The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century

By Mayo Adams Shattuck*

THE ENGLISH AND AMERICAN BACKGROUND

History, old style, had a comfortable way of being factual. It recorded the death of Victoria, good Queen and Empress, on a dreary day in 1901 and made due note of the accession of her son, Edward, as King Emperor, in its usual accurate manner. It declared precisely that the Victorian era had come to a definite end, at a precise moment, just at the beginning of the twentieth century.

Looking back now over the first fifty years of the twentieth century, however, the social commentator, new style, would have a good deal of difficulty in pinpointing the time when Victoria "died". Some might say that the good Queen had not ceased breathing until the advent of the First World War or until its close. Others might say that the years of frenzy and inflationary activity which succeeded the First World War and which terminated so disastrously in 1929 marked the twilight of her life. Others, looking for a personal villain, might venture the initials of F.D.R. as those of the regicide.

Whatever the date of Victoria's death, whatever the length of her long reign, there are many who hold to the nostalgic thought that her period of power was truly a Golden Age; "golden" especially with respect to the ownership and management of property. "Golden" because the economy of the civilized world was directly keyed to troy ounce of gold as a standard of monetary value. "Golden" because the great and expanding forces of private business were operating without substantial interference by government. "Golden" because it was comparatively easy, in those days, to amass a comfortable portfolio of lifetime savings and comparatively simple and "routine" to manage the portfolio once it has been acquired. Like all nostalgic notions of the sort, there is much to be distrusted in any such summation. The trustee-minded person, however, remembers very well the sort of placid connotations to which I refer.

To be sure, a hundred or more years before the time of Victoria's death trusteeship had passed, somewhat nervously, from the concept of safe conduct of a specific *res* into the concept of maintenance of a stated set of values. During that transition the duty of

*Of the firm of Hausserman, Davidson & Shattuck; Member of the Boston Bar. Ralph F. Tuller, Esq. of the Boston Bar gave valuable assistance in the preparation of this paper.

the English trustee had transformed itself from the relatively restricted obligations related to care, custody and operation of family agricultural real estate and its appurtenances to the much more intricate task of trading in commercial and financial markets and to the attempted maintenance, through the life of the trust, of a value which had been stated to exist at the time of the opening inventory. This ante-Victorian development had, to be sure, amounted to a revolution in trust thinking. But that ferment had largely subsided as the effects of the industrial revolution were consolidated and absorbed. The successful business man in England and in America in the second half of the nineteenth century had settled down in his thinking about management of his family property. He built his private fortune by taking considerable risks, to be sure, but he entertained a different sort of notion about what should happen to that fortune after he was gone.

Fiduciary practices in England were especially staid and conservative after 1850. It was the attitude of the British government and body of law, particularly after the scandals of the regimes of the last years of the eighteenth and the opening years of the nineteenth centuries, that beneficiaries must be protected from any hazards or risks like those which had surrounded the infamous South Sea bubble. It was the purpose of government, moreover, to maintain a constant market for the royal obligations. Fiduciaries were generally limited in the exercise of their art to acquisition of British consols or other government obligations and certain other types of investments which were considered proper for persons whose sole duty, or at least whose most emphatic duty, was the conservation of principal. The heavy balance of the trustee's art was considered to lie, especially in England, toward the protection of generations which would appear only in the distant future. Text writers and observers of the fiduciary art were wont to express the trustee's duties in terms of emphasis upon preservation of principal. The cases reveal a ready sacrifice of the interests of the income tenant wherever a question of safety of principal arose.

This picture of the conservative fiduciary art of the late nineteenth century in England is, of course, a portrait of a full and ripe civilization. With government regulation at a minimum and taxation barely reaching these accumulations of private capital, there was little apprehension, and no actual consideration or thought, about a possible decline in the purchasing power of the British pound. The trustee's duty, in full discharge, required a comparatively small amount of imagination. There were, to be sure, many private securities which would have been available to the trustee of England if he had been allowed at the law to acquire them. The economy was still expanding. But imagination was not permitted to the trustee. He was to act as a conservator and not as a manager.

This same sort of placid conservatism marked the fiduciary developments in much of the United States during the maturing years of the nineteenth century. There was a background, to be sure, in the Colonies and in the young Nation, and particularly in New England, of enterprising and imaginative administration of trust funds. This background may be placed in history as dating, roughly, from the closing years of the eighteenth century until the middle of the nineteenth. During that period fiduciary funds were placed hard at work in the establishment of new mills and industrial enterprises of all sorts, in the conduct of the clipper trade with the Orient and with the West Indies, and in sundry other semi-speculative enterprises which had long characterized the developments of the New England and Middle Atlantic State Colonies. That employment of fiduciary funds was based upon necessity. There was a new nation to develop. There was a shortage of the type of "safe" fiduciary investment participation which was constantly available in England.

It was a background of that nature which found expression in the now famous case of *Harvard College v. Amory,* decided in the March term of the Massachusetts Supreme Judicial Court in the year 1830.[1] Any person who is interested in the development of fiduciary property management in the United States ought to take time to study that celebrated decision. As with all other great cases in the history of the law the interesting aspect of the case is not so much the language of the court but the state of facts, and the reasoning which was advanced by counsel on both sides and by the court in coming to its conclusion. It is a pity, these days, that we do not ordinarily have in the reports of our cases the abstracted briefs of the opposing counsel; it is a distinct loss, also, that modern courts do not refer more often to the clash of opposing arguments and state more fully their estimates of the respective values of those arguments. Study of the extended discussion of facts and arguments in *Harvard College v. Amory* will reveal the clash and interplay of the English economy against the economy of the American Colonies and will demonstrate the fact that leading New England lawyers and judges of that day were accomplished business men on their own. The remarks set forth in the opinion concerning the defects of exclusive purchase, or of any purchase, of government bonds are not impertinent even in the modern scene! And the summation of the opinion, as to the position in which a bank finds itself when it is confronted with a default on the part of its borrower, is penetrating in the extreme. That tribunal was too well versed in the commercial arts to believe that any distinction in kind could be drawn between shares in a bank and shares in manufacturing enter-

[1] 9 Pick. (Mass.) 446 (1830).

prise. The bank, as they well knew, was entirely too likely to become a manufacturer, *nolens volens,* when the loan had to be enforced! The entirely shrewd conclusion of the court boiled down to one statement. "Do what you will the capital is at hazard." There were, in short, no "safe" investments. This concept reflected the fact, of course, that during the hundred years preceding 1830, all property management in America had been necessarily speculative. The rejection of a category of so-called "safe investments" was a typically American mental approach. It possessed the added psychological comfort, of course, of rejection of one more British tradition. Out of it came the final distillation of Yankee investment management thinking now so often appearing in print as a classic statement of the prudent man rule.

> All that can be required of a trustee to invest, is, that he shall conduct himself faithfully and exercise sound discretion. He 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.

The court in *Harvard College v. Amory,* moreover, was keenly aware of an added factor, especially important in the light of the amount of discretion which its investment rule reposed in the trustee. That factor was the possible personal liability of the trustee for mistakes in judgment. In the final paragraph of the decision appeared this language:

> Trustees are justly and uniformly considered favorably, and it is of great importance to bereaved families and orphans, that they should not be held to make good, losses in the depreciation of stocks or the failure of the capital itself, which they held in trust, provided they conduct themselves honestly and discreetly and carefully, according to the existing circumstances, in the discharge of their trusts. If this were held otherwise, no prudent man would run the hazard of losses which might happen without any neglect or breach of good faith.

Thus the leading court of that day in the New England States, and possibly the leading court of that day in the United States, in one clear announcement freed the Massachusetts fiduciary from the ancient English shackles and pointed the way toward a use of the accumulated savings of previous generations which could be imaginative, daring, fruitful in the public and private sense and, yet, free of unwarranted personal risks on the part of the trustee. That salutary rule was, of course, the chief reason for the later flowering of what has come to be known as Boston trusteeship.

But, as is so often the case in the development of the law, the statement of the rule laid down in *Harvard College v. Amory* reflected rather more the customs of preceding generations than a

true anticipation of what was lying ahead. The rule had barely been announced when it began to be narrowed in practice in important respects. The process of narrowing was speeded, also, by the fact that during the remaining years of the nineteenth century the economy of the United States was also maturing and settling down. And in some parts of the Republic legal thinking had become more conservative than that of Massachusetts. The investment rule in New York, for example, was stated in terms not far different from those promulgated in Massachusetts. But in 1869 the New York court narrowed the rule in a most restrictive way in the leading case of *King v. Talbot.*[2] That opinion stated, emphatically, that no prudent man would purchase or retain for trust management any share of stock, as contrasted with a bond or other obligation having a fixed maturity. For some mysterious reason acquisition or retention of any equity in real estate was permitted but purchase of shares of stock were declared to be a speculative and dangerous delegation of the trustee's control.

The tide was turning, with the ripening years, toward English conservatism. Even the Massachusetts court began placing certain limitations upon its own language. It made certain motions towards emphasis upon the doctrine of diversification, which had not been mentioned in the original statement of the rule, and which, while very sound in itself, could, if the court had not later escaped the noose which it really laid for itself, have proved to be a most troublesome restrictive requirement. It fell into the error, chiefly by dicta but widely copied by trust commentators all over the Victorian world, of heavy and undue emphasis upon the protection of the rights of future principal beneficiaries at the expense of the life tenants, who were, obviously, the chief objects of the testator's bounties. It followed the trend, with the passage of the later nineteenth century years, in short, of regarding the trustee as essentially a conservator. It emphasized "safety of principal" at the expense of reasonable yields of income. The result was inevitable. It is fair to say that as of the year 1900 the trustees of the United States, speaking broadly, were little more than a pallid reflection of their own forefathers. They were doing a distinctly pedestrian job.

Yet the trustees of 1900 are not to be unduly criticized. They were in step with those times. Social customs, business *mores* and government protocol were heavily laden with "taboos." So also was the fiduciary management field. There were numerous media of investment available to the fiduciaries of the American nation, as well as to the fiduciaries of England, but no cause had yet arisen for demanding their use. The trust was, by and large, the rich man's tool.

[2] 40 N.Y. 76 (1869).

The fiduciary problem, on both sides of the water, was chiefly a matter of placing the accumulated savings of previous generations of leading families in a sort of "guaranteed" retirement, where they would be "safely" preserved for dozens and even hundreds of years to come.

The sterilization of accumulated trust funds which characterized the "golden age" rule may have done no harm during Victorian days. Certainly there were few commentators who thought it evil. Massachusetts adhered to its liberal viewpoint but most of the Republic did not, and even that resolute Massachusetts protagonist Augustus Peabody Loring admitted, in 1898, that

> In the hands of a good trustee the Massachusetts rule is undoubtedly superior, since it gives him a larger opportunity to use his skill and ability as a financier for the benefit of his beneficiaries; but undoubtedly the English rule, or New York rule, is better adapted to inexperienced or ignorant trustees, as much less is left to their discretion, and unfortunately trustees are too often appointed from considerations of friendship, and not from consideration of their discretion or business ability.

The Period of Unsettlement

Space does not permit a description of the dramatic growth of security transaction on the American markets from the year 1898 to the close of the 1920's. Most of us have clear enough memories, however, of the glamorous 1920's. Nor shall we soon forget how after an exuberant rise of unparalleled intensity and duration the market "broke" in October of 1929, and the rose-tinted skies of the American new era became suddenly and darkly overcast. The period of unsettlement which ensued has continued with very brief interludes until the present day. As a result of the dislocations of the Second World War and the threats of a Third, it appears likely that we shall continue to move through troubled times for years to come. And it is more than likely that the "swings" in values upon the security markets will continue to alternate in successive response to whatever deflationary or inflationary influences may turn out from time to time to be prevailing.

At all events the historical "averages" declare that following hard upon the initial break in the autumn months of 1929, there ensued a deflationary decline which was first felt in the values of equity participations. Bond values, during this initial period, tended to hold, even to improve, their relative positions. The investment "conservatives" had their brief, if lugubrious, innings. But eventually, and without much delay, there arrived a period of depression so deep that the values of negotiable covenants of all sorts, secured and unsecured, were themselves grievously affected. Great aggregations of "guaranteed" mortgage bonds stood in default and

railroad bonds declined with discouraging rapidity. Farm mortgage auctions produced scenes of bitter defiance to the law. The statutory moratorium became the order of the day. Gold rapidly resumed its prime place in the affections of men. Money stood next in public preference. All forms of money's worth, indeed, with the notable exception of a few commodities, were viewed with suspicion and mistrust.

Upon evidence of the hoarding of gold, and eventually of money, the Federal Government stepped in and closed the banks, devalued the gold content of the dollar, inaugurated an extensive and continuing policy of cheap money and assumed for all practical purposes a working control over the security markets. From that critical low point there ensued a period of slow but accelerating credit and currency inflation. This process has continued to the point, at the date of these comments, where one hears, predominately, discussion of the following topics in work-a-day trust circles:

1. Shall we be able to prevent an uncontrollable upward spiraling of the costs of living and consequent uncontrollable diminution of the purchasing power of the fixed-content dollar?
2. Shall we ever be able to expect the yield from fixed income capital to resume its former comparative position vis-a-vis the yield from equity participations?

These questions bespeak an uncertainty among men of prudence, intelligence, and discretion about the values of the things that they find for sale in the financial world and, consequently, about the things which they hold in their fiduciary portfolios. All of us are now required to steer our craft, not by the fixed and reliable stars of old, nor yet by the magnetic compass for whose expected deviation we can compensate, but by dead reckoning solely, the color of the water, the size and shape of the visible reefs, and the set of the tide so far as we can discern it. We are passing, in other words, through the sort of period to which Chief Justice Rugg referred, with dignified understatement, in *Kimball v. Whitney*,[3] when he spoke of "new financial institutions and business customs, changed commercial methods and practices, altered monetary usages and investment combinations." We have rediscovered, moreover, the eternal verity of Mr. Justice Putnam's sentence, "Do what you will the capital is at hazard."[4]

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

These developments have led to interesting discussions among persons who are occupied in the trust field about the nature of the duty of the modern trustee. It has been suggested, for example, that the time may be at hand when the trustee must be prepared to take

---

[3] 233 Mass. 321, 331 (1919).

into account and seek some compensating factor for fluctuations in the purchasing power of the monetary standard.[5] Distinctions have been drawn between the functional approaches to the problem of property management which are characteristic of various walks of life. Shall the savings banker, for example, who deals with an obligation to repay upon demand, be expected to use the same approach as the insurance company executive who has issued obligations to pay in dollars but who is to some degree protected by tables of experience in mortality? Should the trustee, who has no fixed maturity but whose fundamental duty is to apply the trust property for the continued benefit of successive beneficiaries, adhere to the same or to a different standard or approach? The question has been asked whether it is any longer sufficient, as a discharge of the fiduciary duty, to maintain values set in the opening inventory over a prolonged period of years, regardless of development in the surrounding economy. These questions are not easily answered. Some have said that a trustee who undertakes to take into account fluctuations in the purchasing power of the dollar runs the risk of becoming a "gentleman adventurer" with other people's money.[6] Some say that a trustee who does not is sacrificing the life tenants of the trust to remote remaindermen.

Certainly there is evidence that during the period of unsettlement, which has characterized the second twenty-five years of the twentieth century, the position of the life tenant has been re-examined and the duty of the trustee to some extent affected. By way of introduction to consideration of the widespread reform in investment powers of the American trustee, which was originally induced largely out of response to the plight of the life tenant (but which now bids fair to do the remainderman an equally good turn), it may be useful to notice some other changes in trust law and practice which have been designed to increase the fruitfulness of the trust device for the benefit of those nearest and dearest to the departed head of family. It has, for example, now become fairly common to remove from the income beneficiary part of the charges for management and to allocate that expense partly to principal.[7] The Restatement and an increasing number of decisions now declare the duty of the trustee, also, to make equitable allocation of the proceeds of delayed sale of unproductive real estate so that the income

---

[5] See Shattuck and Headley, *Whither Trusteeship?* (a debate), 89 TRUSTS AND ESTATES 92-5, 120-5 (1950).

[6] See Headley, *Trustees or "Gentlemen Adventurers"?*, 88 TRUSTS AND ESTATES 91 (1949).

[7] This is sometimes accomplished by statute as for example in Massachusetts where allocation is left to the discretion of the Probate Court. MASS.G.L. (Ter. Ed.) Ch.206, s.16.

tenant is no longer burdened with all carrying charges without eventual reimbursement.[8] So, also, in practice draftsmen have learned to authorize fiduciaries to use, apply and expend principal for the protection of income tenants. The concept of conservation of principal for distribution intact to future generations is certainly weakening even if it must be said, still, that most trust authorities and decisions get the cart before the horse.[9]

THE TRUST INVESTMENT RULE
LEGAL LIST VS. PRUDENT MAN

In 1900 the individual states of the United States had divided themselves unevenly between allegiance to the Massachusetts rule (a distinct minority) and the New York or "legal list" rule (a strong majority). The New York rule states represented vastly greater accumulations of capital. Loring's estimate, made in 1898, that the Massachusetts rule states were in the majority was certainly inaccurate. The key states, in an economic sense, New York, Ohio, Pennsylvania, Texas, Illinois, Cailfornia and the entire bloc of Northwest territory jurisdictions, had carefully limited their trustees to "legal lists." The same restriction, or something like it, was embodied in the constitutions of a handful of states. The legal lists were similar in nature to the savings bank lists which had long been established almost everywhere, even in Massachusetts. They were prepared by the legislative or executive branch of government. They were designed to protect the beneficiary from Loring's "inexperienced or ignorant trustees." The eligible investments consisted largely of government and municipal obligations but they sometimes included "high quality" bonds and notes selected in accordance with prescribed formulae. Equity participations were almost universally excluded. Common stocks were emphatically "taboo." The trustee who purchased or retained unauthorized securities became in substance a guarantor against depreciation.

In the legal list states, after the boom and during the depression years of the 1930's, a number of factors became operative which focussed attention upon investment restrictions. The first of these factors was the startling increase, beginning in the 1920's, in the accumulation of fiduciary funds. The nation had become, after World War I, a growing aggregation of modest "capitalists." The trust, moreover, was obviously becoming the average man's tool. According to figures compiled in 1938 by the Comptroller of the Currency the growth of trust funds in national banks alone had increased from $922,328,677 in 26,053 trusts as of June 1926 to $9,419,-

[8] RESTATEMENT, TRUSTS, s.241; 20 B.U.L.REV. No. 3 (June 1940).

[9] The rule stated in *Harvard College v. Amory* was of course balanced in nature; it is not often remembered that it placed income considerations first in order of expression.

017,042 in 135,655 trusts as of June 1938, an increase of 921 per cent in trust assets and 466 per cent in the number of trusts.[10] The state banking institutions engaged in the trust business, about equal in number to the national banks, enjoyed a similar boom. And while individual trusteeships were believed to be declining in relative importance they nevertheless continued to contribute enormously to the total volume of fiduciary business. Thus an important fraction of the nation's capital had found its way into trust portfolios. The trust men of the country worked very hard and very steadily not merely to increase their business but to do it with prudence and intelligence.[11] The public was in a mood to provide for the future, especially after the lesson of 1929. Life insurance trusts became common.

But moving hand in hand with this striking growth of trust business during the period of depression there was an equally striking diminution in the quantity of "eligible" securities. Great portions of the legal list selections disqualified themselves by automatic operation of the formulae under which they were chosen and were removed from the list. In New York State alone the volume of "legal investments" declined from approximately $7,600,000,000 in 1931 to approximately $2,580,000,000 in 1939.

These factors, taken together with open market purchases by the Federal Reserve Bank, expansion of silver purchases, devaluation of the dollar, adoption of a national policy of low interest rates, and the general lessening of public confidence in bond values served to place the income tenant in an unenviable position. Income was declining; prices were going up.

There was, moreover, a social aspect to the problem. The enterprise capital market was languishing. In the words of Edmund Burke, Jr., "Equity money is dynamic and debt money is static." Even the conservative minded S. E. C. stated its belief that, " A reasonable capital structure calls for a substantial amount of common stock equity both as a protective cushion for the bonds and preferred stock and to prevent temporary declines in earning from resulting in receivership."[12] Yet a report of the Public Utilities Di-

[10] Comptroller of the Currency. 76th Annual Report. Pg. 3.

[11] These statistics have been limited, for purposes of historical pertinency, to the decade 1930-1940. Trust growth has proceeded almost geometrically since. For an estimate of the extent of trust business in National Banks as of December 30, 1950 see *Trusts and Estates,* September, 1951. The total is nearly four times that of 1938. It is to be remembered that these totals do not include trusts in about 1500 state chartered banks or in the hands of individuals, or charitable and educational funds, "corporate" trusts, society funds or the like. I estimate that the total aggregations of trust funds in the nation as of this writing may exceed two hundred billions of dollars.

[12] 6 SEC Ann Rep.

vision of the S. E. C. gave a picture in 1941 of the five previous years of public utilities financing. The total sum of that financing amounted to $5,890,000,000, in round figures. Of this total bonds and notes accounted for approximately 95.1 per cent, preferred stocks 4.7 per cent, and common stocks only 2/10 of 1 per cent. Free enterprise requires equity capital. The social question that arose in the minds of lawyers and legislators was whether it was entirely safe, let alone wise, to continue to exclude from the enterprise capital market the entire aggregation of fiduciary funds of great centers of commerce like New York and Chicago.

In the meantime trustees in those states which had followed the Massachusetts trust investment rule had found the going much easier than their "legal list" brethren. The task of selection remained as difficult as ever, to be sure, perhaps even more so, but the investment choice was comparatively wide and the opportunity to balance a stuttering bond yield by utilization of the relatively higher income derived from equity participations, at reduced values, was always at hand. Needless to say the lot of the life tenants was happier in the Massachusetts Rule states than in the "legal list" states. The yield in portfolios which were limited to legal investments did not greatly exceed 2 per cent on the average, while it was still comparatively easy to maintain a 4 per cent yield under the Massachusetts rule. That difference of one and a half, or two, per cent was fifteen hundred to two thousand dollars a year in a trust of one hundred thousand dollars.

The combined effect of these factors, beginning with the year 1939, led to a series of desertions from the ranks adherent to the "legal list" rule.

Connecticut adopted the Massachusetts rule by statute in 1939. Missouri took what amounted to the same step by court decision in 1940. New Hampshire greatly relaxed its long established strict practice in 1941. The trust division of the American Bankers Association in February 1942 devoted a part of its annual meeting to the subject and ended by instructing its legislative committee to prepare a model statute designed to enact the Massachusetts rule. The present writer prepared the statute in the form set out later in this article. The governing words were those of the court in *Harvard College v. Amory*. No way was found to improve them.

Results were almost immediate and have been continuing in marked fashion ever since.[13]

A tabulation of American jurisdictions which follow the prudent man rule, as of this writing, either by judicial decision or legis-

---

[13] The American Bar Association Section of Real Estate, Trust and Probate Law also appointed a continuing committee to further this reform and there have been local committees in many states.

lative action taken prior to the drafting of the model statute, or by subsequent adoption of the model statute (sometimes with slight variations) is as follows:

A. *The Prudent Man Rule States (prior to 1940).*

*1939 Connecticut	(Conn. Gen. Stats. 1949, § 6893)
*1890 Kentucky	(Ky. Rev. Stat. 1946, § 386.020)
1884 Maryland	McCoy v. Horwitz, 62 Md. 183 (1884)
1830 Massachusetts	Harvard College v. Amory, 9 Pick. 446 (1830).
*1937 Michigan	(Mich. Comp. Laws 1948, § 487.232)
1940 Missouri	Rand v. McKittrick, 346 Mo. 466 (1940)
1928 North Carolina	Sheets v. J. G. Flynt Tobacco Co., 195 N. C. 149 (1928)
1886 Rhode Island	Peckham v. Newton, 15 R. I. 321 (1886)
1908 Vermont	Scoville v. Brock, 81 Vt. 405 (1908)

B. *The Prudent Man Rule States, by statute (after 1940) in some form or other, 100 per cent or less:*

*1941 New Hampshire	(N. H. Rev. Laws 1942, c. 363, § 17, as amended by Laws 1949, c. 135, § 1) 50%
1943 California	(Cal. Civil Code, § 2261, as amended by Laws 1943, c. 811) 100%
1943 Delaware	(Del. Rev. Code, c. 117, § 35, as amended by Laws 1943, c. 171 and Laws 1947, c. 268) 100%
1943 Minnesota	(Minn. Stat. Ann., § 501.125) 100%
1945 Illinois	(Ill. Rev. Stat. c. 148, §§ 32 to 32.1c.) 100%
1945 Maine	(Me. Rev. Stat. c. 147, §§ 17a-d, as amended by Laws 1951 HB.102) 100%
1945 Texas	(Tex. Stats. (Vernon Supp.) § 7425b-46, as amended by Laws 1945, c. 77, § 13) 100%
1947 Nevada	(Nev. Laws 1947, c. 51, p. 81) 100%
1947 Oregon	(Ore. Comp. Laws Ann. §§ 73-103a to 73-103d, as inserted by Laws 1947, c. 523, and amended by Laws 1949, c. 220, § 1) 100%
1947 Washington	(Wash. Laws 1947, c. 100) 100%
1949 Idaho	(Ida. Laws 1949, c. 36) 100%
1949 Kansas	(Kan. Laws 1949, c., 319 as amended Laws 1951 HB. 71, § 1) 100%
1949 Oklahoma	(Okla. Stats. Ann., Title 60, § 161) 100%
1951 Utah	(Utah Laws 1951, HB. 51) 100%
1951 Colorado	(Col. Laws 1951, HB. 272) 100%

*The dates are those of the first adoption of a Prudent Man Statute. The Kentucky and Michigan statutes have been somewhat altered by later amendments.

1951 New Mexico	(N. M. Laws 1951, c. 41) 100%
1951 Tennessee	(Tenn. Acts 1951, c. 125) 100%
*1951 New Jersey	(N. J. Rev. Stats. 1943, § 24-601 as amended 1951) 40%
*1951 North Dakota	(N. D. Rev. Code of 1943, § 6.0515 as amended 1951) 50% rule for corporate fiduciaries only.
*1951 South Carolina	(S. C. Code of 1942, § 9051 as amended 1951) 30%

C. *The Legal List States (of various types).*

The list of legal list states, so formidable as of the year 1900, has now dwindled to a small minority of the jurisdictions in the United States. Those legal lists states, which do not permit equities in any form, are as follows:

Alabama	(Code, 1940, as amended, Title 58, § 47)
Arkansas	(Stats. 1947, Ann., as amended, §§ 106,221)
Florida	(Stats. 1949, as amended, § 518.01)
Georgia	(Code, 1933, as amended, § 108-417 et seq.)
Iowa	(Code, 1950, as amended, § 682.23)
Louisiana	(Rev. Stats., 1950, as amended, § 9:2061)
Montana	(Constitutional prohibition)
Ohio	(Gen. Code, 1910, as amended, § 10506-41) Legislation in 1951 vetoed by Governor.
West Virginia	(Code, 1931, as amended, Art. 6, c. 44, § 2)
Wyoming	(Comp. Stats. 1945, as amended, § 8-301) (Constitutional prohibition)

In some jurisdictions the "legal lists" include *some* kinds of preferred and, or, common stocks, but typically only a limited amount can be invested in equities. In addition, the relatively few equities which are eligible must meet certain fixed requirements, such as high investment service ratings, exchange listings, earnings and dividends records, etc. This group of jurisdiction includes:

District of Columbia	(Local Civil Rules of Dist. Ct., Rule 23)
Indiana	(Laws 1945, as amended, c. 184, § 1)
Nebraska	(Rev. Stats. 1943, as amended, § 24-601)

---

*The question is, of course, whether states which have a percentage rule belong in a "legal list" or in a Prudent Man column.

New York	(Personal Property Law, § 21 (1), as amended by Laws 1950, c. 464) (a "legal list" state with a limited 35% Prudent Man Rule amendment)
Pennsylvania	(Pa. Stat. Ann. (Purdon) tit. 20, §§ 821.1 to 821.20, as amended by Laws 1951, S.B.11, §1)
Virginia	(Code, 1950, as amended, § 26-40) Preferred stocks only.
Wisconsin	(Stats. 1945, as amended, § 320.01)

In Arizona, Mississippi and South Dakota there is no specifically declared fiduciary investment law, and fiduciaries in these states do not customarily purchase equities or investment company shares without specific authorization.

A glance at the above tables which show only four American states definitely in the Prudent Man column as of the year 1900, and only nine definitely in that column by 1940, reveals the sweeping extent of the reform in the past dozen years.

It seems clear, now, that the standard laid down in *Harvard College v. Amory* is destined to be the American trustee's guide for years to come.

COLLATERAL DEVELOPMENTS.

THE COMMON TRUST FUND. THE INVESTMENT TRUST.

During the same period of years which have marked extension of the Prudent Man Rule there have risen, and flourished, in the American states two interesting methods of collective investment. One, the Common Trust Fund, was especially designed for use in the fiduciary field. The other, the Investment Company or Investment Trust, is eminently suited for use in that field and is being legally qualified for that purpose by increasing degrees.

The Common Trust Fund, which offers the advantages of concentrated and economical trust management and a high degree of diversification to multiple trust accounts in the hands of a single fiduciary, usually corporate, is now legal in thirty states and at a recent date was said to embrace $634,315,895 in 37,008 accounts.[14] Discussion of its characteristics and virtues must be reserved for another time and place. It is plain, however, that the Common Trust Fund has earned a definite place in the American fiduciary field and is here to stay.

The shares of investment companies and investment trusts also fill a definite need in the field, particularly where the Common Trust Fund is not available. Smaller corporate fiduciaries and the thousands of individual fiduciaries of the nation must also have better diversification and the benefits of expert management, par-

---

[14] *Operating Economies,* 90 TRUSTS AND ESTATES 100 (1951).

ticularly as the numbers of relatively small investment accounts of a fiduciary nature increase and the complexities of modern investment techniques grow more baffling. There has been discussion of the legality of purchase and retention of this sort of investment by the trustees of the nation. It now appears probable that even in the absence of specific authorization set forth in the instrument the courts will permit this sort of purchase.[15] A substatnial number of states have recently enacted legislation permitting purchase and retention of shares of investment companies and investment trusts, sometimes in the form of an amendment to the Prudent Man Rule,[16] sometimes as a specific extension of a legal list, or as an express permission for the permitted fraction of equities.[17]

Discussion of the characteristics and virtues of this type of modern fiduciary investment must, like discussion of the Common Trust Fund, be reserved for another time and place. These two collateral methods of collective investment of American fiduciary funds are increasingly recognized, however, as the handmaidens of the Prudent Man Rule and must be noted with interest by any student of developments in that field.

THE PRUDENT MAN RULE IN OPERATION

Massachusetts has recorded, in the decisions of her Supreme Judicial Court, a century and a quarter of experience with the rule announced by *Harvard College v. Amory*. There have been extensive notations of the results.[18] I made the attempt, in 1945, to annotate the rule, clause by clause, in the light of the Massachusetts decisions.[19]

The established pattern, as woven in Massachusetts, is not

---

[15] Stevenson, *Shares in Mutual Investment Funds* (1946); Shattuck, *The Legal Propriety of Investment by American Fiduciaries in the Shares of Boston-Type Open-End Investment Trusts,* 25 B.U.L.REV. 1 (1945); Stevenson, *Fiduciaries and Investment Company Shares,* 89 TRUSTS AND ESTATES 228 (1950); *May Trustees Invest in Investment Trusts?,* 89 TRUSTS AND ESTATES 396 (1950).

[16] Colorado, Kansas, Maine, New Mexico, Tennessee and Washington.

[17] New Hampshire, New Jersey, North Dakota, South Carolina and Wisconsin.

[18] *See, e.g.* J. J. Robinson and H. Robinson, *Trustee's Investments in Massachusetts,* 14 B.U.L.REV. 88 (1934); R. S. Walker, *Investment of Trust Funds under the so-called "Massachusetts Rule",* 13 CONN. B. J. 237 (1939); J. L. Robson, *Investment of Trust Funds in Massachusetts and Pennsylvania,* 21 J. COMP. LEG. 3rd ser. 205 (1939); *Prudent Investor Rule in the Investment of Trust Funds,* 16 TEMP. L. Q. 216 (1942); R. Neill, Jr., *Prudent Man Rule of Trust Investments,* 82 TRUSTS AND ESTATES 90 (1946); R. P. Chapman, *Investing Trust Funds under the Prudent Man Rule,* 23 TRUST BULL. 2 (1944); E. R. Lewis, *The Prudent Man Investment Rule,* 35 ILL. B. J. 65 (1946); F. G. Sayre, *Prudent Man Rule for Trust Investments,* 88 TRUSTS AND ESTATES 663 (1949), 89 TRUSTS AND ESTATES 706 (1950).

[19] See 25 B.U.L.REV. (Nov. 1945).

greatly different from that of any other part of the nation. The rule, so far as I know, has been regarded with admiration wherever it has been adopted and placed in operation. No decision by the highest court of any state has been more widely cited elsewhere than *Harvard College v. Amory*. A modest collection of cases, suggestive of the rule in operation, is appended to this article. I see no evidence that any of these cases have distorted or abused the rule in any important particular. The degree of its fruitfulness in the American fiduciary field will, of course, depend upon how it is handled by the fiduciaries, the lawyers and the courts of the future. It is entirely malleable in nature and completely suitable for changing times and circumstances.

CONTEMPLATION OF THE FUTURE

Consideration of the economic and social circumstances which hold sway at the expiration of the first half of the twentieth century, and of the legal currents which have asserted themselves in the American fiduciary field with sufficient strength so that they may property be called "trends," suggests the possibility of some of the following developments, all of which are pertinent to a study of trust investment practices:

First: Private aggregations of trust capital are likely to grow in total size. The persistence and ingenuity of estate planning advertising, the unsettling condition of private and public affairs, the availability of new and interesting investment media, the increasing burdens of taxes and an enlarged sense of family responsibility may be expected to contribute to increasing emphasis upon planning for a "rainy day."

Second: Public and charitable aggregations of trust capital will also increase in substantial measure. The doing of good works is characteristic, always, of a maturing society; the American people are, moreover, instinctively generous. The tax structure has served, and will continue to serve, to enhance the resolution of our citizens to provide protection for their less fortunate brethren.

Third: The instruments and statutes which control management of trust funds, public and private, will be drawn and enacted with an eye to an unpredictable future, rather than with the conviction, as in Victorian days, that the future can be foreseen with reasonable accuracy. Thus fiduciary discretions may be expected to be enlarged; powers of alteration, amendment and use and application of principal will be common rather than exceptional; investment powers will be broad and elastic in an increasing degree. The Prudent Man Rule, possibly somewhat broadened, is almost certain to be the trust investment rule of the next fify years.

Fourth: The *inter vivos* trust may confidently be expected to find increasing use in domestic and commercial areas. It bids fair to

take root as a sort of mercantile specialty on its own, as the insurance policy has done, and to be applied in myriad forms, to specific purposes. It may well become the "poor man's tool."

Fifth: Because the average man's family trust is likely to be of modest size, and the substantial Victorian portfolio a distinct relic of the past, one must expect an increasing experimentation with all sorts of collective investment devices. The Common Trust Fund is certainly here to stay and will probably extend itself markedly throughout the banking system. The modern Investment Company will continue to attract fiduciary participation and, as it gains in stature and confidence, may come to provide both a complete investment service for trusts of modest size and a supplementary service for larger aggregations of trust capital.

Sixth: The accumulated savings of the Republic are more likely than not, regardless of recessions and booms, to find dominant investment in equity participations, as contrasted with mortgages, bonds and notes of hand. The trust function is not adequately discharged by heavy possession of fixed income bearing securities having a fixed maturity, especially when one considers that the broad record of advancing civilization is inflationary in character. The trustee's prime practical concern will be not to safeguard principal but to keep reasonably abreast of the times in purchasing power and values. A sense of cautious responsibility will always dictate, to be sure, a somewhat different attitude on the part of the trustee from that of the "gentleman adventurer," notably with relation to diversification of classes and individual holdings of securities, but it is safe to say that the Victorian definition of the prohibited "business man's risk" will undergo a softening change. The essential market for fixed income bearing securities is more likely to be found not in the fiduciary field but among the property management institutions which are themselves confronted with fixed maturities, or are subject to demands in dollars, such as savings banks, building and loan cooperative societies and insurance companies.

Seventh: Because so many American business men are essentially unliquid in their financial affairs, having placed all or a very large part of their eggs in one basket, and because the operation of tax laws makes it almost impossible to gain a position of liquidity without heavy sacrifice of values or contribution to the tax collector, there will be a tendency to "hang on" to family properties of high earning power and low marketability. The fiduciaries of the Republic may, therefore, find themselves increasingly occupied with managerial functions of a commercial and industrial character. They must be prepared to operate competitive enterprises in trust form and to conform their administrative and compensation schedules and procedures accordingly.

Eighth: Since the duty of the trustee of the future is likely to be one of leadership in new and strange areas, all in a highly technical world, one may expect a heavier emphasis upon "professionalism" in the trust world. A lawyer will not expect to be a successful trustee merely because he is a member of the bar, nor a bank merely because it holds a charter, nor an investment broker merely because he deals in stocks and bonds. Fiduciary compensation schedules will inevitably be subject to wide variations, depending upon the nature of the task in hand; ancient rules bearing upon delegation of duty and responsibility will require modification to suit growing practices of committee and agency performance; the risk of individual liability of the trustee, saving always in the sacrosanct area of his duty and loyalty, will certainly be diminished to a character more resembling that of the director-business executive than that of the old fashioned fiduciary.

Ninth: Certain practical and legal assumptions of the trust world must be altered to fit the future fiduciary prospect. Professional fiduciaries have tended to assume, for example, that sole trusteeship will be the order of the new day; it seems more likely, however, that committee operation is desirable, with division of duties and responsibilities. One may fairly expect, also, that the ancient legal rule of unanimity of decision in decision and action will give way to the more workable business and social, or political rule of decision by the majority. A fixed schedule of fees will not be applicable to this new order of things. Responsibility for the acts or omissions of a co-fiduciary or inferior will be lessened. The heavy emphasis upon conservation of principal at the expense of the life or income tenant will continue to diminish. Business practices relating to reserves for obsolescence and depletion will be imported into the trust law. The trust vehicle will, in short, find a way to take an unhandicapped place as a modern and competitive American business device.

The Prudent Man Rule may be thought of, in this aspect of things, as a bright star in a newly discovered galaxy. Maitland considered the invention of the trust concept to have been a major, perhaps the greatest, achievement of the English legal mind. Scott adds that the use of the trust is limited only by the imagination of the draftsman. Given these virtues and the elasticity of administration which is promised by the Prudent Man Rule, one can expect the trust to reach full stature in American hands.

APPENDIX *A*

THE MODEL PRUDENT MAN RULE STATUTE WITH THE INVESTMENT COMPANY AMENDMENT

SECTION 1. In acquiring, investing, reinvesting, exchanging, retaining, selling and managing property for the benefit of another,

a fiduciary shall exercise the judgment and care, under the circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of 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 their capital. Within the limitations of the foregoing standard, a fiduciary is authorized to acquire and retain every kind of property, real, personal or mixed, and every kind of investment, specifically including but not by way of limitation, bonds, debentures and other corporate obligations, and stocks, preferred or common, and securities of any open-end or closed-end management type investment company or investment trust registered under the Federal Investment Company Act of 1940, as from time to time amended, which men of prudence, discretion and intelligence acquire or retain for their own account.

SECTION 2. Nothing contained in this act shall be construed as authorizing any departure from, or variation of, the express terms or limitations set forth in any will, agreement, court order or other instrument creating or defining the fiduciary's duties and powers, but the terms "legal investment" or "authorized investment" or works of similar import, as used in any such instrument, shall be taken to mean any investment which is permitted by the terms of section 1 hereof.

SECTION 3. Nothing contained in this act shall be construed as restricting the power of a court of proper jurisdiction to permit a fiduciary to deviate from the terms of any will, agreement, or other instrument relating to the acquisition, investment, reinvestment, exchange, retention, sale or management of fiduciary property.

SECTION 4. The provisions of this act shall govern fiduciaries acting under wills, agreements, court orders and other instruments now existing or hereafter made.

APPENDIX *B*

Note: A collection of Massachusetts authorities, which I hope would give a fair picture of the operation of the Massachusetts Prudent Man Trust Investment Rule as of November, 1945, was printed in the Boston University Law Review, Volume 25, No. 4. In the course of that discussion I attempted to illustrate the Rule by annotating its separate clauses as follows:

(1) "All that can be required of a trustee to invest, is, that he shall conduct himself faithfully
(2) and exercise a sound discretion.
(3) He is to observe how men of prudence, discretion and intelligence
(4) manage their own affairs,
(5) not in regard to speculation, but in regard to the permanent disposition of their funds,
(6) consideirng the probable income, as well as the probable safety of the capital to be invested."

It would have been an impossible task then, and it remains an impossible task, to extend a comprehensive inquiry into jurisdictions other than Massachusetts in anything less than a full volume.

This appendix, therefore, can do nothing more than set forth a very few interesting recent cases, drawn from Massachusetts and other jurisdictions, which suggest the application of the Rule and the practice under some of the foregoing clauses.

(1) ". . . he shall conduct himself faithfully . . ."

The trustee is to be selfless; he is to work exclusively in the intersts of those who have present or future beneficial interests in the trust. This is the uniform rule in all Prudent Man jurisdictions.

In *City Bank Farmers Trust Co. v. Taylor,* 69 A. 2d 234 (R. I. 1949), the testator gave his widow and the Trust Company, as trustees, broad investment discretion, and authorized them to retain securities owned by him and to participate in reorganizations. The estate included large blocks of the Trust Company and of the National City Bank. When the Trust Company affiliated itself with the Bank, the Trust Company lost its right to retain the shares received from the affiliation. The rule of the *Cannon* case was thus reaffirmed. See also *Hutchings v. Louisville Trust Co.,* 303 Ky. 147, 197 S. W. 2d 83 (1946).

Profits derived from the trustee's self-dealing will accrue to the trust: "recovery may be had by the benficiary even though he has suffered no damage and even though the trustee may have acted in good faith." *Slay v. Burnett Trust,* 143 Tex. 621, 187 S. W. 2d 377 (1945); *Continental Illinois National Bank & Trust Co. v. Kelley,* 333 Ill. App. 119, 76 N. E. 2d 820 (1948).

Any dealing by the trustee with the subject matter of the trust will be scrutinized closely, but a transaction that is open, fair and above board, made with the consent of the beneficiaries after full disclosure to them, may possibly gain the court's sanction. *Kuhn v. Zepp,* 355 Mo. 295, 196 S. W. 2d 249 (1946).

The trust instrument may authorize the trustee as an individual to purchase trust assets, *Robertson v. Hert's Adm'rs.,* 312 Ky. 405, 227 S. W. 2d 899 (1950), and such authorization does not violate public policy. *Morris v. The Broadview, Inc.,* 328 Ill. App. 267, 65 N. E. 2d 605 (1946).

There are instances of unabashed disloyalty; the remedy is severe. *Sauvage v. Gallaway,* 329 Ill. App. 38, 66 N. E. 2d 740 (1946) (operating a competitive business); *McCleary v. Lewis,* 397 Ill. 76, 72 N. E. 2d. 862 (1947) (concealing the purchase of trust property). But usually the trustee falls victim of a prohibition which is designed to remove all temptation toward self-dealing. *Wootten v. Wootten,* 151 F. 2d 147 (C.C.A. 10th, 1945), s.c. 159 F. 2d 567 (C.C.A. 10th 1947), (individual ownership of majority interest in corporation, shares of which are also held by trust).

It might be argued that courts increasingly accustomed to a generous attitude in their examination of investments will inevit-

ably tend to "erode" the "punctilio of honor" historically demanded of a trustee. *In re Keyston's Estate,* 102 Cal. App. 2d 223, 227 P. 2d 17 (1951) might for example, be cited as having some factual similarity to the *Wootten* case, but with a more lenient holding. What may be loosely described as technical conflicts of interests were also held not to be breaches of trust in *Security Trust Co. v. Appleton,* 303 Ky. 328, 197 S. W. 2d 70 (1946), and *Warner v. King,* 337 Ill. App. 99, 85 N. E. 2d 196 (1949). But no trend can be found as yet. Each case stands on its own facts.

Two cases serve to illustrate: *In re Schlemm's Estate,* 11 N. J. Super. 286, 78 A. 2d 156 (1951), surcharged the corporate trustee for retention of its own stock. *In re Trust under Will of Comstock,* 219 Minn. 325, 17 N. W. 2d 656 (1945), found no breach of trust by the corporate trustee which retained stock of corporations to which it had made large loans and the directorates of which were interlocking with itself. Both may be described as close cases; the decisions could conceivably have turned either way. Nevertheless, the facts are distinguishable: In the *Schlemm* case, the trustee held its own stock; in the *Comstock* case it held stock in which it was more remotely interested. In the one case, the stock constituted the bulk of the estate, in the other it made up slightly more than half the trust assets. The *Schlemm* trustee retained for a longer period than did the *Comstock* fiduciary. The former acted in its own complete discretion; the latter obtained the informed approval of the life tenant. In brief, there is an aura of unsullied honesty about the *Comstock* trustee's actions which is not so clearly evidenced in the *Schlemm* case. It cannot fairly be said that the standards of one of these courts are lower or higher than those of the other. The test, as the Minnesota court said in the *Comstock case,* is whether or not the trustee's position is such that he is "interfered with or prevented from acting fairly, impartially, and honestly and for the best interests of the trust estate and the beneficiaries thereof."

(2) ". . . and exercise a sound discretion . . ."

Indiscretion, of course, covers a multitude of sins. It may range from doing nothing, or little, to doing something carelessly or dishonestly. In *Sauvage v. Gallaway,* 331 Ill. App. 309, 73 N. E. 2d 133 (1947), the court found that a proposed sale of the trust's most productive asset was in fact an attempt to cripple the trust for the benefit of a competing business owned by the trustee's wife. The trustee was "indiscreet." He was obviously "not acting in good faith and within the limits of sound discretion, but rather arbitrarily and unreasonably."

His purpose may be honest but his judgment clearly bad. So when he determines to exchange trust assets for valueless certificates, *(Hopkins v. Loeber,* 332 Ill. App. 140, 74 N. E. 2d 39 (1947),

or to give away trust property (*Hendrick v. Mitchell*, 320 Mass. 155, 69 N. E. 2d 466 (1946).

By and large, however, where the trust instrument grants a broad discretion to the trustee in matters of judgment, the courts will be slow to condemn a decision which, viewed after the event, may seem dubious. A typical example is *In re Trust under Will of Comstock*, 219 Minn. 325, 17 N. W. 2d 656 (1945), where more than half the estate consisted of shares of two small corporations, and concerning which the testator said, "It is my suggestion to the trustee that said stock be gradually converted." The fiduciary held the stock for a year as executor and for a year and a half as trustee. Then came October, 1929. The court found no abuse of discretion; "Cases of this kind must be viewed, not restrospectively, but from the position in which the trustee found itself in a suddenly upset financial world."

A bona fide decision not to sell trust property, even though coupled with a decision to take advantage of a granted authority to hold an individual interest in the trust, does not necessarily constitute a breach of trust. *Victor v. Hillebrecht*, 405 Ill. 264, 90 N. E. 2d 751 (1950).

"Sound discretion," however, is far from synonymous with "good faith." In *Merchants Nat. Bank of Aurora v. Frazier*, 329 Ill. App. 191, 67 N. E. 2d 611 (1946), the trustee's decision, reached, no doubt, in perfect good faith, to buy mortgage participations resulted in surcharge when, in addition to the fact that they were bought from itself, the mortgage was found to have no parity clause, other notes were found to have prior maturities, and the participations were therefore not first mortgages.

Courts everywhere take pains to warn, even while sanctioning an exercise of discretion, that the trustee "will be held accountable for any bad faith or abuse of discretion." *Carter v. Kempton*, 233 N.C. 1, 62 S.E. 2d 713 (1950). See *In re Moir Hotel Co.*, 186 F. 2d 377 (1950); *Ilari v. Ewing*, 314 Ky. 182, 234 S. W. 2d 293 (1950); *Estate of Canfield*, 80 Cal. App. 2d 443, 181 P. 2d 732 (1947); *First National Bank of Beaumont v. Howard*, 223 S. W. 2d 694 (1949).

The diversification cases involve a most interesting question of sound discretion. The two cases of *New England Trust Co. v. Paine*, 317 Mass. 542, 59 N. E. 2d 263 (1945), and 320 Mass. 482, 70 N. E. 2d 6 (1946), reiterate the established Massachusetts rule that overinvestment in a single security may be a breach of trust. While the decision in the *Paine* cases rests on a broad interpretation of an exculpatory clause, the court takes particular pains to point out that "There is no hard and fast rule as to the extent of diversification required . . . . The principles set forth in *Harvard College v. Amory*,

9 Pick. 446, 461 (1830), govern trustees in the matter of diversification as in other problems of investment."

Worth mention also in the second *Paine* case is the discussion of changing standards of the prudent investor. The investments complained of, railroad stock, were largely made in the first decade of the century. The court said,

> The present rules for diversification of trust investments were not so well established at the turn of the century as they now are. The amount to be invested in any one venture still remains a matter of judgment and discretion, although the judgment and discretion should now be exercised within the more narrow limits usually employed by trustees.

Similarly, in *Warmack v. Crawford,* 239 Mo. App. 709, 195 S. W. 2d 919 (1946), where 83 1/3 per cent of the estate consisted of common stock of a single corporation, and the trustee was authorized to retain original holdings at his discretion, there was held to be no requirement to diversify holdings unless the stock should appear to be "not such an investment as a prudent man would make."

Since diversification is desirable it is not surprising that the trustee should be allowed to obtain it without liability. See *Kimball v. New England Trust Co.* 14 Conn. Supp. 432 (1947), where sales for the purpose of diversification were made in a falling market. An exculpatory clause excused all liability except for "wilful default," but the court pointed out that it was hard to find a loss in any event, since the low market made it possible to buy new securities at a favorable price.

A typical process of diversification is very likely to result in a decrease of annual income; the testator's large holding of a favorite small corporation will often produce a markedly higher return than the standard prudent man portfolio. Although no case in point has been discovered, it is to be presumed that a court requiring diversification would be hard pressed to give the protesting widow anything more substantial than sympathy. Compare the typical amortization case, as for example, *Brookings v. Mississippi Valley Trust Co.,* 335 Mo. 513, 196 S. W. 2d 775, 167 A.L.R. 1424 (1946), and its sequel, *Lang v. Mississippi Valley Trust Co.,* 359 Mo. 688, 223 S. W. 2d 404 (1949).

On the other hand, the Kentucky court in *Security Trust Co. v. Appleton,* 303 Ky. 328, 197 S. W. 2d 70 (1946), is not yet convinced that failure to diversify is necessarily a sin of itself. The trustee there retained about two-thirds of the trust estate in a single holding of a well regarded bank stock. The bank's failure was entirely unexpected. Said the court: the duty to diversify, "if one, is merely an application of the general rule as to the care required of a trustee in making investments, and whether it exists depends

largely on circumstances . . . . We are not, under the circumstances here, inclined to hold liability on the ground of failure to diversify, even to the extent of concluding that the failure is to be considered in connection with the more serious charges, or as in anywise contributing to the loss."

There are other jurisdictions, notably Pennsylvania and New York, where the existence and extent of the duty to diversify is far from clear.

(3) *"He is to observe how men of prudence, discretion and intelligence . . . ."*

How shall we recognize the prudent, discreet and intelligent man? Obviously he is to be described largely in terms of his actions. Equally obviously those actions must be judged in the light of the action of other men of prudence, discretion and intelligence. Is it possible, however, in general terms, to portray such a man in a manner sufficiently understandable and accurate so that he will stand as the accepted model of trustee behavior? I doubt it. The law is not in clear agreement as to approach let alone as to result.

To many courts, for example, a good deal will depend upon the amount of experience and ability in financial and fiduciary affairs the trustee chances to possess. In New Jersey it was recently stated flatly that "a stricter standard of care and skill is applicable to corporate and other professional trustees than that which is applicable to individual non-professional trustees." *In re Schlemm's Estate,* 11 N. J. Super. 286, 78 A. 2d 156 (1951). Logically, this dual-standard approach infers that the non-professional trustee may be pardoned for a certain amount of imprudence, indiscretion and lack of intelligence, an inference which can hardly be expected to appeal to the court.

Elsewhere the distinction between amateur and professional trustees is not so sharply drawn. Compare *Security Trust Co. v. Appleton,* 303 Ky. 328, 197 S. W. 2d 70 (1946), where on the facts it was held immaterial that the corporate trustee had loudly blown its own horn as having special skill in fiduciary matters. The implication of the *Appleton* case is that there is not so much a variation in objective standards as there is an obligation to make use of whatever knowledge or skill may reasonably be available to the trustee.

Certainly it is clear that the courts will look searchingly at the corporate trustee to determine "whether it had the proper internal organization, and whether that organization functioned properly." *Kimball v. New England Trust Co.,* 14 Conn. Supp. 432 (1947). And of course the courts will be particularly alert for improper delegation of discretion to individual officers of the trustees. See *New England Trust Co. v. Paine,* 317 Mass. 542, 59 N. E. 2d 263

(1945), and *In re Trust under Will of Comstock,* 219 Minn. 325, 17 N. W. 2d 656 (1945). On the other hand, the individual trustee of *Ridgely v. Pfingstag,* 188 Md. 209, 50 A. 2d 578 (1947), may arguably have been allowed a somewhat lower standard when it was said approvingly that he handled the trust funds "in the same way he handled much larger amounts of his own money."

The difference, however it may be phrased, is sufficiently real if met in practice. It could easily affect the decision of the court.

Some courts, in further illustration of the disagreement in definition of the objective Prudent Man, will deal with a prudent *trustee* rather than with a prudent *individual.* See *In re Cook's Will,* 136 N.J. Eq. 123, 40 A. 2d 805 (1945): "I am therefore convinced that the nature of his undertaking to act for others is a practicable factor of significance in determining the responsiiblity of a fiduciary." See also SCOTT, TRUSTS § 227. There is no warrant for that distinction under the language of *Harvard College v. Amory,* and there is no logical reason for it if all the words of the Prudent Man Rule are given full effect, but there is nevertheless a constant temptation, backed by British precedent, to fall into that error.

So far as I know all courts are agreed (although the cases are few in number) that evidence of the conduct of other trustees in the vicinity is admissible when the actions of the subject trustee are being called into question. 25 B.U.L.REV. 307,328. SCOTT, TRUSTS § 227. I can state, but by hearsay only, that trial courts outside of Massachusetts have admitted evidence of the investment habits of the community outside of strict fiduciary circles. This would include investment "ratings," the holdings of endowment funds, investment companies and the like. The evolution of evidentiary customs of American courts in this respect needs research.

(4) ". . . manage their own affairs . . ."

The emphasis here is upon avoidance of undue delegation as well as upon doing "something" rather than "nothing." It is a dangerous business for the untutored layman to leave everything to an "active" trustee. Compare *McMahon v. Krapf,* 323 Mass. 118, 80 N. E. 2d 314 (1948). There seems to be a genuine appreciation of the need for professional and expert assistance in the art of investment but the trustee himself must be alert and not leave everything to someone else.

Thus the practicing physician of *In re Sellers' Estate,* 67 A. 2d 860 (Del. Ch. 1949), who finds himself trustee of a sizeable estate consisting mainly of securities, has no excuse when he discovers that he inadvertently failed to finish the dreary task of preparing stock transfer papers, with a resultant loss when the sale did not go through. Nor is he allowed the cost of having his accounts checked over; that is his own job. On the other hand the physician

may, under these circumstances, employ an investment counselor, he may have tax returns prepared, and he may be allowed the expense of accounting and bookkeeping services.

The Minnesota court, *In re Butler's Trusts,* 223 Minn. 196, 26 N. W. 2d 204, 172 A.L.R. 977 (1947), had occasion to discuss the employment of agents to perform trust duties. The case involved payment for services to the trust—whether the cost is to be borne by the estate or included in the trustee's compensation—but the general question of authority to delegate duties was considered: "In unusual and complicated cases, there may be both justification and need for the employment of specialized skill in the preparation of certain periodic accounts or in establishing a fundamental plan of bookkeeping."

General slackness cannot be condoned. Informality of administration—with mingling of individual and trust assets, failure to keep records and accounts, and a consequent inability to provide the beneficiary with adequate information about the trust—will not be excused under the guise of constituting an exercise of discretionary power. *In re McCabe's Estate,* 98 Cal. App. 2d 503, 220 P. 2d 614 (1950).

For other typical cases involving laxness in performance of the more mechanical trust duties, see *McMahon v. Krapf,* supra; *Rugo v. Rugo,* 325 Mass. 612, 91 N. E. 2d 826 (1950); *Akin v. Warner,* 318 Mass. 669, 63 N. E. 2d 566 (1945); *Riggs v. Loweree,* 189 Md. 437, 56 A. 2. 152 (1947).

There is a distinction, of course, between inattention to duty and a deliberate determination not to take action. See the much-litigated New Jersey case of *Liberty Title and Trust Co. v. Plews,* 142 N. J. Eq. 632, 61 A. 2d 297 (1948) (cash may be held uninvested for a reasonable time in expectation of pending distribution), and the same case at 6 N. J. Super. 196, 70 A. 2d 784 (1950) (periodic consideration of whether to retain or dispose of testator's securities).

As might be expected, a court accustomed to prudent man standards will tend to be sympathetic toward intentional inaction. *Ridgely v. Pfingstag,* 188 Md. 209, 50 A. 2d 578 (1947), carries the sympathy rather far, particularly in the casual way with which an apparent mingling of trust and individual assets was disregarded. As to the inaction, however,—a failure to invest cash received—the court adopts a rather common sense attitude: "It is common knowledge, illustrated in inventories of decedents' estates, that cash in bank, bearing no interest, constitutes a formerly unheard of proportion of the total net worth of many prudent individuals . . . . In the absence of evidence on the subject, no question of negligence is properly before us. We merely hold that failure to invest this

$3,550 was not, as a matter of law, negligence which caused loss to the heirs."

So also, in *Delaware Trust Co. v. Bradford*, 59 A. 2d 212 (Del. Ch. 1948), where the testator instructed that his estate should be "invested in good securities," the court looked with approbation at the retention of unproductive land for 20 years, such retention having been made as a result of an independent judgment that the property would continue to increase in value. One cannot but wonder, however, what the attitude would have been if the trustee's judgment had not been proved correct by the sale price.

The trustee is charged with the affirmative duty of disposing of improper investments. See discussion in *Dickerson v. Camden Trust Co.*, 1 N. J. 459, 64 A. 2d 214 (1949), *affirming* 140 N. J. Eq. 34, 53 A. 2d 225 (1947). But the courts will not be hasty to condemn the retention of an investment which, viewed in retrospect, should obviously have been sold, but which at the time was not nearly so obvious in its demand for action. *In re Trust under Will of Comstock*, 219 Minn. 325, 17 N. W. 2d 656 (1945).

(5) ". . . not in regard to speculation, but in regard to the permanent disposition of their funds . . ."

Definitions of "speculative" participations must vary with time and place and circumstances. The concept of *permanence* of investment, as contrasted with transactions entered into for a quick turnover or profit, is, however, basic.

Conant v. Lansden, 409 Ill. 149, 98 N. E. 2d 773 (1951), is an interesting example of a generous attempt by the court to sort out the trustees' prudent, permanent investments from those made in a frantic, speculative attempt to extricate the trust from financial quicksand. The trustees held a majority interest in a small mercantile company, and when the company required additional cash the money was provided from the trust in exchange for unsecured promissory demand notes. No surcharge was levied as a result of loss ensuing from this attempt to preserve a major trust asset. The trustees went too far, however, when they endorsed notes of the mercantile company after it was in the actual process of being dissolved. Similarly, the trustees were not charged for loss on unsecured loans at 7 per cent interest to a leading dry goods concern at a time when "bank officers considered loans to it as good investments," but it was hardly felt to be prudent to make another such loan after the borrower was in default on two outstanding notes.

Similarly, the fact situation in *St. Germaine's Adm'r. v. Tuttle*, 114 Vt. 263, 44 A. 2d 137 (1945), shows a trustee prompted considerably more by hope than by realities. He bought preferred stock of the Tuttle Publishing Company. "The Tuttle Company was a heavy borrower at the banks, no dividends had been paid on its

common stock for over two years and its business was on the decline. The Tuttle Publishing Company started out without any surplus and on the same day that it issued its stock it mortgaged all its property for over $16,000, and soon began to lose money." The trustee's name, incidentally, was Tuttle.

Compare also the confused and confusing transactions entered into, in the midst of the 1929 crash, by the trustee of *Riggs v. Loweree,* 189 Md. 437, 56 A. 2d 152 (1947). He purchased Anaconda, sold it at a major loss, bought Standard Oil on margin, suffered a further loss. Taken in conjunction with his other activities it can hardly be denied that he was speculating rather than investing.

Hutchings v. Louisville Trust Co., 303 Ky. 147, 197 S. W. 2d 83 (1946), and *Humpa v. Hedstrom,* 341 Ill. App. 605, 94 N. E. 2d 614 (1950), each concern restrictions on investment powers—by the then statute and by the trust instrument—but in each case the investment would be of doubtful long-term validity if made in the exercise of full discretion, and even if the element of self-dealing were lacking.

Slay v. Burnett Trust, 143 Tex. 621, 187 S. W. 2d 377 (1945), is another example of self-dealing combined with obvious speculation; the trustees borrowed from the trust and made spectacular personal profits, but the court felt that the profits had best be turned over to the trust.

Investment in a trade or business is also forbidden as excessively risky, although it is, of course, proper to carry on the testator's enterprise when so directed by the will. *Nelligan v. Long* 320 Mass. 439, 70 N. E. 2d 175 (1946).

(6) ". . . considering the probable income, as well as the probable safety of the capital to be invested."

To state any clause of the Prudent Man Rule is to state, basically, the dual nature of the trustee's task—proper attention to the rights of both the life tenant and the remainderman. The prudent man is by nature moderate and balanced, looking to the future but living in the present. Thus his duty of loyalty runs equally to both sets of beneficiaries; his obligation to make the trust productive has its counterpart in the requirement that he not bleed the trust for the sole advantage of the income beneficiary.

Specifically, just as it is necessary that trust funds should produce income, *McInnes v. Goldwaite,* 94 N. H. 331, 52 A. 2d 795, 171 A.L.R. 1414 (1947), so too is it "settled that an unauthorized investment in wasting assets will not be sustained," *Nelligan v. Long* 320 Mass. 439, 70 N. E. 2d 175 (1946).

The Nelligan case makes the point, in a situation where authority is given to retain a wasting asset, a traprock business, that a depreciation reserve may or may not be in order depending upon

whether the authority is for a permanent retention of the asset, or merely until a sale can be conveniently made. In the former situation, says the court, the inference is that the power to retain is given for the benefit of the life tenant, especially since testamentary provisions for the wife and children "are to be liberally construed." The case is interesting in that it rules against amortization in the jurisdiction where the evil inherent in a failure to amortize has long been recognized.

The Missouri court describes as "the Massachusetts Rule" the practice of amortizing bonds purchased at a premium. *Mercantile-Commerce Bank & Trust Co. v. Morse,* 356 Mo. 336, 201 S. W. 2d 915 (1947). In this case the trustee was authorized to amortize, over the protests of the testator's grand-daughter who was the current life tenant, but the trustee was instructed that it should not, in the reverse situation, accumulate discounts on bonds bought below par and credit such discounts to income.

Much may apparently depend on who the income beneficiary is. In *Lang v. Mississippi Valley Trust Co.,* 359 Mo. 688, 223 S. W. 2d 404 (1949), for example, the court was obviously not too sympathetic toward the plea of the income beneficiary who was already receiving about $30,000 per year from the trust. Actually, this may have been the major factor on which the decision rested; the case concerned unproductive property which had been retained simply because the successor trustee in office did not have a power of sale under the trust instrument, and when the property was finally sold by court authorization it was held that there should be no allocation of the proceeds to income because the trustee did not have a duty to sell. It may be questioned whether the prudent trustee might not well feel that he has at least some duty to ask for a power of sale when he finds the trust burdened with an unexpectedly unprofitable investment.

For what is perhaps a more typical case of apportionment of the proceeds of sale of unproductive property see *Delaware Trust Co. v. Bradford,* 59 A. 2d 212 (Del. Ch. 1948).

Obviously the trustee cannot defend himself, when the principal deteriorates, by pointing out that the income had equalled or exceeded the current rate of return on usual trust investments. *St. Germaine's Admr. v. Tuttle,* 114 Vt. 263, 44 A. 2d 137 (1945). A rather more balanced attention to all interests would be that of the trustee who was limited by the testator to deposits in savings banks, but who nevertheless took it upon himself to ask for, and receive, authorization to invest somewhat more fruitfully. *Citizens' National Bank v. Morgan,* 94 N. H. 284, 51 A. 2d 841, 170 A.L.R. 1215 (1947).

Despite a growing appreciation of the income beneficiary's needs it is nevertheless not to be supposed that cases and commen-

tators will cease declaring that the trustee must lay primary stress on the preservation of capital.

In the *St. Germaine's* case, *supra*, for example, with its investment in stock of a family corporation which was clearly heading down-hill, the court automatically used the standard phraseology, "considering the probable income, as well as the probable safety of the capital." In the very next sentence, however, the opinion adjures the trustee that he "must always bear in mind that the primary object of the creation of the trust is the preservation and perpetuity of the fund until the time for its distribution arrives; and he must make no investment by which this object may be at all likely to be defeated."

A more balanced approach may be expected when the court itself is considering an investment program. In *Security Trust Co. v. Mahoney*, 307 Ky. 661, 212 S. W. 2d 115 (1948), the testator had placed his farms in trust, with directions that they not be sold. When the real estate became unproductive, however, authorization was given to sell, and the life tenant then sought to have the proceeds invested in a blue chip common stock list. She was successful —at least to the extent of 75 per cent of the fund; (the court felt that 25 per cent should be put in government bonds). While emphasis formerly lay on preservation of the trust, it now "seems to be a well settled principle that a trustee, in administering an estate for present beneficiaries of income and for remaindermen, is bound as much to secure the usual rate of income upon sale investments for the present benficiary of income as to preserve the corpus for the benefit of the remaindermen . . . . In order then impartially to discharge this dual duty, it is proper to invoke the aid of the prudent man investment doctrine."

The so-called "deviation" cases, where permission is sought to broaden the investment powers contained in the trust instrument, often furnish an insight into the approach which a particular court expects of its trustees. To some degree the court in these cases is given the opportunity to say that it is as imprudent for a trustee as for anyone else to be so occupied with preservation of principal that he loses sight of the need for income.

In Connecticut, *Second Ecclesiastical Society v. Attorney General*, 133 Conn. 89, 48 A. 2d 266 (1946), and Missouri, *St. Louis Union Trust Co. v. Ghio*, 240 Mo. App. 1033, 222 S. W. 2d 556 (1949), liberal decisions expanded the scope of investments available to the trustee. In Minnesota, however, the trustee was unsuccessful when he sought authority, after passage of the Minnesota Prudent Man Statute, to expand his granted powers so as to invest in stocks. The court quoted the familiar line, "prime consideration is the necessity for the preservation of the estate," and refused to allow deviation

from the will merely to produce higher income or benefits to the beneficiaries. *In re Trust under Will of Jones,* 221 Minn. 524, 22 N. W. 2d 633 (1946).

Charges of favoritism toward either life tenant or remainderman may, of course, arise in myriad ways. It may be urged that too many trust expenses are being paid from income. *Chicago Title and Trust Co. v. Shellaberger,* 399 Ill. 320, 77 N. E. 2d 675 (1948). Or that not enough expenses are being charged to income. *Merchants Bank & Trust Co. v. New Canaan Historical Society,* 133 Conn. 706, 54 A. 2d 696 (1947). Or that capital improvements are being made in bad faith in order to deprive the beneficiary of his income. *Craven v. Craven,* 407 Ill. 252, 95 N.E. 2d 489 (1950). Or that a discretionary power to make principal payments is being abused. Compare *Smith v. Paquin,* 325 Mass. 231, 90 N.E. 2d 1 (1950).

* * * * * *

It is apparent, in short, that the trustee operating under the Prudent Man Rule will find himself with many decisions to make; he will certainly need sympathetic and sometimes generous courts to protect him in those decisions. He assumes a heavy duty. Yet I cannot but think that he must be comforted when he compares his lot to that of his brother in Mississippi who succeeded to a trusteeship where only the named trustee had been granted discretionary powers. The court, *In re Hart's Estate,* 206 Miss. 498, 40 So. 2d. 263 (1949), authorized the retention of stable common stocks, but just to be sure that things didn't get completely out of hand it required the trustee to report the values of the stocks to the court every six months—so that decision might be handed down for guidance during the succeeding half year!