Study L-648 September 9, 1994

Memorandum 94-47

Uniform Prudent Investor Act: Draft of Tentative Recommendation

Attached to this memorandum is a staff draft of a tentative recommendation proposing enactment of the Uniform Prudent Investor Act (1994). A preliminary copy of the UPIA is attached — the final text of the act has not yet been approved by the style committee of the Uniform Law Commissioners. (See Exhibit pp. 1-18.) Also attached is a parallel table comparing the text of UPIA to corresponding provisions of the California Trust Law. (Exhibit pp. 19-24.)

As noted in Memorandum 94-44 concerning new topics, the staff is suggesting that the Commission consider circulating the new uniform act on an expedited basis with a view toward recommending legislation to the 1995 Legislature. Normally the Commission spends more time on a topic than suggested here. However, in a case like this, an expedited schedule is appropriate — the statutory proposal has been under consideration by the Uniform Law Commissioners for several years, the material is relatively brief and uncomplicated, and it fits fairly well within a larger framework (the Trust Law) that was enacted on Commission recommendation. Interested persons can easily comprehend the subject and make their comments within the time available.

An overview of the UPIA is presented in the draft tentative recommendation. Drafting and policy issues are discussed in the Staff Notes following the relevant sections of the draft statute.

If the Commission approves, the staff can revise the draft as needed and distribute a tentative recommendation shortly after the September meeting so that comments can be reviewed at the November meeting.

Respectfully submitted,

Stan Ulrich
Assistant Executive Secretary

UNIFORM PRUDENT INVESTOR ACT

PREFATORY NOTE

Over the quarter century from the late 1960's the investment practices of fiduciaries experienced significant change. The Uniform Prudent Investor Act (UPIA) undertakes to update trust investment law in recognition of the alterations that have occurred in investment practice. These changes have occurred under the influence of a large and broadly accepted body of empirical and theoretical knowledge about the behavior of capital markets, often described as "modern portfolio theory."

This Act draws upon the revised standards for prudent trust investment promulgated by the American Law Institute in its Restatement (Third) of Trusts: Prudent Investor Rule (1992) [hereinafter Restatement of Trusts 3d: Prudent Investor Rule; also referred to as 1992 Restatement].

Objectives of the Act. UPIA makes five fundamental alterations in the former criteria for prudent investing. All are to be found in the Restatement of Trusts 3d: Prudent Investor Rule.

(1) The standard of prudence is applied to any investment as part of the total portfolio, rather than to individual investments. In the trust setting the term "portfolio" embraces all the trust's assets. UPIA § 2(b).

(2) The tradeoff in all investing between risk and return is identified as the fiduciary's central consideration. UPIA § 2(b).

(3) All categoric restrictions on types of investments have been abrogated; the trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the trust and that meets the other requirements of prudent investing. UPIA § 2(e).

(4) The long familiar requirement that fiduciaries diversify their investments has been integrated into the definition of prudent investing. UPIA § 3.

(5) The much criticized former rule of trust law forbidding the trustee to delegate investment and management functions has been reversed. Delegation is now permitted, subject to safeguards. UPIA § 9.

Literature. These changes in trust investment law have been presaged in an extensive body of practical and scholarly writing. See especially the discussion and reporter's notes by Edward C. Halbach, Jr., in Restatement of Trusts 3d: Prudent Investor Rule (1992); see also Edward C. Halbach, Jr., Trust Investment Law in the Third Restatement, 27 Real Property, Probate & Trust J. 407 (1992); Bevis Longstreth, Modern Investment Management and the Prudent Man Rule (1986); Jeffrey N. Gordon, The Puzzling Persistence of the Constrained Prudent Man Rule, 62 N.Y.U.L. Rev. 52 (1987); John H. Langbein & Richard A. Posner, The Revolution in Trust Investment Law, 62 A.B.A.J. 887 (1976); Note, The Regulation of Risky Investments, 83 Harvard L. Rev. 603 (1970). A succinct account of the main findings of modern portfolio theory, written for lawyers, is Jonathan R. Macey, An Introduction to Modern Financial Theory (1991) (American College of Trust & Estate Counsel Foundation). A leading introductory text on modern portfolio theory is R.A. Brealey, An Introduction to Risk and Return from Common Stocks (2d ed. 1983).

Legislation. Most states have legislation governing trust-investment law. This Act promotes uniformity of state law on the basis of the new consensus reflected in the Restatement of Trusts 3d: Prudent Investor Rule. Some states have already acted. California, Delaware, Georgia, Minnesota, Tennessee, and Washington revised their prudent investor legislation to emphasize the total-portfolio standard of care in advance of the 1992 Restatement. These statutes are extracted and discussed in Restatement of Trusts 3d: Prudent Investor Rule § 227, reporter's note, at 60-66 (1992).

Drafters in Illinois in 1991 worked from the April 1990 "Proposed Final Draft" of the Restatement of Trusts 3d: Prudent Investor Rule and enacted legislation that is closely modeled on the new Restatement. 760 ILCS § 5/5 (prudent investing); and § 5/5.1 (delegation) (1992). As the Comments to this Uniform Prudent Investor Act reflect, the Act draws upon the Illinois statute in several sections. Virginia revised its prudent investor act in a similar vein in 1992. Virginia Code § 26-45.1 (prudent investing) (1992). Florida revised its statute in 1993. Florida Laws, ch. 93-257, amending Florida Statutes § 518.11 (prudent investing) and creating § 518.112 (delegation). New York legislation drawing on the new Restatement and on a preliminary version of this Uniform Prudent Investor Act was enacted in 1994. N.Y. Assembly Bill 11683-B, Ch. 609 (1994), adding Estates, Powers and Trusts Law § 11-2.3 (Prudent Investor Act).

Remedies. This Act does not undertake to address issues of remedy law or the computation of damages in trust matters. Remedies are the subject of a reasonably distinct body of doctrine. See generally Restatement (Second) of Trusts §§ 197-226A (1959) [hereinafter cited as Restatement of Trusts 2d; also referred to as 1959 Restatement].

Implications for charitable and pension trusts. This Act is centrally concerned with the investment responsibilities arising under the private gratuitous trust, which is the common vehicle for conditioned wealth transfer within the family. Nevertheless, the prudent investor rule also bears on charitable and pension trusts, among others. "In making investments of trust funds the trustee of a charitable trust is under a duty similar to that of the trustee of a private trust." Restatement of Trusts 2d § 389 (1959). The Employee Retirement Income Security Act (ERISA), the federal regulatory scheme for pension trusts enacted in 1974, absorbs trust-investment law through the prudence standard of ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a). The Supreme Court has said: "ERISA's legislative history confirms that the Act's fiduciary responsibility provisions 'codif[y] and mak[e] applicable to [ERISA] fiduciaries certain principles developed in the evolution of the law of trusts.'" *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110-11 (1989) (footnote omitted).

Other fiduciary relationships. The Uniform Prudent Investor Act regulates the investment responsibilities of trustees. Other fiduciaries — such as executors, conservators, and guardians of the property — sometimes have responsibilities over assets that are governed by the standards of prudent investment. It will often be appropriate for states to adapt the law governing investment by trustees under this Act to these other fiduciary regimes, taking account of such changed circumstances as the relatively short duration of most executorships and the intensity of court supervision of conservators and guardians in some jurisdictions. The present Act does not undertake to adjust trust-investment law to the special circumstances of the state schemes for administering decedents' estates or conducting the affairs of protected persons.

Although the Uniform Prudent Investor Act by its terms applies to trusts and not to charitable corporations, the standards of the Act can be expected to inform the investment responsibilities of directors and officers of charitable corporations. As the 1992 Restatement observes, "the duties of the members of the governing board of a charitable corporation are generally similar to the duties of the trustee of a charitable trust." Restatement of Trusts 3d: Prudent Investor Rule § 379, Comment *b*, at 190 (1992). See also id. § 389, Comment *b*, at 190-91 (absent contrary statute or other provision, prudent investor rule applies to investment of funds held for charitable corporations).

UNIFORM PRUDENT INVESTOR ACT

SECTION 1. PRUDENT INVESTOR RULE.

(a) Except as provided in subsection (b), a trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule, as set forth in Sections 2 through 9.

(b) The prudent investor rule is a default rule that may be expanded, restricted, eliminated, or otherwise altered by provisions of the trust. A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on provisions of the trust.

Comment

This section imposes the obligation of prudence in the conduct of investment functions and identifies further sections of the Act that specify the attributes of prudent conduct.

Origins. The prudence standard for trust investing traces back to *Harvard College v. Amory*, 26 Mass. (9 Pick.) 446 (1830). Trustees should "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." Id. at 461.

Prior legislation. The Model Prudent Man Rule Statute (1942), sponsored by the American Bankers Association, undertook to codify the language of the *Amory* case. See Mayo A. Shattuck, The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century, 12 Ohio State L.J. 491, at 501 (1951); for the text of the model act, which inspired many state statutes, see id. at 508-09. Another prominent codification of the *Amory* standard is Uniform Probate Code § 7-302 (1969), which provides that "the trustee shall observe the standards in dealing with the trust assets that would be observed by a prudent man dealing with the property of another . . . ."

Congress has imposed a comparable prudence standard for the administration of pension and employee benefit trusts in the Employee Retirement Income Security Act (ERISA), enacted in 1974. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a), provides that "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims . . . ."

Prior Restatement. The Restatement of Trusts 2d (1959) also tracked the language of the *Amory* case: "In making investments of trust funds the trustee is under a duty to the beneficiary . . . to make such investments and only such investments as a prudent man would make of his own property having in view the preservation of the estate and the amount and regularity of the income to be derived . . . ." Restatement of Trusts 2d § 227 (1959).

Objective standard. The concept of prudence in the judicial opinions and legislation is essentially relational or comparative. It resembles in this respect the "reasonable person" rule of tort law. A prudent trustee behaves as other trustees similarly situated would behave. The standard is, therefore, objective rather than subjective. Sections 2 through 9 of this Act identify the main factors that bear on prudent investment behavior.

Variation. Almost all of the rules of trust law are default rules, that is, rules that the settlor may alter or abrogate. Subsection (b) carries forward this traditional attribute of trust law. Traditional trust law also allows the beneficiaries of the trust to excuse its performance, when they are all capable and not misinformed. Restatement of Trusts 2d § 216 (1959).

SECTION 2. STANDARD OF CARE; PORTFOLIO STRATEGY; RISK AND RETURN OBJECTIVES.

(a) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.

(b) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.

(c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:

(1) general economic conditions;

(2) the possible effect of inflation or deflation;

(3) the expected tax consequences of investment decisions or strategies;

(4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property;

(5) the expected total return from income and the appreciation of capital;

(6) other resources of the beneficiaries;

(7) needs for liquidity, for regularity of income, and for preservation or appreciation of capital; and

(8) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

(d) A trustee shall take reasonable steps to verify facts relevant to the investment and management of trust assets.

(e) Subject to the standard of this [Act], a trustee may invest in any kind of property or type of investment.

(f) A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.

Comment

Section 2 is the heart of the Act. Subsections (a), (b), and (c) are patterned loosely on the language of the Restatement of Trusts 3d: Prudent Investor Rule § 227 (1992), and on the 1991 Illinois statute, 760 § ILCS 5/5a (1992). Subsection (f) is derived from Uniform Probate Code § 7-302 (1969).

Objective standard. Subsection (a) of this Act carries forward the relational and objective standard made familiar in the *Amory* case, in earlier prudent investor legislation, and in the Restatements. Early formulations of the prudent person rule were sometimes troubled by the effort to distinguish between the standard of a prudent person investing for another and investing on his or her own account. The language of subsection (a), by relating the trustee's duty to "the purposes, terms, distribution requirements, and other circumstances of the trust," should put such questions to rest. The standard is the standard of the prudent investor similarly situated.

Portfolio standard. Subsection (b) emphasizes the consolidated portfolio standard for evaluating investment decisions. An investment that might be imprudent standing alone can become prudent if undertaken in sensible relation to other trust assets, or to other nontrust assets. In the trust setting the term "portfolio" embraces the entire trust estate.

Risk and return. Subsection (b) also sounds the main theme of modern investment practice, sensitivity to the risk/return curve. See generally the works cited in the Prefatory Note to this Act, under "Literature." Returns correlate strongly with risk, but tolerance for risk varies greatly with the financial and other circumstances of the investor, or in the case of a trust, with the purposes of the trust and the relevant circumstances of the beneficiaries. A trust whose main purpose is to support an elderly widow of modest means will have a lower risk tolerance than a trust to accumulate for a young scion of great wealth.

Subsection (b) of this Act follows Restatement of Trusts 3d: Prudent Investor Rule § 227(a), which provides that the standard of prudent investing "requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust."

Factors affecting investment. Subsection (c) points to certain of the factors that commonly bear on risk/return preferences in fiduciary investing. This listing is nonexclusive. Tax considerations, such as preserving the stepped up basis on death under Internal Revenue Code § 1014 for low-basis assets, have traditionally been exceptionally important in estate planning for affluent persons. Under the present recognition rules of the federal income tax, taxable investors, including trust beneficiaries, are in general best served by an investment strategy that minimizes the taxation incident to portfolio turnover. See generally Robert H. Jeffrey & Robert D. Arnott, Is Your Alpha Big Enough to Cover Its Taxes?, Journal of Portfolio Management 15 (Spring 1993).

Another familiar example of how tax considerations bear upon trust investing: In a regime of pass-through taxation, it may be prudent for the trust to buy lower yielding tax-exempt securities for high-bracket taxpayers, whereas it would ordinarily be imprudent for the trustees of a charitable trust, whose income is tax exempt, to accept the lowered yields associated with tax-exempt securities.

When tax considerations affect beneficiaries differently, the trustee's duty of impartiality requires attention to the competing interests of each of them.

Subsection (c)(8), allowing the trustee to take into account any preferences of the beneficiaries respecting heirlooms or other prized assets, derives from the Illinois act, 760 ILCS § 5/5(a)(4) (1992).

Duty to monitor. Subsections (a) through (d) apply both to investing and managing trust assets. "Managing" embraces monitoring, that is, the trustee's continuing responsibility for oversight of the suitability of investments already made as well as the trustee's decisions respecting new investments.

Duty to investigate. Subsection (d) carries forward the traditional responsibility of the fiduciary investor to examine information likely to bear importantly on the value or the security of an investment — for example, audit reports or records of title. E.g., *Estate of Collins*, 72 Cal. App. 3d 663, 139 Cal. Rptr. 644 (1977) (trustees lent on a junior mortgage on unimproved real estate, failed to have land appraised, and accepted an unaudited financial statement; held liable for losses).

Abrogating categoric restrictions. Subsection 2(e) clarifies that no particular kind of property or type of investment is inherently imprudent. Traditional trust law was encumbered with a variety of categoric exclusions, such as prohibitions on junior mortgages or new ventures. In some states legislation created so-called "legal lists" of approved trust investments. The universe of investment products changes incessantly. Investments that were at one time thought too risky, such as equities, or more recently, futures and market-simulating "derivatives," are now used in fiduciary portfolios. By contrast, the investment that was at one time thought ideal for trusts, the long-term bond, has been discovered to import a level of risk and volatility — in this case, inflation risk — that had not been anticipated. Accordingly, section 2(e) of this Act follows Restatement of Trusts 3d: Prudent Investor Rule in abrogating categoric restrictions. The Restatement says: "Specific investments or techniques are not per se prudent or imprudent. The riskiness of a specific property, and thus the propriety of its inclusion in the trust estate, is not judged in the abstract but in terms of its anticipated effect on the particular trust's portfolio. Restatement of Trusts 3d: Prudent Investor Rule § 227, Comment f, at 24 (1992). The premise of subsection 2(e) is that trust beneficiaries are better protected by the Act's emphasis on close attention to risk/return objectives as prescribed in subsection 2(b) than in attempts to identify categories of investment that are per se prudent or imprudent.

The Act impliedly disavows the emphasis in older law on avoiding "speculative" or "risky" investments. Low levels of risk may be appropriate in some trust settings but inappropriate in others. It is the trustee's task to invest at a risk level that is suitable to the purposes of the trust.

The abolition of categoric restrictions against types of investment in no way alters the trustee's conventional duty of loyalty, which is reiterated for the purposes of this Act in Section 5. For example, were the trustee to invest in a second mortgage on a piece of real property owned by the trustee, the investment would be wrongful on account of the trustee's breach of the duty to abstain from self-dealing, even though the investment would no longer automatically offend the former categoric restriction against fiduciary investments in junior mortgages.

Professional fiduciaries. The distinction taken in subsection (f) between amateur and professional trustees is familiar law. The prudent investor standard applies to a range of fiduciaries, from the most sophisticated professional investment management firms and corporate fiduciaries, to family members of minimal experience. Because the standard of prudence is relational, it follows that the standard for professional trustees is the standard of prudent professionals; for amateurs, it is the standard of prudent amateurs. Restatement of Trusts 2d § 174 (1959) provides: "The trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property; and if the trustee has or procures his appointment as trustee by representing that he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill." Case law strongly supports the concept of the higher standard of care for the trustee representing itself to be expert or professional. See Annot., Standard of Care Required of Trustee Representing Itself to Have Expert Knowledge or Skill, 91 A.L.R. 3d 904 (1979) & 1992 Supp. at 48-49.

The Drafting Committee declined the suggestion that the Act should create an exception to the prudent investor rule (or to the diversification requirement of Section 3) in the case of smaller trusts. The Committee believes that subsections (b) and (c) of the Act emphasize factors that are sensitive to the traits of small trusts; and that subsection (f) adjusts helpfully for the distinction between professional and amateur trusteeship. Furthermore, it is always open to the settlor of a trust under Section 1(b) of the Act to reduce the trustee's standard of care if the settlor deems such a step appropriate. The official comments to the 1992 Restatement observe that pooled investments, such as mutual funds and bank common trust funds, are especially suitable for small trusts. Restatement of Trusts 3d: Prudent Investor Rule § 227, Comments *h*, *m*, at 28, 51; reporter's note to Comment *g*, id. at 83.

Matters of proof. Although virtually all express trusts are created by written instrument, oral trusts are known, and accordingly, this Act presupposes, no formal requirement that trust terms be in writing. When there is a written trust instrument, modern authority strongly favors allowing evidence extrinsic to the instrument to be consulted for the purpose of ascertaining the settlor's intent. See Uniform Probate Code § 2-601 (1990), Comment; Restatement (Third) of Property: Donative Transfers (Preliminary Draft No. 2, ch. 11, Sept. 11, 1992).

SECTION 3. DIVERSIFICATION. A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.

Comment

The language of this section derives from Restatement of Trusts 2d § 228 (1959). ERISA insists upon a comparable rule for pension trusts. ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C). Case law overwhelmingly supports the duty to diversify. See Annot., Duty of Trustee to Diversify Investments, and Liability for Failure to Do So, 24 A.L.R. 3d 730 (1969) & 1992 Supp. at 78-79.

The 1992 Restatement of Trusts takes the significant step of integrating the diversification requirement into the concept of prudent investing. Section 227(b) of the 1992 Restatement treats diversification as one of the fundamental elements of prudent investing, replacing the separate section 228 of the Restatement of Trusts 2d. The message of the 1992 Restatement, carried forward in Section 3 of this Act, is that prudent investing ordinarily requires diversification.

Circumstances can however, overcome the duty to diversify. For example, if a tax-sensitive trust owns an underdiversified block of low-basis securities, the tax costs of recognizing the gain may outweigh the advantages of diversifying the holding. The wish to retain a family business is another situation in which the purposes of the trust sometimes override the conventional duty to diversify.

Rationale for diversification. "Diversification reduces risk . . . [because] stock price movements are not uniform. They are imperfectly correlated. This means that if one holds a well diversified portfolio, the gains in one investment will cancel out the losses in another." Jonathan R. Macey, An Introduction to Modern Financial Theory 20 (American College of Trust and Estate Counsel Foundation, 1991). For example, during the Arab oil embargo of 1973, international oil stocks suffered declines, but the shares of domestic oil producers and coal companies benefitted. Holding a broad enough portfolio allowed the investor to set off, to some extent, the losses associated with the embargo.

Modern portfolio theory divides risk into the categories of "compensated" and "uncompensated" risk. The risk of owning shares in a mature and well-managed company in a settled industry is less than the risk of owning shares in a start-up high-technology venture. The investor requires a higher expected return to induce the investor to bear the greater risk of disappointment associated with the start-up firm. This is compensated risk — the firm pays the investor for bearing the risk. By contrast, nobody pays the investor for owning too few stocks. The investor who owned only international oils in 1973 was running a risk that could have been reduced by having configured the portfolio differently — to include investments in different industries. This is uncompensated risk — nobody pays the investor for owning shares in too few industries and too few companies. Risk that can be eliminated by adding different stocks (or bonds) is uncompensated risk. The object of diversification is to minimize this uncompensated risk of having too few investments. "As long as stock prices do not move exactly together, the risk of a diversified portfolio will be less than the average risk of the separate holdings." R.A. Brealey, An Introduction to Risk and Return from Common Stocks 103 (2d ed. 1983).

There is no automatic rule for identifying how much diversification is enough. The 1992 Restatement says: "Significant diversification advantages can be achieved with a small number of well-selected securities representing different industries.... Broader diversification is usually to be preferred in trust investing," and pooled investment vehicles "make thorough diversification practical for most trustees." Restatement of Trusts 3d: Prudent Investor Rule § 227, General Note on Comments *e-h*, at 77 (1992). See also Macey, supra, at 23-24; Brealey, supra, at 111-13.

Diversifying by pooling. It is difficult for a small trust fund to diversify thoroughly by constructing its own portfolio of individually selected investments. Transaction costs such as the round-lot (100 share) trading economies make it relatively expensive for a small investor to assemble a broad enough portfolio to minimize uncompensated risk. For this reason, pooled investment vehicles have become the main mechanism for facilitating diversification for the investment needs of smaller trusts.

Most states have legislation authorizing common trust funds; see 3 Austin W. Scott & William F. Fratcher, The Law of Trusts § 227.9, at 463-65 n.26 (4th ed. 1988) (collecting citations to state statutes). As of 1992, 35 states and the District of Columbia had enacted the Uniform Common Trust Fund Act (UCTFA) (1938), overcoming the rule against commingling trust assets and expressly enabling banks and trust companies to establish common trust funds. 7 Uniform Laws Ann. 1992 Supp. at 130 (schedule of adopting states). The Prefatory Note to the UCTFA explains: "The purposes of such a common or joint investment fund are to diversify the investment of the several trusts and thus spread the risk of loss, and to make it easy to invest any amount of trust funds quickly and with a small amount of trouble." 7 Uniform Laws Ann. 402 (1985).

Fiduciary investing in mutual funds. Trusts can also achieve diversification by investing in mutual funds. See Restatement of Trusts 3d: Prudent Investor Rule, § 227, Comment *m*, at 99-100 (1992) (endorsing trust investment in mutual funds). ERISA § 401(b)(1), 29 U.S.C. § 1101(b)(1), expressly authorizes pension trusts to invest in mutual funds, identified as securities "issued by an investment company registered under the Investment Company Act of 1940...").

SECTION 4. DUTIES AT INCEPTION OF TRUSTEESHIP. Within a reasonable time after accepting a trusteeship or receiving trust assets, a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this [Act].

Comment

Section 4, requiring the trustee to dispose of unsuitable assets within a reasonable time, is old law, codified in Restatement of Trusts 3d: Prudent Investor Rule § 229 (1992), lightly revising Restatement of Trusts 2d § 230 (1959). The duty extends as well to investments that were proper when purchased but subsequently become improper. Restatement of Trusts 2d § 231 (1959). The same standards apply to successor trustees, see Restatement of Trusts 2d § 196 (1959).

The question of what period of time is reasonable turns on the totality of factors affecting the asset and the trust. The 1959 Restatement took the view that "[o]rdinarily any time within a year is reasonable, but under some circumstances a year may be too long a time and under other circumstances a trustee is not liable although he fails to effect the conversion for more than a year." Restatement of Trusts 2d § 230, comment *b* (1959). The 1992 Restatement retreated from this rule of thumb, saying, "No positive rule can be stated with respect to what constitutes a reasonable time for the sale or exchange of securities." Restatement of Trusts 3d: Prudent Investor Rule § 229, comment *b* (1992).

The criteria and circumstances identified in Section 2 of this Act as bearing upon the prudence of decisions to invest and manage trust assets also pertain to the prudence of decisions to retain or dispose of inception assets under this section.

SECTION 5. LOYALTY. A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries.

Comment

The duty of loyalty is perhaps the most characteristic rule of trust law, requiring the trustee to act exclusively for the beneficiaries, as opposed to acting for the trustee's own interest or that of third parties. The language of Section 4 of this Act derives from Restatement of Trusts 3d: Prudent Investor Rule § 170 (1992), which makes minute changes in Restatement of Trusts 2d § 170 (1959).

The concept that the duty of prudence in trust administration, especially in investing and managing trust assets, entails adherence to the duty of loyalty is familiar. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B), extracted in the Comment to Section 1 of this Act, effectively merges the requirements of prudence and loyalty. A fiduciary cannot be prudent in the conduct of investment functions if the fiduciary is sacrificing the interests of the beneficiaries.

The duty of loyalty is not limited to settings entailing self-dealing or conflict of interest in which the trustee would benefit personally from the trust. "The trustee is under a duty to the beneficiary in administering the trust not to be guided by the interest of any third person. Thus, it is improper for the trustee to sell trust property to a third person for the purpose of benefitting the third person rather than the trust." Restatement of Trusts 2d § 170, comment *q*, at 371 (1959).

No form of so-called "social investing" is consistent with the duty of loyalty if the investment activity entails sacrificing the interests of trust beneficiaries — for example, by accepting below-market returns — in favor of the interests of the persons supposedly benefitted by pursuing the particular social cause. See, e.g., John H. Langbein & Richard Posner, Social Investing and the Law of Trusts, 79 Michigan L. Rev. 72, 96-97 (1980) (collecting authority). For pension trust assets, see generally Ian D. Lanoff, The Social Investment of Private Pension Plan Assets: May it Be Done Lawfully under ERISA?, 31 Labor L.J. 387 (1980). Commentators supporting social investing tend to concede the overriding force of the duty of loyalty. They argue instead that particular schemes of social investing may not result in below-market returns. See, e.g., Marcia O'Brien Hylton, "Socially Responsible" Investing: Doing Good Versus Doing Well in an Inefficient Market, 42 American U.L. Rev. 1 (1992). In 1994 the Department of Labor issued an Interpretive Bulletin reviewing its prior analysis of social investing questions and reiterating that pension trust fiduciaries may invest only in conformity with the prudence and loyalty standards of ERISA §§ 403-404. Interpretive Bulletin 94-1, 59 Fed. Regis. 32606 (Jun. 22, 1994), to be codified as 29 CFR § 2509.94-1. The Bulletin reminds fiduciary investors that they are prohibited from "subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives." Further, "an investment will not be prudent if it would be expected to provide a plan with a lower rate of return than available alternative investments with commensurate degrees of risk…."

SECTION 6. IMPARTIALITY. If a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries.

Comment

The duty of impartiality derives from the duty of loyalty. When the trustee owes duties to more than one beneficiary, loyalty requires the trustee to respect the interests of all the beneficiaries. Prudence in investing and administration requires the trustee to take account of the interests of all the beneficiaries for whom the trustee is acting, especially the conflicts between the interests of beneficiaries interested in income and those interested in principal.

The language of Section 6 derives from Restatement of Trusts 2d § 183 (1959); see also id., § 232. Multiple beneficiaries may be beneficiaries in succession (such as life and remainder interests) or beneficiaries with simultaneous interests (as when the income interest in a trust is being divided among several beneficiaries).

The trustee's duty of impartiality commonly affects the conduct of investment and management functions in the sphere of principal and income allocations. This Act prescribes no regime for allocating receipts and expenses. The details of such allocations are commonly handled under specialized legislation, such as the Revised Uniform Principal and Income Act (1962) (which is presently under study by the Uniform Law Commission with a view toward further revision).

SECTION 7. INVESTMENT COSTS. In investing and managing trust assets, a trustee may only incur costs that are appropriate and reasonable in relation to the assets, the purposes of the trust, and the skills of the trustee.

Comment

Wasting beneficiaries' money is imprudent. In devising and implementing strategies for the investment and management of trust assets, trustees are obliged to minimize costs.

The language of Section 7 derives from Restatement of Trusts 2d § 188 (1959). The Restatement of Trusts 3d says: "Concerns over compensation and other charges are not an obstacle to a reasonable course of action using mutual funds and other pooling arrangements, but they do require special attention by a trustee.... [I]t is important for trustees to make careful cost comparisons, particularly among similar products of a specific type being considered for a trust portfolio." Restatement of Trusts 3d: Prudent Investor Rule § 227, comment *m*, at 58 (1992).

SECTION 8. REVIEWING COMPLIANCE. The prudent investor rule expresses a standard of conduct, not outcome. Compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of a trustee's decision or action.

Comment

This section derives from the 1991 Illinois act, 760 ILCS 5/5(a)(2) (1992), which draws upon Restatement of Trusts 3d: Prudent Investor Rule § 227, comment *b*, at 11 (1992). Trustees are not insurers. Not every investment or management decision will turn out in the light of hindsight to have been successful. Hindsight is not the relevant standard. In the language of law and economics, the standard is ex ante, not ex post.

SECTION 9. DELEGATION OF INVESTMENT AND MANAGEMENT FUNCTIONS.

(a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in:

(1) selecting an agent;

(2) establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and

(3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.

(b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.

(c) A trustee who complies with the requirements of subsection (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.

(d) By accepting the delegation of a trust function from the trustee of a trust that is subject to the law of this State, an agent submits to the jurisdiction of the courts of this State.

Comment

This section of the Act reverses the much-criticized rule that forbad trustees to delegate investment and management functions. The language of this section is derived from Restatement of Trusts 3d: Prudent Investor Rule § 171 (1992), discussed infra, and from the 1991 Illinois act, 760 ILCS § 5/5.1(b), (c) (1992).

Former law. The former nondelegation rule survived into the 1959 Restatement: "The trustee is under a duty to the beneficiary not to delegate to others the doing of acts which the trustee can reasonably be required personally to perform." The rule put a premium on the frequently arbitrary task of distinguishing discretionary functions that were thought to be nondelegable from supposedly ministerial functions that the trustee was allowed to delegate. Restatement of Trusts 2d § 171 (1959).

The Restatement of Trusts 2d admitted in a comment that "There is not a clear-cut line dividing the acts which a trustee can properly delegate from those which he cannot properly delegate." Instead, the comment directed attention to a list of factors that "may be of importance: (1) the amount of discretion involved; (2) the value and character of the property involved; (3) whether the property is principal or income; (4) the proximity or remoteness of the subject matter of the trust; (5) the character of the act as one involving professional skill or facilities possessed or not possessed by the trustee himself." Restatement of Trusts 2d § 171, comment *d* (1959). The 1959 Restatement further said: "A trustee cannot properly delegate to another power to select investments." Restatement of Trusts 2d § 171, comment *h* (1959).

For discussion and criticism of the former rule see William L. Cary & Craig B. Bright, The Delegation of Investment Responsibility for Endowment Funds, 74 Columbia L. Rev. 207 (1974); John H. Langbein & Richard A. Posner, Market Funds and Trust-Investment Law, 1976 American Bar Foundation Research J. 1, 18-24.

The modern trend to favor delegation. The trend of subsequent legislation, culminating in the Restatement of Trusts 3d: Prudent Investor Rule, has been strongly hostile to the nondelegation rule. See John H. Langbein, Reversing the Nondelegation Rule of Trust-Investment Law, 59 Missouri L. Rev. 105 (1994).

The delegation rule of the Uniform Trustee Powers Act. The Uniform Trustee Powers Act (1964) effectively abrogates the nondelegation rule. It authorizes trustees "to employ persons, including attorneys, auditors, investment advisors, or agents, even if they are associated with the trustee, to advise or assist the trustee in the performance of his administrative duties; to act without independent investigation upon their recommendations; and instead of acting personally, to employ one or more agents to perform any act of administration, whether or not discretionary...." Uniform Trustee Powers Act § 3(24), 7B Uniform Laws Ann. 743 (1985). The Act has been enacted in 16 states, see "Record of Passage of Uniform and Model Acts as of September 30, 1993," 1993-94 Reference Book of Uniform Law Commissioners (unpaginated, following page 111) (1993).

UMIFA's delegation rule. The Uniform Management of Institutional Funds Act (1972) (UMIFA), authorizes the governing boards of eleemosynary institutions, who are trustee-like fiduciaries, to delegate investment matters either to a committee of the board or to outside investment advisors, investment counsel, managers, banks, or trust companies. UMIFA § 5, 7A Uniform Laws Ann. 705 (1985). UMIFA has been enacted in 38 states, see "Record of Passage of Uniform and Model Acts as of September 30, 1993," 1993-94 Reference Book of Uniform Law Commissioners (unpaginated, following page 111) (1993).

ERISA's delegation rule. The Employee Retirement Income Security Act of 1974, the federal statute that prescribes fiduciary standards for investing the assets of pension and employee benefit plans, allows a pension or employee benefit plan to provide that "authority to manage, acquire or dispose of assets of the plan is delegated to one or more investment managers...." ERISA § 403(a)(2), 29 U.S.C. § 1103(a)(2). Commentators have explained the rationale for ERISA's encouragement of delegation:

> ERISA . . . invites the dissolution of unitary trusteeship.... ERISA's fractionation of traditional trusteeship reflects the complexity of the modern pension trust. Because millions, even billions of dollars can be involved, great care is required in investing and safekeeping plan assets. Administering such plans — computing and honoring benefit entitlements across decades of employment and retirement — is also a complex business.... Since, however, neither the sponsor nor any other single entity has a comparative advantage in performing all these functions, the tendency has been for pension plans to use a variety of specialized providers. A consulting actuary, a plan administration firm, or an insurance company may oversee the design of a plan and arrange for processing benefit claims. Investment industry professionals manage the portfolio (the largest plans spread their pension investments among dozens of money management firms).

John H. Langbein & Bruce A. Wolk, Pension and Employee Benefit Law 496 (1990).

The delegation rule of the 1992 Restatement. The Restatement of Trusts 3d: Prudent Investor Rule (1992) repeals the nondelegation rule of Restatement of Trusts 2d § 171 (1959), extracted supra, and replaces it with substitute text that reads:

> § 171. Duty with Respect to Delegation. A trustee has a duty personally to perform the responsibilities of trusteeship except as a prudent person might delegate those responsibilities to others. In deciding whether, to whom, and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a prudent person would act in similar circumstances.

Restatement of Trusts 3d: Prudent Investor Rule § 171 (1992). The 1992 Restatement integrates this delegation standard into the prudent investor rule of section 227, providing that "the trustee must ... act with prudence in deciding whether and how to delegate to others ...." Restatement of Trusts 3d: Prudent Investor Rule § 227(c) (1992).

Protecting the beneficiary against unreasonable delegation. There is an intrinsic tension in trust law between granting trustees broad powers that facilitate flexible and efficient trust administration, on the one hand, and protecting trust beneficiaries from the misuse of such powers on the other hand. A broad set of trustees' powers, such as those found in most lawyer-drafted instruments and exemplified in the Uniform Trustees' Powers Act, permits the trustee to act vigorously and expeditiously to maximize the interests of the beneficiaries in a variety of transactions and administrative settings. Trust law relies upon the duties of loyalty and prudent administration, and upon procedural safeguards such as periodic accounting and the availability of judicial oversight, to prevent the misuse of these powers. Delegation, which is a species of trustee power, raises the same tension. If the trustee delegates effectively, the beneficiaries obtain the advantage of the agent's specialized investment skills or whatever other attributes induced the trustee to delegate. But if the trustee delegates to a knave or an incompetent, the delegation can work harm upon the beneficiaries.

Section 9 of the Uniform Prudent Investor Act is designed to strike the appropriate balance between the advantages and the hazards of delegation. Section 9 authorizes delegation under the limitations of subsections (a) and (b). Section 9(a) imposes duties of care, skill, and caution on the trustee in selecting the agent, in establishing the terms of the delegation, and in reviewing the agent's compliance.

The trustee's duties of care, skill, and caution in framing the terms of the delegation should protect the beneficiary against overbroad delegation. For example, a trustee could not prudently agree to an investment management agreement containing an exculpation clause that leaves the trust without recourse against reckless mismanagement. Leaving one's beneficiaries remediless against willful wrongdoing is inconsistent with the duty to use care and caution in formulating the terms of the delegation. This sense that it is imprudent to expose beneficiaries to broad exculpation clauses underlies both federal and state legislation restricting exculpation clauses, e.g., ERISA §§ 404(a)(1)(D), 410(a), 29 U.S.C. §§ 1104(a)(1)(D), 1110(a); New York Est. Powers Trusts Law § 11-1.7 (McKinney 1967).

Although subsection (c) of the Act exonerates the trustee from personal responsibility for the agent's conduct when the delegation satisfies the standards of subsection 9(a), subsection 9(b) makes the agent responsible to the trust. The beneficiaries of the trust can, therefore, rely upon the trustee to enforce the terms of the delegation.

Costs. The duty to minimize costs that is articulated in Section 7 of this Act applies to delegation as well as to other aspects of fiduciary investing. In deciding whether to delegate, the trustee must balance the projected benefits against the likely costs. Similarly, in deciding how to delegate, the trustee must take costs into account. The trustee must be alert to protect the beneficiary from "double dipping." If, for example, the trustee's regular compensation schedule presupposes that the trustee will conduct the investment management function, it should ordinarily follow that the trustee will lower its fee when delegating the investment function to an outside manager.

SECTION 10. LANGUAGE INVOKING STANDARD OF [ACT]. The following terms or comparable language in a trust instrument, unless otherwise limited or modified by the instrument, authorizes any investment or strategy permitted under this [Act]:

"investments permissible by law for investment of trust funds," "legal investments," "authorized investments," "using the judgment and care under the circumstances then prevailing that persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital," "prudent man rule," "prudent trustee rule," "prudent person rule," and "prudent investor rule."

Comment

This provision is taken from the Illinois act, 760 ILCS § 5/5(d) (1992), and is meant to facilitate incorporation of the Act by means of the formulaic language commonly used in trust instruments.

SECTION 11. UNIFORMITY OF APPLICATION AND CONSTRUCTION. This [Act] shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this [Act] among the States enacting it.

SECTION 12. SHORT TITLE. This [Act] may be cited as the "[Name of Enacting State] Uniform Prudent Investor Act."

SECTION 13. SEVERABILITY. If any provision of this [Act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [Act] which can be given effect without the invalid provision or application, and to this end the provisions of this [Act] are severable.

SECTION 14. EFFECTIVE DATE. This [Act] takes effect __________________.

SECTION 15. REPEALS. The following acts and parts of acts are repealed:

(1)

(2)

(3)

SECTION 16. APPLICATION TO EXISTING RELATIONSHIPS. This [Act] applies to trusts existing on and created after its effective date. As applied to trusts existing on its effective date, this [Act] governs only decisions or actions occurring after that date.

EX 19

UNIFORM PRUDENT INVESTOR ACT	CALIFORNIA TRUST LAW
Section 1. Prudent investor rule (a) Except as provided in subsection (b), a trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule, as set forth in Sections 2 through 9.	**§ 16000. Duty to administer trust** 16000. On acceptance of the trust, the trustee has a duty to administer the trust according to the trust instrument and, except to the extent the trust instrument provides otherwise, according to this division.
(b) The prudent investor rule is a default rule that may be expanded, restricted, eliminated, or otherwise altered by provisions of the trust. A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on provisions of the trust.	**§ 16040. Trustee's standard of care in administering trust** 16040.... (c) The settlor may expand or restrict the standards provided in subdivisions (a) and (b) [see below] by express provisions in the trust instrument. A trustee is not liable to a beneficiary for the trustee's good faith reliance on these express provisions.
Section 2. Standard of care; portfolio strategy; risk and return objectives (a) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution. (b) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust. (c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries: (1) general economic conditions; (2) the possible effect of inflation or deflation; (3) the expected tax consequences of investment decisions or strategies; (4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property; (5) the expected total return from income and the appreciation of capital; (6) other resources of the beneficiaries; (7) needs for liquidity, for regularity of income, and for preservation or appreciation of capital; and (8) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.	**§ 16040. Trustee's standard of care in administering trust** 16040. (a) The trustee shall administer the trust with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims to accomplish the purposes of the trust as determined from the trust instrument. (b) When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing trust property, the trustee shall act with the care, skill, prudence, and diligence under the circumstances then prevailing, including but not limited to the general economic conditions and the anticipated needs of the trust and its beneficiaries, that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims to accomplish the purposes of the trust as determined from the trust instrument. In the course of administering the trust pursuant to this standard, individual investments shall be considered as part of an overall investment strategy. ...
(d) A trustee shall take reasonable steps to verify facts relevant to the investment and management of trust assets.	

UNIFORM PRUDENT INVESTOR ACT	CALIFORNIA TRUST LAW
(e) Subject to the standard of this [Act], a trustee may invest in any kind of property or type of investment.	**§ 16223. Investments** 16223. The trustee has the power to invest in any kind of property, whether real, personal, or mixed.
(f) A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.	**§ 16014. Duty to use special skills** 16014. (a) The trustee has a duty to apply the full extent of the trustee's skills. (b) If the settlor, in selecting the trustee, has relied on the trustee's representation of having special skills, the trustee is held to the standard of the skills represented.
Section 3. Diversification A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.	**§ 16008. Duty to dispose of improper investments** 16008. ... (b) Unless the trust instrument expressly provides otherwise, the trustee may, without liability, continue to hold property included in the trust at its creation or later added to the trust or acquired pursuant to proper authority, if retention is in the best interests of the trust or in furtherance of the purposes of the trust.
Section 4. Duties at inception of trusteeship Within a reasonable time after accepting a trusteeship or receiving trust assets, a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this [Act].	
Section 5. Loyalty A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries.	**§ 16002. Duty of loyalty** 16002. (a) The trustee has a duty to administer the trust solely in the interest of the beneficiaries. (b) It is not a violation of the duty provided in subdivision (a) for a trustee who administers two trusts to sell, exchange, or participate in the sale or exchange of trust property between the trusts, if both of the following requirements are met: (1) The sale or exchange is fair and reasonable with respect to the beneficiaries of both trusts. (2) The trustee gives to the beneficiaries of both trusts notice of all material facts related to the sale or exchange that the trustee knows or should know.
Section 6. Impartiality If a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries.	**§ 16003. Duty to deal impartially with beneficiaries** 16003. If a trust has two or more beneficiaries, the trustee has a duty to deal impartially with them.

EX 20

UNIFORM PRUDENT INVESTOR ACT	CALIFORNIA TRUST LAW
Section 7. Investment costs In investing and managing trust assets, a trustee may only incur costs that are appropriate and reasonable in relation to the assets, the purposes of the trust, and the skills of the trustee.	**§ 15680. Trustee's compensation under trust instrument** 15680. (a) Subject to subdivision (b), if the trust instrument provides for the trustee's compensation, the trustee is entitled to be compensated in accordance with the trust instrument. (b) Upon proper showing, the court may fix or allow greater or lesser compensation than could be allowed under the terms of the trust in any of the following circumstances: (1) Where the duties of the trustee are substantially different from those contemplated when the trust was created. (2) Where the compensation in accordance with the terms of the trust would be inequitable or unreasonably low or high. (3) In extraordinary circumstances calling for equitable relief. (c) An order fixing or allowing greater or lesser compensation under subdivision (b) applies only prospectively to actions taken in administration of the trust after the order is made. **§ 15681. Trustee's compensation where trust silent** 15681. If the trust instrument does not specify the trustee's compensation, the trustee is entitled to reasonable compensation under the circumstances. **§ 15684. Repayment for expenditures** 15684. A trustee is entitled to the repayment out of the trust property for the following: (a) Expenditures that were properly incurred in the administration of the trust. (b) To the extent that they benefited the trust, expenditures that were not properly incurred in the administration of the trust.
Section 8. Reviewing compliance The prudent investor rule expresses a standard of conduct, not outcome. Compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of a trustee's decision or action.	**§ 16440. Measure of liability for breach of trust** 16440. (a) If the trustee commits a breach of trust, the trustee is chargeable with any of the following that is appropriate under the circumstances: (1) Any loss or depreciation in value of the trust estate resulting from the breach of trust, with interest. (2) Any profit made by the trustee through the breach of trust, with interest. (3) Any profit that would have accrued to the trust estate if the loss of profit is the result of the breach of trust. (b) If the trustee has acted reasonably and in good faith under the circumstances as known to the trustee, the court, in its discretion, may excuse the trustee in whole or in part from liability under subdivision (a) if it would be equitable to do so.

UNIFORM PRUDENT INVESTOR ACT	CALIFORNIA TRUST LAW
Section 9. Delegation of investment and management functions (a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in: (1) selecting an agent; (2) establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and (3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.	**§ 16012. Duty not to delegate** 16012. (a) The trustee has a duty not to delegate to others the performance of acts that the trustee can reasonably be required personally to perform and may not transfer the office of trustee to another person nor delegate the entire administration of the trust to a cotrustee or other person. (b) In a case where a trustee has properly delegated a matter to an agent, cotrustee, or other person, the trustee has a duty to exercise general supervision over the person performing the delegated matter. **§ 16247. Hiring persons** 16247. The trustee has the power to hire persons, including accountants, attorneys, auditors, investment advisers, or other agents, even if they are associated or affiliated with the trustee, to advise or assist the trustee in the performance of administrative duties.
(b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.	
(c) A trustee who complies with the requirements of subsection (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.	**§ 16401. Trustee's liability to beneficiary for acts of agent** 16401. (a) Except as provided in subdivision (b), the trustee is not liable to the beneficiary for the acts or omissions of an agent. (b) The trustee is liable to the beneficiary for an act or omission of an agent employed by the trustee in the administration of the trust that would be a breach of the trust if committed by the trustee under any of the following circumstances: (1) Where the trustee has the power to direct the act of the agent. (2) Where the trustee delegates to the agent the authority to perform an act that the trustee is under a duty not to delegate. (3) Where the trustee does not use reasonable care in the selection of the agent or the retention of the agent selected by the trustee. (4) Where the trustee does not exercise proper supervision over the agent's conduct in a case where the trustee has the power to supervise the agent. (5) Where the trustee conceals the act of the agent. (6) Where the trustee neglects to take reasonable steps to compel the agent to redress the wrong in a case where the trustee knows of the agent's acts or omissions. (c) The liability of a trustee for acts or omissions of agents that occurred before July 1, 1987, is governed by prior law and not by this section.
(d) By accepting the delegation of a trust function from the trustee of a trust that is subject to the law of this State, an agent submits to the jurisdiction of the courts of this State.	

EX 22

UNIFORM PRUDENT INVESTOR ACT	CALIFORNIA TRUST LAW
Section 10. Language invoking standard of [act] The following terms or comparable language in a trust instrument, unless otherwise limited or modified by the instrument, authorizes any investment or strategy permitted under this [Act]: "investments permissible by law for investment of trust funds," "legal investments," "authorized investments," "using the judgment and care under the circumstances then prevailing that persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital," "prudent man rule," "prudent trustee rule," "prudent person rule," and "prudent investor rule."	**§ 16042. Interpretation of trust terms concerning legal investments** 16042. If a trust created before, on, or after July 1, 1987, refers to "investments permissible by law for investment of trust funds," "authorized by law for investment of trust funds," "legal investments," "authorized investments," or "investments acquired using the judgment and care which men of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of their capital," or uses other words of similar meaning in defining the powers of the trustee relative to investments, such language, in the absence of other controlling or modifying provisions of the trust instrument, shall be construed as imposing the standard of care provided by Section 16040 and authorizing any investment permitted under Chapter 2 (commencing with Section 16200).
Section 11. Uniformity of application and construction This [Act] shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this [Act] among the States enacting it.	**§ 2. Construction of provisions drawn from uniform acts** ... (b) A provision of this code, insofar as it is the same in substance as a provision of a uniform act, shall be so construed as to effectuate the general purpose to make uniform the law in those states which enact that provision.
Section 13. Severability If any provision of this [Act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [Act] which can be given effect without the invalid provision or application, and to this end the provisions of this [Act] are severable.	**§ 11. Severability** If any provision or clause of this code or application thereof to any person or circumstances is held invalid, the invalidity does not affect other provisions or applications of the code which can be given effect without the invalid provision or application, and to this end the provisions of this code are severable.

EX 23

UNIFORM PRUDENT INVESTOR ACT	CALIFORNIA TRUST LAW
Section 16. Application to existing relationships This [Act] applies to trusts existing on and created after its effective date. As applied to trusts existing on its effective date, this [Act] governs only decisions or actions occurring after that date.	**§ 3. General transitional provisions** 3. (a) As used in this section: (1) "New law" means either of the following, as the case may be: (A) The act that enacted this code. (B) The act that makes a change in this code, whether effectuated by amendment, addition, or repeal of any provision of this code. (2) "Old law" means the applicable law in effect before the operative date of the new law. (3) "Operative date" means the operative date of the new law. (b) This section governs the application of a new law except to the extent otherwise expressly provided in the new law. (c) Subject to the limitations provided in this section, a new law applies on the operative date to all matters governed by the new law, regardless of whether an event occurred or circumstance existed before, on, or after the operative date, including, but not limited to, creation of a fiduciary relationship, death of a person, commencement of a proceeding, making of an order, or taking of an action. ... (f) No personal representative, guardian, conservator, trustee, probate referee, or any other fiduciary, officer, or person is liable for any action taken before the operative date that was proper at the time the action was taken, even though the action would be improper if taken on or after the operative date, and such a person has no duty, as a result of the enactment of the new law, to take any step to alter the course of action or its consequences. (g) If the new law does not apply to a matter that occurred before the operative date, the old law continues to govern the matter notwithstanding its amendment or repeal by the new law. (h) If a party shows, and the court determines, that application of a particular provision of the new law or of the old law in the manner required by this section or by the new law would substantially interfere with the effective conduct of the proceedings or the rights of the parties or other interested persons in connection with an event that occurred or circumstance that existed before the operative date, the court may, notwithstanding this section or the new law, apply either the new law or the old law to the extent reasonably necessary to mitigate the substantial interference.

#L-648

STATE OF CALIFORNIA

CALIFORNIA LAW REVISION COMMISSION

Staff Draft

TENTATIVE RECOMMENDATION

Uniform Prudent Investor Act

September 1994

This tentative recommendation is being distributed so that interested persons will be advised of the Commission's tentative conclusions and can make their views known to the Commission. Any comments sent to the Commission will be a part of the public record and will be considered at a public meeting when the Commission determines the provisions it will include in legislation the Commission plans to recommend to the Legislature. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you believe revisions should be made in the tentative recommendation.

COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE RECEIVED BY THE COMMISSION NOT LATER THAN **November 1, 1994.**

The Commission often substantially revises tentative recommendations as a result of the comments it receives. Hence, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739
(415) 494-1335 FAX: (415) 494-1827

UNIFORM PRUDENT INVESTOR ACT

A new Uniform Prudent Investor Act was approved by the National Conference of Commissioners on Uniform State Laws in the summer of 1994.[1] The new act seeks to modernize investment practices of fiduciaries, focusing on trustees of private trusts. The main objectives of the UPIA are stated in its Prefatory Note:

> (1) The standard of prudence is applied to any investment as part of the total portfolio, rather than to individual investments. In the trust setting the term "portfolio" embraces all the trust's assets....
>
> (2) The tradeoff in all investing between risk and return is identified as the fiduciary's central consideration....
>
> (3) All categoric restrictions on types of investments have been abrogated; the trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the trust and that meets the other requirements of prudent investing....
>
> (4) The long familiar requirement that fiduciaries diversify their investments has been integrated into the definition of prudent investing....
>
> (5) The much criticized former rule of trust law forbidding the trustee to delegate investment and management functions has been reversed. Delegation is now permitted, subject to safeguards....

Some of these objectives have already been met in existing California law. California adopted a portfolio approach to investments by trustees in 1984,[2] and early recognized the trustee's power to make any type of investment in conformance with applicable duties.[3] While preserving the traditional rule against delegating administration of the trust to others, existing law recognizes the ability of trustees to make limited delegations where appropriate and to hire experts to assist in administration of the trust.[4] The duty to diversity has not been codified, but is recognized in case law.[5]

Adoption of the Uniform Prudent Investor Act would add several new features to the Trust Law:

Risk. The law would specifically recognize the importance of analyzing both risk and return, consistent with modern investment theory. Rather than avoiding risk categorically, the uniform act encourages balancing risk and return at levels

1. A copy of the Uniform Prudent Investor Act [hereinafter UPIA or the "uniform act"] is set out as an [Appendix, *infra*.] The uniform act relies heavily on the revised standards for prudent trust investments promulgated in the new Restatement (Third) of Trusts: Prudent Investor Rule (1992).

2. See Prob. Code § 16040(b) & Comment; see also Selected *1986 Trust and Probate Legislation,* 18 Cal. L. Revision Comm'n Reports 1201, 1240-42 (1986).

3. See Prob. Code § 16223 & Comment. This rule was adopted from the Uniform Trustees' Powers Act (1964).

4. See Prob. Code §§ 16012 (general duty not to delegate), 16247 (hiring accountants, investment advisors, etc.).

5. See , e.g., Estate of Collins, 72 Cal. App. 3d 663, 669-72, 139 Cal. Rptr. 644, 648-49 (1977).

appropriate for the purposes of the trust.[6] This is not inconsistent with existing law,[7] but adds greater detail as to the factors to be considered in devising the portfolio investment strategy.

Delegation. A trustee would be able to delegate investment and management decisions where prudent in light of the trustee's skills.[8] The trustee must exercise care, skill, and caution in selecting the agent and establishing the scope and terms of the delegation consistent with the purposes and terms of the trust, and must monitor the agent's performance.

Trustee's liability for delegation. A trustee who satisfies the delegation standards is not liable to the beneficiaries for the acts of an agent.[9] This rule is more protective of trustees who make a proper delegation than the existing standard which, among other things, subjects a trustee for liability if the trustee has the power to direct the act of the trustee.[10]

Liability of agent. An agent who performs a delegated function owes a duty to the trust and, by accepting the delegation, submits to the jurisdiction of California courts.[11]

Standard of compliance. The prudent investor rule "expresses a standard of conduct, not outcome. Compliance with the prudent investment rule is determined in light of the facts and circumstances existing at the time of a trustee's decision or action."[12] This rule emphasizes and protects reliance on the fundamental rule of prudence in adopting an investment strategy and managing the trust. It is consistent with the principle in existing law protecting a trustee who has acted "reasonably and in good faith under the circumstances as known to the trustee."[13]

Application to existing trusts. The prudent investor rule would apply to existing trusts but not to decisions or actions occurring before it became operative.[14] The same general principle was applied when the Trust Law became operative.[15]

6. See UPIA § 2 & comment.

7. See Prob. Code § 16040(b).

8. See UPIA § 9 & comment.

9. See UPIA § 9(c) & comment.

10. See Prob. Code § 16401(b)(1).

11. See UPIA § 9(b) & (d).

12. UPIA § 8 & comment.

13. Prob. Code § 16440(b).

14. See UPIA § 16.

15. See Prob. Code § 15001 & Comment; see also Prob. Code § 3.

Contents

Prob. Code §§ 16045-16054 (added). Uniform Prudent Investor Act

SEC. ____. Article 2.5 (commencing with Section 16045) is added to Chapter 1 of Part 4 of Division 9 the Probate Code, to read:

Article 2.5. Uniform Prudent Investor Act

§ 16045. Short title

16045. This article, subdivision (a) of Section 16002, and Sections 16003 and 16223 may be cited as the Uniform Prudent Investor Act.

Comment. Section 16045 has the same purpose as Section 12 of the Uniform Prudent Investor Act (1994). Most of the uniform act is set forth in this article, but some rules already exist in other parts of the Trust Law and are included within the short title by specific reference. See Sections 16002(a) (duty of loyalty), 16003 (duty to deal impartially with beneficiaries), 16223 (power to invest in any kind of property).

See also Sections 2 (construction of provisions drawn from uniform acts), which is the same in substance as UPIA § 11; 13 (severability), which is the same in substance as UPIA § 13. For a list of uniform acts in the Probate Code, see Section 2 Comment.

Staff Note. As discussed in staff notes herein, some provisions of UPIA are omitted in favor of pre-existing California statutes. The structure of the Trust Law, which was enacted on Commission recommendation, was crafted with great care. Thus, provisions relating to powers, duties, liabilities, compensation, etc., are grouped logically as an aid to lawyers, judges, and others who need to read the statute. We have sought to balance the need to preserve this benefit while also promoting uniformity through adoption of the language and structure of the uniform act.

§ 16046. Prudent investor rule

16046. (a) Except as provided in subsection (b), a trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule, as provided in this article.

(b) The prudent investor rule is a default rule that may be expanded, restricted, eliminated, or otherwise altered by provisions of the trust. A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on provisions of the trust.

Comment. Section 16046 is the same as Section 1 of the Uniform Prudent Investor Act (1994). Subdivision (a) and the first sentence of subdivision (b) are a special application of the general duty provided in Section 16000 (duty to administer trust according to statute, subject to control in trust). The second sentence of subdivision (b) provides a special rule protecting reasonable reliance under the prudent investor rule. Compare Section 16040(b) [as amended] (protection of trustee for good faith reliance on express trust provisions).

Staff Note. This section raises an issue. As noted in the Comment, UPIA protects "reasonable reliance" on the terms of the trust. Existing California law in Section 16040(c) protects "good faith reliance." It would be best if the law adopted one standard or the other, rather than having different standards for investment and management, on one hand, and for other decisions on the other. The staff is unclear whether the two standards would lead to significantly different results in practice, nor do we know whether the affected interest groups might have a problem with changing the good faith standard to a reasonable standard. A reasonable standard is more objective, but might be seen to invite a court to rethink the decision and substitute its own judgment for the good faith efforts of the trustee. On the other hand, a good faith standard could theoretically excuse an unreasonable decision, as long as it was made in good faith. The good faith standard is more consistent with the duty of the trustee to administer the trust according to its terms. The reasonable standard can be viewed as inviting the trustee to second guess the settlor. The good faith standard was enacted in the course of amendments to former Civil Code Section 2261 in 1984. See 1984 Cal. Stat. ch. 1372, § 1. It appears that the 1984 amendments may have been inspired by ERISA.

§ 16047. Standard of care, portfolio strategy, risk and return objectives

16047. (a) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.

(b) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.

(c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:

(1) General economic conditions.

(2) The possible effect of inflation or deflation.

(3) The expected tax consequences of investment decisions or strategies.

(4) The role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property.

(5) The expected total return from income and the appreciation of capital.

(6) Other resources of the beneficiaries.

(7) Needs for liquidity, for regularity of income, and for preservation or appreciation of capital.

(8) An asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

(d) A trustee shall take reasonable steps to verify facts relevant to the investment and management of trust assets.

(e) Subject to the standard of this article, a trustee may invest in any kind of property or type of investment.

Comment. Section 16047 is the same as Section 2(a)-(e) of the Uniform Prudent Investor Act (1994). Subdivisions (a)-(c) of Section 16047 replace the portfolio investment rule of former subdivision (b) of Section 16040. Subdivision (d) is new to the code. Subdivision (e) is the same in substance as Section 16223.

Section 2(f) of the Uniform Prudent Investor Act has been omitted from Section 16047 because it is unnecessary. The same general rule is provided by Section 16014 (duty to use special skills).

Staff Note. Subdivision (e) overlaps with Section 16223 (see parallel table attached to Memorandum 94-47) but does not seem to cause any harm. We have retained it in the interest of uniformity, although it could be deleted in favor of Section 16223 without harm.

UPIA Section 2(f) has been omitted because it overlaps with Section 16014. Section 2(f) reads:

> (f) A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.

This language is just as good as Section 16014, but the existing section was a subject to some opposition when the Trust Law was under development, and there is no point in raising the issue again.

§ 16048. Diversification

16048. A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.

Comment. Section 16048 is the same as Section 3 of the Uniform Prudent Investor Act (1994). This section is new to the Trust Law, but is consistent with case law. See, e.g., Estate of Collins, 72 Cal. App. 3d 663, 669-72, 139 Cal. Rptr. 644, 648-49 (1977). For a related rule, see Section 16008(b) (retention of property in furtherance of trust purposes).

Staff Note. There is some tension between this rule and Section 16008:

> **§ 16008. Duty to dispose of improper investments**
>
> 16008. (a) Except as provided in subdivision (b), the trustee has a duty within a reasonable time to dispose of any part of the trust property included in the trust at the time of its creation, or later acquired by or added to the trust, that would not be a proper investment for the trustee to make.
>
> (b) Unless the trust instrument expressly provides otherwise, the trustee may, without liability, continue to hold property included in the trust at its creation or later added to the trust or acquired pursuant to proper authority, if retention is in the best interests of the trust or in furtherance of the purposes of the trust.

Section 16008 could be repealed in favor of draft Section 16048. We have retained both rules because of the detail in Section 16008 since, as the staff recalls, there was some concern by the

State Bar when the Trust Law was under consideration as to the authority of the trustee to hold on to the family home. The rule in draft Section 16048 does not preclude this type of retention, but the emphasis of UPIA is on diversification and productive investment. The UPIA comment recognizes that circumstances may overcome the duty to diversify, as in the case of retention of a family business. (See Exhibit p. 9.)

§ 16049. Duties at inception of trusteeship

16049. Within a reasonable time after accepting a trusteeship or receiving trust assets, a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this chapter.

Comment. Section 16049 is the same as Section 4 of the Uniform Prudent Investor Act (1994). For related duties, see Sections 16000 (duty to administer trust on acceptance), 16006 (duty to take control of and preserve trust property), 16008(a) (duty to dispose of improper investments within reasonable time).

Staff Note. The uniform act provides for compliance with the "requirements of this [Act]" which would technically mean this "article." However, there are other duties that the trustee is subject to set out in other parts of this chapter, so we have broadened the reference.

§ 16050. Investment costs

16050. In investing and managing trust assets, a trustee may only incur costs that are appropriate and reasonable in relation to the assets, the purposes of the trust, and the skills of the trustee.

Comment. Section 16050 is the same as Section 7 of the Uniform Prudent Investor Act (1994). For related rules concerning reimbursement and compensation of trustees, see Sections 15680-15685.

Staff Note. This rule is included in the interest of consistency with the uniform act. It is not inconsistent with existing California rules. See the parallel table attached to Memorandum 94-47. On its own, the uniform act provision is inadequate so cannot be considered as a replacement for existing law. Clearly the trustee *can incur* costs. The real issue is whether the trustee may properly charge them to the trust. Nor is the uniform act clear on whether it applies to compensation or reimbursement for expenses or to both.

§ 16051. Reviewing compliance

16051. The prudent investor rule expresses a standard of conduct, not outcome. Compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of a trustee's decision or action.

Comment. Section 16051 is the same as Section 8 of the Uniform Prudent Investor Act (1994). For related rules governing trustee liability, see Sections 16440-16465.

Staff Note. This rule works hand in hand with Section 16440(b) which gives the court *discretion* to excuse a trustee:

> **§ 16440. Measure of liability for breach of trust**
>
> 16440. (a) If the trustee commits a breach of trust, the trustee is chargeable with any of the following that is appropriate under the circumstances:

(1) Any loss or depreciation in value of the trust estate resulting from the breach of trust, with interest.

(2) Any profit made by the trustee through the breach of trust, with interest.

(3) Any profit that would have accrued to the trust estate if the loss of profit is the result of the breach of trust.

(b) If the trustee has acted reasonably and in good faith under the circumstances as known to the trustee, the court, in its discretion, may excuse the trustee in whole or in part from liability under subdivision (a) if it would be equitable to do so.

The staff has not suggested revising this rule since it was a subject of controversy during its development. It would be possible to try to merge draft Section 16051 and existing Section 16040(b) to retain the court's discretion, but add the language concerning the "facts and circumstances existing at the time of a trustee's decision or action."

§ 16052. Delegation of investment and management functions

16052. (a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in the following:

(1) Selecting an agent.

(2) Establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust.

(3) Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.

(b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.

(c) A trustee who complies with the requirements of subsection (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.

(d) By accepting the delegation of a trust function from the trustee of a trust that is subject to the law of this State, an agent submits to the jurisdiction of the courts of this State.

Comment. Section 16052 is the same as Section 9 of the Uniform Prudent Investor Act (1994). This section provides special exceptions to the general rules concerning the duty not to delegate (Section 16012) and the trustee's liability for acts of agents (Section 16401).

Staff Note. This section presents two significant inconsistencies with existing California law:

Delegation. Section 16247 permits the trustee to hire accountants, auditors, investment advisors, and the like to *assist* the trustee in administration of the trust. But Section 16012 imposes a duty not to delegate acts the trustee can reasonably be required to perform and forbids delegation of the *entire* administration of the trust. Subdivision (a) of the uniform act section authorizes delegation of investment and management functions that a *prudent trustee of comparable skills could properly delegate under the circumstances.*

On the face if it, these two standards seem to cover much of the same ground. But the California rule is believed to impose a general duty not to delegate, whereas the UPIA rule is intended to encourage delegation in appropriate cases. (For background on these issues, see UPIA § 9 comment, Exhibit pp. 14-16.) In practice, the differences may prove to be relatively unimportant.

The simplest way to resolve the inconsistency, to the extent that it is real, is to provide an exception in the general rule of Section 16012. See the conforming revisions, *infra.*

Liability. It is difficult to harmonize this section and Section 16401, the existing rule governing the trustee's liability for acts of agents. The uniform act excuses the trustee if reasonable care, skill, and caution were used in selecting the agent, if delegation was consistent with the trust purposes, and if the trustee monitors the agent's performance.

Existing Section 16401 (drawn from the Restatement (Second) of Trusts) makes the trustee liable in the following circumstances:

> (1) Where the trustee has the power to direct the act of the agent.
>
> (2) Where the trustee delegates to the agent the authority to perform an act that the trustee is under a duty not to delegate.
>
> (3) Where the trustee does not use reasonable care in the selection of the agent or the retention of the agent selected by the trustee.
>
> (4) Where the trustee does not exercise proper supervision over the agent's conduct in a case where the trustee has the power to supervise the agent.
>
> (5) Where the trustee conceals the act of the agent.
>
> (6) Where the trustee neglects to take reasonable steps to compel the agent to redress the wrong in a case where the trustee knows of the agent's acts or omissions.

Existing law is less protective of trustees than the uniform act.

The draft preserves the existing rule, subject to the special UPIA rule applicable to investment and management delegations. However, it may be difficult to determine which rule applies to a given fact situation, and determining which rule applies could have significant results in terms of the trustee's liability. A better approach, more disruptive of the rule drawn from the uniform act, would be to add some of the rules from Section 16401, specifically paragraphs (5) and (6), into the uniform act.

However, a difficulty arises as to paragraph (1) of the existing rule which makes the trustee liable where the trustee has the power to direct the act of the agent. This would seem to impose liability in most cases of agents' misfeasance or neglect. The authority to direct the agent would defeat the purpose of the uniform act. Should it be eliminated from the general rule?

§ 16053. Language invoking standard of Uniform Prudent Investor Act

16053. The following terms or comparable language in a trust instrument, unless otherwise limited or modified by the instrument, authorizes any investment or strategy permitted under this [Act]: "investments permissible by law for investment of trust funds," "legal investments," "authorized investments," "using the judgment and care under the circumstances then prevailing that persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital," "prudent man rule," "prudent trustee rule," "prudent person rule," and "prudent investor rule."

Comment. Section 16053 is the same as Section 10 of the Uniform Prudent Investor Act (1994) and restates former Section 16042 without substantive change.

Staff Note. Section 16042 also specifically incorporated the standard of care under Section 16040, but as relates to investments, the standard of care in draft Section 16046 is picked up indirectly by the language of this section. The staff does not believe that this change in language will cause any confusion.

§ 16054. Application to existing relationships

16054. This article applies to trusts existing on and created after its effective date. As applied to trusts existing on its effective date, this article governs only decisions or actions occurring after that date.

Comment. Section 16054 is the same as Section 16 of the Uniform Prudent Investor Act (1994) and is a specific application of the general transitional provisions in Section 3.

Staff Note. This section is, strictly speaking, unnecessary in light of the general transitional rule in Section 3. However, it is easier to understand the rule as stated in this section than by wading through the lengthy general rule.

CONFORMING REVISIONS

Prob. Code § 16003 (amended). Duty to deal impartially with beneficiaries

SEC. ____. Section 16003 of the Probate Code is amended to read:

16003. If a trust has two or more beneficiaries, the trustee has a duty to deal impartially with them and shall act impartially in investing and managing the trust property, taking into account any differing interests of the beneficiaries.

Comment. Section 16003 is amended to provide additional detail drawn from Section 6 of the Uniform Prudent Investor Act (1994).

Staff Note. The uniform act language could be retained in the UPIA article (see below), overlapping with this general rule. However, the staff thinks it is better to keep this fundamental rule in one place and not fragment it in different language between two parts of the Trust Law.

Section 6 of UPIA reads: "If a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries."

Prob. Code § 16012 (amended). Duty not to delegate

SEC. ____. Section 16012 of the Probate Code is amended to read:

16012. (a) The trustee has a duty not to delegate to others the performance of acts that the trustee can reasonably be required personally to perform and may not transfer the office of trustee to another person nor delegate the entire administration of the trust to a cotrustee or other person.

(b) In a case where a trustee has properly delegated a matter to an agent, cotrustee, or other person, the trustee has a duty to exercise general supervision over the person performing the delegated matter.

(c) This section does not apply to investment and management functions under Section 16052.

Comment. Section 16012 is amended to recognize the special rule in Section 16052 applicable under the Uniform Prudent Investor Act (1994).

Prob. Code § 16040 (amended). Trustee's standard of care in administering trust

SEC. ____. Section 16040 of the Probate Code is amended to read:

16040. (a) ~~The~~ Subject to the Uniform Prudent Investor Act (Article 2.5 (commencing with Section 16045), the trustee shall administer the trust with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims to accomplish the purposes of the trust as determined from the trust instrument.

~~(b) When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing trust property, the trustee shall act with the care, skill, prudence, and diligence under the circumstances then prevailing, including but not limited to the general economic conditions and the anticipated needs of the trust and its beneficiaries, that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims to accomplish the purposes of the trust as determined from the trust instrument. In the course of administering the trust pursuant to this standard, individual investments shall be considered as part of an overall investment strategy.~~

~~(c)~~

(b) The settlor may expand or restrict the standards provided in ~~subdivisions~~ subdivision (a) ~~and (b)~~ by express provisions in the trust instrument. A trustee is not liable to a beneficiary for the trustee's good faith reliance on these express provisions.

Comment. Section 16040 is amended for harmony with the new Uniform Prudent Investor Act (1994). This section provides a general standard of care that applies where the special, more detailed rule applicable to investments does not apply, such as in determining whether a discretionary distribution is appropriate.

The portfolio rule formerly provided by subdivision (b) is restated in Section 16047. Former subdivision (c) has been redesignated as subdivision (b) and revised the delete the reference to former subdivision (b). For a special rule concerning the default nature of the prudent investment rule and protecting the trustee's reasonable reliance on trust provisions concerning investments, see Section 16046 (prudent investment rule).

Prob. Code § 16042 (repealed). Interpretation of trust terms concerning legal investments

SEC. ____. Section 16042 of the Probate Code is repealed.

~~16042. If a trust created before, on, or after July 1, 1987, refers to "investments permissible by law for investment of trust funds," "authorized by law for investment of trust funds," "legal investments," "authorized investments," or "investments acquired using the judgment and care which men of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of their capital," or uses other words of similar meaning in defining the powers of the trustee relative to investments, such language, in the absence of other controlling or modifying provisions of the trust instrument, shall be construed as imposing the standard of care provided by Section 16040 and authorizing any investment permitted under Chapter 2 (commencing with Section 16200).~~

Comment. Section 16042 is continued without substantive change in Section 16053.

Prob. Code § 16401 (amended). Trustee's liability to beneficiary for acts of agent

SEC. ____. Section 16401 of the Probate Code is amended to read:

16401. (a) Except as provided in subdivision (b), the trustee is not liable to the beneficiary for the acts or omissions of an agent.

(b) The trustee is liable to the beneficiary for an act or omission of an agent employed by the trustee in the administration of the trust that would be a breach of the trust if committed by the trustee under any of the following circumstances:

(1) Where the trustee has the power to direct the act of the agent.

(2) Where the trustee delegates to the agent the authority to perform an act that the trustee is under a duty not to delegate.

(3) Where the trustee does not use reasonable care in the selection of the agent or the retention of the agent selected by the trustee.

(4) Where the trustee does not exercise proper supervision over the agent's conduct in a case where the trustee has the power to supervise the agent.

(5) Where the trustee conceals the act of the agent.

(6) Where the trustee neglects to take reasonable steps to compel the agent to redress the wrong in a case where the trustee knows of the agent's acts or omissions.

(c) The liability of a trustee for acts or omissions of agents that occurred before July 1, 1987, is governed by prior law and not by this section.

<u>(d) This section does not apply to the liability of a trustee for acts or omissions of an agent delegated investment and management functions under Section 16052.</u>

Comment. Section 16401 is amended to recognize the special rule in Section 16052 applicable under the Uniform Prudent Investor Act (1994).

REVISED COMMENTS

Prob. Code § 2. Continuation of existing law; construction of provisions drawn from uniform acts

Comment. Section 2 continues Section 2 of the repealed Probate Code without change. See also Gov't Code §§ 9604 (reference made in statute, charter, or ordinance to provisions of one statute carried into another statute under circumstances in which they are required to be construed as restatements and continuations and not as new enactments), 9605 (construction of amended statutory provision).

Some of the provisions of this code are the same as or similar to provisions of uniform acts. Subdivision (b) provides a rule for interpretation of these provisions. Many of the provisions of this code are drawn from the Uniform Probate Code (1987). Some provisions are drawn from other uniform acts:

Sections 220-224 — Uniform Simultaneous Death Act (1953)
Sections 260-288 — Uniform Disclaimer of Transfers by Will, Intestacy or Appointment Act (1978)
Sections 260-288 — Uniform Disclaimer of Transfers Under Nontestamentary Instrument Act (1978)
Sections 3900-3925 — Uniform Transfers to Minors Act (1983)
Sections 4001, 4124-4127, 4206, 4304-4305 — Uniform Durable Power of Attorney Act
Sections 4400-4465 — Uniform Statutory Form Power of Attorney Act

Sections 6300-6303 — Uniform Testamentary Additions to Trusts Act (1960)
Sections 6380-6390 — Uniform International Wills Act (1977). See also Section 6387 (need for uniform interpretation of Uniform International Wills Act)
Sections 16002, 16003, 16045-16053, 16223 — Uniform Prudent Investor Act (1994)
Sections 16200-16249 — Uniform Trustees' Powers Act (1964)
Sections 16300-16313 — Revised Uniform Principal and Income Act (1962)

[remainder of Comment unchanged]

Prob. Code § 16007. Duty to make trust property productive

Comments. Section 16007 continues Section 16007 of the repealed Probate Code without change. The section codifies the substance of Section 181 of the Restatement (Second) of Trusts (1957). For the trustee's standard of care governing investments and management of trust property, see Section ~~16040(b)~~ 16047. In appropriate circumstances under Section 16007, property may be made productive by appreciation in value rather than by production of income. If the trust instrument imposes a duty on the trustee to hold property and give possession of it to a beneficiary at a later date, this duty would override the general duty to make the property productive. See Restatement (Second) of Trusts § 181 comment a (1957). Similarly, if a beneficiary has the right under the trust instrument to occupy a home, the trustee would have no duty to make the property productive of income. For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance). See also Sections 16000 (duties subject to control by trust instrument), 16046(b) (prudent investor rule subject to control by trust instrument).

Staff Note. Additional comment revisions will also need to be made.