Denver Law Review

Volume 28 | Issue 6 Article 5

June 2021

# The Prudent Man Rule Now Applies to Investments by Fiduciaries

Charles A. Baer

# THE "PRUDENT MAN RULE" NOW APPLIES TO INVESTMENTS BY FIDUCIARIES

CHARLES A. BAER
*of the Denver Bar*

Colorado has had in its Constitution a prohibition against the investment of funds held in estates and trusts in the stocks or bonds of private corporations.[1] At the last general election, there was included in Constitutional Amendment No. 2 a provision which permitted the General Assembly to enact legislation by which fiduciaries might invest in such stocks and bonds.[2]

The legislature, in pursuance of this provision of Constitutional Amendment No. 2 enacted, and the Governor signed, H.B. 272. The Governor's signature was affixed on March 29, 1951. The statutes of the State of Colorado, therefore, now contain this particular bill as well as previous statutes relating to investments.[3]

The statute adopted by our legislature is one which might be referred to as a model "Prudent Man Rule" type of investment statute. Colorado, according to my information, is the 25th state having the prudent man rule by judicial construction or by statute, many of them similar to that referred to. In no state where such a statute has been adopted has there been a return to the old type of investment practice which we have followed in Colorado for many years, namely, the enactment of a legal list by our legislature or by the creation of a commission which adopts a legal list for the guidance of fiduciaries. Even where the legal list has been in existence, the courts have, in considering the propriety of particular investments, surcharged or refused to surcharge the fiduciary on what might be called the "Prudent Man Rule" of conduct. Some courts have held that a purchase within the legal list removed the fiduciary from liability for investing improperly. Of course these cases arise where the asset purchased by the fiduciary has depreciated in value through some set of events. However, in most such cases there are other factors involved, such as self-dealing, improper appraisals and holding improperly after receipt of information, which indicates that the investment is improper and of questionable value.

---

[1] COLO. CONST. Art. V, § 36.

[2] The General Assembly shall from time to time enact laws prescribing types or classes of investments where the investment of funds held by executors, administrators, guardians, conservators and other trustees, whose power of investment is not set out in the instrument creating the trust.

[3] Statutes as of April 13, 1951 were all in COLO. STAT. ANN., c. 176: Sec. 126—repealed 1937; Sec. 126(1)—repealed as to (c) 1945 (Exec., etc.); repealed as to (b) 1951 fiduciaries, still effective as to (a); Sec. 126 (2)—repealed as to executors, administrators, guardians, trustees 1945; still effective as to all others named; Sec. 126 (3)—repealed as to (c) 1945; repealed as to (b) 1951; still effective as to (a); Sec. 126 (4)—repealed except as to its use in conjunction with Sec. 13 Chapter 235 Session Laws of Colo. (Uniform Veteran Guardianship Act) applying to minors and incompetents receiving benefits from V.A.

The question then is, "What is the Prudent Man Rule?" From talking with many attorneys here in Denver, and in Colorado, I realize that there are many different notions of what those words mean. There are even some who feel that the adoption of this statute amounts to a general invitation to carelessness in trust investments, especially where individuals are acting as fiduciaries. However, it is my belief that this is not so; rather, that the adoption of this statute imposes upon fiduciaries a higher degree of care and skill in investing than that which we have had previously. As long ago as 1830, Mr. Justice Putnam in the case of *Harvard College v. Amory,* the basic decision from which the American rule evolves, said:

> He [the fiduciary] is to observe how men of prudence, discretion, and intelligence manage their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of the capital to be invested.[4]

Very much the same wording is to be found in other early cases,[5] and there is quite a lengthy statement on the rule in *Scott on Trusts,* Section 227. The Restatement of the Law on Trusts reads as follows:

> (Section 227). In making investments of trust funds the trustee is under a duty to the beneficiary;
>
> (a) In the absence of provisions in the terms of the trust or statute otherwise providing, to make such investments and only such investments as a prudent man would make of his own property. having primarily in view the preservation of the estate and the amount and regularity of the income to be derived.

It is my belief that the fiduciary is not ordinarily bound to the highest degree of care, but only to the degree of care used by the reasonably prudent man. This is so in investments even though in other matters a fiduciary is held to strict accountability. It is quite different from and lower than the level or quality of honesty required of a fiduciary.

The purpose of this article is only to acquaint you with the passage of this statute and not to answer all the questions which might immediately occur to you. From conversations I have had with the deans of our law schools, I am sure that we will have articles in *Dicta* and *The Rocky Mountain Law Review* covering comprehensively the problems presented. It might be well, however, to mention some of the problems which face us:

1. The Prudent Man Rule is without doubt the rule of investment to follow in all guardianships and conservatorships other than those in which funds are received from the Veterans Administration.

---

[4] Harvard College v. Amory, 9 Pick 446, 461, (Mass. 1830).

[5] King v. Talbot, 40 N. Y. 76 (1869); Mattocks v. Moulton, 84 Me. 545, 24 A. 1004 (1892).

2. The Prudent Man Rule undoubtedly should be used in investing in all cases where the will is silent on the problem.

3. The Prudent Man Rule should be followed in conjunction with Section 147, Chapter 176, in holding investments in any estate where the will is silent or in any estate where there is no will.

4. In all trusts created under contract, and in all testamentary trusts, reappraisal of the investment problem and of the investment clause must be made. The rule does not limit the express provisions of such trusts, but rather should be read in connection therewith, just as it should have been before the passage of the statute in connection with those accounts wherein the trustee was given unlimited discretion in the investing of the funds. Typical as examples of such problems are clauses as follows:

(a) To "invest and reinvest" where undoubtedly the rule now applies.

(b) To "invest and reinvest in safe, interest bearing securities" where undoubtedly the rule applies within the limits of what are interest bearing securities such as bonds and notes.

(c) To "invest and reinvest in those securities prescribed as legal by the State of Colorado" wherein the rule undoubtedly applies to investments made after March 29.

(d) To "invest and reinvest in Government bonds, municipal bonds, and loans secured by a first mortgage on Colorado real estate not in excess of 50% of the value of such real estate" wherein the rule probably does not apply except insofar as it is superimposed in purchasing the municipal bonds and the mortgages.
The cases on these points are decided by the courts under the rules of construction regarding intent of the testator.

5. It also presents a problem to the draftsmen of new wills and trust agreements. In my opinion such draftsmen should, as in the past, incorporate in the trust instrument a complete investment clause setting forth the ideas and desires of the testator or trustor and limiting or giving discretion to the trustee as desired. The well-drawn trust instrument does not rely on the changing conditions of our economy or of the ideas of our legislature.

6. The attorney for a fiduciary must now advise his client that in investing funds such client must investigate with the care and skill of ordinary prudent men from the sources which such men use whether the asset to be purchased is proper for the particular fund. One therefore doesn't buy particular investments from a salesman on the word of the salesman alone unless such individual has a knowledge of the facts and conditions separate and apart from that of the salesman.