Trust Investments -- Prudent Man Rule

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diligence he could not have ascertained that notes were being taken. There seems to be no exception to this rule, even in a capital case where the defendant is on trial for his life, as the application of the rule in the principal case illustrates.

No case was found in which it was held that there is an absolute right to have the jury take notes, absent a statute to that effect. It is at most a matter in the sound discretion of the trial court and it is not error to prohibit note taking. It has never been suggested that the judge must permit the practice; the question has always been whether he must forbid it. At least nine states have enacted statutes which expressly authorize the jury to take notes in criminal trials.

While permitting the jury to take notes may not be entirely advantageous, the argument is well in favor of allowing the practice within the sound discretion of the trial court. It should not be permitted to delay or unduly prolong the trial, nor should it be allowed where it might in some way be prejudicial, but otherwise it would seem to be a useful and favorable practice.

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The recent Virginia case of Goodridge v. National Bank of Commerce, raised the issue of whether or not a prudent man investment statute, enacted in 1956, was applicable to trusts created prior to the enactment of the statute. The trusts in question gave authority to the trustees to make such investments as were authorized “under the statute laws of the State of Virginia.” The trustees contended that they were bound to invest according to the “legal lists” statutes that were in existence when the trusts were created, because to apply the new prudent man statute to previously created trusts would be an unconstitutional impairment of the contract obligation owed the settler by the trustees, and would interfere with the vested rights of the beneficiaries without due process of law. The Virginia court rejected the above contentions, holding that the settlor is presumed to have contemplated that the legislature might change the type of investments allowed fiduci-

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24 United States v. Chiarella, 184 F.2d 903 (2d Cir. 1950).
25 CAL. PEN. CODE § 1137; IDAHO CODE ANN. § 19-2203 (1947); IOWA CODE § 784.1 (1954); MINN. STAT. ANN. § 631.10 (1947); MONT. REV. CODES ANN. § 94.7303 (1947); NEV. REV. STAT. § 175.390 (1957); N.Y. CODE CRIM. PROC. § 426; N.D. REV. CODE § 29-2204 (1943); UTAH CODE ANN. § 77-32-2 (1953). While these statutes apparently apply only to criminal cases, it is certainly arguable that they are declarative of the state’s policy and apply by analogy to civil cases.
1106 S.E.2d 598 (Va. 1959).
3 One of the trust indentures omitted the word “statute” and the trustees to invest according to “the laws of the State of Virginia.”
aries as economic conditions changed, and that consequently, in the absence of an express provision to the contrary, the settlor is presumed to have intended that the trustees make such investments as were lawful and proper under the statutes in effect at the time the investments were made.\(^4\)

While this case as a matter of law merely upholds the constitutionality of Virginia's new prudent man statute as applied to trusts created prior to its enactment, the case has additional significance as another illustration of the recent tendency of state legislatures to adopt the prudent man rule for trust investments.

The first introduction of the prudent man rule in this country was in 1830 by way of the famous Massachusetts case, *Harvard College v. Amory*,\(^5\) where the basic philosophy of the rule was stated in the following words:

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

The classic divergence from the Massachusetts rule is found in a New York case, *King v. Talbot*,\(^7\) decided in 1869. While agreeing with the basic philosophy of the Massachusetts rule, the New York court prohibited the investment of trust funds in stocks. Clearly the Massachusetts rule had not contemplated such a prohibition against the investment of stocks, as the court in *Harvard College* specifically held that the trustees were authorized to make investments in the stocks of a manufacturing company. Yet the New York rule was to set a precedent which found expression in case law,\(^8\) statutes,\(^9\) and even the constitutions\(^10\) of states all over the country.

The majority of the states enacted statutes which set out so-called "legal lists" for fiduciary investments. These "legal lists" statutes, in the main, followed the New York rule and made no provision for in-


\(^5\) 26 Mass. (9 Pick.) 446 (1830).

\(^6\) Id. at 461.

\(^7\) 40 N.Y. 76 (1869).


\(^10\) See, *e.g.*, Ala. Const. art. 4, § 74.
vestment in private corporate stocks. Usually the "legal lists" included only the traditionally conservative trust investments such as government bonds, municipal bonds, and first mortgages on land and were either permissive in that the trustee could go outside the list, if he sustained the burden of proving reasonable care and skill, or mandatory in that any investment outside the list would be a breach of trust.11

This ultra-conservative attitude of the legislature and courts of our country prevailed during the whole of the nineteenth century; and as late as 1937, 107 years after the Harvard College case, only six states12 used the Massachusetts or prudent man rule. Since 1937, however, one finds an astonishing shift. Today at least 36 states13 follow the prudent man rule either in complete or limited form. Thus in the comparatively short space of 21 years, 30 states have completely or partially adopted the rule by judicial decision14 or legislative enactment.15

There are several reasons for this sudden change in attitude. Perhaps first and foremost is that of inflation. It is common knowledge that we have been and are now experiencing an inflationary trend in our economy with a corresponding decrease in the purchasing power of the dollar. In many instances life beneficiaries of trusts set up prior to World War II are no doubt receiving much less purchasing power than their benefactors intended. Furthermore the dollar value of the trust res itself, if restricted to debt securities, has not increased in accordance with the general rise in prices. The only remedy for this inflationary devaluation seems to be equity investment.16

It should be further pointed out that today financial information about private corporations is more readily available than it was in the nineteenth century and the marketing of stocks is subject to stringent regulation. It follows then that the courts and legislatures are now more inclined to allow investment of fiduciary funds in stocks of corporations which have acquired a reputation for financial soundness.

North Carolina's position in regard to the prudent man rule is somewhat unusual. It has adopted the prudent man rule by judicial de-

22 Kentucky, Maryland, Massachusetts, North Carolina, Rhode Island, Vermont.
24 See, e.g., Rand v. McKittrick, 346 Mo. 466, 142 S.W.2d 29 (1940).
25 See, e.g., N.Y. Pers. Prop. Law § 21 (Supp. 1958) (35% of the trust estate may be invested under the prudent man rule); Cal. Civ. Code § 2261 (100% of the trust estate may be invested under the prudent man rule).
26 For a complete discussion of the reasons for the use of stocks in trust investments, see generally, Torrance, Legal Background, Trends, and Recent Developments in the Investment of Trust Funds, 17 Law & Contemp. Probs. 128, 143 (1952).
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This decision17 and in addition maintains a statutory permissive list.18 This situation has been confusing to legal writers19 so that it is not illogical to assume that it has also been confusing to members of the Bar as well as corporate trustees.

Without expressly adopting it, the North Carolina court as far back as 1858 seems to have used what might be considered substantially the prudent man rule. In Washington v. Emery,20 a testamentary trustee held an unsecured note of a known speculator. The trustee converted the note into sixty shares of a well-established railroad stock. The stock had been paying dividends for many years, and the trustee had consulted competent advisors before investing in the railroad stock. No loss to the estate had resulted from acquisition of the stock. The court held that the trustee had acted in good faith and with a reasonable belief that the fund would be benefited, and that he should be credited with the value of the stock in his final accounting.

Later where a trustee invested over 9,000 dollars more than the court originally authorized in a building, the court approved his investment saying:

While the utmost degree of good faith is exacted of a trustee, he is not always held to an assured judgment in the management of a trust fund or in making an investment; the exercise of the sound discretion that a prudent man would show in the management of his own affairs is usually the approved standard in such cases.21

Although corporate stocks were not involved in this case, under the circumstances it would seem that the language is broad enough to include stock investments as well.

Eventually in Sheets v. J. G. Flynt Tobacco Co.,22 the North Carolina court expressly approved the Massachusetts prudent man rule. Here a guardian invested 9,000 dollars in the preferred stock of a tobacco company. The stock subsequently depreciated, and a newly appointed guardian sued to rescind. A holding for the plaintiffs was re-

19 See Bogert, Trusts § 104 nn. 72-4 (3d ed. 1952), where North Carolina was not included in a list of prudent man states; Torrance, Legal Background, Trends, and Recent Developments in the Investment of Trust Funds, 17 LAW & CONTEMP. PROB. 128, 161 (1952), where North Carolina was classified as a permissive list state; Stevenson, Why the Prudent Man Rule?, 7 VAND. L. REV. 74, 91 (1953), where North Carolina was classified as a prudent man state.
20 57 N.C. 32 (1858).
21 Fisher v. Fisher, 170 N.C. 378, 382, 87 S.E. 113, 115 (1915). See also State ex rel Cummings v. Mebane, 63 N.C. 315 at 317 (1869), where very similar language was used by the court in holding that there was no imprudence in a guardian accepting Confederate money as payment of a loan of estate funds.
22 195 N.C. 149, 141 S.E. 355 (1928).
versed on appeal and a new trial ordered, because of the trial court's refusal to submit the defendant's issues as to the good faith and diligence of the guardian in making the investment. The court said that if there was any liability it was primarily the guardian's and the prudent man rule as stated in the *Harvard College* case was quoted as the standard to be applied to trust investments.

Even though the court did not decide the question, it would seem unlikely that the investment in the above case would be a proper one under the prudent man rule. While there is no information as to how great a proportion of the trust estate was placed in this particular investment, the stock was that of a small relatively unknown corporation. The prudent man rule is not to be interpreted as allowing investment in such a corporation, nor is an unduly large share of the estate to be placed in one particular investment. As the Massachusetts court said in the *Appeal of Dickenson*:23

>[T]rustees in this Commonwealth are permitted to invest portions of trust funds in dividend paying stocks and interest-bearing bonds of private business corporations when the corporations have acquired, by reason of the amount of their property and the prudent management of their affairs, such a reputation that cautious and intelligent persons commonly invest their own money in such stocks and bonds as permanent investments. (Emphasis added.)

This language emphasizes the high standards a corporation must meet in order to justify the investment of fiduciary funds in its stock.

The *Sheets* case seems to be the only North Carolina case expressly upholding the prudent man rule24 and even then the court did not have the opportunity to apply it to the facts of the case. Perhaps one of the reasons for this dearth of case law is the existence of our permissive list statute25 which, like the old New York rule authorizes investment in traditional government bonds and similar securities, but makes no pro-

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24 But see Young v. Hood, 209 N.C. 801, 184 S.E. 823 (1936), where testator created a trust estate, part of which was bank stock. The number of shares of stock was increased by a stock dividend and by the trustee's exercise of stock subscription rights. The bank subsequently merged with other banks and the trustee exchanged the old stock for stock in the new bank which resulted in the trustee holding its own stock. The new bank failed and in an action to restrain an assessment against the estate on the ground that the trustee acted in bad faith in exercising the stock subscription right, and in exchanging the old stock for the new, the court found no bad faith and upheld the trustee's action. However this case is complicated by the fact that the testator suggested in his will that the bank stock was not to be sold without certain consents unless holding it would, in the opinion of the trustee, be detrimental. See also Cutter v. American Trust Co., 213 N.C. 686, 197 S.E. 542 (1938), where an original restriction to invest only in government bonds was removed, and the trustee authorized by the court to invest in stocks and bonds.
vision for investing in private corporate stocks. In a permissive list state, the general rule is that the trustees may invest according to the statutory list, or they may invest outside the list providing they use reasonable skill and prudence.\textsuperscript{26} It is also a general rule that a trustee cannot blindly follow the statutory list. He is usually expected to display reasonable skill and prudence even in making investments which are provided for by statute.\textsuperscript{27} Unfortunately North Carolina is not wholly in accord with this latter rule, and by statute\textsuperscript{28} insures the trustee against personal liability if he follows the statutory list.

Consequently, this statute would seem to limit the use of the prudent man rule in North Carolina. Assuming trustees know the prudent man rule has been adopted by judicial decision, they may still be hesitant to follow it when they can enjoy statutory protection. Such a situation, in these days of inflation could conceivably prove very unfavorable to trust beneficiaries. Therefore it is submitted that the North Carolina legislature would be well-advised in considering statutory enactment of the prudent man rule.\textsuperscript{29} The enactment of the prudent man rule would clarify the present situation on trust investments; and at the same time, create an atmosphere less inhibiting on trustees who presently hesitate to go outside our permissive list.

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\textsuperscript{27} 3 BOGERT, op. cit. supra note 26 ; 3 SCOTT, op. cit. supra note 26.


\textsuperscript{29} An illustrative statute embodying the prudent man rule is as follows:

"In investing, reinvesting, purchasing, acquiring, exchanging, selling and managing property for the benefit of another, a trustee shall exercise the judgment and care, under the circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital. Within the limitations of the foregoing standard, and subject to any express provisions or limitations contained in any particular trust instrument, a trustee is authorized to acquire every kind of property, real, personal or mixed, and every kind of investment, specifically including, but not by way of limitation, corporate obligations of every kind, and stocks, preferred or common, which men of prudence, discretion and intelligence acquire for their own account.

"In the absence of express provisions to the contrary in the trust instrument, a trustee may continue to hold property received into a trust at its inception or subsequently added to it or acquired pursuant to proper authority if and as long as the trustee, in the exercise of good faith and of reasonable prudence, discretion and intelligence, may consider that retention is in the best interests of the trust." CAL. Civ. CODE § 2261 (1), (2).