

ELDER FINANCIAL ABUSE: FIDUCIARY LAW AND ECONOMICS

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ABSTRACT

As baby boomers in the United States enter retirement with a high life expectancy, courts and legislatures are increasingly pressed to resolve disputes over the properties of the elderly. Empirical studies suggest that financial abuse against the elderly is hard to detect and likely prevalent. Those who manage property for the elderly may have perverse incentives to exploit their position. Presuming the worst from the property manager, American fiduciary law typically imposes onerous fiduciary duties to minimize conflicts of interest and deter misconduct. Orthodox fiduciary law explicitly aims to over deter.

This Article argues that orthodox fiduciary law is too strict on most guardians and agents who manage property for the elderly. The problem is that mental or physical decline is common among seniors, but a lack of mental capacity in the eyes of the law typically stultifies the power to authorize a fiduciary to depart from adherence to strict fiduciary duty. By contrast, mentally-capable individuals are free to discharge those aspects of fiduciary law that they find intrusive and undesirable. In other words, while fiduciary law is mostly a default law when applied to capable individuals, it is a mandatory law when applied to elderly incapable individuals. Harming the welfare of many seniors, mandatory application of fiduciary law tends to stultify the pursuit of valuable other-regarding preferences in close families and personal relationships. Such strict and inflexible application further disregards the presence of intrinsic bonds and informal norms.

To remedy these shortcomings, this Article proposes a substituted-judgment defense to permit those departures from strict fiduciary law that the incapable individual would have authorized if she was mentally capable.

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This defense should be made available to close relatives and friends, but not to profit-driven professionals. To deter and sanction elder financial abuse by professional guardians and agents, this Article further proposes reforms to harness their reputational concerns.

INTRODUCTION

Consider the following hypothetical¹: Mary, a ninety-seven-year-old woman, entrusted the management of her bank accounts to her son Chauncey. Just before Christmas, Chauncey took money out of Mary's accounts to buy himself and her grandchildren gifts. Mary was in the habit of making Christmas gifts to family members for as long as everyone could remember. After Mary passed away, her daughter, Fern, became entitled to a share of Mary's estate. Fern now sues her brother Chauncey and the grandchildren to recover the gifts bought with Mary's money. The question that this Article aims to resolve is who should succeed in this and similar cases.

The issues presented in the above hypothetical deeply divide legislatures, courts, and scholars in the United States. Like most fiduciaries, Chauncey had significant discretion over the management of Mary's property. Orthodox fiduciary law presumes the worst from him² and therefore imposes rigorous and comprehensive duties on Chauncey. Most demanding among these is the duty of *undivided loyalty*: that Chauncey must avoid a conflict between his duties to Mary and his personal interests.³ Many courts would inflexibly enforce that duty to hold Chauncey liable for using his position to enrich himself and the grandchildren.⁴ It is irrelevant that Mary was in the habit of making similar gifts in the past. The result is that Fern successfully recovers the gifts (or their value) from Chauncey and in some circumstances the grandchildren also can be held liable.⁵ The apparent harshness of this result has led many legislatures and courts to ease the burden of fiduciary regulation. For example, many states have enacted statutory provisions to permit small gifts, while others go further to abrogate the duty to avoid conflicts of interest.⁶ Scholars and practitioners

1. This hypothetical is based on *In re Tillman*, 137 N.E.2d 172 (Ohio Prob. Ct. Darke Cty. 1956).

2. See generally John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 YALE L.J. 929, 944, 951–52 (2005).

3. See generally *infra* Section I.C.

4. See generally *infra* Section I.C.

5. *In re Tillman*, 137 N.E.2d at 175–77. See *infra* notes 61–62 and accompanying text.

6. See generally *infra* Section I.D. The jurisdictions that adopt the UNIF. POWER OF ATTORNEY ACT (UNIF. LAW COMM'N 2006) or substantially similar law can be found at *A Few Facts About the Uniform Power of Attorney Act*, UNIF. LAW COMM'N, <https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=5db0c5fd-6dfb-54bc-67da-3a64217991fa&forceDialog=0>.

consistently call for clarification of fiduciary duty,⁷ even though clarification may be found in at least three modern Restatements.⁸

How best to regulate fiduciaries who provide property management services to the elderly is the puzzle that animates this Article. Guardianships and powers of attorney commonly facilitate provision of these services. Under prevailing American law, if an adult is mentally incapable of managing her property,⁹ then a court may appoint a *guardian* to manage her property for her, especially if her needs cannot be met by a less restrictive alternative.¹⁰ The guardianship regime can generate cost, emotional stress and embarrassment, while deprive a person liberty and autonomy.¹¹ Individuals who anticipate the possibility of mental or physical decline in the future may avail themselves of alternative legal regimes. In particular, while she is mentally capable, an individual may execute a durable *power of attorney* to appoint an agent to act on her behalf. The power of attorney starts to operate, or remains valid, when the individual becomes mentally incapable.¹²

Fiduciary law can proactively deter and retroactively sanction elder financial abuse by guardians and agents—an alarming problem in an era of an aging population.¹³ While the private nature of elder financial abuse makes it

7. See, e.g., Nina A. Kohn, *Elder Empowerment as a Strategy for Curbing the Hidden Abuses of Durable Powers of Attorney*, 59 RUTGERS L. REV. 1, 15–17, 52 (2006); Linda S. Whitton, *Durable Powers as an Alternative to Guardianship: Lessons We Have Learned*, 37 STETSON L. REV. 7, 25–27 (2007) (discussing survey responses on fiduciary duties of agents).

8. See RESTATEMENT (THIRD) OF AGENCY §§ 8.03, 8.05 (AM. LAW INST. 2006); RESTATEMENT (THIRD) OF TRUSTS § 78 (AM. LAW INST. 2007); RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 43 (AM. LAW INST. 2011).

9. As a functional concept in law, *mental incapacity* typically means insufficient mental ability to undertake some task. See generally Am. Bar Ass’n Comm’n on Law & Aging & Sally Balch Hurme, *Capacity Definition & Initiation of Guardianship Proceedings*, A.B.A., http://www.americanbar.org/content/dam/aba/administrative/law_aging/chartcapacityandinitiation.authcheckdam.pdf (last visited Dec. 8, 2018) (surveying definitions of incapacity in American guardianship statutes). Courts tend to have “maximal flexibility” in determining whether an individual is mentally-incapable. PAUL S. APPELBAUM & THOMAS G. GUTHEIL, *CLINICAL HANDBOOK OF PSYCHIATRY & THE LAW* 181 (4th ed. 2007). Clinical evaluation typically examines the individual’s awareness of situation, factual understanding of issues, appreciation of likely consequences, rational manipulation of information, functioning in her own environment, and the extent of demands on her. See *id.* at 181–82.

10. See *infra* note 32 and accompanying text. Guardians who manage property are also often called *conservators*. See, e.g., UNIF. PROBATE CODE § 5-401 (UNIF. LAW COMM’N amended 2010); UNIF. GUARDIANSHIP, CONSERVATORSHIP, & OTHER PROTECTIVE ARRANGEMENTS ACT § 401 (UNIF. LAW COMM’N 2017). Because this Article only concerns property managers, all “guardians” discussed here refer to guardians who manage property.

11. See, e.g., David J. Feder & Robert H. Sitkoff, *Revocable Trusts and Incapacity Planning: More than Just a Will Substitute*, 24 ELDER L.J. 1, 27–28 (2016).

12. See UNIF. POWER OF ATTORNEY ACT § 104 (UNIF. LAW COMM’N 2006); RESTATEMENT (THIRD) OF AGENCY § 3.06 cmt. b (AM. LAW INST. 2006).

13. See *infra* Section I.A.

difficult to obtain reliable statistics, one nationwide survey suggests that every year, about 5.2% of Americans age sixty years or over potentially experience financial mistreatment by a family member.¹⁴ Some even describe a power of attorney as “a license to steal.”¹⁵ Although tort law or criminal law may deter and sanction a financial abuser, she may still have an incentive to engage in misconduct if her ill-gotten gain exceeds her expected tortious or criminal liability. Fiduciary law can disgorge her ill-gotten gain;¹⁶ it deters and sanctions the abuser by taking away what motivated her to engage in misconduct in the first place.

Taking a law-and-economics approach, this Article aims to optimize the fiduciary duties of guardians and agents in order to promote welfare. The main claim is that orthodox fiduciary law unnecessarily deters guardians and agents from supporting elderly incapable individuals to pursue valuable other-regarding goals and preferences. This is because the pursuit of other-regarding goals and preferences benefits someone other than the incapable individual—a violation of the sole-interest duty of loyalty. Most other fiduciaries could have avoided liability by obtaining the fully-informed consent of their beneficiaries.¹⁷ However, an incapable individual typically cannot give valid consent. Thus, by deterring the pursuit of other-regarding preferences, orthodox fiduciary law can harm the welfare of elderly incapable individuals. This is particularly problematic in cases concerning close families and personal relationships.¹⁸ Moreover, in these cases, orthodox fiduciary law fails to recognize that biological and affective bonds, as well as social and moral norms, already partially disincentivize close relatives and friends from committing misconduct.¹⁹

This Article thus proposes to loosen the fiduciary regulation of close relatives and friends in order to accommodate strong intrinsic bonds and other-regarding preferences.²⁰ In particular, fiduciary law ought to permit those

14. See Ron Acierno et al., *Prevalence and Correlates of Emotional, Physical, Sexual, and Financial Abuse and Potential Neglect in the United States: The National Elder Mistreatment Study*, 100 AM. J. PUB. HEALTH 292, 292, 296 (2010). These authors broadly defined “financial mistreatment by family” to mean the family member “spent money,” “did not make good decisions,” “did not give copies,” “forged signature,” “forced respondent to sign a document,” or “stole money.” *Id.* at 294; see also *id.* at 292 (summarizing the consistent results of earlier surveys).

15. See Whitton, *supra* note 7, at 29.

16. See generally RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT §§ 16, 33 (AM. LAW INST. 2011).

17. See *infra* Section I.E.

18. See *infra* Section II.B.

19. See *infra* Section II.B.2.

20. While the present analysis focuses on guardians and agents, it can be extended to other fiduciaries that serve incapable individuals. For example, a person can become a de facto fiduciary on the basis of a relationship of trust and confidence. See, e.g., *McHugh v. Jeffries*, 183 S.W.2d 309 (Ark. 1944); *Eagerton v. Fleming*, 700 P.2d 1389 (Ariz. Ct. App. 1985); see also RESTATEMENT

conflicts of interest that the elderly incapable individual would have authorized if she were mentally capable.²¹ On the other hand, in cases where intrinsic bonds and other-regarding preferences are weak, the need to deter and sanction misconduct calls for strict fiduciary regulation. These cases mainly concern professional guardians and agents who charge fees for their services. Hence, for professionals, I propose strengthening fiduciary regulation by harnessing their reputational concerns.²²

This Article should be interesting to several groups of scholars and practitioners. Economic analysis of fiduciary law neglects the special issues arising from mental incapacity;²³ this Article fills in that gap. While some disability-rights and doctrinal scholars have studied the fiduciary duties of guardians and agents,²⁴ they have not considered the law's potential to align or misalign incentives. Moreover, the present subject matter falls squarely within the interests of those who work in trusts and estates, and elder law. Finally, this Article offers guidance and reform proposals to legislatures—which are regularly pressed to reform guardianship law and agency law—and to courts—which regularly resolve disputes involving property managers of the elderly.

Part I below offers an overview of fiduciary law and its economic foundations. Part II argues that existing fiduciary law and theory fail to accommodate the special characteristics of mental capacity cases. Parts III and IV then propose reforms to promote welfare.

I. FIDUCIARY REGULATION OF GUARDIANS AND AGENTS

This Part will first discuss the two main legal devices that facilitate provision of property management services to mentally-incapable individuals: guardianship and power of attorney. It will then introduce the standard economic theory of fiduciary relationships and use that theory to explain the two main models of fiduciary law in American jurisdictions.

A. *Property Managers of Elderly Incapable Individuals*

Population aging is old news. Since the last century, the percentage of Americans age sixty-five or over (hereinafter, seniors) has tripled. The population of seniors was estimated at 49.2 million in 2016, 15.2% of the

(THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 43 cmt. a (AM. LAW INST. 2011) (restitutionary liability arising from misconduct in a relationship of trust and confidence).

21. See generally *infra* Section III.A.

22. See generally *infra* Part IV.

23. See generally *infra* Sections II.A–I.B, I.E.

24. See, e.g., Robert B. Fleming & Rebecca C. Morgan, *Standards for Financial Decision-Making: Legal, Ethical, and Practical Issues*, 2012 UTAH L. REV. 1275; Kohn, *supra* note 7; Nina A. Kohn, *Fiduciary Principles in Surrogate Decision-Making*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019); Whitton, *supra* note 7.

population, and is projected to reach ninety-eight million by 2060.²⁵ In the modern economy, the stereotype that seniors are “frail, out of touch, burdensome or dependent” is outdated.²⁶ Physical or mental decline nonetheless remains prevalent. In particular, recent studies estimate that Alzheimer’s dementia affects over 5 million seniors.²⁷ “[One in three] seniors dies with Alzheimer’s or another dementia. It kills more than breast cancer and prostate cancer combined.”²⁸ The combination of longevity and mental decline can explain the increasing demand for property management services to mentally-incapable seniors.²⁹

The state has long claimed a power as *parens patriae*—meaning “parent of the nation”—to make decisions on behalf of mentally-incapable individuals. The formal legal institution created by that power is commonly called *guardianship*. To create a guardianship under prevailing American law, the relevant state court (typically the probate court) must first be satisfied that the individual lacks mental capacity to manage some aspect of her life or property. Mental capacity is a legal and functional concept that accounts for cognitive functioning, the specific tasks to be undertaken, and concerns for autonomy and protection.³⁰ The presence of some mental or physical disorder in the medical sense is typically neither sufficient nor necessary for the individual to lack mental capacity in the eyes of the law.³¹ Once the individual is found incapable of managing some aspect of life or property, the court has the discretion to appoint a substitute decision-maker—the guardian—to make decisions regarding that aspect of life or property. To safeguard the autonomy and dignity of the mentally-incapable individual, modern guardianship statutes tend to mandate that guardianship be created only as a last resort, in other words, when there is no less restrictive alternative to facilitate the decision-making assistance

25. U.S. ADMIN. FOR CMTY. LIVING, 2017 PROFILE OF OLDER AMERICANS 1–2 (2018), <https://acl.gov/sites/default/files/Aging%20and%20Disability%20in%20America/2017OlderAmericansProfile.pdf>.

26. WHO, WORLD REPORT ON AGEING AND HEALTH 10, 16 (2015), <https://www.who.int/ageing/events/world-report-2015-launch/en/>.

27. *Facts and Figures*, ALZHEIMER’S ASS’N, <https://www.alz.org/alzheimers-dementia/facts-figures> (last visited Dec. 8, 2018).

28. *Id.*

29. *See, e.g.*, Feder & Sitkoff, *supra* note 11, at 27.

30. *See supra* note 9 and accompanying text.

31. *See* APPELBAUM & GUTHEIL, *supra* note 9, at 181. *See also* AM. PSYCHIATRIC ASS’N, DIAGNOSTIC AND STATISTICAL MANUAL OF MENTAL DISORDERS xiii–xl (5th ed. 2013) (providing a standard list of mental disorders).

needed.³² Most individuals subject to guardianship are seniors experiencing cognitive disorders, especially dementia.³³

While a guardianship is officially created, a power of attorney is a private instrument through which an individual—the *principal*—authorizes another person—the *agent*—to act on behalf of the principal.³⁴ There was an old common law rule that voided the agent’s authority upon the principal’s loss of mental capacity. The rationale was that the agent could only do what the principal was able to do. Abolishing that common law rule, modern power of attorney statutes permit a *durable* agency to commence, or remain valid, upon the principal’s loss of mental capacity.³⁵ These statutes allow individuals to choose their own representatives in the event of losing mental capacity, and also to avoid the cost, emotional stress and embarrassment of invoking the official guardianship regime.³⁶ In fact, the principal can even stipulate a *sui generis* definition of “incapacity” and provide a procedure for determining whether that definition is met.³⁷

B. Economic Foundations of Fiduciary Law

The economic theory of relational contracts provides a framework for understanding the problem of misuse of power by guardians and durable agents. This Section will introduce the key components of that framework: the guardian or agent’s broad discretion, a lack of satisfactory monitoring mechanisms, and the resulting moral hazard problem. Sections I.C–E below will use this framework to explain how fiduciary law can deter and sanction misconduct.³⁸

32. See, e.g., UNIF. PROBATE CODE § 5-401 (UNIF. LAW COMM’N amended 2010). While the guardianship system under the Uniform Probate Code is “fairly representative,” Feder & Sitkoff, *supra* note 11, at 27, the Uniform Law Commission recently promulgated UNIF. GUARDIANSHIP, CONSERVATORSHIP, & OTHER PROTECTIVE ARRANGEMENTS ACT § 401(b) (UNIF. LAW COMM’N 2017). To cover both the representative statute and the modern trend, this Article cites the relevant sections of both of these uniform legislation.

33. See, e.g., Jean Callahan, Raquel Malina Romanick & Angela Ghesquiere, *Guardianship Proceedings in New York State: Findings and Recommendations*, 37 BIFOCAL 83, 85–86 (2016); *In re Caminite*, 62 N.Y.S.3d 724, 726 (Nassau Cty. Ct. 2017). Another common class of individuals subject to guardianship are those who have suffered some brain injury, where the guardianship is created to manage the tort judgment or settlement arising from that injury. See, e.g., *Johnson v. Puchalski (In re Estate of O’Hare)*, 34 N.E.3d 1126 (Ill. App. Ct. 2015); *In re Tinsmon*, 79 N.Y.S.3d 854 (Sur. Ct. 2018).

34. See UNIF. POWER OF ATTORNEY ACT § 102(1) (UNIF. LAW COMM’N 2006); RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. LAW INST. 2006).

35. See UNIF. POWER OF ATTORNEY ACT § 102(2) (UNIF. LAW COMM’N 2006); RESTATEMENT (THIRD) OF AGENCY § 3.06 cmt. b (AM. LAW INST. 2006).

36. See, e.g., Feder & Sitkoff, *supra* note 11, at 28–30.

37. See, e.g., *id.* at 42–43.

38. This Section adopts the “agency costs” framework. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). Economic theories of fiduciary law typically use the “agency costs”

1. Broad Fiduciary Discretion

In a fiduciary relationship, the fiduciary tends to have broad discretion over how to provide her services. At the time of creating the relationship, the creator is unlikely to give comprehensive, rule-like instructions to the fiduciary. This reflects the reality that it is impossible to anticipate all future contingencies, and that it is prohibitively costly to account for all contingencies that can be anticipated. In other words, the “contract” that governs the fiduciary relationship is incomplete, leaving the fiduciary to respond to unaccounted-for contingencies by exercising her discretion.³⁹

For example, at the time of drafting an order to appoint a guardian, the court is unable to give rule-like instructions, leaving the guardian with no discretion regarding how to respond to future contingencies. Satisfactory property management (or caretaking) requires the guardian to perform a broad range of tasks in light of changing circumstances. Even a simple task like buying groceries requires a comparison of prices, which differ across grocery stores and fluctuate over time; it would be prohibitively costly and unrealistic for the court to tell the guardian exactly where to shop and how much to spend. As predicted by economic theory, the available empirical observations suggest that courts typically give guardians broad discretion.⁴⁰

For similar reasons, at the time of drafting a durable power of attorney, the drafter is unlikely to give rule-like instructions telling the agent exactly what to do in every eventuality that may arise in the future. Nothing prevents the power of attorney from containing rule-like instructions in respect to *some* eventualities, but it would be prohibitively costly and unrealistic to cover *all* eventualities.

framework. See, e.g., Elizabeth S. Scott & Robert E. Scott, *Parents as Fiduciaries*, 81 VA. L. REV. 2401 (1995) (on parents' fiduciary duties as mandatory law); Robert H. Sitkoff, *An Economic Theory of Fiduciary Law*, in PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 197 (Andrew S. Gold & Paul B. Miller eds., 2014) (on fiduciary duties as penalty-defaults). An alternative economic theory conceives fiduciary law as supplying potentially efficient solutions to holdup problems. See Oliver Hart, *An Economist's View of Fiduciary Duty*, 43 U. TORONTO L.J. 299 (1993); Richard R.W. Brooks, *Incorporating Race*, 106 COLUM. L. REV. 2023 (2006); see generally Richard R.W. Brooks, *The Economics of Fiduciary Law*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW, *supra* note 24 (discussing various economic theories of fiduciary law).

39. See Sitkoff, *supra* note 38, at 199; see also Scott & Scott, *supra* note 38, at 2417 (explaining performance of caring duty is complex and subject to uncertainties and requires responses to contingencies as they arise).

40. See, e.g., Alison Barnes, *The Liberty and Property of Elders: Guardianship and Will Contests as the Same Claim*, 11 ELDER L.J. 1, 7–8 (2003); Leslie Salzman, *Guardianship for Persons with Mental Illness—A Legal and Appropriate Alternative?*, 4 ST. LOUIS U. J. HEALTH L. & POL'Y 279, 294 (2011); Lawrence A. Frolik, *Guardianship Reform: When the Best Is the Enemy of the Good*, 9 STAN. L. & POL'Y REV. 347, 352–53 (1998).

2. Ineffective Monitoring

Fiduciaries are typically subject to limited or no monitoring. First, that the beneficiary lacks the specialized skills necessary to take the relevant actions without assistance is often the very reason of engaging the fiduciary; the same reason prevents the beneficiary from effectively monitoring the fiduciary.⁴¹ Second, any observable and verifiable output tends to be imperfectly probative of the fiduciary's unmonitored actions. What is typically observable and verifiable is some imperfect signal of the fiduciary's actions, such as incomplete reports.

The problem of ineffective monitoring affects both guardianships and agency relationships. First, in the case of guardianship, the individual subject to guardianship lacks mental capacity; this tends to place significant restrictions on her own monitoring efforts. While modern guardianship statutes increasingly provide for public monitoring by courts or state agencies,⁴² they typically remain a recipient of information proffered by the parties.⁴³ Limited funding, heavy caseloads, and shortages in staffing are all constraints that prevent courts or state agencies from engaging in extensive monitoring.⁴⁴ For instance, in a 2014 survey of American guardianship law and practice, about one-fifth of the respondents answered that financial accountings by guardians were not completely audited or evaluated.⁴⁵

Second, ineffective monitoring is also a problem in the typical agency relationship.⁴⁶ This happens frequently when the agent continues to act after the principal loses mental capacity. In this situation, public monitoring is also limited or non-existent, given the private nature of the agency relationship.⁴⁷

3. Moral Hazard

The combination of broad discretion and ineffective monitoring suggests that the fiduciary may exploit the problem of *moral hazard*: the exact action

41. See Sitkoff, *supra* note 38, at 199; see also Scott & Scott, *supra* note 38, at 2419–21 (discussing the limits of monitoring mechanisms in the family context).

42. See ADMIN. CONF. U.S., SSA REPRESENTATIVE PAYEE: SURVEY OF STATE GUARDIANSHIP LAWS AND COURT PRACTICES 21–22 (2014), <https://www.acus.gov/report/ssa-representative-payee-survey-state-guardianship-laws-and-court-practices> (almost nine-tenths of respondents to survey answer all or most guardianship-of-property cases require inventory filing and annual financial accounting).

43. See Alison Barnes, *The Virtues of Corporate and Professional Guardians*, 31 STETSON L. REV. 941, 980–82 (2002).

44. See *id.* at 980–84.

45. ADMIN. CONF. U.S., *supra* note 42, at 25.

46. See Kohn, *supra* note 7, at 38; see also *id.* at 42–45, 52 (proposing to require agents to communicate with their elderly principals in order to promote better monitoring and participation by these principals).

47. See generally *infra* notes 71, 287–88 and accompanying text (discussing the accounting and reporting duties of agents).

taken by the fiduciary, such as any actual wrongdoing, can be hidden from others.⁴⁸ Moreover, the true costs and benefits of the fiduciary's chosen action are usually not fully known to others; this prevents an accurate inference of the action taken by the fiduciary based on her financial gains and losses alone. Assuming her interests do not align perfectly with her beneficiary's, the fiduciary has incentives to exploit the moral hazard problem.⁴⁹

In re Conservatorship of Smith illustrates the moral hazard problem.⁵⁰ In that case, an elderly woman's long-term partner and caregiver became her guardian of property when she lost her mental capacity. After taking his office, the guardian opened a joint bank account with the woman and started moving money from the woman's own accounts into the joint account. Motivating these actions was that upon the woman passing away, the guardian would become the sole owner of the joint account, while the woman's heirs would become entitled to the accounts in her own name.⁵¹ Here, there was a problem of moral hazard because no one other than the guardian would know for sure whether he had actually overreached to get the elderly woman to open the joint account with him. The guardian's financial gain alone was insufficient to support an inference of actual wrongdoing because the woman might well have wished to benefit her guardian, who was her caregiver and long-term partner.

C. Prohibition of Conflicts of Interest

American jurisdictions impose fiduciary duties on guardians and agents to deter and sanction exploitation of the moral hazard problem. This Section introduces the strict model of fiduciary law, which is based on the fiduciary duties of trustees.⁵² This model represents an orthodoxy for both guardians and agents.⁵³ Section I.D below will discuss the modern trend of adopting a relaxed model for agents.

Jurisdictions that follow the strict model of fiduciary law impose rigorous and comprehensive duties on guardians and agents. The most demanding of

48. See Sitkoff, *supra* note 38, at 199.

49. See *id.* at 199. See *infra* Part II (explaining and challenging this assumption).

50. See *Fitzmaurice v. Vandevort (In re Conservatorship of Smith)*, 237 So. 3d 852 (Miss. Ct. App. 2017) (reversing and remanding trial court's summary dismissal of breach-of-fiduciary duty claim).

51. See *id.* at 855–57.

52. A trustee holds the legal title of some property for the benefit of one or more other person, or for the benefit of charity. See RESTATEMENT (THIRD) OF TRUSTS §§ 2 cmt. a, 3 cmt. c (AM. LAW INST. 2003). Guardians and agents are not trustees because they do not hold legal title of the incapable individual's property.

53. See UNIF. PROBATE CODE § 5-418(a) (UNIF. LAW COMM'N amended 2010) (applying trust fiduciary law to guardians); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 418 cmt. (UNIF. LAW COMM'N 2017) (“While a [property guardian's] role is not identical to that of a trustee, many principles of trust law are relevant . . .”); RESTATEMENT (SECOND) OF AGENCY § 387 (AM. LAW. INST. 1958); Lawrence A. Frolik, *Is a Guardian the Alter Ego of the Ward?*, 37 STETSON L. REV. 53, 66–67 (2007).

these is a *duty of undivided loyalty*. Subject to some narrow exceptions,⁵⁴ the duty of loyalty prohibits the guardian or agent from acting in any way other than in the *sole* interest of the incapable individual. In particular, the guardian or agent breaches her sole-interest duty by entering into transactions that involve a substantial conflict between her duties to the incapable individual and her personal interests.⁵⁵ There is a “*no further inquiry*” rule, which holds that it is generally immaterial whether a conflicted action is taken in good faith or results in no loss.⁵⁶ There is also a *rule against self-dealing* that prohibits the guardian or agent from entering any transaction involving the incapable individual’s property on her own account.⁵⁷ Unless permitted by statute, commingling her own property (or someone else’s property) with the property of the incapable individual also breaches her sole-interest duty.⁵⁸ The main exemption to the duty of loyalty is that the guardian or agent may receive reasonable remuneration for providing her services, but only if the incapable individual can afford to pay her.⁵⁹

A breach of the sole-interest duty of loyalty makes available a broad range of remedies. These remedies include the rescission of any impugned transaction, an injunction to restrain a prospective breach, loss-based remedies to compensate any loss to the incapable individual, and gain-based remedies to disgorge the errant guardian’s or agent’s ill-gotten gain.⁶⁰ A third party who

54. See generally *infra* Section III.A.3.

55. See RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. b (AM. LAW INST. 2007); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 425 (UNIF. LAW COMM’N 2017) (voiding transactions tainted with “substantial conflict between the [property guardian’s] fiduciary duties and personal interests”); see also UNIF. PROBATE CODE § 5-423 (UNIF. LAW COMM’N amended 2010); RESTATEMENT (SECOND) OF AGENCY § 387 (AM. LAW. INST. 1958). Unlike many other duties of a fiduciary, the sole-interest duty of loyalty is typically expressed in negative terms, which duty obliges the fiduciary to avoid conflicts rather than positively to take some action. See RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. b (AM. LAW INST. 2007).

56. See Langbein, *supra* note 2, at 931, 934–35.

57. See UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 425 (UNIF. LAW COMM’N 2017) (“A transaction affected by a substantial conflict includes a . . . transaction involving the [guardianship] estate entered into by the [guardian of estate]”); see also UNIF. PROBATE CODE § 5-423 (UNIF. LAW COMM’N amended 2010). See, e.g., *In re Brownell*, 447 N.Y.S.2d 591, 594 (Delaware Cty. Ct. 1981) (guardian violated the rule against self-dealing by charging the guardianship property to pay her for caring for the incapable individual’s dog).

58. See RESTATEMENT (THIRD) OF TRUSTS § 84 (AM. LAW INST. 2007); see, e.g., *In re Campione*, 872 N.Y.S.2d 210, 214 (App. Div. 2009) (family guardian in breach of duty of loyalty on grounds including commingling guardianship funds); see generally Langbein, *supra* note 2, at 972–73 (discussing legislative relaxation of the rule against commingling in trust law).

59. See RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. c(4) (AM. LAW INST. 2007).

60. See RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. d (AM. LAW INST. 2006); RESTATEMENT (THIRD) OF TRUSTS § 78 (AM. LAW INST. 2007); RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 43 cmt. a (AM. LAW INST. 2011).

participates in or benefits from a breach can also be liable,⁶¹ although many jurisdictions condition such liability on the third party having sufficient knowledge of the breach.⁶² The duty of loyalty is also expressive;⁶³ its morality rhetoric suggests that a breach finding can impose informal social costs of guilt and moral opprobrium.⁶⁴ Moreover, the court may remove the errant guardian or agent from her office.⁶⁵ The court also may reduce or remove the errant guardian's or agent's remuneration.⁶⁶

The duty of loyalty is peculiarly fiduciary, but it is not the only duty that guardians and agents owe. They also have duties to act within the scope of their authority,⁶⁷ and to act with reasonable care and prudence.⁶⁸ In particular, the duty of care and prudence requires guardians to invest and manage the property of the incapable individual as a prudent investor or person would.⁶⁹ Moreover, many jurisdictions impose periodic accounting and reporting duties on

61. See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT §§ 17 cmt. c, 43 cmt. g (AM. LAW INST. 2011).

62. See generally RESTATEMENT (THIRD) OF TRUSTS § 108 (AM. LAW INST. 2012); UNIF. TRUST CODE § 1012 (UNIF. LAW COMM'N, amended 2010); see, e.g., *Smallwood v. Lupoli*, 968 N.Y.S.2d 515, 517–19 (App. Div. 2013) (applying *Palmetto Partners, L.P. v. AJW Qualified Partners, LLC*, 921 N.Y.S.2d 260, 265–66 (App. Div. 2011), which imposes a knowledge requirement on third-party liability).

63. See Hanoch Dagan & Sharon Hannes, *Managing Our Money: The Law of Financial Fiduciaries as a Private Law Institution*, in PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 38, at 91, 109–10; Hanoch Dagan & Elizabeth S. Scott, *Reinterpreting the Status-Contract Divide: The Case of Fiduciaries*, in CONTRACT, STATUS, AND FIDUCIARY LAW 51, 67 (Paul B. Miller & Andrew S. Gold eds., 2016).

64. See Scott & Scott, *supra* note 38, at 2425–26; see, e.g., *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928).

65. See, e.g., RESTATEMENT (THIRD) OF TRUSTS §§ 37 cmt. b, 65 cmt. f (AM. LAW INST. 2003); *In re Helen S.*, 13 N.Y.S.3d 516, 517 (App. Div. 2015).

66. See *infra* Section IV.D.

67. See, e.g., RESTATEMENT (THIRD) OF AGENCY § 8.07, 8.09 (AM. LAW INST. 2006); UNIF. PROBATE CODE §§ 5-314(a), 5-410(b) (UNIF. LAW COMM'N amended 2010) (stating the court has the power to decide scope of guardian's authority); see also UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 411(c), (d) (UNIF. LAW COMM'N 2017).

68. See UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 418(a) (UNIF. LAW COMM'N 2017); UNIF. PROBATE CODE § 5-418(a) (UNIF. LAW COMM'N amended 2010); UNIF. POWER OF ATTORNEY ACT § 114(b)(3) (UNIF. LAW COMM'N 2006); RESTATEMENT (THIRD) OF AGENCY § 8.08 (AM. LAW INST. 2006).

69. See UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 418 cmt. (UNIF. LAW COMM'N 2017); Fleming & Morgan, *supra* note 24, at 1302–05. Imprudent transactions involving a conflict of interest violate the duty of care and prudence, in addition to the duty of loyalty. See, e.g., *Green v. Lombard (In re Guardianship of Stalker)*, 343 A.2d 905, 908–10 (Md. Ct. Spec. App. 1975); *In re Guardianship of Stalker*, 953 N.E.2d 1094 (Ind. Ct. App. 2011).

guardians.⁷⁰ Agents also tend to owe accounting and reporting duties, but these duties are less onerous than the duties for guardians.⁷¹

Orthodox fiduciary law is prophylactic;⁷² it over deters the guardian or agent to ameliorate the misalignment of her personal interests and the incapable individual's.⁷³ That misalignment is the source of incentives to exploit the moral hazard problem.⁷⁴ As Professor Robert Sitkoff wrote, the sole-interest duty of loyalty deters a fiduciary from placing herself in a position of conflict by disgorging any personal gain arising from that position.⁷⁵ The disgorgement remedy adds to the usual deterrence effect of compensatory remedies.⁷⁶ Alternatively, Professor Henry Smith conceived the function of fiduciary law as preventing *opportunism*: behaviors that are detrimental to social welfare but cannot be cost-effectively defined, detected, and deterred by explicit ex-ante rulemaking.⁷⁷ Because self-dealing and non-avoidance of conflicts are correlated with opportunism, fiduciary law regards such conduct as proxies and presumptions of opportunism.⁷⁸ As a prophylactic measure, fiduciary law requires the fiduciary to avoid self-dealing and conflicts of interest, regardless of any bad faith or fraud on her part.⁷⁹ This prophylactic objective explains how the availability of disgorgement remedies strips the fiduciary of any personal profit arising from conflicted transactions.⁸⁰ Compensatory remedies further strengthen the deterrence function.⁸¹

70. See, e.g., UNIF. PROBATE CODE §§ 5-317, 5-420 (UNIF. LAW COMM'N amended 2010); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT §§ 420, 423 (UNIF. LAW COMM'N 2017).

71. See generally RESTATEMENT (THIRD) OF AGENCY § 8.12(3) (AM. LAW INST. 2006); *infra* note 287 and accompanying text.

72. See RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. b (AM. LAW INST. 2007) (“The rationale [underlying the duty of loyalty] begins with a recognition that it may be difficult for a trustee to resist temptation when personal interests conflict with fiduciary duty.”); RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 43 cmts. b, d, h (AM. LAW INST. 2011); Sitkoff, *supra* note 38, at 199.

73. But see Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045 (1991) (conceiving fiduciary duties as providing optimal deterrence).

74. See *supra* Section I.B.3.

75. See Sitkoff, *supra* note 38, at 201–02, 206–07; see also Scott & Scott, *supra* note 38, at 2419–21 (discussing the incentive-alignment effects, or “bonding,” of fiduciary law in families).

76. See Sitkoff, *supra* note 38, at 202, 206–07.

77. See Henry E. Smith, *Why Fiduciary Law is Equitable*, in PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 38, at 261, 264, 267, 271, 273.

78. See *id.* at 262, 271.

79. See *id.* at 271.

80. See *id.* at 273–74.

81. See *id.* at 274, 280.

In re Estate of O'Hare can illustrate the practical implications of the sole-interest duty of loyalty.⁸² This case concerned a young woman, Sarah, who suffered injuries at birth and obtained substantial property as a result of a medical malpractice settlement. Sarah's mother, Virginia, was her primary caregiver and became the guardian of her property when she reached the age of majority. When Sarah's stepfather relocated interstate for his job, the family moved into a house purchased with Sarah's funds. Virginia also used Sarah's funds to pay family expenses and a caregiver's salary to herself.⁸³ The Illinois court held Virginia in breach of fiduciary duty because she used Sarah's funds to benefit the family as a whole rather than Sarah specifically.⁸⁴

An instructive aspect of this case is the way that the court enforced the duty of loyalty in the presence of informational deficiency. Virginia did not give prior notice to the court regarding her uses of Sarah's funds, and kept poor records.⁸⁵ The information that the court could observe and verify mainly consisted of these poor records, Virginia's personal gain, the family's gain, and a reduction in Sarah's funds. However, gift-giving and property-sharing are common in close families.⁸⁶ The mere fact that Sarah's family benefited from her funds could not indicate that Virginia engaged in any actual wrongdoing. To the contrary, the court thought Virginia provided "excellent care" to Sarah.⁸⁷ What animated the court's ruling against Virginia was not evidence of actual wrongdoing, but her conflict of interest.

D. The Best-Interest Standard

This Section introduces an alternative formulation of the duty of loyalty, under which the guardian or agent is permitted to take a conflict of interest action if it is in the *best interest* of the incapable individual. The best-interest standard directs an objective, multifactorial analysis of context-sensitive facts and circumstances. The incapable individual's known wishes are the predominant factor in determining what amounts to her best interest.⁸⁸ Other factors include the individual's financial circumstances, eligibility for public benefits, and tax consequences of the proposed action.⁸⁹

82. Johnson v. Puchalski (*In re Estate of O'Hare*), 34 N.E.3d 1126 (Ill. App. Ct. 2015).

83. See *id.* at 1128–30.

84. See *id.* at 1131.

85. See *id.* at 1130–31.

86. See generally *infra* Section II.B.3.

87. See *In re Estate of O'Hare*, 34 N.E.3d at 1131.

88. See, e.g., UNIF. POWER OF ATTORNEY ACT § 114 cmt. (UNIF. LAW COMM'N 2006); UNIF. PROBATE CODE §§ 5-314(a), 5-418(b) (UNIF. LAW COMM'N amended 2010); N.Y. MENTAL HYG. LAW §§ 81.20(a)(6)(i), (a)(7) (McKinney 2016); ROBERT H. SITKOFF & JESSE DUKEMINIER, WILLS, TRUSTS, AND ESTATES 509–10 (10th ed. 2017) (discussing *Estate of Kurrelmeyer*, No. 1079-03 CnCiv., 2008 WL 7810419 (Vt. Super. Ct. 2008), *aff'd, sub nom. In re Estate of Kurrelmeyer*, 992 A.2d 316 (Vt. 2010)).

89. See, e.g., UNIF. POWER OF ATTORNEY ACT § 114 cmt. (UNIF. LAW COMM'N 2006).

Professor John Langbein—a leading advocate of the best-interest standard—argued that the sole-interest duty of loyalty generates more costs than benefits.⁹⁰ In his view, the main problem with the sole-interest duty is the overdeterrence of actions that benefit both the beneficiary and the fiduciary.⁹¹ According to Langbein, the old English Court of Chancery developed the sole-interest duty to address the concern that a trustee could easily conceal his own wrongdoing.⁹² This concern reflected the “grievous shortcomings” in fact-finding processes at the time, but it no longer reflects the efficacy of recordkeeping and fact-finding processes in modern times.⁹³ In the language of economic theory, Langbein challenged the assumption that the fiduciary is always poorly monitored. Replacing the sole-interest duty with the best-interest standard would enable a cost-benefit analysis on a case-by-case basis.

Proposals to introduce the best-interest standard have partially informed the development of modern agency law. Under modern power of attorney statutes, an agent may defend a conflicted transaction by proving that she acted with care, competence, and diligence for the best interest of her principal.⁹⁴ The availability of this defense largely abrogates the sole-interest duty.⁹⁵ Such

90. See Langbein, *supra* note 2, at 933. Langbein’s arguments specifically address trusteeship, but scholars and law reformers have made similar arguments in relation to other fiduciary relationships. See, e.g., Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1126–30 (1981) (discussing fiduciary duties of parties to relational contracts); Scott & Scott, *supra* note 38, at 2437–39 (opposing application of conflict-of-interest rules or standards to parents in close families); UNIF. POWER OF ATTORNEY ACT § 114 cmt. (UNIF. LAW COMM’N 2006).

91. See Langbein, *supra* note 2, at 933.

92. See *id.* at 932, 944–45. Cf. Joshua Getzler, *An Interdisciplinary View of Fiduciary Law: “As If:” Accountability and Counterfactual Trust*, 91 B.U. L. REV. 973, 981–85 (2011). The modern conception of fiduciary law originally took shape against a culture of corruption and incompetence among private and public officials, including Lord Chancellors and Masters of the English Court of Chancery. In the early eighteenth century, Lord Chancellor King, an anti-corruption reformer and former Chief Justice of the Court of Common Pleas, succeeded as Lord Chancellor after presiding over the impeachment of his predecessor. Lord Chancellor King adopted a prophylactic policy in “a run of stringently moralistic decisions” to restore the integrity and reputation of his Court, *id.* at 983–94, including *Keech v. Sandford* (1726) 25 Eng. Rep. 223; Sel. Cas. T. King 61, a leading case in fiduciary law. See RESTATEMENT (THIRD) OF TRUSTS § 78 reporter’s note on cmt. a (AM. LAW INST. 2007); RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 43 reporter’s note b (AM. LAW INST. 2011). An anti-corruption sentiment also might underlie Judge Benjamin Cardozo’s opinion in *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928), another leading case in fiduciary law. See Getzler, *supra*, at 985.

93. See Langbein, *supra* note 2, at 932, 945–51.

94. See UNIF. POWER OF ATTORNEY ACT § 114(d) (UNIF. LAW COMM’N 2006). This standard is consistent with Langbein’s proposal. See generally Langbein, *supra* note 2; see also *supra* Section I.D. See also RESTATEMENT (THIRD) OF AGENCY § 8.01, reporter’s note a (AM. LAW INST. 2006) (“[A]n agent’s loyal service to the principal may, concurrently, be beneficial to the agent.”).

95. See Langbein, *supra* note 2, at 933–34.

departure from the orthodoxy reflects “the practical reality that most agents . . . are family members who have inherent conflicts of interest with the principal arising from joint property ownership or inheritance expectations.”⁹⁶ However, modern agency law continues to prohibit agents from engaging in self-dealing transactions.⁹⁷ Similarly, agents are prohibited from using their principals’ property for their own (or a third party’s) purposes.⁹⁸ Both of these prohibitions derive from the sole-interest duty of loyalty.⁹⁹ Hence, the best-interest standard seems to have displaced the sole-interest duty to a great extent, but not completely.

The best-interest standard also has a role to play in modern guardianship law. In addition to her sole-interest duty of loyalty, a guardian owes a standalone duty to exercise her discretion to advance the known wishes of the incapable individual.¹⁰⁰ If the individual’s wishes are not known, or if giving effect to her wishes would unreasonably harm or endanger her, then the guardian owes a duty to act in her best interest.¹⁰¹

In re Keri illustrates how the best-interest standard can permit actions that benefit both the incapable individual and her guardian or agent.¹⁰² In that case, the two sons of an elderly incapable woman—Keri—took care of her in her house for as long as they could; one of the sons was her agent. When the sons could no longer avoid placing her in a nursing home, they devised a plan to accelerate her eligibility for Medicaid reimbursement of her nursing home costs. They planned to sell Keri’s house and transfer a significant proportion of the proceeds to themselves.¹⁰³ Their justification was that under Keri’s will, they would receive her estate when she passed away, but they would likely receive nothing if her assets were spent on her nursing home costs.¹⁰⁴ Applying the best-interest standard, the New Jersey court approved the sons’ plan. The court found that the plan would likely increase the amount that she would leave to her sons and that she would not have disapproved of the plan if she was mentally

96. UNIF. POWER OF ATTORNEY ACT § 114 cmt. (UNIF. LAW COMM’N 2006). *See also* Langbein, *supra* note 2, at 935–36.

97. *See* RESTATEMENT (THIRD) OF AGENCY § 8.03 cmt. b (AM. LAW INST. 2006).

98. *See id.* § 8.05(1) (AM. LAW INST. 2006).

99. *See supra* notes 55–58 and accompanying text.

100. This duty reflects the doctrine of substituted judgment. *See generally infra* Section III.A.

101. *See, e.g.*, UNIF. PROBATE CODE §§ 5-314(a), 5-418(b) (UNIF. LAW COMM’N amended 2010); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 418(c) (UNIF. LAW COMM’N 2017). *See generally* Lawrence A. Frolik & Linda S. Whitton, *The UPC Substituted Judgment/Best Interest Standard for Guardian Decisions: A Proposal for Reform*, 45 U. MICH. J.L. REFORM 739, 742–43 (2012) (surveying financial decision-making standards in American guardianship statutes).

102. *See In re Keri*, 853 A.2d 909 (N.J. 2004).

103. *See id.* at 911–12.

104. *See id.* at 911–12, 917–18.

capable.¹⁰⁵ The plan would not have been approved if the court were to enforce the sole-interest duty of loyalty, because the sons had a conflict of interest.¹⁰⁶

E. Operation as Default Law

Both the orthodox and relaxed models of fiduciary law are contractarian; they conceive fiduciary law as supplying mostly *default* duties to fill in the gaps in the incomplete “contract” between the fiduciary and the beneficiary.¹⁰⁷ This reflects the prevailing doctrinal position that fiduciary law generally yields to party modification. By modifying the terms of the instrument underlying the fiduciary relationship, the creator or the beneficiary may modify the duties of the fiduciary.¹⁰⁸ Similarly, the beneficiary may consent to a departure from default fiduciary law before it takes place, or ratify it afterward.¹⁰⁹ The fiduciary must make a fair and frank disclosure and the beneficiary’s consent or ratification must be fully informed;¹¹⁰ information asymmetry, cognitive biases, limited willpower, and some other obstacles to efficient bargaining justify the imposition of these procedural safeguards.¹¹¹ The beneficiary or creator can therefore discharge the fiduciary from compliance with almost all of her

105. See *id.* at 913, 917–18. Although the New Jersey court formally discussed both the best-interest standard and a substituted-judgment standard to be discussed *infra* Section III.A., it really only applied the best-interest standard. See Frolik, *supra* note 53, at 82.

106. See *In re Keri*, 853 A.2d at 918–19.

107. See Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993). But see Tamar Frankel, *Watering Down Fiduciary Duties*, in PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW, *supra* note 38, at 242 (resisting contractarian approaches to fiduciary law).

108. See, e.g., RESTATEMENT (THIRD) OF TRUSTS §§ 64, 65 (AM. LAW INST. 2003); RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. c (AM. LAW INST. 2006) (“[A]n agent’s fiduciary duties to the principal vary depending on the parties’ agreement and the scope of the parties’ relationship.”). The instrument underlying the fiduciary relationship is the power of attorney in the case of an agency relationship, and the court order that appoints the guardian in the case of a guardianship.

109. See, e.g., RESTATEMENT (THIRD) OF AGENCY § 8.06 (AM. LAW INST. 2006); RESTATEMENT (THIRD) OF TRUSTS § 97 (AM. LAW INST. 2012). The fiduciary law literature often denotes by “authorization” or “consent” an ex-ante permission to take the conflicted action or transaction, and by “ratification” or “release” an ex-post permission. See, e.g., Langbein, *supra* note 2, at 963–64; Robert H. Sitkoff, *Fiduciary Principles in Trust Law*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW, *supra* note 24, at 58. For simplicity, this Article uses “authorization” to denote both, and emphasizes timing where relevant.

110. See Matthew Conaglen, *The Extent of Fiduciary Accounting and the Importance of Authorisation Mechanisms*, 70 CAMBRIDGE L.J. 548, 563 (2011); see also Sitkoff, *supra* note 38, at 201–02; see, e.g., RESTATEMENT (THIRD) OF TRUSTS § 78(3) cmt. g (AM. LAW INST. 2007) (fair and frank disclosure requirements).

111. See, e.g., Dagan & Scott, *supra* note 63, at 22; see generally Benjamin E. Hermalin, Avery W. Katz & Richard Craswell, *Contract Law*, in 1 HANDBOOK OF LAW AND ECONOMICS 7, 30–46 (A. Mitchell Polinsky & Steven Shavell eds., 2007) (discussing the obstacles to efficient contracting).

fiduciary duties. The only potential exception is a *mandatory core* of fiduciary law that holds the fiduciary liable for breaches taken in bad faith or with indifference.¹¹² Overall, fiduciary law places few restrictions on a private individual's power to authorize departures from adherence to strict fiduciary duties. This power may be called the *power of authorization*.

The essentially default nature of fiduciary law supplies the standard objection to reform proposals to legitimize conflict of interest transactions that are welfare-enhancing.¹¹³ To see this, suppose the fiduciary has an opportunity to commit an *efficient breach* of the sole-interest duty of loyalty. This means that the benefits arising from noncompliance are greater than the costs, so the breach would generate a positive (net) welfare gain. If the fiduciary seeks authorization from the beneficiary, then they can negotiate and form an agreement on how to share the welfare gain. The disclosure requirements help to facilitate an arm's length negotiation at this juncture. Such negotiation likely leads to a distribution of the welfare gain to both the fiduciary and the beneficiary. On the other hand, if the fiduciary acts without prior authorization, and is later found in breach, then her personal gain would be disgorged. Thus, the fiduciary would be better off acting with the beneficiary's authorization than without. In sum, by simultaneously imposing the sole-interest duty on the fiduciary and granting the power to authorize any departure to the beneficiary, orthodox fiduciary law can incentivize the fiduciary to take a welfare-enhancing action and share the resulting welfare gain with the beneficiary. (This line of reasoning critically depends on the beneficiary having mental capacity, as Part II below will explain.)

A numerical example can illustrate how the sole-interest duty and the power of authorization operate in tandem. Suppose the fiduciary has an opportunity to take an action that generates \$100 to herself but harms the beneficiary by \$30. Taking this action without authorization would constitute a breach of the sole-interest duty; a conflict of interest arises when the fiduciary gains at the beneficiary's expense. If the fiduciary were sanctioned for committing such a breach, then her gain of \$100 would be disgorged; this outcome would leave the fiduciary with \$0 and the beneficiary with \$70 ($\$100 - \$30 = \70).¹¹⁴ On the other hand, if the fiduciary were to seek prior authorization from the beneficiary, then they could agree on how to share the

112. See, e.g., RESTATEMENT (THIRD) OF TRUSTS § 96 cmt. c (AM. LAW INST. 2012). Aside from protecting the principal, the mandatory core of fiduciary law reduces the information costs of a third party who deals with the fiduciary. See Sitkoff, *supra* note 38, at 205–06.

113. See, e.g., RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 43 cmt. h (AM. LAW INST. 2011). *Contra* Tess Wilkinson-Ryan, *Fiduciary Law and Psychology*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW, *supra* note 24, at 717–19 (the empirical literature on disclosure of conflicts of interest suggests that “[d]isclosures appear to increase the provision of biased advice and increase compliance with biased advice, while also weakening the trust between the parties.”).

114. To simplify the calculation, this example assumes a breach of fiduciary duty is detected and sanctioned with certainty. Little depends on that assumption.

net gain of \$70. The exact shares would depend on their respective bargaining powers. For example, the beneficiary could get \$50 while the fiduciary gets \$20. The numbers are unimportant, because the fiduciary is incentivized to seek authorization as long as she can obtain more than \$0.

F. Rule Versus Standard

The extent of legal indeterminacy also affects the choice between the sole-interest duty of loyalty and the best-interest standard. Brightline rules stipulate in advance the exact legal criteria to be applied in individual cases. Vague standards, on the other hand, leave courts to determine the criteria with the benefit of hindsight. Compared to rules, standards typically generate greater compliance costs and litigation costs to litigants as well as greater decisional costs to courts.¹¹⁵ On the other hand, rules may be more informationally demanding and costlier to promulgate ex-ante, especially when the facts are complex and future contingencies are hard to foresee or describe.¹¹⁶

Scholars have criticized the best-interest standard for its legal indeterminacy.¹¹⁷ Breach of fiduciary duty claims typically involve a guardian or an agent who is in a familial relationship with the incapable individual.¹¹⁸ The best-interest standard grants broad judicial discretion to consider a variety of factors.¹¹⁹ Yet, as Professors Elizabeth Scott and Robert Emery argued, the largely private nature of family life keeps much relevant information hidden from outsiders, such as a court.¹²⁰ Another problem pertains to the need to weigh or rank inherently incommensurable best-interest factors.¹²¹ In stark contrast, the sole-interest duty of loyalty supplies a highly determinate rule: whether there is an unauthorized conflict of interest, and if there is, does it fall within a recognized exception? This inquiry typically ends with finding some unauthorized financial benefit—an observable and verifiable piece of information—to the guardian or agent (or a third party).¹²²

115. See, e.g., Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992).

116. See *id.* at 621–22.

117. See, e.g., Elizabeth S. Scott & Robert E. Emery, *Gender Politics and Child Custody: The Puzzling Persistence of the Best-Interests Standard*, 77 L. & CONTEMP. PROBS. 69, 72–76 (2014); Robert H. Mnookin, *Child-Custody Adjudication: Judicial Functions in the Face of Indeterminacy*, 39 L. & CONTEMP. PROBS. 226 (1975); see also Robert H. Sitkoff, *Trust Law, Corporate Law, and Capital Market Efficiency*, 28 J. CORP. L. 565, 573–74 (2003) (“[I]n the trust law context [seal-dealing transactions] are so frequently undesirable that the costs of extirpating the entire class of transaction (a *rule*) are less than the costs of case-by-case adjudication (the *fairness standard*.”); Whitton, *supra* note 7, at 25, 38–39 (discussing survey responses complaining that the fiduciary duties of agents are uncertain and confusing).

118. See *supra* notes 33, 96 and accompanying text.

119. See *supra* notes 88–89 and accompanying text.

120. See Scott & Emery, *supra* note 117, at 74.

121. See *id.* at 75.

122. See *supra* notes 54–58 and accompanying text.

G. Summary

Orthodox fiduciary law imposes the sole-interest duty of loyalty to remove the fiduciary from situations involving a conflict of her interests with the beneficiary's. Over deterring the fiduciary, the sole-interest duty ameliorates the misalignment of interest that gives rise to perverse incentives. With most successes in modern agency law, reform proposals have led to the adoption of a best-interest standard to permit conflicted transactions that simultaneously benefit the fiduciary and the beneficiary. Those who resist proposals to relax the sole-interest duty often point to the default nature of fiduciary law: assuming the beneficiary is mentally capable, she can authorize her fiduciary to enter into conflicted transactions that are welfare enhancing.

II. FIDUCIARY LAW AS MANDATORY LAW

This Part will argue that orthodox fiduciary law is too strict on close relatives and friends, while proposals to introduce the best-interest standard are too lenient on professionals. As Section II.A below will elaborate, underlying these arguments is an observation that, when applied to incapable individuals, fiduciary law tends to operate as mandatory law rather than default law.

A. Mandatory Application to Mentally Incapable Individuals

1. Stultification of the Power of Authorization

Confined to cases concerning mentally incapable individuals, fiduciary law becomes problematic because it no longer operates as default law. There are severe restrictions on an incapable individual's power to authorize departures from strict fiduciary law. First, under the law of trusts, a beneficiary must have mental capacity in order to validly exercise her power of authorization.¹²³ Because American courts typically apply trust fiduciary law to guardians,¹²⁴ this mental capacity requirement removes the power of authorization from individuals subject to guardianship.¹²⁵ Some courts even disregard conflict-authorizing agreements formed before the individual's loss of capacity.¹²⁶

123. See RESTATEMENT (THIRD) OF TRUSTS § 97(a) cmt. d (AM. LAW INST. 2012).

124. See generally *supra* Section I.C.

125. See, e.g., *Hanson v. Peck* (*In re* Conservatorship of Hanson), 682 N.W.2d 207 (Neb. 2004); *Prichard v. Rininger* (*In re* Conservatorship of Rininger), 500 N.W.2d 47, 49, 51 (Iowa 1993). *Contra* *Mullins v. Ratcliff*, 515 So. 2d 1183 (Miss. 1987) (sustaining an incapable individual's gifts to his sister-guardian upon satisfaction of: (1) good faith on part of the sister-guardian; (2) the individual's full knowledge and deliberation of his actions and their consequences; and (3) clear and convincing evidence that the individual exhibited independent consent and action).

126. See, e.g., *In re* Guardianship & Conservatorship of Saylor, 121 P.3d 532, 536 (Mont. 2005) ("[A]ny arrangement between [the guardian and the incapable individual] which subsisted prior to the imposition of the [guardianship] does not necessarily determine the standard of care

Second, even if mental capacity is not a formal requirement for a valid exercise of the power of authorization, it can be very costly to “litigation-proof” any consent obtained from an elderly incapable individual. To minimize the risk of overreach at the time of obtaining authorization, fiduciary law requires that the fiduciary make a fair and frank disclosure and that the beneficiary’s consent be fully informed. Given the typical bases of mental incapacity are dementia and similar degenerative conditions,¹²⁷ the guardian or agent may need to incur the cost of engaging a medical professional to verify and document the quality of consent.¹²⁸ Even consent given in the presence of a lawyer can be suspicious to a court, especially if the lawyer has previously acted for the fiduciary.¹²⁹

Third, in most cases the elderly incapable individual cannot forbear a potential breach of fiduciary duty by not commencing proceedings, nor can she testify to support her guardian or agent. Breach of duty claims are frequently brought by relatives who would personally benefit from a finding of breach. These claimants often expect to inherit a share of the elderly incapable individual’s estate, and they sue the guardian or agent in order to increase the value of that estate.¹³⁰ Litigation tends to take place after the individual has passed away, denying her the opportunity to give evidence to support her guardian or agent. Even if she is alive at the time of litigation, her mental incapacity can make it difficult or impossible to give evidence.¹³¹ Many jurisdictions also do not guarantee her representation by an independent counsel.¹³²

Fourth, conflict of interest transactions are often gifts to the incapable individual’s close relatives and friends. Modern guardianship statutes prevent

which the [guardian] owes”); *In re Estate of Clark*, 772 P.2d 299, 302 (Mont. 1989) (same for the duty of loyalty).

127. See *supra* note 33 and accompanying text. The typical reasons for needing unpaid care are also older age and Alzheimer’s or dementia. See NAT’L ALL. FOR CAREGIVING & AARP PUB. POLICY INST., CAREGIVING IN THE U.S. 2015, at 17–18 (2015), https://www.caregiving.org/wp-content/uploads/2015/05/2015_CaregivingintheUS_Final-Report-June-4_WEB.pdf.

128. See, e.g., AM. BAR ASS’N COMM’N ON LAW & AGING & AM. PSYCHOLOGICAL ASS’N, ASSESSMENT OF OLDER ADULTS WITH DIMINISHED CAPACITY: A HANDBOOK FOR LAWYERS 20 (2005); SITKOFF & DUKEMINER, *supra* note 88, at 307.

129. See, e.g., *Fitzmaurice v. Vandevort (In re Conservatorship of Smith)*, 237 So. 3d 852, 856, 861 (Miss. Ct. App. 2017).

130. See, e.g., *In re Conservatorship of Hanson*, 682 N.W.2d 207 (children from a deceased incapable individual’s previous marriage seeking to recover the deceased estate’s conflict of interest payments to his guardian and surviving spouse).

131. See, e.g., *In re Caminite*, 62 N.Y.S.3d 724, 729 (Nassau Cty. Ct. 2017).

132. See generally Am. Bar Ass’n Comm’n on Law & Aging & Sally Balch Hurme, *Representation and Investigation in Guardianship Proceedings*, A.B.A., http://www.americanbar.org/content/dam/aba/administrative/law_aging/chartrepresentationandinvestigation.authcheckdam.pdf (last visited Dec. 8, 2018) (surveying right to counsel in American guardianship statutes); cf. *In re Zhuo*, 42 N.Y.S.3d 530 (Sur. Ct. 2016) (holding that incapable individuals have a constitutional right to counsel in guardianship proceedings).

guardians from making large gifts without prior judicial approval.¹³³ (Section II.A.2 below will discuss the shortcomings of the mechanism for obtaining prior judicial approval.) Modern power of attorney statutes also deny agents a general power to make large gifts without an express provision in the power of attorney.¹³⁴

2. Alternative Ways to Authorize Departures from Fiduciary Law

There are two alternative ways to authorize departures from strict fiduciary law, but neither is a substitute for a private individual's power of authorization. First, as Section II.C below will explain in detail, judicial approval may legitimize a potential breach.¹³⁵ A problem with the judicial approval mechanism is the cost of going to court. Modern statutes also typically require *prior* judicial approval to legitimize conflicted transactions.¹³⁶ Relative- and friend-guardians and agents (and other non-professionals) are usually not familiar with the requirement of judicial scrutiny, let alone the importance of timing.¹³⁷

Second, the instrument underlying the guardianship or agency relationship may authorize departures from strict fiduciary law. In the case of agency, the principal may authorize departures in the power of attorney before she becomes mentally incapable. Similarly, in the case of guardianship the court that appoints the guardian may authorize departures in the order of appointment.¹³⁸ However, the instrument underlying the guardianship or agency relationship

133. See, e.g., UNIF. PROBATE CODE §§ 5-411(a)(1), 5-427(b) (UNIF. LAW COMM'N amended 2010); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 414(a)(1) (UNIF. LAW COMM'N 2017).

134. See, e.g., UNIF. POWER OF ATTORNEY ACT § 217 (UNIF. LAW COMM'N 2006); RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS § 8.1 cmt. 1 (AM. LAW. INST. 2003) (an agent cannot make gifts unless expressly or implicitly authorized by power of attorney).

135. See, e.g., UNIF. PROBATE CODE § 5-411(a) (UNIF. LAW COMM'N amended 2010); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 425 (UNIF. LAW COMM'N 2017); RESTATEMENT (THIRD) OF TRUSTS § 11 cmt. f, note to cmt. f re: subsec. (5) (AM. LAW. INST. 2003); Samuel L. Bray, *Fiduciary Remedies*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW, *supra* note 24, at 460 (discussing an equity court's "supervisory jurisdiction" to give instructions to trustees on the legitimacy of doubtful transactions).

136. See, e.g., UNIF. PROBATE CODE § 5-411(a) (UNIF. LAW COMM'N amended 2010); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 425 (UNIF. LAW COMM'N 2017); Kohn, *supra* note 24, at 257. *But see* DeWald v. Morris, 397 S.W.2d 738, 742-43 (Mo. Ct. App. 1965) (a guardian's failure to seek prior judicial approval of a conflict of interest payment does not "militate against the propriety" of the payment, but exposes her to the risk of having the payment invalidated *ex post facto*).

137. See Langbein, *supra* note 2, at 984-85. See, e.g., Johnson v. Puchalski (*In re* Estate of O'Hare), 34 N.E.3d 1126, 1128-29 (Ill. App. Ct. 2015) (lay guardian of her incapable daughter failing to seek prior judicial approval of conflict of interest payments to herself and her family).

138. See *supra* note 108 and accompanying text.

tends to be incomplete. As the relational contracts literature has recognized,¹³⁹ the drafter of a document to govern a long-term relationship is typically unable to foresee all future contingencies; the cost of accounting for every foreseeable contingency is also prohibitively high. The resulting incomplete document then fails to respond to unforeseen or unaccounted for contingencies when they arise. This observation squarely applies to guardianships and agency relationships. Today elderly incapable individuals have high life expectancy and tend to need years of assistance.¹⁴⁰ In the case of guardianship, it would be unrealistic and too costly for the court to decide in advance the desirability of departures from strict fiduciary law in all contingencies. For the same reason, powers of attorney drafted before the onset of mental or physical decline typically cannot consider in advance the desirability of all future departures from strict fiduciary law.

B. Mandatory Prohibition of Conflict of Interest in Close Families and Personal Relationships

Section II.A shows that when applied to guardians and agents who serve mentally incapable individuals, fiduciary law practically operates as mandatory law rather than default law. In this light, the following will argue that mandatory application of the sole-interest duty of loyalty usually does little to align incentives and can become a genuine obstacle to welfare enhancement.¹⁴¹

A preliminary observation is that fiduciary law—either the orthodox form or the relaxed form—does not formally recognize that there is a spectrum of guardians and agents. These fiduciaries differ in their relationship with the elderly incapable individual and in the degree of sophistication of that

139. See, e.g., Victor P. Goldberg, *Regulation and Administered Contracts*, 7 BELL J. ECON. 426, 432–33, 439–40 (1976); Goetz & Scott, *supra* note 90, at 1089; Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691 (1986); Oliver Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. POL. ECON. 1119 (1990). Cf. e.g. Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963) (alternative, norms-based approach to relational contracts); IAN R. MACNEIL, *THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS* (1980) (same).

140. See NAT'L ALL. FOR CAREGIVING & AARP PUB. POLICY INST., *supra* note 127, at 20–22.

141. Welfare enhancement is consistent with the pursuit of personal autonomy, which has emerged as one of the underlying policies of modern disability law in the United States. See, e.g., UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 302 cmt. (UNIF. LAW COMM'N 2017). There is also an international movement to make disability law more respectful of autonomy. See generally Convention on the Rights of Persons with Disabilities, *opened for signature* December 13, 2006, 2515 U.N.T.S. 3; Eilíonóir Flynn & Anna Arstein-Kerslake, *The Support Model of Legal Capacity: Fact, Fiction, or Fantasy?*, 32 BERKELEY J. INT'L L. 124 (2014); Michael L. Perlin, "Striking for the Guardians and Protectors of the Mind": *The Convention on the Rights of Persons with Mental Disabilities and the Future of Guardianship Law*, 117 PA. ST. L. REV. 1159 (2013). In the language of economic theory, to the extent possible modern disability law seeks to advance the welfare of the incapable individual as evaluated by her choices. See generally *infra* Section III.A.

relationship. The available empirical evidence suggests that most guardians and agents are laypersons who are closely related to, or friends with, the incapable individual.¹⁴² In particular, courts prefer to appoint the individual's spouse or adult child as guardian unless large and complex property is involved.¹⁴³ While close relatives and friends constitute one extreme of the spectrum, the other extreme comprises of private professionals who charge fees for their services. These professionals are typically lawyers, financial advisers, mental health professionals, or institutions.¹⁴⁴ Across the spectrum are sophisticated relatives and friends,¹⁴⁵ and publicly funded professionals.¹⁴⁶ To highlight the inflexibility of orthodox fiduciary law, the following will compare and contrast how it regulates the two extremes of the spectrum: close relatives and friends versus fee-earning professionals.

1. Ubiquity of Conflicts

Conflicts of interest are ubiquitous in close families and personal relationships.¹⁴⁷ Relative and friend guardians and agents can have conflicts arising from psychological involvement with the incapable individual and financial interests in her property, for example, shared residence, joint ownership, or inheritance expectations.¹⁴⁸ The following will argue that mandating avoidance of conflicts in close families and personal relationships can narrow the pool of candidates who can provide safe and reliable fiduciary

142. Surveys typically reveal that roughly three-quarters of all guardians are relatives or friends of incapable individuals. *See, e.g.*, ADMIN. CONF. U.S., *supra* note 42, at 16; Callahan, Romanick & Ghesquiere, *supra* note 33, at 85; Lawrence K. Marks, *Court-Appointed Fiduciaries: New York's Efforts to Reform a Widely-Criticized Process*, 77 ST. JOHN'S L. REV. 29, 33 (2003); SHEILA BIRNBAUM ET AL., REPORT OF THE COMMISSION ON FIDUCIARY APPOINTMENTS 9 (2005), <https://www.nycourts.gov/reports/fiduciary-2005.pdf>; *see also supra* note 96 (agents are mostly relatives of their incapable principals).

143. *See, e.g.*, Barnes, *supra* note 40, at 24.

144. *See* Barnes, *supra* note 43, at 943.

145. *See, e.g.*, Black v. Black, 422 P.3d 592, 597 (Colo. App. 2018) (a family guardian—"a tenured law professor who has written on the subject of corporate directors' fiduciary duties"—got prior approval to make conflicted transactions to benefit himself and his children, but was later held in breach of fiduciary duty for failing to disclose his conflicts to the court).

146. *See, e.g.*, ADMIN. CONF. U.S., *supra* note 42, at 16.

147. This Article uses "close family" as a shorthand for a familial relationship that satisfies the "core qualities [of] . . . a demonstrated, long-term commitment and the assumption of mutual care and financial responsibility . . ." *See* Elizabeth S. Scott & Robert E. Scott, *From Contract to Status: Collaboration and the Evolution of Novel Family Relationships*, 115 COLUM. L. REV. 293, 306 (2015); *see generally id.* at 305 (explaining the key attributes of a contemporary family that is based on adult relationships). Rather than based on biological relationship, *see id.* at 305, a close family is a family of "affection and dependence." LAWRENCE M. FRIEDMAN, *DEAD HANDS: A SOCIAL HISTORY OF WILLS, TRUSTS, AND INHERITANCE LAW* 11 (2009).

148. *See* UNIF. POWER OF ATTORNEY ACT § 114 cmt. (UNIF. LAW COMM'N 2006); APPELBAUM & GUTHEIL, *supra* note 9, at 205; Barnes, *supra* note 43, at 956–57.

services to incapable individuals. This is particularly problematic given the current shortage of elder caregivers.¹⁴⁹

It may be instructive to consider first the pool of professional fiduciaries who may provide property-management services to elderly incapable individuals. In relation to the law governing financial fiduciaries, Professors Hanoach Dagan and Sharon Hannes argued that rigorous legal regulation makes it safe and reliable to delegate decision-making authority to professionals who have superior knowledge, skills, and experience.¹⁵⁰ Their argument can be extended to professional guardians and agents, who tend to have acquired specialist knowledge and skills through training and repeated dealings with many incapable individuals.¹⁵¹ The prophylactic nature of orthodox fiduciary law makes it safe and reliable to delegate authority to these professionals. Thus, orthodox fiduciary law expands the pool of safe and reliable candidates to include professionals with superior knowledge, skills, and experience. Incapable individuals can then benefit from the safe and reliable provision of specialist services.

By comparison, when applied to close relatives and friends with mandatory force, orthodox fiduciary law can *narrow* the pool of safe and reliable candidates for fiduciary appointment. Unlike professionals, close relatives and friends have acquired their specialist knowledge, skills, and experience from having an intimate relationship with the incapable individual and being empathetic of the individual's will and preferences. Compared to professionals, close relatives and friends are far more likely to have conflicts of interest.¹⁵² Compliance with the sole-interest duty of loyalty would require the close relative or friend to remove her conflicts. The costs of doing so can deter her from taking on the fiduciary office. Thus, onerous fiduciary duties can narrow the pool of safe and reliable,¹⁵³ but nonprofessional, candidates for fiduciary appointment.

In re Estate of O'Hare illustrates this point.¹⁵⁴ Recall that the mother-guardian in that case—Virginia—kept poor records and did not seek prior

149. See, e.g., Barnes, *supra* note 43, at 947; Clare Ansberry, *America Is Running Out of Family Caregivers, Just When It Needs Them Most*, WALL ST. J. (Jul. 20, 2018, 10:32 AM), <https://www.wsj.com/articles/america-is-running-out-of-family-caregivers-just-when-it-needs-them-most-1532094538>.

150. See Dagan & Hannes, *supra* note 63, at 105. These authors argued that expanding the pool of safe and reliable candidates for fiduciary appointment advances autonomy. *Id.* at 93.

151. See Barnes, *supra* note 43, at 954–55. Cf. APPELBAUM & GUTHEIL, *supra* note 9, at 188 (due to the tendency to standardize or bureaucratize, institutional fiduciaries can fail to cater to incapable individuals with special needs).

152. See Perlin, *supra* note 141, at 1181; Barnes, *supra* note 43, at 956–57; APPELBAUM & GUTHEIL, *supra* note 9, at 205–06.

153. See generally *infra* Section II.B.2 (discussing the extralegal mechanisms that deter misconduct in close families and personal relationships).

154. See *Johnson v. Puchalski (In re Estate of O'Hare)*, 34 N.E.3d 1126, 1130–31 (Ill. App. Ct. 2015).

judicial approval for using her incapable daughter Sarah's funds to benefit the whole family. Holding Virginia liable for breaching the sole-interest duty, the Illinois court removed her from her office as Sarah's guardian. This was notwithstanding her good intentions and the "excellent care" that she had provided to Sarah. As a result, Sarah, whose own attitude toward her mother's behaviors was not apparent on the report of the case, had to incur the costs of replacing her mother with a public guardian.¹⁵⁵ Moreover, this outcome could discourage Sarah's other close family members from taking on the guardianship role.

Another illustrative case is *Moore v. Self*.¹⁵⁶ In that case, an elderly woman—Catherine—acquired accounts and real property as joint tenants with her daughter, Nancy, with rights of survivorship. Catherine subsequently became mentally incapable, and Nancy applied for and accepted appointment as Catherine's guardian. After Catherine passed away, her sons sued Nancy to recover the jointly-held properties to Catherine's estate.¹⁵⁷ There was no allegation or evidence of any actual wrongdoing by Nancy. Nancy did *not* attempt to preserve the value of the jointly-held properties to benefit her individual survivorship rights; she even placed a small proportion of the jointly-held accounts in Catherine's own account.¹⁵⁸ Yet the Georgia court ruled in favor of the sons. Holding Nancy in breach of the sole-interest duty of loyalty, the court took the view that if Nancy "intended to claim title to the jointly held accounts and real property as the survivor after her mother's death, she should not have applied for and accepted the guardianship."¹⁵⁹ Given the ubiquity of joint property ownership in close families, the court's ruling could dissuade close relatives and friends from seeking and accepting fiduciary appointment.

2. Intrinsic Bonds and Social Norms

In a close familial or personal relationship, financial conflicts do not necessarily lead to significant misalignment of incentives, nor do they usually warrant extensive legal regulation. In respect of the parent-minor child relationship, Professors Elizabeth Scott and Robert Scott argued that the biological and affective bonds among the members of a close family, together with social and moral norms, have a dominating effect in aligning incentives.¹⁶⁰ These incentive-alignment effects explain the law's preference for engaging

155. *See id.* at 1129–31.

156. *See Moore v. Self*, 473 S.E.2d 507 (Ga. Ct. App. 1996).

157. *See id.* at 508.

158. *See id.* at 509–10. *See generally infra* paragraph accompanying notes 239–41 (discussing potential misuse of jointly-held properties).

159. *Moore*, 473 S.E.2d at 510.

160. *See Scott & Scott, supra* note 38, at 2430, 2433. Law and economics literature often denotes "bonding" as a device that functions to align incentives. *See, e.g., id.* at 2403. To avoid confusion with "bonds" in the insurance sense, *see generally infra* Section IV.C. This Article uses "incentive-alignment" to denote what these authors meant by "bonding."

close family members as fiduciaries.¹⁶¹ By comparison, extralegal mechanisms are less effective in aligning incentives in cases involving estranged families.¹⁶² The extent of formal legal regulation of a parent-minor child relationship should depend on the strength of extralegal mechanisms.¹⁶³

Extralegal mechanisms can also align incentives when a close relative or friend serves as guardian or agent to an elderly incapable individual.¹⁶⁴ The individual's spouse/partner or adult child is typically the preferred guardian or agent.¹⁶⁵ Close relatives and friends tend to serve as guardian or agent on an unpaid basis.¹⁶⁶ This tendency is consistent with the available evidence on unpaid caregivers, which reveals the critical role of intrinsic bonds and informal norms in close families. A recent empirical study estimates that about 34.2 million Americans provide unpaid care to an adult, with nearly half of the care-recipients being seventy-five years or older.¹⁶⁷ Caregivers typically provide four years of unpaid care to an aged parent or a spouse/partner. Caregiving is burdensome and time consuming; it generally takes 24.4 hours per week on average and increases to 44.6 hours per week on average when the care-recipient is a spouse/partner.¹⁶⁸ Yet orthodox fiduciary law cynically ignores the presence of well-intended family fiduciaries that are motivated by biological and affective bonds as well as social and moral norms.

In close families or personal relationships, where intrinsic bonds and informal norms tend to be strong, there is typically no need to impose the sole-interest duty of loyalty. Extralegal mechanisms can more cost-effectively align the guardian's or agent's incentives with the incapable individual's. In the language of economic theory, the fiduciary exploits the moral hazard problem to the extent that her incentives are misaligned with the beneficiary's. When intrinsic motivations and informal norms become more effective in aligning

161. See Scott & Scott, *supra* note 38, at 2426.

162. See *id.* at 2442–51.

163. See *id.* at 2452.

164. See generally Elizabeth S. Scott & Ben Chen, *Fiduciary Principles in Family Law*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW, *supra* note 24, at ch. 12.

165. See, e.g., UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 410 (UNIF. LAW COMM'N 2017); UNIF. PROBATE CODE § 5-413(a) (UNIF. LAW COMM'N amended 2010); Kohn, *supra* note 7, at 2–3.

166. See, e.g., RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS § 8.3 cmt. g (AM. LAW INST. 2003).

167. NATIONAL ALL. FOR CAREGIVING & AARP PUB. POLICY INST., *supra* note 127, at 15, 17–18.

168. *Id.* at 20–21, 33–34. To provide care, family caregivers often have to reduce their own work hours, sacrifice their own careers, or tap into their own retirement savings. See generally U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-19-382, RETIREMENT SECURITY: SOME PARENTAL AND SPOUSAL CAREGIVERS FACE FINANCIAL RISKS 23–25 (2019).

incentives, the fiduciary becomes less likely to exploit her discretion.¹⁶⁹ This then diminishes the need for incentive-alignment by strict legal regulation.¹⁷⁰

To be sure, courts can strictly enforce the sole-interest duty of loyalty, and reward the errant guardian or agent with remuneration commensurate with her services.¹⁷¹ For example, in *In re Estate of O'Hare*, the mother-guardian was allowed to keep some of her caregiver's salary notwithstanding her breach of the sole-interest duty of loyalty.¹⁷² However, monetary remuneration can have complex effects in close familial and personal relationships. While monetary remuneration can generate incentives to provide fiduciary services, it can also "crowd out" intrinsic motivations.¹⁷³ Tying monetary remuneration to fiduciary service can commodify the underlying familial or personal relationship.¹⁷⁴ Relatives and friends who request remuneration also risk signaling that they are driven by money rather than intrinsic bonds and moral norms.¹⁷⁵ An additional complication is the risk of signaling distrust of the relative or friend;¹⁷⁶ the signal may be that the court or the incapable individual believes the relative or

169. Strong other-regarding preferences, especially reciprocity, fairness, and inequality aversion, can also align incentives. *See infra* Section II.B.3; *see, e.g.*, Florian Englmaier & Stephen Leider, *Contractual and Organizational Structure with Reciprocal Agents*, 4 AM. ECON. J. MICROECON. 146, 171 (2012); Hideshi Itoh, *Moral Hazard and Other-Regarding Preferences*, 55 JAPANESE ECON. REV. 18 (2004).

170. The incentive-alignment effects of intrinsic bonds and social norms in the relationship between the guardian (or agent) and the incapable individual depend little on the guardian's (or the agent's) relationship with another person. This clarification matters because many disputed cases concern someone *other than* the elderly incapable individual bringing claims against the guardian (or agent). *See generally* Barnes, *supra* note 40, at 17–18. The active litigants are often related to the elderly incapable individual, for example, her children from different marriages. *See, e.g.*, *Hanson v. Peck (In re Conservatorship of Hanson)*, 682 N.W.2d 207 (Neb. 2004). The relationship between the claimant and the guardian (or agent) is typically acrimonious. However, it is the characteristics of the guardian's (or agent's) relationship with the incapable individual, not with the claimant, that matter for aligning incentives. Thus, the fact that the disputed cases often involve litigants who are related does not weaken the argument that strong intrinsic bonds and social norms can align incentives in the relationship between the guardian (or agent) and the incapable individual.

171. *See generally infra* Section IV.D.

172. *See Johnson v. Puchalski (In re Estate of O'Hare)*, 34 N.E.3d 1126, 1129–30 (Ill. App. Ct. 2015).

173. Empirical research shows that the likelihood of such "crowding out" is increased when the monetary remuneration is small relative to the services provided. *See, e.g.*, Uri Gneezy & Aldo Rustichini, *Pay Enough or Don't Pay at All*, 115 Q.J. ECON. 791 (2000).

174. *See generally* Melanie B. Leslie, *Enforcing Family Promises: Reliance, Reciprocity, and Relational Contract*, 77 N.C. L. REV. 551 (1999).

175. *See* Benjamin Ho & David Huffman, *Trust and the Law*, in RESEARCH HANDBOOK ON BEHAVIORAL LAW AND ECONOMICS 294, 307–08 (Joshua C. Teitelbaum & Kathryn Zeiler eds., 2018) (explaining the likely causes of "crowding out"). *But see* APPELBAUM & GUTHEIL, *supra* note 9, at 206 (remuneration can inculcate seriousness and responsibility to a lay fiduciary and reduce her emotional conflicts).

176. *See, e.g.*, Roland Bénabou & Jean Tirole, *Intrinsic and Extrinsic Motivation*, 70 REV. ECON. STUD. 489, 492 (2003).

friend would shirk her responsibilities without monetary reward. Moreover, services provided in a familial or personal relationship—which is largely private—can be hard to describe and document;¹⁷⁷ insufficient records can stand in the way of a request for remuneration.¹⁷⁸

However, in cases concerning professional guardians and agents, extralegal mechanisms are unlikely to be strong enough to justify weakened formal regulation. While professionals may be constrained by social and moral norms, they tend not to be constrained by biological and affective bonds. Moreover, professionals serve a multitude of incapable individuals; rather than becoming intimate with and empathetic for a specific incapable individual, professionals have the incentive to develop transferable skills and expertise.¹⁷⁹ In particular, institutional guardians often standardize and bureaucratize, especially when under budgetary pressures.¹⁸⁰ These tendencies can weaken any intrinsic bonds between a professional and each incapable individual she serves.

The author does not suggest that formal legal regulation is completely unnecessary when a close relative or friend serves as guardian or agent to an elderly incapable individual. Intrinsic bonds and informal norms can be strong in these relationships, but not as strong as in a close parent-minor child relationship.¹⁸¹ Moreover, the incentive-alignment effects of intrinsic bonds can be asymmetric. For example, a parent's affection for her child can be stronger than the child's affection for the parent. Thus, as Professor Elizabeth Scott and the author recently argued, the strength and direction of affective bonds and informal norms can explain the contrast between American law's deference to parents who take care of minor children, and its imposition of formal fiduciary duties on adult children who serve as guardians to their elderly parents.¹⁸² Hence, I do not argue for the complete removal of guardians' and agents' formal fiduciary duties; I argue that the rigor of these duties ought to depend on the strength of intrinsic bonds and informal norms in typical cases.

3. Other-Regarding Preferences

Experimental research in psychology and behavioral economics shows that individual preferences are often other-regarding, rather than purely self-regarding. Other-regarding preferences can take various forms. One form is altruism, and other forms include preferences for *reciprocity fairness*—

177. See Scott & Emery, *supra* note 117, at 74.

178. See, e.g., Johnson v. Puchalski (*In re Estate of O'Hare*), 34 N.E.3d 1126, 1129–30 (Ill. App. Ct. 2015).

179. See Barnes, *supra* note 43, at 954–55; Linda S. Whitton & Lawrence A. Frolik, *Surrogate Decision-Making Standards for Guardians: Theory and Reality*, 2012 UTAH L. REV. 1491, 1508.

180. See APPELBAUM & GUTHEIL, *supra* note 9, at 188.

181. See generally Scott & Scott, *supra* note 38, at 2430, 2433.

182. See generally Scott & Chen, *supra* note 164.

returning kindness for another's kindness but also unkindness for another's unkindness—and *inequality aversion*—deriving value from comparing oneself with another person.¹⁸³ In close families and personal relationships, strong other-regarding preferences can manifest in gift-giving norms and property-sharing arrangements. For instance, gift-giving is often reciprocated in long-term relationships.¹⁸⁴

While the subsequent arguments do not depend on which exact form of other-regarding preferences is involved, reciprocity fairness stands out as particularly relevant. A recent survey reveals that almost half of unpaid caregivers take care of their aged parents, with spouses/partners being the next largest category of care-recipients.¹⁸⁵ Adult children and spouses/partners are also the most common categories of guardians and agents.¹⁸⁶ Reciprocity fairness can partially explain what motivates adult children to take care of their aged parents; a child receives care from her parents in her adolescence, and she later returns the favor in her parents' old age. Similarly, couples who receive unpaid care from each other may well reciprocate in their old age.

In cases where other-regarding preferences are strong, mandatory application of the sole-interest duty of loyalty tends to harm welfare. Strict enforcement of the sole-interest duty typically leads to a one-sided distribution of welfare gains—in favor of the incapable individual and no one else.¹⁸⁷ This remains the case even in the absence of harm to the incapable individual. A one-sided distribution is far from optimal if the incapable individual has strong other-regarding preferences. Such one-sidedness is particularly stark in cases concerning close relatives and friends, because they usually do not receive remuneration for providing fiduciary services (especially when the incapable individual's estate is small).¹⁸⁸ This is in contrast to cases involving professional guardians and agents who charge fees for their services.¹⁸⁹

183. See, e.g., Ernst Fehr & Klaus M. Schmidt, *A Theory of Fairness, Competition, and Cooperation*, 114 Q.J. ECON. 817 (1999); Gary E. Bolton & Axel Ockenfels, *ERC: A Theory of Equity, Reciprocity, and Competition*, 90 AM. ECON. REV. 166 (2000); Gary Charness & Matthew Rabin, *Understanding Social Preferences with Simple Tests*, 117 Q.J. ECON. 817 (2002); see generally SANJIT DHAMI, *THE FOUNDATIONS OF BEHAVIORAL ECONOMIC ANALYSIS* chs. 5.2, 5.3, 6.7 (2016) (surveying experimental research on other-regarding preferences); see also *id.* ch. 5.5 (discussing external validity of experimental research); Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641, 1646, 1685–90 (2003) (preferences for reciprocal fairness provide a source of self-enforcement in deliberately incomplete contracts).

184. See generally Leslie, *supra* note 174, at 564–78.

185. NAT'L ALL. FOR CAREGIVING & AARP PUB. POLICY INST., *supra* note 127, at 20. See also *id.* at 21 (“As caregiver age rises, it is more likely they care for their spouse.”).

186. See Callahan, Romanick & Ghesquiere, *supra* note 33, at 85; see also *supra* note 142.

187. For instance, in the numerical example discussed in Section I.E, strict enforcement of the sole-interest duty gives all of the welfare gain of \$70 to the beneficiary and none of it to the errant fiduciary.

188. See Barnes, *supra* note 43, at 954.

189. See *id.* at 943–44, 949–50.

Moreover, providing services to the incapable individual can generate high opportunity costs; the guardian or agent becomes less available to generate income to herself.¹⁹⁰ The sole-interest duty thus forces the incapable individual to be selfish; her welfare is harmed whenever she has other-regarding preferences.

An illustrative case is *In re Conservatorship of Hanson*,¹⁹¹ in which a married couple formed an agreement years before the husband became the subject of a guardianship. Pursuant to the agreement, Mr. Hanson regularly paid Mrs. Hanson for the added expense of his living in her home. After her appointment as guardian to her husband, Mrs. Hanson continued to receive payments without prior judicial approval. When Mr. Hanson passed away, his children from his former marriage sought to recover the payments that Mrs. Hanson received during the period of guardianship. The Nebraska court found a breach of the sole-interest duty of loyalty on the basis of self-dealing and disgorged those payments from Mrs. Hanson. This was notwithstanding a lack of sinister motive on her part.¹⁹² The court also deliberately paid no attention to “family financial management in the family’s accustomed manner.”¹⁹³ In the language of economic theory, the strict enforcement of the sole-interest duty harmed Mr. Hanson’s welfare by denying his preferences to benefit his wife.

Another illustrative case is *In re Campione*.¹⁹⁴ This case concerned an elderly incapable woman whose guardian, Carol, was one of her daughters. Carol commingled her own funds with her mother’s funds and purchased property in her own name with her mother’s funds. Because these funds were previously held in trust for her benefit, Carol mistakenly thought they belonged to her. After her mother passed away, some of Carol’s relatives succeeded in their claim to recover the relevant property and guardianship funds from Carol. The court did not enquire into whether Carol’s actions reflected her familial understanding with her mother. It was also unclear whether, if she were mentally capable, the mother would have wanted to share her funds with Carol.¹⁹⁵ What was clear, however, was that Carol would not have been able to enjoy her mother’s funds even if her mother wanted her to.

C. Incentives to “Game the System”

A further reason for regulating professional guardians and agents more strictly than close relatives and friends is to ensure that judicial scrutiny of professional conduct is more rigorous before the fact than after the fact. This Section argues that relaxed fiduciary regulation can blur the distinction between

190. See NAT’L ALL. FOR CAREGIVING & AARP PUB. POLICY INST., *supra* note 127, at 55, 60.

191. See *Hanson v. Peck (In re Conservatorship of Hanson)*, 682 N.W.2d 207 (Neb. 2004).

192. See *id.* at 209–12.

193. *Id.* at 211.

194. See *In re Campione*, 872 N.Y.S.2d 210, 214 (App. Div. 2009).

195. See *id.* at 212–14.

judicial scrutiny before the fact and after the fact, which in turn gives professionals a perverse incentive to avoid judicial scrutiny before the fact.

The distinction between judicial scrutiny of suspicious conduct before the fact and after the fact is critical for the operation of fiduciary law. The discussions so far concern judicial scrutiny after the fact, that is, when the guardian or agent is sued for having committed the suspicious conduct. To minimize the risk of liability after the fact, the guardian or agent can petition the relevant state court for approval before committing the suspicious conduct.¹⁹⁶ To obtain such ex-ante judicial approval, the guardian or agent is typically required to give notice to the incapable individual and any interested parties, and disclose any conflict of interest.¹⁹⁷ This procedure gives the court and any interested parties an opportunity to evaluate the pros and cons of the suspicious conduct.¹⁹⁸ In some cases, independent legal representation can also be afforded to the incapable individual,¹⁹⁹ her own view on the suspicious conduct can be expressed directly or through legal counsel to the extent possible. If properly granted, prior judicial approval protects the guardian or agent from liability for any potential breach of fiduciary duty. However, a failure to comply with the notification and disclosure procedures would withdraw the protection afforded by prior judicial approval.²⁰⁰

The equitable doctrine of substituted judgment (or its statutory adoption) provides the substantive standard for determining whether to grant prior judicial approval. This standard typically requires the court to give effect to what the incapable individual would have wanted if she was capable.²⁰¹ If her wishes are

196. See UNIF. PROBATE CODE § 5-411 (UNIF. LAW COMM'N amended 2010); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 414 (UNIF. LAW COMM'N 2017). An agent can invoke the procedure to obtain prior judicial approval by petitioning for the appointment of a guardian (such as herself). For example, when a bank or financial institution doubts an agent's instruction regarding the property of her incapable principal, the agent is often asked to initiate a guardianship proceeding. See, e.g., Whitton, *supra* note 7, at 38-39. The agent can then ask the court to scrutinize and approve the relevant transaction.

197. See, e.g., UNIF. PROBATE CODE § 5-411(a) (UNIF. LAW COMM'N amended 2010); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 414(a) (UNIF. LAW COMM'N 2017).

198. See *In re Castner*, 661 A.2d 344, 348 (N.J. Super. Ct. Law Div. 1995).

199. See, e.g., *In re Keri*, 853 A.2d 909 (N.J. 2004). See generally Am. Bar Ass'n Comm'n on Law & Aging, *supra* note 132 (surveying right to counsel in American guardianship statutes).

200. See, e.g., *In re Guardianship and Conservatorship of Jordan*, 616 N.W.2d 553, 558-61 (Iowa 2000) (guardian held in breach of the rule against self-dealing for selling his elderly incapable mother's property to his shell company with prior judicial approval obtained without complying with the requirement to give notice); *Black v. Black*, 422 P.3d 592 (Colo. App. 2018) (guardian held in breach of fiduciary duty for engaging in conflicted transactions with prior judicial approval obtained without disclosing his conflicts).

201. See, e.g., UNIF. POWER OF ATT'Y ACT § 217 (c) cmt. subsec. (c) (UNIF. LAW COMM'N 2006) (gifting by agent); UNIF. PROBATE CODE §§ 5-411(a), 5-411 (c), 5-427(b) (UNIF. LAW COMM'N amended 2010) (gifting by guardian); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 414 (c) (UNIF. LAW COMM'N 2017); N.Y. MENT. HYG.

not known, or if giving effect to her wishes would unreasonably harm or endanger her, then the court applies the best-interest standard.²⁰² In particular, the court can pre-approve transactions tainted with a conflict of interest, especially if there is evidence showing that such approval would carry out the incapable individual's wishes.²⁰³

In respect of professional guardians and agents, the availability of prior judicial scrutiny weakens the case for relaxed judicial scrutiny after the fact.²⁰⁴ An examination of proposals to replace the sole-interest duty of loyalty with the best-interest duty can illustrate this point.²⁰⁵ If the best-interest standard governs judicial scrutiny after the fact, then the distinction between judicial scrutiny before the fact and after the fact essentially disappears; both the substantive and procedural aspects of ex-ante and ex-post judicial scrutiny become very similar, if not identical. This implies that a given suspicious conduct has roughly the same chance of passing judicial scrutiny before the fact and after the fact. As a result, sophisticated guardians and agents are encouraged to avoid ex-ante scrutiny of suspicious conduct, and "chance it" if, and when, they get sued.²⁰⁶

A numerical hypothetical can illustrate what may happen if the distinction between judicial scrutiny before the fact and after the fact is blurred. Suppose a sophisticated professional guardian has an opportunity to take an action that allows her to gain \$50 but harms the incapable individual by \$100. Monitoring and detection of misconduct are far from perfect,²⁰⁷ so that with 50% probability, the guardian can take the action without getting sued later. The incapable individual's own wishes are not known in this case, so judicial scrutiny of the action can only be done in the light of evidential uncertainty regarding the harm done to her; the court would never know for sure whether the action is truly harmful. Due to such evidential uncertainty, an application of the best-interest standard would approve the action with 60% probability and

LAW § 81.21 (McKinney 2015); RESTATEMENT (THIRD) OF TRUSTS § 11 cmt. f, note to cmt. f re: subsec. (5) (AM. LAW INST. 2003).

202. See UNIF. PROBATE CODE §§ 5-314 (a), 5-418 (b) (UNIF. LAW COMM'N amended 2010); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 418 (c) (UNIF. LAW COMM'N 2017); see generally Frolik & Whitton, *The UPC Substituted Judgment*, *supra* note 101, at 742–43 (surveying financial decision-making standards in American guardianship statutes). See, e.g., *In re Tinsmon*, 79 N.Y.S.3d 854 (Sur. Ct. 2018) (granting prior approval to gifts to the incapable individual's children, upon taking into account his intention to do so before becoming incapable).

203. See Kohn, *supra* note 24, at 257.

204. However, prior judicial scrutiny is not a substitute for a private individual's power of authorization. See *supra* Section II.A. Hence the availability of prior judicial scrutiny does not weaken the case for applying the sole-interest duty of loyalty to scrutinize suspicious conduct after the fact.

205. See generally *supra* Section I.D.

206. See Conaglen, *supra* note 110, at 576.

207. See *supra* Section I.B.2.

prohibit it with 40% probability.²⁰⁸ These probabilities are the same whether judicial scrutiny is undertaken before the fact or after the fact.

In this hypothetical, given some technical assumptions to simplify analysis,²⁰⁹ the professional guardian's expected gain for seeking prior judicial scrutiny is $\$50 \times 60\% + \$0 \times 40\% = \$30$. On the other hand, if she chances it by taking the action without prior scrutiny, then her expected gain is $\$50 \times 50\% + (\$50 \times 60\% + \$0 \times 40\%) \times 50\% = \40 . She is better off taking the action and risking judicial scrutiny after the fact than inviting judicial scrutiny before the fact. Thus, the professional guardian has the incentive to take the action and risk judicial scrutiny after the fact.

The above result critically depends on two factors: that the professional guardian enjoys a positive probability of taking the action without getting sued, and that the action has the same chance of surviving judicial scrutiny before the fact and after the fact. While the real world is obviously more complex, the above numerical hypothetical illustrates a broader problem that arises from assimilating the standards for judicial scrutiny of fiduciary conduct before the fact and after the fact. The problem is that sophisticated guardians and agents can be encouraged to "game the system" when they have a good chance of evading judicial scrutiny completely and a similarly rigorous standard of scrutiny applies in the event that they get sued.

The "gaming-the-system" problem primarily affects cases concerning professional guardians and agents, because they tend to be sophisticated and well-informed about the law. By comparison, lay relatives and friends are unlikely to be aware of, and exploit, the similarities and differences between ex-ante and ex-post scrutiny. Moreover, professionals tend to be able to spread the risk and cost of liability across the multitude of incapable individuals they serve. Hence, compared to relatives and friends, professionals tend to have bigger risk-appetites for committing suspicious conduct without seeking prior scrutiny.

D. Summary

This Part has argued that fiduciary law practically applies by mandatory force to guardians and agents; mentally-incapable individuals usually cannot authorize departures from adherence to strict fiduciary duty. Unable to be modified, fiduciary law—both the orthodox form and the relaxed form—can be detrimental to welfare. Orthodox fiduciary law tends to harm welfare in cases where the guardian or agent is a close relative or friend of the incapable individual. These cases tend to exhibit strong intrinsic bonds and informal

208. If the sole-interest duty of loyalty is applied, then the action would be prohibited with 100% probability due to the guardian's personal benefit. *See supra* Section I.C.

209. Assume that the guardian is risk-neutral, would have no incentives to take the relevant action if it was prohibited by the court before the fact, and would be liable to disgorge her personal benefit if she was sued and found in breach. Another assumption is that she pays the same legal costs for seeking prior judicial approval as for litigating a breach-of-fiduciary duty claim after the fact.

norms, as well as other-regarding preferences. In these cases, mandatory application of the sole-interest duty of loyalty adds little in terms of incentive alignment, but can discourage the guardian or agent from supporting the incapable individual to pursue valuable other-regarding goals and preferences. Moreover, given the ubiquity of conflicts of interest in close families and personal relationships, strict enforcement of the sole-interest duty can discourage relatives and friends from seeking and accepting fiduciary appointment to provide valuable services.

On the other hand, strict fiduciary regulation remains justified in cases concerning professional guardians and agents. In these cases, intrinsic bonds and other-regarding preferences are unlikely to be strong. Professionals also tend to be sophisticated and well-informed of the law; they can take advantage of the mechanism for obtaining ex-ante judicial authorization of suspicious conduct. Moreover, relaxed fiduciary regulation can give professionals perverse incentives to “game the system”; reducing the rigor of judicial scrutiny of suspicious conduct after the fact can discourage professionals from seeking judicial authorization before the fact.

III. INTRODUCING A SUBSTITUTED-JUDGMENT DEFENSE

This Part and Part IV below will make reform suggestions to loosen fiduciary regulation of close relatives and friends and tighten fiduciary regulation of professionals. More precisely, this Part will propose to retain the sole-interest duty of loyalty and make available a *substituted-judgment defense* to close relatives and friends who serve as guardians or agents. This defense protects the guardian or agent from liability for exposing herself to a conflict of interest if she can prove that:

(1) the incapable individual would have authorized the conflict if she was mentally-capable and fully-informed; and

(2) mental incapacity was the only reason that prevents the individual from validly authorizing the conflict on her own.²¹⁰

Section III.A below will explain that the proposed defense aims to approximate a valid exercise by the incapable individual of the power to authorize departures from strict fiduciary law. Section III.B will compare the proposed defense with the best-interest standard—the main reform alternative. Section III.C will suggest that fiduciary law should not relax its usual rigor on account of assent to suspicious conduct given after the appointment of guardian or agent.

A. Approximation of the Power to Authorize Departures from Adherence to

210. Mental incapacity is not the only basis for inability to authorize departures from strict fiduciary law. In particular, even mentally-capable individuals cannot authorize a departure from the “mandatory core” of fiduciary law. See *supra* note 112 and accompanying text.

Overbroad Fiduciary Duties

As Part II has shown, by removing a fiduciary's unauthorized profits arising from a conflict of interest, the sole-interests duty of loyalty incentivizes her to seek authorization from her beneficiary. Valid authorization requires the fiduciary to make a fair-and-frank disclosure, so that the beneficiary is fully informed. The combination of the sole-interest duty and the power of authorization thus facilitates agreements to permit the conflict and share the welfare gain arising from it, *assuming* the parties are mentally capable.²¹¹ However, in cases concerning incapable individuals, mental incapacity tends to stultify the power to authorize departures from strict fiduciary law.²¹² The proposed substituted-judgment defense approximates the outcome that arises from a valid exercise of the power of authorization: the guardian or agent is allowed to keep her personal gain in cases where the incapable individual would have authorized the relevant conflict if she was mentally capable and fully informed.

1. Relaxation of Mandatory Fiduciary Law

When made available to close relatives and friends, the proposed substituted-judgment defense prevents the sole-interest duty of loyalty from stultifying the pursuit of other-regarding goals and preferences. A capable individual who wishes to be other-regarding may exercise her power to authorize a conflict of interest; this can facilitate a relatively even distribution of welfare gains between her and her fiduciary (or a third party). The proposed defense performs a similar function for an incapable individual. It does so by allowing the conflicted guardian or agent to defend a distribution of welfare gains that enriches herself (or a third party) to the extent that such distribution would have been authorized by the incapable individual. The proposed defense thus permits the guardian or agent to support the incapable individual to pursue non-selfish goals and preferences.²¹³

The proposed defense also eases the burden of fiduciary regulation on close relatives and friends. Section II.B.1 has argued that compliance with strict fiduciary law can require close relatives and friends to incur the costs of removing conflicts of interest. Such costs can be substantial because conflicts are ubiquitous in close familial and personal relationships. The proposed defense can reduce the costs of removing conflicts; it does so by permitting those conflicts that are consistent with what the incapable individual would have wanted. When the costs of complying with fiduciary law are reduced, close relatives and friends are more likely to take on the fiduciary office.

Moreover, the proposed defense accommodates strong intrinsic bonds and informal norms. Mandatory enforcement of strict fiduciary law ignores the fact

211. *See supra* Section I.E.

212. *See supra* Section II.A.

213. *See generally supra* Section II.B.3.

that these extralegal mechanisms can partially and more cost-effectively align incentives.²¹⁴ Loosening fiduciary regulation of close relatives and friends, the proposed defense thus leaves room for extralegal mechanisms to deter misconduct.

2. Evidence of Subjective Will and Preferences

To ascertain what the incapable individual would have wanted if she was capable, the proposed substitute-judgment defense typically looks to evidence of her past conduct, transacting patterns, and relational norms.²¹⁵ The individual's own choices made in a mentally-capable state are evidence of her subjective will and preferences.²¹⁶ To be sure, breach-of-fiduciary duty claims often concern one-off transactions that the incapable individual may not have had an opportunity to make in the past.²¹⁷ However, most incapable individuals are seniors who have had a lifetime of opportunities to make use of testamentary instruments, such as wills and wish letters.²¹⁸ They also tend to have left behind a "memory trail" of informed opinions and value preferences in the minds of their family and friends.²¹⁹ Moreover, transactions made near the end of an individual's life may be the final manifestation of property-sharing and gift-giving norms within close familial or personal relationships.²²⁰ The substituted-judgment defense directs courts to consider the individual's past relational norms and succession plans, in addition to her past conduct and transacting patterns.

In re the General Power of Attorney of Miller provides an example of how courts should apply the substituted-judgment defense.²²¹ That case concerned Xenia, a wealthy, elderly woman who had a long history of giving to the

214. See generally *supra* Section II.B.2.

215. See, e.g., *In re Brice's Guardianship*, 8 N.W.2d 576, 578 (Iowa 1943).

216. See generally Agnieszka Jaworska, *Advance Directives and Substitute Decision-Making*, STAN. ENCYCLOPEDIA OF PHIL. § 1 (Mar. 24, 2009), <https://plato.stanford.edu/entries/advance-directives>; RONALD DWORKIN, *LIFE'S DOMINION: AN ARGUMENT ABOUT ABORTION, EUTHANASIA, AND INDIVIDUAL FREEDOM* 222–29 (1993) (discussing how the substituted-judgment standard promotes individual autonomy); B. Douglas Bernheim, *Behavioral Welfare Economics*, 7 J. EUR. ECON. ASS'N 267, 290–93 (2009).

217. See, e.g., *Dubree v. Blackwell*, 67 S.W.3d 286 (Tex. App. 2001) (a potentially incapable individual making a one-off transfer of her house to her life-long friend and caretaker).

218. See, e.g., *Miller v. Miller (In re the General Power of Attorney of Miller)*, 935 N.E.2d 729, 733–34 (Ind. Ct. App. 2010).

219. See Terry Carney, *Adult Guardianship and Other Financial Planning Mechanisms for People with Cognitive Impairment in Australia*, in *SPECIAL NEEDS FINANCIAL PLANNING: A COMPARATIVE PERSPECTIVE* 3 (Lusina Ho & Rebecca Lee eds., 2019).

220. See generally Leslie, *supra* note 174, at 564–78; Alexander M. Meiklejohn, *Contractual and Donative Capacity*, 39 CASE W. RES. L. REV. 307, 342, 364–67, 379, 387 (1988) (analyzing contractual capacity cases from the 1960s to 1980s showing that court tended to uphold contracts made in the course of long-term and close relationships).

221. See *In re the General Power of Attorney of Miller*, 935 N.E.2d at 729–46.

community. When she lost mental capacity, one of her children—William—and a close family adviser started managing her property as her agents. The two agents continued to use her money toward philanthropy, and on maintaining a family home to be inherited by William.²²² After Xenia passed away, one of her other children sued the agents for breach of fiduciary duty. The Indiana court applied a substituted-judgment analysis to rule in favor of the agents. In so ruling, the court aimed to uphold Xenia's known wishes as manifested by what she had historically said and done as well as the wish letters that she and her husband wrote to their children.²²³

In re Campione can illustrate how the proposed substituted-judgment defense may operate in marginal cases.²²⁵ Recall that in that case, the court restored to the estate of an elderly incapable woman those guardianship funds that her daughter-guardian—Carol—had commingled and used to benefit herself.²²⁴ Strictly enforcing the sole-interests duty of loyalty, the court did not give significance to the limited and inconclusive evidence of property sharing in that family.²²⁵ The proposed substituted-judgment defense would have incentivized Carol (or her legal representative) to adduce more evidence of her mother's will and preferences before she lost capacity, and would not shield Carol from liability if such evidence were not adduced. The proposed defense would facilitate the pursuit of other-regarding goals and preferences only to the extent supported by evidence.

In cases involving conflicting evidence of what the incapable individual would have wanted if she had capacity,²²⁶ there should be a rebuttable presumption in favor of respecting her testamentary intent expressed in any properly-executed will (or will substitute).²²⁷ The individual must have executed the testamentary instrument when she was mentally-capable.²²⁸ The testamentary instrument also generally needs to comply with formality requirements. For example, an attested will needs to be in writing, signed by the individual and attested by several witnesses.²²⁹ Similarly, a revocable trust of interest in land created in the individual's lifetime—a will substitute—needs

222. *See id.* at 733–36.

223. *See id.* at 739–43.

²²⁵*See In re Campione*, 872 N.Y.S.2d 210, 214 (App. Div. 2009).

224. *See id.* at 212.

225. *See id.* at 214.

226. *See generally* Whitton & Frolik, *supra* note 179, at 1492–93.

227. Will substitutes are transactions to effectuate transfers of wealth at death without going through the formal probate system. *See generally* John H. Langbein, *The Nonprobate Revolution and the Future of the Law of Succession*, 97 HARV. L. REV. 1108 (1984); RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS § 7.1 (AM. LAW INST. 2003).

228. *See generally* RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS § 8.1 (AM. LAW INST. 2003).

229. *See generally id.* § 3.1 (1999). Courts may excuse some harmless errors in executing a will. *See generally id.* § 3.3.

to be in writing and signed by her.²³⁰ Formality requirements function to generate solid evidence of the individual's wishes. Another function is to caution the individual against making ill-considered choices. A further function is to protect the individual from fraud and imposition. Finally, formality requirements perform the channeling function of facilitating standardization, so that testamentary instruments can be distinguished from other expressions of intention.²³¹ Thus, properly-executed testamentary instruments should be afforded special weight in the application of the proposed substituted-judgment defense.

In cases involving insufficient evidence of what the incapable individual would have wanted if she had capacity, the criterion for judicial scrutiny of fiduciary conduct (after the fact) should fall back to the sole-interest duty of loyalty.²³² In these cases, the substituted-judgment standard would provide no practical guidance on what to do.²³³ Moreover, as Section III.A.4 below will explain further, relaxed fiduciary regulation is not justified when evidence of strong intrinsic bonds and other-regarding preferences is absent. Thus, in cases of insufficient evidence, the sole-interest duty should continue to prohibit previously-unauthorized conflicts of interest; a substituted-judgment analysis would be unnecessary and useless in these cases.

3. Doctrinal Support

The proposed substituted-judgment defense has doctrinal support. First, courts already tend to apply the substituted-judgment standard when they scrutinize suspicious fiduciary conduct *before the fact*.²³⁴ This criterion can facilitate ex-ante judicial approval of transactions that benefit the close family members of an incapable individual.²³⁵ With some qualifications to be explained in Section III.B.3 below, the proposed defense largely extends the substituted-judgment standard to govern judicial scrutiny of suspicious conduct *after the fact*. Such extension, in particular, protects those relative and friend guardians and agents who seek legal advice and assistance only after being sued.

Second, courts also sometimes apply a substituted-judgment analysis in cases concerning non-fiduciaries. For example, in *Dubree v. Blackwell*, an

230. See generally RESTATEMENT (THIRD) OF TRUSTS §§ 23, 24 cmt. a (AM. LAW INST. 2003).

231. See generally RESTATEMENT (THIRD) OF PROP.: WILLS AND OTHER DONATIVE TRANSFERS § 3.3 cmt. a (AM. LAW INST. 1999); RESTATEMENT (SECOND) OF CONTRACTS § 72 cmt. c (AM. LAW INST. 1981); Lon L. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799 (1941); John H. Langbein, *Substantial Compliance with the Wills Act*, 88 HARV. L. REV. 489, 492–97 (1975).

232. See also *supra* Section II.C; *infra* Section III.B.3 (discussing the differences between judicial scrutiny before the fact and after the fact).

233. See Whitton & Frolik, *supra* note 179, at 1506.

234. See *supra* note 201 and accompanying text.

235. See Kohn, *supra* note 24, at 257.

elderly woman gifted her house to her lifelong friend and caregiver, and changed her own bank account to a joint account with the friend (with a right of survivorship).²³⁶ After the woman passed away, her nephew—the sole beneficiary of her estate—sought to avoid these transactions on grounds of mental incapacity and undue influence. Medical experts and lay witnesses gave conflicting testimonies on the woman’s mental conditions at the time of transacting.²³⁷ The Texas court upheld these transactions upon taking into account a long history of property sharing between the woman and her friend.²³⁸ Guided by the woman’s past transacting patterns and relational norms that took place when her capacity was not in doubt, the court essentially applied a substituted-judgment analysis.

Moreover, the proposed substituted-judgment defense extends and improves upon several existing exemptions in fiduciary law, most of which protect close relatives and friends.²³⁹ The proposed defense subsumes an existing exception that may permit conflicts pre-dating the creation of the fiduciary relationship. For example, a couple may become joint owners of some property before one of them is appointed guardian to the other. The guardian will inherit the property upon the death of her spouse—the incapable individual. Before the individual passes away, the guardian may be tempted to transfer the jointly-owned property to herself, or to preserve its value by spending the incapable individual’s solely-owned resources. Such conduct is suspicious because, contrary to a prohibition of the sole-interest duty of loyalty, it benefits the guardian or agent. Some courts permit the guardian to benefit from a pre-appointment conflict if the suspicious conduct results in no actual harm to the incapable individual.²⁴⁰ Some other courts disagree, holding the guardian in breach of the sole-interest duty even if she has done no more than merely accept her appointment without renouncing the pre-existing conflict.²⁴¹ The proposed defense sides with those courts that permit pre-appointment, harmless conflicts; such conflicts are consistent with strong intrinsic bonds and other-regarding preferences, which should be respected.

Finally, a court of equity has a discretion to excuse an errant guardian or agent in whole or in part from her liability for a breach of fiduciary duty.²⁴² That

236. See *Dubree v. Blackwell*, 67 S.W.3d 286, 288 (Tex. App. 2001).

237. See *id.* at 290–91.

238. See *id.* at 288.

239. See Langbein, *supra* note 2, at 985.

240. See, e.g., *Fielder v. Howell*, 631 P.2d 249, 250–51 (Kan. Ct. App. 1981); *In re Estate of Ross*, 131 A.3d 158 (R.I. 2016).

241. See, e.g., *Dowdy v. Jordan*, 196 S.E.2d 160 (Ga. Ct. App. 1973); *Moore v. Self*, 473 S.E.2d 507, 509–10 (Ga. Ct. App. 1996); *SunTrust Bank, Middle Ga., Nat’l Ass’n v. Harper*, 551 S.E.2d 419, 426–27 (Ga. Ct. App. 2001).

242. See RESTATEMENT (THIRD) OF TRUSTS § 95 cmt. d (AM. LAW INST. 2012). Modern guardianship and power of attorney statutes typically preserve the principles of equity. See, e.g., UNIF. PROBATE CODE § 1-103 (UNIF. LAW COMM’N amended 2010) (applying trust fiduciary law to guardians); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE

discretion can excuse a breach that the fiduciary has taken to further her beneficiary's interests.²⁴³ In such a case, the proposed defense achieves the same practical outcome as an exercise of judicial discretion to excuse the fiduciary in whole. However, the proposed defense reduces the indeterminacy arising from judicial discretion and relieves the fiduciary of the guilt and moral opprobrium accompanying a finding of disloyalty.

4. Preservation of Existing Protection

Two conditions restrict the availability of the proposed substituted-judgment defense: first, the guardian or agent bears the burden of proving (by the usual civil standard of preponderance of evidence) that the incapable individual would have authorized the suspicious conduct or transaction if she was capable; and second, mental incapacity is the only reason that prevents the individual from making a valid authorization. Failing any of these conditions, the proposed defense does not diminish the usual rigor and breadth of orthodox fiduciary law. Mental incapacity justifies a relaxation of the fiduciary prophylaxis only to the extent of its stultification of a private individual's power to authorize suspicious conduct.²⁴⁴ The following will argue that the two conditions preserve the usual operation of orthodox fiduciary law when mental incapacity does not justify weakened fiduciary regulation.

First, by placing the burden of proof on the guardian or agent, the proposed defense preserves the usual operation of orthodox fiduciary law in cases of insufficient evidence. In these cases, the guardian or agent remains able to seek prior judicial scrutiny according to the best-interest standard;²⁴⁵ substituted judgment is no longer the juridical standard due to evidential deficiency. The process of prior judicial scrutiny may impose significant costs on the guardian or agent, and tends to demand a high degree of sophistication from her. However, these problems also affect fiduciaries who serve mentally-capable individuals. In other words, what really prevents the guardian or agent from seeking judicial authorization is *not* mental incapacity, but is another aspect of fiduciary law that applies equally to capable and incapable individuals. Moreover, it is hard to attribute significance to mental incapacity in the absence of sufficient evidence on what the individual would have wanted if she was capable. Hence, the proposed defense does not interrupt the usual operation of orthodox fiduciary law in cases of insufficient evidence. In particular, the proposed defense does not subvert the fiduciary prophylaxis when there is no evidence of potential displacement of other-regarding preferences.

Second, the "only reason" condition—that the proposed defense protects the guardian or agent only if mental incapacity is what prevents a valid

ARRANGEMENTS ACT § 103 (UNIF. LAW COMM'N 2017); UNIF. POWER OF ATTORNEY ACT § 121 (UNIF. LAW COMM'N 2006).

243. See RESTATEMENT (THIRD) OF TRUSTS § 95 cmt. d (AM. LAW INST. 2012).

244. See *supra* Section II.A.

245. See *supra* note 202 and accompanying text.

authorization by the incapable individual—preserves those restrictions on modification of fiduciary law that give equal protection to capable and incapable individuals. The “only reason” condition is imposed to ensure that any modification of fiduciary law by the proposed defense does *not* go beyond what is necessary to address the special problems arising from mental incapacity. In particular, the “only reason” condition preserves the mandatory core of fiduciary law, because the individual could not modify it even if she were mentally-capable.²⁴⁶ Moreover, in a rare case involving a limited guardianship that does not withhold the individual’s power of authorization,²⁴⁷ the “only reason” condition is not satisfied. Thus, imposition of the “only reason” condition preserves the guardian’s incentives to seek authorization from the individual when she can still validly exercise the power of authorization.

B. Comparison with the Best-Interest Standard

The best-interest standard is the main alternative to the substituted-judgment standard and to the sole-interest duty of loyalty.²⁴⁸ Under this alternative, even without prior authorization, a guardian or an agent can retain some benefit to herself if her conduct advances the best interest of the incapable individual. Empirical research has shown that guardians who apply the best-interest standard often consider the family of the incapable individual.²⁴⁹ The best-interest standard thus relaxes mandatory fiduciary regulation in close families and personal relationships; inevitable conflicts can be accommodated, and intrinsic bonds and other-regarding preferences recognized and respected. This Section argues that the proposed substituted-judgment defense should be preferred to proposals to adopt the best-interest standard.

1. Indeterminacy

The proposal to adopt the substituted-judgment defense leads to a greater degree of determinacy than proposals to introduce the best-interest standard. Under my proposal, in cases involving sufficient evidence of what the incapable individual would have wanted, the proposed substituted-judgment defense requires that her wishes be given effect. By comparison, in addition to factors that are relevant to applying the substituted-judgment standard, the best-interest standard requires consideration of many other factors.²⁵⁰ Thus the best-interest standard can only tend to produce greater indeterminacy and be more informationally demanding to apply. This tendency generates greater decisional costs and error costs than the substituted-judgment standard.

246. See *supra* note 112 and accompanying text.

247. Modern guardianship law encourages the use of limited guardianships that are tailored to the individual’s specific needs, but the available evidence suggests that broad guardianships remain the norm. See *supra* note 40 and accompanying text.

248. See *supra* Section I.D.

249. See Whitton & Frolik, *supra* note 179, at 1532–35.

250. See *supra* notes 88–89 and accompanying text.

Similarly, in cases where evidence of what the incapable individual would have wanted is deficient, my proposal leaves the sole-interest duty of loyalty to guide judicial scrutiny of fiduciary conduct. Courts tend to look for some financial benefit—typically in the form of money or property—to the guardian or agent (or a third party). Such financial benefit is usually observable and verifiable.²⁵¹ By comparison, the best-interest standard requires consideration of a broader range of context-specific factors.²⁵² Thus, given insufficient evidence to apply the substituted-judgment standard, falling back to the sole-interest duty tends to lead to a more predictable outcome than the best-interest standard.²⁵³

2. Room for Paternalism

Another reason for rejecting the best-interest standard is that it leaves more room for paternalism and discrimination than does the substituted-judgment standard. A subjective notion, the substituted-judgment standard permits a conflict of interest if the incapable individual would have authorized it. The best-interest standard, on the other hand, traditionally directs courts to do what is objectively best for a reasonable or rational person in like circumstances.²⁵⁴ The best-interests can be a vehicle for paternalism and discrimination; rather than the incapable individual's wishes, the decisionmaker may act according to her own values, stereotypes or prejudices.²⁵⁵

Cases involving Medicaid or tax planning are illustrative.²⁵⁶ These cases typically involve guardians who seek prior judicial approval to make large gifts of an elderly incapable individual's estate in order to qualify the individual for certain Medicaid or tax benefits. The family members of the individual are typically the intended recipients of such gifts. The practical effect of these gifts is typically to shift the financial burden of caring for the individual from her family to the state. An application of the substituted-judgment standard would allow these gifts to the extent consistent with what the incapable individual would have wanted.²⁵⁷ Courts that apply the best-interest standard, on the other hand, can rule according to their own assumptions regarding whether a

251. What is typically not observable and verifiable is any actual wrongdoing by the guardian or agent. *See generally supra* Sections I.B.2–3.

252. *See supra* notes 88–89 and accompanying text.

253. *See supra* Section I.F.

254. *See generally* text accompanying *supra* notes 88–89; Jaworska, *supra* note 216, § 1; Whitton & Frolik, *supra* note 179, at 1505–17 (discussing and comparing the best-interest standard, the substituted-judgment standard, as well as their expanded and hybrid versions); Frolik & Whitton, *supra* note 101, at 751–57.

255. *See, e.g.*, Duncan Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563, 633, 641–44 (1982); Linda S. Whitton, *Ageism: Paternalism and Prejudice*, 46 DEPAUL L. REV. 453, 480, 482 (1997).

256. *See generally* Frolik, *supra* note 53, at 65–85.

257. *See, e.g.*, *In re M.L.*, 879 N.Y.S.2d 919, 920–21, 923 (Sup. Ct. Bronx Cty. 2009).

reasonable (or rational) person would have benefitted from helping her family at the expense of the state. For example, while the court in *In re Keri* assumed that it was in the best interests of an incapable individual to increase her children's expected inheritance at the expense of the state,²⁵⁸ other courts often make the opposite assumption.²⁵⁹ In extreme cases, courts may even act on their own notion of public policy and own view regarding the interests of the taxpayers.²⁶⁰

3. Disincentives to "Game the System"

Section II.C has shown that a problem with proposals to replace the sole-interest duty with the best-interest standard is that essentially the same criteria end up governing judicial scrutiny before the fact and after the fact. This can generate incentives to "game the system"; sophisticated guardians and agents are encouraged to avoid ex-ante scrutiny of suspicious conduct with the hope of escaping sanction after the fact.²⁶¹ The following will argue that, unlike proposals to adopt the best-interest standard, the proposed substituted-judgment defense does not generate incentives to "game the system."

Recall that the criterion for judicial scrutiny of suspicious conduct before the fact is typically the substituted-judgment standard if there is sufficient evidence of what the incapable individual would have wanted if she was capable. If such evidence is deficient, then courts tend to rule according to what is in the best interest of the individual.²⁶² Introducing the proposed substituted-judgment defense would lead to ex-post scrutiny according to the substituted-judgment standard in cases of sufficient evidence, but would fall back to the sole-interest duty of loyalty in cases of insufficient evidence. Hence, in cases of insufficient evidence, the criterion for ex-ante judicial scrutiny tends to be the best-interest standard, while the sole-interest duty continues to guide ex-post judicial scrutiny. Table 1 below summarizes these similarities and differences.

Table 1: Criteria for Judicial Scrutiny of Suspicious Conduct, Under the Author's Proposal

	Before the fact	After the fact
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258. See *In re Keri*, 853 A.2d 909 (N.J. 2004) (discussed in text accompanying *supra* notes 102–06).

259. See, e.g., *In re Estate of Berger*, 520 N.E.2d 690, 704 (Ill. App. Ct. 1987) (rejecting gifts to the incapable individual's children notwithstanding tax benefits).

260. See, e.g., *In re Guardianship of F.E.H.*, 453 N.W.2d 882, 883, 887 (Wis. 1990) (excerpting the lower court's statements that "[W]hen people work during their lifetime and acquire assets, . . . those assets should primarily be used for their care in the later years, and to expect the public to support the parents while the children take the assets without encumbrance is, in my view, contrary to public policy . . ." and that "[T]he court has a responsibility to consider the interests of the taxpayer . . .") (first alteration in original) (quoting the lower circuit court).

261. See generally *supra* Section II.C.

262. See generally *supra* Section II.C.

Sufficient evidence	Substituted judgment	Substituted judgment
Insufficient evidence	Best-interest standard	Sole-interest duty of loyalty

Table 1 shows that, under my proposal, judicial scrutiny of suspicious conduct tends to be more demanding after the fact than before the fact; in cases of insufficient evidence, the sole-interest duty is more rigorous than the best-interest standard.²⁶³ In other words, unlike proposals to adopt the best-interest standard, my proposal to introduce the substituted-judgment defense does not lead to convergence of the criteria for judicial scrutiny before the fact and after the fact. My proposal thus limits any incentive to “game the system”; judicial scrutiny remains more demanding after the fact than before the fact.

C. Disrespecting Assent Expressed After the Guardian or Agent Takes Office?

The proposed substitute-judgment defense tends to show great deference to the incapable individual’s past transacting patterns and relational norms, which took place before the appointment of her guardian or agent. However, the proposed defense is unlikely to excuse a breach of the sole-interest duty of loyalty on the basis of assent expressed after the guardian or agent took office. This is unlikely to be a problem in most cases; courts usually cannot access evidence of expressions of assent from an individual in an incapable state anyway.²⁶⁴ Cases involving such expressions of assent nonetheless exist, and this Section explains the author’s reluctance to relax the fiduciary prophylaxis in these rare cases.

Two cases can illustrate how orthodox fiduciary law treats assent to suspicious conduct expressed after the guardian or agent takes office. Consider first *In re Conservatorship of Rininger*.²⁶⁵ In that case, Darrell—the incapable individual—had paranoid schizophrenia and was the beneficiary of a trust created by his father’s will. In his final years of life, Darrell was very close to and dependent upon his twin sister, who was his caregiver. After seeking advice from his professional guardian but without obtaining prior judicial approval, Darrell used his trust income to purchase properties with his twin sister as joint owner. When Darrell passed away, his estranged children sought compensation from the professional guardian. These children argued that the guardian breached the sole-interest duty of loyalty by allowing Darrell’s purchase to go ahead. Ruling in favor of the children, the Iowa court held the professional guardian liable to reimburse Darrell’s estate for the value of the relevant properties. In so ruling, the court disregarded the professional guardian’s

263. See generally *supra* Sections I.C–D.

264. See *In re Caminite*, 62 N.Y.S.3d 724, 726 (Nassau Cty. Ct. 2017).

265. See *Prichard v. Rininger (In re Conservatorship of Rininger)*, 500 N.W.2d 47 (Iowa 1993). *In re Conservatorship of Rininger* is known as a “never competent” case in the philosophical literature on surrogate decision-making. See generally *Jaworska, supra* note 216, § 2.

sincerity and good intentions and the “substantial evidence” that Darrell wanted to help his twin sister with her poor financial situation.²⁶⁶

A less obvious case is *In re Conservatorship of Smith*.²⁶⁷ Recall that in that case, an elderly woman and her guardian opened a joint account together after the guardian took office. The guardian then started moving money from the woman’s own accounts into that joint account; he would become the sole owner of the account upon the woman passing away. The Mississippi Court of Appeals reversed the lower court’s summary dismissal of the breach-of-fiduciary duty claim that followed.²⁶⁸ Finding the claim viable, the court of appeals drew a distinction between opening a joint account before and after the guardian was appointed; it was permissible to open a joint account before appointment, but not after appointment.²⁶⁹ This is a subtle example of respecting past expressions of assent, but not new expressions; by going to the bank with her guardian to open a joint account,²⁷⁰ the elderly incapable woman could be said to have expressed assent to her guardian using the joint account to enrich his own pockets.

Cases like these reveal the problem of evidential uncertainty in judicial scrutiny of suspicious conduct after the fact. Actual wrongdoing is hard to observe and verify. Guardians and agents tend to be in a position to obtain expressions of assent from incapable individuals. For example, an intimate caregiver can use her position to procure from the incapable individual a manifestation of assent to a harmful transaction.

For the reasons that follow, the sole-interest duty of loyalty should not be relaxed on account of assent to suspicious conduct expressed after the appointment of guardian or agent. First, although not a substitute for a private individual’s power to authorize departures from strict fiduciary law,²⁷¹ the process for obtaining prior judicial approval can scrutinize post-appointment expressions of assent. Before the guardian or agent takes advantage of a post-appointment expression of assent, she can invoke the process for obtaining prior judicial approval.²⁷² That process is imperfect, but it nonetheless partially facilitates the pursuit of valuable goals and preferences that are expressed post-appointment.²⁷³

266. See *In re Conservatorship of Rininger*, 500 N.W.2d at 49, 51. Cf. *Laufert v. Wegner*, 62 N.W.2d 758 (Iowa 1954) (allowing gifts to a family guardian and some other relatives of the incapable individual where those gifts reflected the individual’s wishes before he became incapable).

267. See *Fitzmaurice v. Vandevort (In re Conservatorship of Smith)*, 237 So. 3d 852 (Miss. Ct. App. 2017).

268. See *id.*

269. See *id.* at 860–61.

270. See *id.* at 855.

271. See *supra* Section II.A.

272. See, e.g., *In re Guardianship of Bose*, 158 N.W.2d 337, 341 (Wis. 1968).

273. See generally *supra* notes 196–203 and accompanying text.

Second, and more importantly, the guardian or agent can argue that the individual was mentally *capable* at the time of expressing her assent. If the individual was functionally competent, then she should be held to be capable of giving valid assent.²⁷⁴ If the individual was capable, then the issue for the court becomes whether the guardian or agent had complied with the procedural safeguards to obtain the individual's fully-informed authorization to engage in the suspicious conduct.²⁷⁵ For example, in *In re Conservatorship of Rininger*,²⁷⁶ the guardian could have argued that Darrell was mentally-capable at the time of gifting his twin sister, and that he had authorized the conflicted transactions with the guardian's detailed advice.²⁷⁷ Whether the guardian had breached his duty would then depend on judicial evaluation of Darrell's functional competency to give such authorization, and of the guardian's compliance with the procedures for obtaining authorization. That judicial evaluation can determine whether to uphold Darrell's authorization.

D. Summary

This Part proposes to loosen the fiduciary regulation of close relatives and friends by introducing a substituted-judgment defense. Effectuating what the incapable individual would have wanted if she was capable, the proposed defense tends to respect intrinsic bonds and other-regarding preferences. The proposed defense preserves the fiduciary prophylaxis in cases of insufficient evidence. The usual operation of orthodox fiduciary law is also preserved when mental incapacity is not what really prevents the individual from authorizing the suspicious conduct on her own. Introducing the proposed defense thus amounts to taking an intermediate position between strict application of the sole-interests duty of loyalty and complete departure from it. This intermediate position tends to restore the welfare-enhancing property of fiduciary law. This position also tends to preserve the usual rigor of the fiduciary prophylaxis in cases where it is unlikely to displace other-regarding goals and preferences.

IV. HARNESSING REPUTATIONAL CONCERNS

The proposed substituted-judgment defense should not be made available to professional guardians and agents. As Part II has argued, strict fiduciary regulation is too onerous in cases concerning close families and personal relationships, but it continues to perform valuable incentive-alignment functions in cases concerning professionals.²⁷⁸ Thus, while Part III above

274. See generally *supra* notes 10, 30–32 and accompanying text.

275. See, e.g., *In re Guardianship of Bose*, 158 N.W.2d at 341.

276. See *Prichard v. Rininger (In re Conservatorship of Rininger)*, 500 N.W.2d 47 (Iowa 1993).

277. The report of the case suggested that the guardian gave Darrell detailed advice on the conflicted transactions. See *id.* at 49–50.

278. See *supra* Section II.B.

proposes to loosen fiduciary regulation of close relatives and friends, this Part offers suggestions to tighten fiduciary regulation of professionals.

More precisely, this Part will propose an *interrelational reporting duty* that requires professional guardians and agents to report proven misconduct to all courts and individuals who contemplate to engage their services. As Sections IV.A–B below will explain, this duty aims to harness, as much as possible, the reputational concerns of professionals who serve multiple incapable individuals. Regardless of whether she is serving an incapable individual, a professional fiduciary often has reputational concerns that may deter her from committing misconduct.²⁷⁹ The following will argue that the proposed interrelational reporting duty further harnesses the reputational concerns of professionals.

A. Repeated Dealings between Courts and Professionals

A preliminary observation is that the relationship between a professional guardian or agent and the relevant state court can involve repeated dealings and interactions.²⁸⁰ Professional guardians and agents serve multiple incapable individuals. At least in theory, the court can acquire knowledge of a professional through multiple proceedings and ongoing dealings. Upon discovering a wrongdoing by the professional, the court may impose reputational sanctions, such as denial of future appointments. Such reputational sanctions are in addition to the usual sanctions for breaches of fiduciary duty.²⁸¹

By comparison, reputational sanctions tend to have limited effects on relatives and friends. Relatives and friends typically only serve one (or very few) incapable individuals. The court tends to know little about, and has limited ongoing dealings with, relatives and friends. Any ongoing dealings are usually confined to inspection of reports.²⁸² Hence the relationship between the court

279. See Langbein, *supra* note 2, at 937–38. Lawyers who provide guardianship services are also subject to professional regulations and disciplinary actions. See, e.g., *In re D'Angelo*, 727 N.Y.S.2d 886 (App. Div. 2001); *Iowa Supreme Court Att'y Disciplinary Bd. v. Murphy*, 800 N.W.2d 37 (Iowa 2011). Cf. Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CALIF. L. REV. 2005, 2033 (1987) (stating that any ongoing relationship inevitably ends, limiting the deterrence effect of reputational concerns arising from repeated interactions).

280. For each potentially incapable individual, there is typically only one state court that has the power to appoint a guardian to her. The widely adopted UNIF. PROBATE CODE §§ 5A-202, 5A-203 (UNIF. LAW COMM'N amended 2010) provides jurisdictional rules to ensure that each potentially incapable individual is subject the guardianship regime of only one state—usually the individual's home state. In a state with more than one court that can appoint guardians, there is usually very little overlap between the respective jurisdictions of these courts. See, e.g., N.Y. SURR. CT. PROC. ACT LAW § 1750 (McKinney 2019) (special guardianship regime for persons with intellectual disability or traumatic head injuries); N.Y. MENTAL HYG. LAW § 81.02 (McKinney 2019) (standard guardianship regime).

281. See generally Section I.C.

282. See *supra* notes 70–71, 283, 287 and accompanying text (the accounting and reporting duties of guardians and agents).

and a relative or friend guardian or agent is best described as a short-term, one-off interaction that does not allow relational norms to develop.

B. Introducing Interrelational Reporting

Section IV.A observes that the relationship between a professional guardian or agent and the relevant state court can involve repeated dealings and effectuate reputational sanctions. In this light, this Section will propose a monitoring mechanism to harness the reputational concerns of professional guardians and agents.

The existing monitoring mechanism primarily takes the form of record-keeping and reporting duties. The extent and effectiveness of these duties depend on the nature of the fiduciary relationship. Modern guardianship law typically imposes detailed reporting duties on a guardian and requires her to report to a court or state agency.²⁸³ The incapable individual also may inspect her guardian's reports.²⁸⁴ A breach of these reporting duties may lead to a loss-based remedy and,²⁸⁵ in extreme cases, removal of the errant guardian from her office.²⁸⁶ Modern agency law also imposes reporting duties, but affords great latitude to any contrary instruction that the principal gave before losing mental capacity.²⁸⁷

Existing reporting duties are typically activity or relationship specific and can be ineffective in harnessing the reputational concerns of professionals. For example, professional agent A may owe a duty to send reports to her principal B, but A owes no duty to send the same reports to a potential principal C who is contemplating to engage A's services. Neither agency law nor fiduciary law provides a mechanism to inform C of what B may learn about A from A's reports. In other words, neither agency law nor fiduciary law prevents A from confining her reputational costs to each agency relationship. This remains the case even if A and B proceed to litigation, as long as their dispute is not well publicized. Similarly, guardianship law typically does not prevent a professional guardian from confining her reputational costs to each guardianship. In particular, limiting public access to guardianship reports and proceedings, confidentiality provisions in many guardianship statutes may even

283. See, e.g., UNIF. PROBATE CODE §§ 5-317, 5-420 (UNIF. LAW COMM'N amended 2010); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT §§ 420, 423 (UNIF. LAW COMM'N 2017); *In re* Mark C.H., 906 N.Y.S.2d 419, 432 (Sur. Ct. 2010).

284. See, e.g., UNIF. PROBATE CODE §§ 5-307, 5-407 (UNIF. LAW COMM'N amended 2010); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT §§ 420(b), 423(d) (UNIF. LAW COMM'N 2017).

285. See, e.g., RESTATEMENT (THIRD) OF TRUSTS § 83 cmt. a(1) (AM. LAW INST. 2007).

286. See, e.g., *Johnson v. Puchalski (In re Estate of O'Hare)*, 34 N.E.3d 1126 (Ill. App. Ct. 2015).

287. See, e.g., RESTATEMENT (THIRD) OF AGENCY § 8.12(3) (AM. LAW INST. 2006).

assist professional guardians to confine their reputational costs to each guardianship.²⁸⁸

The proposed interrelational reporting duty aims to strengthen the existing monitoring mechanisms. This duty requires professional guardians and agents to report proven misconduct to all courts and individuals who contemplate to engage their fiduciary services. Strengthening interrelational sharing of information and monitoring, this duty primarily aims to deter and sanction misconduct by amplifying the errant guardian's or agent's reputational costs. For example, in the scenario above, upon seeing the reports about agent A's potential misconduct against principal B, principal C may be less willing to engage A's services. The proposed duty also elicits valuable information to inform the court. In particular, the court may refuse to offer future appointments to professionals who repeatedly commit misconduct. Alternatively, to bargain for advantageous terms and conditions for a particular incapable individual,²⁸⁹ the court may use reports regarding the professional guardian's misconduct against other incapable individuals.

The proposed interrelational reporting duty only marginally increases the reporting costs of professional guardians and agents. Professionals already have to comply with reporting duties;²⁹⁰ their pre-existing reporting mechanisms (such as account officers and computers)²⁹¹ can easily accommodate the additional costs of complying with the proposed duty. By comparison, the proposed duty should not be imposed on relatives and friends. There is no point to insist on reports to multiple courts and potential principals when relatives and friends typically only serve one incapable individual. Without the benefit of professional reporting mechanisms, relatives and friends can also struggle to cope with onerous reporting duties.²⁹²

Moreover, the proposed interrelational reporting duty should apply as a default duty that is waivable at the option of the court in the case of a guardianship, or the prospective principal (before she loses capacity) in the case

288. See, e.g., UNIF. PROBATE CODE §§ 5-307, 5-407 (UNIF. LAW COMM'N amended 2010). See generally Am. Bar Ass'n Comm'n on Law & Aging, *Privacy and Confidentiality: Guardianship Statutes and Court Rules*, A.B.A. (Dec. 31, 2016), https://www.americanbar.org/content/dam/aba/administrative/law_aging/chartguardianshipprivacy.authcheckdam.pdf. Cf. UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT § 409 (UNIF. LAW COMM'N 2017).

289. For example, the court may bargain for a bond to secure the proper performance of duties. See *infra* Section IV.C.

290. See *supra* notes 70–71, 283, 287 and accompanying text (discussing the accounting and reporting duties of guardians and agents).

291. See, e.g., Langbein, *supra* note 2, at 948.

292. See, e.g., BRENDA K. UEKERT, CENTER FOR ELDERS & THE COURTS, ADULT GUARDIANSHIP COURT DATA AND ISSUES: RESULTS FROM AN ONLINE SURVEY 18 (2010), http://www.eldersandcourts.org/~media/Microsites/Files/cec/GuardianshipSurveyReport_FINAL.ashx.

of an agency relationship. This ameliorates concerns about attention costs;²⁹³ taking into account the particular circumstances of the case, the court or prospective principal may decide whether to insist on a report about the guardian's or agent's proven misconduct in other relationships.²⁹⁴

By facilitating better monitoring and sharing of information, the proposed interrelational reporting duty strengthens other incentive-alignment mechanisms in fiduciary law. These include insurance bonds, remuneration for services and loss-based liabilities. The remainder of this Part will explain.

C. Bond

The proposed interrelational reporting duty can strengthen the incentive-alignment functions that bonds perform in a guardianship or an agency relationship. As a condition of appointment as guardian, the court may require that a bond be obtained to insure the incapable individual against any losses arising from misconduct.²⁹⁵ When creating an agency relationship, the principal also may stipulate similar bonding requirements. In the event of misconduct, the bond provider first pays the incapable individual (or her estate), and then pursues the errant guardian or agent to recover such payment.²⁹⁶ Thus, in addition to insuring the incapable individual, the bond exposes the errant guardian or agent to claims from the bond provider. The bond provider is typically better resourced and more sophisticated than the incapable individual (and those who expect to inherit from her). Moreover, upon becoming aware of misconduct, the bond provider may increase the guardian's or agent's premiums for obtaining bonds in the future. Overall, bonds disincentivize guardians and agents from committing misconduct by the threat of claims from bond providers and by the possibility of increased premiums.

Strengthening the existing monitoring mechanisms, the proposed interrelational reporting duty can provide to bond providers additional information regarding an errant professional guardian or agent. The proposed duty requires reporting of misconduct in multiple relationships to the court. The court may provide such report to bond providers. Bond providers can then increase the errant guardian's or agent's premiums for obtaining bonds to insure

293. See generally DHAMI, *supra* note 183, ch. 19.17 (surveying empirical research on limited attention and limited cognitive abilities).

294. See *id.* ch. 19.17.4 (economic models of rational inattention).

295. See, e.g., Am. Bar Ass'n Comm'n on Law & Aging, *Conservatorship and Guardianship Bonds: State Statutory Requirements*, A.B.A., http://www.americanbar.org/content/dam/aba/administrative/law_aging/2014_guardian_bond_chart.authcheckdam.pdf (last visited Dec. 8, 2018) (surveying bonding provisions in American guardianship statutes). See generally RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 71 cmt. d (AM. LAW INST. 1996).

296. See, e.g., *Seaboard Sur. Co. v. Boney*, 761 A.2d 985, 996–98 (Md. Ct. Spec. App. 2000) (discussing the functions of guardianship bonds). See generally RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 27 (AM. LAW INST. 1996) (on subrogation).

multiple incapable individuals. The threat of such a large increase in premiums amplifies the deterrence effects arising from bonds.

D. Remuneration for Services

As an established exemption to the sole-interest duty of loyalty, a fiduciary may receive reasonable remuneration for her services.²⁹⁷ The court typically has a discretion to grant reasonable remuneration to a guardian.²⁹⁸ When creating an agency relationship, the principal also may stipulate remuneration to the agent.²⁹⁹ Remuneration primarily functions to incentivize professional guardians and agents to provide specialist services.³⁰⁰ Moreover, a grant of remuneration encourages professional guardians and agents to comply with their duties because the court may reduce their remuneration in part or in whole in response to misconduct.³⁰¹

The proposed interrelational reporting duty further strengthens the deterrence effects of tying remuneration to proper performance of duties. It does so by providing the court with information about misconduct in multiple relationships. Upon obtaining information about misconduct against one incapable individual, the court may reduce the professional guardian's or agent's remuneration for providing services to *other* incapable individuals as well. This can lead to a large reduction in the guardian's or agent's remuneration. The threat of such a large reduction can be a strong deterrent against misconduct.

E. Loss-Based Liability

Loss-based remedies are available to deter and sanction breaches of fiduciary duty. In addition to the duty of loyalty and reporting duties, guardians and agents owe duties to comply with the instrument underlying the fiduciary relationship, to act within the scope of their authority, and to exercise a

297. See RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. c(4) (AM. LAW INST. 2007); see also *In re Alice D.*, 979 N.Y.S.2d 77, 81–82 (App. Div. 2014) (factors affecting a guardian's remuneration).

298. See, e.g., UNIF. PROBATE CODE §§ 5-316(a), 5-417 (UNIF. LAW COMM'N amended 2010); UNIF. GUARDIANSHIP, CONSERVATORSHIP, AND OTHER PROTECTIVE ARRANGEMENTS ACT 120(b) (UNIF. LAW COMM'N 2017); N.Y. MENTAL HYG. LAW § 81.28 (McKinney 2019).

299. See RESTATEMENT (THIRD) OF AGENCY § 8.01 cmts. b, c (AM. LAW INST. 2006).

300. See Langbein, *supra* note 2, at 939–41; RESTATEMENT (THIRD) OF AGENCY § 8.01 cmts. b, c (AM. LAW INST. 2006).

301. See generally RESTATEMENT (THIRD) OF TRUSTS § 38 cmt. c(1) (AM. LAW INST. 2003); RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. d(2) (AM. LAW INST. 2006); Deborah A. DeMott, *Fiduciary Principles in Agency Law*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW, *supra* note 24, at 297; see e.g., *In re Lillian A.*, 868 N.Y.S.2d 695, 697 (App. Div. 2008) (upholding lower court's denial of remuneration to an errant guardian who disbursed guardianship funds after expiration of appointment).

reasonable degree of care and prudence.³⁰² A breach of these duties makes available compensatory damages to cover the incapable individual's losses.³⁰³ The imposition of loss-based liability disincentivizes inefficient breaches by shifting to the guardian or agent the resulting losses.³⁰⁴ Moreover, responding to concerns about elder abuse, many jurisdictions now impose criminal penalties to sanction culpable misconduct.³⁰⁵ These penalties further deter professional guardians and agents from harming incapable individuals.

The proposed interrelational reporting duty strengthens the deterrence effects of these loss-based liabilities and penalties. It does so by empowering the court to consider prior misconduct in determining the size of compensatory damages or penalties. For example, when dealing with misconduct against one incapable individual, the court can increase the size of damages or penalties if the errant guardian or agent had committed misconduct against other incapable individuals in the past. This can be a strong deterrent against repeated breaches.

CONCLUSION

Prohibiting conflicts of interest, orthodox fiduciary law is meant to align a fiduciary's incentives with her beneficiary's.³⁰⁶ Such prohibition is too strict on close relatives and friends who serve as guardians or agents to elderly incapable individuals. In close families and personal relationships, strict prohibition of conflicts tends to disregard the incentive-alignment effects of biological and affective bonds, as well as social and moral norms. Such strict prohibition also tends to stultify the pursuit of valuable other-regarding goals and preferences.³⁰⁷

Recognizing these problems, this Article proposes reforms to optimize the fiduciary duties of guardians and agents. The main suggestion is that a substituted-judgment defense should be made available to close relatives and friends; this defense permits those conflicts of interest that the incapable

302. See *supra* notes 68–69 and accompanying text.

303. See generally RESTATEMENT (THIRD) OF TRUSTS § 95 cmt. b (AM. LAW INST. 2012); RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. d(1) (AM. LAW INST. 2006).

304. See Sitkoff, *supra* note 38, at 207. An efficient breach occurs when the gain it accrues to the fiduciary exceeds the loss it imposes on the beneficiary. A loss-based remedy permits such a breach by shifting the beneficiary's loss to the fiduciary, so the fiduciary has incentives to breach only if the net gain is positive. See, e.g., RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 39 cmt. h (AM. LAW INST. 2011) (discussing the interplay of disgorgement liability and efficient breach arising from loss-based liability).

305. See, e.g., Lori Stiegel & Ellen Klem, Am. Bar Ass'n Comm'n on Law & Aging, *Undue Influence: Context, Provisions, and Citations in Adult Protective Services Laws, by State*, A.B.A. (2007),

http://www.americanbar.org/content/dam/aba/administrative/law_aging/Undue_Influence_Context_Provisions_and_Citations_Chart.authcheckdam.pdf (last visited Dec. 8, 2018) (surveying select American statutes penalizing undue influence).

306. See *supra* Section I.C.

307. See *supra* Section II.B.

individual would have authorized if she was capable. To the extent consistent with the individual's own wishes, the substituted-judgment defense aims to accommodate intrinsic bonds and informal norms, and to facilitate the pursuit of valuable other-regarding goals and preferences.

The proposed substituted-judgment defense admittedly weakens the protection against elder financial abuse offered by fiduciary law. Such weakened protection is justified in cases concerning close relatives and friends, but not in cases concerning professional guardians and agents. Cases concerning professionals tend to exhibit weak intrinsic bonds and other-regarding preferences; strict fiduciary regulation continues to perform valuable incentive-alignment functions. Thus, the substituted-judgment defense should not be made available to professionals. Moreover, to deter and sanction elder financial abuse by professionals, I propose an interrelational reporting duty to harness their reputational concerns. This duty requires professional guardians and agents to report proven misconduct to all courts and individuals who contemplate to engage their services. The goal is to amplify the reputational costs of misconduct.

Overall, fiduciary law ought to regulate different guardianships and agency relationships differently. In particular, the incentives of close relatives and friends tend to differ from those of professionals. Ignoring these important differences, prevailing fiduciary law tends to operate as "an instrument of hardship and injustice in individual cases."³⁰⁸

308. *Chan v Zacharia* (1984) 154 CLR 178, 205 (Austl.).