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Alex B. Stevenson

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WHY THE PRUDENT MAN?

ALEC B. STEVENSON*

In the law relating to fiduciary investments there has been going on of recent years something very like a revolution. One needs an excuse for adding anything at all to the very considerable volume of comment about the Prudent Man Rule for trust investment. However, failing the hope that anything really new may be said, there does remain a persistent belief that the rationale of what has happened has been somewhat oversimplified.

In the interests of perspective, accordingly, it might be serviceable if we were first (and briefly) to re-examine some of the history of the more dramatic highlights of the revolution, but if next we were to attend somewhat more fully to phases of the Rule in daily practice which we may assert to have had quite as much to do with its wider adoption as have some of the more publicized causes.

The actual trend of events has been dramatic enough, overturning in state after state, as it has in a comparatively few years, the legal embodiments of a trust investment philosophy which had long dominated the greater part of the area and population of the United States.

As recently as 1939 there were only nine jurisdictions in which the trustee, either by law or statute, enjoyed that freedom of choice and concomitant acute necessity for the exercise of sound discretion which characterize the Prudent Man Rule. Yet by November, 1953, there were only twelve or fifteen states (depending on how the statutes are classified) in which, whether or not diluted, whether or not applying to all kinds of fiduciaries, the rule (or something very like it) was *not* the law, either by fiat of the legislature or decision of the bench.[1]

Why, between 1939 and 1953, did so many states after decades under the respectable and comfortable umbrella of a legislatively defined list of trustee investments, abandon that shelter? Or, to put it another way, why is it that after 123 years Justice Putnam's pungent Yankee precepts, soundly and drily laid down like Massachusetts salt cod, have only now, so to speak, gained elsewhere the acclaim and observance they have long enjoyed in his native state? The full answers to these questions lie, to be sure, in the whole social and economic history of the United States. Various parts of the story have been treated ably and at length elsewhere,[2] and neither the scope nor the purposes of this

* Partner, Vance, Sanders & Company, Boston. Formerly Vice President and Trust Officer, First American National Bank, Nashville, Tennessee.

1. For a check list of relevant statutes and decisions, see Appendix, *infra* p. 91.
2. *E.g.*, Price, *Fallacy of Statutory Investment Standards*, 73 TRUSTS & ESTATES 71 (1941); Shattuck, *The Development of the Prudent Man Rule for*

paper would permit the exhaustive treatment they should receive. Perhaps the simplest answer — and one not too wide of the mark — is to say that only in the last twenty years or so did a series of events occur and conditions arise which rather clearly indicated the inadequacy of the "legal list," or "New York" trust investment rule. Meanwhile the Prudent Man Rule had not been found wanting in ability to adapt itself to and cope with

> "new financial institutions and business customs, changed commercial methods and practices, altered monetary usages and investment combinations."[3]

Reference to the two leading cases will help to fill in the background. First, in the very famous case of *Harvard College v. Amory*,[4] Justice Putnam, using only sixty-eight words, laid down what has become recognized as the heart of the Prudent Man Rule:

> "All that can be required of a trustee to invest, is, that he shall conduct himself faithfully and exercise a 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."[5]

Bearing in mind that the case involves examination, and eventual approval of the propriety of, retention of and investment in shares of banks, insurance companies and mill enterprises, at a time when the weight of English trustee tradition was still heavy in favor of investment in debt rather than in ownership, the revolutionary character of Justice Putnam's decision is apparent. Not less radical than the approval of share investment itself was the objective character of the Rule enunciated. Reference to the quoted phrases discloses four highly important principles, among others, to which the trustee must conform:

(1) It is not enough that the trustee have discretion, he must exercise it; that is, form judgment, and then act.

(2) The trustee cannot take for granted what the investment practice of prudent men may be; he must investigate.

Fiduciary Investment in the United States in the Twentieth Century, 12 Ohio St. L.J. 491 (1951); Shattuck, *The Massachusetts Prudent Man in Trust Investments*, 25 B.U.L. Rev. 307 (1945); Shattuck, *The Massachusetts Trustees' Investment Rule, Its Virtues and Defects*, 21 Trust Bull. No. 9, p. 10 (May 1942); Torrance, *Legal Background, Trends, and Recent Developments in the Investment of Trust Funds*, 17 Law & Contemp. Prob. 128 (1952); White and Lawres, *The Modernization of Legal Lists*, 5 Law & Contemp. Prob. 386 (1938).

3. Kimball v. Whitney, 233 Mass. 321, 331, 123 N.E. 665, 666 (1919).
4. 9 Pick. 446 (Mass. 1830).
5. *Id.* at 461.

(3) The trustee cannot appraise as of equal interest and merit for his purposes all the financial commitments of the prudent man; he must consider only those not made as speculations.

(4) It is naturally assumed that a trustee will think of the safety of the capital to be invested; Justice Putnam reminds him that impartiality between beneficiaries is his duty, and he must consider "probable income as well."

It was not unnatural that these results were reached in Massachusetts, a community then both socially more mature and financially more sophisticated than most of the rest of the country. It was nearly forty years before there arose in New York a case in which the court flatly contradicted the basic assumption of *Harvard College v. Amory,* which was, to quote a much more recent case, that

> "the preservation of trust estates depends more upon the integrity, honesty and business acumen of the trustees than it does upon arbitrary legal classification of securities wherein trust funds may be invested."[6]

In the New York case[7] there were factual elements of similarity to *Harvard College v. Amory,* and also even in the language of the court as to the requirement of prudence: it was only the scope of prudence which the court narrowed. After paying tribute to the rule of prudence in words closely paraphrasing those of Justice Putnam, after decrying speculation, and after emphasizing the importance of the "preservation of the fund and the procurement of a just income therefrom," the court then proceeded to disallow investment in shares of stock in the following words:

> "The moment the fund is invested in bank, or insurance, or railroad stock, it has left the control of the trustees; its safety and the hazard, or risk of loss, is no longer dependent upon their skill, care, or discretion, in its custody or management, and the terms of the investment do not contemplate that it ever will be returned to the trustees.
> "If it be said, that, at any time, the trustee may sell the stock, (which is but another name for their interest in the property and business of the corporation), and so re-possess themselves of the original capital, I reply, *that* is necessarily contingent and uncertain; and so the fund has been voluntarily placed in a condition of uncertainty . . . ."[8]

Justice Putnam was either more cynical or more perceptive in his decision. He simply remarked, "Do what you will, the capital is at hazard."[9]

6. Rand v. McKittrick, 346 Mo. 466, 142 S.W.2d 29, 31 (1940).
7. King v. Talbot, 40 N.Y. 76 (1869).
8. *Id.* at 88-89.
9. Harvard College v. Amory, 9 Pick. 446, 461 (Mass. 1830).

Though much more was involved in *King v. Talbot*[10] than merely a judicial preference for evidences of debt rather than evidences of ownership in the trustee's portfolio, it was this aspect which drew the most attention, and, as Torrance points out, "found reflection in the laws favoring trust investments not only in New York but in a number of other states."[11]

Resulting statutes specified, often with the most elaborate detail, precisely the investment formulae, ratios and fiscal standards by which the "legal" trust investment was to be tested, or, in many cases, empowered appropriate state authorities using such standards to publish lists of legal trust investments. Despite the fact that the legislative wisdom was a wisdom after the event, the standards by which investment excellence was to be established eventually failed in practice, though it was many years before the failure became apparent.

First, the great economic disaster of 1929-1933 shocked those who put too much faith in the form of investment, since it wiped out values of all kinds, bonds as well as stocks, and second, after 1933, in a more prosperous economy, but one very different from any that had gone before, the legal list philosophy failed, because its nature was to fail to adjust itself rapidly enough to change conditions. In the long years of growth and continent-taming from 1865 to the early 1900's the demand for capital had resulted, in the main, in liberal interest rates, and, again in the main, the cost of living was not high. These were conditions favorable to investment in debt: why risk equities when the rewards were not sufficiently greater? But when, with the 1929-1933 debris still littering the scene, there followed a systematic and artificial lowering of interest rates, a systematic and artificial raising of commodity prices, a systematic and punitive increase in the rate of income taxation, the abandonment of the convertibility of currency into gold and the nullification of the gold-payment clauses in private and public debt, and by legislation and court decision (especially in the railroad bankruptcy cases) the evisceration of the preferred position of the mortgage creditor — when all these things happened, and high grade common stocks were yielding twice or more as much as good bonds, is it any wonder that trustees and income beneficiaries alike begin to ask for freedom to choose?

Even in some of the legal list states trust institutions reported that 70% to 80% of trust instruments gave the trustee full discretion as to investments,[12] and an American Bankers Association inquiry showed similar indications.[13] And the changed attitude of testators and settlors

10. 40 N.Y. 76 (1869).
11. Torrance, *supra* note 2, at 130.
12. STEPHENSON, GILBERT T., STUDIES IN TRUST BUSINESS, SECOND SERIES 77-78 (Trust Division, American Bankers Ass'n, 1944).
13. 21 TRUST BULL. 13, 20 (1941).

was discussed in a 1943 study by the Graduate School of Banking of American Bankers Association, showing that they were very much more interested in the welfare of their life beneficiaries than of their remaindermen, even to the extent of granting their trustees power to use principal for the life beneficiaries.[14]

In New York itself, by 1950, the legislature had passed a limited 35% Prudent Man amendment to the trust investment statutes. The amendment was inspired by a thorough study made by the Trust Division of New York State Bankers Association.[15] It included a careful appraisal of the results of the New York legal list of trust investments, and of the relative performance of trusts under restricted and unrestricted powers.

Some of the comments are illuminating.

> "Inclusion of a bond in a legal list creates a strong presumption of its safety. We have seen that this presumption is not always justified."[16]

> "The legal list has not been notably more successful than the other methods in selecting issues of better quality. It has demonstrated little responsiveness to the broad trend of economy developments, and has not been especially effective in warning of trouble to come . . . . *nevertheless, over the years legal bonds have commanded a premium in the market, with the result that investors were obliged to accept 1/8 to 1/4 of 1% less in yield when purchasing legal bonds as compared with bonds of similar quality which were not eligible.*" [Italics supplied][17]

> "Any official list requires frequent revision and legislative correction is usually tardy."[18]

> "The concept of a legal list originating in New York State more than fifty years ago, and involving publication of an official list for the guidance of inexperienced trustees, was appropriate to a period of extremely meager financial information. Today investment appraisals can be made on the basis of access to sources of financial information which had not even been imagined a half century ago . . . successful investment experience in a dynamic country like the United States depends largely on a *perception of current trends and the ability to appraise the significance of new developments.* This approach is the reverse of the concept of statutory formulas for which the past is projected into the future regardless of the circumstances prevailing." [Italics supplied][19]

The phrases italicized just above do not state but certainly imply what is the real difficulty with the legal list approach, namely, the inability of the trustee to do anything about the situation after he has

14. STEPHENSON, *op. cit. supra* note 12, at 78.
15. REPORT OF THE TRUST INVESTMENT STUDY COMMITTEE, TRUST DIVISION, NEW YORK STATE BANKERS ASS'N (1949).
16. *Id.* at 50.
17. *Id.* at 54.
18. *Id.* at 57.
19. *Id.* at 62-63.

appraised "the significance of new developments." On the other hand, the critics of the so-called excessive liberality of the Prudent Man Rule should remember that equally with the freedom it gives the trustee to invest, for example, in common stocks when prudent, it imposes the duty not to invest in them when such a course is not prudent.

While the question of a just income for the life beneficiary has been the focal point of much of the debate between proponents of the two rules, back of this has lain, as is evident in the cases, the more fundamental problem of the duty and the powers of the trustee under changed and unforeseen conditions, and in emergencies and the like. Consider the situation reported by the New York State Bankers Association, which made a study of a hypothetical trust restricted to New York legals over a twenty-year period beginning in 1927. Beginning annual income was $4700. It had dropped to $3800 by 1937 and to $2900 in 1949. The report says:

> "If we assume that the income from such a trust is for the benefit of a widow with two dependents, the present income, which is 40% lower than that of twenty years ago, and 25% lower than that of 1937, must meet a cost of living close to 70% higher than in 1937 and Federal taxes ten times as high."[20]

To the unfortunate if hypothetical widow just mentioned, two remedies were open, either to ask for the annual use of some of the principal (if, happily, powers of encroachment existed in the trust instrument), or to petition the court for a deviation from the investment terms of the trust. Neither is a very good substitute for an original grant of responsible discretionary powers to the trustee in the matter of investments, for in the latter event, as the cases show, the attitudes of the courts vary widely and frequently are not sympathetic to income beneficiaries. Nevertheless, if the trustor and his draftsman have been unimaginative and inflexible, and if the investment statutes are likewise, then only the court can, in its discretion, say how much, if any, relief may be granted.

Thus, in 1927 a New Hampshire testator[21] executed a will, setting up trusts which he directed were to be invested entirely in savings bank deposits, at a time when the interest return on such deposits average about 4.15%. In 1932, the year of the testator's death, the average was still around 4.1%, but by 1946 it had shrunk to 1.951%. The court held that the circumstances amply justified deviation from the terms of the will, but a deviation, it said, to be allowed only with respect to

20. *Id.* at 119.
21. Citizens' National Bank v. Morgan, 94 N.H. 284, 51 A.2d 841, 170 A.L.R. 1215 (1947).

the investment of enough of the corpus in other legal investments[22] to make good the shrinkage of income. And, further, the court said:

> "The aim is not to better the interests of the life tenants over and above the provisions made for them but to prevent impairment of the gifts enjoyed by them at the establishment of the trust by the different, unforeseen circumstances, in so far as this can be done by investments authorized by law for trustees . . . . It is true there is no allegation of need or suffering on the part of the life beneficiaries. . . . It is shown that these beneficiaries are losing substantially with respect to the gifts the testator provided for them. . . . The requirement that the funds must be invested as stated by the statute . . . sufficiently safeguards the remaindermen."[23]

The court was acting under a statute[24] permitting deviation under changed conditions, whether actual or "reasonably foreseeable," which "would defeat or substantially impair the accomplishment of the purposes of the trust."

The New Hampshire court said further,

> "Substantially lower interest rates should be carefully considered by a trustee and the court of equity as well as the factor of inflation. The one as well as the other results in loss that is an impairment of the gifts of a trust. It is true that the lower dividends of the savings banks affect only the life tenants, but their rights must be protected as well as those of the remaindermen."[25]

Not all courts have been as favorably disposed toward income beneficiaries, though one cannot on principle quarrel too violently with a strict adherence to the terms of the trust, and to the best guess that can be made as to the intent of the testator. At the same time, it is well to remember, first, that in practice what the testator meant often does not correspond with the meaning of his words (or his draftsman's words)[26] and, next, that the testator, as a layman, is thinking much more of the most effective use of his property for the benefit of those closest to him than, by either inclination or indeed awareness of the situation at all, he is of the problems of construction of the trust instrument that may arise after his death.

The courts are reluctant, and properly so, "to assume the role of rewriting a will by substituting their judgment for that of its creator at every suggestion of a trustee or beneficiary of a plan of administra-

22. The New Hampshire statute permits up to 50% of a trust estate to be invested under the Prudent Man Rule. N.H. REV. LAWS c. 363, § 17 (1942).

23. Citizens' National Bank v. Morgan, 94 N.H. 284, 51 A.2d 841, 843-44, 170 A.L.R. 1215 (1947). See also 2 SCOTT, TRUSTS § 167, pp. 840-41 (1939); RESTATEMENT, TRUSTS § 167(1) (1935).

24. N.H. REV. LAWS c. 371, § 4 (1942).

25. Citizens' National Bank v. Morgan, 94 N.H. 284, 51 A.2d 841, 844, 170 A.L.R. 1215 (1947).

26. *In re* Rayner, [1904] 1 Ch. 176, 180. See Schaefer, *Intent of the Testator*, 92 TRUSTS & ESTATES 716 (1953).

tion thought to be better than the plan originally designated."[27] Nevertheless, one of the great difficulties in the legal list states has been that even where relief was granted when the investment restrictions of the trust instrument were more severe than those of the legal list, the relief afforded has usually been inadequate, and this is for a good reason, since it has been stated that

> "Whether, in order to provide for an emergency, an equity court has 'power' or jurisdiction to authorize investments outside the designations of a so-called 'mandatory' statute defining trust investments is a question which does not appear as yet to have been squarely decided." "[Footnote to text] In Re Muller (1935) 155 Misc 748, 280 NYS 345 . . . the court stated that it knew of 'no power in any court to disregard the command of the legislature' as to trust investments."[28]

Even where the courts have had somewhat more latitude than in New York, the results have not always been pleasing to the income beneficiaries. In New Jersey relief was denied with the statement that it is "not the province of this court to allow trustees to speculate in stocks which might result in loss to the remaindermen."[29] And this was said despite the existence of a statute empowering the court to authorize and direct non-statutory investments, including common and preferred stocks. In another New Jersey case the court felt that a mere slight shrinkage in income from a trust, such as from $70,000 to $54,000, is not sufficient to establish that the purposes of the trust may be defeated, and relief was denied with the statement:

> "It appears that the sole purpose to be accomplished is to increase income by investing in stocks that will produce more but will not be legals. . . . In this case the whole situation was put upon the basis of economics, not the necessity of the beneficiaries."[30]

Again a New Jersey court, holding that statutes at inception of the trust were controlling, refused permission to deviate, saying:

> "The income from the principal of the trust has steadily decreased to a point where it is only approximately 50 per cent of what it was in the years immediately following the inception of the trust.

27. Wentworth, *Deviations from Terms of Will*, 92 TRUSTS & ESTATES 720 (1953).

28. Note, 170 A.L.R. 1219, 1221 and n.15 (1947). The New York court appears to have placed considerable reliance on Cruger v. Jones, 18 Barb. 467 (N.Y. 1854), which, however, involved not the question of investing outside the statute but rather a requested permission for trustees to be allowed to mortgage trust property, an action declared by statute to be void. See also *In re Jones' Will*, 202 Minn. 187, 277 N.W. 899 (1938).

29. Bliss v. Bliss, 126 N.J. Eq. 308, 8 A.2d 705 (1939), *aff'd per curiam*, 127 N.J. Eq. 20, 11 A.2d 13 (1940).

30. Reiner v. Fidelity Union Trust Company, 127 N.J. Eq. 377, 13 A.2d 291, 292-93, 128 A.L.R. 964 (1940), *reversing* 126 N.J. Eq. 78, 8 A.2d 175 (1939).

> "Vera Grace Osborne is almost entirely dependent upon her share of the income for her maintenance and support. . . . True, the income is presently affected but the security of the principal is intact for aught that appears herein. . . . *Shrinkage in income is not sufficient of itself to permit the court's intervention upon the ground that the trust might be defeated.*" [Italics supplied][31]

In Minnesota the court refused a petition to allow investment under the Prudent Man statute, passed since the death of the testator, and referring to its own earlier construction of the testator's intent as to classes of investments to be permitted, quoted with approval the following statement:

> " 'A court will emphasize the ultimate intention of the trustor rather than the interests of the beneficiaries, and the prime consideration is the preservation of the estate, and not merely the administration of the trust in a way to produce a greater benefit for the beneficiaries.' "[32]

The court, applying this principle, found that

> "There has been no showing that authority to deviate from the terms of this trust is necessary to effectuate the ultimate intention of the testator."[33]

With the attitudes of the courts just cited, compare those below described for example in Nebraska, where a home for poor working girls was involved, maintenance and operation of which was provided for out of a trust established in a will executed in 1904. It appeared that the average interest yield on book value of the trust investments had declined from 10.19 per cent in 1916 to 2.55 per cent in 1940, and that the home was running at a deficit. Deviation was permitted, with these comments:

> "The secondary restriction on investments made in the will and in the authority given the trustee by the court must yield to the primary purpose of the trust, which is the effective operation of the home. The primary object is to preserve the trust property so that it may be used to the greatest advantage of the beneficiaries. This property must produce an income. To do so it must be safely invested in productive property. The present base . . . is shown to be inadequate to the need. The broader base proposed permits a wider diversification of investments, assuring a better balanced investment of the funds of the trust and should tend to safeguard the preservation of the principal fund."[34]

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31. National Newark & Essex Banking Co. v. Osborne, 16 N.J. Super 142, 84 A.2d 38 (1951).
32. *In re* Jones' Will, 221 Minn. 524, 22 N.W.2d 633, 634 (1946), quoting 54 AM. JUR., *Trusts* § 285 (1945). See also the earlier case with the identical style at 202 Minn. 187, 277 N.W. 899 (1938).
33. *In re* Jones' Will, 221 Minn. 524, 22 N.W.2d 633, 635 (1946).
34. Creighton v. Waltman, 140 Neb. 3, 299 N.W. 261, 266 (1941).

And in New York, once the statutes had been amended so that a uniform, and, what may have been even more important, a *statutory,* uniform standard of prudence was established with respect to investments made outside the old legal list, we find evidence of changed judicial attitudes. For example,

> "testator showed his keen business acumen in realizing that what corpus might be sufficient when the will was made might not be adequate when he died, or in later years when conditions might materially change. His first thought, therefore, must have been to insure adequate support for his widow under the standards when he fixed at $7500.00 per year. [At the time of trial, income from the trust had declined to $5000.00 annually.] . . . It was impossible in 1930 for any person to have forseen[*sic*] the changes and developments which were to take place either in general inflation or in the continued successful expansion of the Corning Glass Works. . . . Section 21, Subd. 1(m) of the Personal Property Law seems to be designed among other purposes to assist situations such as this and make it possible for a cestui que trust to combat the inflation of the times without jeopardizing the securities for the remaindermen."[35]

In another recent New York case, granting relief, the court commented that events had moved in such a way as to "narrow the trustees' investment field to an extent that the testator could not have contemplated."[36] Earlier, in a case where the trust instrument authorized investment outside the legal New York list, the court remarked, in refusing to surcharge the trustee,

> "He must, however, exercise reasonable care and prudence. Those on their face are terms which may be thought irritatingly vague, but in their practical operation they reflect a recognizable standard. . . . As the learned referee has stated in his opinion, an imprudent investment even in legals and under an investment clause conferring broad discretionary powers is not justified."[37]

The foregoing sample collection of cases, typical of many more on both sides of the debate, shows more clearly than any citation of textbook authority that the legal list cannot accomodate itself — or only too tardily at best — to changing conditions which may defeat or impair the purposes and gifts of a trust. It also shows that the rule of prudence does, as Justice Rugg said in *Kimball v. Whitney*[38] thirty-four years ago, adapt itself to "new financial institutions and customs." Since *King v. Talbot*[39] laid down the New York rule the tendency of courts in the legal list states has generally been to regard common stocks as

35. *In re* Sinclaire's Will, 203 Misc. 56, 116 N.Y.S.2d 624, 626 (Surr. Ct. 1952).
36. *In re* Daly's Estate, 203 Misc. 851, 120 N.Y.S.2d 896, 900 (Surr. Ct. 1953).
37. *In re* City Bank Farmers Trust Co., 68 N.Y.S.2d 43, 46-47 (Sup. Ct. 1947).
38. 233 Mass. 321, 331, 123 N.E. 665, 666 (1919).
39. 40 N.Y. 76 (1869).

that earlier court (and later the legislature) did; that is, as speculative essentially, by their very nature.[40] Accordingly, as we have seen, the result, and the logical result was to shrink from authorizing investments outside the statute when the investment powers in the trust instrument seemed to be restricted to the "legal" class, and also when the question was as to departure from individual and specially phrased language. On the other hand, one frequently finds that these same courts point out the applicability of the rule of prudence, not merely in cases involving discretionary investment powers[41] but also in situations where the fiduciary is acting under the legal list statute. Thus,

> "The statutory authority to invest trust funds was never intended to act as a cloak exculpating trustees from the performance of their duties as prudent men."[42]

> "The fiduciary who invests in securities within the specified classes is not by the statutes freed from liability for resultant losses if he fails to exercise reasonable judgment and discretion in making the investment."[43]

So, as we have seen, though the divergence between the New York and Massachusetts rules, *as applied to investment in stocks,* remained the principal point at issue for many years, in other respects affecting the duties of trustees there were very considerable areas of agreement. There had been in the early days, even in New England, a residual worry (noted by Torrance in his excellent article)[44] where the court said

> "the question as to what are good and proper securities is left somewhat at large, and must be conceded to be not without its difficulties."[45]

Torrance goes on to say

> "here, incidentally, we have in large part the explanation of our legal lists. It was to resolve just such questions that some states deemed it advisable to set precise statutory standards for trust investments. They had their uses during a certain stage of our economic development, but more and more, as we shall see later, they are passing from the scene."[46]

40. Fidelity Union Trust Co. v. Price, 18 N.J. Super 578, 87 A.2d 565, 569 (1952), citing Gray v. Fox, 1 N.J. Eq. 259 (1831), saying, "The stock of private companies is not considered safe."

41. *In re* Leonard's Will, 118 Misc. 598, 193 N.Y. Supp. 916 (Surr. Ct. 1922); *In re* Hall, 164 N.Y. 196, 200, 58 N.E. 11, 12 (1900).

42. *In re* Doyle's Will, 191 Misc. 860, 79 N.Y.S.2d 695, 697 (Surr. Ct. 1948).

43. *In re* Weinz' Will, 65 N.Y.S.2d 302 (Surr. Ct. 1946).

44. Torrance, *supra* note 2, at 133-34.

45. Kimball v. Reding, 31 N.H. 352, 374, 64 Am. Dec. 333, 336-37 (1855).

46. Torrance, *supra* note 2, at 134.

Before passing on to other considerations, it will be appropriate to observe that, while we have been concerned so far mainly with the Prudent Man Rule as affecting the trustee's acquisition of investments, it does in actuality, cover many other phases of his activities. Shattuck annotated the Rule as construed in Massachusetts very carefully taking the phrases directly from the *Harvard College v. Amory* opinion, and remarked that one of the virtues of the Rule was its "consistency with the general body of law governing trust administration."[47] Among other matters taken account of by the Massachusetts courts and referred to in Shattuck's article were: duty of loyalty, purchase of improper investments, failure to diversify, undue retention of investments, failure to make trust property productive, failure to supervise agents employed in the business of the trust, commingling of trust assets, duty not to delegate, duty not to speculate (including transactions entered into for a quick turnover or profit), duty of impartiality (including purchase or retention of wasting, unproductive or unproductive property), deviation from terms of the trust instrument, etc. As to this last matter, Shattuck cites cases where, contrary to the frequent practice in legal list states, trustees' powers, where narrower than the standard, have been broadened by court decree.[48]

It was no doubt due to his consciousness of the extent to which and the period of time over which the Prudent Man Rule had been construed in his native state that led Shattuck, as adviser and draftsman for the Trust Division of American Bankers Association, to use Justice Putnam's words as the effective heart of the Model Statute, later to be adopted by so many states. The statutory embodiment of these oft-construed words should obviously be of great assistance to both courts and trustees in states where cases under the Rule might often be ones of first impression.

The Tennessee Prudent Man statute,[49] varies very slightly from the Model Act. As is the case in other states adopting the Model Act, provision is made not only with respect to acquiring, investing, reinvesting, exchanging, selling and managing trust property, but also with respect to retaining it. Further, there is a provision with respect to the power of a court to authorize deviation from terms of the trust. In some states special statutes now exist, stating conditions under which deviation may be permitted,[50] quite probably in reflection of the difficulties experienced by trustees and beneficiaries alike.

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47. Shattuck, *The Massachusetts Prudent Man in Trust Investments*, 25 B.U.L. Rev. 307, 312 (1945).
48. *Id.* at 340 n.137, citing Estate John P. Monks, Sup. Jud. Ct., Suffolk County, Docket No. 61020 Eq.; and Estate of Wm. B. Rice, Norfolk County Probate Ct., Docket No. 44455.
49. Tenn. Pub. Acts 1951, c. 125.
50. La. Rev. Stat. §§ 9:1942 and 9:1275 (1950); N.H. Rev. Laws c. 371, § 4 (1942); N.J. Stat. Ann. § 3A:15-15 (1953); N.D. Rev. Code § 59-0415 (1943); Vt. Rev. Stat. § 3127 (1947).

The Tennessee statute also gives attention to two other matters not covered by all (though treated by some) of the model statutes enacted in other states, and includes among the enumerated kinds of investments both common trust funds and investment trusts and companies. Inclusion of these items was in recognition of discussion prevalent for some years of the alleged improper delegation and commingling involved in purchases of such property. As to common trust funds, a number of decisions have placed them within the definition of "securities" and, when appropriate, as legal investments.[51] The so-called delegation involved in the purchase of investment company shares by fiduciaries, in the debate concerning which the present writer took part, was denied, however, in two cases, including one under the Model Prudent Man Statute in Oklahoma, where the statute did not mention investment company shares.[52] In Massachusetts, in 1948, sixteen of the twenty Probate Judges in their annual meeting addressed a letter to Shattuck stating that fiduciary purchases of investment company shares "are not such a delegation of authority on the part of a trustee as would warrant an objection on that score alone."

The wide popularity and distribution of investment company shares, and the substantial amount of money invested therein (currrently estimated at nearly $4,000,000,000), have brought about considerable judicial and legal attention. At the present writing eleven out of the group of thirty-two states and one territory having the Prudent Man Rule in whole or in part, have statutory provisions specifically mentioning investment company shares. Of the seven legal list states whose statutes permit stock purchases under certain restrictions two include investment company shares. It now appears, as Shattuck stated, that "the standard laid down by *Harvard College v. Amory* is destined to be the American trustee's guide for years to come."[53]

It will still be subject, and should, if it is to live, continue to be subject to searching analysis and debate. There will always be the question, "Who is the Prudent Man?" And, as long as our society continues to grow more instead of less complex, we can expect a continuation of the argument as to the precise nature of the trustee as conserver. What does he conserve, *res* or *quantum? Quantum* or

51. *In re* Peck's Estate, 199 Misc. 1051, 101 N.Y.S.2d 288 (Surr. Ct. 1950); *In re* Hoaglund's Estate, 74 N.Y.S.2d 156 (Surr. Ct. 1947).

52. *In re* Rees' Estate, 53 Ohio L. Abst. 385, 85 N.E.2d 563 (Ct. App. 1949), *affirming* 53 Ohio L. Abst. 513, 87 N.E.2d 937 (Prob. Ct. 1947); *In re* Flynn's Estate, 205 Okla. 311, 237 P.2d 903 (1951). See also STEVENSON, ALEC B., SHARES IN MUTUAL INVESTMENT FUNDS (1946); STEVENSON, ALEC B., INVESTMENT COMPANY SHARES (1947); Stevenson, Alec B., *Investment Company Shares,* 89 TRUSTS & ESTATES 228 (1950).

53. Shattuck, *The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century,* 12 OHIO ST. L.J. 491, 504 (1951).

value (purchasing power)? Can the prudent trustee be both cautious and aggressive? What is "security"?[54]

SUMMARY

The emphasis in this paper upon cases having to do with deviation from the terms of the trust is deliberate, because they so well illustrate both the value of the flexibility inherent in the Prudent Man Rule, and, also, draw attention to the circumstances with which the working trustee is all too familiar. Despite all the organized efforts made in the past, one suspects that the cumulative plaints of income beneficiaries have had more to do with liberalizing the investment powers of the trustee than any other one cause. When Mrs. Jones says, "Henry left this money to take care of me. Why can't you do it, like you and both know he meant you to do?", there is all too often a legally correct answer but still none that is satisfactory to Mrs. Jones.

In the legal list states the answer of the courts has often been, to paraphrase that of the New Jersey court quoted earlier,[55] "The principal is intact, even though the income has shrunk." The nub of the position of the Prudent Man advocates, accordingly, has been, "There are other kinds of sound investments available, which often pay greater income." It is true, as Torrance states that

> "To begin with, the position of the trustee as a conserver, rather than a creator, of capital, as indicated in the cases cited, is not just an accident or a whim. There are excellent practical as well as legal reasons why the emphasis is where it is. If we lose principal, we generally lose income, sometimes permanently."[56]

However, Torrance does not fall into the error of assuming either that preservation of principal lies only in the closest possible approximation to riskless investment, or that common stocks and other equity-type investments are never suitable as permanent trust investments. His penetrating comments[57] are worth careful study, particularly as regards purchasing power, inflation and the "growth" element in stocks, and they supplement the conclusions of the New York Trust Investment Study Committee, of which he was a leading member. The report of that committee, though it recommended that purchases outside the old list be limited to 35% of the value of a trust estate, rather eloquently said

54. For thoughtful comments on these and allied questions see Headley, *Trustees as Conservators,* 29 TRUST BULL. No. 7, p. 15 (March, 1950); Headley, *Trustees or "Gentlemen Adventurers?",* 88 TRUSTS & ESTATES 91 (1949); Shattuck and Headley, *Whither Trusteeship,* 89 TRUSTS & ESTATES 92 (1950).
55. National Newark & Essex Banking Co. v. Osborne, 16 N.J. Super. 142, 84 A.2d 38 (1951).
56. Torrance, *supra* note 2, at 134.
57. *Id.* at 143-152.

> "the plain fact is that prudent men do buy stocks. The prudent man buys them with discretion, after due investigation, 'with a view to the probable income as well as the probable safety of the capital to be invested.' He buys stocks that he is willing to consider permanent investments, in so far as anyone can judge the future, without any false notions or exaggerated hopes as to what they are or what they can do. . . . . He avoids new, weak, or untried situations; he knows he must seek these stocks which deserve the confidence of investors. He does not expect any insurance or guarantee of purchasing power, for he knows there is no consistent parallel between stock prices and living costs."[58]

Many studies of the investment merits of stocks vs. bonds have been made, and opinion now can be fairly said to accept the notion that, despite a greater tendency to fluctuate in quoted value (and, of course, in income), common stocks carefully selected and carefully watched, constitute a desirable complement to fixed-income investments in a trust portfolio.[59]

The realization has come that while, as Torrance states, loss of principal usually means loss of income, failure to maintain income (i.e., failure to provide continuous investment analysis) often means loss of principal. Investment analysis will frequently show that appraisal of corporate management is as important in evaluation of bonds as of stocks, or, as is frequently said, plant and equipment in themselves do not guarantee safety, even when pledged under mortgage.

The Director of Trust Studies, The Graduate School of Banking, American Bankers Association, himself a lawyer and a former trust officer, observed last year:

> "The method of the common law trust requires a permanent source of income and a continuous flow. The permanent source is provided by placing a capital fund in the hands of a trustee. The trustee is charged with a duty to preserve its dollar value. . . . The duty of the trustee, therefore, is two-fold: He must preserve the principal, for out of it flows the income; and he must so invest principal that the flow will be ample and continuous. Source and flow must be kept in balance. Principal must not be unduly risked to enlarge the flow; nor must the income be less than is consistent with the safety of the source. . . . in fact the chief purpose in maintaining a principal intact is to insure a steady flow of spending money to the dependent family. . . . What, then, of common stocks? . . . some of them have demonstrated, over a long period of years,[60] the qualities required for sound permanent investments. Intrinsic values have been maintained and dividends have been adequate and regular. The principal has been reasonably safe for a number of reasons: competent

58. REPORT OF THE TRUST INVESTMENT STUDY COMMITTEE, *op. cit. supra* note 15, at 106.

59. COWLES, COMMON STOCK INDEXES (1939); SCULLY, THE PURCHASE OF COMMON STOCKS AS TRUST INVESTMENTS (1937); Scully, *Why Common Stocks for Trust Funds*, 71 TRUSTS & ESTATES 294 (1940).

60. For a list of common stocks with long dividend records, see REPORT OF THE TRUST INVESTMENT STUDY COMMITTEE, *op. cit. supra* note 15, at 131-162.

> management, sound financing, position in an essential industry, a successful record and an adequate market."[61]

For many years the attitudė of the law, of trustees and of testators themselves was prejudiced in favor of the remaindermen, and economic and social conditions favored the trend. Reversal came about at the instance of trustees and testators, plus the beneficiaries of income, though actual results of maintaining more productive portfolios may in the end benefit remaindermen as well. There is no sign that trustees newly liberated are rushing into speculative courses of action, and if they do err on the side of risk taken deliberately or negligently, then court precedents under the Prudent Man Rule certainly hold little comfort for them. As to the courts, the record in the older Prudent Man states affords little grounds for belief that an ignorant and inexperienced judge may often do serious damage either to the trustee or his beneficiaries. However, as Shattuck has stated, the judge in a state having newly adopted the Rule has "a difficult task before him . . . he will need to acquaint himself with the oft expressed considerate attitude of the Massachusetts high court toward the problems of the trustee."[62] We have seen, on the other hand, that even courts in legal list states, when faced with a decision under the rule of prudence, seem to have been able to hand down opinions consonant with its principles and its spirit. To the problem of the ignorant and incompetent trustee there may be a more uncertain answer, though it does seem fair to say that most testators and trustors having sufficient property to consider setting up a trust are likely to consult a good attorney, either directly or in collaboration with a trust institution, and will be advised of the perils of appointing an inexperienced fiduciary. With investment information much more accessible than in other years, there is less and less reason, if there ever was a good one, for a too timid and underproductive trust investment policy.[62a] The recognition of the changed circumstances of modern times has even appeared in legislative acts themselves, as witness the preamble to the New Mexico statute:

> "The legislature, mindful of the fact that a fiduciary needs the power to acquire and hold diverse types of securities and property at various times and under varying economic conditions to best serve the beneficiaries or wards in providing income and preserving the trust or guardianship estate. . . ."[63]

61. Headley, *Trust Investments*, 90 TRUSTS & ESTATES 739, 739-741 (1952). See also Headley, *A Trustee in a World of Changing Values*, 5 LAW & CONTEMP. PROB. 355 (1938).
62. Shattuck, *The Massachusetts Prudent Man in Trust Investments*, 25 B.U.L. REV. 307, 346 (1945).
62a. *Matthew*, XXV, 14-30.
63. N.M. Laws 1951, c. 41.

Trusteeship, dealing always and at close range with human beings, is an art and not a science, and nowhere more so than where the matter of concern is the proper investment of trust property. Investment itself is merely an art, however much its practitioners may be aided by the elaborate factual analyses, ratios and carefully determined factors of safety which are supplied by the numerous and excellent financial statistical publishing houses, metropolitan trust institutions, investment counsel firms, investment bankers and the like. These, carefully constructed out of the records of the past, are the indispensable raw materials for the trustee's judgment, but cannot, save at his peril, be used as a substitute for it. That judgment must impartially correlate and compare past and present, and even, though eschewing prophecy, look also toward the future. These continuous and progressive acts of judgment no legislature, unless in constant session, is equipped to perform, as witness the record of failure in adaptation to changed circumstances. As was said by a Pennsylvania court

> "We must think in terms of business cycles, of the return as well as the ebbing of values, and of the cause of this. Fiduciaries cannot be put in a vacuum and set apart from other investors. They too must scan the turbulent horizon of our financial and industrial life and do the best they can."[64]

If they are really to "do the best they can" and are to be held responsible, it would be strange, indeed, in a country such as this, whose genius has lain not in totalitarian proscriptions and controls but in the creation and defense of free institutions by free men, had trustees not eventually been given that opportunity to choose which is the precondition of effective action and, indeed, of freedom itself. No one, to be sure, would argue seriously that human freedom is or should be absolute under any conditions of which we know. But an increase in relative freedom is one of the marks of an advancing civilization, just as a continuance of deterministic custom and law is a mark of primitive peoples.

> "The beginning of civilization is marked by an intense legality; that legality is the very condition of its existence, the bond which ties it together; but that legality — that tendency to impose a settled customary yoke upon all men and all actions, if it goes on, kills the variability implanted by nature, and makes different men and different ages facsimilies of other men and other ages, as we see them often."[65]

Nowhere is that variability more apparent than in the confused interplay of economic and social forces which the trustee must appraise and with which he must contend. If, having observed in the

64. *In re* Carwithen's Estate, 327 Pa. 490, 495, 194 Atl. 743 (1937).
65. Bagehot, Physics and Politics 64 (1873).

records the history of the inception, growth, maturity and decay of whole industries, he is bound alike to continue in the old pattern, and to shun the new even when proven, then his powers are stultified and his work is of little value to those whom he serves. How much better to let him be guided, if he is a man of conscience — and he should be — by some very old advice.

> "He himself made man from the beginning,
> And left him in the hand of his own counsel.
> If thou wilt, thou shalt keep the commandments;
> And to perform faithfulness is of thine own good pleasure.
> He hath set fire and water before thee:
> Thou shalt stretch forth thine hand unto whichsoever thou wilt."[66]

APPENDIX

A. The Prudent Man States (prior to 1940)

1939	Connecticut	CONN. GEN. STAT. § 6893 (1949), as amended by Pub. Acts 1953, 101.
1890	Kentucky	KY. REV. STAT. ANN. § 386.020 (Baldwin Cum. Supp. 1953).
1884	Maryland	McCoy v. Horwitz, 62 Md. 183 (1884).
1830	Massachusetts	Harvard College v. Amory, 9 Pick. 446 (Mass. 1830).
1937	Michigan	MICH. COMP. LAWS § 487.232 (1948).
1940	Missouri	Rand v. McKittrick, 346 Mo. 466, 142 S.W.2d 29 (1940).
1928	North Carolina	Sheets v. J. G. Flynt Tobacco Co., 195 N.C. 149, 145 S.E. 355 (1928).
1886	Rhode Island	Peckham v. Newton, 15 R.I. 321 (1886).
1908	Vermont	Scoville v. Brock, 81 Vt. 405, 70 Atl. 1014 (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 c. 342, § 22 (1942), as amended by Laws 1945 c. 363, § 17, and Laws 1949, c. 134, § 1—50%.
1943	California	CAL. CIV. CODE § 2261 (1949) — 100%.
1943	Delaware	DEL. REV. CODE c. 117, § 35 (1935), as amended by Laws 1943, c. 171, and Laws 1947, c. 268 — 100%.
1943	Minnesota	MINN. STAT. § 501.125 (1949) — 100%.
1945	Illinois	ILL. REV. STAT. c. 148, §§ 32 to 32.1c (Supp. 1952) — 100%.
*1945	Maine	ME. REV. STAT. c. 147, §§ 17a-17d (1944), as amended, Laws 1951, c. 24 — 100%.
1945	Texas	TEX. REV. CIV. STAT. ANN. art. 7425b-46 (1951) — 100%.
1947	Nevada	NEV. COMP. LAWS §§ 7718.55-57 (Supp. 1949) — 100%.
1947	Oregon	ORE. COMP. LAWS ANN. §§ 73-103a to 73-103d (Supp. 1947), as amended, Ore. Laws 1949, c. 220, § 1 — 100%.
1947	Hawaii	HAWAII REV. LAWS § 8661 (1945), as amended, Series C-147: Act 125, 1947 — 100%, *applying to trust companies only.*
*1947	Washington	Wash. Laws 1947, c. 100 — 100%.
1949	Idaho	Idaho Laws 1949, c. 36 — 100%.

66. *Ecclesiasticus*, XV.

1949	Kansas	KAN. GEN. STAT. §§ 17-5003 to 17-5007 (1949), as amended, Laws, 1951, c. 209, § 1—100%.
1949	Oklahoma	OKLA. STAT. ANN. tit. 60, § 161 (1951) —100%.
1951	Utah	UTAH CODE ANN. § 33-2-1 (1953) —100%.
*1951	Colorado	COLO. STAT. ANN. c. 176, §§ 126(5)-(10) (Supp. 1952) —100%.
*1951	New Mexico	N.M. Laws 1951, c. 41—100%.
*1951	Tennessee	Tenn. Pub. Acts 1951, c. 125—100%.
*1951	New Jersey	N.J. STAT. ANN. §§ 3.16-4.3 (Supp. 1951) —40%.
*1951	North Dakota	N.D. REV. CODE § 6-0504-6-0515 (1943), as amended, Laws 1951, c. 103—50% rule *applying to corporate fiduciaries only.*
*1951	South Carolina	S.C. CODE § 67-58 (1952) —30%.
1951	West Virginia	W. VA. CODE ANN. § 4216(1)(2) (1949), as amended, Acts 1951, c. 2, adding section 2a *applying only to charitable, educational, religious institutions,* etc.—100%.
*1953	Ohio	OHIO CODE ANN. § 2109.371 (Supp. 1953) —35%.
1953	Florida	FLA. STAT. ANN. § 518.01 (1943), as amended, Laws 1953, c. 28154—100%.

C. The Legal List States (of various types)

(1) States which do not permit investment in equities in any form
Alabama
Arkansas
Georgia
Iowa
Louisiana
Montana
Wyoming

(2) States in which eligible equities must meet prescribed tests, and in addition limit the amount which may be invested in equities

District of Columbia	Rule 23, Local Civil Rules of Dist. Ct.
Indiana	IND. ANN. STAT. § 31-501 (Burns 1949).
*Nebraska	NEB. REV. STAT. § 24-601 (Supp. 1947) (Not over 30% of a trust in stocks, including investment company shares, and in no event over 20% in investment company shares, all as set forth in the statute, and only with court approval).
*Pennsylvania	PA. STAT. ANN. tit. 20, §§ 821.1-821.20 (1950), as amended, Acts 1951, No. 340, and 1953, S.B. 203.
Virginia	VA. CODE § 26-40 (1950), as amended, Acts 1952, c. 196 (preferred stocks only). But see Powell, *The Virginia Prudent Man Rule of Trust Investments,* 34 VA. L. REV. 102 (1948), where the author argues that the Prudent Man Rule is in effect in Virginia, statutes to the contrary notwithstanding.
*Wisconsin	WIS. STAT. § 320.01 (1945), as amended, Laws 1951, c. 404, and Laws 1953, c. 164, § 1.

(3) States which have no specifically declared fiduciary law (fiduciaries do not usually purchase equities without specific authorization in the governing instrument)
Arizona
Mississippi
South Dakota

* States marked thus permit the purchase of investment company shares, sometimes with and sometimes without limitations.