

Special Lecture on Trust Law

Lecture No.5

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Points for This Time

- Duty of care
- Duty of impartiality
- 3 trusts
 - Self-trust
 - Special purpose trust
 - Limited liability trust

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, standard of prudence may constitute an imposed limit on recognizing contract=self-responsibility.

Duty of Impartiality

1 One example in the 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

Self-Trust: Declaratory Trust

Art. 2: The term "trust" in this Law shall mean for a specific person to implement in accordance with a certain objective (excluding an objective to seek exclusive interests for the said person; the same shall apply to the said Article.) the management or disposal of properties and other deeds necessary to accomplish the competent objective in any of the method listed in each item of the following Article.

(2) The term "trust deed" in this Law shall mean, in conformity with the classification of trusts listed in each of the following items, the matter provided in each of the said items:

- (i) Trust in the method listed in the item (i) of the next Art.; a trust agreement in the same item
- (ii) Trust in the method listed in the item (ii) of the next Art.; a testament in the same item
- (iii) Trust in the method listed in the item (iii) of the next Art.; a declaration of intention conducted by a document in the same item or an electromagnetic record (i.e., an electromagnetic record stipulated in the same item)

Art.3: Trust shall be conducted in whichever method listed in the following.

- (iii) A method either by recording or documenting, with respect to a declaration of the intention for a specific person as per a certain objective to implement by the said person himself the management or disposal of certain properties owned by the said person himself and other acts necessary to accomplish the said objective, in a notarial deed and other document or an electromagnetic record (made in electronic, electromagnetic and other forms which cannot be recognized by human perception, to be used in information processing with an electronic computer as provided in the ordinance of Ministry of Justice; the same shall apply hereinafter.) the said objective, items necessary to identify the said properties, and other items provided in the ordinance of Ministry of Justice.

Art.4, para. (3): Trust implemented by the method listed in the item (iii) of the preceding Article., in conformity with the classification of trusts listed in each of the following items, inures under the prescription provided in each of the said item:

- (i) When implemented by a notarial deed, or a document attested by a notary public, or an electromagnetic record (hereinafter generically referred to as the "notarial deed and such" in this and the following items), to draw up the said notarial deed or the like.
- (ii) When implemented by a document or an electromagnetic record other than the notarial deed and such, to notify of the completion of the said trust and its content by means of a certificate with an inconvertible date addressed to the third party (if comprised of more than two persons, to be addressed to one) who has been appointed to be a beneficiary.

(4) Despite the provisions in the preceding three paragraphs, when a condition precedent or the date of beginning is affixed to a deed of trust, the trust shall take its effect with the completion of the said condition precedent or the coming of the said date of beginning.

Self-trust

□ Use and effect

□ S T(=S) B

□ Commercial trust: Occupation-law type
regulation

T= joint-stock company

□ Civil trust: Barrier of business concept

Repetitive continuance

□ Effect?

Special Purpose Trust

Art. 258, para. (1): "Trust without the provision for a beneficiary (including the provision for the method to appoint a beneficiary; the same shall apply hereinafter.) may be implemented by the methods listed in Art. 3, item (i) or (ii) "

Former special purpose trust

Charitable trust: S T

No B; charitable purpose in its place

Charitable Trust

Japan: Regulations by the competent authorities

U.S.: IRC (after-the-fact regulation under the taxation law)

Effect of charitable trust

1) Rule against perpetuities

2) Cy pres doctrine (= a principle of law to adopt the closest way)

3) Special privilege under a taxation system

Non-charitable Special Purpose Trust

- Utilization
- Formerly an ethical trust

- Use in commercial trust

Limited Liability Trust

Art. 2: The term “trust” in this Law shall mean for a specific person to implement in accordance with a certain objective (excluding an objective to seek exclusive interests for the said person; the same shall apply to the said Article.) the management or disposal of properties and other acts necessary to accomplish the competent objective in any of the method listed in each item of the following Article.

▣ 12: The term “limited liability trust” in this Law shall mean a trust in which a beneficiary bears the fulfillment responsibility only with the property that belongs to the trust property regarding the entire liability for debt of the trust property with respect to the said trust.

Art. 216: Limited liability trust shall come into force as a limited liability trust by providing that a beneficiary bears the fulfillment responsibility only with the property which belongs to the trust property regarding the entire liability for debt of the trust property in a trust deed, and by registering in accordance with the provision in Art. 232.