Resisting the Contractarian Insurgency: The Uniform Trust Code, Fiduciary Duty, and Good Faith in Contract

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Fiduciary duty has long formed the basis of the relationship of a trustee to the beneficiaries of a trust. The law and economics doctrine of legal theory, popular in academia and with certain courts, holds that legal relationships are profoundly contractual. The result of such interpretation is to strip fiduciary duty of its moral footing and to reinterpret it as merely requiring good faith in the contract sense: a minimal requirement of honesty in fact. This article explores the implications of the contractarian

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model to the law of trusts, how the Uniform Trust Code handles the issue and, by way of contrast, how the contractarian model transformed the fiduciary duties owed by partners under the revised Uniform Partnership Act.

I. The Notion of Fiduciary Duties

> We ought to call one province of the law "Affiliations," or perhaps, "Relationships." Contract law is one of its parts. Another is fiduciary duty – the law governing attorneys, trustees, guardians, corporate directors, and partners. Fiduciary duty delineates the way in such relationships arise and identifies the standards of conduct to which a fiduciary must conform, including requirements of loyalty, zeal, and self-sacrifice. A fundamental change in the jurisprudence and ethics of affiliations is underway, or at least several prominent writers are attempting to work such a change. An insurgent theory asserts that fiduciary relationships are really contractual in nature.[1]

For centuries, the fiduciary duties owed by a trustee to his or her beneficiaries formed the core, indeed definitional, component of a trust, something arising from the relationship itself. Thus, the Restatement (Second) of Trusts could confidently proclaim:

> A trust . . . is a fiduciary relationship with respect to property, subjecting the person by whom the title is held to equitable duties to deal with the property for the benefit of another person . . . .[2]

This fiduciary relationship, of course, is not the exclusive province of trust law. It also governs the relation of guardian and ward, agent and principal, attorney and client, corporate director and shareholder, as well as the relations among partners.[3]

Although the fiduciary relation operates in various settings, it is not identical, or as pronounced, in every situation: "The scope of the trans-

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1 Scott Fitzgibbon, *Fiduciary Relationships are not Contracts*, 82 Marq. L. Rev. 303 (1999).

2 Restatement (Second) of Trusts; § 2

3 Restatement (Second) of Trusts, § 2 cmt. b ("Fiduciary relations include not only the relation of trustee and beneficiary, but also, among others, those of guardian and ward, agent and principal, attorney and client."); A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 Harv. L. Rev. 1049 (1931) (All corporate action must be measured "by equitable rules somewhat analogous to those which apply in favor of the cestui que trust to the trustee's exercise of wide powers granted to him in the instrument making him a fiduciary."); Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (N.Y. 1928) (Partners are "bound by fiduciary ties.").

actions affected by the relation and the extent of the duties imposed are not identical in all fiduciary relations. The duties of a trustee are more intensive than the duties of some other fiduciaries."[4]

The traditional treatment of fiduciary duty in the law of partnership, however, closely followed that of the law of trust. Until recently, the fiduciary duty owed among partners dictated a "duty of finest loyalty" similar to that demanded of a trustee to his or her beneficiary:

> Joint adventures, like corporations, owe to one another, while the enterprise continues the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those operating at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.[5]

At common law, trust fiduciary law generally "resolves into two great principles, the duties of loyalty and prudence. . . . Sub-rules of fiduciary administration abound. . . . All of these rules are subsumed under the duties of loyalty and prudence, they are means of vindicating the beneficial interest."[6] Of these two great principles, the duty of loyalty has been described as the "essence" of the fiduciary relationship.[7] Loyalty dictates that the trustees act for the sole benefit of the beneficiary: "The duty of loyalty requires the trustee 'to administer the trust

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[4] RESTATEMENT (SECOND) OF TRUSTS, § 2 cmt b.

[5] Meinhard v. Salmon, 249 N.Y. 458, 463-4, 164 N.E. 545, 546 (N.Y. 1928) (Cardozo). It is difficult to overestimate the enduring importance of Chief Judge Cardozo's decision in *Meinhard*: "*Meinhard* has aged well. No case of its period is of comparable contemporary influence in the business law area. *Meinhard* is cited today for the power and vitality of the idea it expresses rather than as a window to an era the values of which have long since been abandoned. The 'punctilio of an honor' precept is as enduring as any expression of partnership or corporate law and continues to guide courts in determining the duties business partners owe one another. The frequency with which courts cite *Meinhard* signals the continuing influence of the idea its expresses, even if its currency has been devalued in the academic community." Robert W. Hillman, *Business Partners as Fiduciaries: Reflections on the Limits of Doctrine*, 22 CARDOZO L. REV. 51, 53 (2000). Although it may have been somewhat devalued in academia, *Meinhard* has been cited in over 1000 cases from the date of the holding in 1928 through 2005. Robert W. Hillman, *Closely-Held Firms and the Common Law of Fiduciary Duty: What Explains the Enduring Qualities of a Punctilio?*, 41 TULSA L. REV. 441, 449 (app.) (2006).

[6] John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 655-6 (1995)[hereinafter Langbein, *Contractarian*].

[7] Karen E. Boxx, *Of Punctilios and Paybacks: The Duty of Loyalty Under the Uniform Trust Code*, 67 MO. L. REV. 279, 280 (2002) ("The duty of loyalty has been called 'the essence of the fiduciary relationship' and even has been considered an expression synonymous with fiduciary.").

solely in the interest of the beneficiary.' This obligation implements the beneficiaries' entitlement to the trust assets. The trustee owns the assets, but only to facilitate the beneficiaries' enjoyment."[8]

Because every partner has an economic interest in the enterprise, the duty of loyalty in a business venture will not be "solely" for the benefit of others. Nevertheless, each partner is called upon to act for the benefit of the enterprise itself not oneself. Justice Cardozo's pronouncement places the law of partnership, like that of corporations, with the law of trusts, not with contract.[9]

II. The Rise of the Insurgency

A. "Contractarian" Approach

An academic doctrine (an "insurgent theory") seeks to establish a contractarian basis for fiduciary relationships with important implications for the continued vitality of that relationship. This doctrine is part of a larger exercise within academia to view all relationships generally as a species of contract:

> Contract has become the dominant doctrinal current in modern American law. In fields ranging from corporations and partnership, to landlord and tenant, to servitudes, to the law of marriage, scholars have come to understand our legal rules as resting mainly on imputed bargains that are susceptible alteration by actual bargains.[10]

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[8] Langbein, *Contractarian*, *supra* note 6, at 655. Professor Langbein describes the other core duty, that of prudence, as follows: "The duty of prudence is a reasonableness norm, comparable to the reasonable person rule of tort. An objective standard of care places the trustee 'under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property.'" *Id.*

[9] The law of contract is the law of the market place. Partnership law is not an isolated example of trust law providing the basis for governance of business organizations where someone is managing property for the benefit of others. In corporate law, the law of trusts, including particularly the duty of loyalty, informs a director's duty: "We are willing to go further and say that it is possible to conceive of there being only one core duty (of a corporate director), that of loyalty, and that the duty of care is itself simply a component of what is expected of a faithful – that is loyal – fiduciary. That is, we think it uncontroversial that the corporate law duty of loyalty has an affirmative aspect, which demands that a fiduciary make a good faith effort to advance the best interests of the corporation and its stockholders. The Hippocratic maxim to first do no harm is of course relevant to a corporate fiduciary's role, but, like the role of a physician, the director's job demands affirmative action – to protect and to better the position of the corporation." Leo E. Strine, Jr., et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporate Law*, 98 Geo. L.J. 629, 635-6 (2010)

[10] Langbein, *Contractarian*, *supra* note 6, at 630.

If all relationships are contracts, then all relationships are governed by the terms of the "deal." Under such a regime, fiduciary duty becomes simply another term of the implied bargain:

> Fiduciary duties are not special duties; they have no moral footing; they are the same sort of obligations, derived and enforced in the same way, as other contractual undertakings.
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> Scholars of non - or antieconomic bent have had trouble coming up with a unifying approach to fiduciary duties because they are looking for the wrong things. They are looking for something special about fiduciary relations. There are is nothing special to find. . . . Contract law includes a principle of good faith in implementation – honesty in fact under the Uniform Commercial Code, plus an obligation to avoid (some) opportunistic advantage taking. Good faith in contract merges into fiduciary duties with a blur and not a line. Searching for the right definition of a fiduciary duty is not a special puzzle. In short there is no subject here, and efforts to unify it on a ground that presumes its distinctiveness are doomed.[11]

To one urging a strict "contractarian" view of the fiduciary relationship, it would be the contract standard of good faith dealings, not a system of moral norms, that should regulate these relationships. These are radically different concepts:

> In general, the contracting party's duty of good faith establishes nothing like the full panoply of fiduciary obligations. Judge Posner says as much in one of his judicial opinions:
> 'The particular confusion to which the vaguely moralistic overtones of "good faith" give rise is the belief that every contract establishes a fiduciary relationship. A fiduciary is required to treat his principal as if the principal were he, and therefore he may not take advantage of the principal's incapacity, ignorance, inexperience, or even naiveté. . . . But it is unlikely that Wisconsin wishes, in the name of good faith, to make every contract signatory his brother's keeper. . . . In fact the law contemplates that people frequently will take advantage of the ignorance of those with whom they contract, without thereby incurring liability. . . . [E]ven after you have signed a contract, you are not obliged to become an altruist "toward the other party."[12]

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11 Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425, 427 & 438 (1993).

12 Fitzgibbon, *supra* note 1, at 324.

Whether, or to what extent, fiduciary duty as a separate and stand-alone, non-contract principle should continue to play a pivotal role in trust and partnership law has been debated over the course of the past few decades.[13] Both the Uniform Trust Code and the revised Uniform Partnership Act were written at the time, and against the general backdrop, of the academic debate reinterpreting all relationships as essentially contractual in nature.

B. The Uniform Trust Code

The Uniform Trust Code provides that the traditional fiduciary obligations operate as default rules that can be modified somewhat by the trust agreement.[14] This very approach suggests a contractarian approach to the law of trusts.[15] Certain rules, however, are non-modifiable, including the ability of any trust agreement to alter the "duty of a trustee to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries."[16] Although this

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13 This debate has generated more than a few articles. Some of the articles related to trusts include: Langbein, *Contractarian*, *supra* note 6; Fitzgibbon, *supra* note1; Boxx, *supra* note 7; Melanie B. Leslie, *Trusting Trustees: Fiduciary Duties and the Limits of Default Rules*, 94 GEO. L.J. 67 (2005)[hereinafter Leslie, *Trusting Trustees*]; Arthur B. Laby, *The Fiduciary Obligation as the Adoption Ends*, 56 BUFF. L. REV. 99 (2008). Some of the articles related to business organizations include: Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879 (1988); Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1 (1990); J. Dennis Hynes, *Freedom of Contract, Fiduciary Duties, and Partnerships: The Bargain Principle and the Law of Agency*, 54 WASH. & LEE L. REV. 439 (1997); Allan W. Vestal, *Fundamental Contractarian Error in the Revised Uniform Partnership Act of 1992*, 73 B. U. L. REV. 523 (1993)[hereinafter Vestal, *Fundamental Contractarian Error*]; Lawrence E. Mitchell, *The Naked Emperor: A Corporate Lawyer Looks at RUPA's Fiduciary Provisions*, 54 WASH. & LEE L. REV. 465 (1997)[hereinafter Mitchell, *The Naked Emperor*]; Allan W. Vestal, *"Assume a Rather Large Boat . . .': The Mess We Have Made of Partnership Law*, 54 WASH. & LEE L. REV. 487 (1997); Hillman, *supra* note 5.

14 UNIF. TRUST CODE §§ 801-804; 105(b) (2005).

15 "Of course, parties to a trust instrument may, to a considerable extent, tailor a trustee's fiduciary duties to facilitate the settlor's objectives. But it is a long leap from the proposition that fiduciary duties can be tailored to further individual objectives to the conclusion that fiduciary duties are merely gap-filling default rules, similar to those found in the Uniform Commercial Code's ("U.C.C.") Article Two." Leslie, *Trusting Trustees*, *supra* note 13, at 69. According to Professor Leslie, one consequence of embracing a contractarian view is that it may dislodge fiduciary duty from its moral/equitable moorings: "[L]abeling fiduciary duties 'default rules' threatens to strip fiduciary rules of their moral content. Fiduciary duties are most effective when they function both as legal rules and moral norms. A label that equates the duty of loyalty with, say, a U.C.C. provision allocating risk of loss undermines the duty's normative force." *Id.* at 70.

16 UNIF. TRUST CODE § 105(b)(2) (2005). The Reporter for the U.T.C. explains the purpose of providing default rules backstopped by non-modifiable provisions: "Most

rule is framed in what may sound like contractarian vocabulary ("good faith"), it is in fact close to the classic formulation of the fiduciary duty of loyalty.[17] The Uniform Trust Code may be "permeated with (contractarian) default rule rhetoric"[18] but it came out solidly in the anti-contractarian camp by rejecting a pure "good faith" standard in the contract, Uniform Commercial Code, sense.[19]

C. The Revised Uniform Partnership Act

The revised Uniform Partnership Act, on the other hand, has embraced a purely contractarian model that strips out fiduciary duty as the broad governing principle law of partnership. It limits the fiduciary duty owed among partners to a duty of loyalty and care as those terms are narrowly defined by the act.[20] Instead of broad fiduciary duties as de-

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American trust law consists of rules subject to override by the terms of the trust. But, prior to the U.T.C., neither the Restatements, treatise writers, nor state legislatures had attempted to comprehensively list the principles of law not subject to override by the trust terms. The U.T.C. collects these principles in Section 105(b)." David M. English, *The New Mexico Uniform Trust Code*, 34 N.M. L. REV. 1, 9-10 (2005).

17 "Close to" but not exactly equal to the fiduciary duty of loyalty. "The duty of loyalty requires a trustee 'to administer the trust solely in the interest of the beneficiary.' This 'sole interest' rule is widely regarded as 'the most fundamental' rule of trust law." John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole or Best Interest?*, 114 YALE L.J. 929, 931 (2005) [hereinafter Langbein, *Questioning the Duty of Loyalty*] (a rule that Professor Langbein considers "unsound"). *See* UNIF. TRUST CODE § 802(a) (2005) for the classic definition of the duty of loyalty with the obligation to administer the trust "solely" in the interest of the beneficiary. The extent a trust instrument can modify or eliminate the "sole" benefit rule has broad-sweeping implications, including the impact on the no-further-inquiry approach to self dealing. See Melanie B. Leslie, *Common Law, Common Sense: Fiduciary Standards and Trustee Identity*, 27 CARDOZO L. REV. 2713 (2006).

18 Leslie, *Trusting Trustees*, *supra* note 13, at 71.

19 Somewhat similarly, under Delaware corporate law, "good faith" is used as an element of the duty of loyalty: "[T]he term good faith has long been used as the key element in defining the state of mind that must motivate a loyal fiduciary. To wit, the duty of loyalty most fundamentally requires that a corporate fiduciary's actions be undertaken in the good faith belief that they are in the best interests of the corporation and its stockholders . . . For these reasons, it has been traditional for the duty of loyalty to be articulated capaciously, in a manner that emphasizes not only the obligation of a loyal fiduciary to refrain from advantaging herself at the expense of the corporation but, just as importantly, to act affirmatively to further the corporation's best interest. In this respect, our law has been clear that the duty of loyalty is implicated by all director actions because all such actions must be undertaken in good faith to advance the corporation's best interests and because directors owe an affirmative obligation to put in a good faith effort to responsibly carry out their duties." Strine, et al., *supra* note 9, at 633-4 (2010).

20 REV. UNIF. PARTNERSHIP ACT § 404, cmt.(amended 1997): "Section 404 begins by stating that the ONLY fiduciary duties a partner owes to the partnership and the other partners are the duties of loyalty and care set forth in subsections (b) and (c) of the Act. Those duties may not be waived or eliminated in the partnership agreement, but the

fault provisions, the revised Uniform Partnership Act mandates that a partner exercise his or her duties and rights under the partnership agreement consistent "with the obligation of good faith and fair dealing" – a contract standard of conduct similar, but not exactly the same, to that of the Uniform Commercial Code.[21]

Both the Uniform Trust Code and the revised Uniform Partnership Act reflect the doctrinal force of the contractarian worldview. The Uniform Trust Code, however, is largely a codification of the long-standing common law trust principles framed by the contractarian rhetoric.[22] In contrast, the Revised Uniform Partnership Act essentially trades in long-standing partnership law fiduciary principles for a purely contractual model. How "good faith" is used, and what it means, under the two uniform acts puts in high relief the stakes involved in shifting from a relational to a contractarian model. Indeed, the developing case law under the Revised Partnership Act should serve as a cautionary tale for those concerned with the future of the law of trusts.

III. The Evolution of Fiduciary Duty and the Theoretical Case for Trust as Contract

A. The Trust As Fiduciary Relationship

Historically, a trust was seen as coterminous with the fiduciary duty owed by the trustee; it was defined by the duty of the trustee to the beneficiary:

> I should define a trust in some such way as the following – when a person has rights which he is bound to exercise on behalf of another or for the accomplishment of some purpose he

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agreement may indentify activities and determine standards for measuring performance of the duties if not manifestly unreasonable. See Section 103(b)(3)-(5) . . . Arguably, the term 'fiduciary' is inappropriate when used to describe the duties of a partner because a partner may legitimately pursue self-interest (see Section 404(e)) and not solely the interest of the partnership and the other partners, as must a true trustee." (Emphasis in original).

[21] Rev. Unif. Partnership Act § 404(d) (amended 1997). "The obligation of good faith and fair dealing is a contract concept, imposed on the partners because of the consensual nature of a partnership. . . It is not characterized, in RUPA, as a fiduciary duty arising out of the partners' special relationship. Nor is it a separate and independent obligation. It is an ancillary obligation that applies whenever a partner discharges a duty or exercises a right under the partnership agreement or the Act." *Id*. The revised Act did not incorporate the U.C.C. definitions of good faith under U.C.C. §§ 1-201(19) and 2-103(b): "Those definitions were regarded as too narrow or not applicable." *Id.*, cmt.

[22] "The U.T.C. does not make sweeping changes in the common law of trusts, but neither does it woodenly copy the previous judge-made law." David M. English, *The Uniform Trust Code (2000): Significant Provisions and Policy Issues*, 67 Mo. L. Rev. 143, 153 (2002).

> is said to have those rights in trust for that other or for that other purpose and he is called a trustee.[23]

The law of trust arose in the fourteenth century: the "ancestor of the modern trust (the feoffment to uses), enjoyed a popularity at least from the reign of Edward III (1327-1377)."[24] Originally, enforcement of uses fell to the courts of the Church of England which used canon law to regulate the conduct of the trustee (the feoffee).[25] In the fifteenth century, Chancery took over the role of enforcing these antecedents to the modern trust.[26] The evolution from the ecclesiastic courts to Chancery carried forward the application of canon-law-based norms to the Equity Courts.[27] Presumably, these ecclesiastic origins count, at least in part, for the moralistic overlay that informs the fiduciary duty of trustees.[28]

B. The Trust As Contract

The most prominent advocate of a contractarian view of trusts, Professor John H. Langbein, points to the deficiencies of the early law courts as to why the law of trusts was not initially treated as a contract:

> Recall Maitland's insight that 'a trust generally has its origin in something that we cannot but call an agreement.' Maitland was asking why the early law did not immediately assimilate the trust to the law of contract. His answer has never been doubted. The common law of contract was too primitive to do the job: "If . . . in the 14th century our law of contract had taken its modern form, I think that the courts of law would have been compelled to say 'yes, there is an agreement; therefore it is a legal enforceable contract.'[29]

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23 FREDERIC W. MAITLAND, EQUITY: A COURSE OF LECTURES (A.H. Chaytor & W.J. Whittaker eds., 1st ed. 1909, reprinted Fred B. Rothman & Co. 1999), 44.

24 R. H. Helmholz, *The Early Enforcement of Uses*, 79 COLUM. L. REV. 1503 (1979).

25 *Id.* At 1504-5.

26 *Id.* At 1512.

27 "The evolution of the enforcement of uses from the ecclesiastical to Chancery jurisdiction serves as an example of the role that canon law has played in the growth and development of our common law. Modern students of legal history may regard it as part of the long continuing absorption into the secular law of remedies once available only in the courts of the Church. The rise of the Chancery jurisdiction over feoffees to uses is not, therefore, the story of the creation of a legal remedy where previously there had been none. Rather it is the story of continuing enforcement in a new setting." *Id*., at 1513.

28 "Beginning in the late fourteenth and early fifteenth centuries, beneficiaries increasingly turned for justice to the Chancellor who granted relief on the theory that he was 'compelling the trustee to act upon the dictates of his conscience.' In other words, the Chancellor's role was to force the trustee to abide by his pre-existing moral or ethical obligation. . .Thus, the duty of loyalty developed as an equitable doctrine to support and enforce pre-existing moral norms." Leslie, *Trusting Trustees*, *supra* note 13, at 73.

29 Langbein, *Contractarian*, *supra* note 6, at 634.

Despite the actual historical origin of the law of trusts and the imprint that this history made on that law, Professor Langbein sees the enforcement of trusts as more properly a part of the law of contract: "In truth, the trust is a deal, a bargain about how the estate assets are to be managed and distributed."[30] Thus, the role of fiduciary duty is nothing special, has no moral footing, and is merely a contract obligation:

> [D]espite decades of pulpit-thumping rhetoric about the sanctity of fiduciary obligations, fiduciary duties in trust law are unambiguously contractarian. The rules of trust fiduciary law mean to capture the likely understanding of the parties to the trust deal, which is why both the duty of loyalty and the duty of prudence yield to more particularized intentions that the parties may choose to express or imply in their trust deal. I depict the default regime of trust law as a type of standardized contract, and I point to some instances in which the contractarian perspective should improve outcomes in trust law.[31]

The law governing fiduciary duty, however, came by its "pulpit-thumping" roots honestly and those roots serve the "institutional integrity" of the trust and its progeny.[32]

IV. Good Faith and the Nature of the Trustee's Duties at Common Law

A. The Good Faith Standard

Under the Uniform Trust Code, regardless of the terms of the instrument, a trustee has a duty "to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries."[33] The good faith formulation, of course, was one of the traditional grounds for courts to intervene and take corrective action in abuse of discretion cases:

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[30] *Id*., at 62.

[31] *Id*., at 629. The leap from a contract theory of trust law to the view that fiduciary duties are merely default rules is recent: "Although the argument that trusts are a species of contract has existed for at least a century, the precise characterization of fiduciary duties as mere 'default rules' crystallized only in the past fifteen years." Leslie, *Trusting Trustees*, *supra* note 13, at 76.

[32] Although decrying the pulpit-thumping rhetoric that surrounds fiduciary duty, Professor Langbein states that his contractarian analysis is not meant "to fold the law of trusts into the law of contract" because "the trust has an institutional integrity and convenience that fully justifies its jurisprudence." Langbein, *Contractarian*, *supra* note 6, at 630. Part of that integrity, presumably, arises from the success that has been achieved by the common law in defining the fiduciary duty owed by trustees in moralistic terms.

[33] Unif. Trust Code § 105(b)(2) (2005).

> [E]quity has established certain limitations on this doctrine (of non-intervention) which are deemed to be necessary to prevent the frustration of the settlor's intent and inequitable conduct by the trustee.
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> Many courts describe the cases where they review and upset the trustee's use of discretionary powers as those involving "an abuse of discretion," "bad faith," "dishonesty," or "arbitrary" action. It is believed that these phrases cover a variety of improper actions, for example, acting for the benefit of the trustee himself, or some third person, or for the purpose of harming the beneficiary or out of ill will or prejudice against him, or an action contrary to the purpose of the trust.[34]

When applying the good faith test, courts looked to whether the trustee exercised his or her discretion "reasonably." Thus, in ordinary situations, a trustee must exercise his or her discretion in "good faith" and "reasonably." Reasonableness is generally viewed as an objective standard – something that a court could review and opine upon.[35] It would seem obvious that both "good faith" and "reasonableness" should be measured – in all cases – by the overall intent of the settler:

> Even when the trustee has discretion, however, the court will not permit him to abuse the discretion. This ordinarily means that so long as he acts not only in good faith and from proper motives, but also within the bounds of reasonable judgment, the court will not interfere; but the court will interfere when he acts outside the bounds of reasonable judgment.[36]

B. Good Faith and Extended Discretion

In some trusts, however, the settlor appears to grant discretion without any standard or measurement of the settlor's intent. In those cases, the settlor grants extended discretion ("absolute" or "unlimited" or "uncontrolled" discretion). Extended discretion, according to the

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[34] GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 560 (rev. 2d ed. 1980).

[35] For tort liability, for example, reasonable care and a reasonable person standard is used that is free from subjective interpretation: "The [reasonable person] standard . . . must be an objective and external one, rather than that of the individual judgment, good or bad, of the particular individual . . . [The standard] affords a formula by which, so far as possible, a uniform standard may be maintained." RESTATEMENT (SECOND) OF TORTS § 283 cmt. c (1965). See Kristin Harlow, *Applying the Reasonable Person Standard to Psychosis: How Tort Law Unfairly Burdens Adults with Mental Illness*, 68 OHIO L.J. 1733 (2007).

[36] 3 AUSTIN WAKEMAN SCOTT, THE LAW OF TRUSTS § 187 (3d ed. 1967).

first two Restatements of Trusts, obviates the requirement that the trustee act reasonably:

> The mere fact that that the trustee is given discretion does not authorize him to act beyond the bounds of a reasonable judgment. The settlor, may, however, manifest an intention that the trustee's judgment need not be exercised reasonably, even where there is a standard by which the reasonableness of the trustee's conduct can be judged. This may be indicated by a provision in the trust instrument that the trustee shall have "absolute" or "unlimited" or "uncontrolled" discretion. These words are not interpreted literally but are ordinarily construed as merely dispensing with the standard of reasonableness. In such a case the mere fact that the trustee has acted beyond the bounds of a reasonable judgment is not a sufficient ground for interposition by the court, so long as the trustee acts in a state of mind in which it was contemplated by the settlor that he would act. But the court will interfere if the trustee acts in a state of mind not contemplated by the settlor. Thus, the trustee will not be permitted to act dishonestly, or from some motive other than the accomplishment of the purposes of the trust, or ordinarily to act arbitrarily without an exercise of his judgment.[37]

In his treatise, Professor Scott distils the test to the "state of mind not contemplated" standard: "The real question is whether it appears that the trustee is acting in a state of mind in which it was contemplated by the settlor that he should act."[38] This shift away from "reasonableness" would appear to embrace subjective criteria which, by its nature, would be difficult for a court to second-guess. It reduces the standard to a test of whether an abuse of discretion has occurred, in trusts providing for of extended trustee discretion, to whether the power was exercised or, for that matter not exercised, in bad faith or through some other showing of improper motive and not in the state of mind contemplated by the settler that he or she would act.

In practice, however, the courts impose a reasonableness standard regardless of whether the discretion is extended or absolute despite the early treatment in the first two Restatements:

> The authorities do not appear to support the Restatement position that there is no requirement of reasonableness in the exercise of a power granted in the trustee's absolute discretion.

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[37] RESTATEMENT (FIRST) OF TRUSTS and RESTATEMENT (SECOND) OF TRUSTS § 187, cmts.j.

[38] SCOTT, *supra* note 36, § 187.

> Most courts have held that the exercise of an absolute power is subject to the court's review and determination as to whether the power had been unreasonably exercised by the trustee.[39]
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> It would appear that the difference in the attitude of the courts towards "simple" discretionary powers, on the one hand, and "absolute" or "uncontrolled" discretionary powers, on the other hand, is one of degree rather than kind. The courts appear more likely to find an abuse of a simple discretionary power than an abuse of an absolute or uncontrolled discretionary power. In addition to the commonly recognized factors used to determine whether there has been an abuse of discretion, a standard of reasonableness has been applied by the courts in judging the exercise of a discretionary power (whether simple or absolute), a standard implied from the settlor's intent and the purposes expressed in the trust instrument. With respect to court review of discretionary powers, this standard is consistent with the standard of care and skill of a prudent man and is based upon established fiduciary standards and principles.[40]

Professor Halbach reached the same conclusion in his seminal 1961 article: that "reasonableness" was, in fact, required in every case involving extended discretion, but usually the courts framed the discussion under "the state of mind contemplated by the settlor" standard:

> [I]n numerous cases the trustee's 'absolute' or 'controlled' discretion has been overturned on much the same ground as that on which simple discretions have often been upset – typically, unreasonably small payments to the beneficiary. Such cases *can* be interpreted as coming within the *Restatement* formulation requiring the trustee to act in the 'state of mind' . . . contemplated by the settlor, 'and the modern opinions, almost without exception, have expressed their results in these terms when interfering with the trustee's judgment. Even though language in the decisions tends to perpetuate the *Restatement's* wording of the rule, any distinction between the test of reasonableness and the state-of-mind test is difficult to discern from the holdings of these cases. In fact, the requirements set out in the dicta of some cases, phrased in terms of requiring 'reasona-

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39 BOGERT, *supra* note 34, § 560.

40 GEORGE GLEASON BOGERT, ET AL., THE LAW OF TRUSTS AND TRUSTEES § 560 (rev. 2d ed. Cum. Supp. 2009).

> ble judgment' and 'sound discretion,' go far in obliterating any such distinction.[41]

If good faith was purely subjective (the "pure heart" test), enforcement would illusory – effectively negating the trust. Trusts presuppose giving enforceable rights to beneficiaries. In a Delaware case, for example, the trust instrument stated that distributions by a committee of trustees were "not subject to review by any court." In that case, the court ignored the provision: "A trust where there is no binding legal obligation on a trustee is a trust in name only and more in the nature of an absolute estate or fee simple grant of property."[42]

C. Immutable Good Faith

The non-modifiable Uniform Trust Code good faith standard, like the standard traditionally governing extended discretion under common law, is applied in a way to implement the settlor's intent and to benefit the beneficiaries. As such, it implies the reasonable exercise of discretion. This immutability mirrors the approach of the Restatement (Third) of Trusts:

> § 50. Enforcement and Construction of Discretionary Interests
>
> (1) A discretionary power conferred upon the trustee to determine the benefits of a trust beneficiary is subject to judicial control only to prevent misinterpretation or abuse of the discretion by the trustee.

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41 Edward C. Halbach, Jr., *Problems of Discretion in Discretionary Trusts*, 61 COLUM. L REV. 1425, 1429 (1961), Professor Halbach's article followed the Restatement (Second) of Trusts by two years but collects and discusses cases that largely substantiate the discussion of the enforcement of discretionary trusts contained in § 50 of the Restatement (Third) of Trusts. That this is so, of course, should come as no surprise as Professor Halbach is its Reporter. The cases that Professor Halbach discusses in his article should put to rest any suggestion that the Restatement (Third) of Trusts radically departed from existing law in this regard.

42 McNeil v. McNeil, 798 A.2d 503, 509 (Del. Super. Ct. 2002). There are potential adverse federal tax consequences if a trustee cannot be held to a reasonability standard as to discretionary distributions. One of the exceptions to grantor income tax inclusion, for example, requires that a power to appoint must be under a reasonably definite, ascertainable standard: "[I]f a trust instrument provides that the determination of the trustee shall be conclusive with respect to the exercise or non-exercise of a power, the power is not limited by a reasonably definite standard." Treas. Reg. § 1.674(b)-1(b)(5)(i). A similar position could be advanced for federal gift and estate tax purposes. Thus when drafting provisions giving a trustee, who is also a beneficiary, distribution discretion under "ascertainable standards," it may be prudent not to use extended discretion language. Generally, of course, a trust without the trustee's obligation to account is not a trust: "A settler who attempts to create a trust without any accounting in the trustee is contradicting himself. A trust necessarily grants rights to the beneficiary that are enforceable in equity." BOGERT, *supra* note 34, at § 974.

> (2) The benefits to which a beneficiary of a discretionary interest is entitled, and what may constitute an abuse of discretion by the trustee, depend on the terms of the discretion, including the proper construction of any accompanying standards, and on the settlor's purposes in granting the discretionary power and in creating the trust.[43]

Thus, where under § 187 of the Restatement (Second) of Trusts, a trustee's exercise or non-exercise of a discretionary power is only subject to review upon a showing of "abuse," now under § 50 of the Restatement (Third), a trustee may be second guessed by a court if the trustee's exercise of a discretionary power was grounded in a "misinterpretation" or the "abuse" of the discretion, and "abuse" is broadly defined. In either event, the standard governing trustee conduct, regardless of whether such trustee enjoyed extended discretion, was never simply that of good faith alone but good faith in reasonably implementing the settlor's intent for the benefit of the beneficiary.[44]

Neither under the Uniform Trust Code, or at common law, is good faith used in the contract law sense. Although "good faith" forms an important role under the Uniform Trust Code, it is not a defined term and one would expect the courts to continue to use the extensive body of the common law of trusts for an understanding of its sense and defini-

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43 THE RESTATEMENT (THIRD) OF TRUTS, § 50 (2003).

44 Critics of the approach adopted by the Restatement (Third) of Trusts and the Uniform Trust Code perceived that there was a change from the common law of trusts and that this change exposed trust assets to heightened exposure to the claims of the beneficiaries' creditors. Mark Merric & Steven J. Oshins, *Effect of the UTC on the Asset Protection of Spendthrift Trusts*, 31 EST. PLAN. 375 (2004). This criticism has drawn pronounced refutation. Kevin D. Millard, RIGHTS OF A TRUST BENEFICIARIES UNDER THE UNIFORM TRUST CODE, 34 ACTEC J. 57, 63 (2008)("[N]ote that the theory that a creditor could not reach the trust because the creditor stood in the shoes of the beneficiary and the beneficiary could not force distributions from the trust was flawed, because no matter how broadly worded the trustee's discretion was, it was always subject to review by a court for abuse."); Robert T. Danforth, *Article Five of the UTC and the Future of Creditors' Rights in Trusts*, 27 CARDOZO L. REV. 2551, 2581 (2006)("Implicit in the critics' argument is the assertion that, by granting a trustee extended discretion, the trustee's exercise of that discretion becomes essentially unreviewable. But this has never been true at common law. An essential principle of the common law of trusts is that a trustee's exercise of discretion is always subject to judicial review, no matter how broadly the trustee's discretion may be described. . .[T]hat will not be interpreted so as to relieve the trustee from an obligation to account for its discretionary judgments. Because a trustee is a fiduciary, it would be inconsistent with the concept of a trust to insulate a trustee's exercise of discretion from all judicial review."); *see also* Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 REAL PROP., PROB. & TR. J., 567, 601-618 (2005).

tion.[45] Whether in the context of a non-modifiable baseline rule under Section 105(b)(3) or when defining the limits of absolute discretion under Section 814(a), good faith under the Uniform Trust Code should be understood in its traditional trust sense. It approximates the common law of trusts and, by wedding good faith to the settlor's intent and the interests of the beneficiaries, it dances back to a general fiduciary duty that cannot be modified by the terms of the agreement: "[A] settlor may not so negate the responsibilities of the trustee that the trustee would no longer be acting in the fiduciary capacity."[46]

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[45] Professor Langbein (one of the Uniform Trust Code drafters), however, suggests that one look to the body of law in contract discussing the meaning of "good faith." John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 Nw. U. L. Rev. 1105, at note 96 (2004) (directing one to a treatise by Professor Robert S. Summers for "a succinct account of the nuances developed in contract law . . . emphasizing the core notion of honest dealing.")[hereinafter Langbein, *Mandatory Rules*]. Professor Summers' view of "good faith" as it has developed in contract law will be discussed below.

[46] Unif. Trust Code §105, cmt. (2005). Within limits, of course, section 105 permits modification of the basic fiduciary duties, including the duty of loyalty. Sections 105(b)(3) and 814(a) provide absolute backstops to the ability to modify such duties by prohibiting the elimination of the obligation to act in good faith and in accordance with the terms and purposes of the trust and in the interests of its beneficiaries. The "missing" piece of this litany, if you will, is the obligation to act in the "sole" interest of the beneficiaries. This opens the door to permitting trustees to engage in acts of self-interest as long as the activity is in the best interest of the trust beneficiaries. Langbein, *Questioning the Duty of Loyalty*, *supra* note 17; Melanie B. Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor Langbein*, 47 Wm. & Mary L. Rev. 541 (2005). The benefit-the-beneficiaries rule is mandatory. Langbein, *Mandatory Rules*, *supra* note 45, at 1112("A default rule is one that the settler can abridge, but only to the extent the settler's term is 'for the benefit of [the] beneficiaries.' The requirement that there be benefit to the beneficiaries sets the outer limits on the settlor's power to abridge the default law."). Coupled with the modern portfolio theory of trust investing, the benefit-the-beneficiary rule may cause difficulties when a settlor wishes to have a trust hold a particular asset instead of a broad array of assets and asset classes. Jeffrey A. Cooper, *Empty Promises: Settlor's Intent, the Uniform Trust Code, and the Future of Trust Investment Law*, 88 B. U. L. Rev. 1165, 1168 (2008)("Under Professor Langbein's formulation of the benefit-the-beneficiaries rule, the 'benefit' of a trust provision is determined by reference to objective notions of prudence and efficiency rather than the settlor's subjective intent. Carried to its logical extreme, this emerging reading of the benefit-the beneficiary rule (the 'emerging rule') could redefine the area of trust investment management. Trust documents frequently include specific investment management directives, such as a mandate that the trustee retain a certain portfolio investment or family business. Whereas trust law historically has honored such restrictions, the emerging rule seemingly would enforce only those which maximize economic value for the trust beneficiaries. If the settlor's chosen restrictions fail this objective test of economic benefit, they simply can be cast aside."); Benjamin H. Pruett, *Tales from the Dark Side: Drafting Issues from the Fiduciary's Perspective*, 35 ACTEC J. 331, 352 (2009)("These provisions (the benefit-the-beneficiary rules) leave open the possibility that *any* provision of a trust that deviates from normal fiduciary practice might be found to be 'out of bounds' on the grounds that such a provision vio-

Indeed, the standards regulating a trustee's exercise of discretion as to beneficiary distributions *is* generally seen as the exercise of fiduciary duty:

> A trustee's discretionary power with respect to trust benefits is to be distinguished from a power of appointment. The latter is not subject to fiduciary obligations and may be exercised arbitrarily within the scope of the power.[47]

It is the fiduciary nature of the exercise of discretion that guarantees review and regulation by the Courts: "[N]o language, however strong, will entirely remove any power held in trust from the reach of a Court of Equity."[48]

V. Good Faith in Contract

A. The Absence of Bad Faith

The concept of "good faith and fair dealing" in the performance of contracts is a mandatory aspect of all contract law: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."[49] Good faith is generally viewed as the absence of bad faith:

> [W]hat meaning have the courts and the Code draftsman given to the phrase "good faith"? It will be argued that good faith, as used in the case law, is best understood as an "excluder" – it is a phrase which has no general meaning or meanings of its own, but which serves to exclude many heterogeneous forms of bad faith.[50]

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lates the rule that the trust provisions must be 'in the interest of' and 'for the benefit of' the beneficiaries.").

47 Restatement (Third) of Trusts § 50 cmt. a (2003).

48 Stix v. Comm., 152 F.2d 562, 563 (2nd Cir. 1945) (J. Learned Hand) (A case involving a trust providing the trustee with "sole and exclusive discretion."). The modern fusion of equity and law courts supplies Professor Langbein with an additional support for his view that trusts should be treated as contracts. Langbein, *Contractarian*, *supra* note 6, at 649("Scott was alarmed over the movement then underway to bring about the fusion of law and equity in American civil procedure and judicial administration. He was worried that the fusion might remove the law of trusts from the nurturing hand of the specialist equity bench, and indeed, that fusion might cause trust litigation to be subjected to jury trial. In England and most leading American jurisdictions, the law of trusts had been the province of separate equity courts or equity divisions. . . Two generations later, with the place of jury-free equitable jurisdiction over trusts now secure in our fused civil procedure, we can safely acknowledge the contractarian character of the modern trust.").

49 Restatement (Second) of Contracts § 205 (1979).

50 Robert S. Summers, *"Good Faith" in General Contract Law and Sales Provisions of the Uniform Commercial Code*, 54 Va. L. Rev. 195, 196 (1968). Professor Summers' article was the basis of the understanding of the nature of good faith in contract as set out

This negative definition of good faith (the absence of bad faith) arose from Professor Robert S. Summers' examination of case law, an examination that informed the treatment of good faith in contract in the Restatement (Second) of Contracts. Judges, he found, used the good faith requirement to perform a safety valve function to regulate behavior, if not directly violating the explicit terms of a contract then violating the spirit of the contract, often frustrating the justified expectations of the parties to the deal.[51] Yet, the good faith standard in contract "is no more than a minimal requirement (rather than a high ideal)."[52]

The law and economics practitioners embrace the view that only a minimal, perhaps negligible, ethical standard underpins the concept of good faith in contract law:

> Contract law does not require parties to act altruistically toward each other; it does not proceed on the philosophy that I am my brother's keeper. That philosophy may animate the law of fiduciary obligations but parties to a contract are not each other's fiduciaries.[53]

In practice, the good faith standard, by operating as an excluder of bad faith, necessarily focuses on the subject of intent of the acting party.

Professor Steven J. Burton uses an example that illustrates the inherently subjective nature of good faith as it is used in the law of con-

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in the Restatement (Second) of Contracts. Steven J. Burton, *More on Good Faith Performance of Contract: A Reply to Professor Summers*, 69 IOWA L. REV. 497, 498 (1984)("The drafters of the Restatement (Second) surely exercised good judgment in 1970 by recognizing the good faith performance obligation and by explaining it largely on the basis of Professor Summers' work.") Given Professor Summers minimalistic view of good faith, it is disturbing that Professor Langbein points to him as a source of defining that concept for the law of trusts. See note 45.

51 Summers, *supra* note 50, at 262-6.

52 Robert S. Summers, *The General Duty of Good Faith–Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810, 811 (1982)[hereinafter Summers, "General Duty"].

53 Original Great American Chocolate Chip Cookie Co., Inc. v. River Valley Cookies, Ltd., 970 F.2d 273, 280 (7th Cir. 1992) (Posner, J.). Judge Posner's view is within the mainstream of the common law of contract: "One commentator recently expressed strong concern that courts may likely overextend a general requirement of good faith of the kind embodied in (Restatement (Second) of Contracts) § 205, the Comments, and the Reporter's Note, all in the name of altruism, Good Samaritanism, general benevolence, moral idealism or the like. The shortest answer to this concern is that the extensive case law to date does not reveal any significant tendencies of this kind. . .The risk of overextension is inherent in any doctrine. Experience to date indicates that the risk is not great with regard to section 205. This is hardly surprising. Our contract law has been relatively free from moralism, especially any forms legitimately described as "Good Samaritanism" or the like. Moreover, legal good faith is not identical with moral good faith." Summers, *General Duty*, *supra* note 52, at 834.

tract.[54] A landlord and a tenant agree to base commercial rent payments on the amount of the tenant's sales at the leased store. Assume, however, that the tenant has two stores, one leased from the landlord and one the tenant owns in the same town. If the tenant diverts customers away from the leased premises to his own store for the "'sole purpose' of bringing gross receipts down at the leased premises, there is good authority for concluding that (the tenant) breached the contract." If, on the other hand, the diversion of customers was because the store inventories differ and the customers would be better served at the other store, no breach occurs: "Consequently, it is necessary to focus on attention on whether the discretion – exercising party used its discretion for an improper purpose, despite the well-known difficulties of an inquiry into subjective intent."[55]

The good faith standard, in itself, does not alter, or extend, the terms of the contract – it merely prohibits conduct that frustrates the explicit agreement:

> Illinois like other states requires, as a matter of common law, that each party to a contract act with good faith, and some Illinois cases say that the test for good faith "seems to center on a determination of commercial reasonability." The equation, tentative though it is ("seems to center on") makes it sound as if, contrary to our earlier suggestion, the judges have carte blanche to declare contractual provisions negotiated by competent adults unreasonable and refuse to enforce them. We understand the duty of good faith in contract law differently. There is no blanket duty in good faith; nor is reasonableness the test of good faith.[56]

Thus, good faith merely polices subjective bad conduct in the performance of the contact. It is in this sense that good faith in contract is intention-implementing. It is in this sense that Professor Burton reports: "In my view, courts generally do not use the good faith performance doctrine to override the agreement of the parties. Rather, the good faith performance doctrine is used to effectuate the intentions of the parties, or to protect reasonable expectations, through interpretation and implication."[57]

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[54] Professor Burton's work commands attention if only because it, along with that by Professor Summers, forms Professor Langbein's frame of reference for the good faith model he advances for trusts. See Langbein, *Contractarian*, *supra* note 6, at 655.

[55] Burton, *supra* note 50, at 502-3.

[56] Original Great American Chocolate Chip Cookie Co., Inc. v. River Valley Cookies, Ltd. , 970 F. 2d 273, 279-80 (7th Cir. 1992)(Posner, J.).

[57] Burton, *supra* note 50, at 499.

B. Application (or Misapplication) to Trusts

If a trustee's fiduciary duty is merely a contract term, susceptible to waiver, then good faith in performance of the "deal" is the only immutable, trust value. This approach would be compatible with the interpretation of fiduciary duty espoused by Judge Easterbrook and Professor Fischel: "Fiduciary duties are not special duties."[58] Professor Langbein embraces the "contractarian vision of the trust" as a useful way "to account for the trust more accurately."[59] He seems willing to transpose good faith in contract as the basis for regulating trustee discretion: "The good faith standard in contract law echoes the norms of trust fiduciary law, which regulate the trustee's embedded discretion in performing the trust deal."[60] He does not, however, go so far as to argue that fiduciary duty can be eliminated in favor of a mere obligation to act in good faith under the contract law standard. Fiduciary duty may be highly alterable by a settlor, but a settlor may not dispense with fiduciary obligations altogether:

> Oddly, however, although the various fiduciary rules are default rules, the settlor may not abrogate them in their entirety, because eliminating all fiduciary duties would make the trust illusory.[61]
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> * * *
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> In this way, the requirement that the trust must have enforceable duties has the consequence of placing aggregate limits on the manner and the extent to which a settlor can oust the default law.[62]

We are not told where the line is to be drawn, nor, of course, was such a line drawn with any precision under the Uniform Trust Code.[63]

VI. The Application of the Good Faith in Contract Standard to Partnerships

A. Historical Partnership Fiduciary Standards

Unlike the law of trusts, the law of partnership has been folded into the law of contract: jettisoning fiduciary duty as its governing principle

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58 Easterbrook & Fischel, *supra* note 11, at 427.

59 Langbein, *Contractarian*, *supra* note 6, at 671.

60 *Id.* at 655.

61 Langbein, *Mandatory Rules*, *supra* note 45, at 1122-3.

62 *Id.*, at 1123.

63 This is not meant as a criticism of the Uniform Trust Code. Indeed, it is one of its great strengths: the Uniform Trust Code was intentionally structured to permit courts to continue to have the traditional discretion to decide where the lines ought to be drawn in any particular case. See *infra* notes 84-5 and accompanying text.

and substituting in its stead a standard of contract law good faith dealings.

Historically, the fiduciary obligation of partners was a defining characteristic of a partnership:

> If nothing else could have been said with confidence about partnerships on the eve of promulgation of the UPA in 1914, it was that the relationship was fiduciary in character. Thus, regardless of the contractual structure to which the partners agreed, the foundation of the relationship was a matter of status, not contract. Simply by virtue of being partners, the participants owed each other certain general obligations of conduct: "The duty of each partner to exercise toward the others the highest integrity and good faith is the very basis of their mutual rights in all partnership matters." Because the obligations were seen as arising by virtue of the status of the partners as partners, and not by their agreement, the remedy for breach of the basic obligations was in tort, not in contract.[64]

Because the fiduciary duty existed independent of the partnership agreement, it could override such an agreement. In an Illinois case,[65] for example, the limited partners claimed that the general partner "squeezed" them out by refusing to make sufficient distributions to cover the taxes generated from the investment, then buying them out at discount. The partnership involved a private placement promoted only to "wealthy and sophisticated investors." The agreement gave the general partner "sole discretion" as to partnership distributions.[66] Nevertheless, the court held that the limited partners had a cause of action based on an intrinsic general fiduciary duty owed by the general partner that is separate from the terms of the agreement.[67]

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64 Vestal, *Fundamental Contractarian Error*, *supra* note 13, at 524-6.

65 Labovitz v. Dolan, 545 N.E. 2d 304 (Ill. App. Ct. 1989).

66 *Id.* At 306. A provision, of course, purporting to give the general partner absolute discretion as to partnership distributions can create gift tax issues. In Hackl v. Comm., 118 T.C. 279, aff'd. 335 F.3d 664 (7th Cir. 2003), the Tax Court held that a transfer of limited partnership units did not qualify as annual exclusion gifts because the gifts did not confer upon the donee-children immediate use, possession, or enjoyment of the transferred property. In part, the Tax Court based the decision on a distribution clause much like that in Labovitz. For the failure of a general fiduciary duty coming to the rescue, see Price v. Comm., T.C. Memo. 2010-2, 7 ("[P]etitioners contend that the general partner has a 'strict fiduciary duty' to make income distributions to the donees. We are not persuaded that such a fiduciary duty, if it exists, establishes a present interest. . .where the limited partner lacks withdrawal rights.").

67 See also, Wartski v. Bedford, 926 F.2d 11, 20 (C.A. 1st Mass. 1991) ("The fiduciary duty of partners is an integral part of the partnership agreement whether or not expressly set forth therein."); BT-I v. Equitable Life Assur. Soc., 75 Cal. App. 4th 1406, 1412, 89 Cal. Rptr. 811, 816 (Cal. App. 4th 1999) ("We agree with several recent decisions

Indeed, the traditional role of fiduciary duty in the partnership relationship was to enforce fairness beyond the letter of the written "deal":

> The rules (governing business relationships) are consistent, however with a concept of persons as a society and with the notion that economic and political competitions are played out not in an environment of pre-Leviathan lawlessness, but on the basis of a set of ground rules. In the laws of business organizations, fiduciary obligations traditionally have provided one of those ground rules. It may be that fiduciary doctrine is not crystal clear, in the sense of a rule requiring traffic to stop at red lights. But the argument from certainty can be overblown. Dean Weidner suggests that a principle motivation behind the "reformation" of fiduciary rules was the desire of lawyers to be certain that their negotiated agreements would be upheld. For lawyers to argue that fiduciary duty creates significant uncertainty is specious.
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> We should move away from rhetoric and confront reality. The call to self-abnegation in fiduciary case law has never quite been the reality. No judge, not even Cardozo, appears to have expected partners to cast aside their worldly longings. What the language conveys is an attitude, a way of thinking about the relationship, which is not at all ambiguous for the language in which it is couched. It is the attitude of the impartial spectator, of the person who desires the approbation of his peers, as well as his own self-respect. It is an attitude that expresses the ideal that some kinds of competition and some forms of risk taking are quite appropriate in some circumstances and not in others. It is an attitude well expressed in *Labovitz v. Dolan*. In *Labovitz*, one of the partners stated: "The risk we took was that the business would not succeed. We did not take the risk that the business would succeed so well that the general partner would squeeze us out and take the investment for himself."[68]

B. Partnership Fiduciary Standards Under RUPA and RULPA

Until recently, Justice Cardozo's "punctilio of an honor" was alive and well: "As a fiduciary, a partner must consider his or her partners'

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holding that a limited partnership agreement cannot relieve the general partner of its fiduciary duties in matters fundamentally related to the partnership business.").

68 Mitchell, *The Naked Emperor*, *supra* note 13, at 485-6.

welfare, and refrain from acting for purely private gain."[69] The 1997 Revised Uniform Partnership Act and the 2001 Revised Uniform Limited Partnership Act[70], however, move away from a reliance on this broad fiduciary duty to regulate partner conduct. Instead, these Acts each limit fiduciary duty to a duty of loyalty, which is further limited ("cabined") to specific conduct instead of being a general concept tailored by courts to cover a broad array of impermissible conduct.[71] The enumerated categories of conduct "are exclusive and encompass the entire duty of loyalty."[72] Both model acts are backstopped by an obligation of good faith and fair dealing which "is a contract concept" not a fiduciary duty.[73]

Thus, under the contractarian theory adopted under the acts, there are very limited mandatory rules governing partner relations: a shrunken duty of loyalty (to the extent that duty is not further restricted by agreement) and the contract obligation of good faith. This is quite different than the role that fiduciary duty traditionally played as the fundamental principle governing partner relations with the power to trump specific authority contained in the partnership agreement:

> Questions about whether these rules (the UPA provisions) are default rules or mandatory rules do not arise simply because textual analysis raises the inevitable comparisons. They arise because different policy conclusions could be reached by different people. A libertarian, free-market oriented policy maker is likely to suggest that all the rules governing the relations among the partners should be merely default rules – that partners ought to be held to whatever bargain the negotiate. A more parentalistic policy maker, on the other hand, would be more inclined to support mandatory fiduciary duties to protect minority partners. For example, a parentalistic might resist the

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69 Wartski v. Bedford, 926 F. 2d 11, 20 (C.A. 1st. Mass. 1991) (quoting from Meehan v. Shaughnessy, 404 Mass. 419, 535 N.E. 2d 1255, 1263 (1989)).

70 The revision of the partnership act is commonly referred to as "RUPA" whereas the revision of the limited partnership act is commonly referred to as "ReRULPA" to distinguish it from the 1982 revision.

71 The restricted duty of loyalty is problematic because of the essential role that it plays in the fiduciary relationship. Boxx, *supra* note 7, at 280 ("The duty of loyalty has been called 'the essence of the fiduciary relationship' and even has been considered an expression synonymous with fiduciary."). RUPA § 404 states that the fiduciary duties are limited to that of loyalty and a separate duty of care which duty, in point of fact, is not a fiduciary duty but rather the "duty" not to engage in grossly negligent or reckless conduct, intentional misconduct or knowing violations of law.

72 REV. UNIF. PART. ACT § 404, cmt. (1997) *See also* REV. UNIF. PART. ACT § 103(b)(3)(i) (1997) which provides that this truncated duty of loyalty, while not permitted to be eliminated totally, may be further precluded from operating on specific types or categories of conduct identified by the partnership agreement.

73 REV. UNIF. PART. ACT § 404, cmt. (1997).

> conclusion that a minority partner should be permitted to contract away his access to partnership books and records.
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> The Draft Committee wanted to make clear that all but a very few of the rules governing the relations among partners are merely *default* rules. It was only in rare situations that the Committee felt that the rules should be *mandatory*. Mandatory rules governing the relations among partners are essentially parentalistic, and the Committee felt that, with only very limited exception, adults in nonconsumer transactions are old enough and wise enough to be held to their agreements.[74]

Under the contractarian model, of course, the parties could be free to adopt provisions that would, in effect, reinstate a general fiduciary duty to govern the relationship between the general partner and the limited.[75]

The contractarian concept of good faith and fair dealing, and the very limited notion of loyalty under the revised acts, are not effective substitutes for a broad fiduciary duty that used to regulate partner con-

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74 Donald J. Weidner, *The Revised Uniform Partnership Act Midstream: Major Policy Decisions*, 21 U. TOL. L. REV. 825, 828 (1990). Professor Weidner is the Reporter for the Revised Uniform Partnership Act. "Parentalistic" is used instead of "paternalistic" presumably to accommodate the changed demographics of the Bench which, but for the adoption of RUPA or RULPA, may continue to be inclined to impose normative values to protect vulnerable minority partners.

75 In theory, the freedom to reinsert fiduciary duty into a partnership agreement may exist, but market forces may conspire against this remedy. Charles W. Murdock, *Limited Liability Companies in the Decade of the 1990s: Legislative and Case Law Developments and Their Implications for the Future*, 56 BUS. LAW. 499, 530 (Feb. 2001):

> The issue of fiduciary duties has been framed by contractarians as embodying a choice between a statutory approach which is paternalistic and one which is contractual. By way of illustration, if a paternalistic approach is chosen, the default provision in the statute would be to provide for the broad and general existence of fiduciary duties and then, if necessary, let the parties contract to limit such duties. On the other hand, in a contractarian approach, the statutes would be silent or would have limited fiduciary duties and would permit the parties, if they chose, by contract to impose additional obligations upon themselves. . . Thus, we have two approaches to drafting a statute, one paternalistic, seeking to protect people by leaving fiduciary duties as the default provision in the statute, and the other contractarian, which leaves people free to fend for themselves and create whatever protections they need. To sharpen the issue as to which approach is more appropriate, it is also well to postulate, as caricature, that there are two types of business arrangements as well. One situation would envision sophisticated people engage in a significant transaction in which substantial funds are involved, including the funds to obtain sophisticated advice. In the other situation, postulate that the investors are less sophisticated, funds in general are limited, and sophisticated advice is less available, not only because of cost but also the nature of legal practice in the area.

duct. In a Maryland case,[76] the court applied the "good faith" in contract standard to police partner conduct, instead of the traditional fiduciary duty of common law. Predictably, the court focused on the subjective intent of the partner rather than on that partner's conduct per se. In this case, the author of numerous techno-thriller novels (Tom Clancy) and his ex-wife (Ms. King) created a limited partnership for the purpose of developing and marketing a series of novels using Mr. Clancy's name but ghost written by another writer picked for the job because of his skill "to affect a 'Clancyesque' style of writing."[77] The partnership entered into a joint venture with a third party to effectuate the project and a series of 12 books were released – all best sellers. At that point, Mr. Clancy announced that he was going to withdraw permission for the joint venture to use his name on further books.

The partnership agreement authorized Mr. Clancy to engage in other business ventures, even ventures competing with the partnership. The issue was whether any duty of loyalty owed by Mr. Clancy to the partnership and his partner would preclude such action. Under prior law, of course, a general fiduciary duty would trump any partnership agreement term to the contrary: "Clancy concedes that, contract law aside, his pertinent actions, which animated King's suit, would violate the fiduciary duty he owed to [the partnership]"[78]under the law of Maryland before the adoption of the 1997 Revised Uniform Partnership Act. Under the new act, however, the court held that Mr. Clancy needed only to show that he acted in good faith with his business partner even if his actions were adverse to the partnership. If, on the other hand, he acted out of personal spite against her, he would have breached his obligation of good faith dealings. The good faith/bad faith distinction is a question of fact and the case was remanded for trial to determine that fact.

C. Shortcomings as Applied to Trusts

The weakness of a good faith/bad faith analysis is that it may punish the forthright and reward the cunning. In *Clancy*, the court uses an illustration from the television comedy, Jerry Seinfeld, to highlight that the good faith standard is a subjective test based on a partner's motive rather than on the consequences of a partner's overt acts:

> Jerry Seinfeld, perhaps an unlikely legal illustrator, once epitomized the duty of good faith in contract. In an episode of his

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76 Clancy v. King , 405 Md. 541, 954 A.2d 1092 (2008) (Harrell, J.). Maryland had adopted RUPA which governed this case.

77 Mr. Clancy gave the series the benefit of his name and reputation but only "glanced at a few" of the books in the series never reading them. *Id*. at 549 and 1095.

78 *Id*. at 554 and 1099-1100.

television show, Jerry's character purchased a jacket at a men's clothing shop. The terms of the contract permitted Jerry to return the item for a refund at his discretion. When Jerry attempted to return the jacket after an unrelated personal quarrel with the salesman, the following discussion took place.

"Jerry: Excuse me, I'd like to return this jacket.
Clerk: Certainly. May I ask why?
Jerry: For spite.
Clerk: Spite?
Jerry: That's right. I don't care for the salesman that sold it to me.
Clerk: I don't think you can return an item for spite.
Jerry: What do you mean?
Clerk: Well, if there was some problem with the garment. If it were unsatisfactory in some way, then we could do it for you, but I'm afraid spite doesn't fit into any of our conditions for a refund.
Jerry: That's ridiculous, I want to return it. What's the difference what the reason is?
Clerk: Let me speak to the manager . . . excuse me . . . Bob!
Bob: What seems to be the problem?
Jerry: Well, I want to return this jacket and she asked me why and I said for spite and now she won't take it back.
Bob: Well you already said spite so. . ..
Jerry: But I changed my mind.
Bob: No, you said spite. Too late."
Seinfeld: *The Wig Master* (NBC original television broadcast 4 April 1996).

In attempting to exercise his contractual discretion out of "spite," Jerry breached his duty to act in good faith towards the other party to the contract. Jerry would have been authorized to return the jacket if, in his good faith opinion, it did not fit or was not an attractive jacket. He may not return the jacket, however, for the sole purpose of denying to the other party the value of the contract. Jerry's post hoc rationalization that he was returning the jacket because he did not "want it" was rejected properly by Bob as not credible.[79]

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[79] *Id*., at note 27. *Clancy* was a split decision by the Maryland Court of Appeals. The dissent pointed to language in the partnership agreement that suggested that the general partner was to be governed by fiduciary duty. Thus, the dissent would have applied the traditional fiduciary duty over-ride to the case to find a breach of that general duty. Not

It may be unusual for courts to look to television programs for guidance in applying contract terms to partnerships. In point of fact, however, the Jerry Seinfeld example closely parallels Professor Burton's example involving a tenant's diversion of business from the store governed by a gross receipts rental to one not so covered. Both examples illustrate the essential subjective nature of the contract good faith standard.[80]

D. The RULLC Act Contrasted

It is perhaps telling that the last uniform business entity act that addressed this issue retreated to the traditional, trust-inspired, fiduciary duty standard to govern relations among its members. In fact, the Revised Uniform Limited Liability Company Act (2006) pointedly did not limit the fiduciary duty owed by its members to each other or to the entity:

> Until the promulgation of RUPA, it was almost axiomatic that: (i) fiduciary duties reflect judge-made law; and (ii) statutory formulations can express some of that law but do not exhaustively codify it. The original UPA was a prime example of this approach.
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> In an effort to respect freedom of contract, bolster predictability, and protect partnership agreements from second-guessing, the Conference decided that RUPA should fence or "cabin in" all fiduciary duties within a statutory formulation. That deci-

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surprisingly, it cited Justice Cardozo's formulation from *Meinhard* to illustrate the sweep of such a duty. *Id*., at 576-7 and 1113.

[80] RUPA § 404(d) provides that a partner shall discharge his or her duties consistent "with the obligation of good faith and fair dealings." The Comment states that fair dealing suggests an objective meaning: "'Good faith' clearly suggests a subjective element, while 'fair dealing' implies an objective component." REV. UNIF. PART. ACT § 404 cmt. (1997). The drafters of RUPA and RULPA did not define these terms but left interpretation to the courts. Given that these acts consciously rejected broad application of the traditional fiduciary duty to regulate partner conduct in favor of the reduced contractarian standard, however, one must assume that courts will not interfere except in the most egregious instances of bad faith dealings. That is not to say that any behavior may pass muster if justified by an appropriately expressed motive. At base, motive is a question of fact to be determined by the trier of fact. Thus, in *Clancy*, the case was remanded for a trial to determine why Mr. Clancy decided to withdraw use of his name. Similarly, in *Alloy v. Wills Family Trust*, 944 A.2d 1234 (2008), the Maryland intermediate appellate court, applying RULPA under Washington, D.C. law, remanded the issue of whether a change in distribution pattern was part of a squeeze-out scheme and therefore constituted bad faith conduct. Ironically, the *Alloy* court cited *Labovitz* for the proposition that partnership distributions must be guided by the general partner's duty of loyalty and good faith.

> sion was followed without re-consideration in ULLCA and ULPA (2001).
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> This Act takes a different approach. After lengthy discussion in the drafting committee and on the floor of the 2006 Annual Meeting, the Conference decided that: (i) the "corral" created by RUPA does not fit in the very complex and variegated world of LLCs; and (ii) it is impracticable to cabin all LLC-related fiduciary duties within a statutory formulation.
>
> As a result, this Act: (i) eschews "only" and "limited to" – the words RUPA used in an effort to exhaustively codify fiduciary duty; (ii) codifies the core of the fiduciary duty of loyalty; but (iii) does not purport to discern every possible category of overreaching. One important consequence is to allow courts to continue to use fiduciary duty concepts to police disclosure obligations in member-to-member and member-LLC transactions.[81]

The about-face in the Revised Uniform Limited Liability Company Act is, of course, a remarkable development given that partnerships and limited liability companies are so similar in most other respects. One anticipates that this issue is not finally resolved and that it may be revisited in the partnership context.[82]

VII. Conclusion

Historically, the common law of trusts and the principles of equity did not look to contract law when applying a good faith standard to trustees. Instead, courts have consistently applied a good faith standard within the context of a broad fiduciary duty of loyalty. The insurgent theory (advanced in academic debates and largely adopted by the new

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81 Rev. Unif. LLC Act § 409, cmt. (2006).

82 Indeed, some states are following the LLC approach when "adopting" RUPA and RULPA. Dean Allan W. Vestal and Thomas E. Rutledge, *The Uniform Limited Partnership Act (2001) Comes to Kentucky: An Owner's Manual*, 34 N. Ky. L. Rev. 411, 453-4 (2007): "KyULPA has modified the uniform language to eliminate the exclusivity of the fiduciary obligation to those of care and loyalty and further eliminated the exclusivity of the formula employed by both. . . These modifications will allow a greater scope for the development of the common law than would be anticipated under the uniform language. . . While ULPA recited the standard of care as being refraining from 'grossly negligent or reckless conduct, intentional misconduct or a knowing violation of the law,' KyULPA adopts an aspirational model for the standard of care, expecting of the partners that they act 'with the care that a reasonable person in a like position would exercise under similar circumstances and in a manner that the partner believes to be in the best interest of the partnership.' This aspirational standard avoids the 'socially impoverished message' of the RUPA/ULPA duty of care formula and preserves an expectancy in the partners that, while perhaps not that of Cardozo's 'trustee' is still meaningful."

uniform partnership acts) to reduce fiduciary relationships to mere contract, to the morals of the market place, may be attractive to scholars of an economic bent, but it provides a poor substitute for the common law rules governing trustee conduct. Good faith under the law of contract is a concept devoid of the normative values that historically governed trustee conduct and those minimalistic standards should not be incorporated in the law of trusts.

The Uniform Trust Code fills a void: "[T]he trust law in many States is thin" and the uniform act "will provide the States with precise, comprehensive, and easily accessible guidance on trust law questions."[83] To a large degree, the Uniform Trust Code "codifies the common law," but also makes some significant changes.[84] The drafters of the uniform act, however, purposely employed a light touch: "[E]fforts to reduce rules to writing will result in excess rigidity and insufficient discretion vested in the courts to adopt to changing conditions. Even on issues the drafters have elected to codify, the UTC in many cases, does not specify every detail, the drafters preferring flexibility and brevity to greater precision."[85] Also, of course, "the common law of trusts and principles of equity supplement" the Act.[86]

The Uniform Trust Code, by design, permits the traditional norms that governed the exercise of trustee discretion to continue to be enforced and refined by that common law – a process that earned the trust Maitland's high tribute.[87]

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83 UNIF. TRUST CODE (2005), Prefatory notes.

84 David M. English, *The Uniform Trust Code (2000): Significant Provision and Policy Issues*, 67 MO. L. REV. 143, 144 (2002).

85 *Id*. At 212.

86 UNIF. TRUST CODE §106 (2005).

87 *Maitland*, *supra* note 23, at 23 (Professor Maitland famously described the trust as "the most distinctive achievement of English lawyers. It seems to us almost essential to civilization."). Conceptually, rules regulating complex human relationships, like those involved in trusts or, for that matter, partnerships, may be more perfectly developed by the evolutionary process of the common law as opposed to the attempting to create such rules from a universal theory of human relationships based, in this case, on contract: "What has been said (about the development of judge made law) will explain the failure of all theories which consider the law only from its formal side; whether they attempt to deduce a corpus from a priori postulates, or fall into the humbler error of supposing the science of the law to reside in the *elegantia juris*, or logical cohesion of part with part. The truth is, that the law always approaching, and never reaching, consistency. It is forever adapting new principles from life and at one end, and it always retains old ones from history at the other, which have not yet been absorbed or sloughed off. It will come entirely consistent only when it ceases to grow." OLIVER WENDELL HOLMES, JR., THE COMMON LAW, LECTURE I-EARLY FORMS OF LIABILITY (Project Gutenberg 2000, www.gutenberg.org).