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Trusts-Trustees-Investment Duties of Trustees and the Problem of Unduly-Conservative Trust Investments

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TRUSTS—TRUSTEES—INVESTMENT DUTIES OF TRUSTEES AND THE PROBLEM OF UNDULY-CONSERVATIVE TRUST INVESTMENTS—A few years ago a New Jersey court, in the case of *Commercial Trust Co. v. Barnard*,[1] was asked, in effect, to surcharge a trustee for being overly conservative in investing the *res* of a discretionary trust. The income beneficiaries and remaindermen alleged that the trustee had breached its duty by failing to exercise its discretionary power to convert investments in low-yield government

1 27 N.J. 332, 142 A.2d 865 (1958).

securities into more diversified higher-yield investments, despite a decline in yield from 14.27 percent in 1927 to 1.51 percent in 1955. Although recovery was denied, the court did not foreclose the possibility that a trustee may be surcharged, on the theory of breach of duty, for pursuing an unduly-conservative investment policy. In exonerating the trustee, the court emphasized the fact that the investment policy followed was actually quite reasonable, since the high tax bracket of the beneficiaries made it advisable that investments in their behalf be in tax-exempt securities.

In the more recent case of *In re Mayo*,[2] a Minnesota court was asked by a trust beneficiary to allow the trustee to deviate from the express terms of a trust, created in 1917, which prohibited investment in corporate stock. The court granted the trustees the right to invest a reasonable amount of the fund in common stock if the trustees felt such investments were advisable. In reaching its decision, the court took note of economic conditions, including a fifty percent decline in the purchasing power of the trust corpus since the settlor's death in 1939. The court's primary justification for its action was the belief that failure to allow deviation would frustrate the dominant intent of the settlor to preserve the trust principal.

Though the two cases described above dealt with admittedly different areas of trust law, both were concerned with a common problem. In both cases it was alleged that the investment policies followed by the trustee, although valid at the time of the establishment of the trust, were no longer fully exploiting the investment potential of the trust, resulting in detriment to the beneficiaries. As such, both cases indicate that trust law has not yet formulated a means of protecting beneficiaries against unduly-conservative trust investments, which may be as costly to them as an overly-speculative investment policy.

This comment will first examine the trustee's investment duties, particularly those relating to investments in securities, and then consider the factors which have brought to the fore the problem of the unduly-conservative trust investment. On the basis of this examination, it may be determined whether the present law in this area provides the beneficiary with adequate safeguards against the unduly-conservative investment. Finally, assuming such safeguards have not been provided, some suggested remedies

2 259 Minn. 91, 105 N.W.2d 900 (1960). *Cf.* Bliss v. Bliss, 126 N.J. Eq. 308, 8 A.2d 705 (Ch. 1939), *aff'd*, 127 N.J. Eq. 20, 11 A.2d 13 (Ct. Err. & App. 1940).

for this situation will be considered, including the possible imposition of a duty upon trustees to invest at least part of the trust funds in common stock.

I. Trustees' Investment Duties

A. *In General*

The trustee must invest the trust *res* in accordance with the expressed intent of the settlor or testator;[3] deviation will be sanctioned only in certain emergency situations.[4] However, due to the greatly increased use of the discretionary trust,[5] trustees frequently find few investment limitations imposed by the trust instrument itself. In such a situation, the trustee is required to act as would a reasonably or ordinarily prudent man in making his investment choices, and his failure to act as such will render him liable to the trust's beneficiaries.[6] Both decisional and statutory law have provided guidelines within which trustees must stay in order to satisfy this rather vague standard of reasonableness and thereby avoid the possibility of surcharge.

In applying the reasonable man standard, courts have maintained that a trustee has not fulfilled his obligations by merely acting as would a reasonable man investing his own money; rather, the trustee must act as a reasonable man investing the money of another.[7] The clear implication of this distinction is the belief that a prudent man is likely to incur fewer risks with assets entrusted to his care than he would with his own personal funds.[8] It is well settled that in judging the reasonableness of an investment the circumstances at the time of investment are to be controlling, and hindsight may not be employed to second-guess the trustee and burden him with liability.[9] Despite this doctrine, it is hardly likely that hindsight is not a prominent consideration in

3 See Vest v. Bialson, 365 Mo. 1103, 293 S.W.2d 369 (1956); Davis v. Davis Trust Co., 106 W. Va. 228, 145 S.E. 588 (1928).

4 See, *e.g.*, *In re* Mayo, 259 Minn. 91, 105 N.W.2d 900 (1960); Bliss v. Bliss, 126 N.J. Eq. 308, 8 A.2d 705 (Ch. 1939), *aff'd*, 127 N.J. Eq. 20, 11 A.2d 13 (Ct. Err. & App. 1940).

5 See Stevenson, *Why the Prudent Man?*, 7 VAND. L. REV. 74 (1953).

6 See Mattocks v. Moulton, 84 Me. 545, 24 Atl. 1004 (1892); Springfield Safe Deposit & Trust Co. v. First Unitarian Soc'y, 293 Mass. 480, 200 N.E. 541 (1936); Rand v. McKittrick, 346 Mo. 466, 142 S.W.2d 29 (1940).

7 See *In re* Estate of Cook, 20 Del. Ch. 123, 171 Atl. 730 (Ch. 1934); *In re* Buhl's Estate, 211 Mich. 124, 178 N.W. 651 (1920). *But cf.* Fox v. Harris, 141 Md. 495, 119 Atl. 256 (1922); Gray v. Lynch, 33 Md. (8 Gill.) 403 (1849).

8 See Mattocks v. Moulton, 84 Me. 545, 24 Atl. 1004 (1892); *In re* Buhl's Estate, *supra* note 7; Miller v. Pender, 93 N.H. 1, 34 A.2d 663 (1943).

9 See Bowker v. Pierce, 130 Mass. 262 (1881); *In re* Beebe's Estate, 52 N.Y.S.2d 736 (Surr. Ct. 1943).

the examination of unprofitable investments which were made years before the time of the trial.

B. *Statutory Influences*

Legislation has also played a significant part in delineating the permissible scope of trust investments.[10] Such statutes are in effect a codification of the reasonable man rule; that is, they represent legislative attempts to define, or at least provide some guidelines for, the type of investments which a trustee may permissibly make. The statutes may be broadly broken down into two categories.

In the first of these fall what are commonly called "legal list" statutes.[11] These statutes attempt to enumerate specifically those types of investments in which a reasonable trustee may safely invest trust funds.[12] Such investments do not, however, free the trustee from his duty to act as a reasonable man in determining which of the items on the legal list he should select.[13] While some "legal list" jurisdictions have treated investments outside the list as a per se breach of duty,[14] others have imposed liability only if the trustee has not acted as a prudent man in making such investments.[15] Of course, the settlor may free the trustee of the restraints of the statutory legal list by a clear expression of his intent to do so.[16] In such a situation, the trustee's duty is, once again, only to act as a prudent man, according to the common-law standard.

The most striking deficiency of the legal lists is their failure to include common stock as a suitable investment, such absence seemingly being attributable to the old English common-law doc-

10 See Stevenson, *supra* note 5, at 91-92, for a state-by-state breakdown of such statutes.

11 Legal list statutes are today in force in less than a dozen states. See Stevenson, *supra* note 5, at 92.

12 *E.g.*, IOWA CODE § 682.23 (Supp. 1962), which provides that all money received by a fiduciary to be invested be placed in the following types of securities: federal bonds; federal bank bonds; state bonds; municipal bonds; real estate mortgage bonds; corporate mortgages; railroad bonds; bonds guaranteed by railroads; bonds and debentures guaranteed by the federal government; stock in federal government instrumentalities; life, endowment endorsement or annuity contracts of legal reserve life insurance companies authorized to do business in Iowa. See generally Note, *Inadequacy of the Iowa Legal List of Trust Investments*, 36 IOWA L. REV. 341 (1951).

13 See *In re* McCafferty's Will, 147 Misc. 179, 264 N.Y. Supp. 38 (Surr. Ct. 1933).

14 See *In re* McCafferty's Will, *supra* note 13; Estate of Herriman, 142 Misc. 164 (Surr. Ct. 1931).

15 See First Nat'l Bank v. Hawley, 207 Ark. 587, 182 S.W.2d 194 (1944); *In re* Estate of Cook, 20 Del. Ch. 123, 171 Atl. 730 (Ch. 1934); Falls v. Carruthers, 20 Tenn. App. 681, 103 S.W.2d 605 (1937).

16 See Fox v. Harris, 141 Md. 495, 119 Atl. 256 (1922); *In re* McCafferty's Will, 147 Misc. 179, 264 N.Y. Supp. 38 (Surr. Ct. 1933); Estate of Herriman, 142 Misc. 164 (Surr. Ct. 1931). *Cf. In re* Carnell's Will, 260 App. Div. 287, 21 N.Y.S.2d 376 (1940).

trine that such investments were per se imprudent.[17] This view was early accepted by the New York courts and later codified with the enactment in New York of a statutory legal list, which served as a model for numerous other subsequent enactments of lists.[18] However, since the mid-1930's there has been a steady movement away from legislative reliance on legal lists,[19] primarily because of their relative inflexibility, whereby a trustee pursuant to such statutes is effectively prohibited from adjusting to fluctuations in economic conditions and to other changing circumstances.[20]

Paralleling the demise of legal list statutes has been the increased legislative recourse to the second general type of statutes defining permissible trust investments, commonly referred to as "prudent man" statutes.[21] Such statutes, now in force in over thirty states, represent codifications of the so-called Massachusetts rule, first announced in 1830 in the landmark case of *Harvard College v. Amory*,[22] and subsequently followed judicially by a handful of states in the nineteenth century.[23] The Massachusetts court in the *Harvard College* case refused to accept the theory that stocks in manufacturing firms were inherently unsafe, and, in so doing, departed from the English common-law requirement that trust investments be in debt rather than in ownership interests.[24] As to the trustee's investment duties, the court said:

> "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

17 See Gray v. Lynch, 33 Md. (8 Gill.) 403 (1849); *In re* Carnell's Will, *supra* note 16.

18 See King v. Talbot, 40 N.Y. 76 (1869).

19 Between 1940 and 1953 approximately twenty-three states adopted "prudent man" statutes in preference to the use of legal lists. See Stevenson, *supra* note 5, at 91-92.

20 See generally Note, *supra* note 12.

21 California's statute is representative of this category. CAL. CIV. CODE § 2261 provides: "In investing . . . a trustee 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 . . . considering the probable income, as well as the probable safety of their capital. . . . [A] trustee is authorized to acquire every kind of property, real, personal or mixed, and every kind of investment, specifically including, but not by way of limitation, corporate obligations of every kind, and stocks, preferred or common . . . ."

22 26 Mass. (9 Pick.) 446 (1830).

23 See, *e.g.*, McCoy v. Horwitz, 62 Md. 183 (1884); Peckham v. Newton, 15 R.I. 321, 4 Atl. 758 (1886).

24 See cases cited in note 17 *supra*.

25 Harvard College v. Amory, 26 Mass. (9 Pick.) 446, 461 (1830). It is interesting to note that the New York court in King v. Talbot, 40 N.Y. 76 (1869), used very similar language.

funds, considering the probable income, as well as the probable safety of the capital to be invested."[25]

The advantages of this broad doctrine, over attempts to define prudent investments more specifically by the use of such devices as legal lists, were concisely outlined in the subsequent Massachusetts case of *Kimball v. Whitney*,[26] where the court stated:

> "That is a comprehensive principle. It is wide in scope. It is not limited to a particular time or a special neighborhood. It is general and inclusive, so that while remaining itself fixed, it may continue to be a safe guide under new financial institutions and business customs, changed commercial methods and practices, altered monetary usages and investment combinations. It avoids the inflexibility of definite classification of securities, it disregards the optimism of the promoter, and eschews the exuberance of the speculator. It holds fast to common sense and depends on practical experience. It is susceptible of being adapted to whatever conditions may arise in the evolution of society and the progress of civilization."[27]

Although the court in *Kimball* may have been guilty of some overstatement, trustees and writers have generally agreed that the flexibility of the Massachusetts rule makes it considerably more useful than the legal lists.[28]

C. *Specific Investment Duties*

1. *Diversification*

In addition to the broad duty to act as a reasonable man, the courts have formulated specific investment duties which are binding on the trustee. Among these is the duty to diversify trust investments, which is generally recognized in those states following the Massachusetts rule.[29] Courts following this rule have indicated there must be diversification among various classes of investments as well as within any one class.[30] This duty is evidently imposed in the hope that it will minimize the possibility of large

26 233 Mass. 321, 123 N.E. 665 (1919).

27 *Id.* at 331, 123 N.E. at 666.

28 See Chapman, *A Changing Economy Brings New Problems of Trust Investment*, Trust Bull., Sept. 1949, p. 11; Comment, 39 CALIF. L. REV. 380 (1951); Note, 36 IOWA L. REV. 341 (1951); Note, 1 RUTGERS L. REV. 130 (1947).

29 See Warren v. Pazolt, 203 Mass. 328, 89 N.E. 381 (1909); *In re* Davis, 183 Mass. 499, 67 N.E. 604 (1903); *In re* Dickinson, 152 Mass. 184, 25 N.E. 99 (1890); The Pennsylvania Co. v. Gillmore, 142 N.J. Eq. 27, 59 A.2d 24 (Ch. 1948).

30 See *In re* Dickinson, *supra* note 29; The Pennsylvania Co. v. Gillmore, *supra* note 29.

losses through the failure of only one of the investments in an entire portfolio. Although the courts have never adopted a specific maximum percentage, the cases as a whole indicate that courts acknowledging and enforcing the duty of diversification will treat the investment of greater than twenty to twenty-five percent of the trust assets in one form as prima facie evidence of breach of duty[31] which may, however, be rebutted by evidence that the failure to diversify further was reasonable under the circumstances.[32]

In *North Adams Nat'l Bank v. Curtiss*,[33] the court refused to surcharge the trustee for retaining stock in A. T. & T., General Electric and First National Bank of Boston, despite the fact these stocks constituted a very large percentage of the trust estate. In reaching its decision, the court noted the fine reputation of the stocks involved and the fact they had originally been placed in the trust at its creation by the settlor. The court further pointed to the unfavorable tax consequences which would have occurred had the trustee sold the stock. The force of this decision may be lessened by the presence of an exculpatory clause in the trust instrument, though the court did not treat this fact alone as controlling.

At least two courts adhering to legal list statutes have refused to impose a duty of diversification upon trustees where the investments entered into were authorized according to the statutory list.[34] The approach of these courts seems to be that trustees should not be restrained from taking full advantage of investments which the legal list and independent investigation indicate are sound. They repeatedly quote Andrew Carnegie's statement, "Put all your eggs in one basket and watch the basket."

2. *Loyalty*

While the courts may differ as to diversification, it is uniformly accepted that a trustee has a duty of loyalty to the trust beneficiaries which is breached by engaging in any self-dealing with the property held in trust;[35] that is, the trustee may not bring his own

31 See *In re* Davis, 183 Mass. 499, 67 N.E. 604 (1903), and cases cited in note 30 *supra*.

32 *Cf.* Security Trust Co. v. Appleton, 303 Ky. 328, 197 S.W.2d 70 (1946); North Adams Nat'l Bank v. Curtiss, 278 Mass. 471, 180 N.E. 217 (1932).

33 278 Mass. 471, 180 N.E. 217 (1932).

34 See *In re* Beebe's Estate, 52 N.Y.S.2d 736 (Surr. Ct. 1943); *In re* Adriance's Estate, 145 Misc. 345, 260 N.Y. Supp. 173 (Surr. Ct. 1932); Saeger Estates, 340 Pa. 73, 16 A.2d 19 (1940). *But see* The Pennsylvania Co. v. Gillmore, 142 N.J. Eq. 27, 59 A.2d 24 (1948).

35 See Matter of Durston, 297 N.Y. 64, 74 N.E.2d 310 (1947); City Bank Farmers

interest into conflict with the trust's interest. Thus, a trustee may not buy securities in his own name and sell them to the trust at a profit,[36] nor use trust funds in any way to make a personal profit.[37] In such cases, the trustee may be surcharged for the profits he received from the use of trust funds or for any losses incurred by the trust estate due to his breach.

However, by virtue of his authority to dictate the terms of the trust, the settlor may specifically vest a trustee with the right to maintain a conflict of interest in relation to the trust.[38] *City Bank Farmers Trust Co. v. Cannon*[39] recognized this proposition in exonerating a corporate trustee who purchased and maintained, for an inter vivos trust, stock in a bank closely affiliated with the trust company. The evidence disclosed that the settlor, who had retained a life interest in the trust with the power to revoke or change the remainderman at any time, had insisted that the bank stock be retained despite the conflict of interest involved. The court held these factors estopped both the settlor and remainderman from charging the trustee with a breach of duty. However, *Matter of Durston*[40] indicates that such a result will be reached only where the permission to maintain the conflict of interest is explicitly and unambiguously conferred. A divided court in that case held that an exceedingly broad discretionary clause[41] did not give the corporate trustee the right to retain and purchase its own stock for the estate. The one dissenting judge felt the broad discretionary language of the will, combined with the knowledge of the testator that he was appointing as trustee one with divided loyalty, evidenced an intent to sanction this arrangement.[42] Judging from the general tenor of the cases, a trustee should be extremely wary of relying on the settlor's consent as a basis for placing himself in a position of divided loyalty.

3. *Independent Judgment*

The trustee must also be wary to some degree of the extent to which he can rely upon the advice of others, for it is generally

Trust Co. v. Cannon, 291 N.Y. 125, 51 N.E.2d 674 (1943); *In re* Rees' Estate, 53 Ohio L. Abs. 385, 85 N.E.2d 563 (Cuyahoga Co. Ct. App. 1949).

36 See *In re* Rees' Estate, *supra* note 35.

37 See Bowen v. Richardson, 133 Mass. 293 (1882).

38 See Matter of Durston, 297 N.Y. 64, 74 N.E.2d 310 (1947); *In re* Flagg's Estate, 365 Pa. 82, 73 A.2d 411 (1950).

39 291 N.Y. 125, 51 N.E.2d 674 (1943).

40 297 N.Y. 64, 74 N.E.2d 310 (1947).

41 See 297 N.Y. at 69, 74 N.E.2d at 312.

42 *Cf. In re* Flagg's Estate, 365 Pa. 82, 73 A.2d 411 (1950).

agreed that the trustee has a duty to exercise independent discretion and judgment in making investment decisions, on the theory that the testator appointed him for this express purpose.[43] This duty would not prohibit the trustee from seeking the advice of others nor from ascertaining any preferences which the beneficiaries might have, as long as the final decision was his own. *In re Garland's Will*,[44] in which the corporate co-trustee was surcharged for retaining bonds which investigation had shown were no longer desirable, clearly illustrates the scope of this duty. The court found that the trustee had breached its duty by retaining the bonds at the insistence of the settlor's widow, who served as co-trustee, and held that the corporate trustee was under a duty to insist upon a sale and, if necessary to overcome the co-trustee's opposition, to petition the appropriate court for authority to sell.

II. Factors Responsible for the Concern With Unduly-Conservative Trust Investments

A. *Inflation*

The greatest factor in bringing the problem of conservative investment to the fore is that of an inflationary economy;[45] for it is a source of potential harm to income beneficiary and remainderman alike. As to the latter, it decreases the purchasing power of the trust principal and, if power exists to invade corpus, may also result in the decrease of its dollar value should the trustee find it necessary to divert part of the principal to the life beneficiary to meet the rising cost of living. The income beneficiary suffers from the decline in purchasing power of the income received, and may receive even less income, dollar-wise, if the principal shrinks through repeated invasion. Therefore, it is not surprising that income beneficiaries have striven with increased vigor to augment returns from trust investments[46] and that remaindermen have likewise sought ways to increase the value of the principal.[47]

43 See *In re* Talbot's Estate, 141 Cal. App. 2d 309, 296 P.2d 848 (1956); *In re* Garland's Will, 159 Misc. 333, 287 N.Y. Supp. 918 (Surr. Ct. 1936). The reluctance of the English courts to allow investments in corporate securities may have been partially due to the trustee's lack of control in corporate management.

44 159 Misc. 333, 287 N.Y. Supp. 918 (Surr. Ct. 1936).

45 The court in *In re* Mayo, 259 Minn. 91, 105 N.W.2d 900 (1960), was undoubtedly greatly influenced in its decision to allow deviation from the terms of the trust by the fact that inflation between 1939 and 1960 had decreased the purchasing power of the trust corpus by 50%. See text at note 2 *supra*.

46 *Cf.* Commercial Trust Co. v. Barnard, 27 N.J. 332, 142 A.2d 865 (1958).

47 *Cf. In re* Mayo, 259 Minn. 91, 105 N.W.2d 900 (1960); Commercial Trust Co. v. Barnard, *supra* note 46.

Although the problems concomitant with inflation have gained widespread recognition among writers,[48] sharp differences of opinion exist as to whether this factor should affect traditional investment behavior and, if so, in what manner and to what extent.

Differences of opinion may focus upon any one of several disputable points, the most fundamental of which relates to the question of whether inflation is merely a short-term phenomenon which does not merit a substantial revision in trust investment doctrine. Although at least one writer has questioned whether inflation in our economy will continue indefinitely,[49] most writers at least feel that inflation is too important a factor to be ignored in the hope it will eventually disappear of its own accord.

In determining the effect of inflation on trust investment doctrine, writers have been forced to come to grips with the related problem, which has long plagued the courts, of whether the trustee's primary concern should be the preservation of principal or the securing of income. It is beyond dispute that the trustee has a duty in formulating investment policy of a twofold nature: first, a duty to the remainderman to guard against loss of principal, and, also, a duty to the income beneficiary to secure income from investments.[50] The courts have rather consistently indicated, however, that the trustee's primary duty is the preservation of the trust principal, even if it is necessary to sacrifice income to accomplish this end.[51] Writers have maintained that some courts have unjustly favored the remainderman in their application of this doctrine.[52] In any event, it seems clear that in many situations a court would do serious injustice to the intent of the settlor or testator by subordinating his wishes with respect to income to the preservation of trust principal; that is, the life beneficiary (*i.e.*, widow or incompetent child) is very commonly the person for whom the

48 See Buek, *"Qualified" Trustee Performance Calls for Full Investment Freedom*, 99 TRUSTS & ESTATES 194 (1960); Fingar, *Changing Concepts of Trust Investments*, 96 TRUSTS & ESTATES 864 (1957); Shattuck, *The Trustee's Duty To Invest*, 86 TRUSTS & ESTATES 119 (1948); Tenney, *The Trustee, the Stock Market and the Measure of Damages*, 96 TRUSTS & ESTATES 824 (1957); Torrance, *By Growth Obsessed: Balance and Perspective Today's Need in Trust Investment Policy*, 97 TRUSTS & ESTATES 226 (1958); Comment, 39 CALIF. L. REV. 380 (1951).

49 See Torrance, *supra* note 48. *But see* Fingar, *supra* note 48, at 866.

50 *In re* Buhl's Estate, 211 Mich. 124, 178 N.W. 651 (1920); The Pennsylvania Co. v. Gillmore, 137 N.J. Eq. 51, 43 A.2d 667 (Ch. 1945).

51 See *In re* Buhl's Estate, *supra* note 50; Brown's Estate, 287 Pa. 499, 135 Atl. 112 (1926); Davis v. Davis Trust Co., 106 W. Va. 228, 145 S.E. 588 (1928). *Cf.* Miller v. Pender, 93 N.H. 1, 34 A.2d 663 (1943). *But cf.* The Pennsylvania Co. v. Gillmore, *supra* note 50.

52 See Fingar, *supra* note 48, at 864; Shattuck, *supra* note 48, at 119; Comment, 39 CALIF. L. REV. 380-81 (1951).

settlor was most interested in providing.[53] The prospect of inflation has added a new twist to this old argument, for now shortsighted concern merely for the preservation of principal may seriously injure the interests of the remainderman himself through loss of purchasing power. Despite this fact, some writers have argued that the trustee's duty to preserve the trust principal refers only to the preservation of the dollar value of the trust rather than to maintain its actual purchasing power.[54] This theory finds support in the analogy that, as the trustee should not risk principal to gain income, he surely should not risk principal to accumulate more principal. In answer to the foregoing view, it may be argued that, even conceding the debatable proposition that trustees are primarily conservers of wealth, since dollar value in today's inflationary market is of little significance,[55] the only way to conserve wealth realistically is through preservation of the purchasing power, and not merely the dollar value, at the trust corpus.

Even if one views inflation as a perpetual phenomenon and the trustee, at least to the extent of his duties to preserve purchasing power, as more than a conserver of wealth, there still remains the question of whether there is a feasible way to compensate for the effects of inflation. The purchase of common stock, in the hopes that the value of the stock and the income derived from it will grow at least proportionately to rate of inflation, has been suggested as the only practical way to accomplish this end.[56] Yet, this course of action may be partially or fully foreclosed to trustees in states with some form of statutory legal list.[57] And, even as to those states applying a "prudent man" standard, some writers have averred that, although common stock may be reasonably purchased to provide income, such purchases become unreasonably speculative ventures when made for the purpose of increasing principal.[58] However, other writers have expressed the view that the trustee should take inflation into account, and thus it is proper, within the framework of the reasonable man rule, for him to se-

[53] *Cf.* Stevenson, *supra* note 5, at 78.

[54] See Headly, *Trustees or "Gentlemen Adventurers"?*, 88 TRUSTS & ESTATES 91 (1949); Torrance, *supra* note 48.

[55] *Cf.* Shattuck, *supra* note 48.

[56] See Bardt, *Selection of Securities*, 91 TRUSTS & ESTATES 742 (1952); Fingar, *supra* note 48, at 866; Jennett, *Changing Concepts of Trust Investments*, 94 TRUSTS & ESTATES 843 (1955).

[57] See text at note 18 *supra*.

[58] See Headly, *supra* note 54. *Cf.* Murray, *Common Stocks in Trust*, 89 TRUSTS & ESTATES 829 (1950). *But see* Axe, *Record of Equity Investment for Trust and Pension Funds*, 89 TRUSTS & ESTATES 508 (1950), in which the following table was used to show

lect common stocks which are not unduly speculative, but which will serve as a hedge against inflation as well as provide a sound income;[59] that is, invest in stocks whose past history indicates to the prudent trustee a high probability of increased valuation and income in the face of continued inflation.

Summarizing, writers in general have recognized the effects of inflation on trust investments but differ in their approach to this problem in at least three significant respects: whether inflation is a short- or long-term phenomenon; whether, even if the trustee is regarded as primarily a conserver of wealth, he fulfills his obligations by maintaining the dollar value of the fund in trust, or whether should he instead attempt to maintain its purchasing power; whether the purchase of common stock as a hedge against inflation is inherently speculative or, rather, an effective way to solve a crucial problem.

B. *Declining Rate of Return From Bond Investments*

A second factor causing increasing concern with conservative investments is the declining rate of return from bond investments coupled with increased returns from attractive common stocks. The securities investment situation has changed greatly since the 1920's, when few high quality stocks were available and bonds, on the other hand, were returning in excess of five percent.[60] Although this factor most directly concerns the income beneficiary, it may, of course, affect the interest of the remainderman if the right to invade principal exists. Thus, the question again

that long-term skillful investments in common stocks, despite possible short-term fluctuations, result in greater income and better protection against inflation than either fixed income securities or retirement annuities provided by life insurance companies:

Basis of 30 years	Amount of Cash Invested	Value of Fund at End of 30 Years	Ratio of Value of Fund to Cash Invested
1. High-grade fixed-income securities (present rate of 2½% per annum)	$3,000,000	4,500,000	1.50
2. Retirement annuity plan of type provided by leading life insurance companies	3,000,000	4,221,000	1.41
3. Diversified high-grade common stock (1908-38)	2,999,675	10,331,075	3.44
4. Diversified high-grade common stock (1918-48)	3,000,825	10,168,875	3.39

59 See Buek, *supra* note 48, at 194-95; Fingar, *supra* note 48, at 866; Comment, 39 CALIF. L. REV. 380, 388-93 (1951). *Cf.* Tenney, *supra* note 48.

60 See Jennett, *supra* note 56, at 844. *Compare* Jennings, *Caution in Equity Selection*, 99 TRUSTS & ESTATES 556 (1960).

arises whether stocks should be substituted for traditionally safer, but now lower yielding, bonds.

C. *The Growth of the Professional Trustee*

One final factor is significant in explaining the recent concern with unduly-conservative trust investments. This is the growth in importance, to the point of predominance, of the professional trustee in the field of trust administration and investment.[61] It is noteworthy that the principal doctrines relating to the investment of trust funds were developed most significantly at a time when most trustees were amateurs.[62] Conservative investment by a trustee who is relatively unfamiliar with wise investment practices and policies is not only justifiable, but is also necessary to give some degree of protection to the income beneficiary and the remainderman. On the other hand, the professional trustee is almost invariably in a far better position to increase the return for the income beneficiary and accumulate added principal for the remainderman safely through the discriminating and informed purchase of various securities. His advantage lies both in his greater experience in extensively investing large amounts of funds and his access to economic and financial reports, data and statistics analyzing all relevant investment information. Thus, the emergence of the professional trustee has furnished a strong arguing point for those alleging that trust law currently imposes an unwarranted degree of conservatism upon trust investment practices.

III. SAFEGUARDS AGAINST UNDULY-CONSERVATIVE TRUST INVESTMENTS

Admitting that the factors discussed above impart added significance to the problem of unduly-conservative trust investments, the question still remains whether trust beneficiaries are in some way legally safeguarded against such investments. Initially, there are apparently no court decisions surcharging a trustee on the ground that he pursued an unduly-conservative investment policy. Indeed, several of the doctrines of trust law previously examined would seem to encourage trustees to take a highly conservative approach to investment practice. An excellent example is the emphasis placed on the preservation of principal rather than the

61 See Tenney, *supra* note 48, at 824.
62 See generally Tenney, *supra* note 48.

obtaining of income;[63] another is the continued existence in some jurisdictions of the basically conservative legal list statutes, under which adherence to the suggested investments guarantees immunity from surcharge.[64] Even the relatively flexible reasonable man rule to some extent fosters conservatism; for the absence of definite criteria by which a trustee may determine whether an investment is speculative may cause him to pursue the more conservative of two possible opportunities in order to avoid the possibilty of being surcharged by a jury using hindsight as its guide.

Despite these tendencies toward conservatism, the reasonable man rule, properly applied, would seem to provide sufficient safeguards to deter unduly-conservative trust investments. In order to determine whether a trustee has breached his duty by entering into an unsound investment, a court will examine all the economic circumstances at the time the investment was made. By the same process of examining all the relevant circumstances, courts can protect beneficiaries from unduly-conservative investments where it is alleged that a reasonable man would have sought investments with greater growth potential and higher returns. Among the factors relevant to such a determination, a court should note the general economic conditions at the time of the making of the investment, including the prospects of inflation, as the trustee who today ignores this factor can hardly be deemed reasonable. The average returns of reputable fixed income and securities investments should also be noted. Apart from these purely economic considerations, however, a court should also judge the trustee's actions in light of the settlor's intent; for a policy of highly conservative investment may be entirely consonant with the primary purpose of the settlor. Thus, if the settlor's widow is the income beneficiary and the remainderman is unascertained, a reasonable trustee might well pursue a conservative investment policy, especially where the trust consists of a sizeable principal and the right of invasion of the corpus is provided for. On the other hand, if there is no such right of invasion, a trustee would seem to be well advised to balance the possibility of a slightly greater degree of risk to principal, but potentially greater return, against the widow's need for such a return. In reaching a decision, the relationship of the income beneficiary and the remainderman to the settlor, their respective ages, and the income beneficiary's depend-

63 See text at note 51 *supra*.
64 See text at note 18 *supra*.

ence upon and need for the trust income should also be taken into account. Whether professional trustees are or are not involved should also be a relevant consideration. Besides the experience and information available to them, the fact that they hold themselves out to the public as being skilled in their profession justifies the expectation of careful analysis of the market conditions which should lead to the greatest potential gains without undue risk to the trust principal. A reasonable professional trustee might well be expected to reach a far different investment decision than a person acting without such experience and information.

A reasonable man approach to conservative investments would seem to be as fair to trustees as would be subjecting them to the same test for allegedly risky investments. As previously noted, the rule provides few set guidelines, but, by placing the burden on those claiming a breach of duty in failing to produce a reasonable income from the trust or in failing to increase its principal, the trustee would be safeguarded from surcharge in all but the most blatant of cases.[65] And, as beneficiaries may be protected from unduly-conservative investments within the framework of the reasonable man rule, there would seem to be no need to develop new trust investment doctrines to accomplish this end.[66]

One additional approach, suggested as relevant in this area, deserves at least passing mention. As previously noted,[67] the purchase of sound securities has been advanced as the only practical way to increase both trust income and principal, and provide a hedge against inflation. Therefore, it has been suggested that trust beneficiaries may be protected from unduly-conservative investments by imposing an affirmative duty upon trustees to invest some portion of the trust assets in common stock. This suggestion has been repeatedly rejected by writers, and for good cause;[68] such an approach is inflexible in many of the same respects as are legal list statutes.[69] It would seem far more realistic to approach the investment of trust funds with the view that the circumstances relevant to each individual trust may dictate different investment

65 *Commercial Trust Co. v. Barnard*, discussed in the text at note 1 *supra*, provides an excellent example of the use of this type of approach. The trustee should be provided with added protection by examining his action in light of the whole trust portfolio rather than on an individual investment basis. *Cf.* Buek, *supra* note 48.

66 In order for this protection to be universal, it is obvious that the few remaining states with legal list statutes would have to replace such statutes with "prudent man" statutes.

67 See text at note 59 *supra*.

68 See Tenney, *supra* note 48, at 826-27; Comment, 39 CALIF. L. REV. 380, 391 (1951).

69 See text at notes 26-27 *supra*.

policies and that reasonable men may differ as to the details of these policies, including the amount, if any,[70] to be invested in securities.

IV. CONCLUSION

Courts have long attempted to discourage trustees from speculating with the money of others by surcharging them for losses incurred in such ventures. Although the courts have recognized a duty on the part of the trustee to produce income from trust investments, there is no parallel development in the case law surcharging trustees for losses caused by unreasonably conservative investments. This anomaly in the law has encouraged trustees to pursue conservative investment policies. At the same time, trust beneficiaries have been spurred by the emergence of a continuingly inflationary economy, the increased returns of reputable securities, and the development of the professional, usually corporate, trustee to seek protection against losses caused by clearly overly-conservative investment policies.

It is probably unnecessary to develop new trust law doctrines to give this needed protection to beneficiaries. Rather, the courts should make greater use of the reasonable man rule to determine the validity of an allegedly unduly-conservative investment of trust funds in the same manner in which the validity of an allegedly speculative investment is determined. In applying the reasonable man rule, a court should take into consideration all relevant factors, including market conditions, the settlor's expressed or probable intent, type of trustee involved and the beneficiaries' financial situations. If, after examining all the relevant factors, the court concludes that a reasonable man in the trustee's position would not have made such a conservative investment, it would seemingly be justified in surcharging the trustee for the losses occasioned to the beneficiaries by the unreasonable investment.[71]

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[70] *Commercial Trust Co. v. Barnard*, discussed in the text at note 1 *supra*, describes one set of circumstances in which the refusal to purchase securities was completely reasonable.

[71] Determining the amount of damages may present difficulties in this situation. The only feasible solution may be to base damages on the average appreciation rate and income return of similar trust funds. If a court feels that this measure of damages is too indefinite, it would still be possible to issue a decree ordering the trustee to change his pattern of investments. See generally Tenney, *supra* note 48.