On Disgorgement and Punitive Damages in Trust Law

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ABSTRACT: Private and charitable trusts hold trillions of dollars in assets. Trustees manage, invest, and distribute these assets, subject to fiduciary duties, including the duty of loyalty and prudence. But the remedies for fiduciary breach, and their justifications, are convoluted. The conventional view, especially in law and economics, is to characterize most fiduciary relationships, including trusts, as contractual and most fiduciary duties as implicit contract terms. One might suppose, then, that the optimal remedy for fiduciary breach would be the same as the usual remedy for contractual breach: damages. But the traditional equitable remedies in fiduciary law, and modern remedies in trust law, allow a plaintiff to elect either damages or disgorgement. Moreover, historically, punitive damages were unavailable for breach in both contract and fiduciary law. Yet, some courts now allow punitive damages for a fiduciary breach that is "egregious."

Applying insights from optimal deterrence theory and the agency costs theory of trusts, this Article analyzes remedies in trust and fiduciary law. It argues that disgorgement and punitive damages serve distinct functional purposes and that both remedies may be necessary to serve the deterrence and disclosure functions of fiduciary law. Specifically, if there is no possibility that the trustee might escape liability, the optimal remedy would be an election of damages or disgorgement. Damages deter self-dealing and conflicts of interest if the harm to the beneficiaries exceeds the gain to a trustee. If the gain to the trustee exceeds the harm to beneficiaries, disgorgement is necessary to deter breach and encourage disclosure. Rather than allowing a trustee to breach and pay damages, a trustee must disclose any potential gains and obtain approval

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from the beneficiaries, whom the settlor has effectively selected as the residual claimants.

However, if a trustee may escape liability, the optimal remedy also may include an election of punitive damages or punitive disgorgement. Given asymmetric information, it is difficult for beneficiaries to detect breach. A total damages multiplier, equal to the inverse of the probability of escaping liability, forces a trustee to internalize the harm by paying average damages equal to expected harm. Moreover, if an election of remedies is optimal, there is a justification for punitive disgorgement. Under this remedy, a court would not only strip ill-gotten gains but also use a punitive multiplier to ensure that a trustee disgorges the full gain by paying average disgorgement equal to the expected benefit.

Disgorgement and punitive remedies thus play a dual role in deterring opportunism in trust law, fiduciary law, and other situations in which the law may seek to strip a defendant’s ill-gotten gains and there is also a significant possibility that a defendant may escape liability.

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I. INTRODUCTION

In the United States, $41 trillion is expected to pass from the dead to the living in the first half of the twenty-first century. Trusts and estates scholars have pointed out that more property now passes through trusts and other nonprobate transfers than in probate through intestacy and wills. Consequently, much of this $41 trillion is likely to pass in private and charitable trusts, which already hold trillions of dollars in assets.

In recent decades, because the form of wealth has shifted from land to stocks, bonds, and other financial assets, most trusts require active management by a trustee. To this end, rather than disempowering trustees, most settlors provide trustees with very broad powers, which state trust law usually authorizes. Therefore, a modern trustee exercises significant authority and discretion over trust assets. However, because the interests of a trustee (agent) and beneficiaries (principal) may diverge, there is a risk that a trustee may misappropriate or mismanage these assets. To provide an ex post check on trustee opportunism, the law imposes fiduciary duties. These duties include the duty of loyalty—to act in the “sole interest” of the beneficiaries—and duty of prudence—to act as a prudent person in administering, investing, and distributing trust property.

But what if a trustee of a private or charitable trust breaches a fiduciary duty? What is the optimal remedy? The conventional view, especially in law and economics, is to characterize most fiduciary relationships, including trusts, as contractual; thus, law-and-economics scholars typically treat fiduciary duties as implicit contract terms. Under this view, fiduciary duties are gap-filling default rules. Accordingly, one might suppose that the optimal remedy

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7. See UNIF. TR. CODE § 815 (UNIF. L COMM’N 2010) (granting a trustee “all powers over the trust property which an unmarried competent owner has over individually owned property”); id. § 815 cmt. (“This section is intended to grant trustees the broadest possible powers . . . .”); see also Langbein, *Rise of the Management Trust*, supra note 6, at 54 (“Broad empowerment legislation . . . is now widespread. Such statutes authorize trustees to engage in every conceivable transaction that might enhance the value of trust assets (and professionally drafted instruments commonly contain such powers).”).


for breach of a fiduciary duty would be the same as the optimal remedy for breach of contract: compensatory damages.\textsuperscript{11}

However, the traditional equitable remedies for fiduciary breach allow a plaintiff to elect either damages (based on plaintiff’s harm) or disgorgement (of a defendant’s gain). Similarly, the remedies under both the Uniform Trust Code (“UTC”),\textsuperscript{12} which a majority of states have adopted,\textsuperscript{13} and the Restatement (Third) of Trusts\textsuperscript{14} allow a plaintiff to elect either damages or disgorgement. Given that damages are the typical remedy in contract law, the use of disgorgement in fiduciary law is arguably in tension with a contractarian view of trusts and other fiduciary relationships.\textsuperscript{15}

In addition, many litigants and courts are confused about the remedies for fiduciary breach, including a breach of trust. The traditional equitable remedies provide courts significant remedial flexibility. But the courts of equity, as well as modern courts since the fusion of law and equity, generally have


\textsuperscript{12} See \textit{UNIF. TR. CODE} § 1001 (UNIF. L. COMM’N 2010).

\textsuperscript{13} See \textit{SITKOFF & DUKEMINIER, supra} note 4, at 399 (noting that, as of 2020, 34 states and the District of Columbia have enacted the Uniform Trust Code).

\textsuperscript{14} See \textit{RESTATEMENT (THIRD) OF TRS.} § 100 (AM. L. INST. 2012) (“A trustee who commits a breach of trust is chargeable with (a) the amount required to restore the values of the trust estate and trust distributions to what they would have been if the portion of the trust affected by the breach had been properly administered; or (b) the amount of any benefit to the trustee personally as a result of the breach.”).

\textsuperscript{15} A number of the seminal articles on the economics of fiduciary law recognize this tension. For example, in applying the principal-agent model to fiduciary law, Robert Cooter and Bradley Freedman point out that disgorgement “aims to return the agent to a situation similar to the one that she would have been in without appropriation.” Cooter & Freedman, \textit{supra} note 8, at 1074. Cooter and Freedman conclude that, in addition, disgorgement “impose[s] some element of punishment that helps overcome any remaining errors in detecting wrongdoing.” Id. at 1074–75. Frank Easterbrook and Daniel Fischel also highlight the tension by noting that “disgorgement of all profit obtained in violation of the fiduciary duty of loyalty . . . looks distinctly anticontractual.” Easterbrook & Fischel, \textit{supra} note 10, at 441. After discussing the idea that disgorgement is “anticontractual” and Cooter and Freedman’s explanation, Easterbrook and Fischel state that “[w]e are not wholly persuaded by either perspective.” Id. Instead, they contend disgorgement “induces the parties to contract explicitly” which may be superior for certain contractual and fiduciary relations “when it is hard to know the optimal approach, when judicial evaluation is haphazard, and when transaction costs ex post are small.” Id. at 444–45. Since then, to the extent scholars have addressed the issue, they have offered various, and at times conflicting, rationales for utilizing disgorgement as a remedy in fiduciary law. See \textit{infra} note 174.
disallowed punitive damages—a legal remedy—for breach of a fiduciary duty.\textsuperscript{16} And punitive damages historically have been unavailable for both contractual breach and fiduciary breach.\textsuperscript{17}

However, in recent decades, some federal and state courts have allowed punitive damages as a remedy for fiduciary breach, especially if the breach is “egregious.”\textsuperscript{18} Many courts have also permitted punitive damages for a trustee’s breach of a fiduciary duty.\textsuperscript{19} As John Langbein notes, “[i]n the mid-1970s, there was scant authority for punitive damages in trust matters, but punitive damages have since spread to many states.”\textsuperscript{20} In arguing for an expansion of

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\item \textsuperscript{16} See Groshek v. Trewin, 784 N.W.2d 163, 179 n.14 (Wis. 2010) (Abrahamson, C.J.), concurring in part and dissenting in part (“The traditional rule was that equity would not award punitive damages, either because equity’s sole province was to provide ‘complete relief,’ and compensatory damages marked the limit of that relief, or because punishment or vengeance seemed vaguely inappropriate to a ‘benignant’ equity.” (quoting DAN B. DOBBS, DOBBS LAW OF REMEDIES: DAMAGES—EQUITY—RESTITUTION § 3.11(1), at 450 (2d ed. 1993))). See generally Andrew Burrows, Remedial Coherence and Punitive Damages in Equity, in EQUITY IN COMMERCIAL LAW 381 (Simone Degeling & James Edelman eds., 2005) (arguing that punitive damages should be available for equitable wrongs).
\item \textsuperscript{17} See Laurence P. Simpson, Punitive Damages for Breach of Contract, 20 OHIO ST. L.J. 284, 284 (1959); Mark Pennington, Punitive Damages for Breach of Contract: A Core Sample from the Decisions of the Last Ten Years, 42 ARK. L. REV. 31, 32–35 (1989) (discussing traditional rule against punitive damages).
\item \textsuperscript{18} See SITKOFF & DUKEMINIER, supra note 4, at 612 (“Modern law has also come to allow punitive damages for a trustee’s egregious breach of trust.”). For example, in Gould v. Starr, 558 S.W.2d 755, 771 (Mo. Ct. App. 1977), the court allowed a punitive damages award in a case to remove trustees, obtain an accounting, and surcharge the trustees for their misconduct. In Yale v. Union Bank, 151 Cal. Rptr. 784, 790 (Cal. App. 1979), the court held that punitive damages are available against a trustee of a pension and profit-sharing plan for fraud and fiduciary breach. In Miner v. Int’l Typographical Union Negotiated Pension Plan, 601 F. Supp. 1390, 1392–93 (D. Colo. 1985), the court held that punitive damages could be awarded against pension plan trustees under the law of trusts to deter misconduct harmful to trusts.
\item \textsuperscript{19} For a state-by-state summary of the use of punitive damages in trust law cases, see generally WALTER L. NOSSAMAN & JOSEPH L. WYATT, JR., 1A TRUST ADMINISTRATION AND TAXATION (rev. 2d ed. 2013).
\item \textsuperscript{20} John H. Langbein, Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?, 114 YALE L.J. 929, 975 n.242 (2005) (citing Mertens v. Hewitt Assoc., 508 U.S. 248, 257 n.7 (1993) and id. at 270–72, 272 n.6 (White, J., dissenting)); see also Jay M. Zitter, Punitive Damages: Power of Equity Court to Award, 58 A.L.R. 4th 844 § 3 (1987) (noting jurisdictions that allow punitive damages be awarded in “actions formerly cognizable only in equity”). Indeed, in Mertens v. Hewitt Associates, an ERISA case, the U.S. Supreme Court concluded that punitive damages are available under a statutory provision incorporating the remedies available in equity and trust law. Mertens, 508 U.S. at 257–58. Writing for the Court, Justice Scalia noted there were situations, including cases for breach of trust, in which equity courts provided all appropriate relief, including punitive damages. Id. at 259; see also Rivero v. Thomas, 194 P.2d 533, 542 (Cal. Dist. Ct. App. 1948) (allowing the imposition of punitive damages stemming from equitable claims where not “unjust [or] unreasonable”); Sharts v. Douglas, 163 N.E. 109, 112 (Ind. Ct. App. 1928) (en banc) (“[T]he character of the action is such that exemplary damages could be recovered.” (emphasis added)). But see Mertens, 508 U.S. at 270 (White, J., dissenting) (highlighting that the “Court has long recognized, courts of equity would not—absent some express statutory authorization—enforce penalties or award punitive damages” and collecting citations); Teamsters
punitive damages, several probate litigators similarly summarized the law’s trajectory: “Historically, most courts have refused to award punitive damages if a plaintiff seeks equitable as well as monetary relief . . . . More forward-thinking courts have rejected that distinction and permit punitive damages, even if equitable claims are interposed.”21 However, even courts that allow punitive damages are unclear about the relationship between disgorgement and punitive damages (Are the different remedies substitutes? complements?), the justification for imposing punitive damages (An “egregious” breach?), and the method for calculating punitive damages.22

Given the confusion about these remedies, in both theory and practice, this Article attempts to provide a more coherent and principled framework for analyzing and applying remedies in trust fiduciary law.23 Recognizing that

v. Terry, 494 U.S. 538, 587 (1990) (Kennedy, J., dissenting) (claiming “exemplary or punitive damages” are inconsistent with historical remedies available to beneficiaries against trustees).

21. Pankauski et al., supra note 2, at 43.

22. See id. at 47 (“Today litigators, particularly probate litigators and those who sue or defend fiduciaries, cannot be sure how a court will react to a claim for punitive damages, if equitable relief is sought in the case.”); see also Cooter & Freedman, supra note 8, at 1069 (“[P]unitive damages remain unpredictable in the sense that their magnitude cannot be determined from knowledge of the law or the facts of the case.”).


There is an emerging literature on agency costs in trust law. See Jonathan Klick & Robert H. Sitkoff, Agency Costs, Charitable Trusts, and Corporate Control: Evidence from Hershey’s Kiss-Off, 108
trustees often play a socially valuable role, the objective is “optimal” deterrence. The law should employ remedies that increase society’s welfare by deterring a trustee’s harmful activities (e.g., misappropriation and mismanagement of trust assets) without deterring the trustee’s beneficial activities (e.g., imposing requirements that create expensive or excessive performance). The framework should also recognize, as estate and planning professionals are aware, that trustees may escape liability. Indeed, given the nature of a fiduciary relationship, where one party (the trustee) often has superior expertise and sophistication, and the other party (the beneficiaries) may lack information, there is a heightened concern about a fiduciary’s escaping liability. In addition, certain types of breach may be easier for beneficiaries to detect and for courts to enforce than others.

Overall, if a trustee of a private or charitable trust breaches its duty of loyalty, and the trustee is found liable with certainty, the optimal remedy is an election of damages or disgorgement. The basic rationale is that an election of remedies eliminates a trustee’s incentive to breach. If the harm to the beneficiaries exceeds the gain to the trustee, damages will deter breach. Conversely, if the gain to the trustee exceeds the harm to the beneficiaries, disgorgement will deter breach. The possibility of disgorgement is consistent with what commentators and courts have long assumed is appropriate for fiduciary breach because a trustee is agreeing to act in the best interests of the beneficiaries rather than the trustee’s own self-interest (as would be the case in a contractual relationship).24

Disgorgement of a trustee’s gains is necessary not only to deter fiduciary breach, but also to encourage “transactions” between a trustee and beneficiaries.


24. Scott, supra note 1, at 526 ("[W]here the trustee sells trust property to himself without the consent of the beneficiaries, he is not permitted to profit if the property goes up in value, and is compelled to bear the loss if its value falls. Courts of equity have felt that it is only by imposing a strict rule like this that all temptation to the trustee to act in his own interest rather than in that of the beneficiaries can be removed. The same rule is applied to other fiduciaries.").
Instead of allowing a trustee to breach its duty of loyalty and pay damages, a trustee must disclose a profitable opportunity and seek approval from the beneficiaries whom the settlor has specified as the donees or residual claimants of the settlor’s gift. If the beneficiaries approve the transaction, the trustee is also likely to benefit from the opportunity, thereby providing an incentive for the trustee to discover and disclose potential gains. This election of remedies advances the welfare of both parties as well as the settlor. That is, it is usually in the interests of the parties to the trust—the settlor, trustee, and beneficiaries—to permit an election of damages or disgorgement.

Similarly, if a trustee breaches its duty of prudence, the optimal remedy is also an election of damages or disgorgement. In most cases, damages are appropriate for deterring a suboptimal level of care by the trustee because the harm to the beneficiaries usually will exceed any gain to the trustee and, as noted above, compensatory damages force a trustee to internalize the harm from breach. While less common, relying on disgorgement as a remedy for lack of prudence does not deter a trustee from engaging in other profitable activities. Thus, if liability is certain, an election of remedies may result in optimal deterrence of a breach of either the duty of loyalty or the duty of prudence. The possibility of disgorging ill-gotten gains is one way of preventing the type of breach that fiduciary law seeks to deter.

But if there is a significant chance a trustee may escape liability, the remedies for breach should include an election of punitive remedies. In trust law, given asymmetric information between trustees and beneficiaries, it is usually difficult for beneficiaries to detect breach and for courts to sanction opportunism. A low probability of detection suggests the need for punitive damages. A total damages multiplier, equal to the inverse of the probability of detection, would force a trustee to internalize the harm by paying expected damages equal to the harm. This damages multiplier is an application of the economic analysis of punitive damages.

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25. See Sitkoff, The Economic Structure of Fiduciary Law, supra note 23, at 1049 (noting that “the default rule in fiduciary law is that all gains that arise in connection with the fiduciary relationship belong to the principal unless the parties specifically agree otherwise” and pointing out that “[t]his default rule . . . induces the fiduciary to make full disclosure so that the parties can complete the contract expressly as regards the principal’s and the fiduciary’s relative shares of the surplus arising from the conduct that would otherwise have constituted a breach”).

26. In this respect, trust law seems to differ from contract law, where supracompensatory remedies or disgorgement may result in excessive performance, see Shavell, supra note 11, at 306; and Schwartz, supra note 11, at 405, suggesting there is less concern that disgorgement will deter a trustee excessively in trust law. Moreover, unlike a contracting party, a trustee may resign to pursue other opportunities. See, e.g., UNIF. TR. CODE § 705(a) (UNIF. L COMM’N 2010) (“A trustee may resign: (1) upon at least 30 days’ notice to the qualified beneficiaries, the settlor, if living, and all cotrustees; or (2) with the approval of the court.”).

In addition, assuming that an election of remedies is optimal in fiduciary law, there is a justification for punitive disgorgement. Under this remedy, a court not only would strip ill-gotten gains (for the reasons discussed above) but also impose a punitive multiplier based on the expected benefit (because of the chance that a trustee may escape liability). A total disgorgement multiplier, equal to the inverse of the probability of detection, would force a trustee to disgorge any benefits by paying expected disgorgement equal to the gain. Because the defendant’s escaping liability is a concern when the defendant may obtain a substantial ill-gotten gain, just as it is a concern when the defendant may impose significant harm, the need for a multiplier is symmetrical and applies equally to cases involving damages or disgorgement. This rationale for punitive disgorgement highlights the dual role that damages and punitive remedies play—they are complements, not substitutes—in achieving optimal deterrence.

* * *

Part I of this Article provides background on trustee opportunism, including the principal-agent problem in trust law and several reasons why a trustee may escape liability. It also provides a brief overview of the fiduciary duties in trust law, including the duty of loyalty, duty of prudence, and subsidiary duties. Finally, it outlines the menu of remedies available for breach of trust.

Part II proposes a basic theory for evaluating the remedies for deterring fiduciary breach. Section II.A considers the optimal remedies assuming a trustee is found liable with certainty. Section II.B analyzes the optimal remedies assuming the trustee can sometimes escape liability. As noted above, the basic conclusion is that, if a trustee is always found liable, the optimal remedy is an election of damages or disgorgement (though disgorgement may be less necessary for the duty of prudence). In addition, if there is a significant probability that a trustee may escape liability, this Article suggests that an election of punitive damages or punitive disgorgement is needed to ensure that a trustee will internalize the harm or disgorge the gain from breach. Part III explores counterarguments and extensions. Section III.A discusses whether “supracompensatory remedies,” or remedies that exceed the plaintiff’s
harm such as disgorgement, punitive damages, or punitive disgorgement, may create a risk of overdeterrence, moral hazard, or judgment-proof defendants. Section III.B discusses non-legal solutions such as the role of market competition and reputation in deterring trustee opportunism. Competition and reputation play a role in deterring breach in some fiduciary relationships, including corporate fiduciaries (consider the “market for corporate control”). But it is unclear whether these forces play a similar role in deterring trustees (there is no analogous “market for trust control”). The forces may be especially attenuated for an individual trustee (e.g., a family member) as opposed to an institutional trustee (e.g., a bank or trust company). Section III.C highlights extensions, by suggesting this Article’s insights may be useful not only for trust law—private, charitable, and business trusts—but for fiduciary law in a broader sense, including traditional and new categories of fiduciaries. The discussion also extends beyond fiduciary law, including the role of “punitive disgorgement” in securities law, commodities law, and criminal restitution. Part IV concludes.

II. TRUSTEE OPPORTUNISM, FIDUCIARY DUTIES, AND REMEDIES

Preventing opportunism by trustees of private and charitable trusts is critical. Over the next several decades, a tremendous amount of property will be transferred between the generations. Wealth management firms like Accenture have noted the high stakes of this intergenerational transfer:

Over $12 trillion in financial and non-financial assets is changing hands, moving from the Greatest Generation—those born in the 1920s and 1930s—to the Baby Boomers, born between 1946 and 1964 . . . . Over the next 30 to 40 years, in North America alone, an additional $30 trillion assets will pass from Boomers to their heirs.

Between 2031 and 2045, 10 percent of total wealth in the United States will be changing hands every five years.

Historically, the primary mechanism for facilitating the transfer of property at death was the probate system. Probate helped to ensure an orderly transfer of assets, either through a will or intestate succession. But, in recent decades, a shift has occurred: More property passes outside of the probate system via nonprobate transfers.

28. See Havens & Schervish, supra note 3, at 2 (reviewing the $41 trillion wealth transfer estimated to be transferred between 1998 and 2052).


30. See SITKOFF & DUKEMINIER, supra note 4, at 41 (discussing the mechanics of succession and observing that “[t]here was a time when probate was the only readily available way to transfer property with clear title at a person’s death”).

31. See Langbein, supra note 4, at 1117; see also SITKOFF & DUKEMINIER, supra note 4, at 41 (“Today much more property passes by nonprobate transfer via a will substitute than by probate transfer via a will or intestacy.”); Thomas P. Gallanis, Frontiers of Succession, REAL PROF. TR.
Chief among these nonprobate transfers is the *inter vivos* trust. A trust is a legal device for facilitating donative transfers of property "on the plane of time." Specifically, a trust is a fiduciary relationship: a *settlor* (donor) seeks to provide a benefit to the *beneficiaries* (donees) by transferring property to a *trustee*. The wide variety of purposes for which a trust may be created, as well as the worldwide proliferation of trusts, suggests the trust has comparative advantages over gifts during life, wills, and other will substitutes.

The focus of this Article is on gratuitous transfers through private and charitable trusts. Functionally, private and charitable trusts are similar, with...
a few exceptions. Although the beneficiaries of a private trust are ascertainable (e.g., family members and friends), a charitable trust requires a charitable purpose (e.g., the relief of poverty, advancement of education or religion, or promotion of health). In a private trust, the beneficiaries typically enforce a trustee’s fiduciary duties. Conversely, in a charitable trust the state attorney general, a charitable organization, or other person with a special interest in the trust enforces a trustee’s fiduciary duties. However, the trustee of a private trust and the trustee of a charitable trust are both subject to the same fiduciary duties, including the duty of loyalty and the duty of prudence, to prevent or mitigate trustee opportunism.

A. TRUSTEE OPPORTUNISM

The key feature of a trust is that it provides managerial intermediation by separating the benefits and burdens of ownership. The beneficiaries are able to enjoy the principal and income from the trust, while the trustee must bear the costs of managing, investing, and distributing the trust property in accordance with the settlor’s instructions for the benefit of the beneficiaries. Importantly, a trustee’s role and powers have changed significantly over time. In earlier eras, a trustee’s role was limited: The main function of the trustee was to hold real property and convey it from one party to another. Accordingly, the risk that a trustee might misappropriate or mismanage trust property was minimal.

In recent decades, as the primary form of wealth has shifted from land to liquid financial assets, the powers of a trustee have expanded. Today, most


38. Compare UNIF. TR. CODE § 402(a)(3) (UNIF. L. COMM’N 2010) (requiring a “definite beneficiary” for the creation of a private trust), with id. § 405(a) (listing charitable purposes).

39. See SITKOFF & DUKEMINIER, supra note 4, at 395 (“The key to the trust’s versatility as an instrument for conveyance and management of property is that it ‘separate[s] the benefits of ownership from the burdens of ownership.’” (alteration in original) (quoting SCOTT & ASCHER, supra note 36, § 1.1)).

40. Technically speaking, the beneficiaries have equitable interests in the trust, whereas the trustee has legal title to the trust property.

41. See Langbein, Rise of the Management Trust, supra note 6, at 52 (“The trust first developed for an age in which real estate was the principal form of wealth. . . . The trust was a conveyancing device . . . .”); see also Sitkoff, The Economic Structure of Fiduciary Law, supra note 23, at 1042 (noting that “in trust law the old rule was that the trustee could not engage in market transactions over the trust property”).

42. See Langbein, Rise of the Management Trust, supra note 6, at 53 (“Today’s trust has ceased to be a conveyancing device for land and has become, instead, a management device for holding a portfolio of financial assets. The management trust is a response to the radical change away from family real estate as the dominant form of personal wealth.” (footnote omitted)).
settlor want their trustee to have broad authority and discretion to maximize the value of trust assets and distribute trust property.\textsuperscript{43} The UTC recognizes this shift by providing that, except as limited by the terms of the trust, a trustee has “all powers over the trust property which an unmarried competent owner has over individually owned property,” as well as “any other powers appropriate to achieve the proper investment, management, and distribution of the trust property.”\textsuperscript{44} Given the expansive role and extensive discretion of the modern trustee, there is an increased risk that a trustee may misappropriate or mismanage trust property.\textsuperscript{45}

1. The Agency Costs Theory of Trusts

The modern trustee has significant authority and discretion over trust assets. Because the interests of the trustee (agent) may diverge from the interests of the settlor or the beneficiaries (principal), trust law entails a classic principal-agent problem. Thus, the trustee’s discretion gives rise to agency costs and the problem of opportunism. Indeed, several scholars have applied insights from the principal-agent model, originally developed by economists Michael Jensen and William Meckling in analyzing the firm,\textsuperscript{46} to trust law and fiduciary law.

The seminal articles on the economic approach to fiduciary law are by Robert Cooter and Bradley Freedman, and by Frank Easterbrook and Daniel Fischel.\textsuperscript{47} Cooter and Freedman “appl[y] the principal-agent model to the fiduciary relationship in order to explain the relationship’s economic characteristics and its legal consequences.”\textsuperscript{48} They discuss “how the legal system does and should treat the fiduciary relationship, focusing upon the

\begin{itemize}
\item \textsuperscript{43} See id. at 54 (“The modern trustee conducts a program of investing and managing financial assets that requires extensive discretion to respond to changing market forces.”); Sitkoff, \textit{The Economic Structure of Fiduciary Law}, supra note 23, at 1042 (“[B]ecause trusts are increasingly funded with liquid financial assets requiring nimble management in the face of swift changes in the conditions of financial markets, modern law gives the trustee broad powers to undertake any type of transaction, subject to the trustee’s fiduciary obligation.”).
\item \textsuperscript{44} UNIF. TR. CODE § 815(a)(2)(A)–(B) (UNIF. L. COMM’N 2010).
\item \textsuperscript{45} See Langbein, \textit{Rise of the Management Trust}, supra note 6, at 54 (“Trustees with transactional powers necessarily have the power to abuse as well as to advance the interests of beneficiaries.”).
\item \textsuperscript{47} See Cooter & Freedman, supra note 8, at 1045–48; Easterbrook & Fischel, supra note 10, at 427–29; see also Robert H. Sitkoff, \textit{An Economic Theory of Fiduciary Law}, in \textit{PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW} 197, 197 (Andrew S. Gold & Paul B. Miller eds., 2014) (describing these publications as the “seminal economic analyses of fiduciary law . . . which together have come to underpin the prevailing economic, contractarian model of fiduciary law”).
\item \textsuperscript{48} See Cooter & Freedman, supra note 8, at 1047.
\end{itemize}
appropriate scope of fiduciary duties and the best ways to deter their violation."\(^{49}\)

In adopting a “contractarian” view of fiduciary obligations, Easterbrook and Fischel contend that “[f]iduciary duties are not special duties; they have no moral footing; they are the same sort of obligations, derived and enforced in the same way, as other contractual undertakings.”\(^{50}\)

Building on these insights, Robert Sitkoff has developed an agency costs theory of trust law.\(^{51}\) Sitkoff notes that “agency problems are caused by the impossibility of complete contracting when one party (the agent) has discretionary and unobservable decision-making authority that affects the wealth of another party (the principal).”\(^{52}\) Specifically, as Sitkoff points out:

> When the agent’s effort is unobservable, ex post enforcement of the ex ante bargain, no matter how detailed it may be, is impractical. The problem is that the principal will be unable to ascertain whether the agent’s breach or an exogenous factor caused a disappointing result. Thus, unless there is a perfect correlation between the agent’s effort and the project’s observable profits, in which case a good or bad return would conclusively show the level of the agent’s effort, it will be difficult for the principal to prevent shirking by the agent . . . . The problem is one of post-contractual asymmetric information.\(^{53}\)

Sitkoff concludes by observing that the “problems of shirking and monitoring, the driving concerns of agency cost analysis, abound in trust administration.”\(^{54}\)

Sitkoff also explains that trust law actually entails two agency relationships, one between the settlor and trustee, and another between the beneficiaries and trustee:

> Both the relationship between [settlor] and [trustee] and the relationship between [beneficiaries] and [trustee] might be modeled on the principal-agent scheme. The former presents the temporal agency problem that helps distinguish the economic analysis of trust law from that of corporate law. The latter presents the traditional agency problem when risk-bearing is separated from management. This means that there is potential for considerable tension between [a trustee’s] loyalty to [the settlor] and [a trustee’s] loyalty to the [beneficiaries] . . . . American law resolves this tension by requiring [the trustee] to

\(^{49}\) Id.


\(^{51}\) See Sitkoff, supra note 8, at 634–38.

\(^{52}\) Id. at 636.

\(^{53}\) Id. (emphasis added) (footnote omitted); see also Cooter & Freedman, supra note 8, at 1048–51 (using simple game theoretical model to illustrate this result for the duty of loyalty); id. at 1050–59 (using similar model to illustrate this result for the duty of care).

\(^{54}\) Sitkoff, supra note 8, at 623.
maximize the welfare of the [beneficiaries] within the ex ante constraints imposed by [the settlor].

More recently, Sitkoff utilizes agency costs theory to explain the economic structure of fiduciary law in general. After discussing the agency cost problem and why conventional approaches to solving the problem (such as limiting the agent’s discretion, active monitoring, and providing incentive-based compensation) are often inadequate, he notes that “the difficult task for legal institutional design is . . . to design a body of law applicable to agency relationships that minimizes agency costs while preserving the benefits of agency.” An important aspect of that body of law is designing the optimal remedies for fiduciary breach.

2. Why Trustees Sometimes Escape Liability

As discussed above, trustee opportunism is a major concern in trust administration, and agency costs have been a central concern in much of the recent literature in trust law. Yet, concerns about opportunism and agency costs are exacerbated in trust law because a breach of trust is especially difficult to detect and sanction. Typically, the law relies on the beneficiaries (or a co-trustee) to monitor and enforce the trustee’s fiduciary duties. However, beneficiaries often have little information about the trustee’s actions. Thus, many beneficiaries may not know whether a trustee has committed a breach of the duty of loyalty or prudence. Moreover, even if a beneficiary suspects or observes breach of a fiduciary duty, it may be expensive or strategically unwise to bring an action against a trustee for breach. If a beneficiary does bring a claim, it may be difficult for a court to enforce the trustee’s duties: Even if beneficiaries can observe the opportunism, it may be difficult for courts to verify and punish it.

Thus, asymmetric information causes two distinct problems in trust fiduciary law. First, the informational asymmetry creates a risk of trustee opportunism and fiduciary breach. This problem is common to any agency relationship, including fiduciary relationships. Second, it is hard for beneficiaries to know whether they have been harmed, whether litigating against a trustee is desirable, and whether they can prove in court that the trustee has breached a fiduciary duty. This problem, which is independent of the agency problem,

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55. *Id.* at 640 (emphasis added) (footnote omitted).
56. See *id.* at 677–78; Sitkoff, *supra* note 47, at 197.
58. *Id.* at 200.
59. See *supra* Section II.A.1.
is common to many plaintiffs, including tort victims. In other words, because
detection and enforcement are imperfect, defendants, including trustees,
may escape liability with a probability that is greater than zero and, in some
cases, significantly greater than zero. Furthermore, fiduciary relationships
and other situations that involve high monitoring and specification costs may
be the very situations in which the probability of escaping liability is high.

In analyzing the use of punitive damages in achieving optimal deterrence,
Polinsky and Shavell describe a number of reasons why injurers may be able
to escape liability: "the difficulty of detecting harm, the inability to identify the
injuror, problems in proving that the injuror is liable even if he can be
identified, and the plaintiff’s failure to sue because of the costs of litigation." Although Polinsky and Shavell focus primarily on tort law, all of these
reasons (with the exception of identifying the injuror) apply in trust law for a
trustee’s breach of fiduciary duty. A beneficiary may have difficulty detecting
harm; a beneficiary may have problems proving a trustee is liable; and a
beneficiary may not sue because of the costs of litigating a breach of trust.

To amplify how injurers may escape liability, Polinsky and Shavell discuss
various scenarios. They first discuss situations in which “the victim may have
difficulty determining that the harm was the result of some party’s act—as
opposed to simply being the result of nature, of bad luck.” Clear analogues
exist in trust law. For instance, a beneficiary may have difficulty detecting
harm—a beneficiary may have problems proving a trustee is liable; and a
beneficiary may not sue because of the costs of litigating a breach of trust.

Polinsky and Shavell also discuss situations in which “even if the victim
knows both that he was wrongfully injured and who injured him, he might not
sue the injuror.” A plaintiff may forego a lawsuit because of the prohibitive
costs of litigation or the difficulty of convincing the court that a defendant is
liable:

A person will tend not to bring suit if the legal cost and the value of
the time and effort he would have to devote to the suit exceed the
expected gain. The decision to forgo suit will often occur when the
harm the victim has suffered is relatively small or the likelihood of
establishing causation is low.

61. See generally Polinsky & Shavell, Punitive Damages, supra note 27 (discussing the difficulty in
assessing punitive damages in tort cases).

62. See id. at 874 n.7.

63. See id. at 936 ("[W]e have been discussing the imposition of punitive damages in situations
governed by tort law . . . .").

64. Id. at 888.

65. Id.

66. Id.
Once again, this scenario parallels the difficulties of enforcing breach in trust law. Even if a beneficiary knows that he or she is injured and that the trustee’s actions are responsible for the injury, the beneficiary may decide not to sue the trustee.

Litigating may also be disproportionately expensive for the beneficiary, as the beneficiary may bear significant litigation costs relative to a trustee whose attorneys’ fees are reimbursed from the trust corpus. Alternatively, the beneficiary may have suffered a relatively small harm from breach, further discouraging enforcement. It also may be difficult to prove in court that the trustee breached one of its fiduciary duties. Moreover, regardless of whether the beneficiary could win, it may be strategically unwise for the beneficiary to sue the trustee if the trustee will continue to have ongoing discretionary decisions over distributions to the beneficiary, or has a personal relationship with the beneficiary. Thus, there are several reasons that injurers, including trustees, will sometimes be able to escape liability for harms for which they should be held responsible.

Unfortunately, there is no reliable data on how often trustees may escape liability for breach of trust. In their article, Polinsky and Shavell cite to several empirical studies on the probability of detecting various types of negligence and fraud, including one empirical study suggesting the average probability of detecting fraud is approximately 30 percent. There are theoretical reasons to believe the probability of detecting a trustee’s breach may be even lower.

First, in private trusts, many beneficiaries are likely to be relatively poor enforcers of a trustee’s fiduciary duties. Beneficiaries are often minors,

67. Sterk, supra note 60, at 2768 (noting “potential underdeterrence of trustee misbehavior” because, among other things, “the trust beneficiaries will bear much of the litigation cost”).

68. In an extension of their theory, Polinsky and Shavell discuss contract law and identify several reasons why a breaching party may escape liability. These reasons are worth mentioning as well given the contractarian theory of fiduciary law. The first reason is an inability to observe whether performance has occurred, a situation that also arises in trust law for breach of a fiduciary duty. See Polinsky & Shavell, Punitive Damages, supra note 27, at 938 (noting that breach party may escape liability “when the breached-against party does not automatically observe whether performance has occurred”). The second reason is an inability to hold the breaching party liable in court because of litigation costs or problems of proof. See id. (noting that breaching party may escape liability “when the breached-against party knows that performance has been deficient, but may not be able to prove this in court or lacks a financial incentive to sue”). Once again, this situation also arises in trust law. In both of these situations, Polinsky and Shavell suggest, the parties themselves may want punitive damages to be paid for breach, even though traditionally punitive damages were not awarded in contract (unless a court classified the wrongful conduct as a tort). See id. However, Polinsky and Shavell point out that, in many circumstances, parties to a contract “will not want damages for breach” to exceed compensatory damages. Id. For example, if “the breach is obvious, the nature of the breach is such that it easily can be proven in court, and the amount at stake is large enough to justify suit,” then punitive damages are not needed to achieve optimal deterrence. Id.

69. See id. at 888 n.45 (citing Jonathan M. Karpoff & John R. Lott, Jr., The Reputational Penalty Firms Bear from Committing Criminal Fraud, 36 J.L. & ECON. 757-789-90 (1993)).
incapacitated, or otherwise lacking in financial or legal sophistication. In fact, the very reason that a settlor may have transferred property in a trust (as opposed to an outright transfer) often suggests that beneficiaries may not be capable of the type of sophisticated analysis needed to detect a conflict of interest or to detect imprudent investment behavior. For example, most beneficiaries are not capable of tracking down potential conflicts among subsidiaries or figuring out that an investment is underperforming due to the trustee’s lack of care rather than an alternative explanation. Even sophisticated actors (including, perhaps, law professors) may have trouble detecting such wrongdoing by trustees. Detecting this type of wrongdoing can often take a significant amount of time, effort, and money.

Second, beneficiaries are often in a difficult position to detect fiduciary breach because a settlor may limit a trustee’s duty to inform the beneficiaries. Beneficiaries’ access to information concerning the trust, including a trustee’s transactions and investments, is essential to enforcing fiduciary duties. However, a settlor may restrict the beneficiaries’ right to information as much as possible through the trust instrument, and may have a good reason for doing so. Among other things, there is “the risk of unnecessary or unwarranted loss of privacy, or the risk of adverse effects upon youthful or troubled beneficiaries about whose motivation or responsibility the settlor has concerns.” But, without this information means, beneficiaries are less capable of monitoring the trustee and enforcing fiduciary duties as it will be more difficult for them to detect a trustee’s self-dealing, conflicts of interest, and lack of prudence in managing, investing, and distributing trust property. For this reason, some settlors now include a trust protector who can receive information about the trust and monitor trustees.

Third, although market competition may restrain opportunism for certain types of fiduciaries, including corporate fiduciaries, there are fewer market constraints on trustee behavior that supplement the beneficiaries' ability to enforce fiduciary duties. Unlike the shareholders of a corporation, there is no exit opportunity for beneficiaries to sell their “shares” of a trust. Furthermore, unlike the market for corporate control, which arguably has a deterrent effect in corporate governance, there is no analogous “market for trust control” that provides a check on trustee opportunism. Indeed, in the context of an individual trustee (e.g., a family member), rather than an

71. On the importance of the trustee’s duty to inform, see generally Philip J. Ruce, The Trustee and the Remainderman: The Trustee’s Duty to Inform, 46 REAL PROP. TRUST & EST. L.J. 173 (2011) (detailing a trustee’s duty to perform).
72. RESTATEMENT (THIRD) OF TRS. § 82 cmt. e (AM. L. INST. 2007).
73. On remedies for breach by a trust protector, see Sterk, supra note 60, at 2797–99.
institutional trustee (e.g., a bank or financial institution), the possibility of constraints imposed by market competition is likely to be even more attenuated.

Fourth, detecting trustee wrongdoing in charitable trusts may be more difficult than in private trusts, even though the primary enforcers of charitable trusts are state attorneys general. Attorneys general are, presumably, at least somewhat sophisticated actors, especially with regard to legal and financial matters. However, in discussing the risk of opportunism in various property arrangements, several scholars, including myself, have noted that “[t]he risk of opportunism is especially significant in charitable trusts.”75 “Unlike donative trusts, whose beneficiaries should in theory have an interest in enforcing the trustee’s fiduciary duties, charitable trusts rely on state attorneys general, who usually have limited resources, and little political will, to expend on enforcement.”76 Other commentators have likewise pointed out that wrongdoing by the trustees of charitable trusts is difficult to detect because of both resource constraints on attorneys general77 and structural political considerations.78

3. The Difficulty of Detecting Breach

Finally, trusts and estates practitioners and others in the field of trust administration have highlighted the ubiquity and the difficulty of detecting breach. The evidence, while admittedly anecdotal, supports the view that breach of a trustee’s fiduciary duties—whether a major or minor breach—is relatively common and unlikely to be detected.

Consider just three perspectives, two regarding private trusts (one from the world of law reform, the other from probate litigation) and one regarding charitable trusts. First, as the Reporter for the Restatement (Third) of Trusts points out:

The inherent subjectivity and impracticability of second-guessing a trustee’s application of business judgment or exercise of fiduciary discretion are aggravated by the opportunities and relative ease of

76. Id. at 907–08.
78. See Klick & Sitkoff, supra note 23, at 781–82 (“The state attorney general . . . is a political official, typically elected, with neither a personal financial stake nor, in the usual case, a political stake in the operation of a charitable trust. . . . [Thus,] supervision of charitable trusts by the attorneys general is either lackadaisical, in which case the trustees will lack an incentive to manage the trust’s assets in an efficient manner, or perverse, entailing imposition of local political preference . . . .” (footnote omitted)). As a result of underenforcement of fiduciary duties in charitable trusts, recent “law reform efforts have attempted to incorporate new enforcement mechanisms, including the expansion of standing for the settlor, in order to monitor the duties of a charitable trustee.” Kelly, supra note 75, at 908.
DISGORGEMENT AND PUNITIVE DAMAGES

concealing misconduct—or at least by the absence of timely information and the likely disappearance of relevant evidence—that result from the trustee’s day-to-day, usually long-term, management of the trust property and control over the trust records.\(^79\)

The Restatement explicitly mentions the problems that trust beneficiaries will have in detecting trustee misconduct and ensuring trustees do not escape liability: “Viewed from the beneficiaries’ perspective, especially that of remainder beneficiaries, efforts to prevent or detect actual improprieties can be expected to be inefficient if not ineffective.”\(^80\)

Second, the scope of the problem identified in the Restatement becomes more apparent based on practitioner accounts. In a recent article, a trio of probate litigators claim that “[o]verreaching by those who are charged with managing property for others,” including “trustees [who] treat trust property as their own,” is a “great problem” and “a unique, explosive situation.”\(^81\) They point out “the current, extraordinary aggregation of wealth, and the difficult economic circumstances that are afflicting so many people, have created the incentive and opportunity for fiduciaries to abuse positions of trust and confidence.”\(^82\) Ultimately, they conclude that “bank accounts, will-substitutes, and trust accounts, including revocable trusts, are where the money is,” that “[g]rantors and beneficiaries need legal protection,” and that “punitive damages are a critical part of the law’s deterrent arsenal.”\(^83\)

Third, an epoch example of trustee opportunism is the scandal that rocked the Bishop Estate, a charitable trust established in 1884 by Bernice Pauahi Bishop, the last descendant of Hawaii’s first and most powerful king.\(^84\) The Bishop Estate included, as of June 2015, an $11 billion endowment and 375,000 acres of land in Hawaii.\(^85\) At one point, it was the largest private educational fund in the United States, with more assets than Harvard and Yale

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79. Restatement (Third) of Trs. § 78 cmt. b (Am. L. Inst. 2007).
80. Id. The Restatement highlights the reasons why the beneficiaries’ efforts to prevent the trustee from escaping liability are likely to be unavailing: “Such efforts are likely to be wastefully expensive and to suffer from time lag and inadequacies of information, from a lack of relevant experience and understanding, and perhaps from want of resources to monitor trustee behavior and ultimately to litigate and expose actual instances of fiduciary misconduct.” Id.
81. Pankauski et al., supra note 2, at 47.
82. Id.
83. Id.
84. For background on the Bishop Estate, see generally Samuel P. King & Randall W. Roth, Broken Trust: Greed, Mismanagement & Political Manipulation at America’s Largest Charitable Trust (2006); and Symposium, Bishop Estate Controversy, 21 U. Haw. L. Rev. 353 (1999); see also Sitkoff & Dukeminier, supra note 4, at 808–11 (summarizing the administration of the Bishop Estate).
combined, and owned 10 percent of Goldman Sachs. The New York Times described it as “a feudal empire so vast that it could never be assembled in the modern world.” Ostensibly, the purpose of the charitable trust was to set up schools to educate Hawaiian children. However, as a newspaper exposé, state attorney general investigation, and IRS audit eventually revealed, the trust was rife with mismanagement, fraud, and abuse.

In this instance, because of the investigative report and efforts of the state AG and IRS, the opportunist trustees were “caught” in one sense. Yet, despite being removed from their positions, the trustees largely escaped liability. Two court-appointed masters recommended that the court impose millions of dollars in surcharges on the former trustee. The AG was preparing to sue the trustees for nearly $200 million. However, the trustees settled the

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90. The exposé raised issues with, among other things, trustee selection and administration. See Samuel King, Charles Recumcano, Walter Heen, Gladys Brandt & Randall Roth, Broken Trust, HONOLULU STAR-BULL. INSIGHT (Aug. 9, 1997), http://archives.starbulletin.com/specials/bishop/story2.html [https://perma.cc/6QGH-35SL]. A court-appointed master and Hawaii’s attorney general subsequently uncovered numerous irregularities. For example, under the terms of the trust, the justices of Hawaii’s Supreme Court were to select the trustees. Id. However, the justices were appointed to the court through a judicial selection committee which consisted of public officials, many of whom were chosen as trustees and received enormous fees. See SITKOFF & DUKEMINIER, supra note 4, at 809–10.

In addition, one employee of the Estate, a state senator, charged $28,000 to the Estate’s credit card in casinos and sex clubs in Las Vegas and Honolulu. Id. at 810. After his misconduct was discovered, the employee was forced to repay the Estate. Id. However, the trustees later reimbursed the employee with a retroactive bonus in the exact amount needed to repay the Estate and to cover his taxes on the bonus. Id. The AG also indicted two trustees for kickbacks in a real estate deal between a trustee’s relative and the trust. Id.

In an audit, the IRS found the trust was not being operated for charitable purposes. As it turned out, very little of the money was going toward education. Id. The IRS also found improper involvement with politics, based on the corrupt trustee selection process. Id. And the IRS found that the trustee fees, $1 million per year per trustee, far exceeded the value of services performed by the trustees, whose investments produced a return of 1%. Id. In light of an IRS threat to revoke the trust’s charitable tax exemption retroactively, which would have cost the trust nearly $1 billion, a court finally removed the trustees. Id.

91. See SITKOFF & DUKEMINIER, supra note 4, at 801–02.
case using an insurance policy paid for by funds from the Estate. Ultimately, the trustees paid no surcharges and returned no money.92

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The premise of the literature on punitive damages and optimal deterrence is that injurers sometimes escape liability. There is reason to fear that, in practice, trustees and other fiduciaries escape liability frequently. Thus, trust law must contend with both trustee opportunism of the type that requires disgorgement of ill-gotten gains and the real possibility that a trustee who has breached a fiduciary duty may escape liability.

B. FIDUCIARY DUTIES

If a trustee violates a trust by misappropriating or mismanaging trust assets, a beneficiary (or co-trustee) can sue the trustee for breach of a fiduciary duty. Ideally, the threat of litigation ex post provides an incentive for the trustee to act in the beneficiaries' interests ex ante. In other words, “[t]he purpose of fiduciary duties, including the duties of loyalty and care, is to reduce agency costs by providing an ex post check on opportunism.”93 Although several checks exist on trustees, including market competition, reputation, and trustee selection,94 the primary legal tools for deterring opportunism and breach of trust are fiduciary duties.95 Among a trustee’s duties are the duty of loyalty, which attempts to deter misappropriation of trust assets, the duty of prudence, which attempts to deter mismanagement, and various subsidiary duties.96

1. Duty of Loyalty

As the leading trusts and estates casebook points out: “Perhaps the most fundamental principle of trust fiduciary law is the trustee’s duty of undivided loyalty to the beneficiary.”97 The UTC specifies that: “A trustee shall administer

92. Id. at 811.
93. Kelly, supra note 75, at 893. “Agency theory, and in particular its emphasis on the problem of opportunism in circumstances of asymmetric information, explains these basic contours of fiduciary doctrine.” Id. at 893 n.203 (citing Sitkoff, The Economic Structure of Fiduciary Law, supra note 23, at 1049).
94. See infra Section IV.B (discussing effect of market competition and reputation among trustees in deterring fiduciary breach and encouraging efficient trust administration).
95. The word “fiduciary” comes from the Latin word, fidere, meaning to trust.
96. This Section draws upon several treatments of fiduciary law as exemplified in previously cited authority. For examples, see generally Sitkoff & Dukeminier, supra note 4; Sitkoff, The Economic Structure of Fiduciary Law, supra note 23; and Sitkoff, supra note 37.
97. Sitkoff & Dukeminier, supra note 4, at 608. The duty of loyalty applies to both private and charitable trusts. Even though the beneficiaries of charitable trusts are indefinite, “the trustee must administer the trust solely in the interests of effectuating the trust’s charitable purposes.”
the trust *solely* in the interests of the beneficiaries.)*98 Thus, in trust law, unlike in corporate law, the duty of loyalty requires a trustee to act in the “sole interest” of beneficiaries, not just the best interests of the beneficiaries.*99

For example, the duty of loyalty prevents a trustee from engaging in a transaction that involves a potential conflict of interest, even if the transaction is in good faith and maximizes the interests of the beneficiaries (e.g., the conflicted party is offering the highest price).100 A court will not evaluate the good faith of the trustee or fairness of the transaction. Instead, if the transaction violates the sole interest rule, the court will make “no further inquiry” and find that the trustee has breached its duty of loyalty.101

The trustee’s duty of loyalty is “the obligation of the trustee not to place the trustee’s own interests over those of the beneficiaries.”102 There are defenses that a trustee may raise, including settlor authorization, beneficiary consent, and judicial approval.103 But the key is that, in obtaining a beneficiary’s consent, the trustee must disclose the conflict and material facts so that the beneficiary is able to make an informed decision.104 Moreover, even if a settlor authorizes a conflicted transaction or the beneficiaries consent, several cases have held that a beneficiary is entitled to judicial review of whether the trustee has acted in good faith and whether the transaction was fair.105

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98. UNIF. TR. CODE § 802 (UNIF. L COMM’N 2010) (citing RESTATEMENT (SECOND) OF TRS. § 379 cmt. a (AM. L. INST. 1959)).

99. See Sitkoff, supra note 9, at 44–45 (explaining the sole interest rule in trust law); see also Langbein, supra note 20, at 943 (describing the one-sidedness of the sole interest rule in the context of non-harmful conflicts of interests).

100. See generally In re Gleeson’s Will, 124 N.E.2d 624 (Ill. App. Ct. 1955) (holding a trustee could not rent out farmland to himself even though rented prior to death of testatrix); Hartman v. Hartle, 122 A. 615 (N.J. Ch. 1923) (holding when heir of executor’s wife buys testatrix’s farmland at a public auction, the additional proceeds of the resale to an innocent third party must be accounted to testatrix’s other children).

101. Sitkoff & Dukeminier, supra note 4, at 611 (“Under the trust law fiduciary duty of loyalty, if a trustee undertakes a transaction that involves a conflict between the trustee’s fiduciary capacity and personal interests, no further inquiry is made; the trustee’s good faith and the fairness of the transaction are irrelevant.”).


103. RESTATEMENT (THIRD) OF TRS. § 78 cmts. c(1)–(c) (AM. L. INST. 2007); see also Sitkoff & Dukeminier, supra note 4, at 611 (“The only defenses that the trustee may raise are that: (a) the settlor authorized the particular conflict in the terms of the trust; (b) the beneficiary consented after full disclosure . . . ; or (c) a court approved the transaction in advance.”).

104. See Sitkoff, supra note 47, at 205.

105. See, e.g., In re Estate of Moncur, 812 N.W.2d 485, 487–88 (S.D. 2012); Mendoza v. Gonzales, 204 P.3d 995, 999–1000 (Wyo. 2009); see also RESTATEMENT (THIRD) OF TRS. § 78 cmts. b, c(2) (“A trustee may be authorized by the terms of the trust, expressly or by implication, to engage in transactions that would otherwise be prohibited by the rules of undivided loyalty . . . . However,] no matter how broad the provisions of a trust may be in conferring power to
Professor John Langbein, a leading proponent of the contractarian view of trusts,106 argues for loosening a trustee’s duty of loyalty.107 Langbein advocates moving from the “sole interest” rule to a “best interests” rule because “a transaction prudently undertaken to advance the best interest of the beneficiary best serves the purpose of the duty of loyalty, even if the trustee also does or might derive some benefit.”108 Langbein’s focus is on the rule of liability, not the remedy; indeed, he does not question disgorgement as a trust law remedy. Yet, Langbein discusses why the sole interest rule, coupled with a disgorgement remedy, may result in both underdeterrence and overdeterrence:

“Any economist will tell you that the rational self-serving defendant knows that he will not be caught and sued to judgment every time he puts himself in a conflict of interest and duty,” and accordingly, that the winnings from undetected misappropriation would be likely to outweigh the costs of having to disgorge gains only when caught . . . . [T]he sole interest rule also overdeters. By penalizing trustees in cases in which the interest of the trust beneficiary was unharmed or advanced, the rule deters future trustees from similar, beneficiary-regarding conduct.109

Langbein recognizes that even the disgorgement remedy may be inadequate to deter fiduciary breach by a trustee because misappropriation often goes “undetected.” This point is consistent with the rationale articulated below for punitive damages (and punitive disgorgement). Second, Langbein recognizes that trust law may (over)penalize a trustee for engaging in a breach of the duty of loyalty in which the total gain, including the gain for beneficiaries, exceeds any harm. But Langbein’s proposal is focused on altering the sole interest rule, not reevaluating the remedies for breach.

engage in self-dealing or other transactions involving a conflict of fiduciary and personal interests, a trustee violates the duty of loyalty to the beneficiaries by acting in bad faith or unfairly.”).

106. See Langbein, supra note 10, at 657. Others argue that trusts entail elements of property law. See, e.g., Hansmann & Mattei, supra note 10, at 435; Thomas W. Merrill & Henry E. Smith, The Property/Contract Interface, 101 COLUM. L. REV. 773, 843–49 (2001). However, these scholars also recognize that significant portions of trust law are contractual. See, e.g., Hansmann & Mattei, supra note 10, at 469–70 ("We agree with Langbein that, so far as the relationships between the settlor, the trustee, and the beneficiary are concerned, trust law adds very little to contract law."); Merrill & Smith, supra, at 844–45 (agreeing with Langbein and Hansmann & Mattei that, "viewed from an internal perspective, the relations among parties to a trust agreement are governed by legal rules that track the law of contract").

107. Langbein, supra note 20, at 933–34.

108. Id. at 932.

109. Id. at 951–52 (footnotes omitted) (quoting Lionel Smith, The Motive, Not the Deed, in RATIONALIZING PROPERTY, EQUITY, AND TRUSTS: ESSAYS IN HONOUR OF EDWARD BURN 53, 60 (Joshua Getzler ed., 2003)). But cf. Leslie, supra note 70, at 539–54 (arguing against Langbein and in favor of the sole interest rule).
2. Duty of Prudence

In addition to the duty of loyalty, the trustee has a duty of prudence. The duty of prudence in trust law is equivalent to the duty of care that applies to other types of fiduciaries.110 The duty of prudence imposes on a trustee an objective standard of care,111 and this objective standard of care is higher if the trustee has specialized skills.112 The UTC defines a trustee’s duty of prudence in the following way: “A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.”113 The “duty does not depend on whether the trustee receives compensation.”114

The trustee’s duty of prudence applies to each of the trustee’s functions: custodial, administrative, investment, and distribution.115 For example, the investment function entails “reviewing the trust assets and implementing an investment program that fits the purpose of the trust and the circumstances of the beneficiaries.”116 In investing trust assets, a trustee must abide by the prudent investor rule.117 Accordingly, consistent with modern portfolio theory,118

110. See SITKOFF & DUKEMINIER, supra note 4, at 622 (“After loyalty, the next great principle of trust fiduciary law is the duty of prudence, which imposes on a trustee an objective standard of care.”).
111. See Sitkoff, supra note 47, at 202 (“The duty of care prescribes the fiduciary’s standard of care by establishing a ‘reasonableness’ or ‘prudence’ standard that is informed by industry norms and practices. The fiduciary standard of care is objective, measured by reference to a reasonable or prudent person in like circumstances.”).
112. See id. (“If a fiduciary has specialized skills relevant to the principal’s retention of the fiduciary, then the applicable standard of care is that of a reasonable or prudent person in possession of those skills.”).
113. UNIF. TR. CODE § 804 (UNIF. L. COMM’N 2010).
114. Id. § 804 cmt.
115. SITKOFF & DUKEMINIER, supra note 4, at 622.
116. Id. at 635.
A trustee has a duty to invest and manage trust assets as a prudent investor would,119 a duty to execute an investment strategy having risk and return objectives reasonably suited to the trust,120 and a duty to diversify trust assets.121 All states have adopted the insights of the prudent investor rule for private trusts.122 Moreover, nearly all the states have adopted these insights for charitable trusts.123 Finally, according to recent empirical studies, the adoption of the prudent investor rule has had a significant effect on the allocation of trust assets,124 suggesting that “trustee behavior is sensitive to changes in trust fiduciary law.”125

3. Subsidiary Duties

In addition to the duty of loyalty and prudence, trust law entails a number of subsidiary duties. Although the duties of loyalty and prudence are framed as standards, the subsidiary duties are usually rules.126 The development of specific subsidiary duties or implementing rules that elaborate on the application of loyalty and care to recurring circumstances helps to mitigate the uncertainty from broad standards like the duty of loyalty and duty of care.127

In trust law, these subsidiary duties include duties regarding the custodial and administrative functions, the duty of impartiality, and duties to inform

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119. See UNIF. PRUDENT INV. ACT § 2(a) (UNIF. L. COMM’N 1994) (“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. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.”).

120. See id. § 2(b) (“A trustee’s investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.”).

121. See id. § 3 (“A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.”).

122. See Schanzenbach & Sitkoff, supra note 117, at 319 (“The core reforms of the new Restatement and Uniform Act, which implement the teachings of modern portfolio theory, have been adopted in all states, primarily though not exclusively through enactment of the [Uniform Prudent Investor Act].”).

123. See Sitkoff & Dukeminier, supra note 4, at 635 n.64 (“Uniform Prudent Management of Institutional Funds Act §3[,] . . . adopted in nearly every state, applies the prudent investor rule to the management and investment of charitable endowments.”).


125. Schanzenbach & Sitkoff, supra note 117, at 329; see Schanzenbach & Sitkoff, Trust Portfolio Allocation, supra note 23, at 707.

126. Sitkoff, supra note 9, at 52.

127. See Sitkoff, The Economic Structure of Fiduciary Law, supra note 23, at 1045; Sitkoff, supra note 8, at 682–83; Sitkoff, supra note 47, at 202–05.
and account.\textsuperscript{128} For example, with regard to the custodial and administrative functions, the duties of loyalty and prudence are elaborated by subsidiary duties to collect, protect, earmark, and not commingle trust property;\textsuperscript{129} to keep adequate records of administration;\textsuperscript{130} and to bring and defend claims.\textsuperscript{131} Likewise, the duty of impartiality and the associated principal and income rules elaborate on loyalty and prudence in trusts with multiple beneficiaries who may have divergent interests.\textsuperscript{132} The duty of impartiality requires that the trustee “shall act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries’ respective interests.”\textsuperscript{133} Finally, the duty to inform requires that, in administering the trust, the trustee provide advance disclosure to the beneficiaries of significant developments or non-routine transactions.\textsuperscript{134}

* * *

Overall, the general duties of loyalty and prudence, coupled with the specific subsidiary rules, provide the decision costs advantage of rules and the error costs advantage of standards, thereby minimizing the costs of applying fiduciary duties.\textsuperscript{135} A critical element of the enforcement of fiduciary duties are the remedies for breach.

\textbf{C. Remedies for Fiduciary Breach}

If a trustee breaches a fiduciary duty—whether the duty of loyalty, the duty of prudence, or a subsidiary duty—a beneficiary (or co-trustee) may sue for breach of trust and seek one or more remedies. This Section briefly summarizes the primary remedies available for breach, with particular attention to the remedies in trust fiduciary law. These remedies include damages, specific performance and injunctive relief, disgorgement (including restitution, constructive trust, and equitable lien), punitive damages, and trustee removal. Notably, a settlor may not relieve the trustee of liability for breach of trust or liability for any profit from breach.\textsuperscript{136}

\begin{itemize}
  \item[128.] Sitkoff, supra note 9, at 51–54.
  \item[129.] See UNIF. TR. CODE §§ 809, 810(c), 812 (UNIF. L. COMM’N 2010).
  \item[130.] Id. § 810(a).
  \item[131.] See Sitkoff, supra note 47, at 203.
  \item[132.] Id.
  \item[133.] UNIF. TR. CODE § 803.
  \item[134.] Id. § 813.
  \item[135.] On the role of subsidiary duties in minimizing error costs in fiduciary law, see Sitkoff, supra note 47, at 203. On the use of rules versus standards in trusts and estates, see Kelly, supra note 75, at 871–73, 887–95.
  \item[136.] RESTATEMENT (SECOND) OF TRS. § 222(2) (Am. L. Inst. 1959) (“A provision in the trust instrument is not effective to relieve the trustee of liability for breach of trust committed in bad faith or intentionally or with reckless indifference to the interest of the beneficiary, or of liability for any profit which the trustee has derived from a breach of trust.”).
\end{itemize}
**DISGORGEMENT AND PUNITIVE DAMAGES**

**Damages.** This Article uses the term “damages” broadly to refer to compensatory damages that a plaintiff may obtain in a court of law or any monetary payment a beneficiary may obtain against a trustee or fiduciary in equity,\(^{137}\) including a surcharge or equitable compensation.\(^{138}\) If a trustee breaches a fiduciary duty, then a beneficiary is entitled to damages to restore the trust estate and trust distribution to what they would have been but for the breach.\(^{139}\) A damages award in trust law is thus analogous to an award of expectation damages in contract law.\(^{140}\)

**Specific Performance and Injunctions.** A beneficiary of a trust can maintain a suit to compel the trustee to perform its duties as trustee.\(^{141}\) Specific performance is available even if there is an adequate remedy at law (i.e., damages). In addition, if there is a reasonable likelihood that a trustee will commit a breach of trust, the beneficiary can sue to enjoin the breach.\(^{142}\) Injunctive relief also may be useful in disgorging any benefit that a trustee may obtain by selling the trustee’s own property to the trust or by attempting to purchase trust property in breach of trust.\(^{143}\)

**Disgorgement (restitution, constructive trust, and equitable lien).** This Article uses the term “disgorgement” to refer to any remedy that allows a plaintiff to strip a defendant’s ill-gotten gains, including restitution, the constructive trust,

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137. On the “legal” remedies of a beneficiary, see, for example, id. § 198(1) (“If the trustee is under a duty to pay money immediately and unconditionally to the beneficiary, the beneficiary can maintain an action at law against the trustee to enforce payment.”); and id. § 198(2) (“If the trustee of a chattel is under a duty to transfer it immediately and unconditionally to the beneficiary and in breach of trust fails to transfer it, the beneficiary can maintain an action at law against him.”).

138. Sam Bray points out that the remedy based on a plaintiff’s loss due to a trustee’s breach can be called “damages” or “equitable compensation” but that “[o]ne advantage of the term ‘equitable compensation’... is that [it] help[s] American courts understand that this traditional remedy for breach of trust is not legal but equitable, a point that is particularly relevant in ERISA cases.” Bray, supra note 23, at 205 n.31 (citing HEYDON ET AL., supra note 23, at 800–01); see also John H. Langbein, *What ERISA Means by “Equitable”: The Supreme Court’s Trail of Error in Russell, Mertens, and Great-West*, 103 COLUM. L. REV. 1317, 1353 n.211 (2003) (noting that courts avoid using “damages” in breach of trust suits and prefer reciting equitable maxims, despite the result resembling common law damages). For a recent overview of the remedy of surcharge, see Lindsay Nako, *Surcharge: The Resurgence of a Monetary Equitable Remedy*, ABA SECTION ON LABOR AND EMPLOYMENT LAW (2012), https://web.archive.org/web/20160822232224/http://www.americanbar.org:80/content/newsletter/groups/labor_law/ebc_newsletter/12_winter_ebc_news/ebc12winter_sur.html [https://perma.cc/M8UT-TNTJ].

139. See SITKOFF & DUKEMINIER, supra note 4, at 611.


141. See RESTATEMENT (SECOND) OF TRS. § 199(a); id. § 199 cmt. a.

142. Id. § 199(b); id. § 199 cmt. b.

143. See SITKOFF & DUKEMINIER, supra note 4, at 612 (noting that, under the Uniform Trust Code, a beneficiary may be entitled to “injunctive relief to compel the trustee to perform, to enjoin a future breach, or to account” (citing UNIF. TR. CODE § 1001 (UNIF. L. COMM’N 2010))).
and equitable lien. 144 Restitution is a remedy aimed at preventing “unjust enrichment.” 145 Rather than imposing damages based on the plaintiff’s harm, restitution allows the plaintiff to recover an amount equal to the defendant’s gain. 146 A constructive trust is an equitable remedy that courts use to prevent unjust enrichment and provide restitution. 147 The constructive trust is an equitable remedy, not a trust, because the sole duty of the constructive trustee is to convey the property to its rightful claimant. 148 For example, if the trustee acquires other property in wrongfully disposing of trust property, the beneficiary can enforce a constructive trust or an equitable lien on the property, treating

144. See, e.g., Cooter & Freedman, supra note 8, at 1051 n.14 (“The disgorgement remedy is effected through the equitable remedies of constructive trust, tracing, and accounting; requiring the fiduciary to indemnify the agent for losses; setting aside an improper transaction or objectionable act; granting injunctive and declaratory relief; and awarding prejudgment interest. Each of these remedies is designed to deprive the fiduciary of all gains resulting from her wrongful act.”).

145. See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT pt. 3, ch. 7, intro. note (AM. L. INST. 2011) (“The remedies described in this Chapter typically achieve ‘restitution’ in the sense that they address a liability based on the unjust enrichment of the defendant at the expense of the claimant.”). Restitution is both a cause of action and a remedy. See id. § 1 (“A person who is unjustly enriched at the expense of another is subject to liability in restitution.”); see also id. § 1 cmt. a (“The use of the word ‘restitution’ to describe the cause of action as well as the remedy is likewise inherited from the original Restatement, despite the problems this usage creates.”).

146. On restitution, see generally HANOCH DAGAN, THE LAW AND ETHICS OF RESTITUTION (2004) (detailing the law and ethics of restitution); Mark P. Gergen, What Renders Enrichment Unjust?, 79 TEX. L. REV. 1927 (2001) (detailing the contours of when unjust enrichment may be warranted); Andrew Kull, Rationalizing Restitution, 83 CALIF. L. REV. 1191 (1995) (explaining the function of restitution); and Saul Levmore, Explaining Restitution, 71 VA. L. REV. 65 (1985) (explaining the function of restitution). Professor Andrew Kull has clarified the role of restitution as a remedy in the Restatement (Third) of Restitution and Unjust Enrichment. According to the Restatement: “Legal rules that give the property to the wrongdoer cannot simply be ignored, but they can be accommodate to the doctrine prohibiting unjust enrichment by a simple, equitable device: a decree that the wrongdoer holds the property as constructive trustee for someone else.” RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT pt. 2, ch. 5, topic 2, intro. note.

147. According to Justice Cardozo’s canonical formulation, “A constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in circumstances that the holder of the legal title may not in good conscience retain the beneficial interest equity converts him into a trustee.” Beatty v. Guggenheim Exploration Co., 122 N.E. 378, 380 (N.Y. 1919). For a recent application, see Richard A. Epstein, Returning to Common-Law Principles of Insider Trading After United States v. Newman, 125 YALE L.J. 1482, 1482 (2016) (arguing, in misappropriation cases, that “private sanctions that regulate the uneven flow of information should suffice to control any abuses, and these sanctions should include the imposition of constructive trust, based on a restitution theory of unjust enrichment”).

148. See STIKOFF & DUKEMINIER, supra note 4, at 133–34; see also RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 55(1) (“If a defendant is unjustly enriched by the acquisition of title to identifiable property at the expense of the claimant or in violation of the claimant’s rights, the defendant may be declared a constructive trustee, for the benefit of the claimant, of the property in question and its traceable product.”). On the forward-looking nature of the constructive trust, see Bray, supra note 23, at 205–06 (citing RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT §§ 55(1)–(2)); and WARD FARNSWORTH, RESTITUTION: CIVIL LIABILITY FOR UNJUST ENRICHMENT 119–27, 132 (2014).
it as party of the trust property. In addition, the beneficiaries may enforce a constructive trust or an equitable lien against a third party who acquires trust property (unless the third party is a bona-fide purchaser). A beneficiary is entitled to restitution by way of a constructive trust or equitable lien to prevent the third party’s unjust enrichment owing to the wrongdoing of the trustee.

Punitive Damages. Historically, punitive damages—a legal remedy—were not available among the traditional equitable remedies. This prohibition against punitive damages not only applied in courts of equity but continued to apply in courts after the fusion of law and equity. In some cases, especially in recent decades, federal and state courts allow punitive damages against a trustee or other fiduciary. However, these courts have typically awarded punitive damages only if the breach of fiduciary duty or the fiduciary’s behavior is “egregious.” In such jurisdictions, courts are especially likely to award punitive damages “if the trustee has acted maliciously, in bad faith, or in a fraudulent, particularly reckless, or self-serving manner.”

How a court determines whether a trustee’s action is “egregious” or particularly self-serving is not exactly clear. But many courts do analyze a

149. See Sitkoff & Dukeminier, supra note 4, at 612.
150. See id.
151. Id. (citing Reinhardt Univ. v. Castlebarry, 734 S.E.2d (Ga. App. 2012)).
152. Bray, supra note 23, at 202 (“The law of trust, including remedies, was developed in the courts of equity, especially the Court of Chancery. In Chancery there were no punitive damages.”).
153. See supra note 16 and accompanying text; see also Bray, supra note 23, at 202–05 (“The law of trusts, including remedies, was developed in the courts of equity, especially the Court of Chancery. In Chancery there were no punitive damages . . . . [T]he introduction of punitive damages as a trust-law remedy does not seem to have had much to do with the merger of law and equity . . . . [W]hatever the justification may be for allowing punitive damages for breach of trust, it does not . . . follow from the present state of the merger of law and equity.”).
154. See Bray, supra note 23, at 201 (noting “that in the last several decades a number of state courts have begun to allow the recovery of punitive damages against a trustee”); see also Cooter & Freedman, supra note 8, at 1069 (“Punishment for breach of fiduciary duty through the use of punitive damages is increasingly common.” (citing Schoenhotz v. Doniger, 657 F. Supp. 899, 914 (S.D.N.Y. 1987) (collecting state court decisions involving extreme trustee disloyalty))); Langbein, supra note 20, at 975 n.242 (“In the mid-1970s, there was scant authority for punitive damages in trust matters, but punitive damages have since spread to many states.”).
155. See Restatement (Third) of Trs. § 100 cmt. d (Am. L. Inst. 2012) (“Ordinarily, a recovery under this Section would not be supplemented by an additional award of exemplary damages . . . . In the egregious case, however, punitive damages are permissible under the laws of many jurisdictions.” (emphasis added)); see also Bray, supra note 23, at 202 (“The emerging principle has a rule-exception structure. The rule is that punitive damages are not available against trustees, with an exception for the ‘the egregious case.’” (citing Restatement (Third) of Trusts § 100 cmt. d)). Bray points out that the merger of legal and equitable courts does not seem to predict whether a state will allow punitive damages against the trustees: Among states with separate law and equity courts, some allow punitive damages in equity (e.g., Mississippi) and some do not (e.g., Delaware). Among states with merged law and equity courts, some allow punitive damages in equity (e.g., New Mexico) and some do not (e.g., Maryland). Bray, supra note 23, at 203 (footnotes omitted).
156. Restatement (Third) of Trs. § 100 cmt. d.
number of facts and circumstances, including “the nature and extent of the
detrailer’s wrongdoing, the trustee’s conduct in presenting an accounting or
defending a surcharge action, and the extent to which punitive damages are
important in order to punish the trustee, to recognize the harm to the
beneficiaries, and to deter similar misconduct.” Descriptively, the extent to
which courts employ punitive damages to “deter similar misconduct” is unclear.
However, at least one commentator has suggested that the modern trend of
some courts’ embracing punitive damages could signal a movement toward
deterrence.158

Trustee Removal. Another remedy for breach of trust is to remove the
trustee. A court will remove a trustee if the trustee “has committed a
sufficiently serious breach of trust or if it is probable that [the trustee] will
commit such a breach of trust.” Under traditional law, a court would permit
removal only for cause. In general, the court would remove a trustee who
had committed a serious breach of trust. But trustee removal was not permitted
for a minor breach or a simple disagreement with the beneficiary. Moreover,
if the settlor has selected the trustee, as opposed to a court-appointed trustee,
trustee removal is even more difficult. Modern law has liberalized trustee
removal. In addition to a breach of trust or dishonesty, the law authorizes
removal due to ineffective administration by the trustee or because of a
change in circumstances or with approval of all the beneficiaries, if removal
is in the best interests of the beneficiaries and not contrary to a material
purpose of the settlor.

* * *

Each of these remedies plays an important role in enforcing a trustee’s
fiduciary duties. In the next Part, this Article focuses on three of these
remedies—damages, disgorgement, and punitive remedies—and examines
how courts might use these remedies to deter a trustee’s fiduciary breach.

157. Id.
158. See Sitkoff, supra note 47, at 207 (“The recognition in modern law of punitive damages
for such egregious fiduciary breaches is a sign of movement toward deterrence of such cases.”).
159. See Restatement (Third) of Trs. § 199(e).
160. Id. § 199 cmt. c.
161. See Sitkoff & Dukeminier, supra note 4, at 758–59 (summarizing traditional law of trustee
removal).
162. Id. at 758.
163. Id.
164. See id.
165. See Unif. Tr. Code § 706 (UNIF. L. COMM’N 2010); see also Sitkoff & Dukeminier, supra
note 4, at 759.
III. DOUBLE DETERRENCE: THE BASIC THEORY

This Part develops a basic theory of deterrence of fiduciary breach. First, it analyzes damages and disgorgement when, theoretically, a fiduciary is always found liable, concluding that an election of damages or disgorgement is optimal. This Part then analyzes damages and disgorgement when a fiduciary may sometimes escape liability, concluding that, in addition to damages or disgorgement, an election of punitive damages or punitive disgorgement is optimal. This Part also briefly compares the optimal remedies for breach of the duty of loyalty and the duty of prudence. As noted above, the objective is optimal deterrence. Therefore, the remedies should neither under-deter, by allowing a trustee to misappropriate or mismanage trust property, nor over-deter, by discouraging trustees from serving as trustees or prohibiting potential gains for the beneficiaries or the trust.

A. WHEN A FIDUCIARY IS ALWAYS FOUND LIABLE

If a fiduciary is always liable for breaching its duty of loyalty or duty of prudence, then what is the optimal remedy to deter breach? To answer this question, consider two scenarios. First, if a trustee breaches its duty of loyalty, the harm to the beneficiary may exceed the gain to the trustee. Here, damages are necessary. Second, if a trustee breaches its duty of loyalty, the gain to the trustee may exceed any harm to the beneficiary. Here, disgorgement is needed.

1. Damages

Consider first the situation in which the harm to the beneficiary exceeds the gain to the trustee. If the harm to the beneficiary is greater than the gain, then the optimal remedy would be the same as compensatory damages. The justification mirrors the traditional justification for expectation damages in contract law. Here, because the harm to the beneficiary exceeds the gain to the trustee, breach is socially undesirable. Therefore, the law aims to deter breach by forcing a trustee to internalize the harm it inflicts on the beneficiaries. By awarding damages, the law ensures that the trustee will not have an incentive to breach (again, assuming the trustee is held liable with certainty).

Consider a simple numerical example. Suppose that Tom, the trustee, breaches his duty of loyalty perhaps by engaging in a transaction that involves self-dealing or misappropriating trust property. If Tom breaches, the harm to Bridget, the beneficiary, is $100. Suppose as well that, by misappropriating

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166. On the social desirability of expectation damages as a remedy in contract law, see sources cited supra note 11. See also Omri Ben-Shahar & Lisa Bernstein, The Secret Interest in Contract Law, 109 YALE L.J. 1885, 1885 (2000) (“A long and distinguished line of law-and-economics articles has established that in many circumstances fully compensatory expectation damages are a desirable remedy for breach of contract because they induce both efficient performance and efficient breach.”).
the property, the gain to Tom is $80. Plaintiff, Bridget the beneficiary, sues defendant, Tom the trustee, for breach of fiduciary duty. Because we are assuming the probability of detecting and enforcing a breach is one, Tom the trustee is found liable with certainty. Here, the court, by setting compensatory damages equal to the plaintiff's harm, $100, forces the trustee to internalize the harm. Thus, because the damages remedy requires Tom the trustee to pay for the harm, Tom should have no incentive to breach his duty of loyalty.

Under the compensatory damages approach, the court's use of a damages award equal to the harm, $100, provides the trustee with the optimal incentives regarding efficient performance and efficient breach. If the court's damages award is too low—say, damages were $60—then Tom the trustee would have a private incentive to engage in a self-dealing transaction because the private gain to Tom, $80, exceeds the private costs to Tom, $60. However, the trustee's private incentive to breach would diverge from the socially optimal outcome because the overall social benefits of the transaction, $80, are outweighed by its costs, $100. Thus, if the harm to the beneficiaries exceeds the gain to the trustee, the use of compensatory damages forces the trustee to internalize the harm, thereby achieving the socially desirable result.

2. Disgorgement

Now consider the second scenario in which, if the trustee breaches its duty of loyalty, the gain to the trustee exceeds the harm to the beneficiary. One might think that, once again, even though the gain to the trustee is greater than the harm to the beneficiary, the optimal remedy would be compensatory damages. Indeed, under the standard remedies in contract law, fully compensatory expectation damages would achieve the optimal outcome.167

Under the basic argument for efficient breach, because the benefit to the breaching party exceeds the harm to the non-breaching party, breach of contract is socially desirable. Breach might even be in the interests of both parties from an ex ante perspective because, if the parties had perfect information and could specify each potential contingency in advance, then the parties would have agreed not to demand performance under these circumstances. The law aims to deter breach by forcing a party to internalize the harm it inflicts on another by breaching its contract. But, from an economic perspective, contract law does not want to deter breach too much; that is, it does not want the parties to engage in expensive or excessive performance if the costs of doing so exceed the benefits. By awarding damages against the breaching party, the law ensures that a party will have an incentive to perform the contract only when doing so is socially desirable.168

167. See supra note 11 and accompanying text.
168. See SHAVELL, supra note 11, at 311–12 (“The point that a moderate damage measure, and in particular the expectation measure, is socially desirable because it induces performance if and only if the cost of performance is relatively low was originally stated, informally, in Posner . . . but he did not observe that the expectation measure is mutually desirable for the parties.”).
Turning to trusts, the issue becomes: what is the optimal remedy for breach of a fiduciary duty if the potential gain to the trustee exceeds the harm to the beneficiaries? If the only remedy is damages, then the trustee will have the same incentives to breach as a contracting party in the efficient breach scenario described above. Namely, if the trustee can breach its fiduciary duty and still gain from the breach even after paying damages for the harm, then the trustee will have an incentive to engage in an “efficient fiduciary breach.”

Consider again the example of Tom and Bridget. Recall that, if Tom the trustee breaches his duty of loyalty, the harm to Bridget the beneficiary is $100. But now suppose that a breach of loyalty entails a gain to Tom of $120 (rather than $80, as before). For example, suppose Tom the trustee leases the trust property to himself, as Tom the tenant, and the gain to Tom from renting the property is $120 (even though the loss to Bridget is only $100, say, because the rental’s fair market value was $100 more than Tom’s rent). Bridget sues Tom for breach of fiduciary duty. Once again, Tom is found liable for breach with certainty. The court, in setting damages equal to the plaintiff’s harm, $100, forces the trustee to internalize the harm. But, under a damages remedy, Tom the trustee would have an incentive to breach his duty of loyalty and lease the property to himself. This is because Tom’s gain, $120, exceeds Tom’s cost, $100.

In order to deter breach when the gain to the trustee exceeds the harm to the beneficiary, fiduciary law must rely on a different remedy: disgorgement of the benefit. If a beneficiary is able to disgorge the trustee’s gain, and not just seek damages for the harm, then disgorgement can remove the trustee’s incentive to breach. So, if the gain to Tom from breach is $120, and the harm to Bridget is $100, a court can deter breach by disgorging Tom’s benefit of

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169. In addition, breach of the duty of loyalty may include cases in which both the trustee and beneficiaries gain. For example, a transaction involving a conflict of interest may in fact be in the beneficiaries’ best interests. This Article does not consider this case separately; it is a specific application of the general case in which the trustee’s gain exceeds the beneficiaries’ harm, where harm is zero or negative. As it turns out, a disgorgement remedy may be socially beneficial even if the gain to the trustee exceeds the harm to the beneficiaries, or even if both the trustee and the beneficiaries might gain from breach, in an individual case.

170. Cf. In re Gleeson’s Will, 124 N.E.2d 624, 626–27 (Ill App. 1955) (“The record indicates no dispute as to the fact that petitioner as trustee leased a portion of the real estate of the trust to himself as a partner of William Curtin and that petitioner received a share of the profits realized by him and Curtin from their farming operation of said real estate . . . . [T]he petitioner herein, upon the death of the testatrix, . . . should have then decided whether he chose to continue as a tenant or to act as trustee. His election was to act as trustee and as such he could not deal with himself.”). In the numerical example in the text, Tom the trustee failed to obtain fair market value for renting the trust property. However, it is worth noting that “[t]he trustee who deals with trust property for the trustee’s own account is liable to disgorge the profits to the trust even if the trustee paid fair value for the property.” Langbein, supra note 10, at 656 (citing Hartman v. Hartle, 122 A. 615, 615 (N.J. Ch. 1923)).

171. On the various types of disgorgement, see supra notes 144–51 and accompanying text.
$120. Under the disgorgement remedy, Tom will have no incentive to breach because Tom’s gain, $120, no longer exceeds Tom’s cost, $120.

But what is the social desirability of damages versus disgorgement? On one account, Tom’s breach of his duty of loyalty would be socially desirable because the overall benefit of breach ($120) exceeds the overall cost ($100). If so, the disgorgement remedy, although preventing breach, creates a private incentive for Tom (i.e., not to breach) that diverges from the socially optimal outcome. Indeed, based on the analysis above, the damages remedy might maximize efficiency while disgorgement would produce an inefficient outcome by discouraging Tom from committing an efficient breach.

However, despite the analogy to efficient breach in contract law, there are reasons to think allowing “efficient” fiduciary breach in trust law is socially undesirable. The reason is that disgorgement of a trustee’s gains may be necessary not only to deter breach but also to encourage disclosure by the trustee. Instead of allowing a trustee to breach its duty of loyalty and pay damages, a trustee must disclose a profitable opportunity and obtain approval from the beneficiaries. The settlor has specified the beneficiaries as the “residual claimants” of the settlor’s gift. Thus, any gain from trust property or investments belongs to the trust beneficiaries.

Other scholars who have considered economic justifications for disgorgement have emphasized similar rationales. For example, Easterbrook

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172. That is, the settlor has selected the beneficiaries as donees of the gift. On the idea of beneficiaries as residual claimants, see Sitkoff, supra note 8, at 649–57.

173. In contract law, it is unclear, as a theoretical matter, which of two contracting parties should receive the “surplus” from an efficient breach. By contrast, in trust law, the settlor has selected the beneficiaries as the recipients of the settlor’s gift of property. Thus, on this distributional issue, any potential gain from the trust property, including any profitable opportunity that may arise, belongs to the beneficiaries. See Sitkoff, The Economic Structure of Fiduciary Law, supra note 23, at 1049 (noting that “the default rule in fiduciary law is that all gains that arise in connection with the fiduciary relationship belong to the principal unless the parties specifically agree otherwise” and pointing out that “[i]n [his] default rule . . . induces the fiduciary to make full disclosure so that the parties can complete the contract expressly as regards the principal’s and the fiduciary’s relative shares of the surplus arising from the conduct that would otherwise have constituted a breach”).

174. To the extent scholars have examined remedies for fiduciary breach, they have offered various, and at times conflicting, rationales for disgorgement. For example, in their seminal article on fiduciary relationships, Cooter and Freedman contend that “[d]isgorgement, the usual remedy for misappropriation, merely aims to return the agent to a situation similar to the one that she would have been in without [the] appropriation.” Cooter & Freedman, supra note 8, at 1074. They argue that, while disgorgement is unnecessary to deter breach of the duty of care, even “perfect disgorgement” is unlikely to deter breach of the duty of loyalty. See id. at 1053 (“Just as a thief cannot be deterred simply by requiring her to return the stolen goods whenever she is caught, an agent cannot be deterred from appropriating the principal’s asset if the sanction is perfect disgorgement.”). Rather, a “[l]ow enforcement probability and mild sanctions create a deterrence problem.” Id. at 1074. In their view, fiduciary law ameliorates this problem by flipping the burden of proof from plaintiff to defendant. The law presumes or, in trust law, conclusively presumes disloyalty in situations involving self-dealing or conflicted transactions. Id. at 1055–56. In addition, Cooter and Freedman highlight several
and Fischel have attempted to justify disgorgement as a transaction-forcing remedy (i.e., a “means to promote actual bargains”) in fiduciary relationships.\footnote{Easterbrook & Fischel, supra note 10, at 444–45.} They emphasize that disgorgement of the defendant’s profits may be socially beneficial because “the profits remedy induces the parties to contract explicitly.”\footnote{Id. at 441.} While aware of the potential costs of transaction-forcing rules like disgorgement, they maintain that a contract-forcing remedy is superior in many situations that involve fiduciaries: namely, “when it is hard to know the optimal approach, when judicial valuation is haphazard, and when transactions costs ex post are small.”\footnote{Id. at 445.}

Examples in which “the disguised element of punishment for disloyalty often seems quite appropriate,” concluding that “disgorgement remedies in fact impose some element of punishment that helps overcome any remaining errors in detecting wrongdoing.” \textit{Id.} at 1071, 1074–75.

Similarly, after noting the potential tension between the use of damages in contract law and disgorgement in fiduciary law, see supra note 15, Easterbrook and Fischel offer a justification for disgorgement as a transaction-forcing remedy, see Easterbrook & Fischel, supra note 10, at 444–45. In defending a contractarian view of fiduciary duties, they address the argument that “[a] remedy aimed at achieving unconditional deterrence is so far from the contractual norm . . . that it disproves the contractual understanding of fiduciary duties.”\footnote{Id. at 441.} Easterbrook and Fischel are skeptical of Cooter and Freedman’s suggestion that disgorgement is inadequate to deter a breach of the duty of loyalty. They characterize Cooter and Freedman’s argument as the following: “Profits alone are an inadequate remedy. Instead of using a multiplier, the law uses a principle of suspicion: the appearance of a breach of duty is treated as a wrong, substantially increasing the probability that a breach of duty will be detected (and reducing the need for a profits multiplier when detection occurs).”\footnote{Id.} Easterbrook and Fischel note that Cooter and Freedman, in arguing for perfect disgorgement, elide the point that “[r]ecompense of some kind is necessary to spur the fiduciary to discover and exploit opportunities.”\footnote{Id. at 442.}

Instead, Easterbrook and Fischel justify disgorgement in fiduciary law, as well as certain cases in contract law, because “the profits remedy induces the parties to contract explicitly.”\footnote{Id. at 444 (discussing Snepp v. United States, 444 U.S. 507 (1980), and concluding that disgorgement is “the remedy the parties would have selected had they bargained in advanced without transaction costs”); see also id. at 446 (“[T]he use of disgorgement remedies in both contract and fiduciary cases ‘show[s] no coherent pattern.’ The lack of pattern in the rules reinforces our conclusion that fiduciary duties are not a distinctive topic in law or economics.” (quoting Farnsworth, supra note 23, at 1369)).} They maintain a contract-forcing remedy is superior in many situations involving fiduciaries: namely, “when it is hard to know the optimal approach, when judicial valuation is haphazard, and when transactions costs ex post are small.”\footnote{Id. at 445.} Easterbrook and Fischel contend these conditions “characterize[] many fiduciary relations. At the outset the range of contingencies is too large and information too scarce for effective contracting. During the course of performance the subjects become more concrete, options more specific . . . . These are more tractable questions, on which voluntary transactions are preferable to judicial guesses. Transaction-forcing remedies promote their resolution.”\footnote{Id. Yet they maintain that “nothing in this approach distinguishes fiduciary duties from other high-transactions-cost cases.” Id. at 445–46.}
Similarly, in considering punitive damages (rather than disgorgement), Polinsky and Shavell contend that a supracompensatory remedy might be optimal in some circumstances in which “it is possible for a party to communicate with a potential victim before causing harm.”\textsuperscript{178} As they explain: “In such circumstances, it may be socially desirable to induce a potential injurer to bargain and purchase the right to engage in harm-creating conduct—by threatening to impose punitive damages if the injurer acts unilaterally to cause harm.”\textsuperscript{179} Polinsky and Shavell offer several reasons why it might be socially desirable to encourage “bargaining and market transactions” through a supracompensatory remedy, including the risk that a court might underestimate damages, the wasteful efforts by parties to take and protect property interests, and the wish to avoid the administrative costs of calculating damages in the legal system.\textsuperscript{180}

Likewise, Sitkoff, in analyzing compensation and disgorgement in fiduciary law, emphasizes that the disgorgement remedy “reflects the additional disclosure and deterrence purposes of fiduciary law.”\textsuperscript{181} He points out that, “[b]ecause the fiduciary is not entitled to keep any gains resulting from the breach, he is given an incentive to disclose the potential for such gains and to work out with the principal how much of the surplus will go to each party.”\textsuperscript{182} Sitkoff contends that the rule in fiduciary law that gives all gains to the principal, a “rule, which is contrary to the preferences of the party with superior information, the fiduciary, offers deterrence in the penalty default sense.”\textsuperscript{183} He thus concludes “the disgorgement remedy is a penalty default rule that induces disclosure.”\textsuperscript{184}

Moreover, assuming the beneficiaries approve the transaction, the trustee is also likely to benefit from the profitable opportunity. In the example above, if Tom the trustee had disclosed to Bridget the beneficiary that Tom would be the tenant and Bridget consented to the transaction, then Tom would not have breached the duty of loyalty and would have received a benefit from the transaction (even if Tom paid the rental’s fair market value) because

\textsuperscript{178} Polinsky & Shavell, Punitive Damages, supra note 27, at 771.

\textsuperscript{179} Id.

\textsuperscript{180} Id.

\textsuperscript{181} Id.

\textsuperscript{182} Id.

\textsuperscript{183} Having a trustee disclose an opportunity to the beneficiaries and obtain approval from the beneficiaries is often feasible even though, as noted above, there is asymmetric information between the trustee and the beneficiaries. Providing information to the beneficiaries helps to reduce this information asymmetry. Also, disclosure and consent may be possible even though there might be some concern about whether the beneficiaries have the sophistication and capacity to give their approval. The approval must be voluntary, and many beneficiaries are capable of approving or not approving. If they do not approve, then the trustee is not authorized to engage in the transaction involving the conflict of interest.

\textsuperscript{184} Id. citing Ian Ayres & Robert Gertner, Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules, 99 YALE L.J. 87 (1989))
$120 - $100 = $20. Thus, there is still an incentive for the trustee to discover and disclose potential gains. Overall, while contract law permits efficient breach by relying on damages, trust law seeks to prevent efficient fiduciary breach by stripping a trustee’s ill-gotten gains. Yet, this election of remedies does not undermine the welfare of the parties because it encourages disclosure.

### 3. Why an Election of Remedies Is Optimal

In sum, an election of remedies is optimal because, if the harm to the beneficiaries exceeds the gain to a trustee, damages will deter breach. Conversely, if the gain to the trustee exceeds the harm to the beneficiaries, disgorgement will deter. Giving the plaintiff an election of remedy is optimal because, presumably, a beneficiary will know whether the beneficiary’s loss or trustee’s gain is greater, and elect the higher amount. By forcing a trustee either to internalize the harm or to disgorge the benefit, the equitable remedies should deter the trustee from engaging in the type of opportunistic behavior that fiduciary law seeks to prevent. Moreover, deterring “efficient” fiduciary breach is not socially undesirable, even if the benefits of a breach exceed the costs. A disgorgement remedy channels the parties into a situation in which the trustee must disclose a profitable opportunity and the beneficiaries can decide whether or not to approve.

In many situations, beneficiaries can and do consent to an action by the trustee that otherwise would be a breach of fiduciary duty. Indeed, UTC section 1009 states: “A trustee is not liable to a beneficiary for breach of trust if the beneficiary consented to the conduct constituting the breach, released the trustee from liability for the breach, or ratified the transaction constituting the breach.” The only exceptions to the validity of beneficiary consent are if the trustee induced the consent, release, or ratification by “improper conduct” or if the beneficiary “did not know of the beneficiary’s rights or of the material facts relating to the breach.” Of course, in certain situations, a beneficiary may be unable to consent. For example, the beneficiary may be a minor, lack capacity, or be unborn. Alternatively, the beneficiary’s identity or location may be unknown or not reasonably ascertainable. The UTC does provide principles of “representation” which allow another party (e.g., a parent, fiduciary, or person having a substantially identical interest) to consent on behalf of the beneficiary.

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185. **UNIF. TR. CODE § 1009 (UNIF. L. COMM’N 2010); see also Langbein, supra note 10, at 660 (“Another fundamentally contractarian reinforcement for the conventional duties of loyalty and prudence is the rule that the beneficiary may consent to trustee behavior that would otherwise breach these duties.” (citing RESTATEMENT (SECOND) OF TRS. §170 cmt. w, § 216 (AM. L. INST. 1959))).**

186. **UNIF. TR. CODE § 1009(1)–(2).**

187. **Id. § 801 cmt. (“In determining whether a beneficiary has consented to a transaction, the principles of representation from Article 3 may be applied.”). However, “a trustee may [not]represent and bind the beneficiaries of the trust” if there is a “conflict of interest between the [trustee] and the [beneficiary] with respect to a particular question or dispute.” Id. § 505(4).**
Thus, an election of damages or disgorgement is desirable because it deters breach but does so in a way that does not reduce the opportunities for trustees to engage in actions and enter deals that enhance the overall welfare of the parties. So far, however, we have assumed that a trustee who breaches a fiduciary duty will be subject to liability with certainty. The next Section relaxes that assumption and considers the optimal remedy if enforcement is imperfect.

B. WHEN A FIDUCIARY CAN SOMETIMES ESCAPE LIABILITY

As discussed above, it is often difficult for beneficiaries to detect breach and for courts to sanction opportunistic behavior. Accordingly, the assumption that trustees will be liable for fiduciary breach with certainty is, in many situations, unrealistic. Because there is a significant chance that trustees may escape liability, optimal deterrence theory suggests the need for a punitive multiplier. However, because the optimal remedy includes an election of damages or disgorgement, a punitive multiplier may be needed both for internalizing harm and for disgorging gains. This symmetry of losses and gains suggests that, if the trustee may escape liability, the optimal remedy should include an election of punitive damages or punitive disgorgement.

1. Punitive Damages

Punitive damages are not a substitute for disgorgement. But punitive damages may be needed for another reason. In trust law, given asymmetric information between trustees and beneficiaries, it can be difficult to detect a breach and to sanction opportunism. Moreover, as discussed above, there are several reasons, beyond traditional agency cost concerns, for why a trustee may escape liability: a beneficiary may have difficulty detecting harm, a beneficiary may have problems proving a trustee is liable, or a beneficiary may not sue because of litigation costs.

This low probability of detection and enforcement may suggest the need for a multiplier. In theory, a total damages multiplier, set equal to the inverse of the probability of detection, would force a trustee to internalize the expected harm. Thus, whether to award punitive damages and the amount of punitive damages should depend on the difficulty of detecting a fiduciary breach, not the “egregiousness” of breach.

Consider again the damages example. As discussed above, if the harm to Bridget the beneficiary, $100, exceeds the gain to Tom the trustee, $80, and the trustee is always liable, damages equal to the harm provides the optimal remedy. By setting compensatory damages equal to the harm, $100, the court

188. See supra Section II.A.2.
189. See supra notes 56–61 and accompanying text.
190. See Polinsky & Shavell, Punitive Damages, supra note 27, at 880–83; Cooter, supra note 27, at 1148; see also Cooter & Freedman, supra note 8, at 1052–53 (explaining the rationale of a probability-based disgorgement multiplier by using comparisons to tort law).
DISGORGEMENT AND PUNITIVE DAMAGES

forces the trustee to internalize the harm. Because a damages remedy requires Tom to pay for the harm, the trustee has no incentive to breach.

But now assume that the probability of detecting and sanctioning Tom the trustee is less than one. Suppose the chance that Bridget will detect a breach by Tom and that a court will award damages is 25 percent (i.e., the trustee pays damages one out of every four times). Because there is a 75 percent chance Tom may escape liability, awarding damages equal to the harm will result in underdeterrence. Specifically, the benefit to Tom of breaching is $80. However, Tom’s cost of breaching is the damages he must pay ($100) multiplied by the probability he is liable (0.25), or $25 on average. Thus, Tom will have an incentive to breach ($80 > $25), even though breach is socially undesirable ($80 < $100). The reason, of course, is that Tom does not internalize the harm in those instances in which he is able to escape liability.

This example illustrates the classic problem of underdeterrence if the wrongdoer is not liable with certainty. One solution to this problem is the use of a total damages multiplier that incorporates the chance that a trustee will escape liability. Specifically, the multiplier should be set equal to the inverse of the probability of detection. In this example, because the probability of detection is 0.25 (or 1/4), the total damages multiplier equals four. To achieve optimal deterrence, the court should multiply compensatory damages, $100, by the total damages multiplier, four, so that total damages = $100 x 4 = $400. Because expected damages ($400 x 0.25 = $100) is equal to the expected harm from breach ($100), the remedy forces Tom the trustee to internalize the harm from breach. So, to achieve optimal deterrence, the court would need to award $100 in compensatory damages and $300 in punitive damages (with punitive damages being equal to total damages minus compensatory damages).191

Thus, if there is a significant probability that a trustee may escape liability for breach, awarding punitive damages is necessary to achieve optimal deterrence.192 Conversely, if a court were to award punitive damages against

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191. Accordingly, in this example, the punitive damages multiplier, which is equal to the probability of the defendant’s escaping liability (0.75) divided by the probability of defendant’s being held liable (0.25), is 3.

192. Professor Rob Sitkoff, building on his work on the agency costs theory of trusts, see generally Sitkoff, supra note 8; Sitkoff, supra note 9; Sitkoff sources cited supra note 23, has restated the economic theory of fiduciary law. Helpfully, Sitkoff provides an updated synthesis in light of developments since the articles by Cooter and Freedman and by Easterbrook and Fischel. See Sitkoff, The Economic Structure of Fiduciary Law, supra note 23, at 1039–42; Sitkoff, supra note 47, at 197. Sitkoff briefly discusses the remedies of compensation and disgorgement. See Sitkoff, supra note 47, at 206–07. With regard to compensation, Sitkoff concludes that “[t]he availability of a compensatory remedy is readily explainable on ordinary contractarian terms.” Id. at 207. With regard to disgorgement, Sitkoff concludes that “[t]he availability of a disgorgement remedy . . . reflects the additional disclosure and deterrence purposes of fiduciary law.” Id. Sitkoff claims that the “recognition in modern law of punitive damages for such egregious fiduciary breaches is a sign of movement toward deterrence of such cases.” Id.
the trustee for an “egregious” fiduciary breach, even without a significant probability of the trustee’s escaping liability, punitive damages may result in overdeterrence (unless the law wants to deter the activity completely). This analysis suggests that punitive damages may be needed to deter an ordinary breach that is difficult to detect but may not be needed to deter an egregious breach that is easy to detect.

2. Punitive Disgorgement

If a trustee sometimes will escape liability, there may be an additional need to impose a punitive multiplier in disgorging gains. That is, if an election of remedies is optimal, there is a potential justification for punitive disgorgement. Under this novel remedy, a court not only would strip ill-gotten gains, the amount by which a defendant profited from wrongdoing, but also impose a punitive multiplier. Just as a total damages multiplier is necessary to force a trustee to internalize the expected harm, a total disgorgement multiplier, set equal to the inverse of the probability of detection, is necessary to ensure full disgorgement of the expected benefit.

Consider again the disgorgement example. As discussed above, if the benefit to Tom the trustee, $120, exceeds the harm to Bridget, $100, and if the trustee is always liable, then only disgorgement will deter fiduciary breach.  

193. A punitive damages award, even if higher than expected harm, may encourage a trustee to engage in a market transaction with the beneficiaries, just as a supracompensatory remedy, like discouragement, may have the effect of encouraging a market transaction. However, the penalty on the trustee is potentially greater because, while disgorgement is limited to the trustee’s gain, punitive damages may exceed the gain. Also, with regard to the duty of prudence, punitive damages may result in overdeterrence, as a trustee may take excessive care, even though disgorgement generally will not result in overly cautious behavior.

194. See Polinsky & Shavell, Punitive Damages, supra note 27, at 874. By contrast, Samuel Bray has argued that the case for punitive damages against trustees is “not proven” and that, from an optimal deterrence perspective, “punitive damages would increase deterrence for those who need it least (risk-averse internalizers), and decrease deterrence for those who need it most (risk-seeking externalizers).” Bray, supra note 23, at 216.

195. Surprisingly, neither courts nor commentators have focused much on this type of remedy. Cooter and Freedman note the possibility of “superdisgorgement” (as opposed to “supercompensation”) for “liability exceeding the baseline of the injurer’s profit” when discussing the possibility of a multiplier to deter disloyalty. Cooter & Freedman, supra note 8, at 1052 n.16; see also id. at 1060 (discussing “superdisgorgement damages” in the context of the duty of care). Polinsky and Shavell allude to the possibility of combining damages based on gain and a punitive multiplier when they consider the limited circumstances in which removing a defendant’s gain may be appropriate. Polinsky & Shavell, Punitive Damages, supra note 27, at 920. Hylton argues that:

If the offender’s gain is probably greater than the victim’s loss, then the punitive award should aim to internalize victim losses; if the offender’s gain is probably less than or equal to the victim’s loss, then the punitive award should aim to eliminate the prospect of gain on the part of the offender.

Hylton, supra note 27, at 423. Cooter and Freedman also explore related ideas in tort law by proposing the use of damages equal to the injurer’s gain divided by the probability of liability. See Cooter & Freedman, supra note 8, at 1052–53.
The disgorgement remedy may be socially optimal, even if it deters an “efficient” fiduciary breach, because disgorgement encourages disclosure by the trustee and approval by the beneficiaries. Thus, because the disgorgement remedy requires Tom to disgorge all of his ill-gotten gains, the trustee has no incentive to breach his duty of loyalty.

But now assume that the probability of detecting and sanctioning Tom the trustee is less than one. Suppose the chance that Bridget the beneficiary will detect a breach by Tom and that a court will disgorge Tom’s benefit is 20 percent. Because there is an 80 percent chance that Tom may escape liability, disgorging a gain equal to his benefit results in underdeterrence. Specifically, the benefit to Tom of breaching his fiduciary duty is $120. However, the cost to Tom of breach is the amount he must disgorge ($120) multiplied by the probability that he is liable (0.20), or $24 on average. Thus, Tom will have an incentive to breach ($120 > $24), even though breach may be socially undesirable (assuming that disgorgement was optimal when the trustee was always held liable). The reason is that Tom does not disgorge the benefit in those instances in which he is able to escape liability.

This example again illustrates the classic problem of underdeterrence if the wrongdoer is not liable with certainty, but the example highlights that this problem occurs with regard to disgorging ill-gotten gains as well as compensating for harms. The solution, though once again straightforward, is rarely invoked: the use of a total disgorgement multiplier, set equal to the inverse of the probability of detection. In this example, because the probability of detection is 0.20 (or 1/5), the total disgorgement multiplier equals five. To achieve optimal deterrence, the court should multiply the disgorgement amount, $120, by the total disgorgement multiplier, five, so that total disgorgement = $120 x 5 = $600. Because expected disgorgement, $600 x 0.20 = $120, equals expected benefit, $120, the remedy forces Tom the trustee to disgorge the gains from breach. So, to achieve optimal deterrence, the court would need to disgorge $120 and impose punitive disgorgement in the amount of $480 (with punitive disgorgement being equal to total disgorgement minus ordinary disgorgement).\(^{196}\) Thus, if there is a significant risk that a trustee may escape liability, then punitive disgorgement is necessary to achieve optimal deterrence. This example also illustrates the idea behind double deterrence: To achieve optimal deterrence, it may be necessary not only to have an election between damages and disgorgement but also to supplement that remedy with an election between punitive damages or punitive disgorgement.

\(^{196}\) In this example, the “punitive disgorgement multiplier,” which is equal to the probability of the defendant’s escaping liability (0.80) divided by the probability of defendant’s being held liable (0.20), is 4.
3. Why an Election of Punitive Remedies Is Optimal

In sum, even when trustees may sometimes escape liability, an election of remedies is optimal. However, because of imperfect enforcement, this election of remedies should include either punitive damages or punitive disgorgement, in addition to compensatory damages or ordinary disgorgement. Otherwise, the expected damages payment will be below expected harm, resulting in underdeterrence, or the expected disgorgement amount will be below the expected gain, again resulting in underdeterrence. If there is a significant chance that a trustee will escape liability, then only an election of either (1) damages plus punitive damages or (2) disgorgement plus punitive disgorgement provides optimal deterrence. As discussed below, the election of remedies if a fiduciary may escape liability highlights that disgorgement and punitive damages—while both supracompensatory remedies—are not functional substitutes.197 Rather, they are functional complements that serve dual purposes in deterring wrongdoing.

C. Distinguishing the Duty of Loyalty and Duty of Prudence

The analysis above regarding the optimal deterrence of fiduciary breach, which at times focused on the duty of loyalty, applies equally to the duty of prudence. The existence of similarities is unsurprising for a few reasons. The remedies themselves developed not in specific compartments—loyalty remedies versus prudence remedies—but rather as “equitable remedies” in the courts of equity.198 In addition, both the duty of loyalty and the duty of prudence address similar concerns regarding trustee opportunism and asymmetric information.199 Finally, both loyalty and prudence involve situations in which there is a risk that trustees may sometimes escape liability.200

However, it is worth highlighting a few differences between the duty of loyalty and duty of prudence, and how these differences may relate to the optimal remedies for each.201 First, while trust law allows an election of remedies for breach of either the duty of loyalty or the duty of prudence, in

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197. In addition to the reasons discussed below, another reason that disgorgement and punitive damages are not identical is based on administrative costs; that is, it may be easier for a court to calculate a defendant’s ill-gotten gains or profits than to calculate the plaintiff’s harm, increased by some multiplier based on the chance of escaping liability (or perhaps other factors). Furthermore, as Omri Ben-Shahar and Lisa Bernstein have highlighted, plaintiffs may have a “secrecy interest” in contract law that makes a remedy based on fully compensatory expectation damages less appealing than the prior literature suggests. See Ben-Shahar & Bernstein, supra note 166, at 1911 (noting that “proposed Code also eliminates the imperfect yet significant secrecy benefits of seeking restitution damages”).

198. See supra Section II.C.

199. See supra Section II.A.1.

200. See supra Section II.A.2.

201. The differences between the duty of loyalty and the duty of prudence also suggest that the many subsidiary duties in trust fiduciary law, see supra Section II.B.3, may involve idiosyncratic considerations, an analysis of which are beyond the scope of this Article.
practice, cases and situations using disgorgement as a remedy for breach of the duty of prudence are relatively rare.202

Second, commentators (most notably, Cooter and Freedman) have applied the Hand formula and traditional negligence concepts when analyzing the duty of prudence.203 Again, some of the same issues, including asymmetric information, apply to Cooter and Freedman’s analysis of both the duty of loyalty and duty of care.204 But, applying the Hand formula to the duty of prudence without any qualifications may oversimplify the analysis.

Unlike a typical accident in which the parties are strangers, a settlor and trustee have the ability to specify certain powers and duties in the terms of the trust. Likewise, in many circumstances, the trustee and beneficiaries have the ability to interact during the administration of the trust. Equating a trustee’s duty of prudence and ordinary negligence also seems to reduce the trustee’s fiduciary obligation to the “morals of the marketplace,” notwithstanding Cardozo’s oft-quoted statement that fiduciaries are held to a higher standard.205 Finally, in analyzing punitive damages, Polinsky and Shavell distinguish between strict liability and negligence because optimal deterrence in a negligence regime, unlike a strict liability regime, should incorporate activity levels.206 Therefore, in trust law, if the duty of loyalty is subject to strict liability, and the duty of prudence is based on negligence, then activity levels will be relevant in considering a breach of the duty of prudence.

Third, while both breach of the duty of loyalty and breach of the duty of prudence may entail situations in which a trustee may escape liability, the probability of escaping liability may differ by context. Specifically, as Easterbrook and Fischel suggest, mismanagement due to carelessness or imprudence is often more difficult for courts to detect than misappropriation through self-dealing or conflicts of interest.207 As a result, courts may need to rely on the punitive remedies, especially punitive damages, more often for the duty of prudence than the duty of loyalty.

202. The most common remedy for breach of the duty of prudence is damages. For example, if a trustee fails to diversify trust investments, resulting in a breach of the duty of prudent investment, the most likely remedy for the loss of value is damages. See, e.g., In re Estate of Janes, 681 N.E.2d 332, 339–40 (N.Y. 1997). It is possible that, in certain situations, a beneficiary may be entitled to both damages and disgorgement. See Kenneth F. Joyce, Trustee Liability for Breach of Trust—Loss or Profit, or Loss and Profit?, 45 ACTEC L.J. 43, 46 (2019).

203. See Cooter & Freedman, supra note 8, at 1051–61.

204. Id. at 1051 (noting the “three general characteristics of the fiduciary relationship [are]: separation of ownership from control or management; open-ended obligations; and asymmetrical information concerning acts and results”).


206. Ultimately, however, Polinsky and Shavell assume away the activity level problem with respect to awarding punitive damages in negligence cases. See Polinsky & Shavell, Punitive Damages, supra note 27, at 886 & n.38.

207. See EASTERBROOK & FISCHEL, supra note 50, at 103 (discussing distinction between the duty of loyalty and duty of care and arguing that it is “easier for courts to detect appropriations than to detect negligence”).
Fourth and finally, it is worth noting that, unlike a contracting party, a trustee may resign if the trustee no longer wishes to serve as trustee. This ability to resign suggests there is, or should be, less concern about overdeterrence in trust fiduciary law than in contract or tort law, especially with regard to the duty of prudence. Because a trustee may resign, relying on disgorgement is less likely to deter a trustee from engaging in other profitable activities or pursuing other opportunities.

Applying insights from optimal deterrence theory and the agency costs theory of trusts, this Article has investigated the optimal remedies for breach of trust, focusing largely on the duties of loyalty and prudence. This Article has analyzed the traditional equitable remedies for fiduciary breach, such as an election of damages based on plaintiff’s harm or disgorgement of the defendant’s gain, as well as innovative remedies, such as punitive damages and punitive disgorgement.

Consistent with the traditional equitable remedies, this Article’s analysis suggests an election of damages or disgorgement is optimal to deter fiduciary breach. First, while the optimal remedy for breach of contract is usually compensatory damages (in the form of expectation damages), the optimal remedy for breach of a fiduciary duty allows an election of (1) damages based on plaintiff’s harm, or (2) disgorgement of defendant’s gain. Allowing an election of damages (which plaintiff will elect if the harm to the plaintiff exceeds the gain to the fiduciary) or disgorgement (which plaintiff will elect if the gain to the fiduciary exceeds the harm) helps to deter fiduciary breach. Disgorgement reflects the additional deterrence and disclosure functions of fiduciary law. For example, by disgorging from a trustee the benefits gained as the result of a breach of the duty of loyalty, the law attempts to deter a trustee from self-dealing or conflicted transactions, and gives the trustee an incentive to disclose the potential gains and obtain the beneficiary’s approval.

208. See Unif. Tr. Code § 705(a) (Unif. L. Comm’n 2010) (“A trustee may resign: (1) upon at least 30 days’ notice to the qualified beneficiaries, the settlors, if living, and all cotrustees; or (2) with the approval of the court.”); see also Sitkoff & Dukeminier, supra note 4, at 417–18 (discussing conditions for accepting and for resigning trusteeship and pointing out that “[b]ecause a trustee is subject to extensive fiduciary obligations and exposed to substantial potential liability, the law does not impose trusteeship upon a person unless the person accepts” and that both the Uniform Trust Code and most professionally drafted trusts allow a liberal standard for resignation).

209. Of course, if a fiduciary duty or remedy causes many (or most) trustees to resign, or discourages trustees from accepting a trusteeship, then excessive penalties could result in overdeterrence.

210. See supra Section III.

211. See supra Section III.A.3.

212. See supra Section III.A.2.
Yet, unlike the traditional remedies, the analysis proposes that punitive remedies may be necessary to achieve optimal deterrence for a straightforward reason: Trustees sometimes escape liability. The use of punitive damages in recent cases is not a substitute for disgorgement and does not approximate an election of remedies. Confusion about the different functions of disgorgement and punitive damages may have led certain state courts to rely increasingly on punitive damages, rather than disgorgement, but perhaps for unsound reasons. Punitive remedies may play a different role in deterring fiduciary breach in situations in which the probability of detection and enforcement is low. Specifically, if there is a significant risk that the trustee may escape liability in particular types of cases, the optimal remedy should include the possibility of punitive remedies. This result differs from both traditional law, in which punitive damages are unavailable for fiduciary breach, and recent cases, which allow punitive damages but only when a fiduciary breach is “egregious.” Moreover, while some recent cases have allowed punitive damages, the analysis suggests that, unlike these cases, the desirability of using punitive damages and magnitude of punitive damages should depend on the probability that a trustee may escape liability, not the egregiousness of the breach.

Finally, unlike either the traditional equitable remedies or these recent cases, the analysis proposes a potential role for punitive disgorgement. The need for “punitive disgorgement” may apply to trusts, other fiduciary relationships, and any other situation in which the law attempts to strip a party’s ill-gotten gains. Once a court or legislature has decided that stripping ill-gotten gains is warranted, an issue on which further research is needed, there is a strong theoretical justification for employing a punitive multiplier to achieve optimal deterrence. Thus, while this Article focuses on the remedies for breach in trust law, and private and charitable trusts in particular, the crux of the argument may apply to other types of fiduciary relationships as well.

IV. COUNTERARGUMENTS AND EXTENSIONS

Having outlined the basic theory of double deterrence in Part III, this Part addresses several counterarguments and extensions. First, this Part considers potential problems with supracompensatory remedies like disgorgement, punitive damages, and punitive disgorgement. Second, this Part discusses non-legal solutions such as the role of market competition and reputation in deterring breach. Third, this Part briefly highlights potential extensions of the theory to other areas of the law.

213. See supra Section II.A.2.
214. See supra Section III.B.1.
215. See supra Section III.B.2.
216. See infra notes 234–41 and accompanying text (discussing similar applications of punitive disgorgement in other areas of law).
A. PROBLEMS WITH SUPRACOMPENSATORY REMEDIES

This Section briefly analyzes a few of the counterarguments against the theory of optimal remedies for fiduciary breach. These counterarguments include: (1) overdeterrence of trustees; (2) moral hazard among beneficiaries; and (3) the problem of judgment proof trustees.

First, one counterargument is that the remedies discussed above might result in the overdeterrence of trustees. The overdeterrence concern is especially pertinent in this Article because several of the proposed remedies, including disgorgement, punitive damages, and punitive disgorgement, entail “supracompensatory” remedies. With supracompensatory remedies, or remedies that exceed the plaintiff’s harm, there is often a fear that defendants will engage in expensive or excessive performance (e.g., in contract law) or take excessive care (e.g., in tort law). 217 Similarly, in fiduciary law, the supracompensatory remedies could require a trustee to engage in excessive performance in complying with the duty of loyalty or be overly cautious in complying with the duty of prudence.

Prior sections have addressed the main concerns regarding overdeterrence. 218 However, it is worth emphasizing several points because the use of supracompensatory remedies proposed in this Article is, perhaps surprisingly, unlikely to result in overdeterrence of trustee behavior.

One concern about overdeterrence is with allowing an election of damages or disgorgement as a remedy for breach of the duty of loyalty and duty of prudence. As the example above highlights, disgorgement may provide an incentive for the trustee not to breach its duty of loyalty, even though the benefits to the trustee exceed the costs to the beneficiaries. 219 Indeed, the sole interest rule in trust fiduciary law prohibits a trustee from engaging in self-dealing or a conflicted transaction, even if the transaction is in the best interests of the beneficiaries. 220 But the disgorgement remedy does not necessarily prevent profitable opportunities. Instead, it merely requires that a trustee disclose the information to beneficiaries and obtain their approval. 221

Moreover, if there is a possibility that a defendant may escape liability, the use of a punitive multiplier would increase total damages or total disgorgement. But the use of punitive remedies should not cause overdeterrence.


218. See supra Section II.B.1.

219. See supra Section II.A.2.

220. See supra notes 97–105 and accompanying text.

221. See supra notes 174–84 and accompanying text.
of trustees. Under an election of damages plus punitive damages, expected damages should equal the expected harm (assuming the court correctly calculates the remedy). Similarly, under an election of disgorgement plus punitive disgorgement, the expected disgorgement amount should equal the expected benefit. Therefore, despite the use of a multiplier, neither punitive damages nor punitive disgorgement should result in overdeterrence. By contrast, if punitive damages were based on the egregiousness of a fiduciary breach, rather than the probability of escaping liability, then overdeterrence may occur for certain types of behavior that a court deems “egregious” but that are relatively easy to detect. Conversely, if no punitive multiplier is used, the result will be underdeterrence.

Second, if beneficiaries can recover supracompensatory remedies, there could be a type of “moral hazard” problem among beneficiaries. Specifically, supracompensatory remedies such as disgorgement of ill-gotten gains and punitive damages allow a beneficiary to recover more than the beneficiary’s loss from fiduciary breach. Thus, in certain situations, it might be profitable for a beneficiary to become a victim of a breach, as the gain to the beneficiary exceeds the loss. However, while theoretically possible, this is unlikely to be a major concern in practice.

In creating a trust, the settlor selects which beneficiaries have present and future interests, and the settlor may give the trustee discretion to select among various beneficiaries. But beneficiaries are not able to select among those trusts or trustees where breach is more or less likely. Once designated as a beneficiary, a beneficiary has only a limited ability to increase his or her probability of becoming a victim of a breach. Therefore, beneficiaries who might seek to exploit the gap between supracompensatory and compensatory remedies are unlikely to be in a position to do so.

Additionally, to the extent this moral hazard concern may exist for trusts, it relates primarily to disgorgement, not punitive damages. Punitive damages will not necessarily be supracompensatory on an expected basis. Of course, ex post, once a trustee has breached (or arguably has breached) a fiduciary duty, a beneficiary who is entitled to disgorgement or punitive damages may have the ability to extract, or threaten to extract, a larger settlement from the trustees. But, from an ex ante perspective, neither disgorgement nor punitive remedies are likely to result in opportunistic behavior by beneficiaries.

Third, another concern with supracompensatory remedies is that they may make it more likely that a trustee is judgment proof. If the trustee is judgment proof, then there is a greater risk of underdeterrence. Once the

222. See supra Section II.B.1.
223. See supra Section II.B.2.
224. Moreover, if a court utilizes a punitive multiplier based on the probability of escaping liability, beneficiaries who purposely seek to increase their odds of being the victims of a fiduciary breach should receive a lower payment as the probability of the trustee’s escaping liability decreases.
trustee does not have any assets, an increase in an expected damages payment or expected disgorgement amount will no longer have any marginal deterrent effect on the trustee’s behavior.\textsuperscript{225}

However, disgorgement does not necessarily exacerbate the judgment-proof problem. Unless the trustee has sold or transferred an asset, the trustee would be disgorging the gains that it has misappropriated. While punitive remedies may exacerbate the judgment-proof problem, there is nothing in particular about a trust or fiduciary relationship that makes this problem more of a concern in trust law than in other legal contexts, such as tort law, that rely on punitive damages.\textsuperscript{226} Thus, the judgment-proof objection applies equally to using punitive remedies to deter accidents or fiduciary breach. Moreover, while the judgment-proof problem is a potential issue, it does not detract from the point that the probability of escaping detection should be a factor in analyzing optimal remedies. Otherwise, there is likely to be underdeterrence of this opportunistic behavior, at least from the perspective of the legal and equitable remedies. The next Section considers other (non-legal) reasons why trustees and other fiduciaries may have an incentive not to breach, irrespective of what remedies are in place.

\textbf{B. Non-Legal Solutions: Market Competition and Reputation}

There may be other available mechanisms to deter various types of trustee opportunism. Most notably, if market competition, reputation, or other non-legal solutions are sufficient to deter opportunism, then perhaps legal and equitable remedies are unnecessary to deter fiduciary breach.

A number of scholars have discussed the role of market competition in deterring opportunistic behavior by trustees and other fiduciaries. In her work on fiduciary law, Melanie Leslie has extensively discussed these possibilities, especially using the market as a policing device.\textsuperscript{227} Leslie highlights why the market is not sufficient in the fiduciary law context: “Almost none of the market forces that pressure corporate fiduciaries to forgo opportunistic behavior are at play in the trust context.”\textsuperscript{228} Moreover, as Leslie points out,

\begin{footnotesize}
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\item \textsuperscript{225} See Cooter & Freedman, supra note 8, at 1071 (“[T]he effectiveness of a sanction is limited by the wealth of the fiduciary. Once a sanction exceeds this wealth, it has no further deterrent effect so long as the fiduciary is willing to escape liability through bankruptcy.”); cf. Polinsky & Shavell, Punitive Damages, supra note 27, at 933 (“If injurers can avoid having to pay for some of the harm they cause because their assets are limited, they will have a reduced incentive both to take precautions and to moderate their participation in risky activities.”).
\item \textsuperscript{226} On punitive damages and the judgment proof problems, see Polinsky & Shavell, Punitive Damages, supra note 27, at 935–54. See generally Steven Shavell, The Judgment Proof Problem, 5 INT’L REV. L. & ECON. 45 (1986) (analyzing the issue of judgment proof defendants and the effects of liability insurance).
\item \textsuperscript{227} See Melanie B. Leslie, Trusting Trustees: Fiduciary Duties and the Limits of Default Rules, 94 GEO. L.J. 67, 79–88 (2005) [hereinafter Leslie, Trusting Trustees]; Leslie, supra note 70, at 555–63.
\item \textsuperscript{228} Leslie, Trusting Trustees, supra note 227, at 82. Specifically, she argues:
\end{itemize}
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Rob Sitkoff, in his work on trust law, corporate law, and capital market efficiency, contends “that the absence of market pressures distinguishes the trust from the public corporation, and that the resulting absence of effective monitoring controls justifies the imposition of greater fiduciary duties in the trust context.”\footnote{229} This Section will not reiterate many of Sitkoff’s arguments. However, as Sitkoff emphasizes, there are important differences between corporate fiduciaries and trustees.

In corporate law, market forces are relatively robust (e.g., investors can sell their shares) and there is a market for corporate control. Moreover, the reputation of corporate fiduciaries is seemingly important, especially in jurisdictions like Delaware and New York.\footnote{230} By contrast, in trust law, market forces that constrain trustee behavior are relatively weak (e.g., beneficiaries are usually unable to transfer their interests),\footnote{231} and there is no robust market for trust control.\footnote{232} Moreover, the reputation of trustees, with a few exceptions, is less salient. Market forces are especially unlikely to restrain individual, as opposed to institutional, trustees. Thus, while market forces and reputation may constrain fiduciaries in corporate law, at least to some extent, non-legal sanctions may be less effective in deterring opportunism in trust law.\footnote{233}

There is no “share price” or secondary information market that informs other potential customers of a trust term that reduces fiduciary duties or communicates trustees’ opportunistic behavior to potential customers. Even if a particular beneficiary discovers that her trustee is performing poorly, she will be unlikely to communicate this to the trustee’s other clients, of whom she is unaware. Moreover, that beneficiary cannot exist if she is dissatisfied.

\footnote{Id. at 82–83 (footnote omitted).}


\footnote{231. \textit{Spendthrift trust provisions often prevent a beneficiary from transferring her shares either voluntarily or involuntarily. See Sitkoff, supra note 229, at 570.}

\footnote{232. It is worth noting that the traditional inability to remove a trustee without either a breach of trust or substantial impairment to the administration of the trust likely reduced competition among trust companies. \textit{See Sitkoff & Dukeminier, supra} note 4, at 758 (“Some have argued that the inability of beneficiaries to change trustees lessens competition among trust companies, contributes to higher trustees’ fees, and leads to a cautious, even indifferent, style of trust management.”). Under the modern trend, trustee removal is permissible in a larger set of situations. \textit{See supra} notes 159–65 and accompanying text (discussing remedy of trustee removal). For example, under the UTC, trustee removal is possible not only as a remedy for breach but also due to the trustee’s ineffective administration or to changed circumstances. \textit{See UNIF. TR. CODE \\ § 706 (UNIF. L. COMM’N 2010). This reform may help to facilitate the creation of a market for trust control.}

\footnote{233. \textit{See Leslie, Trusting Trustees, supra} note 227, at 82–83 (“Almost none of the market forces that pressure corporate fiduciaries to forgo opportunistic behavior are at play in the trust context. There is no ‘share price’ or secondary information market that informs other potential customers...
appears, therefore, that in trust law there is still a need for legal and equitable remedies.

C. EXTENSIONS

This Article has implications not only for trust law but also for fiduciary law and many other areas of the law. As noted above, many state courts and legislatures are considering whether to allow punitive damages as a remedy in trust law. However, the issues discussed in this Article also arise in other areas of fiduciary law, including “fact-based” fiduciaries and “status-based” fiduciaries.

For example, there are a number of traditional fiduciary relationships, including guardianships, in which abuse appears to be widespread. This widespread abuse is due in part because opportunism may remain hidden and because fiduciaries may escape liability for their misbehavior. Moreover, there has been a heated debate, as well as litigation, over the Department of Labor’s decision to extend fiduciary obligations to investment-advisers who are managing $3 trillion of advised, commission-based brokerage IRA assets. The stakes are high because, according to one estimate, this move could save Americans $17 billion annually. Yet the imposition of fiduciary relationships on market relationships also can entail certain costs.

In addition, the restitutio remedies which this Article refers to as disgorgement arise in many areas of the law besides trust and fiduciary law. There are, therefore, a variety of potential extensions, including securities law.

of a trust term that reduces fiduciary duties or communicates trustees’ opportunistic behavior to potential customers. Even if a particular beneficiary discovers that her trustee is performing poorly, she will be unlikely to communicate this to the trustee’s other clients, of whom she is unaware. Moreover, that beneficiary cannot exit if she is dissatisfied.” (footnote omitted)); Leslie, supra note 70, at 561 (“For professional trustees . . . almost none of the market forces that pressure service providers or corporate fiduciaries to forego opportunistic behavior exists.”).

234. See supra notes 16–22 and accompanying text; see also discussion and sources cited supra note 138 (detailing Sam Bray’s position on the significance of remedy labels).


236. See Sitkoff, supra note 9, at 41.

237. See supra Sections II.A.1–3.


239. Traditionally, under the securities laws, disgorgement cannot be punitive. See, e.g., SEC v. First City Fin. Corp., 860 F.2d 1215, 1231 (D.C. Cir. 1988) (citing SEC v. Blatt, 585 F.2d 1325, 1335 (5th Cir. 1978); SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1104 (2d Cir. 1972)). On the role of disgorgement as a remedy, both equitable and punitive, in the SEC’s civil enforcement cases, see generally Russell G. Ryan, The Equity Façade of SEC Disgorgement, 4 HARV.
commodities law, to name a few. Overall, punitive disgorgement may be a remedy for courts and legislatures to consider to achieve optimal deterrence in any situation in which the law attempts to strip ill-gotten gains and the defendant has a significant chance of escaping liability.

V. CONCLUSION

The law typically assumes that individuals are either self-interested or opportunistic. But at least one type of “other-regarding” relationship is ubiquitous: the fiduciary relationship. A fiduciary has a duty to act not in its own self-interest but in another party’s interest. In a trust, a classic fiduciary relationship, a trustee has a duty of loyalty to act in the sole interest of the beneficiaries, and a duty of prudence to act with care in administering, investing, and distributing trust property.

To moralists, there has always been something special about fiduciary obligations. To most economists, the word “fiduciary” does no independent work; a fiduciary duty is at most an identifying label for a contractual undertaking

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240. Disgorgement is a remedy for violations of the Commodity Exchange Act. The purpose of the remedy is “to deprive the wrongdoer of his or her ill-gotten gains and to deter violations of the law.” 73 AM. JUR. 2D Stock and Commodity Exchanges § 22 (2022). Yet, in these cases, “district courts may order disgorgement . . . only to the amount with interest by which a defendant profited from his or her wrongdoing.” Id.

241. Traditionally, in criminal law, disgorgement was intended to strip a defendant’s ill-gotten gains, not to punish the defendant. But recent developments suggest a change in the remedy’s application. See, e.g., Cortney E. Lollar, What Is Criminal Restitution?, 100 IOWA L. REV. 93, 123–26 (2014) (“Criminal restitution . . . moves far beyond its traditional purpose of disgorging a defendant’s ill-gotten gains. Instead, restitution has become a mechanism of imposing additional punishment.”). But, even under the traditional purpose of criminal restitution, “punitive disgorgement” may be necessary if defendants may escape liability.


243. See STIKOFF & DUKEMINIER, supra note 4, at 595 ("Even a fleeting examination of the cases reveals that they are rife with the language of morality and fairness . . . ."). The classic example is, of course, Judge Cardozo’s opinion in Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928). See supra note 205 and accompanying text.
characterized by unusually high costs of specification and monitoring. This Article has attempted to bridge this divide by providing an economically-informed account of the optimal remedies for fiduciary breach in one specific context: trust law.

As it turns out, the optimal remedy of allowing a plaintiff to elect damages or disgorgement is largely consistent with traditional equitable remedies. Although the equitable remedies that allow beneficiaries to disgorge a trustee’s ill-gotten gains appear to be anti-contractual, disgorgement serves both a deterrent and disclosure purpose that is consistent with a contractarian view of fiduciary relationships. However, unlike contract law, which generally awards only expectation damages for a breach (at least if a breach is non-opportunistic and does not involve certain specialized situations like contracts involving real property), trust law seeks to deter a breach even if the gain to the trustee would exceed the loss to the beneficiary by allowing the beneficiary to disgorge any of the trustee’s gains. Yet, deterring unilateral breach in this situation, or even in situations in which both the trustee and the beneficiaries may both benefit, does not necessarily decrease social welfare. A trustee may disclose an opportunity to beneficiaries and obtain their consent. Requiring beneficiary approval is not anti-contractual, inefficient, or unrealistic, and it makes sense that the beneficiaries may obtain the associated surplus: After all, the beneficiaries are the parties whom the settlor intends to benefit. By encouraging disclosure and beneficiary approval, the disgorgement remedy increases social welfare.

In addition, the injurer might sometimes escape liability. In trust law, the chance that trustees may escape liability for breach is especially high, given the inability of beneficiaries to monitor trustees in private trusts and given the inability of state attorneys general to monitor trustees of charitable trusts. The scholarly and practitioner literature contains many references to the difficulty of detecting trustee opportunism. However, scholars have not fully incorporated this reality into an analysis of the remedies for fiduciary breach and the need for punitive remedies, instead suggesting that it may justify disgorgement or switching the burden of proof. This Article attempts to remedy that deficiency by suggesting that disgorgement and punitive remedies may serve different remedial purposes, and that disgorgement and punitive remedies may both be necessary to achieve optimal deterrence.

While prior scholars tend to conflate disgorgement and punitive damages, or to focus on one remedy to the exclusion of the other, this Article emphasizes

244. See Easterbrook & Fischel, supra note 10, at 427 ("[A] 'fiduciary' relation is a contractual one characterized by unusually high costs of specification and monitoring."); id. at 446 ("Contract and fiduciary duty lie on a continuum best understood as using a single, although singularly complex, algorithm.").

245. One possible explanation for these remedial silos is that many scholars writing about punitive damages multiplier generally ignore disgorgement whereas many scholars researching
the different functions played by disgorgement and punitive damages. Scholars often view supracompensatory remedies, including disgorgement and punitive damages, as functional substitutes, or assume a rough equivalency. But, as this Article highlights, disgorgement and punitive damages, while both supracompensatory remedies, are not functional substitutes.

Moreover, there are some situations in which both disgorgement and punitive remedies are necessary. Recognizing that disgorgement and punitive damages serve different purposes highlights that “punitive disgorgement” may be a useful remedy in situations in which the law seeks to disgorge a defendant’s ill-gotten gains and the defendant may escape liability. Thus, this Article not only applies the model of punitive damages to trust and fiduciary law, but extends the model to many situations involving the disgorgement of ill-gotten gains, suggesting that punitive disgorgement may be necessary to achieve optimal deterrence.

disgorgement and remedies in equity that strip ill-gotten gains or profits generally do not focus on punitive damages—a legal remedy.

246. Cooter & Freedman, as well as Easterbrook & Fischel, discuss the disgorgement remedy and mention the multiplier principle, although at times they seem to suggest that either disgorgement or a punitive multiplier will serve the same functional purpose. See supra notes 190–97 and accompanying text.

247. Specifically, there is functional justification for the disgorgement remedy even when there is no possibility that a trustee may escape liability: Disgorgement deters breach and encourages disclosure to beneficiaries so that beneficiaries may approve transactions when the gain to the trustee exceeds the harm to the beneficiaries. See supra Section III.A.2. Conversely, there is a functional reason for punitive damages even if disgorgement is unnecessary: Punitive damages deter fiduciary breach by forcing a trustee to pay expected damages equal to expected harm when there is a significant chance that the trustee may escape liability. See supra Section III.B.1.