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The Punctilio of an Honor the Most Cents-itive Trustees, Broker-Dealers, and North Carolina's Self-Dealing Ban

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COMMENT

The Punctilio of an Honor the Most "Cents"-itive:[1] Trustees, Broker-Dealers, and North Carolina's Self-Dealing Ban

INTRODUCTION

In 1939, the State of North Carolina imposed a statutory ban on trustee self-dealing.[2] The legislation, based upon the Uniform Trusts Act (UTA),[3] modified state common law[4] and set North Carolina apart from most other states[5] by removing the settlor's and beneficiaries' power to permit the trustee to self-deal and vesting it solely in the courts.[6] This self-dealing prohibition has provided a strong statement of North Carolina's tradition of protecting the interests of its beneficiaries.[7] But the current legal and economic climate is prompting experts to question the efficiency and usefulness of the ban[8] and courts to work hard to avoid its application.[9] Widespread availability of financial information and the rise in the numbers and activities of individual investors,[10] the emergence of the trust as a popular method of asset management,[11] and the increased affiliation[12] of trust institutions and broker-dealers[13] have resulted in

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1. The title is a play on Justice Cardozo's famous words describing the trustee's fiduciary duty. *See* Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

2. Act of Mar. 28, 1939, ch. 197, sec. 5, 1939 N.C. Sess. Laws 445, 446 (codified as amended at N.C. GEN. STAT. §§ 36A-66 (1999) (prohibiting a trustee from buying or selling to self), 36A-78 (1999) (indicating that the settlor may not relieve the trustee of liability for self-dealing), 36A-79 (1999) (indicating that the beneficiary may not prospectively relieve the trustee of liability for self-dealing), § 36A-80 (1999) (empowering the court to relieve the trustee of liability for self-dealing)); *infra* notes 66–74 and accompanying text.

3. *See* UNIF. TRUST ACT, 7B U.L.A. 763 (1985).

4. *See infra* notes 40–65 and accompanying text.

5. *See infra* notes 241–48 and accompanying text.

6. *See infra* notes 73–74 and accompanying text.

7. *See infra* notes 33–65 and accompanying text.

8. *See infra* notes 217–41 and accompanying text.

9. *See infra* notes 152–91 and accompanying text.

10. *See infra* notes 117–19 and 195–201 and accompanying text.

11. *See infra* notes 130–32 and accompanying text.

12. This Comment adopts the definition of "affiliate" given in chapter 36A, article 5 of the North Carolina General Statutes. Thus, a trustee's affiliate is any person who (1) directly or indirectly controls or is controlled by the trustee; (2) is under direct or indirect common control with the trustee; or (3) has an express or implied agreement with the

conditions that might make the existence of a rigid self-dealing ban appear unnecessary.

The National Conference of Commissioners on Uniform State Laws (NCCUSL),[14] the author of the UTA, recently approved and recommended for enactment new model legislation—the Uniform Trust Code (UTC)[15]—that, if adopted by North Carolina, would significantly relax the state's self-dealing prohibition. The UTC removes the UTA's prohibition against trustee self-dealing and allows either the settlor[16] or the beneficiary[17] to permit self-dealing, so long as the trustee acts in good faith and treats the beneficiary fairly.[18] This approach is considerably less restrictive than North Carolina's

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trustee regarding the purchase of trust investments by each from the other, directly or indirectly, except through a broker or stock exchange. *See* N.C. GEN. STAT. § 36A-60(1) (1999).

It is important to note that a broker is excluded from the definition of "affiliate" in the context of those persons with whom the trustee has agreements to trade and not in the context of those who are affiliated by way of control. *See* N.C. GEN. STAT. § 36A-60(1) (1999). The term "broker," while not statutorily defined within Article 5, has a definition in other places similar to this Comment's working definition of "broker-dealer." *See* N.C. GEN. STAT. § 33A-1(3) (1999) (defining "broker" under Uniform Transfers to Minors Act); *infra* note 13 (defining "broker-dealer" for purposes of this Comment). Thus, whether the statute contemplates excepting only those who are acting for the account of others or includes those acting as dealers for their own account, the exemption of a broker from the definition of affiliate does not apply when the broker and the trustee are related by control.

13. This Comment uses the term "broker-dealer" to mean an entity that is in the business of buying and selling securities issued by others. When acting solely as an intermediary between buyer and seller, the broker-dealer is trading as a broker. When acting as the buyer or seller and trading for its own account, the broker-dealer is trading as a dealer. *See infra* notes 103–06 and accompanying text.

14. The NCCUSL promotes interstate uniformity in the law by drafting model legislation and then encouraging states to enact it. *See* 7B U.L.A. IV (1985); JOHN TRAIN & THOMAS A. MELFE, INVESTING AND MANAGING TRUSTS UNDER THE NEW PRUDENT INVESTOR RULE: A GUIDE FOR TRUSTEES, INVESTMENT ADVISORS, AND LAWYERS 29 (1999) (stating that the NCCUSL's "charter is to promote uniformity among the fifty states in certain areas of the law").

15. UNIF. TRUST CODE (2000). In 1993, the NCCUSL began the process of drafting the UTC, a comprehensive body of legislation that would address all aspects of trust law. *See* Prefatory Note, UNIF. TRUST ACT (October 1999 Draft).

16. The settlor must give his permission explicitly in the trust instrument. *See infra* notes 140–41 and accompanying text. The settlor, also often called the trustor, the grantor, or, in the case of a trust established by a will, the testator, is the person who creates the trust by transfering legal ownership of her property to a trustee and directing the trustee to hold and manage the property for the benefit of another. *See* RESTATEMENT (SECOND) OF TRUSTS §§ 3(1), 17 (1959).

17. The beneficiary can permit the transaction by giving informed consent prior to the transaction, by ratifying the transaction afterward, or by simply failing to pursue his claim before the statute of limitations runs. *See* UNIF. TRUST CODE § 802(b)(4), (5) (2000).

18. *See infra* notes 135–36 and accompanying text.

statutory ban[19] and more closely mirrors the law in other jurisdictions.[20] Adoption of the UTC by the General Assembly would severely weaken the protection North Carolina law has historically given to trust beneficiaries.[21]

This Comment addresses the current legal and practical status of trustee self-dealing in North Carolina and the possible repercussions of any modifications. Part I introduces the basic concepts of trustee self-dealing jurisprudence and discusses the historical treatment of self-dealing trustees in North Carolina courts prior to the passage of the UTA.[22] Part I also examines the general common law rules, exceptions to the common law, and the remedies available to injured beneficiaries.[23] Part II explains the UTA, the legislative intent behind its passage, and the scope of its ban on self-dealing.[24] Part II concludes by discussing the effects of the ban on modern trust administration.[25] Part III details UTC provisions relevant to trustee self-dealing and contrasts the UTA's position on trustee self-dealing with that of the UTC.[26] Part IV considers the advantages and disadvantages of the various ways the North Carolina legislature may respond to the divergence of trust law from trust practice.[27] The Conclusion submits a recommendation designed to maximize protection of the beneficiaries while minimizing trustee inconvenience.[28]

I. NORTH CAROLINA'S COMMON LAW TREATMENT OF SELF-DEALING TRUSTEES PRIOR TO THE UNIFORM TRUST ACT

A trustee[29] is a fiduciary[30] who holds legal title to property and

19. *See infra* notes 66–74 and accompanying text.
20. *See infra* notes 241–48 and accompanying text.
21. *See infra* notes 254–70 and accompanying text.
22. *See infra* notes 29–64 and accompanying text.
23. *See infra* notes 40–59 and accompanying text.
24. *See* infra notes 66–128 and accompanying text.
25. *See infra* notes 107–28 and accompanying text.
26. *See infra* notes 130–47 and accompanying text.
27. *See infra* notes 148–250 and accompanying text.
28. *See infra* notes 251–75 and accompanying text.
29. As used in this Comment, the word "trust" means an express, non-charitable trust, the word "trustee" refers only to the trustee of an express, non-charitable trust, and "self-dealing" is the action described and forbidden by section 36A-66 of the North Carolina General Statutes. *See infra* note 74 for a brief explanation of the text of that statute.
30. North Carolina courts consider a fiduciary to be one in whom a special confidence has been placed such that she is bound "in equity and good conscience . . . to act in good faith and with due regard to the interests of the one reposing confidence." Abbitt v. Gregory, 201 N.C. 577, 598, 160 S.E. 896, 906 (1931). *See generally* Gregory S. Alexander, *Essay: A Cognitive Theory of Fiduciary Relationships*, 85 CORNELL L. REV. 767

manages the property for the benefit of another, the beneficiary.[31] North Carolina law allows both individuals and corporations to act as trustees.[32] Regardless of its form, a trustee owes its beneficiaries a duty of loyalty,[33] which in North Carolina, as in most jurisdictions,[34] includes administering the trust " 'solely in the interest of' " those beneficiaries.[35] Situations where the interests of the trustee and beneficiaries conflict present the trustee with opportunities to breach its duty of loyalty[36] and abuse the beneficiaries' confidence.[37] The

(discussing the effect of the judiciary's treatment of fiduciary relationships on fiduciaries and their beneficiaries).

31. The term "beneficiary" has not been precisely defined by North Carolina courts. Relying on the "persuasive authority" of the Uniform Probate Code, however, the North Carolina Court of Appeals suggested it might define a beneficiary as "including 'a person who has present or future interest, vested or contingent' in the trust property." Taylor v. Nationsbank Corp., 125 N.C. App. 515, 518, 481 S.E.2d 358, 360 (1997) (quoting UNIF. PROBATE CODE § 1-201(3) (revised 1990), 7B U.L.A. 33 (1996)).

32. *See* N.C. GEN. STAT. § 36A-60(5) (1999) (defining "trustee" to include a "corporate as well as a natural person"). Although this Comment primarily addresses the issues surrounding corporate trustees with broker-dealer affiliates, most of the principles discussed are applicable to other trustees as well.

33. *See* Wachovia Bank & Trust Co. v. Johnston, 269 N.C. 701, 711, 153 S.E.2d 449, 457 (1967) ("It is universally recognized that one of the most fundamental duties of the trustee throughout the trust relationship is to maintain complete loyalty to the interests of his *cestui que trust.*").

34. *See, e.g., In re* Trust of Wickman, 289 So. 2d 788, 790 (Fla. App. 1974); *In re* Estate of Campbell, 36 Haw. 631, 653 (1944); Schildberg v. Schildberg, 461 N.W.2d 186, 192 (Iowa 1990); Albritton v. Albritton, 622 So. 2d 709, 713 (La. App. 1993); Board of Trustees of Employees' Retirement Sys. v. Mayor & City Council, 562 A.2d 720, 738 (Md. App. 1989); *In re* Krause Estate, 172 N.W.2d 468, 470 (Mich. App. 1969); Bryan v. Holzer, 589 So. 2d 648, 657 (Miss. 1991); Masterson v. Department of Social Services, No. 72204, 1997 Mo. App. LEXIS 1753, at *12 (Mo. Ct. App. Oct. 7, 1997); Refshause v. Sesostris Temple Ancient, 298 N.W. 755, 781–82 (Neb. 1941); Warehime v. Warehime, 722 A.2d 1060, 1064 (Pa. Sup. Ct. 1998); Fire Baptized Holiness Church of God of the Americas v. Greater Fuller Tabernacle Fire Baptized Holiness Church, 475 S.E.2d 767, 770 (S.C. App. 1996); Wilters v. Wettestad, 510 N.W.2d 676, 680 (S.D. 1994); Slay v. Burnett Trust, 187 S.W.2d 377, 387–88 (Tx. 1945); Wheeler v. Mann, 763 P.2d 758, 760 (Utah 1988); *In re* Estate of Vance, 522 P.2d 1172, 1176 (Wash. App. 1974); Estate of Van Epps v. City Bank of Portage, 161 N.W.2d 278, 282 (Wis. 1968).

35. *Wachovia Bank & Trust*, 269 N.C. at 714, 153 S.E.2d at 459 (quoting RESTATEMENT (SECOND) OF TRUSTS § 170(1) (1959)); Wittkowsky v. Baruch, 127 N.C. 313, 318, 37 S.E. 449, 450 (1900); McEachern v. Stewart, 114 N.C. 370, 371, 19 S.E. 702, 703 (1894) (quoting North Carolina R.R. Co. v. Wilson, 81 N.C. 223, 230 (1879)) ("The law frowns upon any act on the part of a fiduciary which places interest in antagonism to duty, or tends to that result."); *In re* Trust Under Will of Jacobs, 91 N.C. App. 138, 143, 370 S.E.2d 860, 864 (1988); *see also* ROBERT E. LEE, NORTH CAROLINA LAW OF TRUSTS 80 (6th ed. 1977) ("A trustee is a fiduciary and he must display throughout the administration of the trust complete loyalty to the interests of the beneficiary.").

36. If a conflict of interest arises in the administration of the trust, a trustee's failure to either remove the conflict or resign his position can constitute a breach of the duty of loyalty. *See In re Jacobs*, 91 N.C. App. at 143, 370 S.E.2d at 864.

37. *See* Boyd v. Hawkins, 17 N.C. (2 Dev. Eq.) 195, 207 (1832) (stating that self-

conflict of interest that arises when a trustee self-deals, while only one of many possible types of conflicts between the trustee and the beneficiary,[38] offers perhaps the greatest potential for abuse.[39]

Prior to 1939, North Carolina courts relied on the common law rules of equity to deal with disloyal trustees.[40] Those rules disallowed self-dealing transactions unless the trustee obtained the informed consent of the beneficiaries[41] or, after notice to the beneficiaries, acquired court approval.[42] If the requisite authorization was not attained, the trustee was held liable for the transaction.[43] The courts used the "no further inquiry" rule to assess liability once a charge of self-dealing was made.[44] Upon satisfactory proof that self-dealing had

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dealing "exposes [the trustee] to temptation and the *cestui que trust* to imposition").

38. Conflicts of interest not involving violations of the self-dealing prohibition include situations in which a corporate trustee purchases its own stock (from a third party) for the trust, *see* RESTATEMENT (SECOND) OF TRUSTS § 170(1) cmt. n (1959), when a trustee competes with the trust for an investment opportunity, *see id.* at § 170(1) cmt. k, and when a trustee votes stock held in trust for his own benefit, *see id.* at § 170(1) cmt. o.

39. A self-dealing transaction creates a high potential for abuse because the trustee's duty to get the best price for the trust is in direct opposition to its interest in getting the best price for itself. Furthermore, as both buyer and seller, the trustee has complete control over the transaction and thus the trustee can set its own price and terms.

40. *See McEachern*, 114 N.C. at 371, 19 S.E. at 703 (holding that a trustee who uses a trust to benefit himself violates a rule of equity); Gibson v. Barbour, 100 N.C. 192, 197, 6 S.E. 766, 768 (1888) (indicating that the rule against self-dealing is an equitable rule); Bruner v. Threadgill, 88 N.C. 361, 367 (1883) ("That the . . . trustee cannot purchase the trust property at his own sale . . . is too well settled by authority to admit of argument . . . ."); Froneberger v. Lewis, 79 N.C. 426, 428–33 (1878) (citing case law prohibiting a trustee from purchasing the items offered at her own sale); *see also* FRANK C. MCKINNEY, TRUST INVESTMENTS: GENERAL PRINCIPLES 356–58 (2d ed. 1927) (indicating no statutory provisions in 1927 dealing with investments by trust companies).

41. *See Froneberger*, 79 N.C. at 436; LEE, *supra* note 35, at 81 ("A sale of the trust property to the trustee individually cannot be set aside by a beneficiary who has consented to the transaction.").

42. *See McEachern*, 114 N.C. at 372, 19 S.E. at 703. The logic of allowing the transaction once full disclosure had been made and approval obtained from the beneficiaries is apparent. If the beneficiaries knew all the details and still approved of the transaction, then the court should defer to their judgment. If the trustee did not make full disclosure or did not obtain the permission of the beneficiaries, the court could presume that such permission would not have been given in light of all the facts.

43. *See id.* at 373, 19 S.E. at 703 (stating that the equitable rights of the beneficiaries cannot be defeated by the trustee without full disclosure and consent).

44. The rule, as explained by the Court of Appeals of New York, dictates that "[t]he law 'does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed . . . without undertaking to deal with the question of abstract justice in the particular case.' " Wendt v. Fischer, 154 N.E. 303, 304 (N.Y. 1926) (quoting Munson v. Syracuse, Geneva, & Corning R.R. Co., 8 N.E. 355, 358 (N.Y. 1886)). Although no North Carolina cases use the phrase "no further inquiry," North Carolina clearly follows this rule. *See, e.g.*, *McEachern*, 114 N.C. at 371, 19 S.E. at 703 ("The fact that in making such investment [the trustee] was free from any actual fraudulent purpose is immaterial . . . .").

occurred, the beneficiaries had a right to void the transaction,[45] to receive from the trustee the full value of the property sold,[46] and to remove the individual as trustee.[47]

Under the common law, liability for self-dealing could linger long after the transaction was completed. In *Ryden v. Jones*,[48] an executor, treated by the *Ryden* court as a trustee, was found liable to the complaining beneficiaries twenty years[49] after purchasing property[50] from the trust.[51] The court voided the sale, holding that the passage of time did not operate to bar the action because the trustee had yet to distribute the funds from the sale; thus, the trust was still open and unexecuted even though several years had passed since the sale was completed.[52]

Relying on the principle that equity is concerned with the substance of a transaction rather than its form,[53] North Carolina courts also upheld the prohibition against self-dealing after finding that a trustee sought to disguise the nature of the transaction. For instance, in *Bruner v. Threadgill*,[54] the trustee made an agreement to sell trust property to a third party.[55] Under the agreement, the third party promised to reconvey the property to the trustee.[56] Despite the form of the transaction, the court found the trustee liable for self-dealing.[57]

A trustee who obtained court approval for a self-dealing transaction was not insulated from liability if such approval was

45. *See* Roberts v. Roberts, 65 N.C. 27, 28 (1871).

46. *See* Hunt v. Bass, 17 N.C. (2 Dev. Eq.) 292, 297 (1832).

47. *See* North Carolina R.R. Co. v. Wilson, 81 N.C. 223, 230–34 (1879).

48. 8 N.C. (1 Hawks) 497 (1821).

49. *See id.* at 499.

50. The property at issue was a black slave named Frank. *See id.* at 497. In 1794, Frank was sold at a public auction by the executor of the estate of the petitioner's uncle. *See id.* at 499. The executor used an agent to purchase Frank for himself at the sale for full value. *See id.* The court found that even though the sale was "fair and necessary" and "all the persons entitled to distribution in the negro assented to the sale," the executor was liable for the sale. *Id.* The court reasoned that the executor, who by statute did not have the power of sale without approval by the court, should be subject to the same rules as trustees with regard to self-dealing. *See id.* at 505.

51. *See id.* at 505.

52. *See id.*

53. *See* Abbitt v. Gregory, 201 N.C. 577, 593, 160 S.E. 896, 904 (1931).

54. 88 N.C. 361 (1883).

55. *See id.* at 363. The decedent Bruner had conveyed real property to a creditor by a deed of mortgage in order to secure several notes. After defaulting on the notes, Bruner assented to the sale of the property. The creditor arranged for the auctioneer to purchase the property at the sale and to then resell it to him. *See id.*

56. *See id.*

57. *See id.* at 367.

premised on inadequate or misleading disclosures. For example, in *Patton v. Thompson*,[58] the trustee petitioned the court to sell some of the trust property so that he could provide for the beneficiary.[59] Although the trustee had obtained the permission of the Orange County Court of Equity to make the sale, the North Carolina Supreme Court voided the sale because the trustee had not disclosed that the purchaser was acting as the trustee's agent.[60]

The reasoning behind North Carolina's strong disapproval of trustee self-dealing was explained repeatedly in these early cases.[61] The trustee had a duty to operate the trust in the best interest of the beneficiaries.[62] The trustee necessarily injected his own interests into the transaction by dealing with the trust on his own behalf. Thus, the trustee would be tempted to defraud the beneficiaries by putting his own interests ahead of those of the beneficiaries without their knowledge or consent.[63] The common law rules sought to avoid this temptation by prohibiting self-dealing without full disclosure and the permission of the beneficiaries or the court.[64] North Carolina's rule of strict liability for violation of the prohibition was not only intended to serve as a deterrent for the trustee, but also to keep the courts free from time-consuming litigation over the fairness of self-dealing transactions.[65]

II. THE UNIFORM TRUST ACT'S RESPONSE TO SELF-DEALING AND ITS EFFECT ON MODERN TRUST ADMINISTRATION

In 1937, the NCCUSL[66] adopted the UTA.[67] Self-dealing, as a violation of the trustee's duty of loyalty, was one of the many issues[68]

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58. 55 N.C. (2 Jones Eq.) 285 (1855).

59. *See id.* at 286.

60. *See id.* at 288–89.

61. *See* McEachern v. Stewart, 114 N.C. 370, 371, 19 S.E. 702, 703 (1894); Gibson v. Barbour, 100 N.C. 192, 197, 6 S.E. 766, 768 (1888); *Bruner*, 88 N.C. at 367; Froneberger v. Lewis, 79 N.C. 426, 430 (1878); *Patton*, 55 N.C. (2 Jones Eq.) at 288.

62. *See supra* note 35 and accompanying text.

63. *See supra* note 37 and accompanying text.

64. *See* Wachovia Bank & Trust Co. v. Johnston, 269 N.C. 701, 711–12, 153 S.E.2d 449, 457–58 (1967).

65. *See* Gordon v. Finlay, 10 N.C. (3 Hawks) 239, 242 (1824) (indicating that "[t]o make exceptions from the rule in particular cases, upon the ground that full value was paid would produce litigation").

66. *See supra* note 14 (explaining the purpose of the NCCUSL).

67. *See* UNIF. TRUSTS ACT prefatory note, 7B U.L.A. 763 (1985).

68. The UTA also addresses securities held as trust property and the liability of the trustee to third parties. *See* UNIF. TRUSTS ACT § 8, 7B U.L.A. 778 (1985) (permitting a trustee to vote corporate stock by proxy); *id.* § 9, 7B U.L.A. 779 (permitting a trustee to hold corporate stock in the name of a nominee); *id.* § 12, 7B U.L.A. 781 (allowing contract

addressed by the Act.[69] One of the main purposes of the Act was to "clarify and tighten the rules regarding loyalty by a trustee to the interests of his beneficiary."[70] North Carolina adopted the UTA in 1939 with only minor modifications to the NCCUSL's model legislation.[71] In so doing, the North Carolina General Assembly expressed its approval of the goals of the Act and signaled that it sought to hold trustees to a standard even more rigorous than that applied under the common law.[72]

North Carolina's version of the UTA[73] flatly prohibits the trustee

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suits against the trustee at law if the contract was within the power of the trustee to make); *id.* § 14, 7B U.L.A. 785 (allowing tort actions against the trustee in his representative capacity).

69. *See* UNIF. TRUSTS ACT § 5, 7B U.L.A. 774 (1985) (prohibiting the trustee's sale or purchase of trust property from or to itself or an affiliate).

70. UNIF. TRUSTS ACT prefatory note, 7B U.L.A. 763 (1985). "It is felt that many of the abuses of modern trust administration have come from indirect disloyalty of the trustee and that a clear statement of the full implications of the loyalty duty might help in securing honest administration." *Id.* at 765. The Act was also designed to abolish "obsolete and unjust rules of trust law" and to facilitate the administration of trusts by easing some of the rules of equity. *Id.* at 763.

71. *See* JOURNAL OF THE HOUSE OF REPRESENTATIVES OF THE GENERAL ASSEMBLY OF THE STATE OF NORTH CAROLINA 829 (1939 Regular Session); JOURNAL OF THE SENATE OF THE GENERAL ASSEMBLY OF THE STATE OF NORTH CAROLINA 605 (1939 Regular Session). The General Assembly added several provisions not included in the NCCUSL's version of the Act. *See, e.g.*, N.C. GEN. STAT. § 36A-63 (1999) (regulating the conditions under which a bank may hold trust funds while awaiting investment or distribution); § 36A-64 (allowing the trustee to make loans to the trust if the transaction is fair); § 36A-65 (permitting the trustee to loan funds from one trust to another). The UTA is now codified as Chapter 36A, Article 5 of the North Carolina General Statutes. *See* N.C. GEN. STAT. §§ 36A-60 to 36A-85 (1999).

72. *See* Wachovia Bank & Trust Co. v. Johnston, 269 N.C. 701, 714, 153 S.E.2d 449, 459 (1967) (stating that the purpose of N.C. GEN. STAT. § 36A-66 (then codified as § 36-28) is to clarify and strengthen the trustee loyalty rules). Interestingly, the North Carolina General Assembly does not impose the same statutory prohibition against self-dealing on estate administrators. *See generally* N.C. GEN. STAT. § 28A (1999) (addressing the administration of decedents' estates). Chapter 28A does not prohibit testators from granting the power to self-deal to the personal representative of their estate. *See id.* The differing treatment of personal representatives and trustees of express trusts perhaps is due to the court's more substantive oversight of probate matters. In North Carolina, a personal representative is supervised by and must account to the court annually. *See* N.C. GEN. STAT. § 28A-21-1 (1999). In contrast, a trustee really answers only to the beneficiaries; the court does not inquire into the management of the trust unless the beneficiaries or their representatives sue the trustee or the trustee herself petitions the court for instructions. *See* LEE, *supra* note 35, at 129. Thus, although both the personal representative and the trustee are fiduciaries, the lack of judicial oversight may have led the legislature to adopt stricter rules for trustee behavior. *Cf.* Tamar Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 825 (1983) ("The extent of fiduciary duty varies with the degree of potential abuse of power stemming from the relation.").

73. The relevant sections are codified in sections 36A-66, 36A-78, 36A-79, and 36A-80 of the North Carolina General Statutes.

and its corporate affiliates from buying property from the trust or selling property to the trust without prior court approval.[74] Thus, even if the settlor desires that the trustee be allowed to purchase trust property for itself or sell its own property to the trust, the trustee must secure the court's permission to enter the transaction or else risk liability.

The North Carolina Supreme Court validated the statutory ban on trustee self-dealing in *Wachovia Bank & Trust Company v. Johnston*.[75] Here the corporate trustee petitioned the court for permission to purchase the corpus of the trust.[76] The adult beneficiaries had received full and complete information about the proposed sale from the trustee and joined in the trustee's petition.[77] The issue, as framed by the parties, was whether circumstances were such that a sale of the trust property was justified.[78] After deciding that the facts of the case necessitated the sale of the trust property, the court questioned the legality of the trustee purchasing the property.[79] The state's highest court considered both equitable[80] and

74. *See* N.C. GEN. STAT. § 36A-66 (1999). The prohibition is accomplished by the combination of four separate statutes. Section 36A-66 of the North Carolina General Statutes prohibits the trustee of an express trust, or most of its related entities, from buying property from or selling property to the trust. Sections 36A-78 and 36A-79 disallow the settlor and the beneficiaries, respectively, from relieving the trustee from liability for future self-dealing acts. Section 36A-80, "for cause shown and upon notice to the beneficiaries," gives the court the power to permit the trustee to self-deal, if the trustee "has acted honestly and reasonably." *Id.* § 36A-80.

The beneficiary may forgive past self-dealing, but may not consent to future self-dealing. *See* § 36A-79. This arrangement seems to allow even the fully-informed beneficiary an opportunity to wait and see how the deal turns out before relieving the trustee from liability. Indeed, the language of this statute suggests that the legislature intended for the beneficiary to have every opportunity to hold the trustee liable, even if the beneficiary gave his fully-informed consent to the transaction. The language of the statute notwithstanding, it is unclear whether a court would actually assess liability under those circumstances. *See* LEE, *supra* note 35, at 81, 155–56 (stating that a beneficiary who consents after complete disclosure may not be heard to complain).

75. 269 N.C. 701, 153 S.E.2d 449 (1967).

76. *See id.* at 704, 153 S.E.2d at 453. The trust consisted of a parcel of downtown real estate with an office building located on it. *See id.* at 702, 153 S.E.2d at 451. The local planning commission designated the building as dilapidated, and net rental income from the building was expected to decline to the point that the property would not generate satisfactory income to the beneficiaries. *See id.* at 703–04, 153 S.E.2d at 452.

77. *See id.* at 705, 153 S.E.2d at 453.

78. *See id.* at 706, 153 S.E.2d at 454.

79. *See id.* at 710, 153 S.E.2d at 457. The court put forth the same reasoning for the propriety of the prohibition under the UTA as earlier courts gave prior to its passage. *See supra* notes 61–65 and accompanying text. The court explained that when presented with the conflict inherent in self-dealing transactions, "there is always the danger that [the trustee] will yield to the call of self-interest." *Wachovia Bank & Trust*, 269 N.C. at 715, 153 S.E.2d at 459–60.

legal[81] authorities in concluding that the lower court had the power to permit the sale of trust property to the trustee in exceptional cases.[82] Nevertheless, the court held that it could not determine whether the case constituted such an exception,[83] because Wachovia had not shown that it was the only buyer willing to purchase the property on such favorable terms.[84] Consequently, the court could not sanction Wachovia's purchase of the trust property.[85] *Wachovia Bank & Trust* reinforced the statutory self-dealing prohibition by adhering to the principle that, notwithstanding the beneficiaries' informed consent and a good-faith belief that the transaction promotes the beneficiaries' interests, the trustee must satisfy the court that the transaction is appropriate in order to escape liability.[86]

As evidenced by the holding in *Wachovia Bank & Trust*, North

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80. *See Wachovia Bank & Trust*, 269 N.C. at 710–15, 153 S.E.2d at 457–59. The court relied on case law from both North Carolina and surrounding jurisdictions as well as trust law treatises. *See id.*

81. *See id.* at 714, 153 S.E.2d at 459. In reaching its conclusion, the court quoted the text of sections 36-28 and 36-42 of the North Carolina General Statutes (now codified as N.C. GEN. STAT. §§ 36A-66, 36A-80). *See id.*

82. *See Wachovia Bank & Trust*, 269 N.C. at 715, 153 S.E.2d at 460. The court stated that although it was "recognizing and reaffirming" the prohibition on trustee self-dealing, there were "rare and justifiable exceptions" when the court might authorize self-dealing upon proof that (1) the trustee has completely disclosed all the facts, (2) the transaction would materially promote the trust's and the beneficiaries' best interests, and (3) there were no other entities willing to enter into the same transaction on as favorable or more favorable terms. *Id.*

83. The court remanded for further findings of fact as to whether Wachovia advertised the sale and whether Wachovia received other equal or better offers to purchase. *See id.* at 715, 153 S.E.2d at 461.

84. *See id.* at 716, 153 S.E.2d at 460.

85. The court stated that the showing of adequate advertisement and the unavailability of comparable purchasers were necessary precautions so that the record would reflect neither the "appearance of [n]or opportunity for fraud." *Id.*

86. A court will examine the transaction only upon petition by one of the beneficiaries. *See supra* note 72 (explaining that a beneficiary must petition the court before it will intervene). Such a petitioner may seek one or more of several available remedies. *See supra* notes 45–47 and accompanying text (listing the remedies available to beneficiaries for a trustee's breach of trust). However, if each beneficiary gave his fully informed consent, whether the courts will interpret the statutes as providing a remedy is unclear. *See* LEE, *supra* note 35, at 81. The court might look to the common law rules of equity to allow a good-faith trustee to escape liability for a transaction that appeared to promote the beneficiaries' interests. *See infra* notes 152–83 and accompanying text (describing a New Mexico case in which the court looked to the common law to find a good faith exception to a statutory self-dealing ban). If the deal reached an unfavorable result for the beneficiaries, especially if it involved a foreseeable risk to the interests of the beneficiaries, the court might reaffirm its historical view and grant relief to the complaining beneficiaries. In addition to the foregoing possibilities, section 36A-80 of the North Carolina General Statutes grants courts the power to excuse self-dealing transactions by an honest and reasonable trustee. *See supra* note 74.

Carolina courts will not grant the trustee permission to self-deal unless they find that the trustee is the only party willing to deal with the trust on the stated terms.[87] Thus, in 1967, the UTA had accomplished the legislature's goal of clarifying and tightening the prohibition against self-dealing.

Since then, the North Carolina legislature has added several statutory exceptions to the self-dealing prohibition.[88] These exceptions are obvious concessions to the pressures of modern trust administration, and they allow the settlor to grant the power to the trustee to enter into certain quasi-self-dealing transactions through express language in the trust instrument. The statutes, however, still impose restrictions on the trustee's exercise of the power and require full disclosure and accounting to the beneficiaries.[89] Whether the self-dealing prohibition retains the strength given to it by the *Wachovia Bank & Trust* court more than thirty years ago or whether the exceptions favoring the corporate trustee have weakened its force is uncertain.

Historically, trust administration was undertaken largely by individuals.[90] In that context, the "inexorable rule"[91] that a trust must be managed for the exclusive benefit of the beneficiaries drew a clear line and kept the courts free of litigation over the fairness of transactions.[92] As investment options open to modern trustees became more varied and complex,[93] trust settlors often were encouraged to seek professional trustees with the knowledge and resources to use those options for the benefit of the trust.[94] Corporate trustees were the only entities capable of competently performing

87. *See Wachovia Bank & Trust*, 269 N.C. at 715, 153 S.E.2d at 460.

88. *See, e.g.*, N.C. GEN. STAT. § 36A-66.1 (1999) (allowing the trustee to purchase securities underwritten by the trusteee); § 36A-66.2 (permitting the trustee to invest trust funds in the trustee's proprietary mutual funds). Section 36A-66.1 was passed in 1985. *See* Act of July 1, 1985, ch. 549, sec. 1, 1985 N.C. Sess. Laws 617, 617 (codified at N.C. GEN. STAT. § 36A-66.1 (1999)). Section 36A-66.2 was adopted in 1993. *See* Act of June 7, 1993, ch. 126, sec. 1, 1993 N.C. Sess. Laws 200, 200–01 (codified at N.C. GEN. STAT. § 36A-66.1 (1999)).

89. *See* N.C. GEN. STAT. §§ 36A-66.1, 36A-66.2.

90. *See Peering Into Trust Industry Archives*, 115 TR. & EST. 452, 453 (1976).

91. *See* McEachern v. Stewart, 114 N.C. 370, 371, 19 S.E. 702, 703 (1894).

92. The clarity of the "no further inquiry" rule, which applied when the trustee had not obtained the beneficiaries' fully informed consent, was largely responsible for this lack of litigation. *See supra* note 44 and accompanying text.

93. *See* MARTIN M. SHENKMAN, THE COMPLETE BOOK OF TRUSTS 7 (2d ed. 1998) (cautioning settlors that modern trust management may be beyond the capabilities of most non-professionals).

94. *See id.*

increasingly complex trustee functions.[95]

Until recently, corporate trustees were either the trust departments of banks or independent trust companies.[96] In the last twenty years, most national and regional broker-dealers have acquired national trustee powers.[97] For these firms, trust management has become a way of increasing the asset pool for investments and of retaining commissions by offering trust services for existing clients.[98] The passage of the Gramm-Leach-Bliley Act[99] clears the way for even more complex, and potentially abusive, combinations of financial institutions.[100] As financial service

95. A trustee with no knowledge of investment matters can hire professional investment advisors or money managers, so long as the trust does not expressly bar this action. *See* SHENKMAN, *supra* note 93 at 78. Engaging such a professional, however, means additional costs to the trust. Thus, appointing a skilled investor as trustee preserves more income for the beneficiaries.

96. *See* William F. Ottinger, *Selling Against Non-Bank Competitors*, TR. & EST., Oct. 1993, at 10, 12.

97. *See* Henry A. Feldman, Jr., *Where the Trust Industry May Be Heading*, TR. & EST., Sept. 1992, at 42, 42; Ottinger, *infra* note 96, at 10, 12.

98. For example, financial services giant Merrill Lynch has stressed the importance of its asset management services (including trust administration) as a vehicle to increase revenues and profits. *See* MERRILL LYNCH, 1998 ANNUAL REPORT 4–5 (1999) ("Our clients have long turned to Merrill Lynch for a total financial relationship-integrated services that are personally tailored and delivered through a central point of contact."); *cf.* Jeffrey Keegan, *The Europeans Are Coming*, INVESTMENT DEALER'S DIG., Sept. 27, 1999, at 14, 16 ("In the future, there will be a certain number of companies with wide distribution and multiple product lines that will compete to get our money into their system and keep it by providing us with financial products that we'll need throughout our entire lifetime." (quoting Jim MacNaughton, head of global FIG M&A at Salomon Smith Barney)).

99. Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 1999 U.S.C.C.A.N. (113 Stat.) 1338. The Act allows banks, including trust companies, insurance companies, and broker-dealers to own each other. *See id.* § 103. The Act has been both praised and criticized; it grants more opportunity for lucrative combinations, but it also subjects the entities to a myriad of complex regulations and regulators. *See* Lisa I. Fried, *Corporate Update, Gramm-Leach-Bliley: Financial-Industry Lawyers See Mixed Blessing*, N.Y. L.J., Apr. 6, 2000, at 5.

100. *See* Fried, *supra* note 99, at 5. The combination of trust companies, broker-dealers, and insurance companies presents other issues which should be considered. For example, the personal information of a client of one of the companies under the corporate umbrella, gained in the course of a transaction, will be accessible by the others. *See* Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 1999 U.S.C.C.A.N. (113 Stat.) 1338, §§502, 503 (putting no restrictions on sharing nonpublic customer information among affiliates so long as the sharing policy is disclosed). Thus, a broker-dealer's affiliated trust institution could not only provide assets to be managed for fees and commissions, but it also may provide the names and financial data of beneficiaries who may be solicited as customers in their own right. While this sort of information swapping is common, and perhaps even expected, from mail-order companies and credit card issuers, the idea that a trustee—a *fiduciary*—could make the beneficiaries' personal information available to its affiliates or others for its own profit is shocking. This issue and others like it are beyond the scope of

providers merge and consolidate in an effort to provide complete offerings of financial products and services to retail clients,[101] assets managed by the broker-dealer affiliated trustees will continue to grow.[102]

Many of the corporate trustees chartered and operating in North Carolina are affiliated with broker-dealers.[103] Prohibited self-dealing transactions, in the context of the trustee's relationship with its affiliated broker-dealer, involve situations when the trustee purchases from or sells to its affiliate stocks, bonds, or other investment property on behalf of the trust. North Carolina's self-dealing prohibition does not bar a trustee from using an affiliated company as a broker.[104] Likewise, North Carolina General Statute section 36A-66 allows a third party to purchase shares underwritten by the trustee or its affiliate[105] and to invest in the trustee's proprietary mutual funds.[106] In the context of a broker-dealer affiliate, the statute appears to prohibit only the affiliate's role as a dealer for the trustee.[107]

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this Comment, but they should be part of any debate surrounding the standard of behavior for North Carolina trustees.

101. *See* Ottinger, *supra* note 96, at 10.

102. *See Merrill Lynch Press Release* (visited May 18, 2000) <http://www.ml.com/woml/press_release/19980805-1.htm> ("Since 1987, the Merrill Lynch trust companies have grown to $65 billion in client assets held in personal trusts, employee benefit trusts, and custody accounts.").

103. The North Carolina Commissioner of Banks lists sixty-eight commercial banks and five trust companies (limited purpose banks) operating in North Carolina. *See NC State-Charted Banks* (visited Sept. 1, 2000) <http://www.banking.state.nc.us/bklist.htm>. Of those, at least twenty-two have an affiliation with a broker-dealer. *See id.* North Carolina recently adopted the Uniform Prudent Investor Act, an act that eases the restrictions historically placed on trust investments under the "prudent person rule." *See* 1999 N.C. Sess. Laws ch. 215, § 1 (codified at N.C. GEN. STAT. §§ 36A-161 to -173 (1999)); *see also* TRAIN & MELFE, *supra* note 14, at 21–25 (tracing the development of the prudent person rule's investment restrictions); Paul G. Haskell, *The Prudent Person Rule for Trustee Investment and Modern Portfolio Theory*, 69 N.C. L. REV. 87, 88–92 (discussing how the "prudent person" rule and the limitations that it has placed on trust investments have evolved over time).

104. This exclusion is somewhat intuitive because a broker does not buy or sell on its own account. Nonetheless, the potential still exists for the trustee to serve its own interests by activities such as increasing the number of trades to generate more commissions for the affiliated broker, a practice commonly known as "churning." *See infra* note 115. Churning, however, is prohibited by federal laws governing broker-dealers. *See* 17 C.F.R. § 240.15c1-7 (1999).

105. *See* N.C. GEN. STAT. § 36A-66.1 (1999) (addressing investments in securities by banks or trust companies). Although the statute permits the purchase of the trustee-underwritten shares, it does so only on the condition that the trustee does not purchase them from itself or from a co-underwriter with whom the trustee has a reciprocal purchase agreement. *See id.*

106. *See* N.C. GEN. STAT. § 36A-66.2 (1999) (addressing investments in mutual funds).

107. Many large financial services corporations also have affiliated insurance,

While North Carolina's statutory self-dealing prohibition clearly seems to apply to trustees buying and selling securities from the inventory of its affiliated broker-dealer,[108] some corporate trustees doing business in North Carolina are seemingly unaware of the ban's existence. For example, at least one corporate trustee openly requires the trust instrument to include a provision granting it the power to self-deal with its affiliated broker-dealers.[109] Whether this requirement is evidence of a blatant disregard for the ban or merely ignorance of its scope is unclear. Regardless, a trustee's inclusion of such language should be sufficient to raise the suspicions of the beneficiaries.

The suspicion of trustee self-dealing with regard to securities has a long history. In 1936, Professor Austin W. Scott[110] examined the idea of allowing corporate trustees to sell securities owned by the trustees or their affiliates to the trust.[111] He concluded that because the corporate trustee had a duty of loyalty to its shareholders, self-dealing by a corporate trustee may well be more dangerous to the beneficiaries than the self-dealing of an individual trustee.[112] An additional consideration, according to Professor Scott, was the danger that the trust company would make the trust estates a "dumping ground for securities left on its shelves."[113]

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mortgage, and real estate companies. The purchase of insurance, mortgage interests, or other property from any of these affiliates on behalf of the trust would also constitute a prohibited act of self-dealing. This Comment, however, concentrates on the self-dealing that occurs when the trust company's affiliate purchases and sells securities as a dealer.

108. The clear and unambiguous language of section 36A-66 of the North Carolina General Statutes makes no exceptions to the "property" included in its self-dealing ban. Consequently, it is appropriate to presume that none were intended. *See* Sara Lee Corp. v. Carter, 351 N.C. 27, 36, 519 S.E.2d 308, 313 (1999) (quoting Upchurch v. Hudson Funeral Home, Inc., 263 N.C. 560, 565, 140 S.E.2d 17, 21 (1965) (quoting 50 AM. JUR. *Statutes* § 432, at 453 (1944) (stating that the absence of an exception creates a presumption that none exists))).

109. MERRILL LYNCH TRUST, TRUST AGREEMENT PROVISIONS 2 (1996) (requiring that all trust agreements include a provision granting Merrill Lynch Trust the power "[t]o engage any corporation, partnership or other entity affiliated with Merrill Lynch Trust (an "Affiliated Entity") to render services to any trust" including the authority "[t]o act as a broker or dealer to execute transactions.") (on file with *North Carolina Law Review*).

110. Professor Scott (1884–1981) was one of the foremost authorities on the law of trusts. *See* JESSE DUKEMINIER & STANLEY M. JOHANSON, WILLS, TRUSTS AND ESTATES 558 (6th ed. 2000).

111. *See* Austin Wakeman Scott, *The Trustee's Duty of Loyalty*, 49 HARV. L. REV. 521, 543–45 (1936).

112. *See id.* at 544 ("[T]he temptation to favor the shareholders may well be more insidious than the temptation of an individual trustee to favor himself.").

113. *Id.* Professor Scott's reasoning suggests that once a trustee is permitted to deal with its affiliates, the beneficiaries must be prepared to scrutinize every self-dealing transaction and the available alternatives to determine whether their interests were served

One must consider, however, that in the modern investing environment, trustee self-dealing in securities with broker-dealer affiliates differs significantly from self-dealing in other types of property. First, there is substantial government regulation of securities trading. The conduct of broker-dealers is governed by the Securities and Exchange Commission (SEC).[114] For example, if a broker-dealer controls the trading account, it is prohibited from making excessive trades solely for the purpose of generating fees,[115] and it is subject to strict disclosure requirements.[116] Thus, transactions on behalf of the trust between a trustee and its affiliated broker-dealer have safeguards beyond those found in trust law.

Second, in addition to government regulation, the investing public has access to vast amounts of information. Investors can obtain online the most recent stock prices, the range of selling prices throughout the day, and charts tracking the performance of stocks, a certain index, or even an entire exchange.[117] SEC filings, reports, and corporate prospectuses can be searched, read, and downloaded.[118] Nearly instantaneous access to such information has changed the dynamics of investing, seemingly making it more difficult for self-

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along with those of the trustee. But if the trustee is prohibited from self-dealing, the beneficiary may presume that any particular investment decision is made with only the best interests of the trust in mind.

114. The SEC has both direct and indirect jurisdiction over broker-dealers. The direct jurisdiction is primarily set forth in the statutes included in the Securities and Exchange Act of 1934, ch. 404, 49, Stat. 881 (1934) (codified as amended at 15 U.S.C.A. §§ 78a to 78mm (1994 & Supp. IV 1998)), and the rules promulgated thereunder. *See* THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 458 (3d ed. 1996); *infra* notes 115–16; *see also*, 15 U.S.C.A. §78(o)(b)(4) (giving the SEC authority to discipline broker-dealers for conduct that violates the 1934 Act, if such discipline is in the public interest). Additionally, the SEC regulates broker-dealers indirectly through its oversight of the securities industry's self-regulatory organizations and national exchanges. *See* HAZEN, *supra*, at 458, 468–70.

115. *See* 17 C.F.R. § 240.15c1-7 (1999). This practice, known as "churning," is prohibited when the broker-dealer has control over the trading of the account. *See* HAZEN, *supra* note 114, at 515–16.

116. For example, the broker-dealer must disclose whether it acts as a principal or as an agent in the transaction. *See* 17 C.F.R. § 240.10b-10(a)(2) (1999). Thus, a broker-dealer affiliate is legally bound to disclose whether the transaction involves self-dealing. Where the broker-dealer's client is its affiliated trust company, the value of that disclosure is questionable.

117. For examples of the resources available online, see *Personal Finance Web Center* (visited Sept. 1, 2000) <http://www.compuserve.com/gateway/personal_finance/>; *E*TRADE* (visited Sept. 1, 2000) <http://www.etrade.com>; and *Ameritrade* (visited Sept. 1, 2000) <http://www.ameritrade.com>.

118. *See* Securities Exchange Commission, *EDGAR Database of Corporate Information* (visited Sept. 1, 2000) <http://www.sec.gov/edgarhp.htm> (a database of company SEC filings).

dealing trustees to take advantage of an unsuspecting beneficiary, because the price at which the trustee bought or sold a security can easily be compared with the market price.[119] As a consequence, one of the primary dangers of self-dealing—the trustee taking advantage of its position of confidence and control to get a better price for itself[120]—is apparently absent from securities transactions between the trustee and its affiliate.[121]

Even though purchasing securities from the inventory of the trustee's affiliate does not pose an obvious threat to the interests of beneficiaries when the exchange is at market price, the interests of the beneficiaries are still subject to harm through the trustee's self-dealing. There are numerous opportunities for temptation when the trustee has the power to deal freely with its affiliate.[122] For example, the trustee may be tempted to serve its own interests by choosing to deal in a certain security so that its affiliate may increase or decrease its position in a certain stock. If the trust's sale or purchase of the stock does not violate the "prudent investor rule,"[123] the trustee and its affiliate may use the trust as a vehicle to achieve that goal. In that case, while the trust would not pay any more to use an affiliated dealer to complete the transaction, the transaction itself is made to further the trustee's interests, not the beneficiaries' interests. A self-dealing prohibition is one way of removing the temptation to engage in this type of behavior.

Another situation that could prove detrimental to the interests of the trust's beneficiaries involves negotiating the purchase of large

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119. *See supra* note 117.

120. *See supra* note 39 (discussing the dangers of self-dealing).

121. *See* EDWARD S. HERMAN, CONFLICTS OF INTEREST: COMMERCIAL BANK TRUST DEPARTMENTS xv (1975) ("[I]t is imperative to recognize that the self-serving opportunities present in conflict-of-interest situations are usually not exploited.").

122. This Comment addresses the most basic ways a trustee may serve its own interests by using its affiliated dealer. There are many, much more complex, forms of investments and transactions through which the trustee and its affiliate may obtain similar or even greater benefits. *See generally* HERMAN, *supra* note 121 (discussing the various conflicts of interest faced by the trust departments of commercial banks).

123. The "prudent investor rule" has been codified in the Uniform Prudent Investor Act and adopted in 45 states, including North Carolina. *See* UNIF. PRUDENT INVESTOR ACT § 1, 7B U.L.A. 61 (Supp. 1999); N.C. GEN. STAT. §§ 36A-161 to 36A-173 (1999). This rule mandates that a trustee's performance should be evaluated "not in isolation but in the context of the trust portfolio as a whole." N.C. GEN. STAT. § 36A-162(b) (1999). *See also* TRAIN & MELFE, *supra* note 14, at 25–34 (explaining that "the essence of the New Rule is that no investments or techniques are imprudent *per se*"). Thus, an individual investment decision will not be scrutinized closely so long as the trustee demonstrates prudence in its overall investment strategy. *See id.* at 39. The UTC incorporates the Uniform Prudent Investor Act. *See* UNIF. TRUST CODE art. 9 (2000).

quantities of stock. In an arm's-length transaction,[124] the buyer can sometimes use the volume he brings to the dealer to negotiate a price lower than the published market price.[125] When a trustee purchases securities from its affiliate, the trustee negotiates with itself. With the usual safeguard of a published market price no longer present,[126] the beneficiary is particularly vulnerable to the trustee's self-interest.[127]

Trustee self-dealing may also provide a disincentive for corporate trustees to search for the best investment opportunities for the trust. Permitting a trustee to self-deal by purchasing its affiliate's products, even though other products or prices[128] may better serve the interests of the beneficiaries, will inhibit outside competition for the trust's investment dollars.[129]

As the foregoing discussion indicates, unsupervised self-dealing between corporate trustees and their broker-dealer affiliates would

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124. When an employee of the firm, whom the client considers to be "his" broker, makes these negotiations, whether the transaction is really at arm's length is uncertain. In that situation, however, the person having final approval of the price (the client) *is* at arm's length from the dealer. In the trust context, final approval is vested in the trustee, who is *not* at arm's length from the dealer.

125. *See* Telephone Interview with Jerry W. Markham, Professor of Law, University of North Carolina School of Law (July 27, 2000).

126. Usually the published market price is the barometer for measuring the deal's fairness. But when the norm under the circumstances is for the price to be less than the published market price, the beneficiary loses that protection. Even if the price is lower than market price, knowing whether the price is as low as one dealing at arm's length would get is difficult to determine with certainty. *See* Telephone Interview with Jerry W. Markham, *supra* note 125.

127. The abundance of timely financial information should prevent dealers from taking advantage of the trust on price issues for most publicly-traded stocks. *See supra* notes 117–118. In the case of private placements or the bulk sale, however, no "market price" exists beyond that negotiated between the dealer and the trustee. *See* Telephone Interview with Jerry W. Markham, *supra* note 125. When the price may vary, as is often the case, the safety net of a published price by which to judge the fairness of securities transactions between the trustee and the affiliate is lost. *See supra* notes 114–16 and accompanying text.

128. Because the emphasis under the Prudent Investor Act is the trustee's overall investment strategy, the availability of a better performing investment, standing alone, will probably not support a finding that the trustee violated the Prudent Investor Act. *See supra* note 123 and accompanying text.

129. When the affiliated dealer's products are clearly inferior to competition or cost significantly more, the trustee will likely be prodded by fear of liability to venture outside its corporate boundaries and purchase from a third-party. But when the affiliate's product is not performing quite as well as that offered by another or when the price of the affiliate's product is just slightly higher than that of its competitor's, the trustee's choice to invest with its affiliate will likely not violate the prudent investor rule. *See supra* note 123 and accompanying text. In that instance, even though the trustee's interest in keeping the profits in-house may directly conflict with the beneficiaries interest in getting the best product at the best price, the trustee will be able to subordinate the beneficiaries' interests to its own without incurring liability for a breach of duty.

pose a risk of harm to the beneficiaries of North Carolina trusts. Many of the concerns voiced by North Carolina courts over 100 years ago are still relevant to trustees engaging in modern-day securities transactions. Therefore, any easing of the self-dealing ban should be carefully considered.

III. A COMPARISON BETWEEN THE UNIFORM TRUST ACT'S AND UNIFORM TRUST CODE'S SELF-DEALING PROVISIONS

A recent upswing in trust activity[130] and the entry of new participants[131] into the trust administration arena has driven the NCCUSL to attempt to unify current trust law on a national level.[132] To this end, the NCCUSL has drafted and approved the Uniform Trust Code. The UTC is a comprehensive code designed to provide precise guidance on trust law[133] and to either replace or incorporate four existing uniform acts, including the UTA.[134]

The UTC superimposes a duty to administer the trust in good faith[135] and "solely in the interest of the beneficiaries" on the trustee's exercise of any of its powers.[136] In keeping with this duty, the general rule under the UTC is that transactions affected by a conflict between the trustee's personal interests and fiduciary duty, such as self-dealing

130. The NCCUSL stated that the use of trusts for both commercial and estate-planning purposes has increased in recent years. *See* UNIF. TRUST CODE prefatory note (Draft for Approval 2000). Since World War II, the increased use is largely attributable to three factors: (1) the grantor's ability to avoid probate through the use of inter vivos trusts, (2) the effectiveness of trusts as a vehicle for minimizing taxes, and (3) the usefulness of trusts in managing private wealth. *See* JESSE DUKEMINIER & STANLEY M. JOHANSON, WILLS, TRUST, AND ESTATES 443–44 (4th ed. 1990).

131. The new participants consist largely of the trust arms of large brokerage firms. *See* Ottinger, *supra* note 96, at 10.

132. *See* UNIF. TRUST CODE prefatory note (2000 Annual Meeting Draft) (describing the current state of trust law in most jurisdictions as "thin").

133. The NCCUSL hoped the UTC would "provide States with precise guidance on trust law questions ... in an easily findable place." UNIF. TRUST CODE prefatory note (Draft for Approval 2000).

134. The uniform acts that will be replaced or incorporated are the Uniform Trustee Powers Act, the Uniform Prudent Investor Act, the Uniform Probate Code Article VII, and the UTA. *See* UNIF. TRUST CODE prefatory note, § 1204 cmt (Draft for Approval 2000). The NCCUSL recommends that states enacting the UTC repeal these acts. *See* UNIF. TRUST CODE §1204 (2000). Article IX of the UTC is reserved for the incorporation of the Uniform Prudent Investor Act. *See* UNIF. TRUST CODE §1204 cmt. (Draft for Approval 2000).

135. *See* UNIF. TRUST CODE § 801 (2000) ("Upon acceptance of a trusteeship, the trustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries, and in accordance with this [Code].").

136. *Id.* at § 802(a) (2000).

transactions, are voidable by the beneficiary[137] and are subject to the "no further inquiry rule.[138] Even in the absence of self-dealing, the trustee is accountable to the beneficiaries for any profits it makes as a result of its position with the trust.[139]

However, unlike the UTA, the UTC does not impose an absolute prohibition on trustee self-dealing. On the contrary, if "expressly authorized by the terms of the trust," self-dealing is not a breach of the trustee's duty of loyalty at all;[140] the settlor's authorization alone snatches the self-dealing transaction from the jaws of strict liability and places it gently on the same footing as transactions unaffected by a conflict of interest.[141] Thus, even though from the beneficiaries' perspective the economic outcome of the self-dealing transaction may be the same with or without a permissive provision in the trust instrument, the consequences to the trustee are vastly different.

Viewing the power of the settlor to permit trustee self-dealing from the beneficiaries' perspective reveals a major difference between the UTA and the UTC.[142] Under the UTA, a trustee who wishes to deal with the trust with the settlor's permission must still obtain court approval.[143] The beneficiaries are notified and have an opportunity to be heard.[144] No such notice is required under the UTC,[145] so the beneficiaries may not even be aware that the self-dealing transaction has occurred. Additionally, the power to enter

137. *See id.* at § 802(b) (2000).

138. *Id.* at § 802(b) cmt. (Draft for Approval 2000); *see also supra* note 44 and accompanying text (explaining the rule).

139. *See id.* at §1003(a) (2000). The trustee is allowed to retain compensation earned. *See* §1003(a) cmt. (Draft for Approval 2000).

140. UNIF. TRUST CODE §802 cmt. (Draft for Approval 2000). The Comment to section 802 does not indicate whether the express language must refer to a specific self-dealing transaction or whether a broad grant of the power to self-deal will be sufficient to protect the trustee from liability for breach of trust.

141. *See id.* (stating that "no breach of the duty of loyalty occurs if the transaction was expressly authorized by the terms of the trust").

142. Another difference is the beneficiaries' ability to relieve the trustee from liability. Recall that under the UTA, the beneficiaries cannot give *forward* permission; they can only absolve the trustee after the fact. *See* N.C. GEN. STAT. § 36A-79 (1999); *supra* note 74. Under the UTC, the beneficiaries can do both. *See* UNIF. TRUST CODE § 802(b)(4) (2000). This difference benefits the trustee by removing the uncertainty surrounding the view a court would take of the equitable defense of consent if it were used by a trustee against a charge of self-dealing. *See supra* note 86.

143. *See* N.C. GEN. STAT. §36A-80 (1999).

144. *See id.*

145. The UTC does require the trustee to keep the beneficiaries reasonably informed and to report to them at least annually. *See* UNIF. TRUST CODE § 813 (2000). It is unclear whether the UTC requires such detail that would reveal self-dealing securities transactions if the transactions were approved in the trust instrument.

into these transactions without judicial oversight, long viewed as perilous for the beneficiaries, may not have been granted to the trustee voluntarily.[146] Thus, the UTC could have the ultimate effect of inhibiting the beneficiaries' ability to protect themselves from a transaction that the settlor felt compelled to authorize only because of a desire for competent trust management.[147]

IV. AN EXAMINATION OF POSSIBLE RESPONSES TO SELF-DEALING CORPORATE TRUSTEES

At present, at least some corporate trustees do not acknowledge the state's self-dealing ban.[148] If those trustees are engaging in prohibited self-dealing, under the auspices of the settlor's grant of permission, the time may come when a disgruntled beneficiary sues, not on the basis of unfairness or imprudence, but simply because the trustee breached its duty of loyalty by purchasing stocks from the inventory of its affiliate in violation of section 36A-66 of the North Carolina General Statutes.[149] The outcome of such a case in North Carolina is uncertain[150] due to the lack of case law decided under the UTA and the competing equitable factors likely to be considered by a court deciding such a case. Consequently, case law from other states that have adopted the UTA will be instructive.

New Mexico adopted the UTA, including its self-dealing ban, in 1951.[151] In *Tays v. Metler*,[152] a recent unpublished decision, the Tenth Circuit addressed New Mexico's statutory ban on trustee self-dealing and may have given North Carolina trustees a preview of the likely judicial treatment of claims brought under legislation modeled on the

146. *See* text accompanying *supra* notes 93–96.

147. *See supra* note 93–95 and accompanying text.

148. *See supra* note 109 and accompanying text.

149. *See* N.C. GEN. STAT. § 36A-66 (1999).

150. In terms of equity considerations, if the transactions at issue were made "honestly and reasonably," N.C. GEN. STAT. § 36A-80 (1999), the court may relieve the trustee from liability. If, however, the trustee had knowledge of the ban, either actual or imputed, then the court may find the honesty element missing. The settlor's explicit authorization of the transaction(s) in the trust instrument favors relief. Nevertheless, the settlor's probable ignorance of the self-dealing prohibition and the trustee's likely insistence on the inclusion of the permissive provision may create an illusive authorization. Even the behavior of the petitioning beneficiary could be a factor; authorities suggest that a beneficiary who ratifies the trustee's action by accepting the profits from some of the transactions with knowledge of their self-dealing origins may be estopped from complaining later. *See* LEE, *supra* note 35, at 156.

151. *See* N.M. STAT. ANN. §§ 46-2-5, 46-2-14, 46-2-15, 46-2-16 (Michie 1997) (codifying Uniform Trust Act sections 5, 17, 18, and 19). These statutes were approved by the New Mexico legislature in 1951. *See* 1951 N.M. Laws ch. 193, §5.

152. *See* No. 97-2317, 1999 U.S. App. LEXIS 4769 (10th Cir. Mar. 19, 1999).

UTA. The settlor in *Tays* named her husband as trustee of a trust whose income would be divided between him and her sons.[153] The trust instrument gave the trustee broad powers to manage the trust[154] and stated the settlor's "intention to give my ... Trustee the same power of investment and reinvestment which I might myself possess in the management of my property."[155] Four years after the settlor's death, the trustee transferred real property that he owned to the trust, removed almost all of the liquid assets from the trust, and deposited them in his own account.[156] The evidence indicated that the value of the property exceeded the value of the trust assets taken in exchange.[157] Nevertheless, one of the settlor's sons sued in federal district court,[158] claiming that his father, the trustee, had violated New Mexico's statutory ban on trustee self-dealing.[159] The district court, finding a good faith exception to the rule against self-dealing,[160] held that the trustee's act did not violate the law.[161]

In considering the son's appeal, the Tenth Circuit noted the absence of case law on point in both New Mexico and other jurisdictions in the Tenth Circuit[162] and thus looked to courts outside the Tenth Circuit for guidance.[163] In doing so, the court recognized the existence of a common law good faith exception to the statutory rule against self-dealing and affirmed the district court's decision.[164]

153. *See id.* at *3.

154. *See id.* at *4.

155. *Id.* (quoting Brief for Appellant at 190, *Tays* (No. 97-2317)).

156. *See id.* at *5.

157. *See id.*

158. The opinion is unclear as to the basis for the federal district court's jurisdiction; because the plaintiff's breach of fiduciary duty claims were based on New Mexico state law, the jurisdiction was probably based on the parties' diversity of citizenship.

159. *See id.* at *7. The son's complaint was not founded on a claim of bad faith or unfairness on the part of the trustee; the sole basis of the cause of action was New Mexico's statutory ban on trustee self-dealing. *See id.* For New Mexico's statutory ban, see sections 46-2-5 and 46-2-14 of New Mexico Statutes Annotated. *See* N.M. STAT. ANN. §§ 46-2-5, 46-2-14 (Michie 1997).

160. *See Tays*, 1999 U.S. App. LEXIS 4769, at *7.

161. *See id.* at *2.

162. *See id.* at *8.

163. *See id.*

164. *See id.* at *12. The court also held that even if the transaction had been a violation of the self-dealing prohibition, the trial court had the discretion to excuse the violation under section 42-2-16 of the New Mexico Statutes Annotated. *Id.* at *13 ("A court of competent jurisdiction may ... excuse a trustee who has acted honestly and reasonably from liability for violations of the provisions of this act."). Thus, the court acknowledged that it had the unilateral power, by statute, to relieve the trustee from liability for self-dealing if the trustee could show that it had acted "honestly and reasonably." The court's decision to inject a common law exception into the statutory ban, rather than relying on its *statutory* ability to relieve the trustee from liability, is instructive.

An examination of the cases relied on by the court reveals that the court's decision rests on what is at best a strained interpretation of the extra-jurisdictional opinions.

The *Tays* court depended heavily on *Bank of Nevada v. Speirs*[165] to support its determination that a common law good faith exception to New Mexico's statutory ban on trustee self-dealing exists.[166] The court stated that *Speirs* was instructive for the following two reasons: (1) Nevada had also adopted the 1937 UTA and thus pertinent case law from Nevada could help the court interpret the statutes uniformly[167] and (2) the trust arrangement in *Speirs*—a trustee-husband with broad discretionary power—was similar to the arrangement in *Tays*.[168] While the *Tays* court correctly identified these attributes of *Speirs*, the court neglected to address a fact that irrefutably distinguishes the two cases. Because the trustee in *Speirs* did not buy or sell property from or to the trust,[169] Nevada's statutory self-dealing ban was not at issue in the case. Thus, the good faith exception[170] that the *Tays* court purported to derive from *Speirs*[171] and then applied to the self-dealing transaction in *Tays* was not an exception to statutory self-dealing at all. It was a common law exception applied to a claim of breach of a common law duty, a claim in which the defining element of Tays' claim, the statutory self-dealing, was strikingly absent.

The *Tays* court also cited three other extra-jurisdictional cases to support a good faith exception to statutory self-dealing when the

165. 603 P.2d 1074 (Nev. 1979). The court found *Speirs* especially persuasive because Nevada also had a statutory self-dealing prohibition.

166. *See Tays*, 1999 LEXIS 4769, at *9.

167. *See id.* The court cited section 46-2-18 of the New Mexico Annotated Statutes as authority for the proposition that the 1937 UTA "must be interpreted consistently with its purpose to make the law uniform." *Id.*

168. *See id.*

169. *See Speirs*, 603 P.2d at 1076. In *Speirs*, the trustee, who was the father of the beneficiary, and the trust inherited from the settlor equal interests in the same property. *See id.* at 1075. Subsequently, the trustee purchased additional interests in the property. *See id.* at 1076. After consulting an expert who opined that increasing the trust's ownership interest in the property would be too risky for the trust, the trustee invested the trust funds in other property. *See id.* The beneficiary-daughter sued, claiming that the trustee breached his fiduciary duty to her by not increasing the trust's position in the investment by the same amount that he had increased his own. *See id.* The Nevada Supreme Court reversed the district court's judgment and declared that the trustee had not acted improperly. *See id.* at 1077.

170. "[T]he trustee will not be penalized when he has acted in good faith and in a manner he believes was for the best interest of the trust." *Tays*, 1999 U.S. App. LEXIS 4769, at *10 (quoting *Speirs*, 603 P.2d at 1077).

171. *See id.*

settlor intends a conflict of interest and gives the trustee broad discretion to invest the trust funds.[172] Like the *Speirs* holding, however, the three cited cases do not support a good faith exception to the statutory self-dealing ban under the *Tays* facts. For example, in *Gregory v. Moose*,[173] the transaction at issue was not one of statutory self-dealing.[174] Thus, the *Tays* court's extrapolation that the trustee purchased property from the trust by characterizing *Gregory's* holding as "no breach of trust . . . even though trustee benefited from sale,"[175] misrepresented the nature of the transaction.[176] Consequently, *Gregory* did not support the *Tays* holding.

The other two cases,[177] both decided under Illinois law, were also inapplicable to *Tays* because Illinois has no statutory prohibition on self-dealing.[178] Thus, any good faith exception to a rule against self-dealing expressed in those cases would be an exception to a common law rule, rather than an exception to the UTA prohibition on self-dealing. Before extending this common law, good faith exception to New Mexico's statutory ban, the appropriate inquiry to make is whether the state's legislature intended such an exception.

In the Prefatory Note to the UTA, the NCCUSL made clear that a primary objective of the model legislation was to make the rules governing trustee loyalty more explicit and restrictive.[179] Indeed, the Prefatory Comment indicates that the Act itself was born of a desire to preempt the common law on the issues it addressed.[180] The provisions expressly precluding the settlor and the beneficiary from giving the trustee permission to self-deal,[181] as well as the expression

172. The *Tays* court claimed that the good faith exception was supported by *Gregory v. Moose*, 590 S.W.2d 665 (Ark. Ct. App. 1979), *In re Estate of Halas*, 568 N.E.2d 170 (Ill. App. Ct. 1991), and *Bracken v. Block*, 561 N.E.2d 1273 (Ill. App. Ct. 1990). *See Tays*, 1999 U.S. App. LEXIS 4769, at *8–9.

173. 590 S.W.2d 665 (Ark. Ct. App. 1979).

174. *See id.* at 670 ("There is no question but that self-dealing is a breach of trust . . . . But that is not the case in the matter before us.").

175. *Tays*, 1999 U.S. App. LEXIS 4769, at *8.

176. In *Gregory*, the trustee was also a beneficiary. *See Gregory*, 590 S.W.2d at 670. Based upon the incomplete facts presented in the opinion, the trustee appeared to benefit from the profit on the sale in his dual-capacity as beneficiary. *See id.*

177. *See In re* Estate of Halas, 568 N.E.2d 170 (Ill. App. Ct. 1991); Bracken v. Block, 561 N.E.2d 1273 (Ill. App. Ct. 1990).

178. *See* 760 ILL. COMP. STAT. ANN. 5/3-1 (West 1992).

179. *See* UNIF. TRUSTS ACT prefatory note, 7B U.L.A. 765 (1985); *supra* note 70 and accompanying text (explaining that the purpose of the UTA was to clarify and tighten the loyalty rules).

180. *See* UNIF. TRUSTS ACT prefatory note, 7B U.L.A. 764–65 (1985) (explaining how the UTA modifies or abolishes various common law rules).

181. *See* UNIF. TRUSTS ACT §§ 4, 17, 18, 7B U.L.A. 773, 787, 790 (1985).

of several specific exceptions,[182] are persuasive evidence that no common law good faith exception was intended.[183]

When construing statutes, New Mexico state courts typically seek to give effect to the legislature's intent by looking for the goal the statute sought to achieve.[184] Had the *Tays* court attempted to determine the intent of the New Mexico legislature in passing the UTA,[185] it would have been guided by ample case law establishing the state courts' practice of considering the plain language of the statute in relation to the legislative act as a whole.[186] Such an approach to interpreting the UTA most likely would have led the Tenth Circuit to a different conclusion.

Additionally, the *Tays* court could have gained useful insight into the proper interpretation of the statutes by considering the New Mexico Attorney General's understanding of the prohibition and the existence of any exceptions. In a 1984 opinion issued on the matter, the Attorney General's Office appears to have accepted the ordinary meaning of the UTA's language and to have been unaware of any exceptions, save those specifically expressed in the Act.[187]

The foregoing discussion indicates that the legislative intent behind the passage of New Mexico's statutory prohibition was to preclude trustees from self-dealing with the trust without court approval outside the enumerated statutory exceptions.[188]

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182. *See, e.g., id.* at § 4, 7B U.L.A 773 (exempting a trustee's deposit of trust funds with itself from the self-dealing ban); § 8, 7B U.L.A 778 (exempting the voting of corporate stock by proxy from the common law rule against the delegation of trust powers).

183. A common law good faith exception, if adopted by North Carolina courts, would shield a trustee from liability if the trustee reasonably believed that the transaction was in the best interests of the beneficiary. Under the UTA, however, the trustee's good faith is only one factor for the court to consider. *See* N.C. GEN. STAT. § 36A-80 (1999) (requiring the trustee to have acted honestly and reasonably in order for the court to relieve it from liability). Thus, good faith alone should not protect the trustee under UTA.

184. *See, e.g.*, State *ex rel* Children, 995 P.2d 1060, 1069 (N.M. Ct. App. 2000).

185. *See* Tays v. Metler, 1999 U.S. App. LEXIS 4769, at *1, *12–14 (10th Cir. Mar. 19, 1999).

186. *See* Plains Elec. Generation & Transmission Coop., Inc. v. New Mexico Pub. Util. Comm'n, 967 P.2d 827, 830–31 (N.M. 1997) (stating that the court's interpretation of legislative intent is based on the ordinary meaning of the statute's language unless a different intent is expressed clearly); *In re* Conservatorship of Chisolm, 973 P.2d 261, 263 (N.M. Ct. App. 1998) (stating that the process of judicial statutory interpretation should include a reading of the entire legislative act and a consideration of each provision relative to the others).

187. *See* 1983-1986 Op. Att'y Gen. N.M. 155 (1984) (concluding that under the UTA, only a court, on a case-by-case basis, could relieve a trustee from liability for illegal self-dealing).

188. This assertion assumes the logical proposition that the New Mexico legislature was aware of the state court's rules of statutory interpretation and desired the ordinary

Accordingly, the *Tays* court's disregard of this intent and the plain language of the statutes[189] in favor of a rule drawn from inapposite case law[190] is perplexing. Whether this action foreshadows the fate of North Carolina's self-dealing ban should a beneficiary petition for its application remains to be seen.[191]

Tays demonstrates how the courts can re-invent a statute that has little active support,[192] and it also provides further evidence of a national trend toward the relaxation of many statutory safeguards erected by fiduciary laws.[193] For North Carolina, determining the origin of the movement toward easing those safeguards is the first step in evaluating whether the state should relax its prohibition on trustee self-dealing. Then the arguments both for and against giving either the settlor or the beneficiary the power to permit trustee self-dealing should be considered in the context of that movement.

Several explanations account for the trend toward easing the restrictions on the corporate trustee.[194] First, America has entered the "Age of the Individual Investor,"[195] in which investors have unprecedented access to financial information and markets.[196] Comprehensive financial information, once accessible by only bankers and brokers, is available today from numerous media outlets.[197] The increased supply of financial information reflects an

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language of the UTA to express its intent.

189. *See* N.M. STAT. ANN. §§ 46-2-5, 46-2-14, 46-2-15, and 46-2-16 (Michie 1997 Supp.). These statutes codify the language of the UTA. *See* UNIF. TRUSTS ACT §§ 5, 17–19, 7B U.L.A. 763 (1985).

190. *See supra* notes 172–78 and accompanying text.

191. The *Tays* decision demonstrates the possibility that if the North Carolina legislature does not act to establish expressly that the self-dealing prohibition supplants the common law exceptions, a beneficiary seeking the statute's protection may find himself a victim of the self-dealer's good faith.

192. Because North Carolina does not appear to have empowered section 36A-66 of the North Carolina General Statutes since *Wachovia Bank & Trust*, 269 N.C. 701, 153 S.E.2d 449 (1967), a *Tays*-like scenario could occur.

193. *See* Joel C. Dobris, *Changes in the Role and the Form of the Trust at the New Millenium, or, We Don't Have To Think of England Anymore*, 62 ALB. L. REV. 543, 548–60 (explaining that "there seems to be an erosion in fiduciary responsibility in the trust world"); *supra* notes 88–89 and accompanying text (discussing statutory exceptions to North Carolina's self-dealing ban); *supra* notes 97–102 and accompanying text (discussing the easing of Depression Era restrictions on corporate combinations of investment companies, banks, and insurance companies).

194. This Comment has referred to the lifting of the prohibition as "allowing the settlor" or "giving the settlor" the power to permit trustee self-dealing as if the settlor was actually receiving something. In reality, the trustee gains something as well—relief from liability for increasing its profits from a party who will not bear the burden in the future.

195. Joseph Nocera, *Power to the People*, FORTUNE, Oct. 11, 1999, at 124, 127.

196. *See id.*

197. Examples include newspapers (*Wall Street Journal*), magazines (*Fortune*, *Money*

increased demand for such information. In 1999, forty-eight percent of American households owned stock, up from only twenty-eight percent in 1989.[198] Additionally, more than twelve percent of American investors are now buying and selling their stock online without the aid of a stockbroker.[199] The world of stocks and bonds is no longer the exclusive province of Wall Street.[200] Investing has "become an integral part of everyday life in middle-class America."[201]

The second change is the recent trend toward full-service financial companies. In the not too distant past, insurance companies, brokerage firms, and banks were all separate entities, referring clients to one another as necessary. As brokerage and insurance firms recognized the natural connection between investment and insurance products, they began evolving into providers of "comprehensive financial services."[202] Tightening competition for the investment dollar caused these rapidly expanding financial service companies to seek to offer their clients an increasing array of asset management options. It soon became clear that the ability to provide banking services, in addition to investments and insurance, would complete their financial services offering and enable the companies to retain all fees and commissions generated by their clients.[203] Until recently, however, Depression Era legislation prohibited the affiliation of banks with these comprehensive financial service providers.[204] The Gramm-Leach-Bliley Act[205] repealed the bulk of that legislation and opened the door for competition between corporations providing a complete package of financial services.[206]

The third major difference which might explain the current movement to relax the self-dealing ban is that the stock market crash

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Magazine, *Kiplinger's*), television (CNBC, CNN-fn), radio (Motley Fools, Investor's Weekly), and internet (etrade, ameritrade).

198. *See* Andy Sewer, *A Nation of Traders*, FORTUNE, Oct. 11, 1999, at 116, 118.

199. *See id.*

200. *See id.* ("For much of the nation's history . . . Wall Street has had a monopoly on all facets of the capital markets. It controlled not only the financing of America's companies . . . but also the investments of individuals.").

201. Nocera, *supra* note 195, at 127 ("People talk about the market now in the same way they talk about their health or their kids' schools or the weather. They tune in to CNBC. They have their portfolios constantly updated on their office computers .... [Investing] has become part of the popular culture.").

202. *See* Ottinger, *supra* note 96, at 10.

203. *See* Keegan, *supra* note 98, at 16–17.

204. *See* Act of June 16, 1933, ch. 89, § 20, 48 Stat. 88, *repealed by* the Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, 1999 U.S.C.C.A.N. (113 Stat.) 1341.

205. *See supra* note 99 and accompanying text.

206. *See* Ottinger, *supra* note 96, at 12. *See also supra* notes 99–102 and accompanying text (discussing the trend toward mega companies).

of 1929 and the Great Depression that followed are no longer a part of the collective memory of the nation. Because the crash occurred over seventy years ago, the majority of Americans have no first-hand knowledge of the financial environment that gave rise to the darkest economic period in American history. The UTA was approved in the aftermath of the Depression when many analysts pointed to the overlap between commercial banks and securities firms as a primary reason for the crash.[207] At that time, a law prohibiting trustees, individual or corporate, from dealing with affiliated entities without court supervision was thought not only wise, but necessary.[208] Since then, economists have discounted the role that the connection between banks and broker-dealers played in the crash.[209] The late 1990s were a period of great public confidence in the stock market.[210] Other financial institutions, most guaranteed by federal deposit insurance, enjoyed similar levels of public confidence.[211] The stock market crash of 1929 and the economic instability which precipitated it no longer seem relevant to financial activity today.

Modern investment opportunities and the resulting desire for professional trust management are important considerations in the formulation of a self-dealing rule. The UTC attempts to fulfill one of the primary objectives of trust law—giving effect to the settlor's intent[212]—by allowing the express terms of the trust to control.[213] In

207. *See* Investment Co. Inst. ("ICI") v. Camp, 401 U.S. 617, 629 (1971) ("Even before the passage of the [Glass-Steagall] Act it was generally believed that it was improper for a commercial bank to engage in investment banking directly."); *see also* Hazen, *supra* note 114, at 6–7; JONATHAN HUGHES & LOUIS P. CAIN, AMERICAN ECONOMIC HISTORY 499 n.22 (5th ed. 1998) (noting that the participation of commercial banks in the securities business was viewed by many as a precipitating factor in the 1929 stock market crash).

208. *See ICI*, 401 U.S. at 630–31 (discussing the legislative history of the Glass-Steagall Act and noting that congressional legislators in the early 1930s feared that if banks were allowed to affiliate with investment firms, the "pressure to sell a particular investment and to make the affiliate successful might create a risk" that banks would engage in impermissible and unsound self-dealing practices); *see also* 75 Cong. Rec. 9912 (1931) (Remarks of Sen. Bulkley) ("[T]he promotional needs of investment banking might lead commercial banks to lend their reputation . . . to the enterprise of selling particular stocks and securities . . . . [T]here can be no doubt that the whole transaction tends to discredit the bank and impair the confidence of its depositors.").

209. *See generally* HUGHES & CAIN, *supra* note 207 ("Modern research fails to reveal any evidence that the 1929 crash or the ensuing depression had been aggravated by the relationship [between commercial and investment banking.]"). *Accord* HERMAN, *supra* note 121, at 12 (stating that while the 1929 stock market crash and the depression that followed revealed abuses the system of securities trading, only a few were "related to the linkage of banks and investment banking affiliates").

210. *See supra* notes 195–201 and accompanying text.

211. *See id.*

212. *See infra* note 260 and accompanying text.

theory, the UTC gives the settlor the power to impose or relieve almost any conditions or restrictions.[214] Yet, in practice, the aforementioned need for the expertise of corporate trustees casts doubt on the extent of the voluntariness of the settlor's inclusion of a self-dealing power in the trust instrument. The UTC's approach presumes that the settlor would be able to choose *not* to allow his trustee to self-deal once the ban is lifted. Some trust companies with investment firm affiliates already require a provision granting them the power to self-deal in the trust instrument.[215] A legal sanction of these presently forbidden transactions is unlikely to lessen the corporate trustee's insistence on such a clause. As the trust arms of large financial institutions become the predominant provider of trust services,[216] settlors in North Carolina who desire a corporate trustee may have no choice but to grant that trustee the power to self-deal.

In a recent law review article,[217] Professor Charles Bryan Baron claims that allowing the terms of the trust to control promotes judicial economy. He asserts that upholding the terms of the trust, while superimposing a general duty of good faith and fair dealing on the trustee, is a more effective and efficient use of judicial resources.[218] To illustrate his argument, Baron cites the Texas case of *Interfirst Bank Dallas, N.A. v. Risser*.[219] In that case, the corporate trustee, Interfirst, sold trust property to one of its debtors, Southwest Pump Company (Southwest), at well below market price.[220] Southwest then resold the property to one of its shareholders.[221] This sale enabled the shareholder to retain control of Southwest, thereby ensuring that Southwest would be able to repay the loans owed to Interfirst.[222] Although the transaction between Interfirst and Southwest did not meet the strict statutory requirements for self-dealing, the Texas

213. *See* UNIF. TRUSTS CODE § 104(b) (2000).

214. *See id.* There are a few items that the terms of the trust may not alter. For example, the terms may not alter the requirements for creating the trust (§ 104(b)(1)), the requirement that the trust and its administration be for the benefit of the trust's beneficiaries (§ 104(b)(3)), or the requirement that the trustee keep the qualified beneficiaries reasonably informed (§ 104(b)(7)).

215. *See supra* note 109 and accompanying text.

216. *See supra* note 131 and accompanying text.

217. See Charles Bryan Baron, *Self-Dealing Trustees and the Exoneration Clause: Can Trustees Ever Profit From Transactions Involving Trust Property?*, 72 ST. JOHN'S L. REV., 43, 79–80 (1998).

218. *See id.* at 80.

219. 739 S.W.2d 882 (Tex. App. 1987).

220. *See id.* at 895.

221. *See id.* at 887.

222. *See id.* at 896.

Court of Appeals affirmed the lower court's determination that the transaction involved self-dealing.[223]

Baron states that by extending the definition of self-dealing to transactions outside those specified in the statute, the court in *Interfirst* rendered the term "superfluous and meaningless."[224] He claims that since the transaction at issue was technically outside the scope of the statutory prohibition, the court relied on Interfirst's bad faith to bring the trustee's actions within those prohibited by the statute.[225] In doing so, Baron concludes that the *Interfirst* court "transformed the analysis of non-statutory self-dealing into a befuddled good-faith analysis as opposed to a self-dealing analysis."[226] This approach wastes judicial resources by forcing courts to consider the fairness of transactions which fall outside the statutory definition of self-dealing.[227]

Baron seems to imply that the presence of a good faith standard, when the trust instrument permits self-dealing, would lead to less litigation than a statutory prohibition that precludes the trust from giving the trustee the power to self-deal. Examining three different situations in light of the two alternatives demonstrates the weakness of this proposition. First, consider a transaction in which the trustee buys property for itself directly from the trust. Under a statutory prohibition against self-dealing, the transaction is clearly illegal; the only issue before the court would involve damages. But without a statutory prohibition, the court must consider evidence concerning whether the trustee acted in good faith. Consequently, a statutory prohibition conserves judicial resources in this context.[228]

Next, consider a scenario where the trustee enters into a transaction that is clearly not self-dealing yet appears to have been a

223. *See id.* at 899–900. Section 113.053 of the Texas Property Code defined a prohibited self-dealing transaction as one in which the trustee bought or sold trust property from or to itself. Because the court did not characterize Southwest as a business associate of Interfirst, the transaction technically did not involve self-dealing. The court found, however, that the circumstances surrounding the sale and Interfirst's improper motive were sufficient to support the jury's determination that Interfirst had engaged in illegal self-dealing. *See id.* at 899. Additionally, the court found the evidence sufficient to support the conclusion that Interfirst had acted in bad faith in making the sale to Southwest, which also constituted a breach of its fiduciary duty to the beneficiaries. *See id.* at 905.

224. Baron, *supra* note 217, at 79.

225. *See id.*

226. *Id.*

227. *See id.* at 80.

228. One might also argue that the statutory prohibition discourages suits by assuring the self-dealer of the outcome and thereby encouraging settlement.

bad deal for the beneficiaries. The prohibition is not implicated, and the court would employ whatever standard the jurisdiction dictates for evaluating investment decisions. Judicial resources would be neither conserved nor wasted, notwithstanding the existence of a self-dealing statute.

Finally, consider a situation similar to the *Interfirst* case, which is technically outside the statutory prohibition but clearly tainted by a self-dealing motive. In a jurisdiction which prohibits self-dealing by statute, the court may either refuse to invoke the statute and look to other grounds, such as fairness and good faith, for finding liability,[229] or it may expand the statutory definition of self-dealing to include the transaction.[230] If the court looks to other grounds, it mimics the work undertaken by the court whose jurisdiction has no statute prohibiting the transaction. If, instead, the court enlarges the statutory definition, then while it is possible that it must use more judicial resources initially, presumably trustees will avoid the conduct that the court ruled unlawful, thus preserving future resources.

The foregoing analysis suggests that the enforcement of a statutory prohibition on self-dealing will not result in the increased use of judicial resources.[231] An approach that calls for a

229. This is the course chosen by the *Interfirst* court. *See supra* notes 223–26 and accompanying text.

230. Baron suggests that a court is incapable of expanding the statutory definition. *See* Baron, *supra* note 217, at 80. In fact, the opposite is true. Courts often construe statutes either more or less broadly than their language would suggest is appropriate. *See* Maxwell O. Chibundu, *Structure and Structuralism in the Interpretation of Statutes*, 62 U. CIN. L. REV. 1139, 1140–41 (1994) (describing the Third Circuit's "revisionist" interpretation of federal securities laws); Carlos J. Cuevas, *Public Values and the Bankruptcy Code*, 12 BANK. DEV. J. 645, 646 (1996) (claiming that the United States Supreme Court has occasionally altered its interpretation of the Bankruptcy Code to achieve "the right result"); Mark J. Garwin, M.D., *Immunity in the Absence of Charity: EMTALA and the Eleventh Amendment*, 23 S. ILL. U. L.J. 1, 4 (1998) (claiming that overly broad judicial interpretations of EMTALA have often extended the Act well beyond its original purpose); Laurie L. Levenson, *Good Faith Defenses: Reshaping Strict Liability Crimes*, 78 CORNELL L. REV. 401, 411 n.61 (1993) (calling the Ninth Circuit's allowance of a defense not provided for by statute a "surprising display of judicial activism"). *Tays v. Metler*, No. 97-2317, 1999 U.S. App. LEXIS 4769 (10th Cir. March 19, 1999), and *Interfirst Bank Dallas, N.A v. Risser*, 739 S.W.2d 882 (Tex. App. 1987), are two cases that illustrate the wide possibilities of outcomes when courts consider statutes prohibiting trustee self-dealing. *See supra* note 164 (explaining the *Tays* court's finding of no liability for a self-dealing trustee); *supra* note 223 (explaining the *Interfirst* court's expansive treatment of Texas' self-dealing prohibition).

231. A comparison of the amount of appellate case law addressing the self-dealing issue in "good faith" jurisdictions and that in North Carolina, Nevada, and New Mexico reveals far fewer appellate cases in North Carolina. *See supra* note 162 and accompanying text (describing the Tenth Circuit's difficulty in finding applicable case law in New Mexico—a statutory prohibition state).

determination of the trustee's intent in every case is more wasteful than one that quickly dispenses with the issue in at least some cases. Thus, contrary to Professor Baron's conclusion, the good faith standard tends to "produce litigation,"[232] not a statutory ban on trustee self-dealing.

Trustee self-dealing may allow the trust to avoid some costs that would otherwise attend certain transactions and to pass the savings on to the trust.[233] On the other hand, the benefits reaped by the trustee as a result of the self-dealing may not be as detectable.[234] Additionally, the added cost to the beneficiaries, in terms of time and money, of scrutinizing self-dealing transactions for an "unfair" or "imprudent" amount of trustee self-interest may be greater than any savings on fees.[235] Ultimately, North Carolina beneficiaries may be better off paying the higher but clearly disclosed fees to third parties and retaining their trustee's undivided loyalty.

Some commentators argue that the UTC's reliance on the prudent investor standard[236] and the duty of good faith[237] is sufficient to protect the interests of beneficiaries from harm due to trustee self-dealing. Professor Baron, for example, claims that if the transaction is one that is reasonable to a prudent investor, and if the terms are such that the transaction is fair to the beneficiaries, then the identity of the party with whom the trust is dealing is irrelevant.[238] If the trustee fails to meet either of these standards, the beneficiaries have a

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232. Gordon v. Finlay, 10 N.C. 239, 242 (1824).

233. For example, by dealing with affiliates, corporate trustees may be able to employ economies of scale to reduce certain fixed costs.

234. *See supra* notes 122–29 and accompanying text (discussing the difficulty in ascertaining the benefit to the trustee and the resulting detriment to the beneficiaries from any particular self-dealing transaction).

235. *See infra* notes 236–41 and accompanying text (discussing the protective capabilities of the fairness and prudent investor standards as applied to self-dealing transactions).

236. *See* UNIF. PRUDENT INVESTOR ACT § 2, 7B U.L.A. 62 (1985) (Supp. 1999) (requiring the trustee to manage the trust as a prudent investor would). *See* UNIF. TRUST CODE cmt. (Interim Draft, Oct. 1999). The Uniform Prudent Investor Act enlarges the common law scope of permissible investment activities in which the trustee may engage. *See Why States Should Adopt... The Uniform Prudent Investor Act* (visited September 1, 2000) <http://www.nccusl.org/uniformact_why/uniformacts-why-upia.htm>. For a practical guide to the Prudent Investor Act and its impact on trust management, see TRAIN & MELFE, *supra* note 14, at 25–34.

237. *See* UNIF. TRUST CODE § 801 (2000); *supra* note 135 and accompanying text (discussing the trustee's duty to exercise its powers in good faith).

238. *See* Baron, *supra* note 217, at 80. *But see* Scott, *supra* note 111, at 544 (arguing that allowing trustee self-dealing under any circumstances is dangerous for the beneficiaries).

cause of action even in the absence of trustee self-dealing.[239] This argument assumes that the beneficiaries have the expertise to determine whether an investment scheme is prudent; it also presumes that a bad faith transaction is readily apparent.[240] Unfortunately, there is no guarantee that either of these presumptions will be true.

Presuming that the UTC is widely accepted, adopting the UTC could bring North Carolina law into uniformity with the majority of states.[241] Jurisdictions without a statute prohibiting the settlor from granting the power to self-deal, however, treat trust clauses that exonerate the trustee from liability in varying ways.[242] In states that expressly permit trustee exoneration clauses, the courts have attempted to erect some safeguards for the settlor and beneficiaries by holding that a broad statement of release from liability is insufficient to establish that the settlor intended to allow the trustee to self-deal.[243] Permission to self-deal must be given in "clear and unmistakable language" in order to relieve the trustee from liability.[244] Additionally, even if the trust instrument permits self-dealing, the courts in these states insist that the trustee must still

239. *See* UNIF. PRUDENT INVESTOR ACT, § 2, 7B U.L.A. 62, 1985 (Supp. 1999) (prudent investor rule); UNIF. TRUST CODE § 801 (2000) (duty to administer the trust in good faith).

240. *See supra* notes 122–27 and accompanying text (discussing the hidden dangers of trustee self-dealing to beneficiaries).

241. Only six states, including North Carolina, adopted the 1937 Uniform Trust Act. The six states are listed as follows: Louisiana (codified as LA. REV. STAT. ANN. §§ 9:1725, 9:2062, 9:2063, 9:2065, 9:2084–9:2086, 9:2112, 9:2114, 9:2122, 9:2124–9:2126, 9:2196, 9:2207, and 9:2208 (West 1991)); Nevada (codified as NEV. REV. STAT. ANN. § 163.010–163.210 (Michie 1997)); New Mexico (N.M. STAT. ANN. § 46-2-1 to 46-2-19 (Michie 1997 Supp.)); North Carolina (N.C. GEN. STAT. § 36A-60 to 36A-84 (1999)); Oklahoma (codified as OKLA. STAT. tit. 60, § 175.1–.23 (1994)); South Dakota (S.D. CODIFIED LAWS § 55-4-1 to 55-4-36 (Michie 1997)). Of those statutes, all but North Carolina, Nevada, and New Mexico modified the legislation to allow the settlor to relieve the trustee of the self-dealing restriction through express language in the trust instrument. Texas, which did not adopt the UTA, nevertheless has implemented a statute that prohibits the settlor from permitting trustee self-dealing. *See* TEX. PROP. CODE ANN. § 113.059(b) (West 1995) (stating that the settlor may not "relieve a corporate trustee from the duties, restrictions, or liabilities of ... Section ... 113.053 [which prohibits the trustee's sale or purchase of property to or from the trust] of this Act"). The rule has been expanded by courts to prohibit transactions in which, while not buying or selling property from or to itself or affiliate in the strict sense, the trustee gains significant benefit from the transaction. *See* Interfirst Bank Dallas, N.A., v. Risser, 739 S.W.2d 882, 898–99 (Tex. App. 1987) (holding that a sale by the trustee of trust property at less than market value to another corporation so that the buyer might repay debt to the trustee corporation was self-dealing for purposes of the statute).

242. *See* Baron, *supra* note 217, at 72–73.

243. *See, e.g., In re* Anneke's Trust, 38 N.W.2d 177, 183 (Minn. 1949).

244. *Id.* at 183.

adhere to a standard of good faith and fairness to the beneficiaries.[245]

Among the many jurisdictions whose statutes are silent as to the ability of the settlor to exonerate the trustee, the rule of law is not clear.[246] However, at least some courts have upheld the clause as an expression of the settlor's intent.[247] The UTC aims to replace this inconsistent case law with a uniform body of statutory law that will offer the settlor the opportunity to allow his trustee to self-deal.[248] As expressed earlier, the uniformity of the UTC depends upon the extent to which state legislatures adopt the model legislation. Therefore, as with its adoption of the UTA,[249] North Carolina's adoption of the UTC does not guarantee uniformity with the rest of the nation because a significant number of states may not enact the UTC.

Further, if the UTC is adopted by the North Carolina legislature, the new statutes essentially result in a return to the common law rules in place prior to the adoption of the UTA, but worse. A trust provision, giving the trustee the power to self-deal continuously without the consent of either the beneficiaries or the court, does not appear to have been contemplated by North Carolina's common law as an appropriate method of relieving the trustee from liability.[250]

CONCLUSION

As North Carolina enters the Age of the Investor,[251] the state must respond to the financial needs of its citizens but still maintain safeguards for those individuals who must rely on the professional skills of others.[252] For good reason the trust law has been slow to change. The concerns about trustee self-dealing raised as early as 1824[253] are still valid. Rather than toss out almost two hundred years of reasoned jurisprudence in favor of the forthcoming UTC, the

245. *See, e.g.*, Renz v. Beeman, 589 F.2d 735, 744–45 (2d Cir. 1978).

246. *See* Baron, *supra* note 217, at 57–73 (explaining that the legal effect of exoneration clauses varies by jurisdiction and can be influenced by factors other than the trust language).

247. *See, e.g.*, Baron, *supra* note 217, at 68–72 (describing differing approaches to the judicial construction of self-dealing clauses).

248. *See supra* notes 132–41 and accompanying text.

249. *See supra* note 241.

250. An extensive search of pre-1939 appellate case law has not yielded a single case that suggests allowing self-dealing without the consent of the beneficiaries or the court was appropriate.

251. *See supra* note 195 and accompanying text.

252. *See* HERMAN, *supra* note 121, at 14; SHENKMAN, *supra* note 93, at 7.

253. *See* Gordon v. Finlay, 10 N.C. (3 Hawks) 239, 242 (1824) ("Lead us not into temptation .... To make exceptions from the rule in particular cases [because] full value was paid, would produce litigation; and who is there to show full value?").

North Carolina legislature should consider the trust beneficiaries, who will be affected directly, and state residents who rely on fiduciary relationships. Because the trustee/beneficiary relationship has been the paradigm for all other fiduciary relationships, relaxing the ban on trustee self-dealing may diminish fiduciary duties in other contexts.

The first issue to consider is whether North Carolina needs to change its law at all. As discussed previously, there are good reasons for keeping the self-dealing ban in place. However, an apparent misunderstanding among settlors, beneficiaries, and trustees about the ability of a settlor to grant her trustee the power to self-deal is preventing the law from protecting those who should benefit from it: instead, the threat of future liability for trustees and the potential for a court to apply the law incorrectly[254] hang over trustees and beneficiaries alike. Ideally, North Carolina should keep the ban, re-energize it with a current legislative statement of purpose or resolution, and educate practitioners and the public about the illegality of trustee self-dealing.

If the state is unwilling to enforce the ban, then it should be repealed. A wholesale adoption of the UTC, however, is not the only option. As discussed earlier, the most dangerous part of the UTC for beneficiaries is the provision that allows the settlor to give the trustee permission to self-deal in the trust instrument. If that provision was left out of North Carolina's codification, trustees could obtain permission to self-deal without going to court, but only with the informed consent of the beneficiaries. Also, the beneficiaries could revoke that consent if the situation deteriorated, thus restoring some of the balance of power between the beneficiaries and their trustee. This option is a preferable and more logical solution to the problem of the self-dealing ban.

North Carolina should reject the UTC's approach. The suggestion that the change would benefit the settlor, by giving effect to his intent,[255] is reasonable only if one supposes that the settlor intended that his trustee be allowed to use the trust for its own advantage, rather than for that of his beneficiaries.[256] Likewise, no

254. *See supra* notes 152–87 and accompanying text (discussing Tays v. Metler, No. 97-2317, 1999 U.S. App. LEXIS 4769, at *1, (10th Cir. March 19, 1999)).

255. *See supra* notes 212–15 and accompanying text (detailing the argument that allowing the settlor to permit self-dealing through express language in the trust instrument gives effect to the settlor's intent, thereby upholding one of the underlying objectives of trust law).

256. *See supra* notes 212–15 and accompanying text (suggesting that the inclusion of a provision granting the trustee the power to deal with its affiliated securities dealer is indicative only of the settlor's desire to use a corporate trustee and not of a desire to allow

real benefit to the beneficiaries has been demonstrated,[257] yet the potential for injury to their interests is clear.[258] The only party who would unquestionably benefit from the change is the corporate trustee. Thus, the real question that the ultimate fate of section 36A-66 of the North Carolina General Statutes will answer is whether North Carolina believes that the benefit of increased profits for corporate trustees outweighs the potential harm to North Carolina beneficiaries.

Trust law has the following two objectives:[259] (1) to allow the settlor the power to distribute his property as he wishes[260] and (2) to protect the corpus of the trust.[261] Every addition or modification to that body of law should be evaluated in light of those two objectives. The UTC's approach to trustee self-dealing does not promote either of them. While arguably neutral with regard to the settlor's intent,[262] it certainly undermines the beneficiaries' ability to detect and remedy trustee misconduct.[263]

Historically, the fiduciary relationship between a trustee and the beneficiary has served as a classic example of the standard of strict

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his trustee to engage in self-dealing); *supra* notes 122–23 and accompanying text (discussing some of the ways in which a self-dealing trustee could use the trust for its own benefit while still not violating the UTC's fairness and prudent investor standards).

257. One might argue that by allowing the beneficiaries themselves to permit self-dealing transactions after full-disclosure, the beneficiaries benefit by the increased availability of investment options. This argument can be answered in two ways. First, North Carolina statutes allow the beneficiaries to relieve the trustee from liability for past violations of the self-dealing ban. *See* N.C. GEN. STAT. § 36A-79 (1999); *supra* notes 74, 142 (discussing the meaning and intent of that statute). Thus, if the transaction is beneficial to the beneficiaries, they may ratify it after the fact. The beneficiaries are then afforded some protection against trustee self-interest while still retaining the ability to benefit from any special investment opportunity available exclusively from the trustee. Second, the trustee may petition for court approval of any such transaction. *See* Wachovia Bank & Trust Co. v. Johnston, 269 N.C. 701, 716–17, 153 S.E.2d 449, 461 (1967) (holding that the court may grant approval for prohibited self-dealing if certain criteria are met); *see also supra* notes 82–84 and accompanying text (discussing the criteria which the trustee must satisfy in order to obtain court approval). The beneficiaries' desire to enter into the transaction will certainly be considered by the court in determining whether the deal should be allowed.

258. *See supra* notes 235–41, *infra* notes 272–75 and accompanying text (discussing the potential harm to beneficiaries inherent in trustee self-dealing).

259. *See* Lichtenfels v. North Carolina Nat'l Bank, 268 N.C. 467, 477, 151 S.E.2d 78, 84 (1966).

260. *See id.*

261. *See id.*

262. *See supra* notes 212–17 and accompanying text (discussing the self-dealing ban and the settlor's intent).

263. *See supra* notes 122–27, 233–36 and accompanying text (discussing the difficulty beneficiaries have in detecting and proving detrimental self-dealing).

loyalty.[264] The UTC's approach, while purporting to include a duty of loyalty,[265] transforms that historical duty from one of "punctilio of an honor the most sensitive"[266] to one grounded in advantage and profit. If North Carolina accepts that characterization of the trustee's duty of loyalty by adopting the UTC, it will devastate the state's longstanding conception of a fiduciary relationship. Unfortunately for North Carolina citizens, the result will be fiduciaries whose only standards are the "morals of the marketplace."[267]

North Carolina must not yield to pressure from corporate trustees or the NCCUSL to repeal its self-dealing ban and replace it with the UTC. Instead, the state should remind trustees, lawyers, and beneficiaries of its existence and of the limitations the ban places on trustees. The office of trustee is vested with the duty to tend solely to the interests of the beneficiaries. The purpose of the self-dealing prohibition is to remove from the trustee all temptation to act in the interest of any other than its beneficiaries and to thereby prevent fraud.[268] The moment the trustee, through its affiliate, enters into a transaction with the trust for the express purpose of making a profit for itself, the trustee is necessarily acting in its own interest.[269] Merely imposing the nebulous standards of "good faith" and "prudent" investing is insufficient protection for beneficiaries against a self-dealing trustee. Beneficiaries may have little or no opportunity in some transactions to assess the extent to which their interests may have been ignored in favor of the trustee's. The fact that the particular transaction may not prove injurious to the beneficiaries is irrelevant.[270] No longer are the beneficiaries' interests the trustee's sole concern.

The Tenth Circuit's decision in *Tays v. Metler*[271] is especially troublesome. Although unpublished, and thus nonbinding, its holding is a radical departure from the plain meaning of the text of the statute and the communicated legislative intent. Because

264. *See, e.g.*, Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

265. *See* UNIF. TRUST CODE § 802(a) (2000).

266. *Meinhard*, 164 N.E. at 546.

267. *Id.*

268. *See supra* notes 61–64 (explaining the court's motivation for the rule).

269. Of course, the argument may be made that the mere act of serving as a trustee for pay is self-interested; this argument glosses over the fact that the trustee is being paid to administer the trust for the best interests of the beneficiaries and that such pay is intended to be the total benefit accruing to the trustee by virtue of his relationship to the trust.

270. The fact that a security is bought or sold at market price does not mean that no harm has been done the beneficiaries. *See supra* notes 122–29 and accompanying text.

271. No. 97-2317, 1999 U.S. App. LEXIS 4769 (10th Cir. Mar. 19, 1999); *supra* notes 152–61 and accompanying text (discussing the facts and holding of the case).

beneficiaries must look to the judiciary to remedy a trustee's violation of the protections intended by the North Carolina General Assembly, a court's unwillingness to enforce the statutes as they are written could render the legislative process moot. The flawed reasoning in *Tays* must be rejected by the North Carolina state courts and the courts in the other 1937 UTA jurisdictions.

The current economic climate, while producing a more savvy, less risk-averse investing public, nevertheless supports keeping and enforcing the self-dealing ban and rejecting the UTC's approach. The information explosion seen in recent years merely offers beneficiaries the opportunity to evaluate any particular transaction in light of the good faith and prudent investor standards included in the new UTC.[272] Access to market information does not include access to the private motivations of the trustee.[273] Without that, the beneficiaries cannot protect themselves if "the shepherd . . . become[s] a wolf."[274]

This Comment submits that North Carolina should retain and enforce its existing prohibition on trustee self-dealing. If not, it should at least prevent the *settlor* from relieving the trustee from liability for self-dealing transactions. By doing so, North Carolina will preserve the integrity of the fiduciary duty, protect its beneficiaries, and conserve judicial resources.

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272. *See supra* notes 236–38 and accompanying text.
273. *See supra* notes 122–27 and accompanying text.
274. Baron, *supra note* 217, at 78.