

**Trustee Delegation of Investment Management Duties
and the Varying Effects on Beneficiaries**

DANIELLE SCHIFFMAN

Introduction

In the development of trust assets and trustees' roles in managing them, a trust's purpose has shifted from a fairly passive stakeholder's instrument, used mainly to convey real property within the family, to holding a variety of financial instruments, in which the trustee has the complex task of managing a portfolio of marketable securities.¹ Trust asset investment can be considered one of the more highly pressured aspects of fiduciary administration, due to beneficiary scrutiny over decreased value in the asset investments. Trustees must take significant care in making prudent decisions with the investment portfolio, as well as continuing adequate monitoring of investments. Asset investing can be a complicated process, though, especially for one who has little experience in the area. In this case, trustees may opt to either seek advice on investment decisions from experienced professionals, or delegate the investment management function in whole to an outside agent, as long as they remain in compliance with Uniform Trust Code §807. If the delegation option is used, trustees are accountable to the beneficiaries to the extent of their duty to select an appropriate agent, establish the scope and terms of the delegation, and monitor the agent to ensure compliance with the terms. Therefore a trustee is still open to liability, but there is a significantly altered line drawn between trustee liability and fund manager liability if the trustee fulfills his UTC §807 obligations. Case specific analysis outlines the varying situations in which trustees and fund managers are held jointly or separately liable to beneficiaries, and the different effects on beneficiaries.

Development of Investment Management in Trust Law

Investment management in trust law sustained a long history without the allowance of delegation to outside agents. Investment as a function of trusteeship first began in the early 1700s when British Parliament authorized trustees the ability to invest in the South Sea Company.² But after the South Sea “Bubble” burst in the next year, trustee investment came to a halt for the duration of the eighteenth century.³ The Court of Chancery responded to this burst, and the standard of prudence in trust investment came to include (1) a list of proper investments that in most cases would relieve a trustee from liability; (2) a forbiddance of trust investment in the securities of private enterprises; (3) and a fixation on the preservation of trust corpus.⁴ This kind of safe investing was suitable for eighteenth and nineteenth century English law since capital markets were comparatively undeveloped, and inflation was not a significant factor, as it is today.⁵ Movement in trust investment law in the United States came after an 1830 Massachusetts decision, *Harvard College v. Amory*.⁶ The court created a more flexible standard by allowing trustees to invest outside the statutory list, stating trustees are “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 outcome, as well as the probable safety of the capital to be invested.”⁷ Although the *Amory* court’s decision did not do away with legal investment lists in their entirety, it offered new sights of trustee discretion in investment management and the Prudent Man Rule.⁸

It was not until the Restatements of Trusts, the first in 1935 and second in 1957, that no particular investments were forbidden.⁹ This opened up doors for flexibility in investing amongst trustees, although neither Restatement permitted delegation in regard to investment management duties.¹⁰ The Restatement (Second) of Trusts states in its opposition to delegation of duties, “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.”¹¹ This leaves the trustee the challenging task of distinguishing which duties are reasonable to perform personally.¹² In the context of investment management, if a trustee does not have investing expertise, or any such background in business or finance, is it reasonable to perform this duty personally? According to the comments to the Restatement, the answer is yes – it is improper to make any delegation of investment duties.¹³ Further, Section 225 addresses trustee liability when delegation is permitted, but because of broad exceptions in its second subsection, leaves very little room for trustee immunity.¹⁴ Specifically, Section 225 states:

- (1) Except as stated in Subsection (2), the trustee is not liable to the beneficiary for the acts of the agents employed by him in the administration of the trust.
- (2) The trustee is liable to the beneficiaries for an act of such an agent which if done by the trustee would constitute a breach of trust, if the trustee
 - (a) directs or permits the act of the agent; or
 - (b) delegates to the agent the performance of acts which he was under a duty not to delegate; or
 - (c) does not use reasonable care in the selection or retention of the agent; or
 - (d) does not exercise proper supervision over the conduct of the agent; or
 - (e) approves or acquiesces in or conceals the act of the agent; or
 - (f) neglects to take proper steps to compel the agent to redress the wrong.¹⁵

This poses an issue when a trustee delegates a task to an agent due to the trustee’s lack of knowledge on the subject, reviews the agent’s work but does not truly understand the content, and then submits the work, only to find there was improper preparation.¹⁶ Technically, the trustee had both permitted and approved the act of the agent, and therefore did not exercise sufficient supervision under §225, and will be held liable.¹⁷

The Restatement (Third) of Trusts was adopted in 1992, its main purpose being the modernization of trustee’s investment management powers.¹⁸ From the Restatement (Third) of

Trusts, the Uniform Prudent Investor Act was created to update trust investment law in light of the changes that have occurred in practice.¹⁹ The Uniform Prudent Investor Act made five fundamental changes to the previous standards for prudent investing, as seen in the Restatement of Trusts 3d: Prudent Investor Rule.²⁰ These five major changes include: (1) focusing on the overall portfolio, as opposed to individual investments; (2) specifying that the fiduciary's chief consideration is the tradeoff between risk and return; (3) relieving the trustee of investment restrictions, as long the decision supports the risk/return objectives and other requirements of prudent investing; (4) incorporating diversification of investments into the definition of prudent investing; and (5) permitting delegation of investment and management functions, subject to safeguards.²¹

Section One, The Prudent Investor Rule, asserts the trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule.²² It includes, though, that the terms of the trust may have the power to alter the rule, and a trustee may rely on the provisions of the trust.²³

Section Two describes the standard of care required, as it pertains to portfolio strategy and risk and return objectives. Subsections (a) through (d) address a trustee's duty to invest and manage assets, and how to assess circumstances relevant to the investment and management of these trust assets. This includes the duty to monitor, which relies on the trustee's continued oversight of the suitability for investments the trustee has previously made, as well as the trustee's decisions for future investments. The duty to monitor though, takes on a new meaning in relation to trustee's delegation of investment management functions to an outside agent. This is addressed in Section Nine (a)(3), and is further discussed in the analysis of Trustee Delegation and Liabilities. Additionally mentioned in the comments of Section Two, Subsection (d) relates

to the duty to investigate, which involves the reasonable effort to validate facts relevant to investment decisions.

Section Two (f) states that a trustee who has special skills or expertise, or was chosen as trustee based on the trustee's special skills or expertise, has a duty to utilize such expertise. Section 2(f)'s main function is to acknowledge the distinction between professional and amateur trusteeship. A professional trustee, like a corporate fiduciary, will be held to the standard of prudent professionals, and an amateur trustee, like a family member with minimal experience, will be held to the standard of prudent amateurs.²⁴

Section Three addresses diversification, where a trustee must diversify the investments of the trust unless special circumstances indicate that the trust would be best served without diversification. An example of a circumstance that would override the duty to diversify is the wish to hold onto the family business. Adequate and informed diversification is an example of an area that beneficiaries could benefit from a trustee's delegation of duties to a highly experienced investor as his fund manager.

Section Five defines the duty of loyalty as the investment and management of trust assets solely in the interest of the beneficiaries. Although not directly applicable to most private trusts, the Employment Retirement Income Security Act of 1974 also provides an interpretation of loyalty that illustrates a goal similar to trustee delegation of investment management duties to a fund manager. ERISA imposes a duty of loyalty, and "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of: (i) providing benefits to the participants and their beneficiaries; and (ii) defraying reasonable administrative expenses of administering the plan."²⁵ In application of trustee duties of investment management, if the delegation provided benefits to the beneficiaries and a

reasonable expense, then delegation to a fund manager would prove to be the more prudent action.

Section Six describes the situation in which the trust has two or more beneficiaries, and it is the duty of the trustee to ensure impartiality in respect to investments and management of the assets by considering the different interests of the beneficiaries. This same duty applies when establishing the scope and terms of the delegation.

Section Eight states that compliance with the prudent investor rule is considered based on facts and circumstances current at the time of the trustee's decision or action. Hindsight does not define compliance, so decisions made by the trustee that produce unfavorable outcomes would trigger liability based on just their unfavorable outcome. Therefore, a decrease in value of the trust assets does not necessarily subject a trustee to liability; rather, liability is solely based on trustee behavior and his compliance with prudent investment management.²⁶ This same standard can apply to the decisions of a delegated fund manager.

Trustee Delegation and Liabilities

A trustee may delegate duties and powers, according to the Uniform Trust Code §807, and investment and management functions, according to Section 9 of the Uniform Prudent Investor Act, to an agent while exercising reasonable care, skill and caution in selecting said agent; establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and, reviewing and monitoring the agent's actions to ensure compliance with the terms of the delegation. “[D]elegation is not limited to the performance of ministerial acts. In appropriate circumstances, delegation may extend, for example, to the selection of trust investments or the management of specialized investment programs, and to other activities of

administration involving significant judgments.”²⁷ Further, §807(c) of the Uniform Trust Code provides that if a trustee continues to strictly satisfy the requirements of subsection (a), he or she escapes liability to the beneficiaries or to the trust for the decisions or actions of the agent performing the function in question.

Sources do not provide specific rules as to qualifications of an agent that a trustee might delegate, but the Third Restatement generally states, “With professional advice as needed, the trustee personally must at least define the trust’s investment objectives. In addition, the trustee must personally either formulate or approve the trust’s investment strategies or approve the trust’s investment strategies and programs...[and] the trustee must exercise reasonable care, skill, and caution in determining what investment responsibilities to delegate. Then, fiduciary prudence must be exercised as well in selecting an agent and establishing the terms of the delegation... all in a manner appropriate to the circumstances and conditions of the delegation and the competence of both agent and trustee.”²⁸

Additionally, §90 comment (j) states that the trustee has a duty to the beneficiaries to take into account all relevant circumstances, such as knowledge, skill, facilities, and compensation of both the trustee and the prospective agents.²⁹ Circumstances also of importance include the size of the estate and the burdens and complexity of both the assets to be managed and the strategies to be implemented.³⁰ The more complex the strategy adopted by the trustee, the more likely it is that the trustee will need to consider advice or delegation.

Another consideration for trustee liability is whether or not losses of trust assets would have occurred “but for” the trustee’s delegation of investment management functions. In *Shriners Hosps. for Crippled Children v. Gardiner*, a settlor appointed Mary Jane as trustee, Charles as first alternate trustee, and Robert as second alternate trustee.³¹ Mary Jane did not have

investment expertise, and placed the trust assets in a brokerage house.³² Charles, on the other hand, was an investment counselor and stockbroker, and effectively made all the investment decisions concerning the trust assets.³³ Eventually, it was discovered that Charles had embezzled a total of \$317,234.36 from the trust.³⁴ A petition was brought against Mary Jane for the full amount of the embezzlements.³⁵ The trial court denied the petition, while the court of appeals reversed.³⁶

The Supreme Court of Arizona reviewed three issues: “(1) Whether Mary Jane’s delegation of investment power to Charles was a breach of Mary Jane’s fiduciary duty; (2) Whether Mary Jane’s delegation to Charles of investment power was the proximate cause of the loss of \$317,234.36; and (3) Whether Robert can properly continue to act as successor trustee and as guardian and conservator for the predecessor trustee Mary Jane.”³⁷ Due to the fact that this case was decided before the adoption of the Restatement (Third) of Trusts and reversal of the nondelegation rule, the discussion will follow only whether or not Mary Jane’s delegation was a proximate cause of the trust assets’ loss.

Mary Jane asserts in her defense that there was no connection between her breach and the loss suffered by the trust.³⁸ The court of appeals rejected this argument, but the present Court disagrees due to the nature of the loss.³⁹ “Without knowledge or consent of the Trustee, said person received from said investments, and diverted to his own use...The Trustee did not learn of said diversions until long after they occurred. No part of the amount so diverted had been returned or paid to the Trustee or the Trust Estate...”⁴⁰ There is no such causal connection between Charles’ diversion of funds and Mary Jane’s breach unless Mary Jane effectively gave Charles total dominion over the trust fund.⁴¹ Rather, for a connection to exist, the trust would have had to suffer because poor investments were made as a result of the delegation.⁴² This

reasoning can be applied to today's trust law as guidance where current case law lacks, despite the changes in the standard for delegation of trustee powers. For example, if instead a delegated investment advisor made embezzlements from the trust fund as opposed to a cotrustee, this case could be used to assess the trustee's liability in light of his "but for" cause.

Fund Manager Duties and Liabilities

With only recent allowance of trustee delegation to a fund manager for investment management decisions, evidence of duties and liabilities are fairly limited. To be in compliance with the Uniform Trust Code §807 and to Section 9(b) of the Uniform Prudent Investor Act as a delegated agent by the trustee as of today, a fund manager owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation. Further stated in Section 9(d), a fund manager's acceptance of delegation by the trustee submits him to the jurisdiction of the courts of the State.

Thus, what exists of a fund manager's duties is fairly straightforward. A fund manager's liability in the case of error, though, leaves more room for development. The issue arises due to the contractual relationship having formed between fund manager and trustee, as opposed to fund manager and beneficiary. Section 302 of the Restatement (Second) of Contracts controls the rights of a third party in a contract.⁴³ The main distinction formed in this section is the difference between an intended beneficiary and an incidental beneficiary, and is stated:

- (1) Unless otherwise agreed between the promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either
 - (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or
 - (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promisee performance.

(2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.⁴⁴

Because the duty of the agent is for the benefit of the trustee, the beneficiary will be considered incidental unless he or she is included in the contract terms.⁴⁵ “An incidental beneficiary is a person who will be benefited by the performance of a promise but who is neither a promisee nor an intended beneficiary,” and “acquires by virtue of the promise no right against the promisor or the promisee.”⁴⁶ This is why in most cases of delegated agent error, beneficiaries must sue the trustee to reach the agent, as they are unable to sue the agent directly.

In the event that the delegated agent commits misconduct and the beneficiary sues the trustee to reach the agent, the trustee may bring a suit against the third party on behalf of the trust and its beneficiaries according to section 107 of Restatement (Third) of Trusts.⁴⁷ Further, in the case that the trustee is in fact at fault as well, he is “not estopped from suing a third party, even if a loss or potential loss to the trust or an improper benefit to the third party is attributable to the trustee’s misconduct.”⁴⁸ An agent is only protected from liability in this provision “when dealing with or assisting a trustee who is committing a breach of the trust if the third party does so without knowledge or reason to know that the trustee is acting improperly.”⁴⁹ An example of this could be an agent providing the trustee with investment advice that the trustee improperly uses to promote the trustee’s self-interest and not the interests of the trust beneficiaries.

Aside from compliance with a trustee’s standards, fund managers who also function as registered investment advisers must adhere to the Investment Adviser Act of 1940, now codified as 15 U.S.C. §80b-1 through U.S.C. §80b-21. Included is a list of prohibited transactions by registered investment advisers in 15 U.S.C. §80b-6, in which a breach could also be considered a failure to observe the duty to the trust to exercise care in compliance with the terms of the delegation. Therefore adherence to these federal regulations would play a larger part for a fund

manager if he were brought to court as a defendant by the trustee, or brought by the beneficiary as a co-defendant with the trustee. His compliance with federal regulation would provide the support necessary to prove they had invested prudently and without error, taking into account market volatility instead.

Joint and Separate Liability

There is a distinction between the trustee's use of an investment advisor as either a fund manager or as an expert to seek advice from. But as stated in Market Funds and Trust-Investment Law by Professor Langbein and Professor Posner, "When the investment advisor 'recommends' and the trustee routinely 'decides' to follow the advice, the trustee in reality is delegating the selection of investments."⁵⁰ This argument was made in contest of the nondelegation rule, before the reversal was adopted in the Third Restatement of Trusts. Although the context of this statement is outdated, the principle maintains relevance since a trustee still has the option to receive advice as opposed to official delegation of investment management. The two options pose different levels of responsibility and liability for both the trustee and the fund manager.

In the case that the trustee seeks to delegate investment functions to the investment advisor as a fund manager, the trustee is required to select, direct, and monitor the advisor in compliance with Section 9 of the Uniform Prudent Investor Act, despite the level of the investment advisor's experience.⁵¹ In the event of a dispute, if the trustee is proven to have acted in compliance with Section 9, the liability shifts from trustee to fund manager.⁵² If the trustee was not in compliance, there is potential for joint liability.

An example of a trustee delegating investment functions to an investment advisor is seen in *In the Matter of the Estate of Younker*.⁵³ Here, a corporate trustee for four testamentary trusts

sought permission to resign, confirmation for a fiduciary's authority to delegate investment powers, and permission to consolidate trusts.⁵⁴ The corporate trustee sought resignation due to dispute with the income beneficiary and her family over investment and administration decisions, and its refusal to delegate its investment function to the family's investment advisor.⁵⁵

The court found that under the new provisions in the recently enacted Prudent Investor Act, a trustee may delegate investment and management functions, if in exercising such authority, the trustee uses care, skill and caution in selecting a suitable delegee, establishing the scope and terms of the delegation so that it is consistent with the governing instrument, monitoring the delegee's activities, and controlling the over-all cost of the delegation.⁵⁶ In this case, the will specifically authorized the trustees to employ various agents to advise on investments and to delegate discretionary powers.⁵⁷ Additionally, the delegation to a family financial advisor is cost-effective, and given the trustee's continued oversight, the delegation would be consistent with the Act.⁵⁸ Ultimately, the Surrogate's Court of New York County held that a trustee could not consolidate the trusts, but could resign and have another bank appointed as successor trustee, and more relevantly, could delegate investment authority to a family financial advisor.⁵⁹

In *O'neill v. O'neill*, the court had to decide if trustees breached their fiduciary duty to beneficiaries by delegating investment management functions to a reputable investment firm and registered financial advisor.⁶⁰ As background, the cotrustees of the trust in question were originally appellant's paternal uncle and an attorney appointed by settlor, until the attorney was replaced by the Society National Bank of Cleveland, now known as Key Bank.⁶¹ Investment firm Merrill Lynch and its financial representative began management of the trust's investments from the summer of 1999 until October 14, 2001, and invested almost exclusively in high-

technology stocks.⁶² When Merrill Lynch began to serve as investment manager, the trust was valued at approximately \$327,539, and in less than one year through asset investments, the portfolio's value grew to over \$600,000.⁶³ However, in 2000, the technology market took a harsh decline, leaving the trust valued at approximately \$37,394.⁶⁴ Appellant filed suit against the trustee for breach of his fiduciary duties due to the severe losses in the trust assets.⁶⁵ The court denied appellant's motion for partial summary judgment, and appellant appealed for two rulings.⁶⁶ For purposes of this paper, discussion will only involve the ruling on delegation.

First, "appellant argues that the trustee fell below the standard of care required of a fiduciary in three aspects: (1) delegating management of the trust; (2) establishing the scope of the delegated authority and monitoring the trust; and (3) acting unilaterally, without the participation of the cotrustee, in violation of the trust."⁶⁷ In response, the court begins its analysis with an overview of trust-investment law, including observance of the reasonable care, skill, and caution requirements of the prudent-investor rule, and noting from Restatement (Third) of Trusts the permission of sophisticated use of investments in an ever-changing financial world. Additionally, the court quotes from *Stock v. Pressnell*, "A claim of breach of fiduciary duty is basically a claim of negligence, albeit involving a higher standard of care."⁶⁸

In assessing the three aspects of the first argument, the court found that the act of delegation of management of the trust to a reputable investment firm and a registered financial advisor was in fact in compliance with the terms of the trust and pursuant to the Ohio Uniform Prudent Investor Act.⁶⁹ The terms of the trust specifically stated that cotrustees have the power and right to "employ, compensate, delegate discretionary powers to, and rely upon the advice and opinion of suitable agents and attorneys, but shall not be liable for their neglect, omission, or wrongdoing if reasonable care is exercised in their selection."⁷⁰ The inclusion of a provision for

relief of liability is important to this case, as it is not required of trust terms to do so, and weakens the appellant's argument.

The court next found that the scope of delegation was consistent with the purposes of the trust, in which the terms of trust was to invest, and therefore delegating this task to an investment firm and financial advisor more than fulfills settlor's intent.⁷¹ Lastly, the court reviews the trustee's duty to review and monitor the agents, specifically, whether or not the trustee assured satisfactory investing. The standard of "review and monitor the agent" was considered unknown at this point, and there were inconsistencies in the evidence concerning how frequently the trustee and financial advisor met.⁷² But the court attributed the trustee's vague recollection of the specific investing tactics to his age and involvement in 15 different trusts, and found the quarterly and annual statements concerning the trust as sufficient evidence of reviewing and monitoring.⁷³

In conclusion, the court found that the trustee did owe the appellant a fiduciary duty of care, but the trustee did not breach that duty.⁷⁴ Further, the court notes that the reason, at least in part, for the diminished value of the trust assets was the collapse of the stock market.⁷⁵ This relates back to the discussion of Section Eight of the Uniform Prudent Investor Act, where compliance with the prudent investor rule is based on the circumstances at the time of the trustee's, or in this case the fund manager's, decision.⁷⁶ Therefore, hindsight of a market crash does not subject a trustee or a fund manager to liability for negligence.

In the case that the trustee is only seeking expert investment advice from an investment advisor as a prudent investor would, then the trustee will continue to be held solely responsible for the ultimate decision, though the trustee may be protected in relying on expert advice.⁷⁷

Additionally, if a trustee chooses to seek advice and not delegation, it is important he does so prudently because a trustee may be required at a later date to justify his investment actions.⁷⁸

An instance of a trustee receiving investment advice without the complete delegation of investment strategy decisions can be seen in *Ewing v. Ruml*. In this case, the action was brought by an income beneficiary, Michael, and the trusts in question were a testamentary trust, of which Citytrust was a sole trustee, a testamentary trust, of which Citytrust was a co-trustee with co-defendant, Alexander, and an inter vivos trust, of which Citytrust was the sole trustee.⁷⁹

However, Alexander chose to delegate his responsibilities as co-trustee to a New York City stockbroker, Alvin Ruml, who subsequently offered his investment counsel to Citytrust.⁸⁰ The relevant argument of Michael's action was his claim against Citytrust for breaching its fiduciary duty to him by delegating full investment management responsibilities to an outside agent, Alvin Ruml.⁸¹

The district court found that although Ruml and Citytrust had a relationship and a variety of contacts, their interaction resulted only in consultation, not delegation, and therefore Citytrust had not breached its fiduciary duty to trust beneficiaries.⁸² For this reason, the court of appeals assessed only the conduct of Citytrust when deciding to relinquish or assert liability for breach of fiduciary duty. This illustrates how in cases of trustees receiving advice, and not delegating, the sole liability rests with the trustee despite an established relationship with an outside agent.

In *The Woodward School for Girls, Inc. v. City of Quincy*, the court had to decide if the city of Quincy committed a breach of its fiduciary duties by failing to invest in growth securities, as well as neglecting to follow investment advice it had obtained from an investment advisor.⁸³ The city of Quincy served as trustee to two different funds, and the Woodward School for Girls, Inc. was the income beneficiary.⁸⁴ Quincy had received investment advice it had

requested from the South Shore National Bank with regard to managing the investment portfolio of both funds.⁸⁵ Additionally, the boards of these funds voted unanimously to establish an agreement with the bank for an advisory relationship, and to follow the bank's diversification investment advice.⁸⁶ Quincy failed to abide by these recommendations though, and invested fully in fixed income instruments.⁸⁷ The investment assets of the larger fund did not change value, and there was slight decrease in value of the smaller fund.⁸⁸

The trial court found that Quincy did not commit a breach of its fiduciary duty by engaging in inappropriate investment strategies, but that it had acted imprudently and in violation of its fiduciary duties by failing to accept the investment advice from the bank, considering it went against its own vote to adopt a diversification plan.⁸⁹ On appeal, the court cites the prudent investor standard, and investment considerations, such as inflation, deflation, appreciation, other resources of the beneficiaries, and needs for liquidity.⁹⁰ In response to Quincy's argument that the judge erred in finding Quincy required to follow the investment advice, the court agreed with Quincy.⁹¹ The court found that a prudent investor is not required to follow investment advice; though it may be protected from liability for doing so.⁹² Further, the court quotes from the Restatement (Third) of Trusts, "After obtaining advice or consultation, the trustee can properly take the information or suggestions into account but then (unlike delegation) must exercise independent, prudent, and impartial fiduciary judgment on the matters involved."⁹³ Requiring a trustee to follow investment advice would in effect amount to mandatory delegation of the trustee's fiduciary duties.⁹⁴ In conclusion, the court held that the lower court erred in treating Quincy's failure to follow received investment advice as a breach of fiduciary duty.⁹⁵

Effects on Beneficiary Interest

The concept of investment management delegation poses a risk for beneficiaries, especially in cases where leniency is shown towards a trustee in satisfaction of his duties, based on the complexity of a fund manager's investment strategy. A trustee is obligated to understand a sophisticated or complex strategy only to the extent he or she holds himself or herself out to be knowledgeable. This relates back to the issue of the amateur trustee versus professional trustee, where the amateur trustee's obligation rests more on prudent delegation as opposed to in-depth understanding of a strategy's complexity.⁹⁶

Comments of Section 9 of the Uniform Prudent Investor Act address this issue in "Protecting the beneficiary against unreasonable delegation." Specifically stated, a trustee must exercise the duties of care, skill and caution when selecting a fund manager, and within these general duties arise specific actions that protect beneficiaries.⁹⁷ The example provided is the prohibition of an exculpation clause in an investment management agreement that leaves the trust without recourse against reckless mismanagement.⁹⁸ Doing so would provide a beneficiary no remedy against a blatant wrongdoing, which does not fulfill the duty to use care and caution.

Professor Langbein addresses investment management delegation and its effects on beneficiaries through an analysis of the reversal of the nondelegation rule.⁹⁹ He states first that a main purpose of the nondelegation rule was to prevent trustees from effectively resigning from trusteeship without the permission of the court, by delegating all responsibility for the administration of the trust.¹⁰⁰ Additionally, nondelegation was meant to protect the settlor's intent in choosing a trustee when the personality of the trustee played a key role.¹⁰¹ Professor Langbein finds that these rationales, though, do not suggest a reason to disallow the very specific delegation of investment management so as to take advantage of an outside agent's investing expertise.¹⁰²

An important issue next addressed is the cost consequence of delegation on the beneficiaries. The nondelegation doctrine effectively prevented a trustee from “double dipping,” meaning a trustee would charge the trust twice – once to the trustee for general investment services, and again to pay an outside agent for performing the investment services.¹⁰³ Professor Langbein refutes the notion of limiting delegation to resolve this issue by pointing out the established trust law that requires trustees to minimalize costs.¹⁰⁴ As specifically stated in the comments of Section 9 of the Uniform Prudent Investor Act, “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.”¹⁰⁵ In theory, this should eliminate the concern of “double dipping,” as long as the trustee’s compensation for investment services was clear enough originally to distinguish a decrease for delegation. An issue with this confidence in trustee’s compliance with the duty to minimize costs is a trustee could bypass double-dipping and achieve the same compensation by increasing his fees, and paying investment advisors off the books.¹⁰⁶

Professor Sterk approaches delegation to fund managers with doubt of its positive outcomes for beneficiaries. While Professor Langbein believes the nondelegation rule is “a clumsy tool for protecting against overcharging”, Professor Sterk speaks to the issue of “double dipping” with belief of error on the part of the Third Restatement and Uniform Prudent Investor Act by solving the problem with delegation of investment responsibilities.¹⁰⁷ Further, Professor Sterk believes delegation will (1) incentivize trustees with limited investment expertise to accept appointments, and (2) delegate investment responsibilities to those with greater expertise.¹⁰⁸ His rationale for the second view is that a trustee who is unsure of his or her investment expertise

gains more than they will lose by hiring an investment advisor, even if their liability is only reduced and not eliminated.¹⁰⁹ Even those who do have investment experience benefit from this delegation by decreased liability. Professor Langbein also notes encouragement of persons who lack investment expertise to accept trusteeship in his article, but does not approach the idea with negativity.¹¹⁰

In response to the varying perspectives, consideration is given to the settlor's intent in choosing a particular trustee, and whether or not providing the incentive of delegation works in the settlor's favor to attain such trustee. A settlor may prefer a family member who is more familiar with the settlor's goals, nature of the assets, and unique needs of the beneficiaries.¹¹¹ Additionally, family members tend to be a less expensive option, as many will perform the service without charge.¹¹² In such case, there runs the risk of not having a family member with investment expertise available. But if a settlor favors a trustee with a more intimate knowledge of his asset situation as opposed to investment expertise, and is willing to support the fee necessary in hiring an outside agent, then providing the trustee with the option to delegate investment management responsibilities helps accomplish the settlor's goal. Aside from the matter of settlor's preference, choosing a corporate trustee with expertise in all aspects of trust administration might not be an option if the settlor's trust account is too small, in which case at least some delegation might become inevitable.¹¹³

Professor Sterk speaks to this issue with three possible solutions. One solution that satisfies a settlor's desire to have a less investment-savvy family member as trustee is to name co-trustees, and put specifically in the terms of the trust that only the professional trustee may make investment decisions.¹¹⁴ Another solution could be to name a professional trustee, but explicitly state that the trustee must follow the instruction of a family member involving

distribution decisions, or any other decision known better to the family member.¹¹⁵ Lastly, a court could designate a co-trustee to absolve a family member of investment responsibility.¹¹⁶

Another concern Professor Sterk voices is deciding who will bear the cost if the delegated agent proves insolvent or unavailable.¹¹⁷ Ultimately, he believes the cost will fall on the trust beneficiaries, even though the trustee is in a better position to control the situation, considering he has the opportunity to investigate the agent's background.¹¹⁸ He disagrees with this outcome, stating that basic economic principles imply that risk should be properly placed on the party that is in the best position to diminish it.¹¹⁹ On the other hand, he recognizes the agency-cost issues that go along with this notion.¹²⁰ If there were no way for a trustee to escape liability in delegation, trustees would have a stronger incentive to exercise care in selecting, instructing, and monitoring agents.¹²¹

Charles M. Bennett addresses a similar concern in his Real Property, Probate, and Trust Journal article.¹²² He cites to a Missouri Court of Appeals case, *Estate of Gangloff v. Borgers*, where the court had to decide whether the state's statutory grants of powers to personal representatives provided protection to the personal representative for a delegated agent's error.¹²³ In this case, a personal representative delegated estate administration tasks to an attorney, including the preparation of the federal estate tax return.¹²⁴ The attorney advised the personal representative of a tax deduction and of an extension for the estate tax return, but failed to inform the personal representative of the need for payment of the estimated tax with the extension.¹²⁵ Due to this oversight, the estate was penalized for the unpaid estimated tax, and the attorney disappeared with the unearned, prepaid fee.¹²⁶ At the district court level, the personal representative was found liable to the estate.¹²⁷ On appeal, the court pointed to statutory language that allowed the personal representative to be free of liability unless the delegation was

unreasonable.¹²⁸ Here, the delegation was not deemed to be unreasonable since there was no evidence that the personal representative had knowledge of estate tax preparation.¹²⁹ The court affirmed the trial court's decision in part for an unreasonable premature payment, but reversed liability for the estate tax penalties and interest.¹³⁰ The court held that the personal representative is accountable for timely filing and payment, but is also permitted to rely on expert advice.¹³¹

Bennett notes this case because the attorney fled, and is therefore not able to compensate for the damages charged to him.¹³² The court had already decided which charges to hold the personal representative accountable for, which means ultimately the unpaid attorney charges would fall on the beneficiaries. Bennett follows with a piece of positivity, though, in that fiduciaries should expect courts to favor protection of innocent beneficiaries at the expense of fiduciaries, even if both parties are without fault.¹³³ The idea behind this is a fiduciary's employment and payment come at a price of assuming risk.

Conclusion

The investment management duties of a trustee have gone through several developments throughout the years, especially concerning delegation. In a persistently advancing financial market, trust law must continue to adapt or else beneficiaries will fall behind in potential earnings. With these prospective gains, though, comes risk involving unforeseeable market crashes and imprudent decision-making. Trustees have been guided by years of unchanged law involving prudence, but the new factor of delegation to fund managers with expertise poses the new issue of liability. The reward of having an experienced fund manager handle trust investments has yet to be proven greater than the risk of fallout risk from limited trustee and fund manager liability. In cases where the fund manager is solvent and capable of compensating for

losses due to error, the beneficiary will sustain all the benefit and none of the loss. But beneficiaries face unlimited liability in cases where trustees have proven compliance with their duties to select, advise, and monitor with due care and are therefore relieved of liability, but the fund manager is potentially unable to return the losses. In either case, the allowance of delegation of investment management functions is still a fairly recent update to trust law, and future case law will establish a balance between trustee, fund manager, and beneficiary liability.

Bibliography

Cases

Estate of Gangloff v. Borgers, 743 S.W.2d 498 (Mo.Ct.App.1987)

Ewing v. Ruml, 892 F.2d 168 (1989)

In the Matter of the Estate of Younker, 174 Misc.2d 296 (1997)

O'neill v. O'neill, 169 Ohio App.3d 852 (2006)

Shriners Hospital for Crippled Children v. Gardiner, 152 Ariz. 527, 733 P.2D 1110
(Ct.App.1987)

The Woodward School for Girls, Inc. v. City of Quincy, 469 Mass. 151 (2014)

U.S. Nat. Bank & Trust Co. of Kenosha, Wis., v. Sullivan, 69 F.2d 412 (7th Cir. 1934)

Secondary Sources

Charles M. Bennett, *When the Fiduciary's Agent Errs – Who Pays the Bill – Fiduciary, Agent, or Beneficiary?* 28 Real Prop., Prob. &Tr. J. 429, 444 (1993)

Stephen M. Dickson, *Trust Administration in Georgia and the Prudent Investor Rule: May Trustees Delegate Their Investment Powers*, 14 Ga. St. U. L. Rev. 633, 661 (1998)

ERISA, Section 404(a)(1)(A)

J. E. Harker, *Choosing a Trustee: The Case for the Corporate Fiduciary*, 8 Prob. & Prop. 44, 52
(1994)

John H. Langbein, *Reversing the Nondelegation Rule of Trust-Investment Law*, 59 Mo. L. Rev. 105, (1994)

John H. Langbein & Richard A. Posner, *Market Funds and Trust-Investment Law*, 1 Am. B. Found. Res. J. 1, 34 (1976)

Restatement (Second) of Trusts §171 (1959)

Restatement (Third) of Trusts §80 (1992)

Restatement (Third) of Trusts §90 (1992)

Restatement (Third) of Trusts §107 (1992)

Restatement (Third) of Trusts §108 (1992)

Restatement (Second) of Contracts §302 (1981)

Stewart E. Sterk, *Rethinking Trust Law Reform: How Prudent is Modern Prudent Investor*

Doctrine, 95 Cornell L. Rev. 851, 899 (2010)

Uniform Prudent Investor Act (1992)

Treatises

George T. Bogert, Trusts §612 (6th ed. 1987)

¹ John H. Langbein, *Reversing the Nondelegation Rule of Trust-Investment Law*, 59 Mo. L. Rev. 105, 110 (1994)

² John H. Langbein; Richard A. Posner, *Market Funds and Trust-Investment Law*, 1976 Am. B. Found. Res. J. 1, 1 (1976)

³ Id.

-
- ⁴ Id. at 3-4
- ⁵ Id at 4
- ⁶ Stephen M. Dickson, *Trust Administration in Georgia and the Prudent Investor Rule: May Trustees Delegate Their Investment Powers*, 14 Ga. St. U. L. Rev. 633, 638 (1998)
- ⁷ Id., quoting *Harvard College v. Amory*, 26 Mass. (9 Pick.) 446 (1830)
- ⁸ Id. at 639
- ⁹ Charles M. Bennett, *When the Fiduciary's Agent Errs – Who Pays the Bill – Fiduciary, Agent, or Beneficiary?* 28 Real Prop., Prob. &Tr. J. 429, 444 (1993)
- ¹⁰ Id.
- ¹¹ Id., citing the Restatement (Second) of Trusts §171 (1957)
- ¹² Id.
- ¹³ Restatement (Second) of Trusts §171 cmt. (h) (1957)
- ¹⁴ Bennett, *supra* note 9, at 445
- ¹⁵ Id., citing Restatement (Second) of Trusts §225 (1957)
- ¹⁶ Id., at 446
- ¹⁷ Id.
- ¹⁸ Bennett, *supra* note 9, at 447
- ¹⁹ Uniform Prudent Investor Act, Prefatory Note (1992)
- ²⁰ Id., at Objectives of the Act
- ²¹ Id.
- ²² Id., at Section One (a)
- ²³ Id., at Section One (b)
- ²⁴ Id, at Section Two, comments
- ²⁵ ERISA, Section 404(a)(1)(A)
- ²⁶ *U.S. Nat. Bank & Trust Co. of Kenosha, Wis., v. Sullivan*, 69 F.2d 412, 414 (7th Cir. 1934)
- ²⁷ Restatement (Third) of Trusts: Prudent Investor Rule §80, cmt. (e) (1992)
- ²⁸ Restatement (Third) of Trusts §80, cmt. (f)(1)
- ²⁹ Restatement (Third) of Trusts §90, cmt. (j)
- ³⁰ Id.
- ³¹ *Shriners Hosps. For Crippled Children v. Gardiner*, 152 Ariz. 527, 528 (1987)
- ³² Id.
- ³³ Id.
- ³⁴ Id.
- ³⁵ Id.
- ³⁶ Id., citing *Shriners Hospital for Crippled Children v. Gardiner*, 152 Ariz. 527, 733 P.2D 1110 (Ct.App.1987)
- ³⁷ Id.
- ³⁸ Id. at 530
- ³⁹ Id.
- ⁴⁰ Id.
- ⁴¹ Id.
- ⁴² Id.
- ⁴³ Restatement (Second) of Contracts §302 (1981)
- ⁴⁴ Id.
- ⁴⁵ Id.

46 Id. §315
47 Restatement (Third) of Trusts §107
48 Id., §107, cmts (b)(1)
49 Id., §108
50 John H. Langbein; Richard A. Posner *supra* note 2, at 20
51 *O’neill v. O’neill*, 169 Ohio App.3d 852, 861 (2006)
52 *Estate of Gangloff v. Borgers*, 743 S.W.2d 498, 506 (Mo.Ct.App.1987)
53 *In the Matter of the Estate of Younker*, 174 Misc.2d 296, 300 (1997)
54 Id., at 296
55 Id., at 297
56 Id., at 298
57 Id., at 299
58 Id.
59 Id.
60 *O’neill*, *supra* note 51, at 852
61 Id., at 854
62 Id.
63 Id.
64 Id.
65 Id.
66 Id., at 855
67 Id.
68 Id., quoting *Stock v. Pressnell* (1988), 38 Ohio St.3d 207, 216, 527 N.E.2d 1235
69 Id. The Ohio Uniform Prudent Investor Act keeps intact Section 9 from the Uniform Prudent Investor Act (1994), in which a trustee may delegate investment and management functions using reasonable care, skill and caution in (1) selecting an agent; (2) establishing the scope and terms of the delegation consistent with the terms of the trust; and (3) periodically reviewing the agent’s actions in order to monitor the agent’s performance with the terms of the delegation.
70 Id.
71 Id., at 857
72 Id., at 858-859. The investment advisor asserted speaking often with the trustee throughout the management period, while the trustee responded, “Very seldom.”
73 Id., at 857
74 Id., at 859
75 Id.
76 UPIA Section 8
77 Bogert §612
78 Bogert §612 id
79 *Ewing v. Ruml*, 892 F.2d 168, 169 (1989)
80 Id. at 170
81 Id. at 170
82 Id. at 172
83 *The Woodward School for Girls, Inc. v. City of Quincy*, 469 Mass. 151, 159 (2014)
84 Id., at 152
85 Id., at 155

86 Id.
87 Id.
88 Id.
89 Id., at 158
90 Id.
91 Id.
92 Id.
93 Id., quoting the Restatement (Third) of Trusts §80, cmt. (b)
94 Id., at 163
95 Id.
96 UPIA Section 2(f)
97 UPIA Section 9, comments
98 Id.
99 Langbein, *supra* note 1, at 106
100 Id.
101 Id.
102 Id.
103 Id., at 108
104 Id., citing Restatement (Third) of Trusts §227 (1992); Uniform Prudent Investor Act § 7 (1995)
105 Uniform Prudent Investor Act, Section 9, comments
106 Stewart E. Sterk, *Rethinking Trust Law Reform: How Prudent is Modern Prudent Investor Doctrine*, 95 Cornell L. Rev. 851, 899 (2010)
107 Id., at 899
108 Id., at 902
109 Id.
110 Langbein, *supra* note 1, at 106
111 J. E. Harker, *Choosing a Trustee: The Case for the Corporate Fiduciary*, 8 Prob. & Prop. 44, 52 (1994)
112 Id. at 44
113 Id. at 46
114 Sterk, *supra* note 106, at 903
115 Id.
116 Id.
117 Id., at 900
118 Id.
119 Id.
120 Id., at 901
121 Id.
122 Bennett, *supra* note 9, at 469
123 Id., at 454, citing *Estate of Gangloff v. Borgers*, 743 S.W.2d 498 (Mo.Ct.App.1987)
124 Id.
125 Id.
126 Id.
127 Id.
128 Id., at 502

¹²⁹ *Id.*, at 503

¹³⁰ *Id.*

¹³¹ *Id.*

¹³² Bennett, *supra* note 9, at 469

¹³³ *Id.*