

## Memorandum 94-55

### **Uniform Prudent Investor Act: Comments on Tentative Recommendation**

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This memorandum considers comments on the tentative recommendation proposing the Uniform Prudent Investor Act which was circulated following the September meeting. We have received letters from two organizations.

The Executive Committee of the State Bar Estate Planning, Trust and Probate Law Section "approved the Tentative Recommendation and agreed that adoption of the Uniform Prudent Investor Act in California is a positive development." (See letter from Monica Dell'Osso, Exhibit pp. 2-4.) The Section also raises several concerns which are discussed in staff notes following the relevant sections of the tentative recommendation. (See staff notes on pages 3-8, in the attached draft recommendation.)

The California Bankers Association (CBA) supports the general concept of the proposal but reserves comment until CBA policy committees can meet on the issue. (See letter from David W. Lauer, Exhibit p. 4.) CBA expects to have its comments and any recommendations for revision no later than December 9.

One general concern expressed by the State Bar Section concerns the effect the default rule may have on small trusts:

2. There was concern about the impact of the Act on trustees of small trusts. Since the Act is a default rule, it would apply to all trusts unless there is language to the contrary in the instrument. The problem is that trustees of a small trust who do not have financial management expertise will feel compelled to retain a money manager or other financial professional in order to meet the applicable standard of care. In a small trust, the cost of such expertise may be burdensome or prohibitive,

The Section does not suggest a way to deal with its concern. The UPIA should not be read to compel hiring investment advisors at a "burdensome or prohibitive" cost. This would be contrary to the trustee's fiduciary duty. See Section 16050. Since the Trust Law already provides for a portfolio approach to investment decisions, in some respects the addition of UPIA is not a change in course, but a clarification of duties encompassed by existing law. By providing

more detail, UPIA should assist trustees of small (and medium and large) trusts in making investment and management decisions.

At the November meeting, the Commission should review the State Bar Section's comments and make any needed revisions. (See also the staff note on page 12 concerning Section 16040.) The Commission should then consider approval of the recommendation for introduction in the 1995 legislative session. This will enable the staff to prepare materials and find a bill author. There is one qualification, however, since CBA may have concerns that need to be addressed, although CBA has expressed support of the concept. Normally, the Commission should postpone approval of a recommendation in such circumstances, but we will need to start looking for an author before the Commission has a chance to consider any CBA proposals at its next meeting in late January.

Respectfully submitted,

Stan Ulrich  
Assistant Executive Secretary

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November 9, 1994

REPLY TO: (510) 444-6800

**Via Facsimile**

Nathaniel Sterling  
California Law Revision Commission  
4000 Middlefield Road, Suite 2D  
Palo Alto, CA 94303-4739

**Re: Law Revision Committee Tentative Recommendation:  
Uniform Prudent Investor Act**

Dear Mr. Sterling:

The following are the comments of the Estate Planning, Trust and Probate Law Section of the State Bar regarding the September 1994 Tentative Recommendation on the Uniform Prudent Investor Act:

1. The Executive Committee approved the Tentative Recommendation and agreed that adoption of the Uniform Prudent Investor Act in California is a positive development.

2. There was concern about the impact of the Act on trustees of small trusts. Since the Act is a default rule, it would apply to all trusts unless there is language to the contrary in the instrument. The problem is that trustees of a small trust who do not have financial management expertise will feel compelled to retain a money manager or other financial professional in order to meet the applicable standard of care. In a small trust, the cost of such expertise may be burdensome or prohibitive.

3. As drafted, the Comment to § 16046 (b) is ambiguous and creates some confusion in the interpretation of the proposed statute. The second sentence of § 16046 (b) states that

a trustee is protected from liability for reasonable reliance on the provisions of the trust. The reference is to those provisions of the trust which expand, restrict, eliminate, or otherwise alter the prudent investor rule. However, the Comment indicates that the second sentence of subdivision (b) "provides a special rule protecting reasonable reliance under the prudent investor rule." In fact, the proposed statute provides protection for reasonable reliance on the express provisions of the trust which modify the prudent investor rule.

4. There is some confusion created by references in the proposed statute to the prudent investor rule rather than the Uniform Prudent Investor Act. Section 16046 specifies that the rule is defined by the provisions of the entire Uniform Prudent Investor Act. Therefore the references should properly be to the Act, rather than the rule. One example occurs in § 16051 which addresses compliance with the prudent investor rule. It would be preferable to refer to compliance with the Uniform Prudent Investor Act.

5. In several instances, the proposed statute refers to delegation of investment and "management" functions. Such references occur, for example, in the Staff Note to § 16046 and in the language of §§ 16050 and 16052(a). The prudent investor rule is intended to establish a standard for investment functions only. Therefore the reference to management duties is confusing. Presumably the standard of care for management functions comes within the ambit of Probate Code § 16040.

6. Section 16052(a) provides that a trustee shall exercise reasonable care in selecting an agent, establishing the scope and terms of the delegation and periodically reviewing the agent's actions. Reasonable care in delegation of investment authority should also include periodic evaluation of the continued need for and appropriateness of the delegation. We would recommend inclusion of this duty in § 16052(a).

7. Section 16052(c) provides that a trustee who meets the standard for proper delegation of investment authority is not liable to the beneficiaries of the trust for the decisions of the agent, except if the trustee conceals the acts of the agent or neglects to take reasonable steps to compel the agent to redress the wrong. The exception should also apply if the trustee fails to terminate the agent's authority when the trustee knows of the agent's acts or omissions. We recommend addition of the following language to the end of subsection (c): or fails to terminate the delegation.

Nathaniel Sterling  
November 9, 1994  
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8. The comment to Section 9 of the Uniform Prudent Investor Act (Appendix 34) states that the trustee will be expected to lower his or her fee when delegating his or her investment functions to an outside manager. No comparable provision or comment appears in the proposed legislation. We would suggest that the Comment to § 16050 be expanded to address this issue.

9. There are several instances in the statute in which the word "caution" is used. This term appears for example in §§ 16047(a) and 16052(a), which require the trustee to exercise "reasonable care, skill and caution". Since the Uniform Act relies upon a "prudent" investor concept, it seems inconsistent, or at a minimum, confusing to introduce the concept of caution. We had a question as to whether use of this term was intentional.

If you have any questions regarding the above or would like to discuss this matter further, do not hesitate to contact me.

Very truly yours,



Monica Dell'Osso

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October 18, 1994

Stan Ulrich, Assistant Executive Secretary  
California Law Revision Commission  
4000 Middlefield Road, Suite D-2  
Palo Alto, CA 94303-4739

**RE: The Uniform Prudent Investor Rule: Tentative Recommendation of the  
California Law Revision Commission**

Dear Stan:

We have received the Law Revision Commissions' proposal to adopt the Prudent Investor Rule in California. On behalf of the California Bankers Association, I want to advise you that although we support the general concept of the proposal, we may have significant concerns about, and objections to, specific provisions in the draft.

The CBA State Governmental Affairs Committee has directed various CBA policy committees to review the draft in detail and identify those provisions which may present problems for banks. We have begun that process but will not complete our review within the time limits set by the Law Revision Commission. Accordingly, please be advised that we will be notifying you no later than December 9, 1994 of our formal position on the proposal and any objections and/or recommended amendments that we may have for it. Thereafter, we will be happy to meet with you and/or with the Commission to discuss our position and recommendations.

Thank you, in advance, for your consideration in this matter.

Sincerely,

David W. Lauer

DWL/oas

bcc: Maurine C. Padden  
All members, Trust State Government Affairs Committee

## 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.<sup>1</sup> The new act seeks to modernize investment practices of fiduciaries, focusing on trustees of private trusts.

The primary 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 categorical 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,<sup>2</sup> and early recognized the trustee's power to make any type of investment in conformance with applicable duties.<sup>3</sup> 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.<sup>4</sup> The duty to diversify has not been codified, but is recognized in case law.<sup>5</sup>

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 appropriate to the purposes of the trust.<sup>6</sup> This rule is not inconsistent with existing

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).

6. See UPIA § 2 & comment.

1 law,<sup>7</sup> but provides greater detail as to the factors to be considered in devising the  
2 portfolio investment strategy.

3 **Delegation.** A trustee would be able to delegate investment and management  
4 decisions where prudent in light of the trustee's skills.<sup>8</sup> The trustee must exercise  
5 care, skill, and caution in selecting the agent and establishing the scope and terms  
6 of the delegation consistent with the purposes and terms of the trust, and must  
7 monitor the agent's performance.

8 **Trustee's liability for delegation.** A trustee who satisfies the delegation standards  
9 would not be liable to the beneficiaries for the acts of an agent.<sup>9</sup> This rule is more  
10 protective of trustees who make a proper delegation than the existing standard  
11 which, among other things, subjects a trustee for liability if the trustee has the  
12 power to direct the act of the agent.<sup>10</sup>

13 **Liability of agent.** An agent who performs a delegated function owes a duty to  
14 the trust and, by accepting the delegation, would be deemed to submit to the  
15 jurisdiction of California courts.<sup>11</sup>

16 **Standard of compliance.** "Compliance with the prudent investment rule is  
17 determined in light of the facts and circumstances existing at the time of a trustee's  
18 decision or action and not by hindsight."<sup>12</sup> This rule emphasizes and protects  
19 reliance on the fundamental rule of prudence in adopting an investment strategy  
20 and managing the trust. It is consistent with the principle in existing law protecting  
21 a trustee who has acted "reasonably and in good faith under the circumstances as  
22 known to the trustee."<sup>13</sup>

23 **Application to existing trusts.** The prudent investor rule would apply to existing  
24 trusts but not to decisions or actions occurring before it became operative.<sup>14</sup> The  
25 same general principle was applied when the Trust Law became operative.<sup>15</sup>

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7. See Prob. Code § 16040(b).

8. See UPIA § 9 & comment.

9. See UPIA § 9(c) & comment.

10. See Prob. Code § 16401(b)(1). This rule should be changed for consistency with UPIA and with the Restatement (Second) of Trusts § 225 (1957). Consequently, the exception where the trustee has the "power to direct" the agent would be revised to refer to cases where the trustee "directs or permits" the acts of the agent.

11. See UPIA § 9(b) & (d).

12. UPIA § 8.

13. Prob. Code § 16440(b).

14. See UPIA § 16.

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

**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, together with subdivision (a) of Section 16002 and Section 16003, 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).

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.

**§ 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 provided in this article.

(b) The prudent investor rule, a default rule, may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust. A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the 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 on the terms of the trust. See also Section 16040(b) [as amended] (protection of trustee for reasonable reliance on express trust provisions).

**Staff Note.** The State Bar Estate Planning, Trust and Probate Law Section makes the following comments:

*State Bar Section comment 3.* As drafted, the Comment to § 16046(b) is ambiguous and creates some confusion in the interpretation of the proposed statute. The second sentence of § 16046(b) states that a trustee is protected from liability for reasonable reliance on the provisions of the trust. The reference is to those provisions of the trust which expand, restrict, eliminate, or otherwise alter the prudent investor rule. However, the comment indicates that the second sentence of subdivision (b) "provides a special rule protecting reasonable reliance under the prudent investor rule." In fact, the proposed statute provides protection for reasonable reliance on the express provisions of the trust which modify the prudent investor rule.

The staff has revised the offending comment language to dispose of this problem.

*State Bar Section comment 4.* There is some confusion created by references in the proposed statute to the prudent investor rule rather than the Uniform Prudent Investor Act. Section 16046 specifies that the rule is defined by the provisions of the entire

Uniform Prudent Investor Act. Therefore the references should properly be to the Act, rather than the rule. One example occurs in § 16051 which addresses compliance with the prudent investor rule. It would be preferable to refer to compliance with the Uniform Prudent Investor Act.

The drafting could have taken that approach, but the Uniform Law Commissioners did it the way they did it and we have not chosen to make taste changes. The staff does not see that this creates any problems. In an effort to remove a possible source of confusion, we have revised the phrase "...prudent investor rule, as provided in this article" to read "...prudent investor rule provided in this article."

*State Bar Section comment 5.* In several instances, the proposed statute refers to delegation of investment and "management" functions. Such references occur, for example, in the Staff Note to § 16046 and in the language of §§ 16050 and 16052(a). The prudent investor rule is intended to establish a standard for investment functions only. Therefore the reference to management duties is confusing. Presumably the standard of care for management functions comes within the ambit of Probate Code § 16040.

The staff notes are relatively informal and temporary. (Earlier staff notes have been removed from this draft.) They are not published when the recommendation is printed and have rarely appeared in tentative recommendations.

However, references to "management" functions are not confined to staff notes. The term is used in UPIA as well as existing law, in conjunction with references to "investment" functions. See existing Section 16040(b). "Management" can include "investment," as "administration" can include both. These terms are not capable of exact precision. However, there should be no question that UPIA applies to investments and management, as is clear from Sections 16046(a), 16047, 16050, and 16052. Investment and management cover almost all imaginable activities of administering a trust. The only important aspect of administration outside of investment and management that we have found are allocating between principle and income and determining distributions. For that reason Section 16040(a) has been retained. If UPIA were broader, Section 16040(a) would be unnecessary. Note that the existing Trust Law (and its predecessor statutes) draw the same distinction, as is clear from comparing existing Section 16040(a) and (b). Contrary to the State Bar Section's suggestion, as the amended version of Section 16040 makes clear, UPIA governs investment *and management*, and Section 16040 governs whatever is left.

**§ 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, regularity of income, and 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 make a reasonable effort to verify facts relevant to the investment and management of trust assets.

(e) A trustee may invest in any kind of property or type of investment consistent with the standards of this chapter.

**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). An expert trustee is held to the standard of care of other experts. See the discussions in *Estate of Collins*, 72 Cal. App. 3d 663, 673, 139 Cal. Rptr. 644 (1977); *Coberly v. Superior Court*, 231 Cal. App. 2d 685, 689, 42 Cal. Rptr. 64 (1965); *Estate of Beach*, 15 Cal. 3d 623, 635, 542 P.2d 994, 125 Cal. Rptr. 570 (1975) (bank as executor); see also Section 2401 Comment (standard of care applicable to professional guardian or conservator of estate); Section 3912 Comment (standard of care applicable to professional fiduciary acting as custodian under California Uniform Transfers to Minors Act).

**Staff Note.** The State Bar Estate Planning, Trust and Probate Law Section makes the following comment:

*State Bar Section comment 9.* There are several instances in the statute in which the word "caution" is used. This term appears for example in §§ 16047(a) and 16052(a), which require the trustee to exercise "reasonable care, skill and caution". Since the Uniform Act relies upon a "prudent" investor concept, it seems inconsistent, or at a minimum, confusing to introduce the concept of caution. We had a question as to whether use of this term was intentional.

The word "caution" is used intentionally. The language of the recommendation tracks the language of the uniform act. The term is used in Section 227 of the Restatement (Third) of Trusts: Prudent Investor Rule (1990). Comment *e* to that section reads, in part, as follows:

In addition to the duty to use care and skill, the trustee must exercise the caution of a prudent investor managing similar funds for similar purposes. In the absence of contrary provisions in the terms of the trust, this requirement of caution requires the trustee to invest with a view both to safety of capital and to securing a reasonable return.

....

As a result of cost-consciousness and the duty of caution, the general emphasis in the typical trustee's asset management program is on long-term investment....

....

Despite variations and flexibility in all of these matters, one pervasive generalization prevails concerning the prudent investor's duty of caution: reasonably sound

diversification is fundamental to the management of risk, regardless of the level of conservatism or risk appropriate to the trust in question....

These are just samples of how the term is fleshed out in the scholarly commentary.

Our use of the term "caution" is not believed to be particularly significant — we could have used "prudent" or "careful" or perhaps some other words to convey the notions outlined above. There have been a number of words used in formulating the basic standard of care over the years. The Commission earlier considered the possible significance of the word "diligence" and the staff has concluded that it has had no special significance in California cases. While we have not done a thorough, historical analysis of the usage of "caution," we anticipate that we would arrive at the same conclusion. As for the juxtaposition of the words "caution" and "prudent" made by the State Bar Section, it might be noted that it is bad form to include a defined term in its own definition. Thus, we should not use the word "prudent" in the "prudent investor rule." And it is preferable to use the same language as the uniform act and the Restatement.

#### **§ 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).

#### **§ 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).

#### **§ 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.

The duty to minimize costs 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.

**Staff Note.** The State Bar Estate Planning, Trust and Probate Law Section makes the following comment:

*State Bar Section comment 8.* The comment to Section 9 of the Uniform Prudent Investor Act ... states that the trustee will be expected to lower his or her fee when delegating his or her investment functions to an outside manager. No comparable provision or comment appears in the proposed legislation. We would suggest that the comment to § 16050 be expanded to address this issue.

This is a good suggestion and has been implemented. It raises an issue, however, concerning the relevance of the comments to the uniform act. Under Probate Code Section 2 and its Comment, comments to uniform acts should be taken into consideration in interpreting California statutes based on uniform acts. Thus, the concern of the State Bar Section could be addressed by a reassurance that the uniform act comment applies in interpreting proposed Section 16050. But this issue was sufficiently important to engage the attention of the State Bar Section, it seems appropriate to put the gloss directly in the Law Revision Commission Comment.

The staff considered the possibility of pulling all of the uniform act comments into the relevant Commission Comments. This has been done in other situations, such as with the Uniform Statutory Rule Against Perpetuities — although that may have been a special case. Normally, the Commission has not done this because the law publishers usually append relevant comments from uniform acts in their annotated codes.

If the Commission is interested, however, we could incorporate an edited set of uniform act comments into the Official Comments in this proposal. The staff would not be inclined to include all of the uniform act commentary, since some of it is not directly relevant to the Commission's work here. E.g., the citations to Illinois law, discussion of suggestions rejected by the drafting committee, extraneous discussions of oral trusts, etc.

#### **§ 16051. Reviewing compliance**

16051. 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 and not by hindsight.

**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.

#### **§ 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 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, except where the trustee knows of the agent's acts or

omissions and conceals the act of the agent, neglects to take reasonable steps to compel the agent to redress the wrong, or fails to terminate the delegation.

(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), except that subdivision (c) has been supplemented with exceptions to the protection of trustees drawn from Section 16401(b)(5)-(6). The reference to failing to terminate the delegation is new. This section provides special exceptions to the general rule concerning delegation (Section 16012) and the trustee's liability for acts of agents (Section 16401). See also Section 16247 (power to hire accountants, auditors, investment advisors, etc.).

**Staff Note.** The State Bar Estate Planning, Trust and Probate Law Section makes the following comments:

*State Bar Section comment 6.* Section 16052(a) provides that a trustee shall exercise reasonable care in selecting an agent, establishing the scope and terms of the delegation and periodically reviewing the agent's actions. Reasonable care in delegation of investment authority should also include periodic evaluation of the continued need for and appropriateness of the delegation. we would recommend inclusion of this duty in § 16052(a).

The staff would prefer to keep variations of the uniform act down to a minimum. It appears that the concern of the State Bar Section is covered under subdivision (a)(3), if that section is read broadly. Perhaps the matter could be addressed by adding language to the Comment to apply the duty under subdivision (a)(3) to include "periodic evaluation of the continued need for the delegation" as suggested by the Bar.

*State Bar Section comment 7.* Section 16052(c) provides that a trustee who meets the standard for proper delegation of investment authority is not liable to the beneficiaries of the trust for the decisions of the agent, except if the trustee conceals the acts of the agent or neglects to take reasonable steps to compel the agent to redress the wrong. The exception should also apply if the trustee fails to terminate the agent's authority when the trustee knows of the agent's acts or omissions. We recommend addition of the following language to the end of subsection (c): or fails to terminate the delegation.

The staff has no problem with adding this language since it would go into a variation already in the recommendation and it seems appropriate. This has been implemented in the language of Section 16052(c).

#### § 16053. Language invoking standard of Uniform Prudent Investor Act

16053. The following terms or comparable language in the provisions of a trust, unless otherwise limited or modified, authorizes any investment or strategy permitted under this chapter: "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."

1     **Comment.** Section 16053 is the same as Section 10 of the Uniform Prudent Investor Act  
2     (1994) and restates former Section 16042 without substantive change.

3     **§ 16054. Application to existing relationships**

4     16054. This article applies to trusts existing on and created after its effective  
5     date. As applied to trusts existing on its effective date, this article governs only  
6     decisions or actions occurring after that date.

7     **Comment.** Section 16054 is the same as Section 16 of the Uniform Prudent Investor Act  
8     (1994) and is a specific application of the general transitional provisions in Section 3.

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).

This section codifies the substance of Section 183 of the Restatement (Second) of Trusts (1957) and is in accord with prior case law. See Estate of Miller, 107 Cal. App. 438, 290 P. 528 (1930). 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), 16040 (trustee's general standard of care in performing duties), 16046 (prudent investor rule), 16047 (standard of care, portfolio strategy, risk and return objectives).

**Prob. Code § 16008 (amended). Duty to dispose of improper investments**

SEC. \_\_\_\_\_. Section 16008 of the Probate Code is amended to read:

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 acquired by or added to the trust ~~or acquired pursuant to proper authority, if the purposes of the trust are better served by retention is in the best interests of the trust or in furtherance of the purposes of the trust of the property.~~

**Comment.** Subdivision (b) of Section 16008 is amended for conformity with Section 16048. See Section 16048 & Comment. The subdivision is also reworded for consistency with subdivision (a). These changes are not intended as substantive revisions. The determination of what would be "a proper investment for the trustee to make" under subdivision (a) depends on the terms of the trust instrument and the application of the prudent investor rule provided by Article 2.5 (commencing with Section 16045). The limitation is not intended to imply categorical restrictions on appropriate investments. See Sections 16047(e) (investments permissible in any kind of property, subject to prudent investor rule), 16223 (power to make investments). See also Uniform Prudent Investor Act, Prefatory Note & Section 2 comment (1994).

Subdivision (a) codifies the substance of Section 230 of the Restatement (Second) of Trusts (1957), subject to the exception provided in subdivision (b). In contrast with the Restatement rule, subdivision (a) is not limited to property received in the trust at the time of its creation, but applies as well to property added or acquired later. 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), 16040 (trustee's general standard of care in performing duties), 16046 (prudent investor rule), 16047 (standard of care, portfolio strategy, risk and return objectives). Exercise of the discretion under subdivision (b) is governed by the standard of care provided in Section 16047. See also Sections 16048 (duty to diversify), 16049 (duties at inception of trust), 16220 (power to collect and hold property), 16221 (power to receive additions to trust).

**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).

Subdivisions (a) and (b) continue Section 16012 of the repealed Probate Code without change. The first part of subdivision (a) codifies the substance of Section 171 of the Restatement (Second) of Trusts (1957). The second part of subdivision (a) codifies the substance of Section 4 of the Uniform Trustees' Powers Act (1964). As to the construction of provisions drawn from uniform acts, see Section 2. The duty not to delegate administration of the trust does not preclude employment of an agent in a proper case. A trust company may delegate matters involved in trust administration to its affiliates. For provisions permitting the beneficiaries to relieve the trustee from liability, see Sections 16463 (consent), 16464 (release), 16465 (affirmance). See also Sections 15620 (actions by cotrustees), 15621 (vacancy in office of cotrustee), 15622 (temporary incapacity of cotrustee), 16000 (duties subject to control by trust instrument), 16040 (trustee's general standard of care in performing duties), 16247 (power to hire agents of trust).

Subdivision (b) is drawn from comment k to Section 171 of the Restatement (Second) of Trusts (1957).

**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, and 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~~ reasonable 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).

**Staff Note.** The phrase "and familiar with such matters" came from the investment standard, was made into general rule when the Trust Law was adopted in order to be consistent with investment standard. The investment standard is now governed by UPIA which does not use this language. The staff sees no benefit to this language. Its purpose is unclear. The staff recommends its deletion from this section for consistency with the investment standard.

**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~~ directs or permits 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) 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.

**Comment.** Subdivision (b)(1) of Section 16401 is amended for consistency with Section 16052, part of the Uniform Prudent Investor Act (1994). See Section 16052 & Comment. The amendment also conforms subdivision (b)(1) to the language of Section 225 of the Restatement (Second) of Trusts (1957).

Subdivision (d) is added to recognize the special rule in Section 16052 applicable under the Uniform Prudent Investor Act.

Subdivisions (a) and (b) are drawn from Section 225 of the Restatement (Second) of Trusts (1957). Whether a trustee has acted reasonably under this section depends upon application of the standard of care provided in Section 16040. The trustee of a revocable trust is not liable where the agent's act is performed or omitted pursuant to the written instructions of the person having the power to revoke the trust. See Section 16462. Similarly, the trustee of a revocable trust is not liable for hiring an agent where the trustee is directed to do so in writing by the person having the power to revoke. See Section 16462. It should also be noted that the liability to beneficiaries does not include beneficiaries under a revocable trust during the time that the trust can be revoked. See Section 15800; see also Sections 15803 (holder of general power of appointment or power to withdraw property from trust treated as settlor), 16000 (duty to administer trust).

The six paragraphs of subdivision (b) state independent bases for imposition of liability on the trustee. For example, if the trustee has not used reasonable care in selecting or retaining an agent, the trustee may be held liable for the agent's breach under paragraph (3); but even if the trustee has no control over selection or retention of the agent, the trustee may still be held liable for the agent's breach under paragraph (1) if the trustee directed or permitted the agent's actions. It should also be noted that paragraphs (2), (5), and (6) of subdivision (b) apply regardless of whether the trustee has any control over the agent.

## REVISED COMMENTS

[Omitted from this draft — see the tentative recommendation.]

