

Special Lecture on Trust Law

Lecture No.4

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Points for This Time

- 1 What are the trustee's obligations
- 2 Significance and problems regarding duty of loyalty
- 3 Care duty
Abstractiveness of the care duty of good administration, and American prudent investor rule
- 4 Duty of impartiality

Recent Topics

◎Izakaya (Japanese-style pub) taxi scandal

Public servants, in taxies on their way home at midnight, receive beers and gift certificates: Perspective from Trust Law...

●**Reading v. Attorney-General, [1951] 1 All E**

R 617: In Egypt a sergeant of British force rode in a car carrying prohibited goods, passed an inspection, and received a kickback;

Constructive trust

● Silver necklace sent from an uncle to an attorney

Contents of Trustee's Responsibility

Authorization contract: ultimate duty= Care duty of good administration (Article 644 of Civil Law Act)

Former Trust Law: Article 20 Care duty of good administration
Article 22 What is this?

New Trust Law: Article 29 Care duty of good administration
Articles 30-32 Duty of loyalty

Independence of duty of loyalty:

Clarification, diffusion, directory statute

How is it different from the care duty of good administration?

Trustee's Duties: Former Law

- ① Duty to execute trust affairs: Article 4
- ② Care duty of good administration: Article 20
- ③ Duty of loyalty: Article 22
- ④ Duty of impartiality: no substantive enactment
- ★⑤ Duty of separate management: Article 28
- ⑥ Duty of self-execution: Article 26
- ★⑦ Duty of provision of information: (Article 39)
Article 40

Trustee's Duties: New Trust Law

- ① Duty to execute trust affairs: Art. 29, para. (1)
- ② Care duty of good administration: Art. 29, para.(2)
- ③ Duty of loyalty: Art. 30-32
- ④ Duty of impartiality : Art. 33
- ⑤ Duty of separate management: Art. 34
- ⑥ Designated supervisory duty in case of a commission to the third party: Art.35
- ⑦ Duty of provision of information: Art. 36-39

What if you are questioned: "How have trustee's duties changed with the revision of Trust Law?"

Analysis on Duties: Duty of Care/Loyalty

Duty of care= Care following acts (behavior)

Duty of loyalty= Duty of nonfeasance

Ban on any activity to devise interests for those except the beneficiary

2 key words: undivided loyalty, and conflict of interest

Violation of care duty→ Indemnity, with burden of proof

Violation of duty of loyalty→Spilling our of earnings,
treatment nearly as a violation of adjective law

Pattern of Duty of Loyalty To Be Questioned (1)

[Example 1] A homespun quilt is being included in the entrusted property. A child of the trustee's, who happens to make a collection of quilt, wishes to purchase subject at an amount appraised by the third party.

What does the care duty of good administration mean in this case?

In the sense distinguished from that, what is the duty of loyalty?

Pattern of Duty of Loyalty To Be Questioned (2)

[Example 2] As trustee, the trust department of a bank A places a part of the fiduciary property on time deposit within the same bank—at a market rate of interest. The office also opens a current account there to pay for operational costs and to the beneficiary.

Is there any problem about the care duty of good administration?

Differences between current account and time deposit

Pattern of Duty of Loyalty To Be Questioned (3)

[Example 3] Included in the trust property were 1000 shares of company A. Trustee T already owned 10 shares of company A and 25 shares of company B. Planning on diversifying the investment, T as trustee decided to sell 500 shares of A and, with that money, to buy shares of B. Can this be approved?

[Example 4] T, entrusted with both trusts A and B, intends to sell A's trust P to trust B.

Pattern of Duty of Loyalty To Be Questioned (4)

[Example 5] Trustee T, independently from trust, intends to purchase realty from beneficiary B. Can this be approved?

[Example 6] Trustee T is an attorney. A party related to the settlor brought to the court an action of nullity of the trust, and T took charge of the assignor's defense. Is it possible to pay out the legal fee from the trust property?

Significance and Problems Regarding Duty of Loyalty

1—Trustee's expertise being unable to be utilized

2—Excessive discipline

Question 1: Though it ought to be legal principles for equity

Question 2: It might be a "play-it-safe procedure."

Duty of Loyalty—4 Exceptions

- ① When approved by trust provisions
- ② Beneficiary's approval/indemnity;
on condition of informed consent
- ③ When authorized by court of law
- ④ When approved by laws

Exceptions in New Trust Law

Art. 31: Trustee shall not conduct following deeds...

- (2) Notwithstanding the provision in the preceding paragraph, when an act falls under any of the following, a person may conduct a deed set forth in each item of the same paragraph. However, as to the reason prescribed in the item (ii), even if an act falls under the same item, this shall not apply if there is a provision regarding trust activities which prohibits the relevant deed, :
- (i) When there is a provision for trust activities to permit a relevant act;
 - (ii) When a trustee indicates an important fact regarding a relevant act and obtains the approval of a beneficiary;
 - (iii) When a right pertaining to property vested in trust property reverts to an inherence property through an inheritance and other universal succession;
 - (iv) When a trustee's relevant act is deemed reasonably necessary to achieve objectives of trust, and is obvious not to be prejudicial to a beneficiary's interests, or there is a valid reason in light of influence of the act on trust property, purpose and terms of the act, the state of affairs with respect to essential interests between the trustee and beneficiary, and other circumstances.

Uniform Prudent Investor Act

- Art. 1 Prudent investor rules
- Art. 2 Standard for care duty, portfolio strategy, objectives regarding risk and return
- Art. 3 Diversification investment
- Art. 4 Duty for observing rules within a reasonable period of time after the start of services as a trustee
- Art. 5 Duty of loyalty
- Art. 6 Duty of impartiality
- Art. 7 Investment costs
- Art. 8 Reviewing compliance
- Art. 9 Delegation of investment and administrative function

Changes in Rules in U.S.

- 1 Age of court list rule
- 2 Age of legal list rule
- 3 Age of prudent man rule
- 4 Age of prudent investor rule

Suggestion to Our Country

1 Problems about the care duty of good administration

Standard for care duty?

Applicable to others or self?

Function as behavioral guideline?

Observed from trustee?

From a standpoint of public entity in the U.S.

How about in Japan?

2 Disclosure of risks in trust and scrupulous explanations

Trust Law

Former law: Art. 4, 20, 21, and Art. 5 of Imperial Ordinance in the 11th year of Taisho (1922)

Textbook at p.199: Outline draft No.10

No major changes (except for the duty of self-execution)

New Trust Law

Art. 29 Care duty

Art. 28 Commission to the third party (in the trustee's authority)

Ruling by Osaka High Court Dated Mar. 30, 2005

Financing and Commercial Precedents No.1215,p.12

- 1 Annuity trust→Structure of annuity trust
- 2 Director of the employees' pension fund v. trust bank
- 3 Breach of joint-management duty
- 4 Breach of asset-mix duty: 50%→58.5%

◆Case

◆Logic of verdict, logic of Trust Law

◆What if under the prudent investor rule?

Ruling by Osaka High Court in 2005

Case: 1970 Contract for an annuity trust to
manage ¥3 billion

1997 Memorandum on the asset mix

2000 Start-up of 19 funds at ¥500 million

Concentrated management in IT

Diminution to short of ¥300 million

Victory for the beneficiary in the first trial, which
was reversed in the second.

Logic of Verdict, Logic of Trust Law

Verdict→ Entirely an interpretation of the
trust contract

Intent of the parties concerned

If this happened in the U.S...

Care Duty of Good Administration in U.S.

- 1 McGinley v. Bank of America (Kan. 2005)
No breach of duty found in the concentration on Enron shares
- 2 Fifth Third Bank v. Firststar Bank (Ohio 2006)
Breach of duty found in the concentration on P&G shares

Significance of what's written in trust provisions
Care duty of good administration= Certain limit, albeit a discretionary provision

In out country?: Absolute priority to provisions; weakness due to no provision other than the general clause

McGinley v. Bank of America, 109 P.3d 1146 (Kan.2005)

Setup of a revocable trust in 1990, withholding the final right to decide on investment. 1500 shares of Enron, which grew to 9500 with stock splits in a little more than 9 years, amounting to 77% of the trust property, or slightly less than \$800,000. Suggested to diversify the investment within the bank in 2000, which did not have an influence on the person in charge. Enron collapsed in Dec., 2001.

Court of Kansas ruled in favor of the bank throughout the three instances.

Self-determination=Self-responsibility? Because it's written in the contract?

Fifth Third Bank v. Firststar Bank, N.A. 2006 WL 2520329 (Ohio App. 1 Dist.), 2006 -Ohio- 4506

P&G shares to the value of \$2 million. The settlor is a grandchild of the founder's. In a year and half, the value halved amid the drop in stock market share prices.

Having presumed breach of duty of diversification investment, the court ordered the trustee to pay \$1.04 million as compensation for damage.

Trust provisions included the clause that the trustee had an authority to maintain the original trust property, and would not be legally held accountable for depreciation.

→ Also in *Wood v. U.S. Bank N.A.*, 828 NE2d 1072 (2005), it was judged that immunity from duty of diversification investment should require more precise wordings; the trustee lost in the appeal, too.

In re Will of Dumont, 4 Misc. 3d 1003 (A), In re Chase Manhattan Bank, 26 A.D.3d 824 (N.Y. 2006)

Concentrated on just retaining shares of Kodak. Provisions included the authority for retaining and immunity from duty of diversification investment, excluding a case of compelling reason.

First trial→Ordered a payment of the compensation at \$21 million, having presumed that an inadequate earnings caused by inadequate dividends constituted “compelling reason.” Second trial reversed the original judgment.

Nonetheless, the reasoning in 1973 was that “imprudence was inapplicable”, and it was not that “there was no problem due to a stipulation in trust provisions.”

Judgment on prudence still remains.

Back to Ruling by Osaka High Court

Interpretation of contract

With legislating the duty of the diligence of a good manager into a discretionary provision, the same trend appears to remain...

However, it is also possible that, as in Ohio and New York, the standard of prudence may constitute an imposed limit on recognizing contract=self-responsibility.

Duty of Impartiality

1 One example in U.S.

Matter of Chase Manhattan Bank (NY 2006)

2 Situation where problems occur in U.S.

Existence of plural and heterogeneous beneficiaries

① Time of policymaking for trust management

② Earnings or principal

③ Burden of expenses and remuneration

In re Chase Manhattan Bank

846 N.E.2d 806 (NY, March 30, 2006)

Trust set up by a father, whose daughter with limited capacity for action. Intended to give its earnings to her in her lifetime, and to donate the balance of the principal to a college and other public-interest corporations (CRAT= charitable remainder annuity trust)

The daughter scarcely spent the money and left \$800,000. Earnings could go to her intestate successors, to which the college and others brought a challenge. The entrusted bank's intention to distribute earnings to the successors was sustained in the first and second trials, but which was dismissed in the Supreme Court.

Duty of Impartiality

Reasons subject has not become problems

Issues henceforth

But no stipulation in the text

Recapitulation: Issues for Our Country

- 1 Clarification of the concept of trustee responsibility
 - Care duty of good administration, duty of candor
 - Ambiguity in duty of loyalty, information-related duties
- 2 Mandatory provision, discretionary provision
 - Business trust, annuity trust→Need for control
 - General legal principles of trust→Being discretionary provision as private law and its limitation
- 3 Trust in which trustee responsibilities remain undigested
 - Danger of widening→ Realization of contractual thinking, business-oriented thought
 - In fact, self-responsibility even for dependent-type trusts