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Obedience as the Foundation of Fiduciary Duty

Rob Atkinson

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Obedience as the Foundation of Fiduciary Duty

Rob Atkinson*

I. INTRODUCTION.....	45
II. IDENTIFYING THE DUTY OF OBEDIENCE	47
<i>A. Locating the Duty of Obedience in the Tripartite Scheme of Fiduciary Duties</i>	47
1. <i>Depth</i>	48
2. <i>Breadth</i>	50
3. <i>Length</i>	54
4. <i>Summary</i>	54
<i>B. Locating the Duty of Obedience in Four Fiduciary Contexts</i>	54
1. <i>For-Profit Corporate Law</i>	55
<i>a. The Trilogy of Bilateral Corporate Relationships</i>	55
<i>i. Relationship of the State as Principal to the Corporation's Equity Investors as Agents</i>	55
<i>ii. Relationship of Owners as Principals to Managers as Agents</i>	59
<i>iii. Relations Among Owners: Minority Shareholders Constraining the Majority</i>	62
<i>b. Why Corporate Law Theorists Overlook the Duty of Obedience</i>	63
2. <i>Private Trust Law</i>	64
<i>a. The Trilateral Structure of Trusts</i>	65
<i>b. The Dual Function of Trusts</i>	67
<i>i. The Earning Function</i>	67

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ii. <i>The Spending Function</i>	67
c. <i>The Strong Form of the Duty of Obedience</i>	69
d. <i>Enforcement</i>	71
3. <i>Charitable Trust Law</i>	72
a. <i>Purpose</i>	72
b. <i>Duration</i>	76
c. <i>Enforcement—The Weakness of the Strong Form</i>	78
4. <i>Charitable Corporation Law</i>	79
a. <i>The Corporate Model</i>	80
b. <i>The Trust Model</i>	80
c. <i>The Common Flow of Both Models</i>	81
III. <i>NORMATIVE ANALYSIS: EVALUATING THE DUTY OF OBEDIENCE</i>	82
A. <i>Narrowing the Scope of the Inquiry</i>	82
1. <i>Normative Analysis of the Weak Form of the Duty of Obedience</i>	82
a. <i>The Absence of Any Strong Duty of Obedience in the</i> <i>Business Corporation</i>	83
b. <i>The Strong Duty of Obedience in the Law of Private Trusts</i>	83
B. <i>Dead Hand Control in the Law of Charity</i>	84
1. <i>The Traditional Case for Dead Hand Control</i>	85
a. <i>Deontological Arguments</i>	85
b. <i>Consequentialist Arguments</i>	86
2. <i>The Positive Alternative to Dead Hand Control: Charitable Independence</i>	87
3. <i>The Wrong Solution to a Real Problem: Dead Hand Control Against</i> <i>Fiduciary Bias Toward Current Expenditure</i>	87
IV. <i>RECOMMENDATIONS FOR REPLACING DEAD HAND CONTROL OF CHARITABLE</i> <i>ASSETS</i>	89
A. <i>Individual Monitors</i>	90
1. <i>Default Takers Policing Restricted Gifts</i>	90
2. <i>The Traditional Charitable Visitor</i>	91
B. <i>Institutional Monitors</i>	92
1. <i>Creating For-Profit Firms</i>	92
2. <i>Expanding Governmental Supervision</i>	95
3. <i>Monitoring Charity with Charity</i>	96
V. <i>CONCLUSION</i>	97

I. INTRODUCTION

Commentators, both doctrinal and theoretical,¹ have come to agree that the fiduciary relationship rests on twin pillars, the duty of care and the duty of loyalty. This paper argues that a third duty, obedience, is more basic, the foundation on which the duties of care and loyalty ultimately rest. In place of the prevailing dualistic theory of fiduciary duty, it offers a trinitarian alternative. As in traditional trinitarianism, the claim here is that, properly understood, three identifiably different elements are, essentially, one.

In that sense, fiduciary trinitarianism is, to shift metaphors from theology to physics, a unified field theorem of fiduciary duty. As in physics, the theory offered here takes up a double challenge: to explain more data—in this case, more legal doctrine and social policy—more simply. The ideal, here as there, will be to reduce all the relevant phenomena to a single, unifying principle. Physicists have yet to name their fundamental force; in the fiduciary relationship, it is the agent's duty to obey the will of the principal.²

1. John H. Langbein, *The Contractarian Basis for the Law of Trusts*, 105 YALE L.J. 625, 655 (1995) [hereinafter Langbein, *Contractarian Basis*] (“The law of fiduciary administration, the centerpiece of the modern law of trusts, resolves into two great principles, the duties of loyalty and prudence.”). As Langbein points out, “[s]ubrules of fiduciary administration abound,” but “[a]ll these rules are subsumed under the duties of loyalty and prudence, they are means of vindicating the beneficial interest.” *Id.* at 656; see also 1 AM. LAW INST., PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS & RECOMMENDATIONS pt. IV, introductory note c, at 137 (1994) [hereinafter PRINCIPLES] (“The legal obligations of directors and officers have traditionally been divided into the duty of care and the duty of loyalty. . . .”); COMM. ON NONPROFIT CORPS., ABA SECTION OF BUS. LAW, GUIDEBOOK FOR DIRECTORS OF NONPROFIT CORPORATIONS 19 (George W. Overton & Jeannie Carmedelle Frey eds., 2d ed. 2002) (“The duty of care and the duty of loyalty are the common terms for the standards which guide all actions a director takes.”); Melanie B. Leslie, *Trusting Trustees: Fiduciary Duties and the Limits of Default Rules*, 94 GEO. L.J. 67, 95 (2005) (listing “the duty of care and the duty of loyalty” as “the two most basic duties of trust law”).

Some commentators—including even the most explicit dualists—sometimes identify a third duty as fundamental, particularly in the law of private trusts: impartiality, or the duty to treat all beneficiaries with equal consideration. See, e.g., John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 NW. U. L. REV. 1105, 1122 (2004) [hereinafter Langbein, *Mandatory Rules*] (listing impartiality as one of three “core duties” along with loyalty and prudence). As we shall see, this duty, too, can be shown to derive from the duty of obedience. See *infra* Part II.B.2.b.ii.

2. Following other analysts of fiduciary duty, I use “principal” and “agent” here in a more general sense than that of the principal-agent relationship in Anglo-American legal doctrine. See, e.g., Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 306 (1976); see also Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227, 233 (“Corporations, whether for-profit or nonprofit, and trusts, whether private or charitable, are contractual relationships in which a principal (a shareholder or a donor, a founder or a settlor) contracts with an agent (a director, a trustee) to provide some service.”).

This broader sense of “principal” includes all those to whom the fiduciary is primarily answerable. These would include not only principals in the narrow sense, but also such others as the shareholders of business corporations, see PRINCIPLES, *supra* note 1 (“So . . . because the directors have ultimate control over the corporation [with narrow exceptions], they do not stand in the traditional relationship of agent to principal.”), and the settlors of private and charitable trusts. RESTATEMENT (THIRD) OF TRUSTS § 5(e) (2003) (distinguishing trustees from agents). As we shall see below, fiduciaries are sometimes secondarily answerable to an analytically distinguishable set of third parties, typically those known in the Anglo-American law of trusts as beneficiaries, but also including such related classes as wards in the law of guardianship and conservatorship and third-party beneficiaries in the law of contract. See Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621, 638–40 (2004) (noting tension between trustees’ fiduciary obligations to settlors and beneficiaries).

Obedience to that will is the source not only of the duties of care and loyalty, but also of a peculiar but widely ignored obligation. This is the duty of private and charitable trustees to follow the directions of principals who are dead, a duty that gives principals what is known in Anglo-American law as dead hand control. As we shall see, this peculiar obligation occurs outside the principal scope of the prevailing dualist theory. That theory, largely economic in its method, has tended to focus on for-profit organizations, particularly business corporations, and to assimilate other fiduciary relationships, especially private trusts and charitable organizations, to the corporate model. This paper reverses that process of analysis. It shows how a close examination of the law of trusts, charitable as well as private, throws useful light on the law of corporations, both for-profit and nonprofit. Trinitarian theory accounts for both the presence of dead hand control in private and charitable trusts and its absence in business organizations.

Part II identifies the duty of obedience in three basic steps. First, and most importantly, it shows how the duty of obedience underlies the duties of care and loyalty. Next, it distinguishes two forms of the duty of obedience, the strong and the weak. The strong form of the duty of obedience is dead hand control, the legally enforceable duty of living fiduciaries to follow the dictates of principals who are no longer alive. The weak form of the duty of obedience, on the other hand, is, essentially, nothing more than the ordinary law of contracts and agency. Under that law, private parties may impose obligations enforceable after their deaths both by and on behalf of surviving private parties, but neither by nor on behalf of the decedents themselves. With the weak form of the duty of obedience, in other words, the dead can pass control of property on to others, but the dead cannot take that control with them.

Finally, Part II locates these two forms of the duty of obedience, the strong and the weak, in four kinds of fiduciary relationships: for-profit corporations, private trusts, charitable trusts, and charitable corporations.³ Each organizational form, we shall see, sheds important light on the others. In its weak form, the duty of obedience is universal in—indeed, essential to—all fiduciary relationships. In its strong form, by contrast, the duty of obedience is far from ubiquitous. It is found in the Anglo-American law of private trusts and charitable trusts, but not in the Anglo-American law of for-profit corporations. As a supposed corollary of charitable trust law, charitable corporation law sometimes includes a “strong” duty of obedience; American authorities are seriously divided on this point. To resolve this dispute, we have to turn from descriptive to normative analysis, from identifying to evaluating the strong form of the duty of obedience.

Part III takes up that normative analysis. It concedes, *arguendo*, that dead hand control serves a useful social purpose in the context of private trusts. But it shows that the

3. Not all nonprofit corporations, it should be noted, are charitable. As we shall see below, charities, whether organized as trusts or as corporations, must serve a legally recognized public purpose; non-charitable nonprofit corporations can, under the typical statute, serve any legal purpose. See REVISED MODEL NONPROFIT CORP. ACT § 3.01(a) (1987) (“Every corporation incorporated under this Act has the purpose of engaging in any lawful activity unless a more limited purpose is set forth in the articles of incorporation.”). On the relationship between charities and other nonprofit organizations, see John Simon, *The Tax Treatment of Nonprofit Organizations: A Review of Federal and State Policies*, in *THE NONPROFIT SECTOR* 67, 69 (Walter Powell ed., 1987).

same rationale cannot justify dead hand control of charitable assets, and it finds that the other rationales usually offered are no more compelling. Rather, the arguments against dead hand control of charitable assets substantially outweigh those in its favor. Accordingly, Part III concludes that the law of charities, both trust and corporate, should eliminate the strong form of the duty of obedience, thus removing legally enforceable dead hand control of charitable assets.⁴

As the absence of dead hand control in the business corporation reminds us, this would hardly be unprecedented. This is not to say, however, that precisely the same policy considerations apply in both contexts. Charities are, at their very root, different from for-profit entities. Charities, as a subset of the more inclusive class of nonprofit organizations, have no residual private “owners”; their distinguishing feature is control by fiduciaries for the public benefit. For-profit corporations, as a subset of for-profit entities, are residually owned and ultimately controlled by private parties, in their private capacities, for their private benefit.

These differences mean that eliminating the strong form of the duty of obedience in charities will necessarily produce a different end state, in either of two directions. On the one hand, control of the charity could come to rest in the charitable fiduciaries themselves. Those fiduciaries would be free to use the charitable assets in their control for any charitable purpose, subject, of course, to the duties of care and loyalty. This is the situation I have called for elsewhere,⁵ but it is a situation rife with problems.⁶ On the other hand, control could come to rest outside the charity, either elsewhere in the nonprofit sector or somewhere in the public or private sectors. The final part of the paper briefly examines these policy options and concludes that, on balance, charities’ changes of purpose are best monitored by other charities.

II. IDENTIFYING THE DUTY OF OBEDIENCE

A. Locating the Duty of Obedience in the Tripartite Scheme of Fiduciary Duties

Our first task is to locate the duty of obedience in relation to the two more generally recognized fiduciary duties in Anglo-American law: the duty of care and the duty of loyalty. As a preliminary step, it will be helpful to think of fiduciary duties as having three dimensions: depth, breadth, and length. The following subsections explore these three dimensions in detail. In each dimension, we shall see, the duty of obedience is more extensive than the duties of care and loyalty; the duty of obedience is, in other words,

4. This leaves aside, you will have noticed, my normative position on the strong form of the duty of obedience in private trusts. Very briefly, it is this: Deceased donor directions as to the disbursement and management of family property should generally be honored, but only for a period reasonably foreseeable by the donor (and, I am inclined to add, only in the case of family members in their minority or suffering from some identified degree of mental incompetence). In this position (except perhaps for the parenthetical) I am in general agreement with Adam J. Hirsch & William K.S. Wang, *A Qualitative Theory of the Dead Hand*, 68 IND. L.J. 1 (1992).

5. Rob Atkinson, *Reforming Cy Pres Reform*, 44 HASTINGS L.J. 1111, 1142–48 (1993).

6. See Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457 (1996) (discussing the challenges facing nonprofit organizations); Manne, *supra* note 2, at 237–40 (discussing the challenges of enforcing nonprofit directors’ fiduciary duties).

deeper, broader, and longer.

1. Depth

The duty of obedience is often overlooked⁷ or included in one of the other two fundamental fiduciary duties,⁸ precisely because it is so basic as to be almost invisible. To see why this is so, we need to examine the very foundation of fiduciary duty. The irreducible root of the fiduciary relationship is one person's acting for⁹ another.¹⁰ The duty of obedience derives directly from—indeed, is virtually synonymous with—that basic principle. The root of the fiduciary relationship is this directive from the principal to the fiduciary: Serve the one the principal designates, as the principal designates.¹¹ The fiduciary must, at the most basic level, obey that directive; that directive is the duty of obedience.¹²

Seen from this perspective, the duties of loyalty and care are derivative from, and

7. See *supra* note 1 and accompanying text (discussing fiduciary duties).

8. Evelyn Brody, *Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400, 1406 n.30, 1475 (1998) (noting and adopting tendency to subsume the duty of obedience under the duties of care or loyalty); cf. Peggy Sasso, *Searching for Trust in the Not-for-Profit Boardroom: Looking Beyond the Duty of Obedience to Ensure Accountability*, 50 UCLA L. REV. 1485, 1520 (2003) (“The first two duties [care and loyalty] exist in for-profit corporate law while the third [obedience] is unique to the not-for-profit sector.”). Commentators sometimes try to reduce loyalty to care, see UNIF. PRUDENT INVESTOR ACT § 5 cmt. (1994) (“The concept that the duty of prudence in trust administration . . . entails adherence to the duty of loyalty is familiar.”), or care to loyalty. AMER. LAW INST., PRINCIPLES OF THE LAW OF NONPROFIT ORGANIZATIONS § 300, cmt. g(3) (Tentative Draft No. 1, 2007) [hereinafter NONPROFIT PRINCIPLES] (noting that “some commentators place the obligation to obey the law and the organizational documents and policies under a third duty unique to charity fiduciaries, the ‘duty of obedience,’” and that “. . . [t]hese Principles . . . do not employ the terminology of duty of obedience”). See Deborah A. DeMott, *Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences*, 48 ARIZ. L. REV. 925, 926 (2007) (arguing that “the law applicable to fiduciary duty can best be understood as responsive to circumstances that justify the expectation that an actor’s conduct will be loyal to the interests of another”).

9. This preposition contains, or conceals, a critical ambiguity. As we shall soon see, “for” in this context can mean either “on behalf of” or “for the benefit of”; clarifying this ambiguity is the key virtue of a three-part, as opposed to two-part, taxonomy of fiduciary duty.

10. Commentators have long sought “one defining criterion to specify the circumstances or define the relationships that warrant the imposition of fiduciary duties.” DeMott, *supra* note 8, at 934 (internal citations omitted). This quest has proved quixotic because, as DeMott points out, “the characteristics of even the standard or conventional fiduciary relationships . . . are too varied to enable one to distill a single essence or property that unifies all in any analytically satisfactory way.” *Id.* at 934–35. The goal of this paper, by contrast, is not to identify a single feature of all the circumstances in which fiduciary duties are (or should be) recognized, but rather to isolate the internal architecture of those duties themselves. Stated more positively, the relationship of the two projects is this: In whatever situations that project identifies as appropriate for the imposition of fiduciary duties, those duties will function in relation to each other as this project outlines.

11. Or, as we shall see with respect to fiduciaries who are also beneficiaries, “serve yourself as if you were another,” or, still more precisely, “you, in your capacity as fiduciary, serve yourself, in your capacity as beneficiary, not according to your own rights, but according to the directions of your principal.”

12. This is implicit in the first and fundamental duty articulated in the American Law Institute’s *Principles of Corporate Governance*. See PRINCIPLES, *supra* note 1, pt. II, § 2.01(a) (stating that with limited, listed exceptions, “a corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.”); see also UNIF. TRUST CODE § 105(b)(2) (amended 2005) (listing among mandatory trust rules “the duty of a trustee to act in good faith and in accordance with the purposes of the trust . . . and the interests of the beneficiaries”).

grounded upon, the more fundamental duty of obedience. The duty of care requires, as the very term suggests, that fiduciaries must, upon pain of legal penalties, manage the assets committed to them at the direction of another with at least a legally mandated degree of effort and skill—in a word, care.¹³ Even more basically, the duty of loyalty requires fiduciaries to manage the assets in their care for the good of those whom the principal designates, not for their own private, personal gain or for the advantage of third parties.¹⁴

If fiduciaries are to benefit the parties designated by their principals, the core of the duty of obedience, then they must not violate the duty of care by stealing or diverting the assets in their hands, and they must not violate the duty of care by affirmatively wasting or unreasonably jeopardizing those assets. These are the three analytic essentials; you cannot have a fiduciary relationship without them, any more than you can have a triangle without three sides.¹⁵ And at the base of the fiduciary triangle is the duty of obedience: to benefit those designated by another, one must be both loyal and careful.¹⁶

13. RESTATEMENT (THIRD) OF TRUSTS § 227 (2003) (discussing the Prudent Investor Rule); see Langbein, *Contractarian Basis*, *supra* note 1, at 656 (discussing the duties of loyalty and prudence); PRINCIPLES, *supra* note 1, pt. IV, § 4.01(a) (“A director or officer has a duty to the corporation to perform . . . in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position under similar circumstances.”).

14. See UNIF. TRUST CODE § 802 cmt. (“A trustee owes a duty of loyalty to the beneficiaries, a principle which is sometimes expressed as the obligation of the trustee not to place the trustee’s own interests over those of the beneficiaries.”); UNIF. PRUDENT INVESTOR ACT § 5 cmt. (1994) (“The duty of loyalty is perhaps the most characteristic rule of trust law, requiring the trustee to act exclusively for the beneficiaries, as opposed to acting for the trustee’s own interest or that of third parties.”); see also RESTATEMENT (THIRD) OF TRUSTS § 78 (discussing the duty of loyalty); PRINCIPLES, *supra* note 1, pt. V, introductory note a, at 199–200 (distinguishing “duty of loyalty” as a more comprehensive term covering all conflicts of interest, non-pecuniary as well as pecuniary, and “duty of fair dealing” as covering only the latter); Brody, *supra* note 8, at 1440 (“Legal disputes involving nonprofit fiduciaries generally deal with breaches of the duty of *loyalty* rather than the duty of *care* [because] [s]elf-dealing and other conflicts of interest go to the heart of the fiduciary relationship.”); DeMott, *supra* note 8, at 926 (“[T]he fiduciary duty of loyalty proscribes self-dealing by the actor and other forms of self-advantaging conduct without the beneficiary’s consent.”).

15. See Langbein, *Mandatory Rules*, *supra* note 1, at 1122 (“Oddly, however, although the various fiduciary duties are default rules, the settlor may not abrogate them in their entirety, because eliminating all fiduciary duties would make the trust illusory.”).

16. That said, it is important to note that these three duties vary in their particular content and contours among various kinds of fiduciary relationships. See PRINCIPLES, *supra* note 1, pt. V, introductory note a, at 199–200 (noting basic similarities and contextually appropriate distinctions in the way various bodies of fiduciary law deal with problems of conflicts of interest); see also UNIF. PRUDENT INVESTOR ACT prefatory note (“Other Fiduciary Relationships”) (noting that guardians ad litem and administrators of decedents’ estates sometimes have responsibilities over property similar to those of trustees, but under identifiably different conditions of short duration and direct court supervision that may call for adjustments in the fiduciary standards applicable to trustees); RESTATEMENT (THIRD) OF TRUSTS § 5 cmts. (distinguishing trusts from other forms of fiduciary relationships).

Traditionally, the standards of both care and loyalty have been stricter in the law of trusts, both private and charitable, than in the law of for-profit corporations. In the law of charity, the trust and corporate standards have tended to converge, with general but not universal scholarly approval. See Rob Atkinson, *Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries?*, 23 J. CORP. L. 655, 663 (1998) [hereinafter Atkinson, *Unsettled Standing*] (summarizing debate over the appropriate charitable standard); see also Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 632 (1998) (“Nonprofit directors and officers generally operate

2. Breadth

We have just seen how the duty of obedience is deeper, more fundamental, than the other two fiduciary duties, care and loyalty. Now we need to see how that greater depth also implies what we will call greater breadth as well. The duty of obedience is not merely tied more directly to the fundamental feature of fiduciary duty, the mandate to serve another; the duty of obedience also has greater reach, a writ that runs into the domains of the other two duties.

To see this second dimension—the metaphorically horizontal—we need first to notice an aspect that all three fiduciary duties share in the vertical dimension that we just identified. There, each has three identifiable levels: the minimal level, the default level, and the optional level.¹⁷ The first of these we have touched on already; it is the minimum required for a fiduciary relationship to exist at all.¹⁸ This has been made most explicit with respect to the duty of loyalty;¹⁹ a transfer to a putative fiduciary without any duty of loyalty is tantamount to an outright gift to that person,²⁰ or a “license to steal.”²¹ The

under the same legal standards under state law in terms of managerial obligations and the duties of loyalty and care as their for-profit peers.”) *But cf.* Goldschmid, *supra*, at 639–40 (“The ALI’s formulation [of principles of for-profit corporate governance] should be marginally modified in the nonprofit context, for example, to take specific account of a nonprofit’s mission . . .”).

17. See Langbein, *Mandatory Rules*, *supra* note 1, at 1105 (arguing that, although “[t]he law of trusts consists overwhelmingly of default rules that the settlor who creates the trust may alter or negate, . . . there are . . . some mandatory rules, which the settlor is forbidden to vary”); Leslie, *supra* note 1, at 69 (“As even default rule proponents recognize, trustees’ fiduciary duties are not, and never have been, completely waivable.”).

18. See UNIF. TRUST CODE § 105 (distinguishing between default rules and mandatory rules and listing the latter); *id.* § 105 cmt. (“[A] settlor may not so negate the responsibilities of a trustee that the trustee would no longer be acting in a fiduciary capacity.”); *id.* § 1008(a)(1) (invalidating any trust term that “relieves the trustee of liability for a breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interest of the beneficiaries”); *id.* § 1008(a)(1) cmt. (“Even if the terms of the trust attempt to completely exculpate a trustee for the trustee’s acts, the trustee must always comply with a certain minimum standard.”); see also NONPROFIT PRINCIPLES, *supra* note 8, § 301 cmt. b(1) (“This Section explicitly provides that the organizational documents may not include waivers of the duty of loyalty that are manifestly unreasonable . . . reduce the standard of care . . . below gross negligence, or waive the fiduciary’s obligation to act in good faith.”); Lucian Arye Bebchuck, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints of Charter Amendments*, 102 HARV. L. REV. 1820, 1821 (1989) (listing significant mandatory rules in corporate law); Langbein, *Mandatory Rules*, *supra* note 1, at 1105 (identifying and defending two broad classes of mandatory rules in trust law).

19. See *supra* note 18. Compare PRINCIPLES, *supra* note 1, pt. VII, § 7.19, cmt. c (“[T]he view that shareholders should be free to shape the rules applicable to their corporation might seem to legitimize the elimination of all liability (including that for duty of loyalty violations).”), with *id.* § 7.19, cmt. d (“Here, case law provides a clear answer that a charter amendment will not be given effect by a court when it infringes on [the duty of loyalty].”), and *id.* (“These cases indicate that not every deviation from the common law’s traditional rules requires that a charter provision be invalidated, but only those that seem to create a substantial possibility of fraud or overreaching.”). See also Leslie, *supra* note 1, at 69 (“[N]o court would uphold a trust provision purporting to eliminate the trustee’s duty of loyalty in its entirety.”).

20. See Atkinson, *supra* note 5, at 1144 (noting the importance of constraints on self-dealing).

21. PRINCIPLES, *supra* note 1, pt. VII, § 7.19 cmt. d (quoting *Irwin v. W. End Dev. Co.*, 342 F. Supp. 687, 701 (D. Colo. 1972), modified on other grounds, 481 F.2d 34 (10th Cir. 1973)); see also RESTATEMENT (THIRD) OF TRUSTS § 29 cmt. m (“A provision is also invalid to the extent it purports to relieve the trustee altogether from accountability and the duty to provide information to beneficiaries, or to relieve the trustee from liability even for dishonest or reckless acts.”); Langbein, *Mandatory Rules*, *supra* note 1, at 1106 (trust clauses eliminating fiduciary duties or excessively exculpating trustees “would authorize the trustee to loot the trust”).

necessity of a similarly essential floor has recently been observed as well with respect to the duty of care.²² In our analysis, it also applies to the duty of obedience, though here it is again so basic as to normally evade notice. It is the fundamental directive from the principal to the agent: serve another.²³

The second level of all three fiduciary duties is what we might call the default level. This is the way the law presumes a principal would want an agent to operate, in the absence of the principal's announcing a more specific standard.²⁴ With respect to the duty of obedience, that default mandate is to "serve the beneficiary in the way that reasonable people would see as genuinely beneficial."²⁵ Thus, under the "benefit reasonably" standard in the law of private trusts, providing the beneficiary with medical care is fine, but chiropractic care is dubious; private, even parochial, elementary schooling is okay, but Montessori may be outside the range of the fiduciary's implicit options. With respect to the duty of care, the standard has now come to be, both for corporate fiduciaries and for trustees, essentially the same: Act as a prudent person would in the conduct of his or her own affairs.²⁶ With respect to the duty of loyalty, by contrast, the default rule for the corporate fiduciary is laxer than for the trustee.²⁷ The former may

22. See UNIF. TRUST CODE § 1008 (precluding exculpation of trustees' recklessness); PRINCIPLES, *supra* note 1, § 7.19 (permitting exculpation for duty of due care breaches, but only to the extent they do not involve "culpable violation of law," awareness of "unjustified risk of serious injury to the corporation," "a sustained and unexcused pattern of inattention" tantamount to "an abdication of the defendant's duty to the corporation," or a benefit to the fiduciary in violation of the duty of fair dealing); see also Leslie, *supra* note 1, at 69, 99–107 (noting limits on enforceability of exculpatory provisions in trusts).

23. See UNIF. TRUST CODE § 105(b)(3) (listing as mandatory "the requirement that a trust and its terms be for the benefit of its beneficiaries, and that the trust have a purpose that is lawful, not contrary to public policy, and possible to achieve"); *id.* § 404 cmt. ("While a settlor has considerable latitude in specifying how a particular trust purpose is to be pursued, the administrative and other nondispositive trust terms must reasonably relate to this purpose and not divert the trust property to achieve a trust purpose that is invalid, such as one which is frivolous or capricious."); see also PRINCIPLES, *supra* note 1, pt. II, § 2.01(a) (stating that, except for limited, listed exceptions, "a corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain").

24. See UNIF. TRUST CODE § 105 cmt. (noting that "the Uniform Trust Code is primarily a default statute" under which "the settlor is generally free to override these rules and to prescribe the conditions under which the trust is to be administered"); UNIF. PRUDENT INVESTOR ACT § 1 cmt. (1994) ("Almost all of the rules of trust law are default rules, that is rules that the settlor may alter or abrogate."); see also Manne, *supra* note 2, at 237 ("Whether culled from the law of trusts or the law of corporations, the duties of loyalty and care operate in the nonprofit sector, as they do in the for-profit sector, as default rules.") (citation omitted).

25. See RESTATEMENT (THIRD) OF TRUSTS § 2 cmt. b ("Despite the differences in the legal circumstances and responsibilities of various fiduciaries, one characteristic is common to all: a person in a fiduciary relationship to another is under a duty to act for the benefit of the other as to matters within the scope of the relationship.").

26. *Id.* § 227 (Prudent Investor Rule as applicable to private and charitable trusts); UNIFORM TRUST CODE § 804 ("A trustee shall administer the trust as a prudent person would. . . ."); UNIF. PRUDENT INVESTOR ACT § 2(a) ("A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust, . . . exercis[ing] reasonable care, skill, and caution."); *id.* § 1(b) ("The prudent investor rule, a default rule, may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust."); PRINCIPLES, *supra* note 1, pt. IV, § 4.01(a) ("A director or officer of a corporation has a duty to the corporation to perform . . . in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.").

27. NONPROFIT PRINCIPLES, *supra* note 8, § 305 cmt. b(2) ("The default rules under corporate law are less stringent than those under trust law.").

engage in objectively fair, fully disclosed self-dealing;²⁸ the latter traditionally may not.²⁹ With respect to all three duties, the significant thing to note is that this second level is a default mode; it may be varied by the principal's more explicit directives (as long as those directives do not drop below the first level, the mandatory baseline³⁰).

These more specific directives set the third and last level of the three fiduciary duties; let's call it the optional, to distinguish it from the baseline and the default levels and to emphasize that setting it is the option of the principal. This third level has two related features. For one thing, it may be either higher or lower than the default level, but not lower than the essential, baseline level. Thus, for example, a principal can relax all three duties. With respect to loyalty, a principal can permit self-dealing³¹ and adjust the agent's compensation;³² with respect to care, atypically risky investments;³³ with respect to obedience, a measure of extravagance beyond what beneficiaries might either reasonably need or personally be accustomed to.³⁴ Conversely, the principal can raise any of the three standards. Thus, for example, with respect to care, the principal can permit overly safe³⁵ investments; with respect to loyalty, heightened procedures for self-

28. See PRINCIPLES, *supra* note 1, pt. V, § 5.01 (explaining that “[d]irectors . . . when interested . . . in a matter affecting the corporation, are under a duty of fair dealing,” which “includes the obligation to make appropriate disclosure”).

29. Compare RESTATEMENT (THIRD) OF TRUSTS § 5 cmt. h (noting a “strict ban on self-interested transactions for trustees”), with UNIF. TRUST CODE § 802(b)–(d) (permitting various forms of formerly forbidden self-dealing transactions). Scholars still debate on whether the traditional ban on self-dealing has been, or should be, made a default rule. Compare John Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 YALE L.J. 929 (2005) (favoring a default rule), with Melanie B. Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor Langbein*, 47 WM. & MARY L. REV. 541 (2005) (opposing a default rule).

30. Exactly where to draw that line is hotly debated in the law of both corporations and trusts. For the debate in corporate law, compare Bebchuck, *supra* note 18 (arguing for relatively high levels of mandatory rules for corporate fiduciaries), with FRANK EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (Harvard Univ. Press 1991) (arguing for relatively low levels of mandatory rules). For the debate in trust law, compare Leslie, *supra* note 1 (arguing for relatively high levels of mandatory rules for trustees) with Langbein, *Contractarian Basis*, *supra* note 1 (arguing for relatively low levels of mandatory rules).

31. See UNIF. TRUST CODE § 802(b)(1) (stating that a trust instrument may permit a trustee to engage in otherwise voidable self-dealing transactions). This would only be necessary, of course, if the default rule itself contains a presumption against self-dealing. As we have seen, sometimes the default level itself permits arms-length self-dealing. PRINCIPLES, *supra* note 1, pt. V, § 5.02 cmt. d.

32. See Langbein, *Mandatory Rules*, *supra* note 1, at 1117 (stating that a court's power to adjust trustee compensation under changed circumstances cannot be removed).

33. GEORGE GLEASON BOGERT, *BOGERT ON TRUSTS: HANDBOOK OF THE LAW OF TRUSTS* §§ 107–08 (1921) (noting that safe investments by trustees on behalf of the trust, such as mortgage backed or government backed notes or bonds, are generally approved by courts, while risky investments, such as personally secured debt, are not); see also UNIF. TRUST CODE § 804 cmt. (explaining that a trust “settlor who wishes to modify the standard of care specified in this section is free to do so, but there is a limit”; the floor is set in section 1008 at bad faith and recklessness.).

34. See UNIF. TRUST CODE § 404 cmt. (“The general purpose of trusts having identifiable beneficiaries is to benefit those beneficiaries in accordance with their interests *as defined in the trust's terms.*”) (emphasis added).

35. See UNIF. PRUDENT INVESTOR ACT § 2 cmt. (1994) (“A trust whose main purpose is to support an elderly widow of modest means will have a lower risk tolerance than a trust to accumulate for a young scion of great wealth.”). This latter example looks more significant than it really is. Unlike all the others listed in the text, this one seems to lower, rather than raise, the applicable fiduciary standard, and by contrast, seems to allow

dealing transactions; with respect to obedience, a higher degree of beneficiary need for distributions than is the reasonably expected norm.³⁶ In this last case, for example, the principal may allow for invasions of trust principal, but only in the case of dire medical emergencies or deep economic distress. But in no case can the principal lower the fiduciary standard below the baseline. As we have seen, the total elimination of the duties of loyalty and care are essentially gifts to the fiduciary, and excessively idiosyncratic beneficences will not be recognized as legitimate benefits.

The second thing to note about these optional variations from the default level of the fiduciary duties is that the principal may make them either mandatory or discretionary. The principal, in other words, may permit the agent to go above or below the default standard, or the principal may mandate, not merely permit, the deviation in either direction. Thus, to take one of our prior examples from each of the three duties, the principal could forbid otherwise permissible self-dealing, or mandate especially “safe” investments, or require attention to beneficiaries’ particular needs, like education, or to the needs of a particular beneficiary, like a surviving spouse or mentally impaired child.

The prospect of making deviations from the default level of duty mandatory, rather than merely discretionary, brings us to the point at which the duty of obedience supersedes, or trumps, the duties of loyalty and care; this is the point, in terms of our three-dimensional metaphor, at which the duty of obedience is broader than the other two. Where the variation from the default level of care or loyalty is mandatory, it falls under the duty of obedience. On the surface, this may seem little more than a matter of semantics: if the variation is mandatory, it must by definition be obeyed, and is thus within the duty of obedience.

There is, however, more here than the merely tautological. The inclusion of mandatory variations of the duties of care and loyalty within the duty of obedience underscores an important structural point as well. To the extent that these deviations are mandatory, they pose the possibility of a conflict between the fiduciary’s duties, respectively, to the beneficiary and to the principal. Placing these variations under the duty of obedience underscores the legal resolution of that conflict: to the extent that the principal’s wishes prevail, we can properly say that the duty of obedience has been recognized. And this distinction becomes especially significant when we consider the third and final dimension of fiduciary duties: their duration.

a kind of investment that, but for the permission, would be unnecessarily safe. But, at least in modern portfolio theory, unnecessarily safe is itself likely to be, technically speaking, too safe, statistically certain to produce too little return relative to risk, and thus to fall below the prevailing prudent investor standard. *See id.* (“Returns correlate strongly with risks, but tolerance for risk varies greatly with the financial and other circumstances of the investor, or in the case of a trust, with the purposes of the trust and the relevant circumstances of the beneficiaries.”).

36. *See* UNIF. TRUST CODE § 105(b) cmt. (noting that a trust “settlor is generally free to override [trust] rules and to prescribe the conditions under which the trust is to be administered”); RESTATEMENT (THIRD) OF TRUSTS § 49 (2003) (“Except as limited by law or public policy[], the extent of the interest of a trust beneficiary depends upon the intention manifested by the settlor.”); *see also id.* § 49 cmt. d (“Thus, a beneficiary may be authorized by the terms of the power to require the payment only of such sums as the beneficiary reasonably believes to be necessary for support or other current expenditure; or the beneficiary may be authorized to demand the payment of any part or all of the principal with no limitation.”). In the corporate context, as we shall see, raising the default level of obedience may take the form of limiting the corporation’s business activities to those listed in its charter, a practice relatively rare today.

3. Length

There is, finally, a third aspect of the fiduciary duties that we must consider: their duration. To complete our three-dimensional metaphor, think of this last dimension as length. How long do the three fiduciary duties last? At one level of analysis, the answer is again obvious, even tautological. If the three duties are essential to the fiduciary relationship, then they must last, at least at their baseline level, as long as the fiduciary relationship itself. And so they do.

But that is not the end of the analysis, nor by any means the most interesting part. Beyond this definitionally minimal duration, we encounter a most unusual, if not unique, feature of the duty of obedience: in the context of trusts, both private and charitable, the duty of obedience may last beyond the life of the individual to whom it is owed. In that context, mandatory modifications of the default level of the duties of care, loyalty, and obedience will all bind living fiduciaries to the directions of dead principals. That, as we saw at the outset, is the duty of obedience in its strong form, what Anglo-American scholars call dead hand control.

4. Summary

In this section we have compared the duty of obedience with the other two fiduciary duties, care and loyalty, in three dimensions. In terms of depth, we have seen that the duty of obedience lies at the root of any fiduciary relationship, any situation in which one person acts at another's direction. At that level, it underlies both the duty of care and the duty of loyalty. We saw that the duty of obedience is not only deeper than the other two, but broader as well. Principals can, by exercising their option to vary the default levels of the other two duties, bring them, at their optional levels, within the ambit of the duty of obedience. Finally, in terms of the third dimension, length, we saw that the duty of obedience, in its strong form, has an unusual, if not unique, feature: it can bind fiduciaries to the directions of a principal who is dead.

The analysis in this section has admittedly been at a very high level of abstraction. The distinctive features of the duty of obedience are more clearly visible when we examine that duty in various legal settings. Accordingly, we turn, in the next section of this part, to a more contextualized analysis.

B. Locating the Duty of Obedience in Four Fiduciary Contexts

This section of the paper examines the role of the duty of obedience in four fiduciary contexts: the business corporation, the private trust, the charitable trust, and the charitable corporation. In each context we will focus on the presence or absence of the duty of obedience in its strong form. We will find the strong form invariably absent in the for-profit corporation and optional in the other three relations: the private trust, the charitable trust, and the charitable corporation. In both private and charitable trusts, the contours of the strong form of the duty of obedience are fairly clear; with respect to the charitable corporation, by contrast, its role is very much a muddle. This, we shall see, is attributable to the charitable corporation's amphibious nature: in form, it is a corporation; in function, it is a charity. As the corporate form becomes the chief mode of organization for

charity,³⁷ it becomes increasingly important to see what that form owes to both its corporate and charitable ancestors. Giving either side of its ancestry excessive weight can lead, as we shall see, to serious anomalies.

1. For-Profit Corporate Law

To fully appreciate the role of the duty of obedience in the modern for-profit corporation, we must observe three pairs of bilateral fiduciary relationships critical to the corporate structure. The first of these is the relationship between the state and the corporation's primary principals, its equity investors. This relationship, which bulked large in the early history of the modern corporation, has now receded into almost total insignificance. But one of its vestiges, the doctrine that a corporation may not exceed its chartered purposes, still plays a subsidiary but significant role in the other two relationships.

In the contemporary life of the corporation, by far the more important of these other two bilateral relationships is that between the corporation's primary principals, its equity investors, and the corporation's primary agents, its managers. This relationship entails the much-mooted problem of the separation of ownership and control; that problem is the focus of the great bulk of modern corporate fiduciary law.

But there is a third relationship, that between minority and majority equity investors, that is essential to understanding the network of corporate fiduciary duties. For a variety of reasons, minority equity investors have to worry that the majority will take advantage of them. To minimize that risk, the law has evolved a set of baseline protections, under the general rubric of a fiduciary duty of the majority to the minority. For our purposes, it is important to see how the duty of obedience is implicated when minority shareholders use a variety of devices to raise that baseline protection.

The remainder of this section explores each of these relationships in turn: the state and equity investors, equity investors and corporate management, and majority and minority equity investors. What we have is three sets of bilateral relationships, a trilogy of pairs.

a. The Trilogy of Bilateral Corporate Relationships

i. Relationship of the State as Principal to the Corporation's Equity Investors as Agents

To understand the vestigial fiduciary duty that runs from the corporation to the state, we must remember the earliest origins of the modern corporation in the late sixteenth and early seventeenth centuries.³⁸ Then, as now, corporations were creatures of the state, holding charters or articles of incorporation issued by the sovereign. But back then, unlike today, corporations could be created only by specific acts of the legislature, and those acts empowered corporations only to undertake particular, designated purposes.

37. See *infra* Part II.B.4 (discussing the charitable corporation as a hybrid between corporate form and charitable function).

38. JAMES WILLARD HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970*, at 2-12 (1970).

What is more, as corporations came into their own in the late eighteenth and early nineteenth century, many, if not most, corporations operated quasi-public facilities: banks, canals, bridges, toll roads, or, eventually, railroads and telegraph lines.³⁹ The state could enforce these restrictions through a quo warranto suit seeking either to enjoin a corporation's actions beyond its chartered limits as *ultra vires*⁴⁰ or, more radically, to dissolve the transgressing corporation.

In that context, the limitation of corporate purposes served a twofold function. On the one hand, the restriction to specified purposes helped ensure that those purposes would in fact be performed. Here the goal was positive, although the mechanism negative and crudely indirect. If the corporation could legally undertake nothing but its chartered purpose, then it would at least be somewhat more likely to pursue that purpose, if only for want of alternatives. On the other hand, the restriction to specific purposes helped ensure that the corporation would not over-reach its chartered bounds. Here the goal was essentially negative, and the means negative but direct. In the era of their novelty, corporations were viewed with suspicion; indulging what in retrospect seem vague and exaggerated fears, the law forbid corporations to perform anything but specified, typically quasi-public, functions.⁴¹ From this perspective, to keep the corporation on task was to keep it out of trouble.

Against this background, these twin goals of early specific-purpose corporate charters can be seen to have imposed a dual duty of obedience. On the one hand, they imposed a very weak affirmative duty: if you do anything, do only this specific, publicly beneficial thing. Only very rarely—and, significantly, only in the case of quasi-public utilities—did charters impose truly affirmative obligations.⁴² On the other hand, they imposed a much more imperative negative duty of obedience: do nothing else. This was, admittedly, a peculiarly thin duty of obedience; its negative component predominated, and its positive component was minimal.

Even this “thin” duty of obedience can be distinguished from the duties of care and

39. See *id.* at 17 (“From the 1780’s well into the mid-nineteenth century the most frequent and conspicuous use of the business corporation—especially under special charters—was for one particular type of enterprise, that which we later called public utility and put under particular regulation because of its special impact in the community.”); *id.* at 22 (noting “[t]he predominance of public-utility-type enterprises among this first generation of business corporations”); Susan Pace Hamill, *From Special Privilege to General Utility: A Continuation of Willard Hurst’s Study of Corporations*, 49 AM. U. L. REV. 81 (1999) (same); Michael A. Schaeftler, *Ultra Vires—Ultra Useless: The Myth of State Interest in Ultra Vires Acts of Business Corporations*, 9 J. CORP. L. 81, 85–87 (1983).

40. The term *ultra vires* did a dubious double duty in this context; it covered not only the pursuit of ends beyond the purposes stated in the corporate charter, but also the use of means not included in the corporation’s powers. See JAMES D. COX & THOMAS LEE HAZEN, COX & HAZEN ON CORPORATIONS § 4.01, at 155 (2d ed. 2003) (“Corporate purposes and corporate powers, although often confused, are fundamentally different.”). This distinction is not critical for our purposes; what the text following this note says about purposes applies equally to corporate powers.

41. See HURST, *supra* note 38, at 25 (“Considerable distrust and controversy attended the special-franchise, special-charter era.”); *id.* at 45 (noting “fear that corporate business might reach a socially dangerous breadth of ambition”).

42. See *id.* at 39 (“Distinctive to transportation company charters were statutory stipulations for provision of promised facilities (that, on pain of forfeiture, minimum capital be subscribed and paid in, operations begin within some specified time, and works be kept in good order and not abandoned), for tolls to be . . . conditioned upon substantial service, and for certain operations reports to be regularly filed.”).

loyalty. It can scarcely be reduced to any recognizable analog of the duty of care, the principle function of which, as we have seen, is to avoid the waste of corporate assets. The state has little interest in the loss of the corporate assets; those assets, after all, are the investments of the corporation's principals, not the state itself, except in the most remote sense.⁴³ The restriction of corporate purpose was not imposed to prevent activities that were overly or inadequately risky from the investors' point of view. Significantly, the limitation of purposes was imposed by the state, not elected by investors, who could not unilaterally alter or override it. Similarly, it is difficult to see the duty to obey chartered limits as a duty of loyalty. It is no more intended to protect investors from managerial misfeasance than from managerial incompetence or excessive risk-taking; its focus, here again, is protecting the state, not the investor.

Several related developments caused the state's interest in special charters to decline. For one thing, corporations expanded their scope of activity into a wider range of economic activity in manufacture and trade, well beyond their original quasi-public functions in transportation, communication, and finance. Partly as a result of this expansion of corporations into other industries, and partly as a result of their having simply become more familiar entities, corporations were increasingly perceived as more legitimate and, correspondingly, less threatening. At the same time, public perception of special charter legislation dramatically changed. Precisely the special legislation that was, in an earlier era, seen as a way of holding corporations to account, later came under increasing suspicion as the source of special privileges and potential corruption of the political process.⁴⁴ And, even as suspicion of the old special charter mode of restricting corporations was losing popular appeal, the newer method of regulatory legislation, aimed at all corporations across the board, was gaining political momentum.⁴⁵

These changes led, during the course of the nineteenth century, to the displacement of special legislatively granted charters by general legislation designed to permit incorporation for any lawful business purpose without special legislation.⁴⁶ Incorporation for "any lawful purpose" under such statutes is now the general rule⁴⁷ and predominant

43. Investors seem, early on, to have relied on such restrictions, especially in the absence of fully formed capital markets. HURST, *supra* note 38, at 25–26. But the fiduciary relationship between investors and corporate managers and among investors themselves are analytically distinct.

44. *See id.* at 33 ("The general incorporation laws . . . put to rest the individualistic-egalitarian issue."); *id.* at 136 ("It is plausible that corruption was a substantial element in the enactment of special charters.").

45. *Id.* at 28–57.

46. To be strictly historically accurate, we must note two qualifications. First, there was an intermediate phase in which early general incorporation acts contained fairly tight restrictions on, among other things, powers and purposes. *Id.* at 44–45; *see also* Schaeftler, *supra* note 39, at 87–88 ("Although general incorporation acts had been in existence since the early nineteenth century, these acts initially imposed strict limits on corporate attributes such as stated capital, duration, purposes and powers." (citations omitted)). But such restrictions were generally dropped around the turn of the twentieth century. *Id.* at 89. Second, and of greater contemporary significance, states still fairly frequently impose special restrictions on businesses incorporating for certain identified purposes like banking or insurance. *See* REVISED MODEL NONPROFIT CORP. ACT § 3.01 cmt. a (1987) ("Some of these [special incorporation] statutes, particularly those relating to banking and insurance, establish a separate incorporation process and incorporating agency.").

47. *See* REVISED MODEL NONPROFIT CORP. ACT § 3.01(a) (1987) ("Every corporation incorporated under this Act has the purpose of engaging in any lawful business unless a more limited purpose is set forth in the articles of incorporation."); *see also* COX & HAZEN, *supra* note 40, at 156 ("Each American jurisdiction today either expressly or by implication authorizes corporations to be formed under its general corporation act for any

practice.⁴⁸ What is more, shareholders may, under modern general incorporation statutes, amend their charters unilaterally, by majority vote,⁴⁹ without state consent. The state's interest in enforcing its side of the charter "contract" has thus been reduced to a virtual nullity.⁵⁰ As a technical matter, the state still may either enjoin a corporation's ultra vires act or, at the extreme, dissolve the wayward corporation. But state power to enforce corporate purpose provisions has been tellingly criticized⁵¹ and has very seldom been invoked.⁵² (This, as we shall see, has not been the case with the other kinds of fiduciary relations we will consider.)

It is important to note that, even in its heyday, the duty of obedience owed by the corporation to the state was always weak, rather than strong. That duty could, in other words, always be altered by the living parties entitled or subject to its protection. As a matter of law, the corporate charter, conceived of as a contract between the corporation and the state, could not be amended unilaterally by either party.⁵³ It could, on the other

lawful purpose or business." (citation omitted)); Schaeftler, *supra* note 39, at 88 (noting that incorporation under general acts replaced special incorporation by the end of the nineteenth century). *But see* Hamill, *supra* note 39, at 85 (offering empirical evidence that special incorporation persisted until the early twentieth century).

48. *See* COX & HAZEN, *supra* note 40, at 154–55; George G. Triantis, *Organization as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trust in Commercial and Charitable Enterprises*, 117 HARV. L. REV. 1102, 1127 (2004) ("Modern corporations, however, generally draft liberal charter provisions that allow for any lawful purpose, and even if a firm adopts a restricted purpose, the provision can be amended by shareholder vote.").

49. Here again, to be strictly historically accurate, we must note an intermediate phase. The original English Companies Act of 1862, which allowed general incorporation, did not allow amendment by even unanimous shareholder action. Schaeftler, *supra* note 39, at 87 n.16.

50. Triantis, *supra* note 48, at 1126–27 ("The statement of a corporate purpose in a charter is therefore essentially a matter of contract law between the firm and its shareholders."); *see also* Henry Winthrop Ballantine, *Proposed Revision of the Ultra Vires Doctrine*, 12 CORNELL L.Q. 453, 455 (1927) ("The practical question then is not what power or capacity or authority has the state granted an imaginary person, but rather what authority has the group of stockholders granted to their representatives, the directors, to do business on their behalf.").

51. *See* JAMES D. COX, THOMAS LEE HAZEN & F. HODGE O'NEAL, CORPORATIONS § 4.9, at 4.22 (Supp. 2002) ("The continued recognition of the state's power to force the corporation's dissolution for *ultra vires* acts is an anachronistic carryover from the early nineteenth century of the pervasive mistrust of corporations that then caused legislatures to severely restrict corporate activities." (citations omitted)); *see also* PRINCIPLES, *supra* note 1, pt. II, § 2.01 cmt. j, at 69–70 (noting that "under the common law doctrine of ultra vires the state could proceed against a corporation that exceeded the purposes and powers granted in its charter," and that "this doctrine arose at a time when incorporation was a special privilege, and the state therefore had an interest in limiting corporations to their certificate powers and purposes," in contrast to the situation today, when "modern corporate law permits general incorporation, very broad purposes and powers in the certificate, and easy certificate amendment"); Michael A. Schaeftler, *The Purpose Clause in the Certificate of Incorporation: A Clause in Search of a Purpose*, 58 ST. JOHN'S L. REV. 476, 482–84 (1984) [hereinafter Schaeftler, *Purpose Clause*] (discussing legislative developments illustrating the state's decreased interest in corporate purpose); Schaeftler, *supra* note 39, at 90 ("Statutory provisions providing a state with the right to either dissolve or enjoin corporations engaging in ultra vires acts stand out as anachronistic remnants of an era when mistrust of the corporate form led to stifling restraints on its operation.").

52. Even in its heyday, state enforcement of charter limitations seems to have been largely, if not exclusively, aimed at public utilities and other quasi-public corporations, Schaeftler, *supra* note 39, at 85–86 (following HURST, *supra* note 38, at 14–24), and never seems to have been applied to purely private corporations that violated their charters without either violating general laws or threatening the public welfare. *Id.* at 85.

53. *Trs. of Dartmouth Coll. v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819).

hand, be amended, at least in theory, by their joint action, although, as a practical matter, this involved the fairly costly process of special legislative action.

ii. Relationship of Owners as Principals to Managers as Agents

As we have just seen, the first pair of our trilogy of bilateral fiduciary relationships in the corporate context, corporate investors' duty to the state to stay within their chartered limits, has virtually vanished below the historical horizon. At the same time, the second of these bilateral relationships, the duties of corporate management to corporate investors, has reached its zenith. The core problem addressed by these latter duties is what Berle and Means and others identified as the separation of ownership and control.⁵⁴ To protect corporate principals from the more egregious forms of managerial slacking and stealing, modern law subjects corporate agents to the baseline duties of care and loyalty. These baseline levels can be lowered, within limits; equity investors can, by special arrangements in the corporation's governing instruments, give their managers more latitude than the law otherwise allows.⁵⁵ As we have seen, such downward, permissive adjustments in the duties of loyalty and care involve the duty of obedience. For purposes of our analysis of that duty, we need to look more closely at adjustments in the other direction. Equity investors can raise as well as lower the fiduciary duties of their corporate agents; adjustments in this upward direction implicate what we identified above as the optional level of those duties in their mandatory mode.⁵⁶

What is the point of these upward adjustments in fiduciary duties? They address what we might call the "Jack and the Beanstalk" problem, what others have called, in more technical terms, the problem of allocation of assets in internal capital markets.⁵⁷ Young Jack's mama, remember, sent him out with her savings, agent to her principal, to buy a cow; Jack thought better of the bargain and bought a bag of magic beans. As the story is generally understood, Jack was a colossal, if ultimately lucky, simpleton.

From a more modern perspective, we can see Jack as the paradigmatically problematic business manager. Faced with a choice among entrepreneurial options, he chooses, not the one most likely to maximize investor return, but the one most likely to minimize his own effort. We all see that the cow's milk promises a much more likely return than bean-magic; what we may miss is how much more of Jack's labor is likely to be expended in daily cow milking than in magic-bean gardening.

Nor are we always left, as we are in Jack's case, to infer the agent's nefarious motive. Consider the case of Isak Dinesen's ultimately unsuccessful Kenyan coffee farm.⁵⁸ Her aristocratically indolent husband admitted to having invested her bourgeois

54. See ADOLPH A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (Harcourt, Brace, & World 1968) (1932) (discussing issues that arise when ownership is separated from control). Their analysis was anticipated by Thorstein Veblen, and it has been elaborated by a host of others. See HENRY B. HANSMANN, *THE OWNERSHIP OF ENTERPRISE* (1996) (analyzing how different forms of ownership impact firm structure); MICHAEL C. JENSEN, *A THEORY OF THE FIRM: GOVERNANCE, RESIDUAL CLAIMS, AND ORGANIZATIONAL FORMS* (2000) (analyzing the modern firm's managerial and organizational structure).

55. See *supra* Part II.A.2.

56. See *id.*

57. See Triantis, *supra* note 48, at 1113 (discussing the principal-agent problem).

58. *OUT OF AFRICA* (Universal Pictures 1985).

dowry in a coffee plantation in the Kenyan hinterlands rather than, as she instructed, a dairy farm near Nairobi. Pressed for a reason, he was quite precise: He figured coffee plants would pretty much grow themselves, and he “didn’t come to Africa to sit with silly cows.”⁵⁹

An obvious way to deal with this sort of self-serving behavior would be post hoc, as a violation of the default level of the duty of either care or loyalty. From the perspective of the duty of care, the principal could attack the agent’s selection of enterprise opportunities as suboptimal, too risky in terms of likely return. That seems quite clearly to have been true in Jack’s case; magic beans offer a phenomenal return, but at what most investors would find an unacceptably high level of risk. From the perspective of the duty of loyalty, the principal could attack the agent’s selection of investments as a sort of in-kind embezzlement. On this theory, rather than dipping into the till to take more than the agreed compensation, the agent has chosen a line of work that allows him to put less labor into the enterprise than he and his principal originally anticipated. This analysis fits the *Out of Africa* situation quite nicely: cows obviously require regular tending; coffee plants seem to grow on their own.

Notice, however, that neither of our principals, Jack’s mama or Isak Dinesen, was content to rely on those default levels of care and loyalty. Neither simply committed her money to her respective man’s reasonable measure of care or loyalty. (Nor is it unlikely that either theory would win either case.) Instead, both issued the same specific entrepreneurial directive: buy bovine. In terms of our analysis, we can see this as a ratcheting up of the duty of either care or loyalty from the default level to the optional level, from what the law infers as the principal’s preference to what the principal actually specifies. In terms of the duty of care, Jack’s mom directs proverbially provident investment in the family cow, thus excluding the speculative adventure of magic beans. Similarly, Dinesen directs investment in a dairy, familiar to her from her Danish homeland, thus excluding the wholly exotic coffee venture. In terms of the duty of loyalty, both women choose a venture that will cut seriously into their respective agents’ likely leisure activities. Caring for cattle will require relatively more work from the men-folk. Either way, as a question of care or of loyalty, the principal’s greater specificity implicates the duty of obedience. Once a principal’s will is embodied in a specified purpose, the agent must obey it.

My examples, of course, involve relatively rudimentary business entities. As I’ve told the stories, Jack’s mother is a sole proprietor, and her principal-agent relation to Jack is essentially employer to employee. In Dinesen’s case, the relationship is more likely an informal partnership, a mom-and-pop operation with wife and husband as reciprocal principals and agents. It takes no great stretch of the imagination, however, to move from the sole proprietorship of Jack’s mom and the partnership of Dinesen and her husband to the corporate context. For any of the usual reasons—avoiding personal liability, say, or attracting anonymous investors—the owners of either enterprise might choose to incorporate.

If they do, they have an additional locus for their elevation of the duties of care and loyalty from the baseline to the optimal level: the corporate charter. As we saw in the last

59. *Id.*

section, the norm is now to incorporate for any permissible business purpose.⁶⁰ But it is still possible today, as it was obligatory in the early days of the business corporation, to incorporate for specific purposes (although apparently few do).⁶¹ Shareholders, as a technical matter, may sue to enforce charter restrictions against management, seeking either to enjoin violations, or to hold management liable for damages.⁶²

Nonetheless, reliance on the baseline fiduciary duties of care and loyalty has tended to displace the doctrine of *ultra vires* in suits by shareholders against management.⁶³ There is a twofold reason for this shift, in both legal doctrine and corporate practice, away from specific charter provisions as a means of protecting corporate principals against management. On the one hand, shareholders typically want to allow their managers maximum flexibility to respond to market changes and, hence, profit-making (or loss-avoiding) opportunities. On the other hand, to the extent that investors want to constrain management beyond the baseline duties of care and loyalty, they have other, less organizationally fundamental, mechanisms readily available. To restrain management choice in particular cases without trammeling their general conduct of corporate business through charting of particular purposes, “investors may . . . forego them in favor of more effective deterrents to opportunistic capital reallocation within the firm, such as debt covenants and security interests.”⁶⁴

Two additional points need to be noted about modern charter restrictions. First, unlike those of the early corporate era, modern charter restrictions impose fiduciary duties intramurally, between owners and managers, not extramurally, between the chartered corporation and the chartering state.⁶⁵ Second, as in the prior era, the duty of obedience imposed by specific charter restrictions is weak, not strong. Now, as then, the charter can be changed by living individuals. Today, that change is, as a practical matter, much easier than before. Then, it required both state and investor approval; now, it requires only the latter.⁶⁶ But in neither era—and this is the significant point—has it ever involved any element of dead hand control. If an investor dies holding shares in a corporation with a restricted purpose, that investor’s successor in interest is entirely free

60. See *supra* Part II.B.1.a.i.

61. Schaeffler, *Purpose Clause*, *supra* note 51, at 482–83 (“A recent survey [conducted by the author] demonstrated conclusively that the overwhelming majority of corporations in most states, particularly medium and large-sized corporations, has adopted broad, boilerplate purposes clauses or, where available, an ‘any lawful purpose’ clause.” (citation omitted)).

62. Triantis, *supra* note 48, at 1127; see also PRINCIPLES, *supra* note 1, pt. II, § 2.01 cmt. j (noting that “[t]he appropriate vehicle to remedy an alleged violation of the principles stated in [section] 2.01 [‘corporate profit and shareholder gain’] would be an action for injunctive or other equitable relief by a shareholder against the corporation,” not a direct or derivative suit for damages).

63. See COX ET AL., *supra* note 51, § 4.17 (stating that “[a]ny significant and harmful departures from the corporation’s stated purposes are an intramural matter in which the executives responsible for the *ultra vires* acts are answerable in damages, provided their conduct is beyond the protection of the business judgment rule,” under which “great discretion is accorded the company’s directors and officers in deciding whether a certain activity is reasonably related to the overall purpose of the corporation”).

64. Triantis, *supra* note 48, at 1127.

65. *Id.* at 1126–27 (“The statement of a corporate purpose in a charter is therefore essentially a matter of contract law between the firm and its shareholders.”).

66. See *id.* at 1127 (“Modern corporations, however, generally draft liberal charter provisions that allow for any lawful purpose, and even if a firm adopts a restricted purpose, the provision can be amended by shareholder.”).

to vote to change the corporate charter to allow other purposes. The right to enforce or amend the charter does not die with the original investor, but neither does it become fixed at that investor's death; rather, it passes to that investor's successor, to enforce or forego as the successor—but not the original investor—sees fit.⁶⁷

iii. Relations Among Owners: Minority Shareholders Constraining the Majority

The ease with which modern charter restrictions on purpose can be removed by charter amendment brings us to the third bilateral relationship relevant to our analysis. We have seen, in the preceding two subsections, that the state once sought to impose restrictions on corporate investors and that corporate investors may still seek to impose restrictions on their managerial agents. In some circumstances, we shall see in this subsection, investors may want to impose restrictions on each other; in particular, minority investors may want to restrict the actions of the majority.

The “Jack and the Beanstalk” problem is mostly one of hidden managerial impropriety; managers are choosing activities that are either less onerous to them or less rewarding to investors than managerial compensation warrants. As between themselves, equity investors have an identifiably different problem: different degrees of risk aversion. Here the conflict of interest is not about slacking or stealing, but rather about changing an agreed-upon amount of risk or return.

In addressing this conflict with their fellow investors, as in addressing conflicts with their common managers, minority shareholders can be understood to be adjusting the baseline duties of care and loyalty. In terms of care, minority investors want to restrict the majority from shifting to purposes that are too risky, albeit too risky only from the perspective of minority shareholders, not as compared to the baseline or default level of the duty of care. In terms of loyalty, minority shareholders want to restrict the majority from shifting to a purpose that is more advantageous to the majority than to the minority. But, here again, this is only from the perspective of the minority, not as compared to the baseline or default levels of the duty of loyalty; it involves no improper self-dealing by the majority under generally-applicable principles of loyalty.

Whether seen as an adjustment to the default-level duties of either care or loyalty, however, the more fundamental duty of obedience is clearly in play here. Once the minority has the majority's commitment to a particular kind of corporate activity, that commitment must be obeyed. Conversely, departures from the specified corporate activities violate the duty of obedience.

As in constraining managers, the usefulness of charter restrictions as a constraint by principals among themselves is, as a general matter, a thing of the past.⁶⁸ Although modern statutes typically allow incorporation for specific purposes, as opposed to “any lawful business,” the universal rule of free amendment makes this little protection to minority shareholders against the majority.⁶⁹ As a technical matter, minority shareholders

67. See Rob Atkinson, *The Low Road to Cy Pres Reform*, 58 CASE W. RES. L. REV. 97, 115–17 (2007) [hereinafter Atkinson, *Low Road*] (explaining how living holders of present and future interests in real estate can “re-bundle” interests separated by their predecessor in title).

68. But see generally Bebhuck, *supra* note 18 (offering a modern, efficiency-maximizing case for limiting free amendment of corporate charters).

69. Modern incorporation statutes and other laws do offer some protection of minority shareholders

could protect their interest in the maintenance of the corporation's original, specific charter provisions by requiring a super-majority vote to amend those provisions; at the extreme, such super-majority vote requirements could give each equity investor an individual veto over changes in the corporation's chartered purpose. Courts will enforce such restrictions, but investors virtually never use them; as we have seen, investors almost always prefer the greater flexibility of general purpose charters. In constraining their fellow investors, as in constraining their common managers, investors have a range of more targeted options. In the context of adjusting the riskiness of their portfolios, investors have the additional option of diversification; if they fear that their fellow investors in one corporation may shift to activities too risky for their tastes, they can balance that prospect with investments in corporations less likely to change their activities.⁷⁰

It is important to note again here, as we did in the prior section, that these restraints as to corporate purpose always involve the duty of obedience in its weak form, never in its strong form. Even in the increasingly unusual case of charter restrictions, they can always be removed by shareholders who are alive at the time. Accordingly, there is no need here, any more than there, to consider the wishes of those who originally imposed the restrictions but who have subsequently died. Thus, in the bilateral relationship between minority and majority shareholders, as the other two bilateral relationships we have examined, there is no strong form of the duty of obedience.

b. Why Corporate Law Theorists Overlook the Duty of Obedience

Against this background, we are in a better position to see why analysts of fiduciary duty in the context of for-profit corporations almost never speak of a duty of obedience. In the first place, the duty of obedience in the context of for-profit corporations is always weak, never strong; the duty is, in other words, always owed to identifiable living people, and always subject to removal or modification with their consent. In the second place, the duty of obedience in the modern corporate context can always be seen as modifying the duty of care or loyalty. In that respect, it involves nothing beyond garden-variety principles of the laws of contract and agency. The duty of corporations to stay within their chartered limits is not so easily reduced to care or loyalty, but that duty is, as we have seen, virtually a nullity today. And, even in its heyday, it operated mostly negatively, as a prohibition on ultra vires activities, not as a positive mandate requiring

against fundamental corporate change without shareholder approval. But this protection is limited in two significant ways: first, as to the kind of change to which it applies, and second, as to the remedial form it takes. In the first place, only the most basic changes trigger the protections, and these changes do not include changes of corporate purpose. Those changes are, rather, limited to more fundamental changes, such as mergers or sales of all corporate assets. In the second place, the remedies available to dissenting shareholders are significantly limited. Shareholders who dissent, even from fundamental corporate changes, are only entitled to the protection of an "exit" rule, a buy-out at a fairly appraised price, not by a legally enforceable "voice" rule, a "veto" through the direct enforcement of the duty of obedience with an injunctive remedy. See 2 PRINCIPLES, *supra* note 1, pt. VII, ch. 4 (describing right of assessment); *id.* § 7.21 (omitting change of corporate purpose); *id.* at 357–79 (change of corporate purpose not listed among changes for which states afford appraisal remedy).

70. See HURST, *supra* note 38, at 26 (noting that investors in the earliest era of American capitalism seem to have relied on charter purpose restrictions in the absence of fully formed capital markets).

affirmative obedience.⁷¹

That raises a radical, but entirely fair, question for our focus on the duty of obedience: if the fiduciary duties in the for-profit corporation can be explained without reference to the duty of obedience, why refer to it? The answer is that, although we can explain the fiduciary duties of corporate law without referring to the duty of obedience when we consider the corporation in isolation, we need to understand the duty of obedience when we deal with the for-profit corporation in the broader context of other institutional forms. In particular, we cannot understand the role of the duty of obedience in the non-profit corporation until we have understood its very different role in the for-profit corporation. In extrapolating only the weak form of the duty of obedience from the for-profit to the non-profit context, some courts and commentators have failed to see that the latter partakes of a second essence as well. To understand that essence, we must look next to the role of the duty of obedience in the context of trusts, both private and charitable.⁷² Here we shall see that it is the strong form, not the weak form, that is most salient.

2. Private Trust Law⁷³

In Anglo-American law, the trust as a commonly used organizational form preceded the modern general-purpose business corporation by half a millennium at the very least.⁷⁴ Yet trusts, both private⁷⁵ and charitable, manifest the duty of obedience much more

71. See *id.* at 39 (“Distinctive to transportation company charters were statutory stipulations for provision of promised facilities that, on pain of forfeiture, minimum capital be subscribed and paid in, operations begin within some specified time, and works be kept in good order and not abandoned, for tolls to be . . . conditioned upon substantial service, and for certain operations reports to be regularly filed.”).

72. Although states no longer take an interest in the purposes of business corporations, both states and the federal government continue to take an interest in the purposes of charities, for reasons explored *infra* at Part II.B.3.a.

73. Particularly in view of the fact that this paper was originally presented in a conference on comparative law, it should be noted that the rhapsodic view once common about the unique brilliance of the common law trust is giving way to a more balanced perspective. Compare ELIAS CLARK, LOUIS LUSKY, & ARTHUR W. MURPHY, *GRATUITOUS TRANSFERS* 435 (2d ed. 1977) (noting that “[t]he trust idea [is] believed by some legal scholars to represent perhaps the greatest achievement of Anglo-American law”), with *id.* (“[O]ther systems of law accomplish similar results by employing different concepts and theories.”). See also RESTATEMENT (THIRD) OF TRUSTS ch.1, pt.1, introductory note (2003) (noting that, although the trust is “peculiarly a product of the Anglo-American legal system,” similar devices “are to be found in all mature systems of law”); GEORGE T. BOGERT, *TRUSTS* 17 (6th ed. 1987) (describing the parallels between common law trusts and civil law equivalents).

74. Douglas Arner, *Development of the American Law of Corporations to 1832*, 55 SMU L. REV. 23, 27 (2002) (noting that the origins of the modern Anglo-American business corporation lie in the late sixteenth century and the seventeenth century); BOGERT, *supra* note 73, at 6 (noting that the antecedents of the trust have been traced back almost to the Norman Conquest).

75. “Private trust” is used here to distinguish the trusts covered in this section not only from charitable trusts, discussed in the next section, but also from business trusts, which this article does not consider. See Langbein, *Contractarian Basis*, *supra* note 1, at 630–31 (distinguishing “gratuitous private trusts” from both “commercial trusts” and “charitable trusts,” and focusing his analysis exclusively on the first); see also RESTATEMENT (THIRD) OF TRUSTS § 1 cmt. b (excluding from the Restatement’s coverage both “trusts as devices for conducting business and investment activities outside the express private- and charitable-trust context” and “a trust as a security device or as an arrangement for the benefit of creditors”). Trusts play a significant role in corporate financial arrangements, both internal, see Triantis, *supra* note 48, at 1145 (noting

clearly than does the business corporation. The greater salience of the duty of obedience in the trust context derives from three major differences between the for-profit corporation and the private trust: (1) fiduciary duties in trusts are typically trilateral, rather than bilateral; (2) the duty of obedience in trusts frequently governs spending as well as earning; and (3) the duty of obedience in trusts often takes the strong form, not just the weak. This section examines each of these differences in the context of private trusts; the following section considers charitable trusts, where these differences are even more pronounced.

a. The Trilateral Structure of Trusts

In corporations, now that the state's interest in policing corporate adherence to chartered purposes is essentially a dead letter, the fiduciary relationship is, analytically speaking, strictly bilateral, although double. It is double, in that the class of all equity investors—the principals in our analysis—may use the duty of obedience to protect themselves from opportunistic behavior by management; a subclass of minority equity investors may also want to use that duty to protect themselves from majority equity investors as well. But the fiduciary relationship is only bilateral, in the sense that the primary agents—corporate management—do not typically find themselves torn between the interests of two other identifiable groups.⁷⁶

In the modern⁷⁷ private trust, by contrast, this kind of conflict is more than common; it is endemic, almost defining. In the private trust, the fiduciary relationship is essentially trilateral, not bilateral: (1) the principal, the trust's settlor or grantor, commits property (2) to his or her agent, the trustee, to use (3) for the good of a third party or class, the beneficiaries. Thus, in the trust context, the fiduciary serves two analytically distinct masters: on the one hand, the principal, on whose behalf and at whose direction the trustee acts; on the other, the beneficiary, for whose benefit the trustee acts.⁷⁸ The

use of trust to constrain allocations of capital within business enterprises), and external, see Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434 (1998) (noting the use of trusts to structure relations and allocate risks among business enterprises). See generally John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 YALE L.J. 165 (1997) (discussing how various types of trusts are used in corporate transactions). But commercial or business trusts, though both practically significant and theoretically interesting, are much less helpful than modern gratuitous transfer trusts in isolating the duty of obedience, our principal task.

76. The only situation in which this kind of conflict occurs in the corporate context nicely illustrates its rarity. It is the unlikely event, analyzed above, in which corporate management is under explicit directions about specific actions that might legitimately benefit one group of equity holders more than another. This would occur in the classic case of charter restrictions on corporate purpose. One group of investors, wary of the corporation's entering into unknown entrepreneurial waters, might insist on a narrow purpose clause. Management, faced with a promising but prohibited new line of business, would be torn between its general, default level duty to maximize shareholder value and its specific, optional level duty to conduct only a specified line of business. As we have seen, this kind of conflict has virtually disappeared in the corporate world. Investors now reflect their differential risk concerns in more sophisticated ways.

77. As John Langbein has shown, what we might call the classic trust was essentially passive, a tax avoidance ruse that involved an invariant conveyancing wrinkle; the modern trust, an almost infinitely flexible form of active third party management, is a relatively new development. See Langbein, *Contractarian Basis*, *supra* note 1, at 632–43.

78. See Sitkoff, *supra* note 2, at 640 (“The dominant (and sometimes conflicting) relationships [in the trust] exist between S[ettlor] and T[rustee] and between the B[eneficiaries] and T[rustee].”).

interests of the principal and the beneficiary, from their respective perspectives, may diverge precisely on the question of how the fiduciary is properly to fulfill the fiduciary's fundamental duty, obeying the principal's directive to serve the beneficiary. The principal may believe the beneficiary will benefit more from one course of conduct by the fiduciary; the beneficiary may prefer another. The parental principal, for example, may want saving; the child beneficiary stereotypically prefers spending. In those conflicts, with rare exception, it is the principal who prevails; it is the duty of obedience that embodies that result.⁷⁹

This trilaterality compounds the importance of the duty of obedience in another way as well. The net revenues of the business corporation are more or less instantly available for its principals to spend as they see fit; so, too, for that matter, are the principals' initial investments. Majority shareholders ultimately control the corporation, which they can, in the last analysis, dissolve; even minority shareholders can withdraw their investment from the corporation by selling their shares.

In a private trust, the fate of assets, both principal and income, is quite different.⁸⁰ Most basically, those assets are typically not available to the principal, the creator of the trust; the principal, rather, has set them aside, for the benefit of identified third parties. Nor, significantly, are the assets directly available to the beneficiaries. The principal, the settlor of such a trust, often wants the fiduciary to protect the beneficiary from the beneficiary's own indiscretions; a significant category of private trusts—the spendthrift trust—operates precisely for that purpose.⁸¹ Since neither the principal nor the beneficiary can typically withdraw the assets of the trust,⁸² the on-going management of the trust necessarily assumes greater significance. In A.O. Hirschmann's classic distinction, when “exit” from an organization is not an option, “voice” within the organization becomes correspondingly more significant.⁸³ In the trust arrangement, the legally relevant “voice” is generally that of the principal, which the trustee as agent must heed under the duty of obedience. And “voice” becomes even more important because the trust, unlike the corporation, has a dual function.

79. See *id.* (“American law resolves this tension by requiring T[rustees] to maximize the welfare of the B[eneficiaries] within the ex ante constraints imposed by S[ettlors].”).

80. This analysis, following that of other scholars, takes as typical the trust that involves three distinct persons in the analytically distinct roles of settlor/principal, trustee/agent, and beneficiary. It does not apply to the situation where two of these functions are conflated, as in the declaration of trust, where the settlor transfers property to him- or herself, to hold for the benefit of another (or, in the limiting case, of him- or herself). See Langbein, *Contractarian Basis*, *supra* note 1, at 627–28 (“Because the declaration of trust dispenses with what is normally the most desirable attribute of the trust, that is, the ability to have a third party manage the trust property, the declaration of trust plays a relatively peripheral role in modern [trust] practice.”).

81. See WILLIAM M. MCGOVERN, JR., SHELDON F. KURTZ & JAN ELLEN REIN, *WILLS, TRUSTS, AND ESTATES* 300 (1988) (“Trusts are frequently used to manage property for a person who is legally incompetent, either a minor or an adult who has been adjudicated incompetent, or one who is legally competent but unable to manage property effectively.”).

82. Settlers may reserve to themselves the right to revoke their trusts, in whole or in part; they may also grant to beneficiaries a parallel right to compel trust distributions. See BOGERT, *supra* note 73, at 514 (“The settler may reserve to himself, or create in another, the power to alter the provisions of the trust.”). Here again, the text example focuses on the more typical trust, irrevocable by the settlor and uninvadable by the beneficiaries.

83. See ALBERT O. HIRSCHMANN, *EXIT, VOICE AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS AND STATES* 33–34 (1970) (explaining the relationship between “voice” and “exit”).

b. The Dual Function of Trusts

The modern business corporation has a single essential purpose, making profits for its principals.⁸⁴ The modern private trust, by contrast, has two analytically distinct purposes: not only making money, but also spending it.⁸⁵ In the former, money-making function, the trustee, like the corporate director or officer, is essentially a surrogate manager; in the latter, money-spending function, by contrast, the trustee is more of a surrogate parent. This second capacity, which has no corporate parallel, makes the duty of obedience especially significant in the trust.

i. The Earning Function

As we saw in the last section, modern corporations are typically general-purpose entities; unlike their predecessors, their business purposes are not restricted either by the state that charters them or by the investors who fund and control them. Investors may, as we have seen, still want to address the Jack and the beanstalk problem, the allocation of internal capital; more typically, investors handle their differential risk preferences by diversifying their investments.

In the trust, by contrast, controlling the level of risk typically looms larger. Indeed, a principal may use a trust as the means by which he or she achieves a measure of diversity across his or her portfolio of investments in for-profit corporations. Thus the trust instrument, the fundamental governance mechanism that corresponds to the corporate charter, is more likely to direct how risky the agent's investments should be. The principal may be concerned that, given the beneficiary's particular needs, the trustee should trade off higher returns in favor of greater security.⁸⁶ To implement that preference, the principal may elect to make a mandatory alteration in the default level of the duty of care. The agent, for his part, would be bound by the duty of obedience to conform to this investment directive.

ii. The Spending Function

For purposes of our analysis, the first function of trusts, earning, is less significant than the second function, spending. As we have seen, corporate principals can remove their investments with relative ease; once they have withdrawn those investments, they can spend them whenever and however they like, subject only to the outer limits of

84. PRINCIPLES, *supra* note 1, § 2.01 cmt. e, at 56–57 (“The business corporation is an instrument through which capital is assembled for the activities of producing and distributing goods and service and making investments . . . with a view to enhancing corporate profit and shareholder gain.”).

85. See Langbein, *Contractarian Basis*, *supra* note 1, at 627 (“In truth, the trust is a deal, a bargain about how trust assets are to be *managed* and *distributed*.” (emphasis added)); UNIF. TRUST CODE art. 8 general cmt. (amended 2005) (“The Uniform Prudent Investor Act prescribes a trustee’s responsibilities with respect to the *management* and *investment* of trust property. The Uniform Trust Code also addresses a trustee’s duties with respect to *distribution* to beneficiaries.” (emphasis added)).

86. See UNIF. PRUDENT INVESTOR ACT § 2 cmt. (1994) (“A trust whose main purpose is to support an elderly widow of modest means will have a lower risk tolerance than a trust to accumulate for a young scion or great wealth.”); *id.* (“Returns correlate strongly with risk, but tolerance for risk varies greatly with the financial and other circumstances of the investor, or in the case of a trust, with the purposes of the trust and the relevant circumstances of the beneficiaries.”).

legality. Coffee from Colombia rather than Kenya is fine; cocaine from Colombia (or anywhere else) is not.

In the trust, by contrast, the principal typically directs when and how the beneficiaries are to receive the benefits of the assets in the trust, the conditions under which beneficiaries are to have those assets paid to them or spent on their behalf. It is here, paradigmatically, that the duty of obedience comes into play in a much more significant way than in the business corporation. There it involves only ways of making money (and there seldom with respect to anything so broad as general purposes of the enterprise). Here it involves not only ways of making money, but also ways of spending money.

With respect to the earning function, default rules are easily defined and understood: more return is better than less, and sooner rather than later (although less risk is better than more, and later risks better than sooner). With respect to the spending function, on the other hand, default rules are much more vague; “benefit the beneficiary” is about as good as the law has been able to do.⁸⁷ Accordingly, variations from the default level with respect to the spending function are much more common, as principals avail themselves of the opportunity to tailor the ways they confer the benefits of their trusts: by payments for education, or by payments out of corpus only in the case of emergency, or at a certain age, or for certain purposes like starting a business or buying a home. In each case, the beneficiary may want the benefits of the trust delivered differently from the way the principal ordered; in each case, then, the trustee as agent faces a conflict between the interests of the principal and the beneficiary.⁸⁸

For purposes of isolating the duty of obedience as an independent fiduciary duty, it is important to notice that this conflict is not between either the principal or the beneficiary and the trustee. There is, then, no problem here with the duty of loyalty; whether the trustee favors the principal or the agent, he will not be favoring himself. Nor is there a problem with the duty of care. What is at issue is not how the trust assets are invested, well or unwisely, but how they are being spent, as the principal directed, on the one hand, or as the beneficiary wishes, on the other.

Sometimes, with respect to the spending function itself, the trustee will be under specific directions from the principal as to not only *how* the trusts assets are spent, but also *for whom*. Distinguishing the duty of obedience from the duties of care and loyalty allows a more subtle dissection of the common situation where a trust has more than one beneficiary. Parents quite frequently provide, for example, for assets to be held in trust for the benefit of their children for their lives, then held for or paid out to grandchildren or more remote descendants. This obviously requires the trustee to balance the interests of different beneficiaries both within and across generations. Current doctrine requires that, unless the settlor specifies otherwise, the trustee is to treat all beneficiaries equally, or at least without preference,⁸⁹ and conventional analysis tends to see this as an issue of

87. RESTATEMENT (THIRD) OF TRUSTS § 27(2) (2003) (stating that “a private trust, its terms, and its administration must be for the benefit of the beneficiaries”); *see also* UNIF. TRUST CODE § 404 cmt. (“The general purpose of trusts having identifiable beneficiaries is to benefit those beneficiaries in accordance with their interests as defined in the trust’s terms.”).

88. *See* Sitkoff, *supra* note 2, at 657–71 (discussing “[t]he Settlor-Beneficiary Tension”).

89. *See* UNIF. PRUDENT INVESTOR ACT § 6 (“If a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the

loyalty⁹⁰ or as a distinct fiduciary duty.⁹¹

Under our analysis, however, there is no issue of loyalty, because this situation presents no conflict between the agent's self interest and the proper focus of the duty of loyalty, serving only the beneficiaries. Notice that, in cases involving multiple beneficiaries, the fiduciary may be entirely disinterested as to the division the principal has directed. These provisions do not implicate the duty of loyalty in that they are about who among the class of beneficiaries is to be served not whether the fiduciary can benefit himself or another at the beneficiaries' expense. Nor do these provisions implicate the duty of care; here again, they are about expenditure, rather than investment or preservation, of the assets committed to the fiduciary.

In our tripartite taxonomy, accordingly, the trustees' duty to multiple beneficiaries falls under the duty of obedience. Where the settlor has stated no preference among beneficiaries, courts, in mandating equal or impartial treatment and working out implementing sub-rules, are applying the default level of the duty of obedience. They are presuming, in other words, that settlors who do not specify different treatment within a class of beneficiaries probably intend equality.⁹² By contrast, when settlors specifically allow or require differential treatment, they are creating an optional level of the duty of obedience, with variations from equal treatment of beneficiaries that they may or may not make mandatory.

Thus, with respect to the trust's spending function, the duty of obedience often operates less as an adjustment of the other two fiduciary duties, care and loyalty, and more as an independent source of fiduciary obligation. With respect to both the investing and spending functions, however, it is the principal who sets any variation from the baseline duties of care, loyalty, and obedience, and, in any conflict between the principal or the beneficiary over how the latter is to be benefited, it is the principal who, with rare exception, prevails under the duty of obedience.

c. The Strong Form of the Duty of Obedience

As the examples of the trust's spending function remind us, the kind of trust analyzed here is paradigmatically a familial, not a market, arrangement.⁹³ The fact that principals can use the trust to control assets not just within a generation of beneficiaries, but also across generations, brings us to the greatest difference between the duty of obedience in the trust, as opposed to the corporate, context. In the trust context, the duty of obedience looms not only larger, but also longer.

The Anglo-American law of private trusts has a very strong form of the duty of obedience. The principal can, in other words, impose restrictions on both investments and distributions of trust assets that continue after the principal's death. In England, this power has been significantly reduced; where the trust has only adult beneficiaries, they

beneficiaries."); RESTATEMENT (THIRD) OF TRUSTS § 183 ("When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them.").

90. See UNIF. PRUDENT INVESTOR ACT § 6 cmt. ("The duty of impartiality derives from the duty of loyalty.").

91. Langbein, *Mandatory Rules*, *supra* note 1, at 1122.

92. See Sitkoff, *supra* note 2, at 651 (analyzing the duty of impartiality as a default rule designed to affect settlor's likely intent).

93. See *supra* note 73.

can force the trustee to deviate from the principal's directions.⁹⁴ In America, the principal's power retains full force.⁹⁵ Neither the trustees nor the beneficiaries of a trust can amend or terminate the trust, even by unanimous consent, if that action would thwart a material purpose of the trust's creator.⁹⁶

In both American and English law, the strong form of the duty of obedience is most distinct from the duties of care and loyalty; the durational aspect of the duty of obedience cannot be reduced to the law of either contract or agency. Agency relationships end with the death of the principal;⁹⁷ the duty of obedience can, and often does, continue afterward. Contractual obligations, of course, can, and often do, survive the original contracting parties, potentially for generations, even forever, as in the case of covenants that run with the land, equitable servitudes, powers of termination, and rights of entry.⁹⁸ But when contractual obligations survive the original parties, they pass into the hands of successors with essentially the same rights and duties as their predecessors. Successor promisees, in other words, can deal with promisors on the same terms that their predecessor promisees could. Successor promisees, like original promisees, are free to contract away the obligations of the original promise. Successor promisees and promisors step into the shoes of their predecessors; more specifically, the obligations of promisors, whether original or successor, always run to the original promisees during the promisees' lives, then to successor promisees.

With respect to trust beneficiaries, however, matters stand very differently. Although the benefits they are to receive under the trust can, and often do, survive the death of the trust's creator and principal, the power to alter the terms under which trust assets are invested and expended does not necessarily, even typically, pass into beneficiaries' hands. Rather, the trustee's duty as agent to handle trust assets as the principal originally directed continues to run to the principal, even after the principal is dead. In starkest contrast, the duties of contractual promisors never run to decedent promisees; if contractual duties survive the promisee, they always pass into the hands of a successor promisee.⁹⁹

94. See BOGERT, *supra* note 73, at 544 (citing *Saunders v. Vautier*, (1841) 49 Eng. Rep. 282 (Ch.)).

95. *Clafin v. Clafin*, 20 N.E. 454 (Mass. 1889) (noting that beneficiaries cannot terminate a trust that the settlor established to last beyond their minority).

96. In adopting this position, American courts consciously, if not entirely consistently, rejected the opposite position of the English courts, as articulated by *Saunders v. Vautier*, (1841) 49 Eng. Rep. 282 (Ch.). Under the English rule, beneficiaries of a trust *can* unilaterally amend or terminate the trust, by unanimous consent, even though that action would thwart a material purpose of the trust's creator. *Id.*

American law does allow for some exceptions, some circumstances under which courts will give priority to the wishes and needs of living beneficiaries over the duty of obedience to the dead principal. These exceptions to the rule of dead hand control, however, are quite narrow. See Sitkoff, *supra* note 2, at 659 ("[C]ourts have had little difficulty finding a 'material purpose' that would be offended by modification or termination.").

97. RESTATEMENT (SECOND) OF AGENCY § 120(1) (1958) ("The death of the principal terminates the authority of the agent without notice to him [with exceptions narrowly limited in time and scope to allow agents to protect assets of principals' estates and to protect agents themselves acting in good faith]."); see also *id.* cmt. a ("One cannot act on behalf of a non-existent person.").

98. Atkinson, *Low Road*, *supra* note 67, at 112–15; see also RALPH E. BOYER, HERBERT HOVENKAMP, & SHELDON KURTZ, *THE LAW OF PROPERTY: AN INTRODUCTORY SURVEY* 214–15 (4th ed. 1991) (listing interests not subject to the common law rule against perpetuities).

99. Atkinson, *Low Road*, *supra* note 67, at 112–15.

If the donor's restrictions last beyond the donor's life, the obvious question is: how far beyond the donor's life? The answer is: "For as long as the trust itself can last." Under Anglo-American law, the duration of trusts has traditionally been set by a complex, judge-created doctrine called the "rule against perpetuities." Under that doctrine, a private trust can last for several generations, or something over a hundred years.¹⁰⁰ Under statutory amendments in a growing number of Commonwealth countries and American states, even that extreme outer limit has been lifted, often to allow private trusts to last, literally, forever.¹⁰¹

d. Enforcement

Private trusts, as we have seen, can and often do survive the death of their principal. The trustee, as agent, continues to hold the entrusted property for the benefit of the third parties the principal designated, under the terms the principal specified. These terms now bind the trustee at the behest of the beneficiaries; in the absence of the principal, the beneficiaries are empowered to hold trustee-agents to the performance of their fiduciary duties. With respect to those duties that operate to their benefit, as they see it, this raises problems no different, in principle, from those of ordinary contract or agency law. The holders of legal rights, here as there, are free to enforce or waive those rights as they like.

With respect to certain forms of the duty of obedience, however, there is a very real difference. As we have seen, the duty of obedience runs, in some cases, not to the living beneficiaries, but to the dead principal. In those cases, who is to enforce that duty? If the trustee and all the beneficiaries agree among themselves against the dead principal's wishes, who is there to enforce them? The somewhat surprising answer is no one.

Speaking of a testamentary trust in which adult legatees held all the beneficial interests, the United States Supreme Court said, almost a century ago:

No other person has any interest in them, and if the trustees should disregard the time of payment [set in the trust instrument], and pay over to each legatee his or her legacy when they are competent to give a valid discharge, there would be no one who could call them to account.¹⁰²

This position is now generally recognized; in the words of the Restatement (Second) of Trusts:

If there is a sole beneficiary who is not under an incapacity and the trustee transfers the trust property to him or at his direction, or if there are several beneficiaries none of whom is under an incapacity and the trustee transfers the

100. See BOYER ET AL., *supra* note 98, at 213 (stating that "the common law rule in its simplest form is, 'No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest.'").

101. See Jesse Dukeminier & James E. Krier, *The Rise of the Perpetual Trust*, 50 UCLA L. REV. 1303, 1309-10 (2003) (stating that settlors will attempt to use a uniform statutory rule against perpetuities to allow private trusts to last forever); Robert H. Sitkoff & Max Schanzenbaugh, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356, 373-76 (2005) (showing that various states have abolished the rule against perpetuities); Note, *Dynasty Trusts and the Rule Against Perpetuities*, 116 HARV. L. REV. 2588, 2592 (2003) (arguing that Alaska's statutory scheme allows certain interests in trusts to last forever).

102. *Shelton v. King*, 229 U.S. 90, 94 (1912).

trust property to them or at their direction, the trust terminates although the purposes of the trust have not been fully accomplished.¹⁰³

The status of the strong duty of obedience in the American law of private trusts is thus something of a paradox. On the one hand, the trustee is bound to obey the dictates of the dead principal, even over the objections of living beneficiaries. On the other hand, if all the living beneficiaries agree to release the trustee from that obligation, then no one can object. The agent's duty to the dead principal is clear, but there is no one to enforce it. In effect, then, here as in ordinary contract law, the rights of the original principal-promisee pass to successor promisees, who may waive them if they wish (although only if they act unanimously). To see a truly strong form of the duty of obedience—a duty practically as well as legally unremovable, or very nearly so—we must look to the law of charitable trusts.

3. Charitable Trust Law

Fiduciary relationships in charitable trusts share the tripartite structure of private trusts, as opposed to the binary structure we found in the business corporation. Principals of charitable trusts place assets in the hands of fiduciaries for the benefit of third parties or the general public in ways legally recognized as charitable.¹⁰⁴ Furthermore, as with private trusts, the function of the charitable fiduciary is not only to earn income with the assets in its charge, but also to spend those assets and their earnings as directed.¹⁰⁵ Accordingly, in charitable trusts as in private trusts, the duty of obedience plays a large role in its own right, quite independent of its use to raise or lower the default levels of the duties of care and loyalty. But charitable trusts differ from private trusts in three ways that bear significantly on the duty of obedience: purpose, duration, and enforcement. These differences combine to make the duty of obedience much more important in charitable trusts.

a. Purpose

The essential difference between private and charitable trusts lies in their respective functions. This functional difference, in turn, produces a dramatically different duty of obedience. Private trusts, as we have seen, are paradigmatically a means for the principal to enlist the services of another person to provide for the needs and wants of identifiable third parties, typically family members or close personal acquaintances. Charitable trusts, by contrast, are vehicles through which principals enlist the service of others to benefit the public.¹⁰⁶

103. RESTATEMENT (SECOND) OF TRUSTS § 342 (1959).

104. RESTATEMENT (THIRD) OF TRUSTS § 1 cmt. c (2003) (“The fundamental distinction between private trusts and charitable trusts is that, in the case of a private trust, property is devoted to the use of specified or described persons who are designated as the beneficiaries of the trust; in the case of a charitable trust, property is devoted to purposes the law deems appropriately beneficial to the public.”).

105. See Triantis, *supra* note 48, at 1148 (“[U]nlike the homogeneous interests of stockholders, the philanthropic motives of donors differ somewhat from each other, and this heterogeneity multiplies the axes of agency conflict.”).

106. See RESTATEMENT (THIRD) OF TRUSTS § 1 cmt. c (noting that the “fundamental distinction between private trusts and charitable trusts is that, in . . . a private trust, property is devoted to the use of specified or

At risk of over-simplification, the public benefit essential to a charitable trust involves providing either especially good goods to anyone, or mundane goods to the especially needy: education or health care, for example, to the general public; food and clothing to the victims of disaster or chronic misfortune.¹⁰⁷ We shall explore the scope of this positive requirement in more detail below. At this point the thing to notice is its much simpler negative corollary: a trust does not meet the public benefit requirement, and hence is not charitable, if it satisfies the private obligations of the principal. Thus, for example, a trust for the education of the principal's own children would not be charitable, even though a trust for the education of virtually any other children would be.¹⁰⁸ What is included in the meaning of public benefit is a much debated question in the Anglo-American law of charity. But on one point everyone is in full agreement: "Private benefit" is not permitted.¹⁰⁹

This distinction between private benefit and public benefit means that the duty of obedience has a profoundly different focus in charities on the one hand and private trusts on the other.¹¹⁰ To see why this is so, it is helpful to recall the three levels of the duty of obedience: the baseline level, the default level, and the optional level. As we have seen, these three levels are related to each other in the following way: The default level is what a reasonable fiduciary would take to be the principals' preference as to how to confer benefits on the beneficiary; principals may vary this default level to an optional level of their own specification, but that optional level may not fall below a minimum of objectively genuine benefit to the beneficiary.¹¹¹

At the default level, the standards for private and charitable trusts are quite different, but also relatively clear. On the private side, as we have seen, the trustee would be free to confer upon the beneficiary advantages that reasonable people would recognize: routine maintenance and support in the beneficiary's accustomed lifestyle, with special dispensations for emergencies or other unusual situations.¹¹² Similarly, on the charitable side, the trustee would be free to conduct a wide range of activities generally recognized in law as beneficial to the public.¹¹³

In the law of private trusts, the other two levels, the optional and the baseline, are fairly straightforward as well. To satisfy the baseline, the purported benefit to the beneficiary must be objectively real, if minimal, by the standards of reasonable people. Thus, as we have seen, the settlor of a private trust cannot impose on his supposed

described persons who are designated as beneficiaries of the trust; in . . . a charitable trust, property is devoted to purposes the law deems appropriately beneficial to the public").

107. Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501, 605 (1990).

108. RESTATEMENT (THIRD) OF TRUSTS § 28 gen. cmt. a(1) (noting a trust is not charitable if it confers a private, not public, benefit); cf. *Sklar v. Comm'r*, 282 F.3d 610, 620–21 (9th Cir. 2002) (disallowing tax deductions for "gifts" to schools by parents in lieu of tuition).

109. RESTATEMENT (THIRD) OF TRUSTS § 28 gen. cmt. a(1).

110. Not to mention, by way of starkest contrast, business corporations, where the beneficiary is not someone else, private person or public body, but the principal himself.

111. See Langbein, *Mandatory Rules*, *supra* note 1, at 1108 (noting that both the Restatement (Third) of Trusts and Uniform Trust Code recognize the traditional "benefit the beneficiary" rule as mandatory).

112. See *supra* Part II.A.2 (discussing the breadth of the duty of obedience).

113. See Langbein, *Mandatory Rules*, *supra* note 1, at 1108 ("In the realm of charitable trusts, the ancient charitable purpose doctrine serves a function comparable to the benefit-the-beneficiary standard [of private trust law] by requiring any purported charitable trust to satisfy standards of public benefit." (citations omitted)).

beneficiary a long-term net liability, the legal equivalent of the proverbial “white elephant,” a gift that keeps on taking rather than giving. Not surprisingly, cases at the baseline are relatively uncommon,¹¹⁴ and fall into one of three predictable patterns.¹¹⁵ First, the principal wants to “mold” the beneficiary’s preferences in ways that are, from the perspective of a reasonable person, overly eccentric, if not actually damaging.¹¹⁶ Second, the principal wants to enlist the trustee in maintaining some kind of memorial to the principal himself, only nominally benefiting the beneficiary as, for example, a supposedly salutary reminder to the beneficiary of the principal’s admirable character.¹¹⁷ Third, the principal attempts to confer on an uncertainly large group of beneficiaries a kind of benefit that the law has not recognized as charitable.¹¹⁸

This third situation takes us to the heart of the problem: the baseline duty of obedience in the context of charity, or, more specifically, efforts by the principal of a charitable trust to vary the default level toward the baseline. The principal of a charitable trust, as we have seen, cannot devote assets to a cause that is not generally recognized in law as publicly beneficial. Part of this baseline, we have also seen, marks the frontier between private and charitable trusts. A trust that more than minimally benefits private parties is, by definition, not charitable.¹¹⁹ The baseline as it runs between private and charitable trusts can thus be traced with relative ease: on the private side, the trust must

114. See *id.* at 1111 (“The characteristic sphere for the application of the anti-dead-hand rule has been the fringe world of the eccentric settlor: the crackpot who wants to brick up her house, or builds statues of himself, or dictate children’s marital choices.”).

115. Note that all these examples involve the spending, as opposed to the earning, function of trusts; it is the former, rather than the latter, that makes the critical distinction between private and charitable trusts that we are seeking here. With respect to the earning function, charitable and private trusts involve more similar problems at the baseline, essentially settlors’ efforts to impose what Langbein calls “value-impairing investment instruction.” *Id.*

116. See RESTATEMENT (THIRD) OF TRUSTS § 29(c) (2003) (invalidating trusts that are “contrary to public policy”); *id.* cmt. i (commenting on the invalidity of “provisions that the law views as exerting a socially undesirable influence on the exercise or nonexercise of fundamental rights that significantly affect the personal lives of beneficiaries and often of others as well.”); see also Gareth Jones, *The Dead Hand and the Law of Trusts*, in DEATH, TAXES AND FAMILY PROPERTY 119, 126 (Edward C. Halbach ed., 1977) (“[S]ome critics have argued that the courts’ intervention has been too hesitant and too deferential to the wishes of settlors, particularly concerning conditions which seek to regulate the conduct and the quality of another’s life.”), cited in RESTATEMENT (THIRD) OF TRUSTS § 29, general notes on clause (c) and comments i through i(2) (2003).

117. See RESTATEMENT (THIRD) OF TRUSTS § 47. The Restatement explains:

Where the owner of property transfers it in trust for a specific non-charitable purpose, and there is no definite or definitely ascertainable beneficiary designated, no enforceable trust is created; but the transferee has power to apply the property to the designated purpose, unless such application is authorized or directed to be made at a time beyond the period of the rule against perpetuities, or the purpose is capricious.

Id. § 124; see also RAIN MAN (United Artists 1988) (situation in which the father of the Tom Cruise character leaves him his antique car, on the condition that he maintain it as an example of excellence).

118. Morice v. Bishop of Durham, (1804) 32 Eng. Rep. 656 (M.R.), *aff’d*, (1805) 32 Eng. Rep. 947 (Ch.); see also RESTATEMENT (THIRD) OF TRUSTS § 29, cmt. m (“It is against public policy to enforce a trust provision that would divert distribution or administration from the interests of beneficiaries to other purposes that are capricious or frivolous . . . , detrimental to the community . . . or otherwise neither private nor charitable in character.”).

119. RESTATEMENT (THIRD) OF TRUSTS § 28 gen. cmt. a(1) (noting that a trust is not charitable if it confers a private, not public, benefit).

benefit private parties at least to some objectively recognizable extent, and these parties are most likely to be the principal's friends and family; on the charitable side, the trust may confer recognized public benefits upon particular individuals, but only if they are not the principal's friends and family (or, some courts have held, simply too small a class).¹²⁰

The problematic part of the charitable baseline runs in the other direction. Here the question is not whether the trust confers too much private benefit, but whether it confers enough public benefit. The easiest cases here are trusts that direct the fiduciary to do something illegal.¹²¹ The law of charity incorporates the sensible assumption that legal prohibitions redound, at least in their net effect, to the public good; conversely, trusts that direct the violation of law can safely be assumed to produce, at least in the mill run of cases, public harm. The hardest cases involve extreme, if well-intentioned, idiosyncrasy;¹²² the limiting case, in a sense, are trusts for the purposes of changing existing law.¹²³

As this analysis and these examples suggest, it is harder to measure the outer limits of public benefit, the baseline of charitable trusts, than the outer limits of private benefit, the corresponding baseline of private trusts. What is more, getting it wrong on matters of public benefit is arguably more costly. Consider first the costs of defining charity too narrowly, by setting the baseline too high. For one thing, it may mean that assets fall out of the charitable sector altogether. Here the law faces the difficult choice between extremely attenuated public benefits and no public benefits at all. More fundamentally, it means that significant public advances may be under-promoted. The classic American case, to put the matter in starkest relief, involved a trust for the abolition of slavery and the enfranchisement of women.¹²⁴ The court found the former charitable, but not the latter. More recent cases have involved efforts to remove legal penalties on consensual, non-commercial homosexual acts¹²⁵ and sales of contraceptives to adults.¹²⁶

120. See CLARK ET AL., *supra* note 73 at 626 (explaining that “[t]he limitation of benefits to a small class will render a gift non-charitable even though the nature of the benefits fits into an accepted charitable category” such as maintaining a public park).

121. See RESTATEMENT (THIRD) OF TRUSTS § 29 (noting that no trust exists if “its purpose is unlawful or its performance calls for the commission of a criminal or tortuous act”).

122. See, e.g., *Wilber v. Asbury Park Nat'l Bank & Trust Co.*, 59 A.2d 570 (N.J. Ch. 1948), *aff'd*, *Wilber v. Owens*, 65 A.2d 843 (N.J. 1949) (denying charitable status to bequest to publish testator's “random scientific notes seeking the essentials in time and space” as lacking public benefit).

123. Here the law has changed dramatically. Traditionally, courts refused to recognize the purpose of changing law as charitable. See, e.g., *Jackson v. Phillips*, 96 Mass. 539 (1867) (holding non-charitable a trust to advance the enfranchisement of women and generally confer them full legal equality with men); CLARK ET AL., *supra* note 73, at 627. Note, however, that a critical correlate of charitable status, federal income tax exemption, is denied to organizations that engage in excessive amounts of lobbying or any amount of political campaigning. I.R.C. § 501(c) (2000). See generally Elias Clark, *The Limitation on Political Activities: A Discordant Note in the Law of Charities*, 46 VA. L. REV. 439 (1960) (discussing the utilization of philanthropic resources and the effect of private donations); Miriam Galston, *Public Policy Constraints on Charitable Organizations*, 3 VA. TAX REV. 291 (1984) (examining the development of public policy limitations on § 501(c)(3) organizations).

124. *Phillips*, 96 Mass. at 539.

125. See, e.g., *State ex rel. Grant v. Brown*, 313 N.E.2d 847 (Ohio 1974) (denying incorporation to organization urging acceptance of homosexuality as a valid lifestyle, even after legal penalties had been lifted).

126. See *Slee v. Comm'r*, 42 F.2d 184 (2d Cir. 1930) (denying federal tax exemption of American Birth Control League for lobbying for the repeal of laws against birth control).

But if there are costs in defining charity too narrowly, by setting the baseline too high, there are costs in the other direction as well. Most basically, if charity is defined too broadly, social assets are wasted. Assets that might have gone to a genuinely publicly beneficial purpose, even to private consumption, go for little or no good at all, public or private. And, beyond the waste of the particular assets committed to the pseudo-public purpose, other social assets may be wasted as well. Recognition as a charity brings eligibility for direct and indirect public subsidies: tax exemption, favorable postal rates, and a plethora of other advantages.¹²⁷

As a result, the state continues to play in the charitable realm a role it long ago abandoned in the realm of business corporations. The state, as we have seen, no longer concerns itself with the purposes for which principals organize business corporations, beyond the barest baseline of minimum legality.¹²⁸ In stark contrast, at the threshold of each state subvention of charity, the state imposes and monitors, more or less diligently, a requirement that the entity in question be initially organized and continuously operated for publicly beneficial purposes.

This latter requirement—continued operation for the public benefit—presents a serious problem that becomes apparent when we look at what should now be a familiar dimension of the duty of obedience: its duration.

b. Duration

Under traditional Anglo-American law, as we have seen, a private trust can last only for a few generations; in English law, the duty of obedience in its strong form can last only for the minority of a single generation.¹²⁹ By contrast, in both English and American law, a charitable trust can last forever.¹³⁰

Viewed in isolation, this difference in duration is not of particularly great significance. It is, to use an ancient distinction, accidental rather than essential. The law could easily allow private trusts to last indefinitely, even infinitely, long; as we have seen, this is now allowed in some Commonwealth countries and American states.¹³¹ On the other hand, the law could restrict the life of charitable trusts. Commentators occasionally call for such sun-setting,¹³² although this has not actually been done in the common law world. To the extent that the duration of private trusts is lengthened or, conversely, the duration of charitable trusts shortened, the differences between the duty of obedience in the two contexts would diminish.¹³³

127. For a list of these advantages, see Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 836–37 (1980).

128. See *supra* Part II.B.1.a.i (discussing the relationship of the state as principal to the corporation's equity investors as agents).

129. See *supra* Part II.B.2.c (discussing the duty of obedience in English and American law).

130. See *supra* Part II.B.2.c (discussing the law of trusts in English and American law).

131. See *supra* Part II.B.2.c (same).

132. See, e.g., *Tax Reform Act of 1969: Hearings Before the S. Comm. on Fin.*, 91st Cong. 676–77 (1969) (debate on merits of sun-setting for private foundations); Manne, *supra* note 2, at 266 (“It is impossible to predict *ex ante* whether or not it would be better for all charities to be limited in duration.”).

133. See Sitkoff, *supra* note 2, at 658 n.188 (noting question of whether, as traditional rule against perpetuities collapses, “private trusts might soon face the sort of dead-hand problems that are familiar in charitable trusts, as the latter have long been exempt from the Rule”).

But the differences would not disappear, because a more fundamental difference remains: the purpose of the two kinds of trusts. It is the very different function of charitable trusts that make their infinite duration particularly problematic. Private trusts, remember, are for the benefit of private individuals; charitable trusts must benefit the public. Private needs and wants certainly change over time, but not as significantly as both social needs and social conceptions of what constitutes a public benefit. Dreadful infectious diseases like polio and small pox are effectively eliminated; new scourges like AIDS emerge. What once was legally allowed is now forbidden,¹³⁴ and, conversely, what once was forbidden is now allowed.¹³⁵ Inevitably, then, charitable purposes that were once comfortably above the public-benefit baseline of bare legality can fall below it. When evolving standards of public benefit diverge from the principal's original directions, what is to be done?

In the face of this dilemma, traditional Anglo-American legal doctrine gives two basic ways to remove or modify dead hand control of charitable assets: equitable deviation and *cy pres*.¹³⁶ Equitable deviation applies to administrative provisions, which are essentially the principal's mandatory alteration of the default level of the duties of care and loyalty. Here, as in the law of private trusts, the law is fairly permissive; indeed, the new Restatement of Trusts says that the standards are now the same.¹³⁷ *Cy pres*, by contrast, applies to substantive provisions, which are essentially the principal's mandatory alteration of the default level of the duty of obedience. Here, again as in the law of private trusts, the law is relatively strict; indeed, the variation allowed by the doctrine of *cy pres* is, if anything, stricter than its private trust counterpart.¹³⁸

Modification of substantive restrictions under the traditional doctrine of *cy pres* requires that three conditions be met.¹³⁹ First, and most basically, carrying out the donor's original charitable purpose must have become more or less seriously frustrated; in the words of the Restatement, those purposes must have become "unlawful, impossible, or impracticable."¹⁴⁰ Second, the donor must have had not only the particular intent to benefit charity in the original, specific way, but also a broader intent to benefit charity more generally.¹⁴¹ The third requirement gives the doctrine its short-hand name. In modifying the donor's original, frustrated purpose, the court must hew as close as possible—in Norman French, *cy pres comme possible*—to the donor's original

134. See *Jackson v. Phillips*, 96 Mass. 539 (1867) (slavery).

135. Prohibition forbade alcohol production and consumption. U.S. CONST., Amend. XVIII. Prohibition was, of course, later repealed by the 21st Amendment and promotion of viticulture is now a legitimate charitable purpose. See U.S. CONST., Amend. XXI.

136. My analysis here follows closely, sometimes verbatim, my parallel analysis in Atkinson, *supra* note 5.

137. Cf. RESTATEMENT (THIRD) OF TRUSTS § 67 (2003) (permitting change only when the settlor's purpose has become "unlawful, impossible, impracticable . . . or . . . wasteful") with *id.* § 66 (permitting change in circumstances unanticipated by the settler if the change will further the trust's purposes).

138. The Restatement suggests that the doctrine of deviation applies to charitable as well as private trusts. See *id.* § 66 cmt. a ("This Section—the so-called 'equitable deviation doctrine'—applies to both charitable and private trusts.") It is hard to see how this could apply to the modification of what it calls "distributive," as opposed to "administrative" terms, without undermining the doctrine of *cy pres*, which the Restatement places in a separate section and describes as applicable only to charitable trusts. *Id.* § 67.

139. MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 173 (2004).

140. RESTATEMENT (THIRD) OF TRUSTS § 67.

141. *Id.* § 67 cmt. b.

purpose.¹⁴²

All three requirements are fact-specific and, therefore, subject to a measure of manipulation in particular cases. What is more, all three requirements have, to some extent, been liberalized by various courts or legislatures,¹⁴³ and commentators are virtually unanimous in calling for further liberalization.¹⁴⁴ The important point to note here is that, despite the safety-valve doctrines of deviation and *cy pres*, dead hand control of charitable assets remains relatively difficult to remove. That very difficulty points us to a final distinguishing feature of the duty of obedience in charitable trusts: the identity of those who can enforce it.

c. Enforcement—The Weakness of the Strong Form

With respect to the enforcement of the strong form of the duty of obedience in private trusts, we have seen a peculiar paradox: although the trustee remains obliged, under that duty, to follow the principal's dictates after the principal's death, there is no one left but the beneficiaries to enforce that duty. In a practical sense, then, the duty of obedience in private trusts is significantly less strong than it appears to be in theory.¹⁴⁵

Only part of this paradox applies in the case of charitable trusts. It is true, here as there, that the dead hand's wishes must, as a practical matter, be enforced by someone who is alive. In the case of charitable trusts, however, those with power to enforce the principal's wishes are not limited to those most likely to benefit directly and materially from having those wishes disregarded. Indeed, the beneficiaries of charitable trusts, unlike the beneficiaries of private trusts, typically lack standing to compel the trustees to follow the principal's directions to use trust assets for their benefit.¹⁴⁶

Charitable co-trustees, like private co-trustees, do have power to enforce obedience to the principal's dictates. Because charities are more likely to have multiple trustees, and because these trustees are more likely to differ as to the course of the trust, this source of enforcement is likely to bulk much larger in the case of charitable trusts.

Another source of enforcement, however, is even more significant. As we have seen, the state retains an ongoing interest in the conduct of charities' operations.¹⁴⁷ As a corollary, the attorney general is universally recognized to have standing to enforce charities' purposes and is a necessary party in *cy pres* proceedings to alter those purposes.¹⁴⁸ In effect, then, dead charitable principals have an immortal sub-agent in the execution of their potentially perpetual charitable wishes.¹⁴⁹

142. *Id.* § 67; FREMONT-SMITH, *supra* note 139, at 38.

143. See, e.g., Alan Newman, *The Intention of the Settlor Under the Uniform Trust Code: Whose Property Is It Anyway?*, 38 AKRON L. REV. 649, 669 (2005) (describing liberalizations under the Uniform Trust Code).

144. See Atkinson, *Low Road*, *supra* note 67, at 139 (noting that "commentators are virtually unanimous in calling for further liberalization" of the *cy pres* doctrine); see also Atkinson, *supra* note 5, at 1113–14 (noting consensus for *cy pres* liberalization). Impatient with these reform efforts, I myself have explored promising prospects of unorthodox means of removing dead hand control: charities acting unilaterally, charities acting with state attorneys general, charities buying out adverse private interests, and charities invoking eminent domain. Atkinson, *Low Road*, *supra* note 67, at 108.

145. See *supra* Part II.B.2.d (discussing the enforcement of private trusts).

146. Mary Grace Blasco et al., *Standing to Sue in the Charitable Sector*, 28 U.S.F. L. REV. 37 (1993).

147. See *supra* Part II.B.3 (describing charitable trust law).

148. See FREMONT-SMITH, *supra* note 139, at 174.

149. That sub-agent, it should be pointed out, serves two masters: not only the principal who establishes the

4. Charitable Corporation Law

We have considered thus far the duty of obedience in business corporations, private trusts, and charitable trusts. In the business corporation, we found the duty of obedience in the weak form, but not the strong; in the other two, we found the strong form as well as the weak. When we consider our final organizational form, the charitable corporation,¹⁵⁰ we find considerable confusion as to the existence of the strong form of the duty of obedience. This confusion arises because the charitable corporation is an odd hybrid of corporate form and charitable function.¹⁵¹ American courts have not resolved this confusion consistently,¹⁵² and on this point the new Revised Model Nonprofit

charitable trust, but also the public whose benefit from the trust is essential to the trust being recognized as charitable. These dual responsibilities of the attorney general open up the possibility, which I have explored elsewhere, that the attorney general could consent to publicly beneficial deviations from the donor's will that are more generous than the current doctrines of *cy pres* and would allow courts to accept this deviation in litigated cases. See Atkinson, *Low Road to Cy Pres Reform*, *supra* note 67 (arguing that *cy pres* reform should take the form of immediately available strategies that can create freer and more fungible charitable assets and increased charitable autonomy). That prospect, however, is a very far cry from current practice and, even if it were to become widespread, it would still leave more dead hand control in charitable than in private trusts.

150. The corporation is the most common alternate to the trust as a mode for the institutional organization of charity in Anglo-American law. See FREMONT-SMITH, *supra* note 139, at 116 ("Charities are usually created in one of two legal forms, corporations or trusts, with the corporation being the most common form utilized in the United States since the mid-twentieth century."); Langbein, *Contractarian Basis*, *supra* note 1, at 631 n.26 ("The charitable corporation is now the favored American form for more complex charitable entities."). The other option, the unincorporated association, functions mostly as a default mode; if a charitable organization does not meet the formal requirements of either the charitable corporation or the charitable trust, it is almost necessarily an unincorporated association. See FREMONT-SMITH, *supra* note 139, at 116 ("Charities can also be created informally as voluntary associations, but this form is rarely used because, like partnerships, each member of the association will be subject to personal liability for the debts of the association."); see also JAMES J. FISHMAN & STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS* 61 (2d. ed. 2001) ("The disadvantages of unincorporated association status outweigh the benefits."). But see E-mail from Evelyn Brody, Professor of Law, Chicago-Kent Coll. of Law, Ill. Inst. of Tech., to Rob Atkinson, Ruden, McClosky, Smith, Schuster & Russell Professor, Fla. State Univ. Coll. of Law (Oct. 3, 2006, 10:30 EST) (on file with the author) (noting IRS data indicating that unincorporated associations bulk large among exempt organizations).

Because the formalities for creating a charitable trust are minimal—nothing more than one person's committing property to another, or even to himself as trustee, for a charitable purpose—virtually any charity that holds any assets at all almost certainly can be viewed as a trust. Thus the only non-incorporated charities that are not trusts are probably those, like small membership organizations, that have no property (except, perhaps, an intellectual property interest in their own name). As such, they cannot independently pose the key problem of the duty of obedience, dead hand control of property. If they have no property, they cannot pose the problem of its control; if they do have property, they can be analyzed as a trust.

151. By contrast, the charitable corporation is not like the private trust in either form or substance: it is in form a corporation, not a trust; it functions for the benefit of the public, not particular private parties.

152. See RESTATEMENT (SECOND) OF TRUSTS § 348 cmt. f (1959) (explaining that, when property is given to a charitable corporation, some courts say that a charitable trust is created and the corporation is a trustee); GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 324, at 379–91 (rev. 2d ed. 1977) (collecting cases); FREMONT-SMITH, *supra* note 139, at 439 ("There has been a question as to whether directors or members may amend the original purposes of a charitable corporation without court approval, thereby in effect avoiding the need to apply to a court for application of the doctrines of *cy pres* or deviation."); SCOTT ON TRUSTS § 348.1, (William F. Fratcher ed., 4th ed. 1989); see also Atkinson, *Unsettled Standing*, *supra* note 16, at 689–91 (explaining two different approaches contemporary courts take to determine donor intent); Evelyn Brody, *Charity Governance: What's Trust Law Got To Do With It*, 80 CHI.-KENT L. REV. 641 (2005) (arguing that policy makers and scholars have overlooked the fact that charities can take the form of

Corporation Act is a study in ambiguity—perhaps a study in studied ambiguity.¹⁵³

This becomes particularly apparent when charitable corporations seek to change their chartered purposes or to shift dramatically within those purposes. In both commentaries and cases, we can see two basic approaches: the corporate model and the trust model. Neither, in its present form, is fully adequate, because neither fully appreciates the very different roles that the duty of obedience plays in corporations and in charities.

a. The Corporate Model

The first possibility, and the most straightforward, is the corporate model. Under this model, courts treat the change in purposes like the analogous change in a modern business corporation. If the statute authorizes change in purpose by a majority vote of the directors, then neither dissenting directors, principals, nor the state has any grounds for objection.¹⁵⁴

b. The Trust Model

The second model takes a more complicated turn. Under this model, the court treats assets a donor transfers to a charitable corporation as if the donor explicitly placed them in trust for the corporation's original purposes or, sometimes, for the purposes the corporation was primarily serving at the time of the gift. In effect, the corporation is thus treated as the donor's trustee, subject under the duty of obedience to adhere to the original or principal purpose. On this view, the directors of a charitable corporation can no more change the organization's purpose than can the trustees of a charitable trust. Indeed, this view effectively makes them trustees, subject to the very strict *cy pres* rule

a trust); Evelyn Brody, *Whose Public? Parochialism and Paternalism in State Charity Law Enforcement*, 79 IND. L.J. 937, 956–68 (2004) [hereinafter Brody, *Whose Public?*] (discussing the relevance of whether the charity is formally organized as a trust or as a nonprofit corporation); Evelyn Brody, *supra* note 8, at 1458–76 (describing how the law deals with purposes changes in charitable corporations); Robert A. Katz, *Let Charitable Directors Direct: Why Trust Law Should Not Curb Board Discretion over a Charitable Corporation's Mission and Unrestricted Assets*, 80 CHI.-KENT L. REV. 689, 689–93 (2005) (arguing that the modern trend is to give boards authority to redefine charitable objectives and some states use trust law to limit this authority).

153. In both the relevant provisions, the new Model Nonprofit Corporation Act (Third Edition) (July 2008 Final Draft) (adopted August 2008), available at <http://www.abanet.org/dch/committee.cfm?com=CL58000>, seems to carefully dodge, or beg, the question. Section 10.09 Effect of Articles Amendment, subsection (b), provides: "Property held in trust by a nonprofit corporation or otherwise dedicated to a charitable purpose may not be diverted from its purpose by an amendment of its articles of incorporation [unless the requirements for change of trust purpose are met]." Similarly, § 12.03, Restrictions on Disposition of Assets, provides, in virtually identical language: "Property held in trust or otherwise dedicated to a charitable purpose may not be diverted from its purpose by [statutorily authorized distributions of assets unless the trust law restrictions on transfer of assets are met.] The comments to both provisions in the final draft merely paraphrase the rules themselves, leaving us to wonder whether all property that a charitable corporation holds, whether or not explicitly restricted to specific purposes, is subject to the full range of trust law limitations.

154. See BOGERT, *supra* note 73, at 205 ("If a gift is made to a charitable corporation for any or all of its purposes, with the intent that the full title shall vest in the corporation, subject only to the duty of the corporation to use the gift within the purposes of its charter, no trust is created. The property will be devoted to charitable purposes, but not through the medium of a trust.").

for change of purpose.¹⁵⁵

c. The Common Flaw of Both Models

Both models share a common flaw. Each borrows from an analogous body of law—charitable trust law on the one hand, for-profit corporate law on the other—without sufficient consideration of relevant differences. The trust model places the principal’s inferred intent over the organization’s explicit form. What’s more, and arguably worse, it infers, without explanation, that a donor would prefer to make a restricted as opposed to an unrestricted gift. As I have argued elsewhere,¹⁵⁶ the other logical possibilities, donor preference for or indifference to fiduciary freedom to change purposes, may be equally likely. The founder of a charitable corporation, that is, may well have chosen that form precisely because it seems to offer the organization’s governing body the power to change the organization’s purpose.

The corporate model reaches exactly the opposite result, with no better analysis. Sometimes courts simply place the organization’s explicit form over the donor’s possibly different intent; sometimes courts infer the donor’s intent from the organization’s form.¹⁵⁷ The rationale is that, if the donor gave to an organization whose form indicated an ability to change purpose, then the donor must have intended that his donation be subject to such changes. But this is not necessarily true, as the trust model makes clear: a donor to a charitable corporation could quite easily have intended that the purpose of the gift remain the same, and the donor could equally easily have assumed that the law guaranteed that result without donor specification.¹⁵⁸ That is, indeed, precisely the result that courts following the trustee model actually reach.¹⁵⁹

Under current doctrine, the result should turn on the intent of the donor/principal. But, as we have seen, fathoming donor intent is especially murky work in this context.¹⁶⁰ Where intent is not clear, the courts have had to rely on default rules. Here, as elsewhere, the design of the default rules should take into account two basic factors: likely donor intent and other social values. In this case, uncertainty as to the first component of default rules, likely donor intent, places considerable pressure on the second, serving other social values. Analysis of those values will take us beyond descriptive analysis, the subject of

155. See RESTATEMENT (SECOND) OF TRUSTS § 348 cmt. f (“Ordinarily the principles and rules applicable to charitable trusts are applicable to charitable corporations.”); RESTATEMENT (THIRD) TRUSTS § 67 cmt. f (2003) (applying *cy pres* rule of the trust model to gifts to charitable corporations); see also BOGERT, *supra* note 73, § 324, at 379 (explaining distinction between corporate model, or “absolute gift,” and trustee model, or “trusteeship”).

156. Atkinson, *Unsettled Standing*, *supra* note 16, at 689–91.

157. See *Oberly v. Kirby*, 592 A.2d 445, 466–67 (Del. 1991) (maintaining a distinction between the trust and the corporate form, with the attendant differences as to changes of purpose, as a matter of the donors’ intent).

158. See Brody, *Whose Public?*, *supra* note 152, at 944 (describing the change in purpose for a particular charity); see also Katz, *supra* note 152, at 689 (commenting on the gap that may exist between a charity’s objectives and its donor’s desires).

159. *Attorney Gen. v. Hahnemann Hosp.*, 494 N.E.2d 1011 (Mass. 1986); *Holt v. Coll. of Osteopathic Physicians & Surgeons*, 394 P.2d 932 (Cal. 1964).

160. See BOGERT, *supra* note 73, at 205 (“It is sometimes difficult to determine whether the intent of a donor to a charitable corporation was to have the corporation act as trustee or to have it own the property outright.”).

this part, to normative analysis, the subject of the next part. As we shall see,¹⁶¹ that analysis may well counsel in favor of a default rule of fiduciary discretion rather than donor direction.

III. NORMATIVE ANALYSIS: EVALUATING THE DUTY OF OBEDIENCE

As a descriptive matter, we have found the weak form of the duty of obedience in all the organizational forms we have considered: the business corporation, the private trust, the charitable trust, and the charitable corporation. We found the strong form of the duty of obedience—dead hand control, as we critics prefer to call it—clearly present in the private trust and the charitable trust, and clearly absent in the business corporation.¹⁶² With respect to the strong form of the duty of obedience in the charitable corporation, our findings were mixed: some courts recognize it; others do not.¹⁶³

In this part we analyze the strong form of the duty of obedience as a normative matter, asking ourselves whether its advantages outweigh its disadvantages. My conclusions are deeply skeptical. In the realm of business corporations, where the strong form of the duty of obedience has never existed, it would best never be created. In the realm of private trusts, where the strong form has long existed, it continues to serve a worthy purpose, though a purpose that does not justify its traditional and expanding scope. In the realm of charity, where the strong form of the duty of obedience has been strongest, it does much harm and no good that cannot be better served by less dubious means. This counsels for reducing its scope in the law of charitable trusts, where that scope has been greatest, and for halting its expansion into the realm of charitable corporations, where its acceptance, as we have seen, has been spotty and badly explained. After making the case against the strong form of the duty of obedience here, we turn in Part IV to alternative means for advancing its limited but not insignificant purposes.

A. Narrowing the Scope of the Inquiry

Before turning to our critique of dead hand control of charitable assets, we need to make three preliminary observations: the legitimacy of omitting normative analysis of the weak form of the duty of obedience, the significance of the absence of the strong form of the duty of obedience in the business corporation, and the relevance of the strong duty of obedience in the law of private trusts.

1. Normative Analysis of the Weak Form of the Duty of Obedience

Why, to parallel our normative analysis of the duty of obedience in its strong form, do we not need a normative analysis of that duty in its weak form? At first glance, this omission seems especially serious; the weak form of the duty of obedience is much more commonly encountered than the strong. Paradoxically, it is the very pervasiveness of the weak form of the duty of obedience that makes it both possible and necessary for us to ignore its normative analysis. As we saw at the outset, the weak form of the duty of

161. I have argued this elsewhere, see Atkinson, *Unsettled Standing*, *supra* note 16, at 691–92.

162. See *supra* Part II.B (locating the duty of obedience in various private and charitable trusts and organizations).

163. See *supra* Part II.B.4 (addressing the duty of obedience in charitable corporation law).

obedience is fundamental, not just to the four organizational forms we have considered, but also to every conceivable fiduciary relationship. Whenever one person commits resources or projects to another, the latter will be under at least some duty to obey the former. The precise scope of that duty will predictably vary with, or determine, the nature and scope of the particular fiduciary relationship.

Thus, to consider the justification of the weak form of the duty of obedience in any given fiduciary relationship is nothing less than to consider the very merits of that relationship itself. The various weak forms of the duty of obedience are analogous to Kant's hypothetical imperatives, or rules of skill.¹⁶⁴ If you want the social function that is performed by the mode of organization they constitute, you must have them as well. Thus to question the weak form of the duty of obedience in the various forms of organizations we have examined would be to question the social utility of those forms of organization themselves. That, of course, lies beyond the scope of our present enquiry.

a. The Absence of Any Strong Duty of Obedience in the Business Corporation

A second preliminary point bears more directly on the task at hand: the absence of the strong form of the duty of obedience from the business corporation. There is not now, and there apparently has never been, a strong duty of obedience in the law of for-profit corporations. What is more, no one seems to be suggesting that we create one. The task here, rather, is to suggest why none has arisen.

This absence, I suspect, is no accident. Rather, the strong form of the duty of obedience is radically inconsistent with a basic purpose of that mode of organization, i.e., making the flow of capital in the market as easy as possible. In that system, there simply is no place for dead hand control. In the absence of very special circumstances, control of commercial assets should be in the hands of the living. Accordingly, to make the case against dead hand control in the corporate sphere would be not so much to flog a dead horse as to attack a straw target.

b. The Strong Duty of Obedience in the Law of Private Trusts

If there is, for our purposes, very little to say about dead hand control in the context of business corporations, virtually the opposite is the case with respect to private trusts. Far too much has been said about dead hand control there, for and against, to cover in this paper.¹⁶⁵ What we can see here, though, is how the rationale for dead hand control in that context, even if accepted, would be of dubious application to charity.

The most compelling normative account of dead hand control in the law of private trusts focuses on its wealth-maximizing potential. The principal of a private trust may want to provide for the care, after his or her death, of minor children or people with mental disabilities. These people, by hypothesis, are not able to deploy resources so as to maximize their own welfare; the resources, accordingly, are best placed in some sort of fiduciary arrangement, with a third party investing and spending them on the

164. IMMANUEL KANT, FOUNDATIONS OF THE METAPHYSICS OF MORALS 36–37 (Robert P. Wolff ed., Lewis W. Beck trans. 1969) (1785).

165. For classic treatments, see LEWIS SIMES, PUBLIC POLICY AND THE DEAD HAND (1955) and ARTHUR HOBHOUSE, THE DEAD HAND (1880).

beneficiaries' behalf. The relevant standards could be simply left at the default level, what a reasonable person would do with another's resources under the circumstances. But the principal may want to adjust those standards mandatorily, and in a way that lasts beyond the principal's own life. The principal's rationale would be that, as the parent or other close relative of the beneficiary, he or she knows the beneficiary's particular needs not only better than they themselves, but also better than any available fiduciary. To the extent that that is true, then allowing dead hand control in this context is likely, in the mill run of cases, to enhance aggregate social wealth.¹⁶⁶

Notice that this rationale, even if credited, carries with it an implicit limit on the duration of the duty. Under the traditional common law rule against perpetuities, no private trust can last longer than a generation after the lives of people the principal actually knew.¹⁶⁷ What's more, as we have seen, in Commonwealth countries a trust can be ended at the behest of its competent adult beneficiaries.¹⁶⁸ Thus dead hand control in the private trust is limited in its subject matter to particular private matters that the principal is likely to know best, and is limited in its duration to only as far ahead as the principal can likely see.¹⁶⁹

With respect to charity, on the other hand, neither the rationale nor the limitation applies. Charities exist, at bottom, to benefit the public at large, not particular private individuals. Thus, if it is their principals' superior insights that are to be the basis for allowing the principals to exercise dead hand control, it will have to be insights about matters of the general public welfare, not their family and friends' special needs. Making that case, presumably, is not only different, but also more difficult. Furthermore, dead hand control in the charitable context is not limited to what the principal can reasonably foresee. Its duration is not a human generation or two into the future; it is, rather, forever. Dead hand control in the private trust thus rests on knowing the needs of particular individuals for the next few decades; dead hand control in charity rests on the very different claim to know the good of humanity better than anyone else, forever.

B. Dead Hand Control in the Law of Charity

We reach, now, the core of our normative analysis: the case for and against dead hand control in the law of charity. This subsection first sets out the traditional arguments in favor of dead hand control, pointing out their respective weaknesses. It then turns, more briefly, to the positive case against dead hand control, the advantages of charitable

166. RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 481–85 (3d ed. 1986). *But see* Jonathon R. Macey, *Private Trusts for the Provision of Public Goods*, 37 *EMORY L.J.* 295, 296 (1988) (asserting that common law trust doctrines do not promote efficiency and increase societal wealth).

167. *See supra* Part II.B.2.c (discussing the strong form of the duty of obedience).

168. *See supra* text accompanying note 94 (discussing the ability of adult beneficiaries to force a trustee to deviate from a principal's directions).

169. As Adam Hirsch and William Wang astutely argue, the fit could be much better than it is. *See Hirsch & Wang, supra* note 4, at 3–5 (noting the underlying structural problems of future interest law). As they point out, the settlor's insights are much more likely to be superior with respect to what we have called the "spending" function than with what we have called the "investing" function; a settlor is quite likely to have superior insights into the particular needs of trust beneficiaries, but much less likely to have superior insights into how best to invest trust assets so as to ensure a particular balance of risk and return. *See id.* at 27–33 (noting the problems with trust investment restrictions).

independence. Finally, it takes up a more recent argument for a measure of dead hand control, in terms of agency costs. This sets the stage for Part IV, which tries to show how the concerns raised by this newer argument for dead hand control can be met by other means, particularly by creative use of the weak, as opposed to the strong, form of the duty of obedience.

*1. The Traditional Case for Dead Hand Control*¹⁷⁰

The traditional case for dead hand control rests on two sets of arguments. The first set is, in traditional terms of normative analysis, deontological; it maintains that recognizing dead hand control is, in some sense, inherently right. The other set of arguments in favor of dead hand control is consequentialist; these arguments maintain that dead hand control produces any one of several good results. We will examine each set of arguments in turn.

a. Deontological Arguments

According to the deontological line of argument, recognizing dead hand control is right either because it respects private property or because it honors promises. To take up the latter first, the argument for dead hand control based on the general obligation to honor promises fails for several related reasons.¹⁷¹ First, removing the agent's legal obligation to follow the dictates of the dead hand would leave intact any valid moral obligations to the dead hand; to say that the agent *may* legally depart from dead hand directions is not to say that the agent *must* depart from them, nor is it to say that such departures are morally as well as legally permissible. Second, the removal of legal enforcement of dead hand control would leave in place many informal, extra-legal means by which principals may ensure that their wishes are honored after their death. Finally, any plausible moral obligation to honor promises must admit of exceptions; some of these exceptions, surely, would allow agents to depart, at least in compelling cases, from the dictates of dead principals. And, all else being equal, the longer ago the commitments to the principal were made, the morally weaker they are likely to be.

The other deontological argument for dead hand control fares no better. According to this argument, principals who donate property to charity are entitled to exercise dead hand control as an incident of their ownership of the property in the first place. To own property, on this theory, entails the right to do with it as one likes across time, even eternity.

Whatever its merits in the realm of political theory (for my money, none), this absolutist theory of property proves far too much in the realm of law. For one thing, law currently imposes a vast array of restrictions on private control of property. In the traditional law of private trusts, as we have seen, the principal can exercise dead hand control only for a relatively short time. More generally, under current law, virtually every aspect of private control of social resources has to be justified in terms of the public

170. This analysis follows, in shorter form, my earlier critique of dead hand control of charitable assets. Atkinson, *supra* note 5, at 1121–34.

171. *Id.* at 1124–33.

good.¹⁷² At its very limit, even arguments for private property that focus on the realization or protection of the individual rest, at bottom, on the aggregate social good of these individual entitlements.¹⁷³ Accordingly, deontological arguments for dead hand control in the legal realm inevitably collapse into consequentialist arguments, to which we now turn.

b. Consequentialist Arguments

Defenders of dead hand control point to three related social benefits it may confer. First, and most generally, individuals may be stimulated to work harder and earn more by the prospect of being able to control after their death what they pass on to charity.¹⁷⁴ Second, and more particularly, that prospect may encourage them to give more to charity.¹⁷⁵ Finally, the wiser of them will be able to ensure that their far-sighted perspective on the public benefit is not overridden, after their death, by fiduciaries with lesser vision.¹⁷⁶ Each of these arguments, though plausible on its face, is deeply problematic on further analysis.¹⁷⁷

It may be true that the prospect of controlling charitable contributions long into the future will stimulate either economic activity in general or charitable giving in particular. There is no hard empirical evidence, however, for either claim. Moreover, in the former case, the impact of removing dead hand control is not likely to be very great. Individuals have many incentives to work, earn, and save; if anything, the loss of the prospect of making dead hand controlled gifts to charity seems likely to rank rather low on the list. Even as a stimulus to charitable giving, the incentive of exercising dead hand control seems relatively weak, especially in light of the many informal, extra-legal ways donors can use to ensure that their wishes, even if legally unenforceable, are nonetheless carried out.

As for the asserted social gains in “locking-in” the good ideas of wise philanthropists, there is an obvious, and ominous, counterpoint: perpetuation of the marginally beneficial schemes of donors who are more than slightly daft. To make the case for dead hand control on this basis would require a particularly difficult metric: weighing the gains from working the will of the wise philanthropists against the costs of catering to the capricious ideas of the whimsical. It scarcely needs to be said that no such calculation has been, or is ever likely to be, made.

172. *Id.* at 1123–24.

173. See Charles A. Reich, *The New Property*, 73 *YALE L.J.* 733, 771–74 (1964) (arguing that protecting individual property rights in a new era with new dangers to individuality is, in fact, in the interest of the public at large).

174. See Macey, *supra* note 166, at 297 (arguing that power to make restricted private gifts spurs productivity).

175. See Manne, *supra* note 2, at 271 (“Upholding the intent of the founder, or ensuring that charitable donations are used for their originally intended results, will simultaneously encourage the creation of charities and secure their continued funding.”).

176. See John Simon, *Charity and Dynasty Under the Federal Tax System*, 5 *PROB. LAW.* 1 (1978) (defending private foundations as vehicles for their founders’ exceptional innovations).

177. Atkinson, *supra* note 5, at 1123, 1133, 1150–51.

2. *The Positive Alternative to Dead Hand Control: Charitable Independence*

The weakness of the traditional arguments for dead hand control of charitable assets is only half of the case against it. The other half—I would say the stronger half—is the positive case to be made for the alternative, freedom of charitable fiduciaries from dead hand donor control. I have made that case at length elsewhere, and thus will only summarize it here.¹⁷⁸

As a matter of political theory,¹⁷⁹ the independence of charitable fiduciaries from dead hand control offers the prospect of dramatically strengthening the nonprofit sector over its two bigger siblings, the private sector on the one side and the governmental sector on the other. Most basically, private parties and state agencies could no longer call charities to task before the courts to enforce the will of donors long dead, subject only to narrow and judicially determined exceptions. This political advantage has an economic side as well.¹⁸⁰ Freed from the legal obligation to pursue the purposes identified by dead donors, charitable fiduciaries could respond more quickly and creatively to current social needs.

The ideal is a self-sustaining yet evolving charitable community. And this ideal is not merely a hypothetical, theoretical construct. Approximations include a wide range of religious bodies around the world, the Western university as it has developed from the European Middle Ages, and the twentieth century American private foundation.

This alternative to dead hand control is not, of course, entirely without problems of its own, which I have examined elsewhere¹⁸¹ and need not repeat here. The most fundamental of these I did not fully appreciate there, and need to address here in more detail. As I said there, the choice between proponents and opponents of dead hand control ultimately comes down to whether one trusts living fiduciaries more than dead donors. Here, as there, I come down in favor of the former. But, even if my earlier treatment was not too pessimistic about dead donors, it may nonetheless have been too optimistic about living fiduciaries. In questioning traditional over-reliance on the virtues of the one, my recommended reform understated a besetting vice of the other.

3. *The Wrong Solution to a Real Problem: Dead Hand Control Against Fiduciary Bias Toward Current Expenditure*

The problem is this:¹⁸² Charitable fiduciaries, like other agents, public and private, operate within shorter time horizons than proper analysis of the public good would require. For several related reasons, they are likely to over-estimate the value of current expenditures and to under-estimate the value of future expenditures. For one thing,

178. *Id.*; Atkinson, *Unsettled Standing*, *supra* note 16, at 686–99.

179. *See* Atkinson, *supra* note 5, at 1144–47 (describing the benefits of removing dead hand control of charitable assets).

180. *See id.* at 1147–48 (recognizing that the elimination of dead hand control has the capacity to generate a new source of capital).

181. *Id.* at 1148–55; Atkinson, *Unsettled Standing*, *supra* note 16, at 692–96.

182. Actually, some argue the problem may be the opposite of this; not spending too fast, but spending too slow. *See, e.g.*, John D. Colombo, *Why is Harvard Tax Exempt? (And Other Mysteries of Tax Exemption for Private Educational Institutions)*, 36 ARIZ. L. REV. 841 (1993); Hansmann, *supra* note 127; Henry B. Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54 (1981).

current expenditures redound to their credit both sooner and more directly than saving for a rainy day. Jesus was doubtlessly right: the poor will always be with us.¹⁸³ But Keynes was also right: In the long run, we're all dead.¹⁸⁴ If we apply the former maxim to charitable beneficiaries and the latter to charitable fiduciaries, we have the core of the problem. In all likelihood, fiduciaries are systemically inclined to favor current expenditures over endowment.

From the perspective of the charity, the ideal mix of spending and saving should be based on a careful consideration of the discounted present value of both alternatives in terms of overall public benefit purchased with a given amount of resources. But, from the perspective of present management, spending today has another factor in its favor, wholly irrelevant to this calculation: Today's managers will be gone tomorrow.

Two points minimize this risk. First, the skewing here is not only toward, or even primarily toward, current operating expenses. Rather, it applies equally, and perhaps more strongly, toward current capital expenditures. The university president who raises faculty salaries or lowers student tuition may be today's darling, but is not likely to be long remembered. By contrast, the president who presides over a large-scale building campaign has literal, and lasting, monuments to his or her success. What we have here, then, is a possible bias against endowment, as opposed to current expenses for either operations or construction, perhaps more likely the latter. And the latter are by definition longer-term, though—again, by definition—not as long-term as permanent endowments.

The second point cutting against the current-spending bias of charitable fiduciaries is more significant for our current analysis. Not all fiduciaries' interests are skewed as strongly in favor of current spending as others. Fundraisers may, as fundraisers, be indifferent as to whether contributions are spent today or saved for tomorrow; they get equal arithmetic credit for the raising of both. Higher level fiduciaries, on the other hand, are likely to get an odd, and systematically skewing, double benefit for spending. They can count it once as money raised, and again as money spent. Bluntly stated, spending money means, for them, two headlines, not one: This week, "University President Meets Capital Campaign Goal"; next week, "University President Breaks Ground for New Physics Building." If the contributions go into endowment, by contrast, there is simply no second headline. The university's money stays in the bank, but the president's gilded ground-breaking shovel stays in the shed.

Typically, of course, the president or other chief executive or managerial officer will not be empowered to make the more significant decisions about allocating institutional funds. These matters will often—though not always—be reserved to the charities' equivalent of a for-profit corporation's board of directors.¹⁸⁵ This policy-making body

183. *Mark* 14:7.

184. JOHN MAYNARD KEYNES, A TRACT ON MONETARY REFORM (1923).

185. Others have noted systemic conflicts between charitable fiduciaries at the trustee and director level, on the one hand, and charitable fiduciaries at the managerial level, on the other. See Eugene F. Fama & Michael C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 344 (1983) (noting the advantages in nonprofit organizations of "a decision system that separates the management (initiation and implementation) and control (ratification and monitoring) of important decisions"); Sasso, *supra* note 8, at 1508-18 (distinguishing functions of, and identifying systemic conflicts between, charities' typically lay "boards" and their typically professional "management"). To come out in favor of "boards" over "managers" in the present "spending-versus-savings" context is not, I want to emphasize, to come out in the same direction in all disputes between these two groups. Indeed, quite often it might be managers who have the better view, particularly in

may not, however, act as a very effective check on the preferences of managers for spending over saving. For one thing, they may share management's incentive to enjoy credit for current expenditure. And, even if their inclinations run in the other direction, they, like for-profit boards, may find themselves beholden to current management for their very positions.¹⁸⁶

Dead hand control by donors offers an initially appealing remedy to this problem. If current fiduciaries are forbidden to spend endowment, then, at least to that extent, their appetite for current expenditure is diverted, if not curbed. But we must be careful to keep this concession to the dead hand within its bounds. To that end, we must note here the extreme limits of this argument, then observe in the final part that there may be alternative remedies that are equally effective and less costly.

Notice that this fiduciary-budgeting argument for a measure of dead hand control is much narrower than the arguments we examined earlier. It allows for dead donors to constrain fiduciaries in their timing of expenditures, but not as to what ultimately to spend the money on, or how to invest it in the meantime. It is one thing for donors to be able to say to an institution's fiduciaries, "You must invest these funds in perpetuity and spend the income on studying the benefits of the gold standard"; it is quite another for donors only to be able say, "You must invest these funds in perpetuity (but you may spend the income in the way that you and your successors believe most benefits the public)." Similarly, it is one thing to say, "You must hold these funds forever, invested in Treasury notes," and quite another to say, simply, "You must hold these funds as part of your permanent endowment." Allowing the donor to dictate the timing of expenditure would be a major, if defensible, concession to the dead hand. But it would also be, by any account, a major reduction of the dead hand's present power, a significant limit of the scope of the strong form of the duty of obedience.

Before we make even that limited concession to the dead hand, however, we need to explore an alternative: Using the weak form of the duty of obedience to craft methods for subjecting current fiduciaries to curbs not policed at the behest of dead donors, but monitored by the fiduciaries' living contemporaries.

IV. RECOMMENDATIONS FOR REPLACING DEAD HAND CONTROL OF CHARITABLE ASSETS

The last part concluded that dead hand control of charitable assets is generally a bad idea. In the one area where it has the strongest policy basis, protecting against current management's incursions into endowments, we promised to offer a more appealing alternative. Its basic function will be to add a measure of external control over charity's fiduciaries, to ensure their obedience to their founders' directives over time. In essence, this will be another "layer" of supervision designed to police the duty of obedience, as opposed to carrying out the basic work of the organization. This final part examines several forms that an additional overlay of obedience monitoring might take. The first two of these involve individual monitors, default takers of restricted gifts and visitors on

matters that involve innovations in current operations and expenditures.

186. Recognizing this problem, James Fishman has called for a charitable analog to "independent directors" or "special committees." James Fishman, *The Development of Nonprofit Corporation Law and an Agenda for Reform*, 34 EMORY L.J. 617, 679-83 (1985). This is functionally similar to my own proposal, below, which I base on the analogy of the traditional office of charitable visitor.

the classic English model. Flaws with both of these will turn us to institutional monitors in each of the three principal sectors of our society: the for-profit, the governmental, and the nonprofit. Each has its strengths and weaknesses; this part concludes that, on balance, the best mechanism is to have special oversight charities watch over operating and grant-making charities.

A. Individual Monitors

1. Default Takers Policing Restricted Gifts

Anglo-American law allows owners of property to make transfers subject to forfeiture on a virtually limitless range of conditions. This mechanism has frequently been used to restrict charitable gifts. Thus, for example, an owner of a parcel of land may convey it to a church, provided the land be used only for church purposes; if the land is ever used for other purposes, the church's interest is forfeited to the donor or, after the donor's death, to his or her legal successors. Similar forfeiture arrangements are also possible, through the trust mechanism, for other forms of property as well. Thus, for example, a wealthy donor might place a fund in trust with the income to be used to benefit a specified department or professorship of a university, subject to forfeiture in favor of the donor and the donor's successors if the funds are ever diverted to other purposes, or if the principal is ever invaded. Gifts to endowment could be made with similar default provisions.

This kind of defeasible gift, though easily deployed and fairly widely used, has a critical functional flaw: both its enforcement incentives for the monitor and its compliance incentives for the organization are badly skewed. This skewing is best seen if we consider two time frames, shortly after the donor's death and much later. Early on, when the need for monitoring is likely to be less, enforcement incentives are greater—perhaps too great. The need for external monitoring early on is likely to be less for two related reasons. First, since less time will have elapsed since the donor's death, the donor's purpose is less likely to have fallen out of step with current demands for charitable resources. Second, informal controls on fiduciaries are most effective shortly after the donor's death. Fiduciaries are more likely to have known the donor personally; the donors, indeed, may have chosen the first generation of fiduciaries primarily on the basis of their loyalty to them. Incentives for fiduciaries to deviate from donor wishes early on, then, are likely to be relatively weak.

At that very time, however, a default taker's incentive to monitor is likely to be relatively strong, quite likely too strong. The main reason is that the reward to the monitor is forfeiture of the donated assets to the monitor himself. The monitor is under no fiduciary obligation to balance the degree of departure from the donor's wishes against the severity of the penalty to the charity itself. Indeed, as I have argued elsewhere,¹⁸⁷ the default taker is free to "sell" his veto to the charity at a mutually agreeable price. And this price may, at least on the monitor's "supply" side, have more to do with the monitor's need for money than with the original donor's likely preferences for continuity or the charity's felt need for change.

187. Atkinson, *Low Road*, *supra* note 67, at 131.

In the other time frame, long after the donor has died, the monitoring and compliance incentives are at least equally skewed, but for different reasons and in different directions. The reason the need for monitoring will be greater is obvious. As the donor's death recedes into the past, his or her purposes are likely to become less popular, and later generations of fiduciaries will feel less beholden to the dimly remembered donor. If, as the Scriptures tell us, there arose a Pharaoh who did not know Joseph, the wise regent for Ramses,¹⁸⁸ so, too, there will arise Josephs who do not remember Ramses.

On the other hand, the reason the incentive to monitor will decline over time is equally great, but much less obvious. It has to do with the fact that the default interest—the entitlement to receive the donated property by forfeiture if the fiduciaries depart from the donor's instructions—is likely to divide to the vanishing point over time. Such interests tend to pass down the generations invisibly, through the residuary clauses of wills or under intestacy statutes. As a result, they are typically divided, by operation of law, among an increasingly large class of holders. These holders are likely to be unaware of the existence of their default interests. And even those who are aware of their interest face a classic collective action problem. The fruits of their monitoring the charity's fiduciaries will not be theirs alone, but will have to be shared with fellow default holders. Thus, if the incentive of default takers to monitor is too great early on, when the risk of fiduciary deviation is small, it is likely to be too small later, when the corresponding risk is greater.

2. *The Traditional Charitable Visitor*¹⁸⁹

Anglo-American law contains an institution that offers a corrective to some of these problems; with appropriate adjustments, it could be refined to address the others. English law gave those who founded or endowed charitable corporations the right to supervise their gifts through a power of visitation.

The classic English visitorship, unlike the standard defeasible gift, did not tend to divide over time among heirs and residuary legatees. Instead, it passed intact to the founder's primogenitory heir, rather like landed estates themselves at early common law and like hereditary titles in England today. Furthermore, the classic visitorship, again unlike the standard defeasible gift, did not entice its holder to excessive monitoring with the prospect of a windfall of forfeited charitable assets. Nor, on the other hand, did it tempt the holder to sell the veto cheap, like hungry Esau's birthright for the opportunistic Jacob's bowl of porridge. It seems, rather, to have been exercisable only in a limited fiduciary capacity, to the general public if not to the particular charity.¹⁹⁰

Here, however, lay a problem with the visitorship itself, which may have contributed to its falling into desuetude. Where the default taker has too much incentive, at least early on, to enforce the donor's wishes, the visitor may, from the very beginning, have had too

188. *Exodus* 1:8.

189. The analysis in this section comes largely from one of my previously authored articles: Atkinson, *Unsettled Standing*, *supra* note 16, at 694–96.

190. See Roscoe Pound, *Visitation Jurisdiction over Corporations in Equity*, 49 HARV. L. REV. 369, 395 (1936) (describing visitation as “a powerful weapon for the protection of the public,” less subject to abuse than private shareholder actions against management).

little. The default taker, as we saw, is rewarded with the forfeiture of the original gift; the visitor, by contrast, received no personal financial compensation at all. What is more, the donor's heirs, visitors along with others, may take less than an eager interest in the success of an organization that received part of what would otherwise have been their own inheritance. These problems may well have been less severe in a bygone era of noblesse oblige and family dynastic integrity, but it is much less likely to work as well today. Indeed, the very idea of hereditary offices, at least in the more republican reaches of the English-speaking world, is distinctly distasteful.¹⁹¹

Each of these problems with traditional visitorship, however, could be corrected. The donor could provide for the visitor, like other fiduciaries, to be compensated for his or her services; if the donor is silent on this point, the law could impose a default rule of reasonable compensation. And the donor could have the office of visitor pass, not down to the hereditary head of his or her family, but as appointed by the visitor him- or herself or by some sympathetic institution. The visitor would then be the charitable equivalent, not so much of a king or queen, but of a parish priest or university president.

That mode of succession raises its own problem: Where are willing and able visitors to be found? Who would want the job and, more particularly, who could be depended upon to carry it out faithfully during life and to pass it on to a worthy successor at death? That problem, too, can be solved, but only by turning from reliance on individuals to reliance upon institutions.

B. Institutional Monitors

Institutions, in modern westernized societies, fall into one of three sectors: the for-profit, the governmental, or the nonprofit. In this section we look at possible institutional solutions from each of these sectors in turn. What we find here, in microcosm, is what theorists of the third, nonprofit sector have long maintained: nonprofits tend to arise where the other two sectors have failed, in situations of market failure on the one hand and government failure on the other.¹⁹² This, we shall see, is just such a case. Institutional monitors of charity tend to be nonprofit organizations because neither for-profit firms nor governmental agencies have offered a viable alternative. Here, however, nonprofits do not just win the field by default; they also offer positive advantages of their own. Chief among these is their contribution to the continued strength and independence of the third sector itself.

1. Creating For-Profit Firms

In our essentially market-based economy, the first place to look for monitors of charitable purposes is private-sector, for-profit firms. In the wake of an extraordinary expansion of economic analysis of legal institutions, the proposal of such a solution can scarcely come as a surprise.¹⁹³

The law has long allowed charitable principals to name institutions, not just

191. See Fishman, *supra* note 186, at 647 (attributing the unpopularity of visitorship in America after independence to "its ecclesiastical origins and the essentially aristocratic tone" of its inheritability); see also U.S. CONST. art. I, § 9, cl. 8 (prohibiting state and federal grants of titles of nobility).

192. FREMONT-SMITH, *supra* note 139, at 1.

193. Manne, *supra* note 2, at 233.

individuals, to the office of visitor; these institutions have typically been other charities.¹⁹⁴ Geoffrey Manne has recently proposed a for-profit alternative.¹⁹⁵ Under that proposal, donors would contract with for-profit monitoring firms to act as their agents in monitoring charities after the donor's death.¹⁹⁶ Power to enforce the terms of the principal's gift to the charity would rest with the for-profit monitoring organization.¹⁹⁷ That organization's incentive to monitor after the donor's death would lie in its desire to attract additional fees-paying clients; the stronger its reputation for maintaining strict adherence to donor wishes, the more attractive it would be to other donors who want their will done after their death.¹⁹⁸

Manne's proposal for for-profit monitors, we should note, is much more broadly based than mine. I, remember, am interested in finding an alternative to the strong form of the duty of obedience for a very narrow purpose, that is, preventing over-consumption of charitable endowment. Manne, by contrast, is interested in supplementing existing means of enforcing dead hand control of charitable assets in all the ways that that control is currently allowed, including those we have examined and found wanting.¹⁹⁹ But Manne's proposal could, in its own terms, be used for my narrower, endowment-protecting purpose as well.

For that purpose, however, Manne's proposal offers at once both too little donor control, and too much. It offers too much because the for-profit firm's incentive to adhere strictly to donor directives is too strong. What we need is a means of monitoring charitable agents that has at least a modicum of flexibility; in some cases, virtually all disinterested living observers would agree that a measure of diversion from endowment to current expenditure is in the charity's best interest, long term as well as short.

Manne's market-based proposal would tend to squeeze out all such institutional flexibility. Manne's proposal would not, technically speaking, necessarily reproduce dead hand control in its strong form; his for-profit monitor could have the legal authority to allow shifts from endowment to current expenditure. It could operate, in other words, with a weak, not just a strong, duty of obedience. But, as Manne argues, for-profit monitoring agents would have a major incentive not to allow such shifts: the prospect of attracting additional buyers of their monitoring services.²⁰⁰ This incentive would tend to produce what I have called a "market in obsequiousness," a race for the reputation of slavish devotion to the wishes of dead donors.²⁰¹

This risk of over-protection is, admittedly, a bit speculative (though not without some empirical evidence in the case of private trusts). Donors may well want a measure of flexibility along the lines I have suggested; they would choose for-profit firms with a reputation for well-considered waivers of their enforcement powers, not wooden-headed obedience to the original terms of the endowment. For my purposes, though, even this

194. BOGERT & BOGERT, *supra* note 152, § 416, at 60 (founders may vest visitorship in "another person, group, or body").

195. Manne, *supra* note 2, at 229.

196. *Id.*

197. *Id.*

198. *Id.*

199. *See generally id.*

200. Manne, *supra* note 2, at 253.

201. Atkinson, *supra* note 5, at 1152–53.

would be too much; my position, again, is that absolute dead hand control is bad and, accordingly, any measure of it, excessive.

How, then, can it be that Manne's model offers, from my perspective, not only too much dead hand control, but also too little? Here is the problem: Although Manne's for-profit monitors, should they exist, would have an excessive incentive to adhere to donor wishes, there seem, in fact, to be no such for-profit monitors at all. Manne, having shown how relatively easily, under current law, donors could contractually arrange a measure of dead hand control that would, for my purposes, be excessive, is at pains to explain why such measures are, not only uncommon, but non-existent.²⁰²

The problem is ultimately something of an irony: Manne's market solution to a market failure in the monitoring of nonprofit agents is itself beset by market failures. He identifies some of these himself; for purposes of our analysis, we should examine several others, some on the demand side and some on the supply side. The first supply side problem is both the most serious and the easiest to see. For-profit suppliers of monitoring services may not arise because returns to their investment are not high enough. In part, this may have to do with the fact that alternative, nonprofit suppliers of that service keep returns lower than market returns. But that explanation raises a series of related questions, which point to the demand side. Why is demand so low as to be met by nonprofit suppliers—suppliers who are, on Manne's theory, more costly to monitor than for-profit competitors, and thus less efficient?

To the extent that such limitations provide a public good, it is not surprising that they would be undersupplied. Public goods are classically undersupplied, precisely because their benefits cannot be fully captured by private purchasers. Here it may seem that what is being purchased is not a public good, but rather a private good; Manne's principals are not seeking to ensure that charity continues to serve a public purpose, but rather that it continues to serve the particular charitable purpose the donor has chosen. The law, to be sure, insists that the purpose be publicly beneficial; only the donor, however, is concerned that his particular purpose be continued.

This would be true of Manne's proposal in general. But, as we have narrowed that purpose to cover monitoring only to prevent over-consumption of endowment, that argument should not apply. If limiting endowment is, in fact, itself socially beneficial, not just an indulgence of donor preference, then it is at least partly a public good and is, accordingly, likely to be undersupplied by for-profit firms.

And there are demand-side problems as well. For one thing, current law lets donor-principals externalize much of the cost of monitoring onto governmental agents. State attorneys general, remember, are required to enforce the terms of charitable gifts, and this monitoring comes at no incremental cost to the donor.²⁰³ Demand for private monitors is lowered by the fact that the government is giving away what they would sell. To be sure, the substitute is not perfect; at best, attorneys general offer relatively flexible, not totally

202. Manne, *supra* note 2, at 259 ("But still [despite predicted efficiency gains] we do not observe such relationships in practice."); *id.* at 260 n.133 ("There is no market yet for a service like the one advocated here. . ."). Manne points out that "[a]t least one example of an arrangement similar to the one advocated here exists today." *Id.* at 255–56. In that example, however, the appointed monitors are not for-profit organizations, as Manne recommends, but rather other charities, as recommended below. See *infra* Part IV.B.3 (discussing nonprofit managers acting as monitors).

203. See *supra* text accompanying note 148.

knee-jerk, enforcement of donor wishes. But demand for super-conservative, absolutely non-deviationist monitors may be very low, too low to produce the kind of reputational capital that Manne predicts would be required to sustain a market for such capital.

Whatever the reason, the reality is, from Manne's perspective, a paradox: Although monitoring charitable agents poses serious agency costs, the only non-governmental institutional monitors that donors use to lower those costs appear to be other nonprofit firms. Those nonprofit monitors, as Manne admits, are relatively common, particularly in the form of accrediting bodies.²⁰⁴ It is here that the better solution to the monitoring of charities is to be sought. But before looking in more detail at these third-sector alternatives, we need to look at least briefly at public-sector alternatives.

2. *Expanding Governmental Supervision*

At the state level, as we have seen, the attorney general has the duty to monitor charities for breaches of all three fiduciary duties: care, loyalty, and obedience. With respect to charitable purposes, government at all levels has an interest in making sure that charities conform to the conditions of the various public subventions they receive, whether as direct subsidies or as favorable tax treatment. More particularly, state attorneys general have the duty to police conformity with the duty of obedience; they are necessary parties in any suit by charitable fiduciaries to change the administrative or substantive terms of charitable trusts (and, where treated on the trust model, charitable corporations).²⁰⁵

But attorneys general are likely to be a particularly bad monitor of the kind of dead hand control we have identified as normatively justified. The ideal monitor would allow charities to divert resources from endowment to current expenditure in appropriate circumstances. But those circumstances are devilishly difficult to identify in advance and reduce to a definitive legal rule.²⁰⁶ What we need, then, is more a standard than a rule, more equity than law.

But standards imply a large measure of discretion on the part of the enforcement authority, and the attorney general is a particularly problematic repository of such discretion in this context. The problem here is primarily one of bounded time horizons. State attorneys general are often elected, not appointed; as Professor Brody has pointed out, AG stands not only for "Attorney General," but also for "Aspiring Governor."²⁰⁷ Elected public officials will be tempted to exacerbate the central problem: consuming charitable resources too quickly or diverting them to the benefit of more politically powerful but less needy or deserving constituencies.²⁰⁸

This could be corrected, at least in part, by committing enforcement to a less politically responsive governmental body, perhaps the paradigmatic independent agency.

204. Manne, *supra* note 2, at 267 (describing and criticizing the extensive monitoring role of nonprofit umbrella groups and accrediting bodies).

205. See *supra* text accompanying note 148.

206. See Atkinson, *supra* note 5, at 1135–42 (describing the difficulty of giving enforceable content to the concept of "charitable efficiency").

207. Brody, *Whose Public?*, *supra* note 152, at 946.

208. See Jill R. Horowitz & Marion R. Fremont-Smith, *The Common Law Power of the Legislature: Insurer Conversions and Charitable Funds*, 83 *MILBANK Q.* 225 (2005) (describing the role of the New York Attorney General in seeking public access to charitable funds devoted to health care).

As a more general means of monitoring charity, this has often been proposed, along the lines of England's Charity Commissioners.²⁰⁹ Some such body could, in all likelihood, develop an ethos of attention to the troubling trade-offs between present and future expenditure. But it is doubtful that proponents of either private or nonprofit sector solutions would care to have such decisions ultimately resolved by public officials.

On a more pragmatic level, any expansion of governmental supervision of the duty of obedience is hardly likely in an era of shrinking budgets and widespread disaffection with state bureaucracy. Lack of resources to police even the default levels of the duties of care and loyalty is already a widely bemoaned problem.²¹⁰ For practical as well as theoretical reasons, then, increased monitoring of the duty of obedience is unlikely to come from the governmental sector. We must, accordingly, look to the third sector.

3. *Monitoring Charity with Charity*

The foregoing analysis of for-profit and governmental monitors brings us, as nonprofit theorists typically do, to the nonprofit sector *faux de mieu*; as I have argued elsewhere, a nonprofit alternative here may, in addition to filling a gap in the other two sectors, also provide more positive benefits of its own.²¹¹

Against the inclination of for-profit monitoring agents to hew too closely to the wishes of their charitable principals, nonprofit managers would enjoin a very large measure of both practical and legal independence. Unconstrained by both the "market in obsequiousness" and the strong form of the duty of obedience, they would be free to assess, by their own independent judgment, the relative merits of moving assets from endowment into current expenditure. If they believed the change unwarranted, they could enforce the original restriction; if they thought the change appropriate, they could give their assent. In either case, their decision would be binding on the charity's governing body.

The fact that their judgment would be made without clearly articulated, *ex ante* standards need not trouble us, as it did in the case of governmental bodies endowed with analogous freedom. Nor would the fact that they are untrammelled by legally binding standards mean that their decisions would be wholly arbitrary. Those decisions would, on the contrary, be subject to two significant constraints. On the one hand, they would have their own internal control mechanisms. On the other hand, they would be subject to a measure of external competition with other organizations seeking to monitor charities. The interaction of these two factors could lead to a "soft" market in supervisor rigor, as organizations develop their own standards of assessing change and charitable donors choose among these standards as they decide which organizations to appoint as their visitors.

This is not likely to be a perfect solution, but it offers several advantages over both the existing regime of dead hand control and plausible alternative arrangements. It meets donors interested in dead hand control about halfway. It gives them a flexible device for having their particular wishes honored by a self-sustaining body committed to the general

209. See, e.g., Kenneth L. Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 HARV. L. REV. 433, 476-83 (suggesting American adoption of the English model).

210. See Fishman, *supra* note 186, at 668-71.

211. Atkinson, *Unsettled Standing*, *supra* note 16, at 693-96.

principal of honoring donor intent. On the other hand, it eliminates dead hand control in its classic form, the strong form of the duty of obedience.

V. CONCLUSION

Conventional analysis identifies two fundamental fiduciary duties, care and loyalty. Focusing on a third fiduciary duty, the duty of obedience, helps to clarify the fiduciary relationship in four common but functionally different forms: for-profit corporations, private trusts, charitable trusts, and charitable corporations. Furthermore, distinguishing between a weak and a strong form of the duty of obedience helps isolate an odd phenomenon in Anglo-American law, the dead hand control of social assets.

Applying these distinctions to the four forms of organization, we see several significant differences. On the one hand, in the for-profit corporate world, the strong duty of obedience has never really existed. On the other hand, in the law of trusts, both private and charitable, the strong form is quite common. In between, in the law of charitable corporations, the legal status of the strong form is a muddle. Some courts, following the law of for-profit corporations, find no strong duty of obedience; others, following the law of charitable trusts, insist upon it.

This confusion led us to a normative analysis of the strong form of the duty of obedience. We found no need for it in the for-profit corporation and only a limited role for it in the private trust. That role has no analog in charitable organizations, whether organized as corporations or as trusts. Furthermore, the traditional rationales for dead hand control of charitable assets have little independent merit, and that merit is more than counterbalanced by the competing values of charitable independence and flexibility. There may still be some merit to the relatively novel argument that dead hand control helps prevent diversion of charitable assets from endowment to current expenditure. But that purpose can be served by other means, particularly the increased use of charitable monitoring organizations, without conjuring up the ancient specter of dead hand control.

Death, then, to the dead hand's old dominion; long live charity's new republic.
