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Charles E. Rounds Jr.

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ARBITRATION CONTRACTS BETWEEN TRUSTEES AND THEIR INVESTMENT AGENTS: A WARNING LABEL

CHARLES E. ROUNDS, JR.*

ABSTRACT

This Article considers whether arbitration clauses in contracts between trustees and their investment managers are binding on the trust beneficiaries. Nowadays, it is default law that a trustee may delegate investment discretion to an investment manager (IM); provided the IM has been prudently selected by the trustee and the IM's activities are prudently monitored on an ongoing basis by the trustee. The core relationship is one of agency, the trustee being the principal and the IM being the agent. The two, as well, are in a contractual relationship incident to the agency. The IM, however, also owes fiduciary duties that run directly to the trust beneficiaries, though the beneficiaries are parties neither to the agency nor the contract. These duties are imposed separately by equity. Assume the beneficiaries bring an action directly against the IM for breaching one or more of his or her equitable duties to them. Should the trust beneficiaries be bound at law by the arbitration clause in the contract between the trustee and the IM? The Article concludes that they should not be; but if they are then the trustee could well have been in breach of his or her equitable duty of undivided loyalty to the beneficiaries by having acquiesced to the clause's insertion in the first place. And as to the IM, he or she, under general equitable principles, may well have a fiduciary duty to the beneficiaries to waive his or her rights at law to have the dispute arbitrated, at least to the extent that it is in the interests of the beneficiaries that he or she does so.

*† Charles E. Rounds, Jr., Professor of law, Suffolk University Law School, is an Academic Fellow of the American College of Trust and Estate Counsel (ACTEC) and co-author of 24 editions of *Loring and Rounds: A Trustee's Handbook*.

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I. INTRODUCTION

The subject of this Article is the arbitration contract that is typically incident to an investment - management agency agreement between a trustee and a non-party to the trust relationship,¹ not the trust term that purports to mandate arbitration of internal disputes between the trustee and the trust beneficiary. The Article concludes that if the trust is both irrevocable and regulated by the Uniform Trust Code (UTC) and/or the Uniform Prudent Investor Act (UPIA), under default law the trustee would be ill-advised to enter into such a contract, absent some very special facts. This is because lurking in UTC § 807, which regulates delegation by trustees, is some stealth liability-shifting language that calls into question whether such an arbitration contract would be enforceable *at law* as against the trust beneficiary, and if it would be, whether in equity the trustee would be breaching his fiduciary duty to the

1. See generally Mary F. Radford, *Predispute Arbitration Agreements Between Trustees and Financial Institutions: Are Beneficiaries Bound?*, 40 ACTEC L.J. 273, 278-83 (2014).

trust beneficiary by entering into the contract with the investment agent in the first place. To further complicate matters, the trustee's investment agent may be asking for trouble were he to decline to waive any *legal* rights he might have under the arbitration contract as against the trust beneficiary if requested to do so by the trust beneficiary. Here is the UTC language this Article is referring to:

(b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.

(c) A trustee who complies with the... [prudent delegation provisions of] . . . subsection (a) is not liable to the beneficiaries or to the trust for an action by the agent to whom the function was delegated.²

The italicized language is repeated almost verbatim in the section of the UPIA that purports to regulate delegation of investment and management functions by trustees that are subject to the Act's provisions.³

To set the stage, a trustee of an irrevocable trust, as principal, enters into a discretionary investment-management agency relationship with a non-party to the trust relationship. The agent is to perform a critical fiduciary duty that the trustee owes the trust beneficiary, namely the prudent management of the entrusted assets.⁴ Incident to the agency agreement is an arbitration contract to which the trust beneficiary is not a party.⁵ Assuming the trustee's delegation of investment discretion is prudent, under the UTC and the UPIA, primary fiduciary liability shifts from the trustee to his agent for any economic harm to the beneficiary's equitable property rights that is occasioned by the negligent or otherwise wrongful actions of the agent.⁶ The trust beneficiary

2. UNIF. TRUST CODE § 807(a) (UNIF. LAW COMM'N 2010). This section provides that a trustee may delegate duties and powers that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in: (1) selecting an agent; (2) establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and (3) periodically reviewing the agent's action in order to monitor the agent's performance and compliance with the terms of the delegation. *Id.*

3. See UNIF. PRUDENT INV'R ACT § 9(b) & (c) (UNIF. LAW COMM'N 1994).

4. It is said that "[t]wo grand principles underlie much of the Anglo-American law of trusts: the trustee's duties of loyalty and of prudence." JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 678 (5th ed. 2010).

5. Radford, *supra* note 1, at 278-83.

6. UNIF. TRUST CODE § 807(c) (UNIF. LAW COMM'N 2010) ("A trustee who complies with subsection (a) is not liable to the beneficiaries or to the trust for an action of the agent to whom the function was delegated."); see also UNIF. PRUDENT INV'R ACT § 9(c) (UNIF. LAW COMM'N 1994) ("A trustee who complies with the requirements of subsection (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.").

is not a party to the agency agreement; the trust beneficiary is not a party to the arbitration contract (the trust beneficiary may yet to be conceived or ascertainable); recourse against the prudent trustee has been foreclosed by the UPIA and the UTC; and still the trust beneficiary is bound *at law* by the terms of the arbitration contract? In no way can it be said that the duties that the trustee's investment agent owes the trust beneficiary are legal in nature. Those duties are equitable in that they are grounded in fiduciary principles of trust and agency as those principles have been tweaked by the UTC and the UPIA.⁷ They are not imposed at law by virtue of the terms of the arbitration contract. As between the trustee's investment agent and the trust beneficiary, equitable fiduciary duties run directly from the trustee's investment agent to the trust beneficiary; the trust beneficiary owes the trustee's investment agent (and the trustee for that matter) no reciprocal fiduciary duties.⁸ Nor does the trust beneficiary owe either contractual obligations of any sort.⁹

The trust beneficiary is at a power disadvantage *vis-à-vis* the trustee and his agents in that critical information that a trust beneficiary would need in order to mount a successful defense of his equitable property rights under the trust and to which the trust beneficiary is entitled in equity is accessible to the trust beneficiary only if the trustee or his investment agent voluntarily divulges that information, or is compelled do so by the equity court.¹⁰ The reason that a trustee has such practical and exclusive control over the flow of

7. The trustee's investment agent owes fiduciary duties to the trust beneficiaries under long-standing general principles of equity, equitable principles that have merely been reinforced by the UTC and UPIA. *See generally* CHARLES E. ROUNDS JR. & CHARLES E. ROUNDS III, LORING AND ROUNDS: A TRUSTEE'S HANDBOOK, § 7.2.9 (2018 ed. 2017); *see also* UNIF. TRUST CODE § 807(b) (UNIF. LAW COMM'N 2010); UNIF. PRUDENT INV'R ACT § 9(b) (UNIF. LAW COMM'N 1994). These duties are not "legal in nature" as the trustee's agent and the trust beneficiaries are neither in a contractual relationship, nor an agency relationship. *See generally* 4 SCOTT & ASCHER ON TRUSTS § 2.3.10.3 (5th ed. 2017); *see also* WARREN A. SEAVEY, HANDBOOK OF THE LAW OF AGENCY 3 (1964).

8. *See generally* CHARLES E. ROUNDS JR. & CHARLES E. ROUNDS III, LORING AND ROUNDS: A TRUSTEE'S HANDBOOK, § 5.6 (2018 ed.).

9. *Id.*

10. *See generally* RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. B (AM. LAW INST. 2012) stating:

The inherent subjectivity and impracticability of second guessing a trustee's application of business judgment or exercise of fiduciary discretion are aggravated by the opportunities and relative ease of concealing misconduct – or at least by the absence of timely information and the likely disappearance of relevant evidence – that results from the trustee's day-to-day, usually long term, management of the trust property and control over trust records.

critical information pertaining to the trust relationship is that legal title to entrusted property is generally in the trustee, not the beneficiary.¹¹

II. THE INTERSECTION OF TRUST AND AGENCY LAW: A PRIMER

A trust, which is a creature of equity, not legislation, is formally defined as:

a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee.¹²

Absent legislation providing otherwise, a trust is not an entity, but a relationship among multiple parties with respect to property, title to which is in the trustee.¹³ As to the world, the trustee is the owner of the subject property. It is the trustee who is liable *at law* for breaching the contract he enters into on behalf of the trust with non-parties to the trust relationship.¹⁴ This is what is meant by an external liability of the trustee.¹⁵ In equity, however, the trustee simultaneously assumes critical internal liabilities incident to the fiduciary duties he owes the trust beneficiaries and incident to the beneficiaries' equitable ownership of the subject property.¹⁶ The trustee's internal duties and liabilities *vis-à-vis* the trust beneficiaries arise from the trust relationship itself, not from principles of agency, contract, or tort.¹⁷ A trustee, *qua* trustee, is neither an agent of nor in a contractual relationship with the trust beneficiaries.¹⁸

Before proceeding, a word about this dual ownership of entrusted property, whereby legal title to an item of property is in X while the equitable interest in the very same property and at the very same time is in Y. To the layman and the civil lawyer, this splitting of interests is as mysterious as the

11. RESTATEMENT (THIRD) OF TRUSTS § 2 (AM. LAW INST. 2012). A trust is defined as a fiduciary relationship with respect to property that subjects the person who holds title to the subject property, namely the trustee, to equitable duties. *Id.*

12. RESTATEMENT (THIRD) OF TRUSTS § 2 (AM. LAW INST. 2012).

13. For an example of such legislation, see UNIF. STATUTORY TR. ENTITY ACT (UNIF. LAW COMM'N 2013).

14. See generally ROUNDS, JR. & ROUNDS III, *supra* note 8, at § 7.3.1.

15. See generally *id.* at § 7.1.

16. *Id.*

17. See generally *id.* ch. 6 (The trustee's equitable duties to the beneficiary incident to the trust relationship). The trustee, however, is not an agent of the beneficiary. *Id.* at § 5.6.

18. See generally *id.* at §3.5.1.

Trinity. How can it be that the trustee and beneficiaries both own the property? “Though the English do not lay exclusive claim to having discovered God, they do claim to have invented the trust with two natures in one.”¹⁹ In sorting out the rights, duties, and obligations of the parties and non-parties to the type of arbitration contract that is the subject of this Article, one needs to be mindful of the overlap of these two ownership regimes, the legal and the equitable.

A. DELEGATION BY TRUSTEES OF INVESTMENT-MANAGEMENT DISCRETION: A PRE-UTC/UPIA LIABILITY PRIMER

More likely than not, a trustee is vested with investment discretion, either expressly or by implication. This has been the trend since the Industrial Revolution.²⁰ As late as 1939, at least on this side of the Atlantic, the investing of entrusted assets was a non-delegable function.²¹ Here is the first edition of *Scott on Trusts*, copyright 1939, on the subject:

. . . [A] . . . trustee cannot properly employ an agent to select investments for the trust. If he entrusts trust funds to the agent for this purpose and through the dishonesty or negligence of the agent the funds are lost, the trustee is personally liable.²²

Thus it follows that were the trustee to enter into an investment management agency agreement under which the agent was vested with investment discretion to make trades without the trustee’s advance approval, the very execution of the agreement would be a *per se* breach of trust.²³ Moreover the agent himself would risk liability *vis-à-vis* the trust beneficiaries for knowingly participating in a breach of trust.²⁴ It is self-evident that an arbitration clause in an unlawful contract would not be enforceable, and would certainly not be enforceable against someone not a party to the contract.

19. J.H. BEEKHUIS ET AL., INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, VOL. VI, ch. 2, ¶ 262 (Frederick H. Lawson et al. eds. 1975).

20. ROUNDS, JR. & ROUNDS III, *supra* note 8, at § 6.2.2.

21. *Id.*

22. II AUSTIN WAKEMAN SCOTT, THE LAW OF TRUSTS § 171.2, at 916 (1939).

23. *See generally* 2 SCOTT ON TRUSTS § 17102 (1939) (“On the other hand, a trustee cannot properly employ an agent to select investments for the trust.”).

24. *See generally* ROUNDS, JR. & ROUNDS III, *supra* note 8, at § 7.2.9 (liability of third parties who knowingly participate with the trustee in a breach of trust).

By the late 1940s, equity was becoming more accommodating when it came to the delegation of investment discretion by trustees.²⁵ A major concession was when it became generally acceptable for trustees to invest in mutual funds, provided the funds were prudently selected *by the trustee* and the performance of the funds prudently monitored *by the trustee*.²⁶ A trustee who invests in a mutual fund effectively delegates investment discretion to the trustees of the mutual fund.²⁷

By the 1970s it had become common practice for banks to perform agency services for individual trustees.²⁸ When it came to investment management, however, a bank would generally want its trustee-customer to sign off in advance of the agent-bank making a trade.²⁹ After all, back then such investment discretion was generally perceived by those of us working in the trust industry as possibly still being a non-delegable fiduciary function, at least under the default law.³⁰ To insert an arbitration clause into the bank's standard "agent-for-the-fiduciary-agreement" form would have been thought a bridge way too far, even tacky, and certainly not binding on the trust beneficiaries who were not parties to the agency agreement and the arbitration contract incident to it.³¹ After all, both the customer, as trustee, and the bank, as the customer-trustee's agent, in equity owed fiduciary duties to the beneficiaries of the particular trust.³² And certainly the equity court would not take kindly to an arbitrator indirectly usurping its ancient authority to regulate fiduciary activity.³³

25. *See, e.g.*, In re Rees' Estate, 85 N.E.2d 563 (Ohio Ct. App. 1949), aff'g 87 N.E.2d 397 (Ohio Prob. 1947).

26. *Id.*

27. *See generally* 4 SCOTT & ASCHER ON TRUSTS § 19.1.10 (5th ed. 2017).

28. To this day, it is the Comptroller of the Currency who is charged with overseeing national banks in the performance of such agency services. *See* 12 C.F.R. §§ 9.1, 9.2(e) (2017).

29. In the 1970s the go-to texts on trust law were asserting that a trustee's authority to delegate investment discretion was unsettled. *See, e.g.*, ROUNDS JR. & ROUNDS III, *supra* note 8, at 79 ("The law is by no means settled on this point although the intricacies of modern investment seem to demand an early answer."). That being the case, it was felt that a bank acting as investment agent for an individual trustee risked liability for knowingly participating in a breach of trust were the bank as the trustee's agent to execute a trade without the trustee-principal signing off in advance. *See generally id.* at § 7.2.9 (showing the liability of a third party who knowingly participates in a breach of trust).

30. ROUNDS JR. & ROUNDS III, *supra* note 8, at § 7.2.9.

31. Radford, *supra* note 1, at 278-83.

32. *See generally* ROUNDS JR. & ROUNDS III, *supra* note 8, at ch. 6 (the trustee's equitable duties to the beneficiary); *Id.* at § 7.2.9 (personal liability of the trustee's agents to the beneficiary).

33. *Cf. id.* at § 3.5.3.3 (the court jealously guards its authority over the administration of trusts).

B. DELEGATION BY TRUSTEES OF INVESTMENT-MANAGEMENT DISCRETION: A POST-UTC/UPIA LIABILITY PRIMER

The publication of the Restatement (Third) of Trusts' Prudent Investor Rule in 1992 pretty much ended the debate as to whether equity should or would look askance at the delegation by trustees of investment discretion.³⁴ It would not and should not. Under the default law, investment discretion was now a function that was properly delegable by a trustee, provided that the agent was prudently selected by the trustee and prudently monitored by the trustee.³⁵ In 1994, the state legislatures began turning out versions of the UPIA, which codified the Prudent Investor Rule, including the provision of the Rule that endorsed the prudent delegation of investment discretion.³⁶ In 2000, the UTC, which tracks virtually verbatim the delegation provisions of the UPIA, was approved by the National Conference of Commissioners on Uniform State Laws.³⁷

Now that investment discretion is properly delegable by trustees, provided the trustee's investment agent is prudently selected by the trustee and his activities prudently monitored by the trustee, who is now primarily liable to the trust beneficiaries for the consequences of imprudent investing, the trustee-principal or the trustee's investment agent? The UPIA's and UTC's answer is the latter.³⁸ Equity eventually would probably have answered the latter as well, the delegation of investment discretion no longer being *per se* improper.³⁹ While the horse has now long been out of the barn, one wonders whether this is good public policy. Of the three parties (the trustee-fiduciary; the trustee's investment agent, who owes fiduciary duties to the trust benefi-

34. See RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE §171 (AM. LAW INST. 1992).

35. See *id.* at §143.

36. See UNIF. LAW COMM'N, *Prudent Investor Act Map*, <http://www.uniformlaws.org/Act.aspx?title=Prudent%20Investor%20Act> (last visited Feb. 21, 2018).

37. See NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, *Uniform Trust Code*, http://www.uniformlaws.org/shared/docs/trust_code/utc_final_rev2010.pdf (last updated Jan. 15, 2013).

38. UNIF. TRUST CODE § 807(c) (UNIF. LAW COMM'N 2010) ("A trustee who complies with subsection (a) is not liable to the beneficiaries or to the trust for an action of the agent to whom the function was delegated"); see also *id.* at § 807(b) ("In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care and to comply with the terms of the delegation"); UNIF. PRUDENT INV'R ACT § 9(b) (UNIF. LAW COMM'N 2010) ("In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care and to comply with the terms of the delegation.").

39. See SCOTT, *supra* note 23, at 914 ("Where the trustee himself is in no way at fault, he is not liable for the acts of agents employed by him in the administration of the trust; but he is liable if he was guilty of an improper delegation in employing the agents, as he is liable also if he did not use reasonable care in the selection of the agent or in supervising his conduct.").

ciary; and the trust beneficiary) the only one who is truly innocent is the clueless, vulnerable trust beneficiary, to whom all fiduciary duties run and by whom no duties are owed.⁴⁰ Why should the trust beneficiary and not the compensated trustee-fiduciary bear the primary burden of any injury to the trust estate that is perpetrated by, say, an impecunious defalcating investment agent of the trustee? The initial delegation was a decision of the trustee, not the trust beneficiary, and for the convenience of the trustee, not the trust beneficiary.⁴¹ In any case, what is done is done. The provisions of the UTC and UPIA off-loading primary fiduciary liability from the shoulders of the trustee onto the shoulders of his investment agent are now statutory law in most states.⁴² As an aside, while the law makes certain allowances for the amateur trustee who breaches his trust,⁴³ no such allowances are made for the amateur investment agent of the trustee who breaches a fiduciary duty that the amateur investment agent of the trustee owes the trust beneficiary.⁴⁴

If one assumes that there is no basis at law or in equity for the enforcement of the arbitration clause against the trust beneficiary and that the *trustee's investment agent* would be advantaged in some way by its enforcement, then the trust beneficiaries should be entitled to an equitable rescission of the contract's arbitration provisions.⁴⁵ Otherwise, the trustee's investment agent would be unjustly enriched by the inability of the trust beneficiaries to gain immediate and full access to the courts.⁴⁶ The unjust-enrichment argument becomes more compelling if the lack of immediate and full access to the courts could credibly and quantifiably compromise the equitable property rights of the trust beneficiaries.⁴⁷

III. THE FAILURE OF THE TRUSTEE'S INVESTMENT AGENT TO

40. See generally ROUNDS JR. & ROUNDS III, *supra* note 8, at § 5.6.

41. See Radford, *supra* note 1, at 283-84.

42. See UNIF. LAW COMM'N, *Enactment Status Maps*, <http://www.uniform-laws.org/Act.aspx?title=trust%20Code> (Trust Code) and <http://www.uniformlaws.org/Act.aspx?title=Prudent%20Investor%20Act> (Prudent Investor Act).

43. See generally ROUNDS JR. & ROUNDS III, *supra* note 8, at § 6.1.4 (discussing the amateur trustee); UNIF. TRUST CODE § 806 (UNIF. LAW COMM'N 2010) (stating that a trustee with special skills has a duty to employ those skills).

44. Neither the UTC nor the UPIA, for example, makes allowances for the amateur investment agent. See generally UNIF. TRUST CODE (UNIF. LAW COMM'N 2010); UNIF. PRUDENT INV'R ACT (UNIF. LAW COMM'N 1994).

45. See RESTATEMENT (FIRST) OF RESTITUTION: UNJUST ENRICHMENT §1 (AM. LAW INST. 1937).

46. See ROUNDS JR. & ROUNDS III, *supra* note 8, at § 8.15.78.

47. Cf. RESTATEMENT (FIRST) OF RESTITUTION: VIOLATION OF FIDUCIARY DUTY § 138(1) (AM. LAW INST. 1937) ("A fiduciary who has acquired a benefit by a breach of his duty as fiduciary is under a duty of restitution to the beneficiary.").

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However, from the trust beneficiary's perspective, it would seem a reasonable corollary that if the trustee's investment agent is now primarily liable in equity to the trust beneficiary for what would be a breach of trust had it been perpetrated by the trustee, there is no principle of contract law, trust law, agency law, or property law that would justify enforcing an arbitration contract to which only the trustee and his agent are parties against the innocent and clueless trust beneficiary.⁴⁸ The trustee's investment agent is not an agent of the trust beneficiary.⁴⁹ The trustee's investment agent is not in a contractual relationship with the trust beneficiary.⁵⁰ The trustee's investment agent owes fiduciary duties directly to the trust beneficiary incident to the trust relationship.⁵¹ There is no basis at law or in equity for imposing an obligation to arbitrate on a non-consenting trust beneficiary.⁵² The trust beneficiary may sue the trustee's investment agent directly, thanks to the UTC and UPIA.⁵³ The trust beneficiary's rights are not derivative of, or incidental to, the agency agreement between the trustee and the trustee's investment agent.⁵⁴ Thus, to judicially deny the trust beneficiary immediate and full access to the courts in derogation of his equitable property rights under the trust is tantamount to a partial taking of those rights by the state.⁵⁵

The UPIA and the UTC have made it settled statutory law that the trustee's investment agent *ab initio* directly owes the trust beneficiary fiduciary duties, such as the duty to refrain from unauthorized self-dealing, a duty that is incident to the duty of undivided loyalty.⁵⁶ A failure on the part of the

48. *Cf.* U.S. CONST. amend. XIV, § 1 (“No state shall . . . deprive any person of life, liberty, or property, without due process of law. . .”).

49. *See* Radford, *supra* note 1, at 278-83.

50. *Id.*

51. *See* UNIF. TRUST CODE § 807(b) (UNIF. LAW COMM’N 2010) (“In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.”); UNIF. PRUDENT INV’R ACT § 9(b) (UNIF. LAW COMM’N 1994) (“In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.”).

52. *See generally* U.S. CONST. amend. XIV, § 1.

53. *Id.*

54. Radford, *supra* note 1, at 278-83.

55. *See generally* U.S. CONST. amend. V; U.S. CONST. amend. XIV.

56. *See* RESTATEMENT (FIRST) OF RESTITUTION § 190 cmt. a (AM. LAW INST. 1937) (“A person in a fiduciary relation to another is under a duty to act for the benefit of the other as to matters within the scope of the relation.”). Section 190 itself provides that “[w]here a person in a fiduciary

trustee's investment agent to waive his rights under the arbitration contract, assuming it would be in the interests of the trust beneficiary for the trustee's investment agent to do so, could well constitute such an act of unauthorized self-dealing.⁵⁷ After all, the trust beneficiary did not enter into the arbitration contract with the trustee, the trustee's investment agent did.⁵⁸ And now let's consider whether the trustee himself assumes some equitable culpability for executing the arbitration contract in the first place, assuming doing so had not been, and is not now, in the interests of the trust beneficiary.

IV. A TRUSTEE WHO ENTERS INTO AN ARBITRATION CONTRACT WITH AN INVESTMENT AGENT MAY BE BREACHING IN EQUITY CERTAIN FIDUCIARY DUTIES THE TRUSTEE OWES THE TRUST BENEFICIARY TO THE EXTENT THE TERMS OF THE CONTRACT ARE NOT IN THE INTERESTS OF THE TRUST BENEFICIARY

Let us assume that the terms of a particular arbitration contract are enforceable *at law* against the non-party trust beneficiary. Does the trust beneficiary have any equitable recourse against the trustee for harm to the trust beneficiary's equitable property interests that is occasioned by the contract's enforcement? A trustee has an equitable duty to act solely in the interests of the trust beneficiary.⁵⁹ He may not subvert the interests of the trust beneficiary for personal benefit or in order to further the interests of third parties.⁶⁰ The trustee who delegates investment discretion to an external investment agent does so either because it is convenient to do so or because the trustee lacks the requisite skills to prudently invest the entrusted assets.⁶¹ Whichever the inducement, the delegation is not *per se* a subversion of the beneficiary's equitable property interests.⁶² But if there is an arbitration contract incident to the investment management agency agreement between the trustee and his investment agent and the terms of the contract are not in the interests of the trust beneficiary, then the trustee has breached his duty of loyalty to the trust

relation to another acquires property, and the acquisition or retention of the property is in violation of his duty as fiduciary, he holds it upon a constructive trust for the other." *Id.*

57. See generally ROUNDS JR. & ROUNDS III, *supra* note 8, at § 6.1.3.

58. Radford, *supra* note 1, at 278.

59. See generally ROUNDS, JR. & ROUNDS, III, *supra* note 8, at §6.1.3 (stating that the trustee's general duty of loyalty is to the trust beneficiaries).

60. See generally *id.* (explaining that the trustee's general equitable duty of loyalty to the trust beneficiary).

61. See generally *id.* at 537 (explaining that a trustee with minimal investment expertise may have a fiduciary duty to prudently delegate investment discretion to agents).

62. See generally ROUNDS JR. & ROUNDS III, *supra* note 8, at §6.1.4.

beneficiary by entering into it in the first place, unless he had received in advance the informed consent of the trust beneficiary.⁶³ Obtaining such a consent may be easier said than done, particularly if the trust beneficiary is an unborn or unascertained contingent remainderman.⁶⁴ The trustee will either need to obtain the informed consent of the beneficiary's court-appointed guardian ad litem (or the informed consent of someone authorized to virtually represent the trust beneficiary) to enter into the arbitration contract.⁶⁵

What if the terms of an arbitration contract are not in the interests of the trust beneficiary but the trustee is unable to locate an investment agent willing to forego the protections of an arbitration contract? The answer is simple: The trustee should either resign in favor of a trustee whose investment management skills make it unnecessary to delegate out investment discretion or retain an investment advisor to whom investment discretion is not delegated.⁶⁶

V. CONCLUSION

An arbitration contract incident to a discretionary investment-management agency agreement between (1) the trustee of an irrevocable trust that is regulated by the UTC and/or the UPIA and (2) his investment agent ought not to be enforceable at law against the beneficiaries of the trust, whether the beneficiaries are current or future, and whether their equitable property interests are vested or contingent. The trust beneficiaries are parties neither to the agency agreement nor the arbitration contract that is incident to it.⁶⁷ The fiduciary duties that the trustee's investment agent owe the trust beneficiaries are imposed in equity by virtue of trust principles, not at law by virtue of the terms of the arbitration contract to which the beneficiaries are not a party.⁶⁸ Even if the arbitration contract is enforceable at law against the non-party trust beneficiaries, in equity the trustee assumes fiduciary liability to the trust

63. *Id.*

64. *Id.* at §8.14.

65. *Id.* (when a guardian ad litem or virtual representative is needed).

66. *Id.* at §6.1.3 (the trustee's duty of undivided loyalty to the beneficiaries).

67. Radford, *supra* note 1, at 278-83.

68. The trustee's investment agent owes fiduciary duties to the trust beneficiaries under long-standing general principles of equity. *See generally* ROUNDS, JR. & ROUNDS, III, *supra* note 8, at § 7.2.9. These equitable principles have merely been reinforced by the UTC and UPIA. *See generally* UNIF. TRUST CODE § 807(b) (UNIF. LAW COMM'N 2010); UNIF. PRUDENT INV'R ACT § 9(b) (UNIF. LAW COMM'N 1994). These duties are not "legal in nature" as the trustee's agent and the trust beneficiaries are neither in a contractual relationship, nor an agency relationship. *See generally* 4 SCOTT & ASCHER ON TRUSTS § 2.3.10.3 (5th ed. 2017); *see also* WARREN A. SEAVEY, HANDBOOK OF THE LAW OF AGENCY 3 (1964).

beneficiaries by having entered into it in the first place.⁶⁹ This is true at least to the extent its terms are not in the interests of the trust beneficiaries.⁷⁰ The trustee's investment agent in equity assumes fiduciary liability to the trust beneficiaries for failing to waive his rights under the contract to the extent such a waiver would be in the interests of the trust beneficiaries.⁷¹ If the terms of an arbitration contract are not in the interests of the trust beneficiaries but the trustee was unable to locate an acceptable investment agent willing to forego the protections of an arbitration contract, the trustee should either resign in favor of a trustee whose personal investing skills make it unnecessary for the trustee to delegate out investment discretion or retain an investment advisor to whom investment discretion will not be delegated by the trustee.

69. *See generally* ROUNDS, JR. & ROUNDS, III, *supra* note 8, at § 6.1.3 (discussing the trustee's duty of undivided loyalty to the beneficiaries).

70. *Id.*

71. *Id.*