require the trustee to act and thus give rise to the trustee's exposure.[180]

Some jurisdictions have provided additional protection to the directed trustee.[181] For example, the Delaware Code provides the following:

> If a governing instrument provides that a fiduciary is to follow the direction of an adviser, and the fiduciary acts in accordance with such a direction, then except in cases of wil[l]ful misconduct on the part of the fiduciary so directed, the fiduciary shall not be liable for any loss resulting directly or indirectly from any such act.[182]

The term *willful misconduct* is defined in the Delaware Code as "intentional wrongdoing, not mere negligence, gross negligence or recklessness."[183] Notably, the Delaware statute relieves the directed trustee from gross negligence and recklessness.[184] The Delaware statute provides greater protection to the trustee than the UTC and the common law, which do not permit waiver of gross negligence and recklessness.[185]

A trust advisor has the power to control the trustee.[186] The trust advisor's exposure to the beneficiaries of the trust depends on how the role is

---

may be personal. Bove, *supra* note 175, at 392 (reproducing Bove, *supra* note 173, at SII-10-AAB).

[180] *See* Rollins v. Branch Banking and Trust Co. of Va., No. CH 00-488, 2001 WL 34037931 (Va. Cir. Ct. Oct. 21, 2002); Belcher, *supra* note 174, at 13-24. In *Rollins*, the trust clearly imposed upon the beneficiaries the investment duties with respect to a concentration in a publicly-held company. *See* 2001 WL 3437831, at *2. In light of the provisions of the trust and Virginia's directed trustee statute, the court held that the trustee had no investment duties. *See id.* However, the court noted that "the trustee has a duty to fully inform beneficiaries of all facts . . . which come to the trustee's knowledge and which are material for the beneficiary to know for the protection of his interest." *Id.* at *3.

[181] *See* Belcher, *supra* note 174, at 13-20.

[182] DEL. CODE ANN. tit. 12 § 3313(b) (2007).

[183] DEL. CODE ANN. tit. 12 § 3301(g) (Supp. 2010).

[184] *See id.*

[185] *See infra* Part IV.G.2 (discussing exculpation clauses). The Delaware law provides protection that may not be available in some of the states that have enacted additional protection for directed trustees. *See* Belcher, *supra* note 174, at 13-20; *see also* Benjamin H. Pruett, *Tales from the Dark Side: Drafting Issues from the Fiduciary's Perspective*, 35 ACTEC J. 331, 357 (2010).

[186] *See* Note, *Trust Advisers*, 78 HAR. L. REV. 1230, 1230 (1965) (defining a trust advisor as "a person who has power to control a trustee in the exercise of some or all of his powers."). Bove describes a trust advisor "as a third party who has discretionary powers with respect to the trust but who is not a trustee." Bove, *supra* note 173, at SII-3-AAB.

characterized and the governing law.[187] If the power is deemed personal, the trust advisor may have no duty to the beneficiaries in some jurisdictions.[188] If the power is deemed a fiduciary power, the trust advisor has a fiduciary duty to the beneficiaries.[189] Under the UTC, a trust advisor granted the power to direct trust investments has a fiduciary duty to properly invest those assets.[190] The Delaware statutes, which provide a great deal of protection to the directed trustee, designate the trust advisor as a fiduciary.[191] Even if the directed trustee is relieved of liability, the trust advisor has a fiduciary obligation to the beneficiaries unless the trust advisor's power is deemed to be personal, which is generally limited to trust advisors who are family members.[192] If the trust advisor is not a family member, the advisor will likely have the fiduciary duty to prudently invest and to diversify. In such event, the directed trustee option merely shifts the fiduciary duty to the trust advisor rather than resolves the investment issues discussed in this Article. On the other hand, if the trust advisor is a family member, the directed trustee and the family trust advisor will have less exposure in some jurisdictions, thereby increasing the possibility that the trust advisor will retain the concentration.[193]

---

[187] *See* Belcher, *supra* note 174, at 13-20; *see also* RESTATEMENT (THIRD) OF TRUSTS cmt. c-c(1) (2007).

[188] *See* Bove, *supra* note 175, at 391 (reproducing Bove, *supra* note 173, at SII-7-AAB to SII-8-AAB).

[189] *See id.* at 392.

[190] *See* UNIF. TRUST CODE § 808(d), 7C U.L.A. 604 (2006); *see also* Richard C. Ausness, *The Role of Trust Protectors in American Trust Law*, 45 REAL PROP. TR. & EST. L.J. 319, 338 (2010).

[191] *See* DEL. CODE ANN. tit. 12, § 3313(a) (2007).

[192] *See* Bove, *supra* note 173, at SII-10-AAB; *see also* Edward C. Halbach, Jr, *The 1999 Joseph Trachtman Lecture—Uniform Acts, Restatements and Other Trends in American Trust Law at Century's End*, 25 ACTEC J. 101, 119 (1999) (speculating "absent some clear indication (possibly even circumstantial) of a settlor's contrary intent, the powers gratned to a protector will be deemed to be held in a fiduciary capacity, even if not strictly that of trustee . . . .").

[193] *See* discussion *infra* Part IV.J.3.

F. Retention Letters[194]

Trustees can find limited protection in holding concentrations through investment retention letters (retention letters) signed by the beneficiaries that direct the trustees to retain the concentration.[195] Section 1009 of the UTC provides as follows:

> [A] trustee is not liable to a beneficiary for breach of trust if the beneficiary consented to the conduct constituting the breach, released the trustee from liability for the breach, or ratified the transaction constituting the breach, unless: (1) the consent, release, or ratification of the beneficiary was induced by improper conduct of the trustee; or (2) at the time of the consent, release, or ratification, the beneficiary did not know of the beneficiary's rights or of the material facts relating to the breach.[196]

Similarly, the *Restatement (Second) of Trusts*, section 216[197] provides the following:

---

[194] Arguably, a discussion of retention letters is beyond the scope of an article about drafting for concentrations in that retention letters often arise if the trust fails to properly address concentration issues. The following analysis illustrates that retention letters do not provide adequate protection to the trustee, illustrating the need for planning to occur when the trust is drafted.

[195] According to the comments at section 1 of the UPIA, "Traditional trust law allows the beneficiaries of the trust to excuse its performance, when they are all capable and not misinformed." UNIF. PRUDENT INVESTOR ACT § 1 cmts., 7B U.L.A. 16 (2006) (citing to RESTATEMENT (SECOND) OF TRUSTS § 216 (1959)).

[196] UNIF. TRUST CODE § 1009 (amended 2001), 7C U.L.A. 656 (2006).

[197] Tentative Draft No. 5 of *Restatement* section 97 provides:

> A beneficiary who consented to or ratified, or released the trustee from liability for, an act or omission that constitutes a breach of trust cannot hold the trustee liable for that breach, provided:
>
> (a) the beneficiary, at the time of consenting to or ratifying the breach or granting the release, had the capacity to do so or was bound in doing so by the act of representation by another; and
>
> (b) the beneficiary (or the beneficiary's representative), at the time of the consent, ratification, or release, was aware of the beneficiary's rights and of all material facts that the trustee knew or should have known relating to the matter; and
>
> (c) the consent, ratification, or release was not induced by improper conduct of the trustee.

RESTATEMENT (THIRD) OF TRUSTS § 97 (Tentative Draft No. 5, 2009).

> (1) Except as stated in Subsections (2) and (3), a beneficiary cannot hold the trustee liable for an act or omission of the trustee as a breach of trust if the beneficiary prior to or at the time of the act or omission consented to it.
>
> (2) The consent of the beneficiary does not preclude him from holding the trustee liable for breach of trust, if
>
> (a) the beneficiary was under an incapacity at the time of such consent or of such act or omission; or
>
> (b) the beneficiary, when he gave his consent, did not know of his rights and of the material facts which the trustee knew or should have known and which the trustee did not reasonably believe that the beneficiary knew; or
>
> (c) the consent of the beneficiary was induced by improper conduct of the trustee.
>
> (3) Where the trustee has an adverse interest in the transaction . . . .[198]

As stated in the UTC and the *Restatement (Second) of Trusts*, a trust is effective only if the beneficiaries have been fully apprised of the effects that execution of the retention letters will have on their legal rights and how the direction to hold the concentration will relieve the trustee of the duty to diversify.[199]

In *In re Saxton*,[200] soon after becoming trustee, the corporate trustee, on its own initiative, mailed the income beneficiary and the presumptive remaindermen retention letters seeking their consent to retain the trust's concentration in International Business Machines (IBM) shares. The beneficiaries never requested the retention letters, had no input in their preparation, and were never advised of the benefits of diversification or the risks associated with retention of a concentration. In the retention letters, the beneficiaries acknowledged that the entire corpus of the trust was invested in IBM stock, consented to the retention of the stock, held the trustee harmless for holding the concentration, and retained the right to revoke the consent with thirty days notice.[201] For nineteen years after receiving the signed retention letters, the trust company "maintained no regular communication

---

[198] RESTATEMENT (SECOND) OF TRUSTS § 216 (1959).

[199] *See* UNIF. TRUST CODE § 1009 (amended 2001), 7C U.L.A. 656 (2006); RESTATEMENT (SECOND) OF TORTS § 216 cmt. k (1959).

[200] 712 N.Y.S.2d 225, 274 (App. Div. 2000).

[201] *See id.* at 227.

with" the remainder beneficiaries and never provided them with annual statements.[202] After nineteen years of silence, one of the remainder beneficiaries demanded to receive annual statements.[203] Four years later, the life income beneficiary and the two remaindermen began a series of meetings with the trust officer in which they expressed concern about the concentration in IBM stock.[204] The trust officer asserted that the IBM stock could not be sold unless the income beneficiary also revoked her retention letter.[205] A year later in October of 1987, the market declined and the trust's shares in IBM had lost $5 million in value.[206] The surrogate awarded damages against the corporate trustee.[207]

The court in *Saxton* noted that the trustee had the burden of proving that "the beneficiaries had the intent to form a contract" when they signed the retention letters and that they signed the letters with "actual and full knowledge" of all of their legal rights.[208] The court doubted whether the beneficiaries had made an informed decision because no evidence had been presented at trial that the trustee had explained to the beneficiaries the benefits of diversification, the trustee's duty to diversify, or the consequences of the beneficiaries signing the retention letters.[209] Even though doubt existed as to informed consent, the court did not charge the trustee for failure to diversify until the beneficiary had actually expressed concern about the lack of diversification.[210] Once one of the beneficiaries withdrew her consent to retention of the concentration, the trustee should have begun selling the concentration.[211]

In *McGinley v. Bank of America, N.A.*,[212] a seventy-nine-year-old grantor created a revocable trust in November 1990 appointing Bank of America as trustee.[213] Article VIII (A) of the trust provided that during the grantor's lifetime, "[s]he shall be consulted by the Trustee as to any purchase or sale,

---

[202] *Id.*
[203] *See id.*
[204] *See id.* at 227-28.
[205] *See id.* at 229.
[206] *See id.*
[207] *See id.* at 230.
[208] *Id.* at 231.
[209] *See id.*
[210] *See id.* at 233.
[211] *See id.*
[212] 109 P.3d 1146 (Kan. 2005).
[213] *See id.* at 1148.

and the Trustee shall abide by the Grantor's decision."[214] She later transferred Enron stock to the trust. Seven months after establishing the trust, the bank sent a retention letter to the grantor for her signature.[215] It provided the following:

> I hereby direct you to continue to retain the following securities as assets of the above referenced account: [the Enron stock was listed] . . . I understand that you do not monitor these securities, and I hereby agree to exonerate, indemnify and hold the Bank harmless from any and all loss, damage and expense sustained or incurred by the Bank for continuing to retain these securities as assets of this account. I also relieve the Bank from any responsibility for analyzing or monitoring these securities in any way.[216]

By December 29, 2000, the Enron stock held by the trust had a value of nearly $790,000 and represented 77% of the value of the trust. One year later, the stock had decreased to a value of $4,800. The grantor was competent during the entire period of time. The grantor sued the trustee.[217] The grantor's legal counsel argued the following:

> 1. The letter and its exculpatory provision were invalid because the Bank failed to adequately communicate and explain them to [the grantor]. [The letter did not constitute a trust amendment because no evidence supported that she intended it to serve as one.] . . .
> 2. The exculpatory provision is invalid because of the Bank's failure to adequately communicate its contents . . . [to the grantor].
> 3. Even if the exculpatory provision is valid, the Bank's failure to recommend portfolio diversification lacked good faith and was indifferent to . . . [the grantor's] best interest.[218]

---

[214] *Id.* at 1149.
[215] *See id.*
[216] *Id.* at 1149-50.
[217] *See id.* at 1150.
[218] *Id.* at 1157.

The prudent man rule applied during the beginning years of the trust administration and the UPIA applied to the balance. The district court granted summary judgment in the bank's favor.[219] The Kansas Supreme Court affirmed the district court's summary judgment but did not base its opinion on the retention letter. Rather, the court notes that the letter served as a direction to the trustee in accordance with Article VIII (A) of the trust agreement.[220] The court held that Article VIII (A) "reduced the Bank's responsibilities contained in the prudent investor rule."[221] The court stated that the letter was consistent with Article VIII (A) and did not need to serve as a trust amendment.[222] As to the letter, the court noted in passing:

> Clearly the better practice for the Bank would have been to have communicated to McGinley the letter's contents and effect before she signed it, and to have notified her of evolving circumstances, *e.g.*, steady decreases in Enron's value which reduced the investment portfolio's overall worth, or steady increases, though desirable, which unbalanced the portfolio.[223]

The grantor argued that the trustee had a fiduciary duty to advise her against a concentration.[224] The court noted, however, that the terms of the trust agreement established the trustee's obligations.[225]

With retention letters, the trustee has numerous burdens to overcome. Initially, the trustee must be able to convince the court that the beneficiaries fully understood the legal ramifications of the retention letters. In practice, the beneficiaries rarely seek their own legal counsel concerning the retention letters; therefore, the trustee will have the duty to fully inform the beneficiaries or insist that the beneficiaries hire legal counsel. Even after the retention letter is signed, the trustee has continuing duties. The courts in *In re Saxton* and *McGinley v. Bank of America, N.A.* indicated that the trustee had some type of continuing obligation to keep the beneficiaries informed as to developments with respect to the stock even though the retention letters relieved the trustee from any liability for holding the stock. Thirdly, and

---

[219] *See id.* at 1148.
[220] *See id.* at 1154.
[221] *Id.*
[222] *See id.* at 1155.
[223] *Id.* at 1156.
[224] *See id.*
[225] *See id.* at 1157.

more importantly, the retention letters may bind only the beneficiaries that sign them.[226] The *Restatement (Second) of Trusts* does not prevent a beneficiary who does not sign the retention letter from bringing an action to surcharge the trustee even though a beneficiary with a greater current interest in the trust has signed a retention letter.[227] Because, in most cases, obtaining retention letters from contingent remainder beneficiaries is impossible, the trustee is open to a surcharge action from those beneficiaries. Under the UTC, a minor, incapacitated, or unborn individual or a person whose identity or location is unknown or not reasonably ascertainable may be represented and bound by another having a substantially identical interest.[228]

---

[226] *See* RESTATEMENT (SECOND) OF TRUSTS § 216, cmt. g (1959) ("If there are several beneficiaries, whether concurrent or successive, the consent of one of them to a deviation from the terms of the trust does not preclude the other beneficiaries from holding the trustee liable for breach of trust so far as their interests are affected."). *Contra* RESTATEMENT (THIRD) OF TRUSTS § 97 cmt. d (Tentative Draft No. 5, 2009) (noting that a beneficiary's personal fiduciary—such as a guardian, conservator, or agent acting under a durable power of attorney—may bind the beneficiary and providing that a beneficiary may be bound by another under the doctrine of virtual representation).

[227] *See* RESTATEMENT (SECOND) OF TRUSTS § 216 (1959); Pruett, *supra* note 185, at 336 (recommending that the trust agreement contain a provision that would permit an individual named in the trust to bind incapacitated, contingent, and unknown beneficiaries by signing retention letters on behalf of such beneficiaries); *see also* Beyer v. First Nat'l Bank of Colo. Springs, 843 P.2d 53, 57 (Colo. App. 1992) (holding that minor beneficiaries were bound by the consents to speculative investments, which their parents signed, when the trust contained a clause specifically stating: "the person having the right of custody of a minor beneficiary, may act for such beneficiary for all purposes under the administrative provisions of this Agreement").

[228] *See* W.A.K. II, a Minor, v. Wachovia Bank, N.A., 712 F. Supp. 2d, 476 (E.D. Va. 2010). The court indicated the father's consent to the retention of the concentration bound the minor child. *See id.* at 483. The grantor funded an irrevocable trust in 1966 predominately with stock in Central National Bank, appointing her husband and Central National Bank as trustees. *See id.* at 479. After several merges, the trust held 65% of its assets in Wachovia Bank. *See id.* at 479-80. The trust waived the duty to diversify and the duty of loyalty. On several occasions between 2003 and 2007, Wachovia recommended to the co-trustee, who was also the current income beneficiary, and to the next successive income beneficiary that the trust be diversified. The co-trustee and the successive income beneficiary refused to consent to diversification. Wachovia presented retention letters to the co-trustee and the successive income beneficiary. *See id.* at 480. These two individuals signed the letters in October 2003 and similar letters in April 2004, September 2005, and again in November 2007. *See id.* at 486. The letters shifted investment responsibility to monitor the stock solely to the individual co-trustee, released Wachovia from liability to monitor its own stock, and indemnified Wachovia from any resulting losses or damaged. The court held the retention letters served to release Wachovia from any responsibility. The minor child of the successive income beneficiary argued that his father's consent did not

Some corporate trustees have concluded that obtaining retention letters from beneficiaries of irrevocable trusts is not worthwhile because most beneficiaries sign them without separate legal representation and contingent remainder beneficiaries are not available to sign them.

G. Extended Discretion and Exculpation Clauses

1. Extended Discretion

Extended discretion, such as a provision that grants the trustee sole or absolute discretion, provides some additional protection for the trustee retaining a concentration.[229] Extended discretion, however, should accompany an exculpation clause. The comments to *Restatement* section 92 state:

> *Extended discretion or exculpatory language.* Sometimes a statutory or trust provision expressly grants the trustee "absolute," "sole and uncontrolled," or similar discretion to retain assets received as a part of the trust estate, or expressly states that the trustee shall not be liable for retaining such assets. Language of this type does not wholly insulate the trustee from judicial intervention or liability for abuse of discretion. Such language, however, confers upon the trustee greater than ordinary latitude in the exercise of judgment with respect to the retention of inception investments, although it does not allow the trustee to act in bad faith or in a state of mind not contemplated by the settlor. Nor does it allow the trustee to act recklessly or in disregard of the fiduciary duty of loyalty.[230]

A grant of absolute investment discretion is always subject to the trustee's duty to discharge its fiduciary obligations.[231] In *Estate of Collins*,[232]

---

serve to bind him. The court disagreed. The opinion is unclear on whether the successive income beneficiary was signing solely on his own behalf or also on behalf of his minor son. The minor child argued that his father's interest was adverse to his. The court could not find any conflict. *See id.* at 483.

[229] *See Fiduciary Powers*, 1983 PRAC. DRAFTING, 153, 176.

[230] RESTATEMENT (THIRD) OF TRUSTS § 92, cmt. (d)(1) (2003) (citations omitted); *see also* UNIF. TRUST CODE § 814(a), cmt. (amended 2004), 7C U.L.A. 620 (2006) (concerning the effect of a grant of extended discretion).

[231] *See* UNIF. TRUST CODE § 814(a), cmt. (amended 2004), 7C U.L.A. 620 (2006); RESTATEMENT (THIRD) OF TRUSTS § 92 cmt. (d)(1) (2003).

[232] 139 Cal. Rptr. 644 (Ct. App. 1977).

the trust provided that "all discretions conferred upon the Trustee shall be absolute, and their exercise conclusive on all persons interest[ed] in this trust."[233] According to the court, "a trustee with 'absolute discretion' may not 'neglect its trust or abdicate its judgment,' or show a 'reckless indifference' to the interests of the beneficiary."[234] The trustee had lent the entire trust estate to two borrowers and taken a second mortgage as collateral.[235] When the borrowers went bankrupt, the first mortgage holder foreclosed, resulting in the second mortgages being worthless. The court held that the trustee had a duty to distribute the risk of loss by reasonable diversification. In addition, the court held that the trustee failed to investigate the soundness of the investment.[236] A grant of absolute discretion does not protect the trustee from reckless indifference or gross negligence; however, it does permit the trustee greater latitude.[237]

2. *Exculpation Clauses*[238]

An exculpation clause in a trust provides additional protection to the trustee and will likely increase the possibility that the trustee will honor a properly drafted retention provision. UTC section 1008 provides the following:

> (a) A term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that it: (1) relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries; or (2) was inserted as the result of an abuse by the trustee of a fiduciary or confidential relationship to the settlor.
>
> (b) An exculpatory term drafted or caused to be drafted by the trustee is invalid as an abuse of a fiduciary or

---

[233] *Id.* at 646.

[234] *Id.* at 650 (citations omitted) (quoting Coberly v. Superior Court L.A. Cnty., 42 Cal. Rptr. 64 (Dist. Ct. App. 1965)).

[235] *See id.* at 647.

[236] *See id.* at 650.

[237] *See* RESTATEMENT (THIRD) OF TRUSTS § 92 (2003).

[238] The following discussion primarily focuses on how the UTC, the *Restatement*, and a number of cases treat exculpation clauses. Certain states have express provisions that address exculpation clauses. For example, New York provides that an attempted exoneration of an executor or testamentary trustee "from liability for failure to exercise reasonable care, diligence and prudence" is against public policy and therefore void. N.Y. EST. POWERS & TRUSTS § 11-1.7(a)(1) (McKinney 2008).

> confidential relationship unless the trustee proves that the exculpatory term is fair under the circumstances and that its existence and contents were adequately communicated to the settlor.[239]

The trust cannot completely exculpate a trustee; the trustee must always comply with a certain minimum standard.[240]

A properly drafted exculpation clause[241] does not shift the standard of care but rather relieves the trustee from liability.[242] In the following cases, trustees escaped liability due to an exculpation clause:

---

[239] UNIF. TRUST CODE § 1008, 7C U.L.A. 654 (2006). UTC section 105(b)(10) provides that the terms of the trust cannot lower the standard of care below the standard set forth in UTC section 1008. *See* UNIF. TRUST CODE § 105(b)(10) (amended 2005), 7C U.L.A. 428 (2006). The Tentative Draft of *Restatement* section 96 provides:

> (1) A provision in the terms of a trust that relieves a trustee of liability for breach of trust, and that was not included in the instrument as a result of the trustee's abuse of a fiduciary or confidential relationship, is enforceable except to the extent that it purports to relieve the trustee
>
> (a) of liability for a breach of trust committed in bad faith or with indifference to the fiduciary duties of the trustee, the terms or purposes of the trust, or the interests of the beneficiaries, or
>
> (b) of accountability for profits derived from a breach of trust.

RESTATEMENT (THIRD) OF TRUSTS § 96 (Tentative Draft Nov. 5, 2009); *see also* Melanie B. Leslie, *Trusting Trustees: Fiduciary Duties and the Limit of Default Rules*, 94 GEO. L.J. 67, 96 (2005) (noting that the UTC section 1008 follows the trend of a number of state legislatures—in footnote 142 of her article, she cites to twenty-seven state statutes—that have adopted provisions expressly authorizing exculpatory clauses in trust instruments).

[240] *See* UNIF. TRUST CODE § 1008 cmt., 7C U.L.A. 654 (2006).

[241] *See* Donato v. BankBoston, N.A., 110 F. Supp. 2d 42 (D.R.I. 2000) (providing an example of an improperly drafted exculpation clause); *See also supra* Parts II.C, III (discussing *Donato* further). In *Donato*, the bank served as trustee of a trust primarily consisting of stock in CML Group, Inc., the maker of Nordic Track equipment. *See* 110 F. Supp. 2d at 46-47. The trust contained two exculpation clauses, one set forth in the broad investment provisions of the powers clause and the other in the retention clause. *See id.* at 49. The broad investment provision provided:

> The trustees, in addition to and not in limitation of all common law and statutory authority, shall have the broadest discretionary powers of investment, reinvestment and management over each trust established under this trust agreement and, without qualifying the foregoing generality, shall be entitled (without applying to any court and without liability except in cases of negligence or bad faith) in their discretion: . . . [t]o retain any securities . . . including . . . securities not ordinarily considered appropriate for trust investment . . . and in each case in amounts which normally would be required as disproportionately large for trust investments.

In *Americans for the Arts v. Ruth Lilly Charitable Remainder Annuity Trust*,[243] the two trusts at issue contained identical provisions granting the trustee the power "to retain indefinitely any property received by the trustee."[244] In addition, the trusts provided that "any investment made or retained by the trustee in good faith shall be proper despite any resulting risk or lack of diversification."[245] The trustee asserted that the trust waived any duty to diversify and asserted that the exculpation clause protected it from any action taken in good faith. The trial court entered summary judgment in the trustee's favor.[246] At the appellate court, the remaindermen argued that the exculpation clause should be held invalid because the corporate trustee

---

Id. at 48. The court noted an exculpatory provision "normally relieves trustees from liability for breach of trust except when 'committed in bad faith or intentionally or with reckless indifference to the interest of the beneficiary.'" *Id.* at 49 (quoting RESTATEMENT (SECOND) OF TRUSTS § 222 (1959)). In this case, the provision exculpated the trustee only in the absence of negligence or bad faith. *Id.* The court concluded that "because the exculpatory provision utilize[d] the word 'negligence,' it [did not] alter the degree of scrutiny required under the 'prudent man' rule." *Id.* Because the exculpation clause in the broad investment provision set forth a negligence provision, the court examined whether the trustee was prudent in retaining the stock, which the trustee had no duty to diversify because the trust waived the duty to diversify. *See id.* The court held the trustee had in fact properly monitored and managed the concentration. *See id.* at 52-54.

[242] *See* 4 AUSTIN W. SCOTT ET AL., SCOTT AND ASCHER ON TRUSTS § 24.27.1 at 1802(5th ed. 2007) ("The effect of a provision relieving the trustee of a liability for a breach of trust is not to extend the trustee's power but to limit the trustee's liability."); *see also* RESTATEMENT (SECOND) OF TRUSTS § 222, cmt. c (1959).

[243] 855 N.E.2d 592 (Ind. Ct. App. 2006); *see also supra* Part II.C (discussing the case further).

[244] 855 N.E.2d at 595.

[245] *Id.* In the authors' opinion, the quoted provision establishes the standard of care for the trust at issue. The court treated the provision as an exculpation provision. The distinction is important. With an exculpation clause, the court may determine the trustee breached its fiduciary duty but is not liable for doing so because of the exculpation clause. In that event, the trustee may not be held liable, but the court may decide not to award trustee's fees. If the provision is deemed to alter the standard of care, the court may conclude that under the established standard, the trustee has not breached the trust even though the trustee's actions would be deemed a breach under the default standard of care set forth in the applicable state law. In the latter, the trustee is entitled to a fee because the trustee has not breached a fiduciary duty. The difficulty arises in distinguishing between an exculpation clause and a clause that shifts the standard of care. *See* Estate of Warden, 2 A.3d 565 (Pa. Super. Ct. 2010); *see also infra* Part IV.H (discussing *Estate of Warden*). In *Warden*, the trust contains a clause that lowers the standard of care to good faith and arguably is also an exculpation provision. The court viewed the provision solely as one shifting the standard of care.

[246] *See* 855 N.E.2d at 596.

had acted with reckless indifference to the interest of the beneficiaries.[247] The remaindermen cited to an Indiana statute, which provided as follows:

> A provision in the trust instrument is not effective to relieve the trustee of *liability for breach of trust* committed in bad faith, intentionally, or with reckless indifference to the interest of the beneficiary, or of liability for any profit that the trustee has derived from a breach of trust.[248]

The remaindermen asserted that this statute voided the exculpation clause because the trustee allegedly acted with reckless indifference when it failed to timely diversify the trust assets. The appellate court disagreed and noted that the statute was not applicable. A breach of trust had not occurred because the trust waived the duty to diversify. At least from the appellate court's perspective, the plaintiffs rested their case solely on the duty to diversify. According to the appellate court, the exculpation clause protected the trustee from any failure to prudently manage and monitor the trust assets provided the trustee acted in good faith.[249] Because the plaintiffs' case solely rested on the duty to diversify, and the complaint failed to assert that the trustee acted in bad faith, the appellate court affirmed the trial court's entry of summary judgment in the trustee's favor.[250]

In *Ewing v. Ruml*,[251] the trustee sold the original investments and invested solely in tax-exempt bonds, producing higher income than stocks.[252] The remainder beneficiary sued, asserting that the trustee tilted the portfolio to unduly benefit the income beneficiary.[253] The trust agreement permitted the trustee to "make, retain or change any investment without liability on account thereof."[254] The court held that to recover, the plaintiffs had to demonstrate that the trustee's actions were dishonest, made in bad faith, made with improper motives, or were grossly negligent. The plaintiffs failed to do so.[255]

---

[247] *See id.* at 596, 602.
[248] *Id.* at 602 (quoting IND. CODE § 30-4-3-32(b) (2009)).
[249] *See id.*
[250] *See id.* at 603.
[251] 892 F.2d 168 (2d Cir. 1989).
[252] *See id.* at 169.
[253] *See id.* at 170.
[254] *Id.* at 170.
[255] *See id.*

In *Americans for the Arts* and *Ewing*, the courts held that the exculpation clauses protected the trustees from liability. Under the UTC, an exculpation clause can relieve the trustee of liability for a breach of trust but is unenforceable if it "relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries."[256] A well drafted and narrowly drawn exculpation clause that limits the trustee's liability for retention of a specific concentration will provide some degree of protection to a trustee retaining the asset concentration.[257]

H. Waiving the Trustee's Duties to Invest with Care, Skill, and Caution

As set forth in the preceding Part IV.G., an exculpation clause does not alter the standard of care but rather limits the liability of a trustee who fails to act prudently.[258] An exculpation clause is distinguishable from a clause that relieves a trustee from a particular duty.[259] The trustee does not commit a breach of trust by failing to do an act which the trust has relieved the trustee from doing.[260] A trustee who escapes liability due to an exculpation clause has still committed a breach and may not be entitled to compensation for the transaction.[261] A trustee does not commit a breach if the trustee does not have the duty to act.[262] The trustee's duties to invest with care, skill, and caution are default duties.[263] The terms of the trust may modify or relax the

---

[256] UNIF. TRUST CODE § 1008(a)(1), 7C U.L.A. 654 (2006).

[257] Cline recommends that lawyers reexamine their standard exculpation clauses to make the clauses more explicit and tailored to the unique circumstances of the trust. *See* Cline, *supra* note 94, at 647. Leslie asserts that a majority of courts have strictly construed exculpatory clauses when applied to professional trustees and only permit a release involving special circumstances. *See* Leslie, *supra* note 239, at 74. She asserts that courts "tended to construe exculpatory clauses strictly; cases finding a trustee liable notwithstanding the trust document's exculpatory clause were the rule rather than the exception." *Id.* at 96. Her assertion may be historically accurate. She points out, however, that state legislatures, the *Restatement*, and the UTC now bless exculpation clauses under certain circumstances. *See id.* at 107-08. She notes that a narrowly drawn exculpation clause addressing a particular investment issue, such as stock in a closely held corporation, should be honored. *See id.* at 103.

[258] *See supra* text accompanying note 242.

[259] *See* RESTATEMENT (THIRD) OF TRUSTS § 222 cmt. c (2003).

[260] *See id.*

[261] *See* SCOTT ET AL., *supra* note 242, § 24.27.1 at 1802.

[262] *See* RESTATEMENT (SECOND) OF TRUSTS § 222, cmt. c (1959).

[263] *See* RESTATEMENT (THIRD) OF TRUSTS § 77, cmt. d (2003); John H. Langbein, *Burn the Rembrandt? Trust Law's Limits on the Settlor's Power to Direct Investments*, 90 B.U. L. REV. 375, 384 (2010).

trustee's duty of caution.[264] The comments to *Restatement* section 77 provide the following:

> Because the normal duty of prudence in matters of administration is default law, the terms of the trust may modify or relax its requirements, especially—but not solely—as regards the element of caution. Trust provisions fixing a standard of prudence lower than that otherwise required of trustees are strictly construed. In any event, trust terms may not altogether dispense with the fundamental requirement that trustees not behave recklessly but act in good faith, with some suitable degree of care, and in a manner consistent with the terms and purposes of the trust and the interests of the beneficiaries.[265]

As stated in this quoted comment from the *Restatement*, the trust cannot totally eliminate the duty of care. The following cases address trusts in which the standard of care was modified.

In *Nelson v. First National Bank and Trust Company of Williston*,[266] the trust permitted the trustee to retain indefinitely any inception assets.[267] It went on to provide "any investment made or retained by the trustee in good faith shall be proper despite any resulting risk or lack of diversification or marketability and although not of a kind considered by law suitable for trust investments."[268] The beneficiaries asserted that the corporate trustee should have sold the concentration within two weeks of their father's death and asserted more than $1 million in damages.[269] The court held that the clause relieved the trustee of a breach of trust based on negligence,[270] and that the trustee was liable only if it had acted in bad faith.[271] Because the benefi-

---

[264] *See* RESTATEMENT (THIRD) OF TRUSTS § 77, cmt. d (2003).

[265] *Id.* (citations omitted).

[266] 543 F.3d 432 (8th Cir. 2008); *see also supra* text at note 70 (discussing this case further).

[267] *See* 543 F.3d at 433.

[268] *Id.* at 434.

[269] *See id.*

[270] *See id.* at 437.

[271] *See id.* at 436.

ciaries had failed to show bad faith, the court entered judgment for the defendant bank.[272]

In *In re Scheidmantel*,[273] the court concluded that the trust agreement shifted the standard of care from ordinary prudence, the default standard set forth under Pennsylvania law, to a standard that would protect the trustee except for fraud, bad faith, or gross negligence.[274] The portfolio manager sold some of the stock in a concentrated holding merely because diversification is a prudent course of action.[275] The court referenced Pennsylvania Statute section 7205, which provides: "[a] fiduciary, in the exercise of reasonable care, skill and caution, may retain any asset received in kind, even though the asset constitutes a disproportionally large share of the portfolio."[276] The trust agreement granted the trustee the power to retain inception assets "without regard to the effect any such retention may have upon the diversity of investments."[277] The trust further provided that "no trustee shall be liable for acts or omissions in administering the trust estate or any trust created by this Agreement, except for the Trustee's own actual fraud, gross negligence or willful misconduct."[278] Before selling the stock, the portfolio manager did not consult with the surviving spouse, who was the only beneficiary currently entitled to income and discretionary principal of the marital trust. The portfolio manager also did not consult with the remainder beneficiary, who was entitled to an outright distribution upon the death of the ill and elderly surviving spouse.[279] If the stock had not been sold, it would have been subject to an adjustment to its income tax basis upon the surviving spouse's demise.[280] The court noted that the portfolio manager changed the investment objectives without ascertaining the current circumstances of the life tenant and never consulted with the remainder beneficiary.[281] The court held that the trustee was grossly negligent in selling a portion of the

---

[272] *See id.* at 437.
[273] 868 A.2d 464 (Pa. Super. Ct. 2005).
[274] *See id.* at 483.
[275] *See id.* at 474.
[276] *Id.* at 480.
[277] *Id.* at 481.
[278] *Id.* at 483.
[279] *See id.* at 490.
[280] *See id.* at 489.
[281] *See id.* at 490.

concentration.[282] The clause changed the standard of care, but the trustee failed to meet even the lower standard.[283]

In *Estate of Warden*,[284] the trust provided: "The exercise of good faith by the Trustees under this instrument of any and all of the foregoing powers, authority and discretion shall be without any responsibility or liability upon them for any depreciation or other loss by reason of so doing."[285]

The court noted that generally a corporate trustee is held to a higher standard of care due to it possessing greater knowledge and skill; however, the heightened standard of care for corporate trustees applies only when the trust instrument does not explicitly mandate a standard of care.[286] Because the grantor in this case specifically indicated a good faith standard of care, that standard would apply to all of the trustees of the trust.[287] The beneficiaries asserted the corporate trustee acted in bad faith when the trustee failed to follow its own policies,[288] attend board meetings of the closely held company in which the trust held a concentration, review financial statements of the company, and meet with the company's president.[289] The court noted that the beneficiaries failed to provide any case law that held that such inaction constituted bad faith.[290] The court held the corporate trustee had acted in good faith and therefore could not be held liable for the loss in the value of the closely-held stock.[291]

Because the duties of care, skill, and caution are default rules, the grantor's desired retention of a particular concentration should waive the trustee's duty to diversify and waive the trustee's duties to invest with care, skill, and caution as to that concentration, subject to the requirement that the

---

[282] *See id.* at 492.

[283] *See id.* at 484-86.

[284] 2 A.3d 565 (Pa. Super. Ct. 2010).

[285] *Id.* at 569.

[286] *See id.* at 574.

[287] *See id.* at 575.

[288] Unfortunately, the opinion does not specify which corporate policies the corporate trustee allegedly failed to take.

[289] *See* 2A.3d at 575.

[290] *See id.*

[291] *See id.* Under Pennsylvania law, the duty to diversify set forth in the UPIA does not apply to any trust that became irrevocable prior to December 25, 1999. *See* 20 PA. CONS. STAT. § 7204(b) (2005). The duty also does not apply to inception assets. *See* 20 PA. CONS. STAT. § 7205 (2005).

trustee in all events must act in good faith.[292] The comments to *Restatement* section 91 expressly recognize that investment "directions and restrictions are legally permissible and are ordinarily binding on the trustee in managing the trust assets, thus often displacing the normal duty of prudence."[293] The Reporter to the *Restatement* notes, "it is generally accepted that settlors may relieve trustees of 'the duty to act as prudent men' act if language is sufficiently 'clear and unambiguous.'"[294] Relieving the trustee of the duties to invest with care, skill, and caution as to a particular asset serves to lower the standard of care, thereby increasing the possibility that a trustee will retain a concentration.[295]

I. Limited Liability Company or Other Entities

Grantors should also consider transferring the asset concentration into a limited liability company (LLC), limited liability partnership (LLP), or other similar entity. The entity documents would establish two classes of interest with identical rights except one class would possess voting rights and the other would not have any voting rights. For example, the grantor could establish an LLP, transfer all of the grantor's concentration in the publicly held company into the LLP, and issue one voting unit and nine hundred ninety-nine nonvoting units (with identical rights except for voting rights). The grantor could provide that the LLP would terminate if the entity no longer held more than a certain number of shares in the publicly held company or if the value of the shares in the publicly held company no longer exceeded a certain value. The grantor could serve as sole voting member of the LLP during his life, and could execute a will or trust to devise the voting

---

[292] UTC section 105(b)(2) prohibits a trust from waiving the trustee's duty to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries. *See* UNIF. TRUST CODE § 105(b)(2) (amended 2005), 7C U.L.A. 428 (2006). Likewise, the *Restatement* notes a provision is invalid if it seeks to relieve the trustee from liability even for dishonest or reckless acts. *See* RESTATEMENT (THIRD) OF TRUSTS § 29 cmt. f (2003). In *Perling v. Citizens and Southern National Bank*, the court states:

> The next step in the decisional process of these cases is whether a settlor or donor may relieve a trustee of the duty of acting as a prudent man. We hold that such can be done but only if the language of the instrument is clear and unambiguous in the expression of the intent. Even so the duty to act in good faith cannot be waived.

Perling v. Citizens and S. Nat'l Bank, 300 S.E. 2d 649, 653 (Ga. 1983).

[293] RESTATEMENT (THIRD) OF TRUSTS § 91 cmt. e (2007).

[294] RESTATEMENT (THIRD) OF TRUSTS § 91 Reporter's note to cmt. a (2007).

[295] *See* Pruett, *supra* note 185, at 357.

share to a very responsible family member (Individual *A*),[296] The grantor could then devise the nonvoting units into a trust for the family with an unrelated individual or entity as trustee. After the grantor's death, the trust essentially would own a nonmarketable interest in a closely-held entity. Individual *A* would serve as managing partner of the LLP. Individual *A*, as managing partner, would have duties to the trust that would hold nonvoting units. It is difficult to imagine that Individual *A* would have any duty to sell the publicly held stock if the sole purpose of the entity is to hold the stock. As managing partner of the LLP, Individual *A*'s standard of care differs from that of a trustee.[297]

The trustee could not force Individual *A* to sell the asset concentration inside the LLP because the shares held by the trustee are nonvoting. A wise approach may be for the trust to provide that the trustee is prohibited from selling the nonvoting units for less than their liquidation value. The trust would also provide that a special purpose of the trust is to retain the nonvoting units in the family LLP.[298] If Individual *A* is also a primary beneficiary of the trust, then Individual *A* is more likely to act in a manner that is also beneficial to the trust because of the substantial degree of identity of interest.

Like all of the options set forth in this Article, this option will not work in all situations. If the grantor cannot identify a trustworthy individual to own the voting units, this option is not viable. Even if the grantor selects a trustworthy individual, the individual may not survive the grantor or may die soon after the grantor's demise.[299] After the individual's death, the voting unit may pass to an incompetent individual or may pass into trust, in which event the trustee may be inclined to vote to sell the concentration and liquidate the entity. In addition, the individual may grow careless over time

---

[296] The grantor may want to consider gifting the voting interest and some of the nonvoting units during lifetime and therefore possibly place the grantor's estate in a position to argue for valuation discounts upon death. *See* Ronald D. Aucutt, *Reflections on FLP and LLC Cases*, 34 ACTEC J. 99 (2008); Louis A. Mezzullo, *Recent Cases Affecting FLPs and LLCs*, 34 ACTEC J. 88 (2008); Milford B. Hatcher and David Pratt, Discounted but not Defeated: Planning without Valuation Discounts (2010) (presentation at the 2010 annual ACTEC meeting).

[297] *See* AUSTIN W. SCOTT ET. AL, SCOTT ON TRUSTS § 170, at 311 (4th ed. 1987); *see also* Daniel S. Kleinberger and Carter G. Bishop, *The Next Generation: The Revised Uniform Limited Liability Company Act*, 62 BUS. LAW. 515 (2007).

[298] Because the UPIA also would require the trustee to diversify the non-voting shares if they represent a concentration, the trust needs to waive the duty to diversify.

[299] In some cases, it may be wise for the LLP or other operative document to provide that the entity terminates when Individual *A* dies.

or demand compensation for serving as managing member. The trustee may be forced into bringing a costly shareholder derivative suit (or similar type of suit) against the managing member. Grantors should carefully weigh the risk of this option because of the possibility that the voting units may pass to an undesirable party.

J. Beneficiaries as Trustees, Co-Trustees, or Trust Advisors

1. Beneficiaries as Trustees

In reality, even if the trust waives the duty to diversify, waives the duties of care, skill, and caution, and contains a broad exculpation clause, a trustee will be strongly inclined to sell a concentration if the beneficiaries do not express a strong preference for retention.[300] If the beneficiaries are lukewarm about retention, a trustee will be inclined to diversify. Generally, retention is only an issue if the beneficiaries insist on retention. Because retention impacts their economic interest, the grantor should consider appointing beneficiaries solely as trustees. At first glance, imposing upon the beneficiaries the duty to monitor and manage a concentration seems illogical. Often the grantor establishes the trust because the grantor believes the beneficiaries lack the investment expertise to manage the trust assets prudently. The beneficiaries should not serve as trustees in some cases. However, in some families, the beneficiaries are fully able to undertake the investment responsibilities. The beneficiaries may be carefully monitoring the publicly held company. In today's internet age, beneficiaries now have access to much of the same information that is available to professional investment managers. Admittedly, most beneficiaries will not have the expertise that professionals have. Beneficiaries may tend to focus too much on the specific company and fail to consider other market conditions that will impact the company in the future. Beneficiaries have a substantial economic interest, however, in keeping themselves fully informed. Shifting the decision to sell the concentration to the beneficiaries works similarly to that of retention letters. In a retention letter, the beneficiary can trigger a sale by withdrawing the consent to the retention.[301] Retention letters do not work effectively because the duty to keep the beneficiaries informed remains with

---

[300] *See* Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621, 656 (2004) (noting that it is frequently observed that trustees are overly cautious). Jesse Dukeminier and James E. Krier state: "Trustees have long been risk averse, conservative investors, reducing the return to the beneficiaries, particularly in an inflationary economy such as we have experienced over the twentieth century." Jesse Dukeminier and James E. Krier, *The Rise of the Perpetual Trust*, 50 UCLA L. REV. 1303, 1335 (2003).

[301] *See In re* Saxton, 712 N.Y.S.2d 225 (App. Div. 2000).

the trustee.[302] If the beneficiaries are the trustees, they bear the risk and the rewards of retention. The individual trustee, however, will face exposure to the other beneficiaries of the trust. The other beneficiaries of the trust may assert that the trustee was imprudent in retaining the concentration.[303] In addition, conflicts may arise if a fiduciary is also a beneficiary.[304] Because the beneficiaries serving as trustees have the same duty to prudently invest, the beneficiaries-trustees may still feel pressure to diversify if another beneficiary demands diversification. While the family relationship may reduce some law suits, families do find themselves in disagreements with one another. Thus, in many families, the grantor's retention desires may be thwarted even if the beneficiaries serve as trustees.

2. Beneficiaries Serving as Co-Trustees with Independent Trustees

In some cases, the grantor may feel comfortable with granting the beneficiaries the power to manage and monitor the concentration but may feel uncomfortable with the beneficiaries having legal title to the trust assets. In such cases, the grantor may desire a third party, such as a corporate fiduciary, to serve as a co-trustee. Grantors may be under the misunderstanding that as long as a beneficiary serves as trustee in those jurisdictions or trusts requiring unanimity of trustee action, or as long as two beneficiaries serve as trustees when majority action controls, the corporate trustee will be prevented from diversifying a concentration as long as the other trustee or the majority of the trustees vote to retain the concentration. According to the *Restatement*, "[e]ach trustee . . . has a duty to use reasonable care to prevent a co-trustee from committing a breach of trust and, if a breach of trust occurs, to obtain redress."[305]

A trustee may have a duty to seek judicial intervention. For example *In Lynch v. Redfield Foundation*,[306] the court held that all three trustees were liable for their failure to invest trust assets in an interest bearing account for five years. In their defense, two of three trustees argued that the third trustee

---

302 *See supra* Part IV.F.

303 *See supra* Part IV.F.

304 For example, in *Estate of Cooper*, 913 P.2d 393, 397-402 (Wash. Ct. App. 1996), the court held that an individual trustee, who was also the income beneficiary of the trust, improperly weighted the trust too heavily in income producing assets when 87% of the trust consisted of bonds. *See also In re* Rosenfeld Found. Trust, O.C. No. 1664 IV of 2002, Control No. 040671, 2006 WL 3040020 (Pa. Com. Pl. July 31, 2006), discussed *infra* Part IV.J.2.

305 RESTATEMENT (THIRD) OF TRUSTS § 81(2) (2005).

306 88 Cal. Rptr. 86 (Ct. App. 1970).

was obstinate and refused to consent to investing the assets. The court held all liable under joint and several liability.[307] The trustees should have filed suit to remove the obstinate trustee.[308]

In *In re Rosenfeld Foundation Trust*,[309] a corporate fiduciary and one of the three individual fiduciaries avoided damages by actively seeking diversification of a concentration in Pep Boys Stock.[310] These two trustees actively and repeatedly encouraged the other two individual trustees to sell the Pep Boys stock that represented nearly 100% of the trust's assets. Over a five year period, the corporate trustee repeatedly sent letters recommending diversification and highlighting the fact that the stock had lagged behind the S&P 500 index for several years. The letters also included investment proposals outlining a two year period in which the concentration should be sold and demonstrating how the sale proceeds would be invested in a broadly diversified portfolio. The corporate trustee also spoke with the obstinate trustees on numerous occasions recommending diversification. The court imposed a damage award against the two obstinate trustees and removed them as trustees.[311] While this case can somewhat serve as a guide to trustees when faced with an obstinate trustee, the trustee's duty to seek judicial relief from an obstinate trustee should be borne in mind. In addition, the fact that the obstinate trustees in the case were wealthy in their own right was probably important to the case.[312] Thus, they had sufficient funds to cover the damages. Query whether a court would come to the same conclusion if the corporate trustee was the only deep pocket.

Because trustees face liability if they do not address a breach by a co-trustee, adding an independent trustee as a co-trustee to serve along with individual trustees creates nearly identical fiduciary issues as that existing if an independent trustee serves as the only trustee. The independent trustee may feel compelled to bring an action to force the individual trustees to diversify the portfolio.

---

[307] *See id.* at 91-92.

[308] *See* RESTATEMENT (THIRD) OF TRUSTS § 81(2) cmt. d (2005) (noting that a "trustee must take reasonable steps seeking to compel the co-trustee to redress the breach of trust").

[309] O.C. No. 1664 IV of 2002, Control No. 040671, 2006 WL 3040020 (Pa. Com. Pl. July 31, 2006).

[310] *See id.* at *1-4.

[311] *See id.* at *31.

[312] *See In re Rosenfeld Found. Trust*, 2006 WL 3040020.

3. *Beneficiaries as Trust Advisors*

The grantor should consider appointing beneficiaries as the trust advisors in a jurisdiction such as Delaware and clearly providing that they serve in a nonfiduciary capacity.[313]

V. BENEFIT-THE-BENEFICIARIES PREEMPTION DOCTRINE

Before concluding, we must ask whether waiving the duty to diversify and the duties to invest with care, skill, and caution is wise. Should we be elated when the court protects the trustee who honors the grantor's retention provision even though the trust has suffered damages in the millions? Are not the cases that protect the trustees and those that surcharge the trustees similar in that substantial damages were sustained when the trustee honored the grantor's retention desires? Because retaining a concentration is imprudent unless special circumstances are present, should the law honor a waiver of the duty to diversify if special circumstances are not present? Professor John Langbein, the reporter for the UPIA, answers the question in the negative. He hypothesizes the following to illustrate his position:

> The settlor has worked all his life for, let us say, IBM. Through stock options and company sponsored investment plans, he has accumulated a large block of IBM common stock. He dies, leaving the block in trust with instructions not to sell it. The block is the only substantial asset of the trust, and because the settlor's death results in a stepped-up basis, selling the block incurs no tax cost. Suppose, further, that the settlor leaves a letter explaining his thinking. "I worked for IBM for 35 years, they were wonderful to me, they helped me buy the stock, and the stock zoomed in value throughout my career. You just cannot do better."[314]

Langbein observes:

> What is happening in this case is that the settlor is imposing his supposed investment wisdom on the trust in circumstances in which the investment strategy is objectively stupid and imprudent. We now know that the advantages of diversifying a portfolio of securities are so great that it is folly not to do it. I am not saying that you

---

[313] *See supra* Part IV.E.2.

[314] John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 IOWA L. REV. 641, 664 (1996).

> can never have an underdiversified trust fund. It will remain common to place a family firm or a family farm in trust, notwithstanding that such a trust will often be underdiversified. There's nothing wrong with using a trust as part of the succession arrangements for a family enterprise. I further concede, following the official Comment to the Uniform Prudent Investor Act, that their will remain cases in which the tax cost of diversifying a low-basis asset may outweigh the gain. When, however, the trust assets are cash or cash-equivalent, in the sense that diversification can be achieved at little cost, I believe that the courts will come to view the advantages of diversification as so overwhelming that the settlor's interference with effective diversification will be found to be inconsistent with the requirement that a private trust must be for the benefit of the beneficiary.[315]

Section 404 of the UTC provides: "[A] trust may be created only to the extent its purposes are lawful, not contrary to public policy, and possible to achieve. A trust and its terms must be for the benefit of its beneficiaries."[316] While most of the provisions of the UTC can be modified, restricted, or eliminated by the grantor,[317] UTC section 105(b)(3) provides the terms of the trust prevail over the provisions of the UTC except "the requirement that a trust and its terms be for the benefit of its beneficiaries, and that the trust have a purpose that is lawful, not contrary to public policy, and possible to achieve."[318] "A fiduciary cannot be prudent in the conduct of investment functions if the fiduciary is sacrificing the interests of the beneficiaries."[319] Langbein predicts that in the future the benefit-the-beneficiaries preemption doctrine set forth in UTC section 105(b)(3) will restrain the grantor from imposing unreasonable restraints on diversification, such as directing the retention of a concentration in a publicly held company.[320]

---

[315] *Id.* at 664-65 (footnotes omitted).

[316] UNIF. TRUST CODE § 404, 7C U.L.A. 484 (2006).

[317] "The Uniform Trust Code is primarily a default statute. Most of the Code's provisions can be overridden in the terms of the trust." UNIF. TRUST CODE Art. 1 cmt., 7C U.L.A. 410 (2006).

[318] UNIF. TRUST CODE § 105(b)(3) (amended 2005), 7C U.L.A. 428 (2006).

[319] UNIF. PRUDENT INVESTOR RULE § 5, cmt., 7B U.L.A. 34 (2006).

[320] John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 NW. U. L. REV. 1105 (2004).

Quinnipiac University Law School Professor Jeffrey A. Cooper vehemently disagrees with Langbein's assertion that a grantor who waives the duty to diversify is acting foolishly.[321] He refers to the numerous reasons (income tax gain, family controlled entities, and special purpose trusts) why investment concentrations are reasonable in certain circumstances.[322] Langbein agrees special circumstances can justify a concentration.[323] But Langbein argues that the law should not honor a dead person's emotional attachment to a publicly held stock.[324]Cooper notes that the grantor's position would be sustainable if the trust in Langbein's IBM example also contained the following sentence: "The market fundamentally misperceives the company's business prospects and its stock is grossly undervalued."[325] He notes this additional sentence illustrates that the grantor had a "far greater understanding of financial markets and investment strategy."[326] Langbein counters:

> The more likely inference, based on what is now known about the difficulty of identifying mispriced securities and the enormous advantages of diversification, is that the settlor's recital is the product not of his "understanding of financial markets and investment strategy," but rather of his sentimental affection for bygone days. The settlor's well-intentioned but primitive views on investment matters do not justify investment directions that are otherwise objectively foolish by the standards of the field.[327]

Before dismissing the foregoing discussion as simply a debate between two academics, worth noting is that Langbein's position is being argued by beneficiaries. In *National City Bank v. Noble*,[328] the beneficiaries argued that the diversification waiver did not trump the grantor's primary desire to

---

[321] *See* Jeffery A. Cooper, *Empty Promises: Settlor's Intent, The Uniform Trust Code, and the Future of Trust Investment Law*, 88 B.U. L. REV. 1165, 1175 (2008).
[322] *See id.* at 1196.
[323] *See* Langbein, *supra* note 314, at 665.
[324] *See* Langbein, *supra* note 320, at 1115.
[325] Cooper, *supra* note 321, at 1175.
[326] *Id.*
[327] Langbein, *supra* note 263, at 392.
[328] No. 85696, 2005 WL 3315034 (Ohio Ct. App. Dec. 8, 2005).

establish a trust to benefit the beneficiaries.[329] The beneficiaries acknowledged that the trust expressly permitted the trustees to retain stock in J. M. Smucker Company and relieved the trustees from any liability for holding it.[330] However, the beneficiaries argued that they were the grantor's primary concern rather than retention of the stock.[331] The court disagreed noting the stock at issue was not publicly held and constituted a sufficient control block to permit the trustees to elect themselves to the board of directors of the company.[332] Retention of the stock was justified under the special circumstances exception.[333]

The benefit-the-beneficiaries preemption doctrine was argued in slightly different form in *In re Will of Dumont*.[334] The surrogate stated a "fiduciary must use good faith and prudence to carry out its duties . . . and that a retention clause cannot trump the application of prudence in the management of an estate."[335] The surrogate noted the testator's primary focus was to benefit his family and preserve their standard of living rather than to retain Kodak stock.[336] In other words, the trust was for the benefit of the beneficiaries. The surrogate asserted: "Retention clauses are valid even though they advocate a holding strategy which has been deemed imprudent in the absence of such a clause . . . and which has not been encouraged by current statutory directives."[337]

The surrogate clearly understood that retention of the concentration in Kodak was imprudent from an investment perspective but refused to override the grantor's expressed wishes.[338]

In *In re Smathers*,[339]the surrogate refused to judicially reform a trust to permit the trustee to sell two parcels of real estate located in New York City merely upon grounds that the sale was in the best interests of the benefi-

---

[329] *See id.* at *4.

[330] *See id.* at *5.

[331] *See id.*

[332] *See id.* at *6-7.

[333] *See* Brown v. Burdett, 21 Ch. D. 667 (1882); *see also* 2 AUSTIN W. SCOTT ET AL., SCOTT AND ASCHER ON TRUSTS § 9.3.13, at 516-18 (2006).

[334] No. 1956TT443, 2004 WL 1468746 (N.Y. Sur. Ct. June 25, 2004), *rev'd sub nom. In re* Chase Manhattan Bank, 809 N.Y.S.2d 360 (App. Div. 2006); *see also supra* Parts II.A, II.B.2.a, III (discussing the case further).

[335] *Id.* at *5.

[336] *Id.* at *7.

[337] *Id.* at *16.

[338] *See id.* at *18-19.

[339] 852 N.Y.S.2d 718 (Sur. Ct. 2008).

ciaries. The decedent's will expressly prohibited the trustees from selling the two parcels and expressed the desire that the proprieties remain permanent assets of the trust.[340] The trustees asserted that the restriction should be lifted because of changed circumstances and because the sale of the properties was in the best interest of the beneficiaries.[341] The surrogate rejected the best interests test and held that the trust could be reformed only if it could be shown that the grantor's intentions were incapable of being fulfilled.[342]

In *National City Bank*, *Dumont*, and *Smathers*, the court deferred to the grantor's expressed direction to retain the concentration rather than strike the provision as capricious. Presently, the courts have honored a grantor's waiver of the duty to diversify for publicly held stock.

VI. CONCLUSIONS

Notwithstanding admonishments against concentrations, grantors will continue to demand that their legal counsel draft trusts that direct the retention of concentrations in publicly held stocks.[343] Standard boilerplate waivers of the duty to diversify will likely prove insufficient.[344] Grantors should consider waiving the duty to diversify (specifically referencing the concentration), expressing the grantor's thoughts and wishes as to retention of the asset, granting the trustee extended discretion, and exculpating the trustee for retention of the specific concentration. Because a waiver of the duty to diversify does not waive the trustee's duties to manage with care, skill, and caution, grantors should further consider appointing the beneficiaries as trustees over the concentrated asset. If the grantor wants the beneficiaries to determine if a concentration should be sold but desire an independent trustee to hold legal title to the assets, one viable option is as follows: (1) for the grantor to waive the duty to diversify by specific reference to the concentration;[345] (2) select a situs such as Delaware for the trust;[346] (3) name a bene-

---

[340] *See id.* at 720.

[341] *See id.* at 723.

[342] *See id.* at 722.

[343] *See* Pruett, *supra* note 185, at 357 (recommending attorneys warn clients of the risks of dictating future investment policy and hoping such consultation will lead the client to conclude that inclusion of a retention provision in a trust is ill advised).

[344] While the standard boilerplate provision may serve to waive the duty to diversify as set forth *supra* at Part II.C., trustees will often be inclined to sell the concentration due to the duties of care, skill, and caution. *See supra* Part III.

[345] *See supra* Part II.C.

[346] *See supra* Part IV.E.2.

ficiary as trust advisor;[347] (4) grant the trust advisor sole authority over managing the concentrated asset;[348] (5) specifically provide that the named trust advisor need not exercise the power in a fiduciary capacity;[349] (6) exculpate the trust advisor for any action taken or not taken;[350] (7) provide that the directed trustee will have absolutely no duty to manage or monitor the concentration;[351] (8) provide that the directed trustee must follow the direction of the trust advisor;[352] and (9) exculpate the directed trustee to the fullest extent allowed by law for any loss resulting directly or indirectly from retention of the concentration.[353] By proper planning, the grantor's retention desires stand a greater chance of being effectuated. Only time will determine whether effectuating such retention desires will serve to benefit the beneficiaries.

347 *See supra* Part IV.J.3.
348 *See supra* Part IV.E.2.
349 *See supra* Part IV.E.2.
350 *See supra* Part IV.G.2.
351 *See supra* Part IV.E.2.
352 *See supra* Part IV.G.2.
353 *See supra* Part IV.G.2.