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Investing Trust Assets: Prudence Redefined

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I. INTRODUCTION

In 1994, the National Conference of Commissioners on Uniform State Laws approved the Uniform Prudent Investor Act (the Uniform Act).[1] The committee acknowledged that significant changes had occurred in the investment practices of individuals and fiduciaries; the Uniform Act updated trust investment law in recognition of those changes.[2] One year later, Oklahoma became one of the first states to modernize trust investing by enacting the Uniform Act without major modifications.[3]

The Restatement (Third) of Trusts, which the American Law Institute released in 1992, significantly influenced the Uniform Act.[4]

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1. UNIF. PRUDENT INVESTOR ACT 1994, Historical Notes (2000).
2. UNIF. PRUDENT INVESTOR ACT 1994, Prefatory Note (2000).
3. UNIF. PRUDENT INVESTOR ACT, ch. 315, §§ 1-13, 1995 Okla. Sess. Laws 1841 (codified at OKLA. STAT. tit. 60, §§ 175.60-175.72 (2001) (effective Nov. 1, 1995)).
4. The drafters of the Uniform Act specifically acknowledged their reliance on the Restatement. *See* UNIF. PRUDENT INVESTOR ACT 1994, Prefatory Note (2000). As a result, the comments and illustrations in the Restatement provide useful guidance when interpreting the Uniform Act.

The drafters of the Uniform Act identified five fundamental changes from prior law, all of which are also found in the Restatement:[5]

> (1) The standard of prudence is applied to the trust's portfolio (which embraces all of the trust's assets), rather than to individual investments.[6]
>
> (2) The balancing of risk and return is identified as a central fiduciary.[7]
>
> (3) All categoric restrictions on types of investments are abrogated. A trustee can invest in anything that plays an appropriate role in achieving the trust's investment objectives and that meets the other requirements of prudent investing.[8]
>
> (4) The long-standing requirement that trustees diversify a trust's investments is integrated into the definition of prudent investing.[9]
>
> (5) The much criticized rule forbidding a trustee from delegating investment and management functions is reversed, with delegation permitted, subject to safeguards.[10]

In addition to significantly altering the investment approach, the Uniform Act is intended to grant a trustee more certainty when investing. Part of this certainty results from comprehensive statutory authority, including a list of circumstances that a trustee should consider when investing and managing trust assets.[11] In addition, one of the Uniform Act's stated purposes is to make the law uniform among the enacting

5. UNIF. PRUDENT INVESTOR ACT 1994, Prefatory Note (2000).

6. OKLA. STAT. tit. 60, § 175.62(B) (2001). *See infra* notes 130-133 and accompanying text.

7. *Id. See infra* notes 134-150 and accompanying text.

8. OKLA. STAT. tit. 60, § 175.62(E) (2001). *See infra* notes 124-129 and accompanying text.

9. OKLA. STAT. tit. 60, § 175.63 (2001). *See infra* notes 168-191 and accompanying text.

10. OKLA. STAT. tit. 60, § 175.69 (2001). *See infra* notes 215-263 and accompanying text.

11. OKLA. STAT. tit. 60, § 175.62(C) (2001).

states.[12] Thus, decisions from other jurisdictions that have enacted the Uniform Act will augment historically scarce Oklahoma case law.

The progressive provisions of the Uniform Act apply only to trusts. While the Oklahoma legislature amended the Oklahoma Banking Code to subject banks and trust companies who serve as trustee to the provisions of the Uniform Act,[13] it did not extend its scope to estate executors and administrators who are held to more conservative investment standards, reflecting an estate's relatively short-term investment horizon.[14]

A. Historical Perspective

A full appreciation of the Uniform Act and its impact on Oklahoma trustees requires a survey of prior Oklahoma law.[15] As early as 1921, trust companies were only permitted to invest in loans adequately secured by real estate or other security and in bonds issued by the federal government, states, counties, cities, and school districts.[16] The list of statutorily approved investments continued unchanged until 1941, when the legislature expanded its application to all trustees, including individual trustees.[17] Although the list of approved investments remained static, the 1941 amendment authorized a trustee to seek court approval for investments deemed to be in a trust's best interests, and acknowledged that trust instruments could expand a trustee's investment authority.[18]

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12. OKLA. STAT. tit. 60, § 175.72 (2001). The Uniform Act was promulgated in 1994, thus there is still limited case law. This deficiency will ameliorate over time.

13. *See, e.g.*, OKLA. STAT. tit. 6, § 714 (D) (2001) (requiring bank investment committees to make investment decisions in accordance with the Uniform Act); OKLA. STAT. tit. 6, § 1008 (2001) (limiting investment to those which the Uniform Act authorizes). Banks and trust companies have more limited authority to delegate fiduciary functions. *Compare* OKLA. STAT. tit. 6, § 1735 (2001) *with* OKLA. STAT. tit. 60, § 175.69 (2001).

14. For example, a personal representative of an estate is still limited to investing in securities guaranteed by the United States government. *See* OKLA. STAT. tit. 58, § 581 (2001).

15. For a discussion of the history of trust investing in Oklahoma, *see* Christin V. Adkins, *Oklahoma Uniform Prudent Investor Act and Its Influence on Oklahoma Trust Investment Law*, 22 OKLA. CITY U. L. REV. 1235 (1997).

16. OKLA. STAT. ch. 24, § 4197 (1921).

17. 1995 Okla. Sess. Laws 10, ch. 15 § 2.

18. OKLA. STAT. tit. 60, § 175.46 (1941). During the ensuing years, the legislature continued to tinker with the list of approved investments. For example, in 1945, trustees were permitted to invest in bonds issued by Langston University. 1945 Okla. Sess. Laws

The statutory list of approved investment categories did not confer on the trustee unlimited discretion to invest within those categories. The Oklahoma Supreme Court first addressed the proper standard for reviewing a trustee's investments in *Finley v. Exchange Trust Co.*,[19] where the trust company lost money in connection with mortgages secured by real estate. Since the investments were statutorily authorized, the issue became whether the trustee acted reasonably in making the specific loans. Relying on section 174 of the Restatement (First) of Trusts,[20] the Oklahoma Supreme Court adopted the following rule:

> The standard of care and skill required of a trustee is said to be the external standard of a man of ordinary prudence in dealing with his own property. A trustee is liable for a loss resulting from his failure to use the care and skill of a man of ordinary prudence, although he may have exercised all the care and skill of which he was capable, and if, on the other hand, the trustee has a greater degree of skill than that of an ordinary man, he is liable for a loss resulting from failure to use such skill as he has.[21]

In *Finley*, the Court considered the trustee's actions with respect to each individual mortgage in isolation. In other words, achieving an overall satisfactory return through the successful investment of the majority of the trust's assets did not insulate the trustee from liability with respect to individual imprudent investments.[22]

In 1949, the Oklahoma legislature eliminated the statutory list of approved investments and adopted the following standard:

> Unless otherwise authorized, directed or restricted by order of court or by the will, trust agreement or other document which is the source of the trust, the trustee may invest trust funds in any property, real, personal or mixed, in which an individual may invest his own funds. In making investments, the trustee shall exercise the judgment and care in the circumstances then

348, ch. 35a § 8 (effective Nov. 1, 1945).

19. 80 P.2d 296 (Okla. 1938).

20. RESTATEMENT (FIRST) OF TRUSTS § 174 (1935).

21. *See Finley*, 80 P.2d 303. The Restatement's prudent person standard was modeled after the famous holding in Harvard Coll. v. Amory, 26 Mass. (9 Pick.) 446, 461 (1830).

22. *See Finley*, 80 P.2d 296.

> 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.[23]

Thus, the prudent person standard which echoed the court's holding in *Finley* remained the law of Oklahoma until the enactment of the Uniform Act in 1995.

The Oklahoma Supreme Court has interpreted the above provision in only two cases. In *In re Flynn's Estate*,[24] the trust at issue was created prior to 1949. After the statutory enactment of the prudent person standard, the trustees requested guidance over whether they were subject to the new standard. The Supreme Court concluded that "[u]nless a trustor specifically restricts the power of his trustee in investing trust funds the trustee is governed by the law in force at the time the investment is made."[25]

More recently, the Supreme Court addressed whether a trustee could avoid surcharge by offsetting losses from imprudent investments with gains from other investments. In *In re Estate of Bartlett*,[26] the trustee breached its duty by first selling trust assets without the court's permission and then loaning the proceeds at a below market rate of interest.[27] The Supreme Court acknowledged the general rule that the trustee cannot net the results of unauthorized investments where the breaches are separate and distinct.[28] However, the Court concluded that the breaches in *Bartlett* were sufficiently related, and the trustee was permitted to offset the gain that occurred on the sale with the losses incurred on the subsequent loans.[29]

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23. 1949 Okla. Sess. Laws. 412, ch. 4a § 1 (effective Nov. 1, 1949) (codified at OKLA. STAT. tit. 60, § 161 (1991) (amended 1995)).

24. 237 P.2d 903 (Okla. 1951).

25. *Id.* at 905. This same rule applies with respect to trusts which existed as of the enactment of the Uniform Act. *See* OKLA. STAT. tit. 60, § 175.71 (2001); *infra* notes 52-58 and accompanying text.

26. 680 P.2d 369 (Okla. 1984).

27. *Id.* at 375.

28. *Id.*

29. *Id.* at 376. The Uniform Act is premised on the belief that the trust's individual investments should not be evaluated in isolation, but rather as part of the entire investment portfolio. *See* OKLA. STAT. tit. 60, § 175.62(B) (2001). Thus, the gains and losses from separate investments are automatically netted to obtain the portfolio's investment results. *See infra* notes 130-133 and accompanying text.

The prudent person standard, originally promulgated in *Harvard College v. Amory*,[30] was intended to be a flexible criterion that would evolve to embrace new investment alternatives. However, the courts applied the rule too rigidly. Court rulings created precedent that prescribed types and characteristics of permissible investments and classified whole categories of investments as too speculative. Thus, the prudent person rule became more arbitrary and less relevant.[31] When applying the rule to trust companies, the courts' focus often shifted from the prudence of an individual investment to the procedure that the trustee followed in selecting that investment.[32]

B. Modern Portfolio Theory

A primary difference between the prudent person rule and the Uniform Act's prudent investor standard is the focus on the portfolio's performance as a whole rather than on the prudence of individual investments. The impetus for this change was the development and general acceptance of modern portfolio theory. Although the Uniform Act does not expressly reference this theory, the drafters acknowledged the importance of modern portfolio theory on its promulgation:

> The Uniform Prudent Investor Act undertakes to update trust investment law in recognition of the alterations that have occurred in investment practice. These changes have occurred under the influence of a large and broadly accepted body of empirical and theoretical knowledge about the behavior of capital markets, often described as "modern portfolio theory."[33]

Since modern portfolio theory underpins the Uniform Act, a cursory discussion of the theory is appropriate.[34] Although the economic analysis

30. 26 Mass. (9 Pick.) 446 (1830).

31. For a discussion of the evolution of the application of the prudent person rule, *see* RESTATEMENT (THIRD) OF TRUSTS § 227 (1990); Stephen P. Johnson, *Trustee Investment: The Prudent Person Rule or Modern Portfolio Theory, You Make the Choice*, 44 SYRACUSE L. REV. 1175 (1993); Paul G. Haskell, *The Prudent Person Rule for Trustee Investment and Modern Portfolio Theory*, 69 N.C. L. REV. 87 (1990).

32. *See, e.g.*, Stark v. United States Trust Co. of N. Y., 445 F. Supp. 670 (S.D.N.Y. 1978).

33. UNIF. PRUDENT INVESTOR ACT 1994, Prefatory Note (2000). *See also* RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE (1992), which is the basis for the Uniform Act.

34. For a brief but excellent outline of modern portfolio theory written by a "self-proclaimed layman for laypersons," *see* Haskell, *supra* note 31, at 100.

seems overwhelming, trustees need not fully grasp all of the theory's nuances to properly manage trust investments.[35]

Under modern portfolio theory, the focus shifts from a determination of a trust's income measured in the traditional sense to a trust's total return, which is comprised of income and principal appreciation or depreciation.[36] For purposes of comparison, the baseline is short term debt issued by the United States government, which is viewed as riskless and provides the lowest return.[37] An individual investment's risk is measured by the likelihood that its actual return will be less than its expected return.[38] Therefore, to compensate for greater risks, the expected return from more speculative investments must be correspondingly higher.[39]

There are two kinds of investment risks, systemic risk and specific risk.[40] Systemic risk can be described as the rising tide which affects all ships. As the broader stock market rises or falls, individual stocks also tend to rise or fall.[41] By contrast, specific risk affects specific stocks or industries.[42] This type of risk is exemplified by the collapse of telecommunication stocks in 2001 and 2002, where economic conditions in the sector resulted in losses disproportionate to those of the broader market.[43]

A trustee can virtually eliminate the specific risk in a portfolio through diversification. Since specific risk associated with individual investments can be avoided, the market does not compensate investors for assuming this type of risk.[44] In other words, an investment's expected rate of return need not be adjusted upward to reflect the associated specific risks.[45] For equity investments, systemic risk is unavoidable, and the market must compensate the investor for assuming

35. Such a requirement would limit a settlor's selection of trustees to economists and others conversant in contemporary economic theory.

36. Haskell, *supra* note 31, at 94.

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* at 101.

41. *Id.*

42. *Id.*

43. Between January 21, 2000, and October 9, 2002, the Nasdaq Telecommunications Index (symbol IXUT) fell from a level of 1,063.14 to 81.43, a precipitous drop of over 90 percent. During that same time frame, the S&P 500 "enjoyed" a decline of only forty-seven percent from 1,445.575 to 776.763.

44. Haskell, *supra* note 31, at 101.

45. *Id.*

the risk that the overall market may go down in value.[46] Thus, the market's expected return should equal the riskless return on government securities plus a rate that reflects the market's systemic risk.

It is consistent with modern portfolio theory to purchase index or market funds (such as a fund that mirrors the Standard and Poor's 500[47]) to eliminate specific risk. The index fund's return should duplicate the broad market return and should also accurately reflect the market's systemic risk. If a trustee desires to even further reduce the portfolio's risk, it could invest a portion of a trust's assets in secure short-term debt obligations. If a trustee desires to assume additional risk, it could select individual stocks or invest in more volatile index funds, such as the NASDAQ 100[48] or the Russell 2000.[49]

The economists' view that the stock market is efficient further supports the wisdom of purchasing index funds:

> Most economic theorists conclude that the pricing of publicly traded stocks is reasonably efficient, i.e., the price of a stock at any time reflects most, if not all, of the information concerning that stock. If this is accepted, then there is no point in trying to do better than the market as a whole by selecting stocks that are underpriced because there are none, and the cost of research that goes into the selection process is a waste of money. The only way to increase return is to increase risk. There is substantial empirical support for the proposition that institutional investors

46. *Id.*

47. The S&P 500 includes a representative sample of five hundred leading companies in leading industries of the United States economy and is regarded as perhaps the best single gauge of the U.S. equities market. The S&P 500 focuses on the large capitalization segment of the stock market.

48. The NASDAQ-100 Index comprised one hundred of the largest domestic and international non-financial companies listed on The Nasdaq Stock Market based on market capitalization. Because of the nature of this market, the NASDAQ-100 Index is weighted toward the technology sector.

49. Russell 3000 Index tracks the performance of the 3,000 largest United States companies based on total market capitalization and represents approximately 98% of the U.S. equity market. Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index. This index represents approximately 8% of the total market capitalization of the Russell 3000 Index. As a result, it reflects corporations with smaller market capitalizations.

who are selective with respect to publicly traded stocks do not do any better than the market as a whole over the long term.[50]

If a trustee elects to invest in individual stocks, the Uniform Act authorizes the purchase of speculative stocks that would not have satisfied the earlier prudent person standard. A speculative stock will have high specific risks and perhaps higher systemic risks than the market as a whole. However, if the portfolio is diversified, the more conservative investments will offset the risks associated with the more speculative ones. In fact, a volatile investment may contribute to the portfolio's overall diversification and therefore may not actually increase the portfolio's overall risk. The prudent person rule, on the other hand, requires that each individual investment be prudent. As a result, before the enactment of the Uniform Act, a trustee was required to achieve the required level of diversification by purchasing only more conservative investments.[51]

II. APPLICATION OF THE UNIFORM ACT TO EXISTING TRUSTS

Prior to Oklahoma's enactment of the Uniform Act, the Oklahoma Supreme Court had already determined that unless the settlor specifically limits a trustee's investment authority in a trust instrument, the prudence of a trustee's acts is governed by the standards in existence at the time of investment.[52] This result is now legislatively dictated by Oklahoma Statute, which provides as follows: "The Oklahoma Uniform Prudent Investor Act applies to trusts existing on and created after its effective date. As applied to trusts existing on its effective date, this act governs only decisions or actions occurring after that date."[53]

For purposes of applying the above rule, the Uniform Act's effective date is November 1, 1995.[54] A question remains over the scope of the

50. Haskell, *supra* note 31, at 103 (citations omitted).

51. Although modern portfolio theory emphasizes the importance of diversification, that obligation also existed under prior law. *See infra* notes 168-191 and accompanying text.

52. In re Flynn's Estate, 237 P.2d 903 (Okla. 1951). In *Flynn*, when the settlor created the trust, the trustee's investments were limited to the legal list set forth in OKLA. STAT. tit. 60, § 175.46 (1941). When the Oklahoma legislature enacted the prudent person standard in 1949, the trustees requested guidance with respect to whether the revised standard applied to trusts existing on the legislation's effective date.

53. OKLA. STAT. tit. 60, § 175.71 (2001).

54. *See, e.g.*, Atwood v. Atwood, 25 P.3d 936 (Okla. Ct. App. 2001) (court applies Uniform Act to a trust established in 1957).

above provision. Decisions relating to individual investments made after the Uniform Act's effective date are not considered in the abstract, but rather as part of a trustee's overall investment strategy.[55] After accepting a trusteeship or receiving trust assets, a trustee is obligated to review a trust's assets to bring the portfolio into compliance with the Uniform Act.[56] The same obligation must exist with respect to trusts that were in existence on November 1, 1995, although neither section 175.64 nor section 175.71 of Oklahoma Statute Title 60 makes specific reference to that obligation.[57]

In most cases, trustees will not have to radically restructure existing investments to bring trusts into compliance with the Uniform Act. For example, in a relatively small support trust, the need for stable and reliable income justifies a conservative, fixed-income approach, which would have been consistent with the prudent person standard. However, in all cases, trustees should reevaluate a trust's investments and investment objectives, and reallocate investments where appropriate.[58]

III. OVERRIDING THE APPLICATION OF THE UNIFORM ACT

The Uniform Act's prudent investor rule is the default rule. A trustee must comply with its dictates unless a trust instrument expands, restricts, eliminates, or otherwise alters its application.[59] The statute provides examples of language that invokes the Uniform Act:

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

55. *See infra* notes 130-133 and accompanying text.

56. OKLA. STAT. tit. 60, § 175.64 (2001).

57. For a complete discussion, *see infra* notes 264-280 and accompanying text.

58. For a discussion of the factors that a trustee should consider when making investments under the Uniform Act, *see infra* notes 116-167 and accompanying text.

59. OKLA. STAT. tit. 60, § 175.61(B) (2001). Uniformity of application, one of the advantages of the Uniform Act, can only be achieved if its provisions are generally applicable within Oklahoma and the other states which enact it.

man rule," "prudent trustee rule," "prudent person rule," and "prudent investor rule."[60]

The above provision is noteworthy for two reasons. First, if a trust instrument requires a trustee to act as a prudent person, the trust arguably overrides the application of the Uniform Act's prudent investor standard. According to Oklahoma Statute Title 60, section 175.70, however, that language not only fails to override the application of the Uniform Act, but actually invokes its terms. Second, the above provision reaffirms that the Uniform Act applies to trusts existing at the time of its enactment, even though a trust instrument references the prudent person rule or some other standard that may have been in effect at a trust's creation.[61]

Although there is a presumption that the Uniform Act controls, the settlor may override its application.[62] When interpreting and enforcing trust terms, the primary goal is to give effect to the settlor's intent.[63] If a trust instrument is unambiguous, the settlor's intent must be ascertained solely from its terms.[64]

Many issues relating to whether trust provisions override the application of the Uniform Act arise from the attorney's actions or inactions. While attorneys may not understand and seldom explain the effect of the provisions in a trust's boilerplate, the settlor is presumed to ratify the language in the trust that he or she signs.[65] Attorneys should include language overriding the Uniform Act only after the client makes an informed decision to do so. If the client desires to impose a different investment standard, the trust instrument should unambiguously express

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60. OKLA. STAT. tit. 60, § 175.70 (2001).

61. *See also* OKLA. STAT. tit. 60, § 175.71 (2001); *supra* notes 52-58 and accompanying text.

62. *See, e.g.*, Bank v. Bank Lumber Co., 543 P.2d 588, 592 (Okla. Ct. App. 1975) (holding that there is no obligation to make trust property productive under prior Oklahoma law if the trust instrument grants the trustee power "[t]o retain, whether originally a part of the trust estate or subsequently acquired . . . any property, whether or not such property is . . . unproductive, or of a wasting nature, all without diversification as to kind or amount").

63. *See* Crowell v. Shelton, 948 P.2d 313 (Okla. 1997); In re Will of Dimick, 531 P.2d 1027 (Okla. 1975); Hurst v. Kravis, 333 P.2d 314 (Okla. 1959).

64. *See Crowell*, 948 P.2d 313; In re Home-Stake Prod. Co. Deferred Compen. Trust, 598 P.2d 1193 (Okla. 1979); *Dimick*, 531 P.2d 1027.

65. *See Crowell*, 948 P.2d 313 (holding the court must ascertain the settlor's intent from the terms of the trust as a whole and may not resort to extrinsic evidence if the instrument is free from ambiguity). *See also Dimick*, 531 P.2d 1027.

that intent by specifically referencing the portion of the Uniform Act that the settlor desires to abrogate.

The issue of whether a trust instrument overrides the application of the Uniform Act may arise in two distinct settings. Initially, the court must determine whether trust language overrides the mandate that a trustee bring the trust portfolio into compliance with the Uniform Act at the time of the trust's inception.[66] The prudent investor rule also generally governs investment decisions that trustees make during the trust's subsequent administration.[67] Language in a trust instrument sufficient to preempt the obligations arising under the Uniform Act during the trust's administration also generally overrides the trustee's obligations to diversify holdings and to otherwise comply with the prudent investor standard at the trust's inception. However, the converse is not necessarily true. A direction or authorization to retain specific assets at the time of creation might not override the application of the Uniform Act regarding subsequent investment decisions made during the trust's administration.[68] These two scenarios are discussed separately below.

Before discussing the Uniform Act's mandates, it is important first to analyze and dismiss the recent Oklahoma decision *Atwood v. Atwood*.[69] The settlors primarily funded an intervivos trust with stock in a publicly traded corporation.[70] The trustee retained those shares for over forty years, during which time the stock comprised between seventy and eighty percent of the trust's assets.[71] The beneficiaries subsequently sued the trustee for his failure to diversify trust holdings.[72] Article VI of the trust instrument authorized the trustee "*[t]o retain cash or other assets*, whether or not of the kind hereinafter authorized for investment, *for so long as they may deem advisable* . . ." and "[t]o invest and reinvest . . . in any securities and properties they deem advisable . . . *without being*

66. *See* OKLA. STAT. tit. 60, § 175.64 (2001); *infra* notes 91-97 and accompanying text. The same principles apply when a successor trustee accepts a trusteeship and when additional assets are contributed to an existing trust.

67. *See infra* notes 98-115 and accompanying text.

68. For a discussion of the language required to override a trustee's obligations at the trust's creation, *see infra* notes 91-97 and accompanying text. For a discussion of the language required to override a trustee's obligations during the continuing administration of the trust, *see infra* notes 98-115 and accompanying text.

69. 25 P.3d 936 (Okla. Ct. App. 2001).

70. *Id.* at 940.

71. *Id.*

72. *Id.*

limited in the selection of investments by any statutes, rules of law, custom or usage."[73]

The Oklahoma Court of Appeals acknowledged that the duty to diversify existed under the prudent person standard prior to 1995 and under the Uniform Act after that date.[74] However, the court had little difficulty determining that the trust instrument abrogated the obligation to diversify. As a result, the court upheld summary judgment in favor of the trustee with respect to his affirmative defense that the trust instrument authorized his actions.[75]

The *Atwood* holding is troubling. Initially, a stated purpose of the Uniform Act is to make the laws governing trust investments uniform among those states enacting it, permitting courts to rely upon decisions in other jurisdictions.[76] If a large number of Oklahoma trusts are determined to fall outside the scope of the Uniform Act, the beneficiaries, trustees, and courts must interpret and enforce those trusts *ad hoc*, and Oklahoma will fail to achieve a stated purpose of the Uniform Act. However, giving effect to a settlor's conscious desires as expressed in the trust instrument remains primary.[77]

The *Atwood* court advanced two theories to support its conclusion. First, it held that "[t]he language of Article VI of the Trust conveys the unequivocal message that the Settlors intended that [a] Trustee not be constrained by the Prudent Investor Rule."[78] The first clause in Article VI authorized the trustee to retain assets contributed to the trust for so long as he may deem advisable, regardless of their nature. This, by itself, does not override the application of the Uniform Act. The beneficiaries claimed that the trustee's exercise of that discretion remained guided by the prudent investor rule, including the duty to diversify investments.[79] This is a strong argument.[80] The second clause

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73. *Id.* at 943.

74. *Id.*; *see also* OKLA. STAT. tit. 60, § 175.63 (2001).

75. *Atwood*, 25 P.3d at 944. The court also was influenced by the trust's investment results since its inception, although it was unwilling to grant summary judgment for the trustee with respect to the beneficiary's initial claim that the trustee breached his fiduciary duty by failing to diversify. *Id.* at 945.

76. OKLA. STAT. tit. 60, § 175.72 (2001); UNIF. PRUDENT INVESTOR ACT 1994, Prefatory Note (2000).

77. *See* Crowell v. Shelton, 948 P.2d 313 (Okla. 1997); In re Will of Dimick, 531 P.2d 1027 (Okla. 1975); Hurst v. Kravis, 333 P.2d 314 (Okla. 1959).

78. *Atwood*, 25 P.3d at 944.

79. *Id.*

80. *See infra* notes 91-97 and accompanying text; OKLA. STAT. tit. 60, § 175.61(B) (2001).

should be viewed as permissive, rather than mandatory. As such, it fails to abrogate the trustee's duty to diversify, and the trustee remains obligated to act prudently.

Even more troubling is the court's observation that absent any relevant language in the trust instrument, Oklahoma Statute Title 60, section 175.163 would have authorized the trustee to retain assets contributed to the trust without liability for that retention. That section, originally enacted in 1949[81] and first cited for authority in *Atwood*, provides that "a trustee may retain in trust any property originally received into the trust and any substitution therefor [sic] without liability for such retention."[82]

The issue, according to the Court of Appeals, was whether the Uniform Act overruled the above provision or whether it retained vitality.[83] Relying on Minnesota case law,[84] the court resolved the "apparent inconsistency" between Oklahoma Statute Title 60, section 175.163 and the duty to diversify under the Uniform Act by ruling that the Uniform Act applies only to investments made after the trust's formation and by refusing to impose a duty on the trustee to diversify assets contributed to the trust.[85]

The *Atwood* court failed to address Oklahoma Statute Title 60, section 175.64, which is part of the Uniform Act and directs the trustee, at the trust's inception, to review the assets and make and implement decisions concerning asset retention and disposition to bring the trust portfolio into compliance with the Uniform Act.[86] As far as practical, the court must attempt to interpret Oklahoma Statute Title 60, sections 175.64 and 175.163 (2001), as consistent and harmonious, giving

81. 1949 Okla. Sess. Laws 413, ch. 4a § 3 (effective Nov. 1, 1949).

82. *Id.* Arguably, the provision also protects the trustee even if the trust instrument expressly imposes a duty on the trustee to review the trust assets to bring them into compliance with the Uniform Act or some other investment standard. It is unlikely that the court would reach this bizarre result.

83. *Atwood*, 25 P.3d at 943.

84. In re Trusts Created by Hormel, 504 N.W.2d 505 (Minn. Ct. App. 1993).

85. *Atwood*, 25 P.3d at 943-44. The Oklahoma Court of Appeals cited *Hormel* for this proposition, although it did not expressly apply the *Hormel* holding to the facts in *Atwood*. Since the court determined that this was the first of "several reasons" why the beneficiaries' argument must fail, the court endorsed the holding in *Hormel*. *Id.* at 944.

86. OKLA. STAT. tit. 60, § 175.64 (2000). Although the Minnesota legislature enacted the Uniform Prudent Investor Act, it made significant changes, including the addition of MINN. STAT. § 501B.151(8) (2001) which expressly authorizes the trustee to retain assets originally contributed to the trust. This is a significant distinction between the Minnesota and Oklahoma statutory schemes.

intelligent effect to each.[87] Although the two provisions seem antithetical, section 175.163 authorizes, but does not require, the trustee to retain assets originally contributed to the trust. There is a strong argument that this language does not authorize the trustee to continue to hold assets if, under the circumstances, so doing would be considered an abuse of discretion.[88] Thus, limiting the application of section 175.163, the courts could still apply the Uniform Act, including the duty to diversify, to determine whether the retention of assets constitutes an abuse of discretion.

It is more likely that courts confronting the issue will determine that the two provisions are irreconcilable. In this case, the legislature's latest enactment takes precedence as the expression of its latest intent.[89] In other words, the enactment of the Uniform Act repeals by implication the earlier provision.[90]

The potential scope of this portion of the *Atwood* holding is staggering. Eliminating the trustee's obligation to diversify with respect to assets contributed to the trust negates most, if not all, of the other duties arising under the Uniform Act. To the extent the trustee has statutory authorization to retain the original assets contributed to the trust without liability, that trustee cannot be required to otherwise act as a prudent investor with respect to those assets. The court's ruling applies to trusts created before and after the Uniform Act's effective date, a result that the Oklahoma legislature could not have intended. The following discussion therefore assumes that this portion of the *Atwood* case will be clarified or that section 175.163 will be repealed.

A. Overriding the Uniform Act with Respect to Assets Contributed to a Trust

If a trust instrument *directs* the trustee to retain certain investments, the trustee is generally not liable for retaining those assets,[91] and may

87. *See* Upton v. State ex rel. Dep't. of Corr., 9 P.3d 84 (Okla. 2000); Sharp v. Tulsa County Election Bd., 890 P.2d 836 (Okla. 1994).

88. *See* RESTATEMENT (THIRD) OF TRUSTS § 229 cmt. d (1990); *infra* notes 91-97 and accompanying text.

89. *See* Okla. Sch. Ins. Ass'n v. Okla. Tax Comm'n, 991 P.2d 553 (Okla. Ct. App. 1999); Pickett v. Okla. Dep't. of Human Serv., 932 P.2d 543 (Okla. Ct. App. 1996); State ex rel. Murphy v. Boudreau, 653 P.2d 531 (Okla. 1982).

90. For an extensive discussion of repeal by implication, *see* Ritchie v. Raines, 374 P.2d 772, 776-77 (Okla. Crim. App. 1962).

91. A trustee may be under an obligation to sell the assets if the retention of the

subject itself to liability if the assets are sold. This directive clearly overrides a trustee's duties at the trust's inception with respect to those specific assets.[92] The trustee remains obligated to review and implement decisions regarding the remaining assets contributed to the trust and those assets acquired during administration to comply with the Uniform Act. In making these determinations, the trustee should consider the nature of the investments it has been directed to retain.

The result is less certain if a trust instrument merely *authorizes* the trustee to retain assets originally contributed to the trust.[93] Since "diversification is fundamental to prudent risk management, trust provisions are strictly construed against dispensing with that requirement."[94] According to the Restatement, authorization to retain assets is equated with the grant of permissive or discretionary authority to make investments.[95] In other words, mere authorization does not empower a trustee to retain assets if, under the circumstances, the retention would be an abuse of discretion. Thus, in jurisdictions that have enacted the prudent investor standard, a trustee's duties and obligations should remain unchanged.

It is more likely that the authorization to retain *specific* assets contributed to a trust overrides the trustee's obligations under the Uniform Act. However, the settlor's direction to retain specific investments does not authorize their indefinite retention. The trustee must be mindful of changed circumstances that would make continued ownership imprudent.[96]

In all of the above scenarios, whether the continued retention of specific assets rises to an abuse of discretion remains a question of interpretation. In this regard, the comments to the Restatement are helpful:

> Among the factors that may be of importance in this matter are: whether, in effect, the settlor has intended to encourage or merely to authorize retention of the investments; whether an authorization to retain applies to specific investments, to

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assets by the trust is illegal or if there occurs a change of circumstances after the trust's creation. *See infra* notes 99-100 and accompanying text.

92. RESTATEMENT (THIRD) OF TRUSTS § 229 cmt. d (1992).

93. Note that OKLA. STAT. tit. 60, § 175.163 (2001), discussed in *Atwood*, authorizes the retention of assets contributed to a trust.

94. RESTATEMENT (THIRD) OF TRUSTS § 228 cmt. f (1992).

95. RESTATEMENT (THIRD) OF TRUSTS § 229 cmt. d (1992).

96. *Id.*

> particular types of investments, or to all property received as a part of a trust estate; the character of the original trust property in question; and the purpose of a trust generally, and especially any identifiable purposes underlying the particular grant of authority.[97]

Although the comments restate general principles of law, a trustee is ultimately guided by the trust terms and by all other relevant facts and circumstances.

B. Overriding the Uniform Act Regarding Investments Made During Administration

With respect to the effect of trust language on investment decisions made after a trust's creation, a preliminary distinction must be made between mandatory and permissive trust provisions. A mandatory provision either directs or prohibits specific action. A trust instrument that merely authorizes a particular investment or a particular investment style is deemed permissive, and a trustee is not under a duty to make specific investment decisions.[98]

A trustee must generally comply with mandatory provisions. However, a trustee is not under an obligation to comply with a mandatory provision if it would be impossible, illegal, or if, as the result of facts or circumstances that the settlor did not know or could not reasonably anticipate, compliance would defeat or substantially impair the accomplishment of a purpose for which the settlor established the trust.[99] For example, assume that a trust instrument prohibits investment in real estate. The trustee purchases real estate, after reasonably determining that the investment has an established record of earnings, represents an excellent investment opportunity, and contributes to the diversification of the investments as a whole. If it was not impossible or illegal to comply with the settlor's desires and if there was no change in circumstances that would impair the purposes for which the settlor established the trust, the trustee will be liable for any loss from the investment.[100]

97. *Id.*
98. RESTATEMENT (THIRD) OF TRUSTS § 228 cmt. f (1992).
99. RESTATEMENT (THIRD) OF TRUSTS § 228 cmt. e (1992).
100. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. b, illus. 5 (1992).

A trustee is not under a duty to make or retain permitted investments. Whether a trustee is obligated to give special consideration to permitted investments depends on the trust terms and other facts and circumstances.[101] Regardless, a trustee must continue to act prudently in making decisions to sell or acquire assets and to diversify trust holdings.[102] However, the more specific the permissive provision, the more likely that the settlor had special objectives that might justify a departure from what is ordinarily considered prudent investing.

Although these decisions are primarily fact based, a few examples provide guidance. Assume that the decedent has two children and establishes a testamentary trust to which he transfers the family farm and other assets. The trust terminates when the youngest child attains age thirty, when the property passes outright to the surviving children. Also assume that both children continue to farm the land.[103] Under these facts, the trustee is authorized to retain the farm even if the trust contains only a permissive statement regarding the retention of assets.[104] However, it is wrong to view the relevant issue as whether the trust instrument overrides the application of the Uniform Act. In this example, the facts support the trustee's continued retention of the farm even if the trust instrument is silent. The duty to diversify is not an end to itself. The trustee may determine that given special circumstances, the purposes of the trust are better served by not diversifying.[105]

[T]he trustee's decision to retain or dispose of certain assets may properly be influenced, even without trust terms expressly bearing on the decision, by the property's special relationship to some objective of the settlor that may be inferred from the circumstances, or by some special interest or value the property may have as a part of a trust estate or that it may have, consistent with trust's purposes and a trustee's duty of impartiality, to some or all of the beneficiaries. Examples of such property might be land used in a family farming operation, the assets or

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101. This is a question of trust interpretation, often made more difficult by careless drafting.

102. RESTATEMENT (THIRD) OF TRUSTS § 228 cmt. f (1992).

103. This example is similar to one set forth in RESTATEMENT (THIRD) OF TRUSTS § 229 cmt. d (1992).

104. The trustee must remain alert to possible changes in circumstances which would make the continued ownership of the farm imprudent.

105.. *See* OKLA. STAT. tit. 60, § 175.63 (2001); *infra* notes 168-171 and accompanying text.

shares of a family business, or stockholdings that represent or influence control of a closely or publicly held corporation.[106]

Now assume the same facts as above, but with a trust instrument that directed the retention of the farm and authorized the trustee to acquire additional land for the farming operation. Although the retention of the farm is a mandatory provision, the direction to liquidate other trust investments to purchase additional farm land is clearly permissive. The comments to the Restatement provide insight:

> The way in which an authorization like that [above] is to influence a trustee's behavior is a matter of interpretation that often becomes difficult because of a lack of precision in the language used by the settlor's lawyer. Is the authorization . . . a reflection of [settlor's] belief in a special competence possessed by two of the beneficiaries? . . . The added risk of further concentrating investments in one farming operation, an inherently risky undertaking in any event, remains a factor for T to take into consideration even though it is not the barrier it would represent without an express authorization.

For this added risk, despite the presence of a permissive provision of this type, some reasonable justification must be found in the settlor's intentions or purposes or in some special opportunity (based, for example, on special skills) available to a trust. In cases of this type the relevant justifications also may offer trustees some guidance in determining when an authorization should no longer be given special consideration. For example, if the reason for the authorization is the special competence or interest of some of the beneficiaries, this would suggest that the permissive provision would not justify an otherwise imprudent decision when there is no longer a beneficiary with special interest or competence with respect to the investment.[107]

Consider one final example. Many trust forms (and therefore trust instruments) contain language similar to the following:

> A trustee shall have power . . . [t]o retain any property (including stock of any corporate trustee hereunder or a parent or affiliate company) originally constituting a trust or subsequently added thereto, and to invest and reinvest a trust property in bonds,

106. RESTATEMENT (THIRD) OF TRUSTS § 229 cmt. a (1992).
107. RESTATEMENT (THIRD) OF TRUSTS § 228 cmt. f (1992).

> stocks, mortgages, notes, bank deposits, options, futures, limited partnership interests, shares of registered investment companies and real estate investment trusts, or other property of any kind, real or personal, domestic or foreign; a trustee may retain or make any investment without liability, even though it is not of a type, quality, marketability or diversification considered proper for trust investments.[108]

Based on its holding in *Atwood v. Atwood*,[109] the Oklahoma Court of Appeals would conclude that the above language overrides the prudent investor rule, regarding both the duty to diversify and the propriety of future trust investments. However, this result is incorrect. The above provision authorizes, but does not direct the retention of assets. It is a general authorization to retain *all* assets contributed to the trust rather than to retain *specific* assets. Absent special circumstances, the provision should not significantly alter the trustee's obligations at the trust's inception, and Oklahoma Statute Title 60, section 175.64 requires the trustee to implement decisions to bring the trust portfolio into compliance with the Uniform Act.[110] The permissive authorization to retain or purchase assets that are not of a type considered proper for trust investments may be relevant in states that still have legal lists or that have adopted the prudent person standard. States such as Oklahoma that have enacted the Uniform Act have already broadened the trustee's investment authority,[111] rendering this authorization redundant.

One question remains: does the reference to diversification in the preceding example abrogate the trustee's duty to diversify trust investments? Since diversification is the foundation of prudent investment, the courts will strictly construe the above provision against dispensing with that requirement altogether. Special circumstances, such as the trust's ownership of a family farm or family corporation, might dictate a relaxation in the degree of diversification. However, absent these circumstances, a wise trustee would prudently diversify the trust investments.[112]

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108. The above language can be found in a trust form published by the Northern Trust Company, 959 South Waukegan Road, Lake Forest, IL 60045.

109. 25 P.3d 936 (Okla. Ct. App. 2001), discussed *supra* notes 69-90 and accompanying text.

110. OKLA. STAT. tit. 60, § 175.64 (2001).

111. *See infra* notes 124-129 and accompanying text.

112. RESTATEMENT (THIRD) OF TRUSTS § 228 cmt. e-f (1992).

There is also an issue relating to the scope of discretion provided for in trust instruments. Provisions that direct that investments be made "in the trustee's discretion" and that authorize the trustee to deal with the property "as owner" are construed strictly and do not alter the obligations that the Uniform Act imposes.[113] A trust instrument may authorize a trustee to make investments in its "absolute discretion" or "sole and uncontrolled discretion."[114] This language normally grants a trustee additional discretion with respect to making investments. However, a trustee must still act in a state of mind that the settlor contemplated and must not jeopardize the accomplishment of the trust's purposes.[115] Although a question of interpretation, such a provision ordinarily does not relieve the trustee of the duties of care, loyalty, and general responsibility for risk management. This should necessarily be the case if the authorization is factually indistinguishable from the other boilerplate provisions.

IV. PRUDENT INVESTOR STANDARD

The Uniform Act creates an objective standard to evaluate a trustee's performance.[116] However, the prudent investor standard is not objective in the sense that the Uniform Act establishes an investment checklist. A trustee still possesses considerable flexibility in selecting investments. Investment portfolios will be as varied as the purposes for which settlors establish trusts, and other circumstances surrounding their creation and administration. The following sections discuss general principles and restrictions with respect to trust investments.[117]

Although this "objective" standard may provide little solace to the prospective trustee, a trustee must remember that its decisions will be

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113. RESTATEMENT (THIRD) OF TRUSTS § 228 cmt. g (1992).

114. *Id.*

115. *Id.*

116. UNIF. PRUDENT INVESTOR ACT 1994 § 2 cmt. (1994). The comments to section one of the Uniform Prudent Investor Act address this issue:

> The concept of prudence in the judicial opinions and legislation is essentially relational or comparative. It resembles in this respect the "reasonable person" rule of tort law. A prudent trustee behaves as other trustees similarly situated would behave. The standard is, therefore, objective rather than subjective.

Id.

117. The best guidance can be obtained from the comments to the RESTATEMENT (THIRD) OF TRUSTS §§ 227-228 (1992), and these comments are cited frequently.

judged as of the time they are made, not on the basis of hindsight, and that it is not a guarantor of a trust's investment performance.[118] The following illustrations in the Restatement are instructive:

> 3. T invests the funds of a trust with the required degree of care, skill, and caution in short-term and intermediate-term Treasury securities and in several mutual funds holding corporate stocks. The combination is suitable to the circumstances and purposes of the trust. As a result of general market and economic conditions, the value of all of the mutual fund shares declines suddenly during the second year of the trust. T is not liable for the losses sustained by the trust, even though some trustees and many other investors suffered lesser or no net losses as a result of the same market events during the same period.
>
> 4. Under the same set of facts, the sudden initial decline in the value of the shares is followed by an eight-month period of a generally declining market that continues to have adverse overall effects on the value of the trust estate. Early in this period and at various times during the period, many investors (including many other trustees) sell their holdings in investments similar to the mutual fund holdings retained by T, investing instead in short-term debt instruments. These investors thereby avoid much of the loss sustained by S's testamentary trust. T, however, reasonably concludes that it is wise to retain the mutual fund shares in which substantial losses of value are eventually sustained. T is not liable for the losses that followed from these reasonable judgments that, in retrospect, prove disadvantageous.[119]

Since courts are hesitant to second guess decisions that a trustee makes in good faith and with full knowledge of the relevant facts and circumstances, perhaps a trustee's greatest exposure emanates from its failure to make a good faith effort to comply with the prudent investor standard.

Initially, it is helpful to note that the prudent person standard enacted by the Oklahoma legislature in 1949 evaluated a trustee's performance by comparing its actions to those of a fictional prudent person investing

118. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. b (1992).
119. *Id.*

his or her own funds.[120] In other states, courts distinguished between the obligation imposed on a prudent person investing his or her own funds and the obligation imposed on a prudent person investing the funds of a third person.[121] The Uniform Act silences this debate. The Uniform Act compares a trustee's actions with a prudent investor similarly situated, investing the assets of the trust.[122] In this regard, a trustee is guided by the "purposes, terms, distribution requirements, and other circumstances of the trust."[123]

A. General Principles of Prudence

The Uniform Act made two fundamental changes regarding a trustee's exercise of investment authority. The first relates to categoric restrictions. As early as 1921, trust companies were only permitted to invest in loans adequately secured by real estate or securities and in bonds issued by the federal government, states, counties, cities, and school districts.[124] In 1949, the Oklahoma legislature replaced the statutory list with the prudent person standard:

> Unless otherwise authorized, directed or restricted by order of court or by the will, trust agreement or other document which is the source of the trust, the trustee may invest trust funds in any property, real, personal or mixed, in which an individual may invest the individual's own funds. In making investments, the trustee shall exercise the judgment and care in 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.[125]

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120. 1949 Okla. Sess. Laws 412, ch. 4a § 1 (effective Nov. 1, 1949) (codified at OKLA. STAT. tit. 60, § 161 (1991)). For a discussion of the history of trust investing in Oklahoma, *see* Adkins, *supra* note 15.

121. Courts generally assumed that a prudent person would be more conservative when investing other persons' assets.

122. UNIF. PRUDENT INVESTOR ACT 1994 § 2 cmt. (2000).

123. OKLA. STAT. tit. 60, § 175.62(A) (2001).

124. Okla. Stat. ch. 24, § 4197 (1921). For a more detailed discussion, *see supra* notes 16-22 and accompanying text.

125. 1949 Okla. Sess. Laws 412, ch. 4a § 1 (effective Nov. 1, 1949) (codified at OKLA. STAT. tit. 60, § 161 (1991)).

The above standard expressly precluded speculative investments. This fact, combined with preoccupation with the preservation of the principal, encouraged courts to continue to classify entire categories of investments as too speculative for prudent trust investment. For example, junior mortgages and unsecured loans were generally deemed imprudent trust investments regardless of the accompanying circumstances.[126]

The Uniform Act eliminated these categoric restrictions, authorizing a trustee to "invest in any kind of property or type of investment consistent with the standards of the Oklahoma Uniform Prudent Investor Act."[127] The drafters observed that the basis for any categoric restriction erodes over time. Some investments originally thought to be too risky are now a staple of trust portfolios.[128] Other acceptable investments such as government bonds entail unanticipated risks during periods of high inflation which erode their value.

Rather than judging an investment's risk in the abstract, a trustee should judge the risk associated with each investment in relation to the trust's other investments.

In short, the prudent investor rule, despite its requirement of caution, does not classify specific investments or courses of action as prudent or imprudent in the abstract. The rule recognizes that what may be underproductive of trust accounting income or risky--or even characterized as speculative--in isolation, or in a different context, may play a role in an investment strategy that contributes to the trustee's compliance with the requirement of caution.[129]

Following this analysis, the trustee's investment in a second mortgage to achieve a higher return may be prudent when viewed together with the trust's other, more conservative investments.

Authorizing trustees to invest in a broader range of investments necessitated a second fundamental change in evaluating their

126. RESTATEMENT (SECOND) OF TRUSTS § 227 cmt. h-i (1959). *See also* Estate of Collins, 139 Cal. Rptr. 644 (Cal. Ct. App. 1977) (holding that an investment in a second mortgage on real estate is also almost improper since a trustee should not place trust funds in a position where they may be endangered by the foreclosure of a superior lien).

127. OKLA. STAT. tit. 60, § 175.62(E) (2001).

128. The comments refer to the common use of futures and other derivatives which, in the not too distant past, would have been improper. UNIF. PRUDENT INVESTOR ACT 1994 § 2 cmt. (2000).

129. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. e (1992). For a discussion of the relationship of risk and reward in the selection of trust investments, *see supra* notes 36-51 and accompanying text.

performance. Before the enactment of the Uniform Act, the courts evaluated the prudence of each trust investment in isolation. A trustee could not avoid being surcharged for an imprudent investment by offsetting losses from that investment against gains on other investments.[130] Since the Uniform Act authorizes trustees to make more speculative investments, those investments cannot be viewed in the abstract. The statute expressly provides as follows:

> 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.[131]

Thus, a trustee may offset disappointing investment results in some assets with favorable results in others. When evaluating a trustee's performance, the court must focus on the trust portfolio as a whole. For purposes of this analysis, the trust portfolio includes the entire trust estate, including cash assets and other assets not currently being invested.[132] The Uniform Act focuses on a trustee's performance, not necessarily the investment results.[133]

A trustee must constantly balance a portfolio's risk with its anticipated return.[134] All investments involve some level of risk.[135] Even United States government securities are subject to the loss of inflation-adjusted value.[136] The duty of caution requires a trustee to manage the inherent risk in the trust's portfolio, rather than eliminate it.[137] In this regard, a trustee must consider risks associated with inflation, volatility of stock prices, a trust's lack of liquidity, and other related factors.[138]

Trustees can eliminate specific risk by adequate diversification. Under the efficient market theory, a stock's value does not recognize and

130. *See supra* notes 26-29 and accompanying text.

131. OKLA. STAT. tit. 60, § 175.662(B) (2001).

132. UNIF. PRUDENT INVESTOR ACT 1994 § 2 cmt. (2000).

133. *See* In re Estate of Cooper, 913 P.2d 393 (Wash. App. 1969) (holding that the trustee who was also the income beneficiary acted imprudently when the trust investments were weighted heavily in bonds and bond equivalents, even though the return on the total trust assets exceeded that of a local bank trust department).

134. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. e (1992).

135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.*

reward a trustee's failure to diversify.[139] Furthermore, a trustee cannot justify its failure to eliminate specific risk by claiming that it is attempting to increase expected returns.[140] As a result, the failure to diversify and reduce specific risk is ordinarily a violation of the duty to exercise caution and the duty to use care and skill.[141] The Restatement observes:

> 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. Therefore trustees ordinarily have a duty to diversify investments. . . . The purpose of diversification (apart from the role it may play in discharging the trustee's duty of impartiality) is not only to moderate risks that are inherent in investing but also to reduce risks that are not justified by some prospect of gain.[142]

A trustee can diversify a modest sized trust by purchasing mutual funds and index funds.[143] The purchase of several different mutual funds, by itself, does not ensure the elimination of a trust's specific risk. A trustee also should not rely solely on the fund's self-declared investment style or past results. In many cases, fund directors make decisions they believe will boost the fund's results independent of the fund's stated investment objectives.[144] A trustee must analyze each fund's holdings to determine whether it has achieved the desired level of diversification. A trustee can more easily eliminate specific risks by investing at least a portion of the trust's assets in broad market index funds, which necessarily provide adequate diversification.[145]

In addition to eliminating specific risk by diversification, a trustee must determine the appropriate level of systemic risk, where a trustee's obligations are less certain and necessarily involve subjective

139. *See supra* notes 44-46.
140. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. e (1992).
141. *Id.*
142. *Id.*
143. *Id.*
144. *Id.*
145. *Id.*

judgments.[146] A trust's tolerance for risk varies greatly with its size, purpose, and the relevant circumstances of its beneficiaries.[147] If a trust's circumstances dictate that it is not able to sustain short term losses for the hope of long term gains, a trustee should necessarily invest more cautiously. For example, if the settlor establishes a modest sized trust to provide a source of income for an older beneficiary, the trustee should adopt a more conservative investment style. However, if the trust is larger and is expected to run for a longer period of time, exercising that same degree of caution might violate the trustee's duty to be impartial to all beneficiaries. Thus, the degree of caution which a trustee must exercise is closely related to its duty of impartiality.[148]

Regardless of the circumstances, a trustee must seriously consider both the preservation of capital and the generation of income. The following factors are relevant in determining a trust's appropriate level of systemic risk:

1. The obligation to make regular distributions to a beneficiary;

2. The possibility of making extraordinary distributions in the future;

3. The size of the trust estate;

4. The needs of the beneficiaries; and

5. The purposes for which the settlor established the trust.[149]

Since there is no objective legal standard which establishes the appropriate level of risk, trustees generally approach this determination with a decidedly conservative bias.[150]

In performing its investment functions, a trustee must exercise that degree of care and skill possessed by an individual of ordinary intelligence.[151] Thus, an individual of below average intelligence may breach his fiduciary obligations even though he exercises all of the care

146. *Id.*
147. UNIF. PRUDENT INVESTOR ACT 1994 § 2 cmt. (2000).
148. *See infra* notes 197-199 and accompanying text.
149. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. e (1992).
150. *Id.*
151. *Id.*

and skill possessed.[152] The comments to the Restatement summarize the practical effect of a trustee's obligations to exercise reasonable care and skill:

> The standards of trusteeship are neither excessively demanding nor monolithic. They should neither effectively preclude service by conscientious family members and friends nor permit casual, inattentive behavior by trustees who can, because of their expertise, meet a higher than ordinary standard of conduct and competence. Thus, the applicable requirements of care and skill allow responsible individuals of ordinary intelligence to serve as trustees and to adopt reasonable investment strategies of types that are appropriate to their skills. Yet the standards require fiduciaries possessing special facilities and skills to make those advantages available to the trust and its beneficiaries.[153]

To fulfill the duty to exercise care and skill, a trustee must formulate an investment strategy that reflects a level of overall investment risk that is appropriate for the trust and its beneficiaries. In this regard, a trustee must use reasonable care to obtain relevant information about the trust and its beneficiaries, the existing trust assets, and the available investment options.[154] The courts presumably will grant a trustee considerable discretion in making these decisions and a trustee's greatest risk involves the failure to make a good faith effort to perform this obligation.

A trustee must also use reasonable care and skill to implement the investment strategy. This ordinarily will include the sale of some assets and the purchase of others. A trustee's failure to diversify the portfolio to reduce specific risk associated with individual stocks or industries is ordinarily both a violation of a trustee's duty to exercise caution and the duty to use care and skill.[155] A trustee must also possess and exercise the necessary skill to implement the chosen investment strategy. In other words, if a trustee includes derivatives as part of the diversified portfolio, it must exercise the care and skill of a person investing in those types of investments.[156] A trustee must take reasonable steps to obtain competent

152. *Id.* A trust company or other professional who serves as trustee is generally held to a higher standard. *See infra* notes 209-214 and accompanying text.

153. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. d (1992).

154. *Id.*

155. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. e (1992).

156. This results in a higher standard of care since individuals of ordinary intelligence

advice if it does not possess the necessary knowledge and skill to develop and implement the investment strategy.[157]

A trustee's obligations under Oklahoma Statute Title 60, section 175.62 apply equally to the continued management of trust assets.[158] A trustee must continue to monitor the suitability of investments already made, as well as implement decisions with respect to new investments. In addition, changed circumstances may mandate that a trustee modify its investment strategy. If a beneficiary's financial needs increase due to illness, that circumstance may dictate that a trustee pursue a more conservative investment style. Also, even in a diversified portfolio, the investment in certain stocks or industries may become imprudent if those investments entail significant risk not present at the time of the initial investment.[159]

In developing, implementing, and monitoring an investment strategy, the comments to the Restatement provide guidance with respect to a trustee's obligation to invest prudently:

> (1) Trustees, like other prudent investors, prefer (and, as fiduciaries, ordinarily have a duty to seek) the lowest level of risk and cost for a particular level of expected return--or, inversely, the highest return for a given level of risk and cost.
>
> (2) Specific investments or techniques are not per se prudent or imprudent. The riskiness of a specific property, and thus the propriety of its inclusion in the trust estate, is not judged in the abstract but in terms of its anticipated effect on the particular trust's portfolio. . . . The same is true of specific courses of action, such as the "defensive" use of options seeking to reduce the risk of an investment strategy and to do so at a lower "price" in terms of program goals than might be exacted by converting to a more conservative portfolio of assets.
>
> (3) Diversification is fundamental to the management of risk and is therefore a pervasive consideration in prudent investment management. So far as practical, the duty to diversify ordinarily

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do not successfully invest in derivatives.

157. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. d (1992).

158. UNIF. PRUDENT INVESTOR ACT 1994 § 2 cmt. (2000).

159. *Id.*

applies even within a portion of a trust portfolio that is limited to assets of a particular type or having special characteristics.

(4) Passive investors raise the expected return of efficient, diversified portfolios by increasing their degree of market risk. This increase in risk requires a fiduciary judgment that a trust, in light of the amounts and timing of its cash needs and obligations, is in a position to accept the resulting risk of greater volatility in asset values, and therefore in portfolio performance for any given year or period. (Thus, a particular danger to be considered is that of having to raise significant amounts of cash for distribution in a down market.) The volatility associated with a strategy involving increased risk will ordinarily have considerably more impact on a trust's principal account than on its income account.

(5) Departures from an ordinarily suitable, diversified portfolio may be justified by special circumstances or opportunities of a particular trust or by peculiar risks facing its beneficiary families. Departures might also be justified by: specialized investment capabilities of or available to the trustee; special interests or managerial abilities of beneficiaries; or special settlor objectives, including particular asset holdings that are preferred or encouraged by the terms of a trust. . . . The greater the departure, the heavier the trustee's burden to justify the strategy in question.[160]

A trustee must also consider relevant tax consequences. A prudent investment strategy generally minimizes the gain on the sale of investments.[161] This includes avoiding mutual funds, which annually make large capital gain distributions.[162] A trustee must also determine whether the resulting gain or loss is taxed to the trust or its beneficiaries.

160. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. f (1992).

161. The potential for recognizing gain or loss on a transaction depends on the trust's basis in its assets. If the assets were recently included in a decedent's gross estate for federal estate tax purposes, the basis of those assets generally will equal their fair market value at the decedent's death, reducing the amount of potential gain. *See* I.R.C. § 1014(b) (all references to the I.R.C. are to the 2004 I.R.C.). A trust's basis in assets which have not received a step-up is generally equal to the settlor's basis at the time of funding. *See* I.R.C. § 1015(a).

162. UNIF. PRUDENT INVESTOR ACT § 2 cmt. (2000).

For example, assume that a trust's primary beneficiary has a significant capital loss carryover. This factor is only relevant to a trustee's decision to recognize capital gain if, under Subchapter J of the Internal Revenue Code, the resulting gain is distributed to the beneficiary.[163]

If a trust is revocable or will otherwise be included in the settlor's estate for federal estate tax purposes, a trustee should be particularly alert to the impact of the basis rules.[164] It is seldom justifiable to recognize gain shortly before the settlor's death if the trustee could avoid that gain by holding the assets until the decedent's death, when the trust would receive a step-up in basis.[165]

The desire to avoid the recognition of capital gains is not always the controlling consideration. The duty to diversify a trust's holdings will, on occasion, necessitate the recognition of gain on the sale of appreciated assets. Even in this situation, a trustee should attempt to minimize the amount of gain by achieving diversification through the sale of assets with less gain potential or through the sale of other assets at a loss.

A trustee should also consider the tax status of the beneficiaries to the extent that the trust's income will be distributed to them pursuant to Subchapter J of the Internal Revenue Code.[166] If the beneficiaries are in the higher tax bracket, a prudent trustee may consider the purchase of tax exempt bonds.[167]

B. Duty to Diversify

Although there was a common law duty under the prudent person standard to reduce the risk of loss by the reasonable diversification of investments,[168] that duty has become one of the fundamental precepts of

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163. Capital gains normally are not included in a trust's distributable net income, and thus generally are not distributed. *See* I.R.C. § 643(a)(3); Treas. Reg. § 1.643(a)-3 (as amended in 2004). *See also* I.R.C. §§ 651-652, 661-662. A trust's capital losses which exceed its capital gains are never distributable to its beneficiaries except in its final year. *See* I.R.C. § 642(h)(1); IRC § 643(a)(3).

164. *See* I.R.C. § 1014.

165. UNIF. PRUDENT INVESTOR ACT § 2 cmt. (2000). A trust may also be included in the gross estate of a beneficiary who was not the settlor. For example, a trust may be included in the surviving spouse's estate if the executor claimed a marital deduction for qualified terminable interest property as provided in I.R.C. § 2056(b)(7) in the estate of the first spouse to die. In this example, the considerations are the same.

166. *See* I.R.C. § 651 and § 661.

167. UNIF. PRUDENT INVESTOR ACT 1994 § 2 cmt. (2000). However, if the income beneficiary is a charity, such a purchase would necessarily be imprudent.

168. RESTATEMENT (SECOND) OF TRUSTS § 228 (1959). In Atwood v. Atwood, 25 P.3d

prudent investing under the Uniform Act. A trustee can virtually eliminate a portfolio's specific risk through diversification, and the overall risk of a diversified portfolio will generally be less than the average risk associated with separate investments.[169] Although diversification generally is desirable,[170] a trustee is left with two important questions: what level of diversification is appropriate, and how should a trustee obtain that result.

There is no map that a trustee can follow to diversify a trust portfolio, and there is no approved list of investments or investment categories that should be included in a model portfolio. In fact, there is almost an infinite variety of defensible investment strategies, particularly when considering an individual trust's specific terms and objectives. The comments to the Restatement make the following observations:

> Significant diversification advantages can be achieved with a small number of well-selected securities representing different industries and having other differences in their qualities. Broader diversification, however, is usually to be preferred in trust investing. Broadened diversification may lead to additional transaction costs, at least initially, but the constraining effect of these costs can generally be dealt with quite effectively through pooled investing. . . . Hence, thorough diversification is practical for nearly all trustees. The ultimate goal of diversification would be to achieve a portfolio with only the rewarded or "market" element of risk.[171]

Effective diversification depends on the number of different investments in the portfolio and how those investments interact with each other in response to economic events.

Although easily stated, the above generalizations provide little practical guidance. Even banks and trust companies, after attempting to

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936 (Okla. Ct. App. 2001), the court acknowledged that a trustee has the duty to diversify under both the prudent person standard and the prudent investor standard. *See supra* notes 69-90.

169. *See* R.A. BREALEY, AN INTRODUCTION TO RISK AND RETURN FROM COMMON STOCKS 103 (2d ed. 1983). For a discussion of the effect of diversification on systemic and specific risk, *see supra* notes 134-150 and accompanying text.

170. In some instances, circumstances dictate that beneficiaries are better served without diversification or a trust instrument (or state law) might abrogate the duty to diversify. *See infra* notes 98-115 and accompanying text.

171. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. g (1992).

digest the model portfolio theory, may be intimidated with the choices and fiduciary obligations that lie ahead. An individual nominated to serve as trustee must remember that the primary purpose of the Uniform Act is to both modernize and liberalize the law relating to trust investments.[172] Although the obligations that the Uniform Act imposes on a trustee are real, a trustee's decisions will be judged as of the time they are made, and not on the basis of hindsight. Courts are hesitant to second guess decisions that a trustee makes in good faith, having full knowledge of the relevant facts and circumstances.[173] Therefore, a trustee's principal exposure may result from its failure to make a good faith effort to diversify a trust's investments.

Historically, it has been difficult to diversify small and moderate trust holdings.[174] Transaction costs make it uneconomic for trustees to purchase a sufficiently diversified portfolio by investing in individual stocks. Professional trustees in Oklahoma have a statutory solution to this problem.[175] Since 1965, banks and trust companies have been permitted to pool assets owned by several trusts into a single fund, proportionately allocating ownership in the investment account among the participating trusts.[176] After pooling assets, the trustee can more easily achieve the desired level of diversification.

Whereas pooling solves one problem relating to economies of scale, it may create another. A trustee should decide upon the investment mix after taking into account the trust terms and other facts and circumstances surrounding the creation of the trust and its beneficiaries. Investments and a level of diversification that are appropriate for a trust whose primary beneficiary is dependent upon the trust's income for support may not be appropriate for a trust that a wealthy settlor establishes and that accumulates income for distribution to future generations who are already wealthy. Since each trust contributing to a pooled fund owns a proportionate interest in that fund,[177] a trustee is unable to adjust a single trust's investments based on other relevant circumstances. Professional trustees may address this concern by creating several investment pools, each having different investment objectives, or by investing a trust's assets separately.[178] A trustee's

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172. *Id.*

173. RESTATEMENT (THIRD) OF TRUSTS § 229 cmt. b (1992).

174. *Id.*

175. OKLA. STAT. tit. 6, § 1010 (2001).

176. *Id.*

177. OKLA. STAT. tit. 6, § 1010(B).

178. Before selecting a professional trustee, settlors should inquire with respect to its

ability to make adjustments between the principal and income for the purposes of calculating a trust's distributable income under the Uniform Principal and Income Act may also alleviate the problem.[179]

All trustees can achieve an adequate level of diversification through the purchase of mutual funds and index funds. Prior to the enactment of the Uniform Act, beneficiaries argued that the purchase of mutual funds amounted to an improper delegation of investment authority to mutual fund advisors.[180] Although there are no cases on point, it appears that Oklahoma trustees were authorized to purchase mutual funds under the prudent person standard.[181]

Regardless of the confusion that may have existed, it is clear that the Uniform Act authorizes the purchase of mutual funds. In this regard, John H. Langbein, the Reporter for the Uniform Act, observes:

> My most confident prediction is that the future will see trustees making ever greater use of pooled investment vehicles. It will be ever less common for a trustee to construct a portfolio of individually selected securities. Increasingly, the main work of the fiduciary investor will be what has come to be called asset allocation. The trustee will form a view of the needs, resources, and risk tolerances of the beneficiaries of the particular trust. The trustee will then decide what proportion of the portfolio to invest in what classes of assets. These choices will take the form of allocating the trust assets among large, diversified portfolios, primarily mutual funds and bank common trust funds. Under the Uniform Act, both the enhanced duty to diversify and the portfolio standard of care point us in that direction. As I have

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investment style and objectives.

179. *See* OKLA. STAT. tit. 60, §§ 175.103-175.104 (2001). For a discussion of the Uniform Principal and Income Act and its interrelationship with the Uniform Prudent Investor Act, *see* Mark R. Gillett and Kathleen R. Guzman, *Managing Assets: The Oklahoma Uniform Principal and Income Act*, 56 OKLA. L. REV. 1 (2003).

180. *See, e.g.*, In re Rees' Estate, 85 N.E.2d 563 (Ohio 1949) (holding that trustees were authorized to purchase mutual funds); Marshall v. Frazier, 80 P.2d 42 (Or. 1938) (holding that the purchase of mutual funds was an improper delegation of a discretionary function).

181. *See* OKLA. STAT. tit. 60, § 175.24(G) (1991) (authorizing trustee to purchase mutual funds consisting of government securities); OKLA. STAT. tit. 60, § 175.55(A) (2001) (authorizing banks and trust companies to purchase mutual funds); Op. Att'y. Gen. 71-303 (June 17, 1971) (authorizing trustees of the Teacher's Retirement System to purchase interests in mutual funds which otherwise comply with the prudent person standard).

previously emphasized, few trusts have the resources to achieve thorough diversification without using pooled vehicles.[182]

The comments to the Restatement make similar observations:

> For example, a relatively small trust pursuing a fairly conservative investment strategy can quite reasonably achieve a desired low-risk portfolio either by relying on suitable mutual funds (or other pooled investment vehicles, including common trust funds in the case of many bank trustees) or by holding a number of securities with a proper mix of volatility characteristics. Similarly, when appropriate to the particular trust, a relatively high level of expected return can be achieved by the trustee through the same types of passive techniques but employing a higher risk portfolio.

The alternative of buying securities of a number of companies, even assuming the trustee has (or obtains through advisers) the understanding and information necessary to select those securities in an appropriate combination, tends to involve relatively high transaction costs for a trust of modest size. Therefore, given the fiduciary duty to avoid excessive administrative expense . . . the alternative of purchasing suitable mutual fund shares may be more inviting to a trustee because it offers a means of obtaining much greater diversification for what will usually be a lower cost. This approach, however, also requires an understanding of the characteristics of particular funds, and attention as well to their management fees and other charges.[183]

If a trustee decides to invest in mutual funds, there are still a myriad of choices. Investing in mutual funds does not automatically provide adequate diversification.[184] Some very broad-based mutual funds may provide adequate diversification, but the fund names and the brief description of their investment styles may be misleading. If the goal is to achieve broad diversification, a trustee should consider the use of index funds that track major market indicators such as the Standard and Poor's 500. In 1973, Burton Gordon Malkiel published his celebrated book, A

182. John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 IOWA L. REV. 641, 655 (1996).

183. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. h (1992).

184. For example, investing all of a trust's assets in gold sector funds would necessarily be imprudent.

Random Walk Down Wall Street.[185] The author argues that in an efficient stock market, stocks are fairly priced, and investors cannot predict prices in the short term. According to Malkiel, a stock-picking "blindfolded chimpanzee throwing darts at the Wall Street Journal" can beat mutual fund managers.[186] Malkiel embraces modern portfolio theory, advising investors to purchase broad index funds which he believes will outperform a professionally managed portfolio over time since investors will avoid expenses and trading costs.[187]

In some instances, the purposes of a trust are better served without diversifying.[188] The comments to the Uniform Act cite two examples where circumstances surrounding a trust may override or limit the duty to diversify. If a trust owns a block of low-basis securities, the tax cost of selling all or a portion of those shares may outweigh the advantages of diversification.[189] Similarly, a trust may own a family farm or business that the trustee and beneficiaries do not want sold.[190]

It is also possible that a trust instrument (and perhaps state law) may override the duty to diversify. In the recent *Atwood* case, the Court of Appeals expressed its opinion with respect to the effect of Oklahoma Statute Title 60, section 175.163 and trust terms on a trustee's duty to diversify.[191]

C. Duty To Be Impartial

The Uniform Act requires a trustee to exercise the care and skill of a prudent investor similarly situated.[192] However, a trustee owes other fiduciary obligations to the beneficiaries that impact the investment of trust assets, including the duty to be impartial. Generally, if a trust has two or more beneficiaries, regardless of whether their interests are

185. (1st ed. 1973). As of 2004, this book is in its seventh edition.

186. BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET INCLUDING A LIFE-CYCLE GUIDE TO PERSONAL INVESTING 15 (1999).

187. Trustees have a fiduciary obligation to minimize expenses. *See* OKLA. STAT. tit. 60, § 175.67 (2001); *see supra* note 183 and accompanying text; *infra* notes 260-263 and accompanying text. Toward that end, the trustee should generally avoid load funds and funds with high expenses. Since index funds are not actively managed, their annual fees tend to be less which makes them more attractive.

188. OKLA. STAT. tit. 60, § 175.63 (2001).

189. UNIF. PRUDENT INVESTOR ACT 1994 § 3 cmt. (2000).

190. *Id.*

191. Atwood v. Atwood, 25 P.3d 936, 943 (Okla. Ct. App. 2001); *see supra* notes 69-90 and accompanying text.

192. UNIF. PRUDENT INVESTOR ACT 1994 § 2 cmt. (2000).

concurrent or successive, a trustee must not favor the interests of one over another.[193] The Uniform Act expressly mandates that a trustee act impartially: "If a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries."[194]

A trustee's obligation to remain impartial is most evident in those trusts where income is payable to one beneficiary for life (or a period of years), with the remainder passing to a different beneficiary. A trustee must balance the income beneficiary's desire to maximize distributable income with the remainderman's desire to protect the assets against inflation. For example, a trustee who regularly invests a significant portion of a trust's assets in certificates of deposit or similar fixed income investments normally subjects the trust to an unreasonable risk with respect to the loss of the real value of its principal, favoring the income beneficiary at the expense of the remainderman.[195]

A trustee has greater discretion when the mandatory income beneficiary is a high bracket taxpayer who does not need, and therefore may not want significant income distributions.

If the beneficiary relies substantially on the trust income for maintenance, and if invasion of principal is not authorized, ordinarily the inference is that the beneficiary's customary support requirements are particularly relevant, although not controlling. On the other hand, the fact that trust income will clearly exceed the life beneficiary's needs is merely one of many considerations to be taken into account. In any event, this lack of need does not permit the trustee, in setting investment objectives, to disregard altogether the income beneficiary's interest in productivity, except upon the informed consent or request of that beneficiary.[196]

A trustee must also be alert to conflicts among beneficiaries when their interests are concurrent. For example, assume that a trustee is required to distribute the trust's income equally to two beneficiaries. If their personal wealth differs, their desire or need for current income, as

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193. RESTATEMENT (SECOND) OF TRUSTS § 183 (1959).

194. OKLA. STAT. tit. 60, § 175.66 (2001).

195. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. d (1992). *See, e.g.*, In re Estate of Cooper, 913 P.2d 393 (Wash. App. 1969) (holding that the trustee who was also the income beneficiary violated his duty of impartiality when the trust investments were weighted heavily in bonds and bond equivalents). Investing heavily in interest bearing obligations may also jeopardize the income beneficiary's long term income stream. Special circumstances may justify the trustee's investment choices.

196. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. i (1992).

opposed to the growth of trust principal, may vary significantly.[197] The comments to the Uniform Act confirm that a trustee must act impartially with respect to the competing interests of each beneficiary.[198] Thus, the trustee must balance the wealthy beneficiary's desire to receive less income (or to receive a greater after tax return from the receipt of tax exempt income) with the other beneficiary's desire to receive more income (or to receive a greater after tax return from the receipt of taxable income).

A few examples in the comments to the Restatement (Third) illustrate the interrelationship between a trust's circumstances and a trustee's duty of impartiality.

[1]. T is successor trustee of a living trust established and previously administered by S, who recently died. The trust is now designed to pay its net income to S's spouse, L, for life, with remainder thereafter to pass by right of representation to the then-living issue of L and S. S's investment program during life was concentrated almost entirely on growth of capital, with a very low income yield. Now, however, the duty of impartiality requires that T make the trust estate, as a whole, productive of income in a trust accounting sense.

[2]. The same facts . . . except that the trust terms also grant T the power to invade principal as needed in order to maintain L's accustomed standard of living. The significance of this additional fact is a matter of interpretation. The ordinary inference, however, is that this power justifies greater deference being paid to T's judgment concerning the inevitably somewhat vague standard of reasonable productivity.

[3]. The [same] facts . . . except that L consents to or encourages an underproductive investment strategy by T. T may now pursue an investment program that produces what would otherwise be an unreasonably low yield overall with an excessive emphasis on growth, provided the standards of the prudent investor rule of this Section are otherwise satisfied.

[4]. A bequeathed and devised her residuary estate to B Bank as trustee for A's spouse and descendants. Under the terms of the trust, H (A's widower) is entitled to receive "such amounts of income or principal or both as B Bank shall deem appropriate for H's comfortable support and care," with the remainder to go by right of representation to A's issue upon H's death. . . . Because the terms of this trust make no

197. The beneficiaries will be required to report on their individual returns the income which the trust receives. *See* I.R.C. § 652.

198. UNIF. PRUDENT INVESTOR ACT 1994 § 2 cmt. (2000).

distinction between income and principal, B Bank's duty of impartiality entails no duty to make a trust property productive. Accordingly, although the normal duties of prudent investing remain, B Bank may adopt an investment strategy that looks to total return without regard to the amount of the trust accounting income included in that return.

[5]. Other provisions of A's will in the preceding Illustration bequeathed specified sums to B Bank to be held in two trusts, each to be administered for certain charitable purposes. The initial corpus of one of these trusts is $250,000. B Bank is directed to invest these funds and to pay the net income quarterly to C Church for purposes to be determined from time to time by certain church authorities. The principal is to be held intact in perpetuity. In prudently investing the funds of this trust, B Bank has a duty to make the trust investments productive, as well as a duty to treat preservation of principal, including its purchasing power, as a consideration in setting investment policy.

[6]. The terms of the second charitable trust mentioned in Illustration 20, to which A also bequeathed $250,000, direct B Bank to distribute $40,000 annually to C College to fund four $5,000 scholarships each semester. This is to continue until the trust estate is exhausted. In investing the funds of this trust, B has no duty to make the investments productive of trust accounting income and may focus entirely on total return. Prudent management of the assets, however, requires appropriate regard for the cash flow needs and other objectives of the trust.[199]

D. Other Related Trustee Duties

The Oklahoma statutory provision merely restates prior law: a trustee is under an obligation to "make a reasonable effort to verify facts relevant to the investment and management of trust assets."[200] The comments provide this example: A trustee loaned money to a third person, securing the debt by a junior mortgage on real estate. However, the trustee failed to have the property appraised and failed to investigate the borrower's unaudited financial statement. The comments conclude that the trustee should be liable for the losses that the trust sustained on the foreclosure of the mortgage.[201]

199. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. i (1992).

200. OKLA. STAT. tit. 60, § 175.62(D) (2001).

201. *See* Estate of Collins, 72 Cal. App. 3d 663 (1977); UNIF. PRUDENT INVESTOR ACT 1994 § 2 cmt. (2000).

This obligation could be interpreted to mean that, in every instance, some investigation is mandated. However, it is unlikely that the statute requires a trustee to check facts available with respect to investments in publicly traded corporations. Such an obligation would be an intolerable burden. Rather, a trustee should only be required to verify those facts that a reasonably prudent investor would verify. However, it is easy to develop a scenario where an investigation might be mandated. For example, if a trustee decides to sell or purchase stock based solely on rumor or innuendo, a prudent investor might use reasonable efforts to verify those claims.

A trustee owes the beneficiaries undivided loyalty, and must invest "assets solely in the interests of the beneficiaries."[202] Both conflicts of interest between the trustee and the beneficiaries and self-dealing between the trustee and the trust assets violate the common law duty of loyalty.[203] Oklahoma Statute Title 60, section 175.65 incorporates the duty of loyalty into the Uniform Act to clarify that the elimination of categoric restrictions of investments does not authorize a trustee to violate its duty of loyalty:

> For example, were the trustee to invest in a second mortgage on a piece of real property owned by the trustee, the investment would be wrongful on account of the trustee's breach of the duty to abstain from self-dealing, even though the investment would no longer automatically offend the former categoric restriction against fiduciary investments in junior mortgages.[204]

In other words, a trustee is not prudently managing the trust's assets if it is compromising the interests of the beneficiaries.[205]

The duty of loyalty encompasses more than potential conflicts of interests. The trustee must always act in the best interests of the trust's beneficiaries.[206] The comments state that a trustee who engages in "social investing" violates its duty of loyalty if the investment results are thereby compromised.[207] In this case, the trustee must establish that its investment decisions did not harm the beneficiaries. Due to the difficulty of proof, a trustee is ill-advised to follow this course unless the trust

202. OKLA. STAT. tit. 60, § 175.65 (2001).
203. RESTATEMENT (SECOND) OF TRUSTS § 170 (1959).
204. UNIF. PRUDENT INVESTOR ACT 1994 § 2 cmt. (2000).
205. UNIF. PRUDENT INVESTOR ACT 1994 § 5 cmt. (2000).
206. *Id.*
207. *Id.*

instrument expressly authorizes social investing or the trustee obtains all of the trust beneficiaries' consent in advance.[208]

The Restatement (Second) of Trusts provides that if a trustee has greater skill than a person of ordinary prudence or procures its appointment by professing to possess greater skill, the trustee will be held to a higher standard of care.[209] The drafters of the Restatement (Third) of Trusts endorsed this double standard:

> [I]t follows from the requirement of care as well as from sound policy that, if the trustee possesses a degree of skill greater than that of an individual of ordinary intelligence, the trustee is liable for a loss that results from failure to make reasonably diligent use of that skill. So also, if a trustee, such as a corporate or professional fiduciary, procured appointment as trustee by expressly or impliedly representing that it possessed greater skill than that of an individual of ordinary intelligence, or if the trustee has or represents that it has special facilities for investment management, the trustee is liable for a loss that results from failure to make reasonably diligent use of that skill or of those special facilities.[210]

The Uniform Act also establishes a higher standard of care for professional trustees. A trustee who possesses special skills or expertise has a duty to utilize those attributes, regardless of whether the settlor acted in reliance on the trustee's representations as to its abilities.[211] Similarly, that same standard of care applies to a trustee that the settlor selects in reliance on its representations that it has special skills, even if it does not, in fact, actually possess them.[212] The effect of Oklahoma Statute Title 60, section 175.62(F) is to provide a sliding standard for prudence. The standard applied to a professional trustee is the standard for prudent professionals. Although the statute is silent, the comments make clear that family members and other nonprofessional trustees must act as prudent amateurs.[213]

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208. *Id.*

209. RESTATEMENT (SECOND) OF TRUSTS § 174 (1959). Oklahoma courts have not addressed whether professional trustees are held to a higher standard of care.

210. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. i (1992).

211. *Id.*

212. *Id.*

213. UNIF. PRUDENT INVESTOR ACT 1994 § 2 cmt. (2000).

If a trust has both professional and individual trustees, the Uniform Act imposes different standards on each trustee.[214] Thus, a professional co-trustee may be liable for an imprudent investment decision while an individual co-trustee may escape surcharge.

V. DELEGATION OF INVESTMENT AUTHORITY

There have always been restrictions on a trustee's ability to delegate its fiduciary responsibilities, and there is a rational basis for these constraints. The selection of a trustee evidences the settlor's special trust in a person or entity. It necessarily follows that the individual in whom such trust is placed personally performs the important functions associated with a trust's administration. The Restatement (Second) of Trusts endorsed this rule, concluding that a trustee could not delegate the power to make investments.[215]

At the same time, courts acknowledged that it was unreasonable to expect a trustee to perform all associated tasks.[216] In the past, courts attempted to distinguish between discretionary and ministerial functions. A trustee could not delegate discretionary functions since a settlor could have reasonably expected that the named trustee would fulfill these obligations.[217] However, courts permitted the delegation of ministerial functions, such as the hiring of attorneys and accountants. Although it was difficult to characterize specific functions, the cases uniformly concluded that a trustee could not delegate to an agent the power to select investments.[218] If a trustee improperly delegated its responsibilities, it was liable for all losses, not just those attributable to a trustee's or agent's negligence.[219]

This standard generally proved unworkable. Courts recognized that few acts are purely ministerial since most entail the use of some judgment and discretion.[220] Even the drafters of the Restatement (Second) acknowledged that there was no clear demarcation between those duties that a trustee could delegate and those that it could not.[221]

214. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. d (1992).

215. RESTATEMENT (SECOND) OF TRUSTS § 171 cmt. h (1959).

216. *Id.*

217. *Id.*

218. *Id.* It was proper, however, for a trustee to act upon recommendations made by an investment advisor which a trust employed.

219. *Id.*

220. *Id.*

221. RESTATEMENT (SECOND) OF TRUSTS § 171 cmt. d (1959).

As a result, some courts began to adopt a "prudent delegation" test: whether ordinary prudent businessmen would delegate the specific task to a third person.[222] The Restatement (Third) of Trusts adopted this standard.[223]

There was no clear guidance in Oklahoma prior to the enactment of the Uniform Act. Oklahoma cases recognized that trustees were not permitted to delegate the administration of a trust among themselves[224] or to others,[225] and there is some evidence that the Oklahoma Supreme Court would have followed the nondelegation rule set forth in the Restatement (Second).[226] However, there are no Oklahoma decisions that distinguished between delegatable and nondelegatable powers.

Regardless of what the law in Oklahoma might have been, it is clear that the Uniform Act has changed it with respect to the delegation of investment authority. Oklahoma Statute Title 60, section 175.69 provides as follows:

> Delegation of Investment and Management Functions.
>
> A. A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in:
>
> 1. Selecting an agent;
>
> 2. Establishing the scope and terms of the delegation, consistent with the purposes and terms of a trust; and
>
> 3. Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.

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222. For a detailed discussion of the evolution of these rules, *see* Langbein, *supra* note 182; John H. Langbein, *Reversing the Nondelegation Rule of Trust-Investment Law*, 59 MO. L. REV. 105 (1994).

223. RESTATEMENT (THIRD) OF TRUSTS § 171 (1992).

224. Cooper v. Fed. Nat'l Bank of Shawnee, 53 P.2d 678 (Okla. 1935).

225. Johnson v. Clark, 518 F.2d 246 (10th Cir. 1975); Harrison v. Barton, 358 P.2d 211 (Okla. 1960).

226. *Johnson*, 518 F.2d 246 (applying Oklahoma trust law in a bankruptcy decision).

> 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 of this section is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.
>
> D. By accepting the delegation of a trust function from the trustee of a trust that is subject to the laws of this state, an agent submits to the jurisdiction of the courts of this state.[227]

Rather than attempting to distinguish discretionary from ministerial acts, the Uniform Act focuses on the actions of a "prudent trustee of *comparable* skills." As discussed below, it may be prudent for a family member serving as trustee to delegate some (or all) investment authority to a professional. It probably would be imprudent under the Uniform Act for a trust company or other professional trustee to abdicate this responsibility.[228] The terms of a trust instrument control in the event they are inconsistent with the above provision.[229]

A trustee must first develop the trust's investment strategies and objectives, regardless of whether it subsequently determines to delegate investment authority.[230] In creating these guidelines, a trustee must consider the settlor's intent, the trust terms, and the beneficiaries' personal situations.[231] A trustee is generally in the best position to assess these contributing factors. However, depending on a trustee's

227. OKLA. STAT. tit. 60, § 175.69 (2001).

228. The Uniform Act may be inconsistent with OKLA. STAT. tit. 6, § 1735 (2001), which permits trust companies to delegate investment duties to third persons. However, that section provides that the trustee remains responsible for the due performance of any delegated fiduciary function. In this regard, *compare* OKLA. STAT. tit. 6, § 1735(B) (2001) *with* OKLA. STAT. tit. 60, § 175.69(C) (2001).

229. For a general discussion with respect to whether a trust instrument overrides a trustee's obligations under the Uniform Act, *see supra* notes 59-115 and accompanying text.

230. OKLA. STAT. tit. 60, § 175.69(A)(2) (2001).

231. For a full discussion of developing investment strategies and theories, *see* RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. h (1992).

sophistication, it may be prudent for a trustee to review and approve investment objectives that a third person develops.[232]

A trustee must then determine whether it is prudent to delegate all or a portion of the investment authority to a third person. The comments to the Restatement (Third) discuss relevant factors:

> These include the knowledge, skill, facilities, and compensation of both the trustee and the prospective agents. Also of importance are such considerations as the size of the trust estate and the burdens and complexity of both the assets to be managed and the strategies to be implemented. Active investment strategies, for example, especially in low efficiency markets such as real estate and venture capital, are likely to require the hiring of agents with special skills not possessed by many trustees, often not even by professional or corporate fiduciaries.[233]

In certain cases, a trustee may have the *duty* to delegate investment authority. This is certainly true under the Restatement which forms the basis for the Uniform Act.[234] However, Oklahoma Statute Title 60, section 175.69(A) provides only that a trustee "*may* delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances."[235] Although a trustee may argue that this language fails to impose a duty to delegate, such an interpretation is too restrictive. The modern trend favors delegation, and both the Uniform Act and the Restatement are hostile to the nondelegation rule.[236] An example in the comments to the Restatement illustrates:

> The trustees of a large trust, after consultations and study, have reasonably concluded that it would be desirable as a part of an overall portfolio strategy to have a portion of the trust estate

232. RESTATEMENT (THIRD) OF TRUSTS § 227 (1992).

233. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. j (1992).

234. "In administering the trust's investment activities, the trustee has the power, and *may sometimes have a duty*, to delegate such functions and in such manner as a prudent investor would delegate under the circumstances." *Id.* (emphasis added).

235. OKLA. STAT. tit. 60, § 175.69(A) (2001) (emphasis added). The Restatement states a trustee "must act with prudence in deciding whether and how to delegate authority." RESTATEMENT (THIRD) OF TRUSTS § 227(c)(2) (1992).

236. *See* UNIF. PRUDENT INVESTOR ACT 1994 § 9 cmt. (2000); Langbein, *supra* note 222.

> committed to a venture capital investment program. They also have reasonable grounds for preferring to do this directly by holding the company shares in the trust estate, rather than by purchasing shares of some suitable stock mutual funds or other venture capital pools . . . the trustees therefore wish to hire agents with specialized skills to manage the program. In this situation, substantial but prudent delegation is justifiable.[237]

The comments conclude that the trustees in the above example have a duty to delegate management activities in some reasonable fashion unless the trustees personally possess the necessary expertise to manage a venture capital program.[238]

Assume a more typical example. A settlor nominates a family friend to serve as the trustee of a moderate sized testamentary trust, which provides for discretionary distributions to the settlor's descendants. The settlor selected her friend because he was uniquely positioned to appreciate both her desires and her descendants' proclivities. Although the trustee is qualified to make distribution decisions, he has no investment experience. Under these circumstances, it is clear that the trustee may delegate investment authority to a third person, assuming that he satisfies the other requirements of Oklahoma Statute Title 60, section 175.69. The more difficult question is whether the trustee is *required* to delegate this authority. Under the prudent person standard, a trustee would have been permitted to seek investment advice, but would have been required to exercise his own judgment in determining whether to follow that advice.[239] Under the Uniform Act, the focus changes from a prudent person to a prudent investor.[240] Whether the trustee makes the investment decisions after relying upon advice from a third person or whether he actually delegates the investment authority to a third person is perhaps a question of semantics. Since the trustee has no investment experience, he must pursue one of these alternatives.[241] Perhaps the more cautious approach is to delegate the responsibility to a third person.[242]

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237. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. j (1992).

238. *Id.*

239. *See* RESTATEMENT (SECOND) OF TRUSTS § 227 cmt. b (1959). *See also* Shriners Hosp. for Crippled Children v. Gardiner, 733 P.2d 1110 (Ariz. 1987) (holding that an unsophisticated trustee could seek advice from a third person but could not permit that person to make unsupervised investment decisions).

240. UNIF. PRUDENT INVESTOR ACT 1994 § 2 (2000).

241. The Restatement (Third) continues to authorize a trustee to personally act upon the advice received from third persons. *See* RESTATEMENT (THIRD) OF TRUSTS § 171 cmt.

The court will intervene in the delegation of investment authority only if the trustee has abused its discretion.[243] A trustee's decision will not be deemed an abuse of discretion merely because the court would have exercised the power differently or would not have exercised the power at all.[244] However, the trustee must exercise discretion honestly, fairly, and reasonably to accomplish the purposes for which the settlor established the trust.[245] In reviewing a trustee's action or inaction, the issue generally becomes whether the trustee failed to exercise the required degree of care, skill, or caution.[246] Disgruntled beneficiaries should be warned that courts are hesitant to second guess a trustee's decision if it acted honestly and without improper motivation. Furthermore, an appellate court will not disturb the trial court's decision unless it is clearly against the weight of the evidence.[247]

If a trustee elects to delegate investment authority, it must exercise reasonable care in selecting the agent and establishing the terms of the delegation.[248] The terms must be consistent with the trust's investment strategies and objectives.[249] In other words, a trustee must give the agent guidance with respect to the investment goals. Both a trustee and the agent benefit if these directions are as detailed as possible and in writing. The written document establishes that a trustee has complied with its obligation to communicate to the agent the scope and terms of the delegation and helps the agent establish that he or she invested within his or her authority.[250]

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c (1992).

242. If a trustee properly delegates investment authority, a trustee is not personally liable for the decisions or actions of the agent. *See* OKLA. STAT. tit. 60, § 175.69(C) (2001). If a trustee seeks advice but personally makes the investment decisions, a trustee must comply with the prudent investor rule, increasing the trustee's potential exposure. OKLA. STAT. tit. 60, §§ 175.61-175.63 (2001).

243. *See* RESTATEMENT (SECOND) OF TRUSTS § 187 (1959); Stallard v. Johnson, 116 P.2d 965 (Okla. 1941); Buck v. Caveat, 353 P.2d 476 (Okla. 1960); Robinson v. Kirbie, 793 P.2d 315 (Okla. Ct. App. 1990).

244. RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. e (1959).

245. *Buck*, 353 P.2d 475; *Stallard*, 116 P.2d 965.

246. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. j (1992).

247. *See, e.g.*, *Robinson*, 793 P.2d 315; *Buck*, 353 P.2d 475 (Okla. 1960).

248. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. d (1992).

249. As discussed above, a trustee may not delegate the obligation to develop the investment strategies and objectives. However, depending on a trustee's sophistication, it may be prudent for a trustee to review and approve investment objectives which a third person develops. *See* RESTATEMENT (THIRD) OF TRUSTS § 227 (1992).

250. RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. j (1992).

A trustee is also obligated to periodically review the agent's actions and performance. Although a trustee's selection of an agent may be questioned, a trustee may more easily subject itself to liability by failing to adequately monitor the agent. In this respect, a trustee must continue to act as a prudent investor.[251] Because the standard is intentionally vague, it is impossible to state with certainty how often a trustee should review the agent's decisions. The reasonableness of a trustee's actions will depend, in part, on the nature and size of the investment portfolio and market conditions in general. More frequent inquiries are appropriate if the portfolio includes speculative investments or if the overall market is trending downwards. Reviewing the investments and the agent's actions annually would always be imprudent.[252]

If a trustee complies with its obligation to exercise prudence regarding the selection of an agent, the delegation of investment authority, the establishment of the scope and terms of the delegation, and the review of the agent's actions, a trustee is not liable to the beneficiaries or to the trust for the agent's actions, even if the agent fails to comply with his or her obligations.[253] If a court determines that a trustee failed to exercise prudence with respect to the delegation, the question remains whether a trustee will be liable for all losses that the trust incurred. Although Oklahoma Statute Title 60, section 175.69 does not expressly address this issue, a trustee's liability should be limited to the losses attributable to those acts which, if performed by the trustee, would constitute a breach of trust.[254] When there existed a broad prohibition against the delegation of investment authority, it was appropriate to hold a trustee responsible for all resulting losses.[255] Since Oklahoma Statute Title 60, section 175.69 authorizes delegation in appropriate circumstances, a trustee's liability should be limited to only those damages proximately caused by a trustee's failure to comply with the statutory requirements.

251. *Id.*

252. In the age of the internet, ask how often a prudent investor looks at his or her portfolio and investment results.

253. OKLA. STAT. tit. 60, § 175.69(C) (2001). However, a trustee's continued failure to discover an agent's malfeasance or nonfeasance may persuade a court to conclude that a trustee failed to exercise reasonable care in monitoring the agent.

254. The Restatement endorses this approach. *See* RESTATEMENT (SECOND) OF TRUSTS § 225 (1959), expressly referenced by the RESTATEMENT (THIRD) OF TRUSTS § 171 cmt. k (1992).

255. Compare this with a trustee's sale of a trust asset when that sale is expressly prohibited by a trust instrument. *See supra* notes 98-100 and accompanying text.

The agent must exercise reasonable care to comply with the terms of the delegation.[256] Thus, the agent must be concerned about the clarity of the trust's investment objectives and the precise scope of the delegation.[257] Furthermore, a trustee cannot agree to indemnify the agent since releasing the agent from responsibility would be an imprudent delegation of investment authority and would impose on the trustee personal liability for any related losses.[258] The Uniform Act also provides that by accepting the delegation, the agent submits to the jurisdiction of the Oklahoma courts.[259]

The authors of the Uniform Act were sensitive to the deleterious effect that the delegation of investment authority might have on administration fees. Under the common law, imprudently wasting trust assets was considered a breach of a trustee's fiduciary obligations. The Uniform Act expressly provides for the same result: "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 a trust, and the skills of a trustee."[260]

The trustee fees, in part, compensate for the trustee's investment activities. If a trustee delegates a portion of this function to a third person who charges a fee based on the value of the investments supervised, it should "ordinarily follow" that a trustee will lower its own fees.[261] The issues blur when the advisor charges a commission on purchases and sales rather than a scheduled fee. A trustee is obligated to implement strategies to minimize costs.[262] Trustee intervention is mandated if the agent is churning the account. Even if the number of trades appear reasonable, a trustee should be sensitive to the total commissions paid as compared to the amounts that would have been payable had the trustee made the investment decisions and trades.[263]

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256. UNIF. PRUDENT INVESTOR ACT 1994 § 9 cmt. (2000). If the agent fails to comply with his or her obligations, the agent must answer to the trust. Although the statute does not give the beneficiaries a direct cause of action against the agent, they can force the trustee to pursue the trust's cause of action.

257. A trustee is obligated to establish the scope and terms of the delegation. *See* OKLA. STAT. tit. 60, § 175.69(A)(2) (2001). To the extent that it failed to use reasonable care in its creation, the trustee should be liable rather than the agent.

258. OKLA. STAT. tit. 60, § 175.69(A)(2).

259. OKLA. STAT. tit. 60, § 175.69(D).

260. OKLA. STAT. tit. 60, § 175.67 (2001).

261. UNIF. PRUDENT INVESTOR ACT 1994 § 9 cmt. (2000).

262. UNIF. PRUDENT INVESTOR ACT 1994 § 7 cmt. (2000).

263. Even if a trustee does not delegate investment authority, a trustee has a duty to avoid unreasonable costs. A beneficiary could legitimately argue that a trustee who

Excessive commissions may also warrant a reduction in the trustee's normal fee.

VI. DUTIES AT TRUST'S INCEPTION

The Uniform Act imposes the following obligations whenever a person accepts a trusteeship or a trustee receives additional assets:

> 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 the Oklahoma Uniform Prudent Investor Act.[264]
>
> The above provision obligates a trustee to determine whether the investments that the trust receives from the settlor comply with the prudent investor standard[265] and are appropriately diversified.[266] These duties also arise when a successor trustee is appointed.[267]

A trustee cannot accomplish these tasks without first determining the trust's purposes, terms, distribution requirements, and other relevant circumstances.[268] The trust terms (and perhaps state law)[269] may

makes its own investment decisions may breach its fiduciary obligations by investing with a full commission broker rather than placing the trades through a discount broker on the internet. Does a reasonably prudent investor, similarly situated, agree to pay full commissions on his or her stock trades?

264. OKLA. STAT. tit. 60, § 175.64 (2001). The above language is modeled after the Restatement (Third) of Trusts, and therefore it serves as an interpretational guide. *See* RESTATEMENT (THIRD) OF TRUSTS § 229 (1992).

265. OKLA. STAT. tit. 60, § 175.62 (2001). For a complete discussion of the prudent investor standard, *see supra* notes 124-167 and accompanying text.

266. OKLA. STAT. tit. 60, § 175.63 (2001). For a complete discussion of the duty to diversify, *see supra* notes 168-191 and accompanying text.

267. The statute imposes this obligation "after accepting a trusteeship." OKLA. STAT. tit. 60, § 175.64 (2001). The comments make it clear that the obligation is also imposed on successor trustees. *Id.*

268. A trust's purposes, terms, and circumstances affect all of a trustee's obligations under the Uniform Act and are explicitly referenced in OKLA. STAT. tit. 60, § 175.62(A) (2001) (establishing the prudent investor rule), OKLA. STAT. tit. 60, § 175.63 (2001) (establishing the duty to diversify), and OKLA. STAT. tit. 60, § 175.64 (2001) (establishing

authorize or direct the retention or disposition of certain assets and thus override a trustee's obligation to bring a trust into compliance with the Uniform Act.[270]

The Uniform Act requires a trustee to bring a trust into compliance within a "reasonable time" after becoming trustee or receiving additional trust assets.[271] In the Restatement (Second), the comments indicate that this responsibility ordinarily should be completed within twelve months.[272] This guideline proved either unworkable or useless, and the comments to the Restatement (Third) omitted the reference to twelve months.[273] Rather than setting an arbitrary deadline, the Uniform Act requires a trustee to fulfill its statutory obligations prudently and without unreasonable delay.[274] The comments to the Restatement (Second) observe:

> The question in each case is whether, under all the circumstances, the trustee acted with prudence in making or delaying the sale. The question may be affected by the terms of the trust. It may also be affected by the trustee's investment strategy, and by long-term and short-term plans and opportunities for reinvestment. In addition, the reasonableness of the delay in making a disposition depends on such factors as: the nature of the property involved; the reason the trustee is required to sell it; whether appraisals are necessary; whether there is a ready market for the property; and the relative degree of price efficiency in that market. Even though the trustee has

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duties at a trust's inception).

269. OKLA. STAT. tit. 60, § 175.163 (2001).

270. In Atwood v. Atwood, 25 P.3d 936, 943 (Okla. Ct. App. 2001), the Oklahoma Court of Appeals recently expressed its opinion with respect to effect of state law and trust terms on a trustee's duty to diversify. For a complete discussion of the Atwood decision and whether a trustee's responsibilities under OKLA. STAT. tit. 60, § 175.64 (2001) have been abrogated, *see supra* notes 69-90 and accompanying text.

271. OKLA. STAT. tit. 60, § 175.64 (2001).

272. RESTATEMENT (SECOND) OF TRUSTS § 230 cmt. b (1959). The comments did acknowledge that in some circumstances the duties should be completed earlier and in other circumstances it may take longer. *Id.*

273. UNIF. PRUDENT INVESTOR ACT 1994 § 4 cmt. (2000).

274. OKLA. STAT. tit. 60, § 175.64 (2001).

opportunities to sell the property, it may be proper for the trustee to delay sale in order to avoid selling at a sacrifice.[275]

Although the above guidelines are easy to recite, they are difficult to apply. Perhaps a trustee's best advice is to commence the review process immediately upon a trust's inception (or after accepting a trusteeship) and work diligently until it has determined and implemented its course of action. It would be imprudent, per se, to perform these responsibilities in a dilatory manner.[276] At the same time, a trustee may be liable for imprudently selling an asset too quickly or for accepting an inadequate price.[277]

Although this seems to place an onerous burden on the trustee, a court will evaluate a trustee's decisions as of the time they are made, and not on the basis of hindsight.[278] Courts are hesitant to second guess decisions which a trustee makes in good faith, having full knowledge of the relevant facts and circumstances.[279] Therefore, as in other situations, perhaps a trustee's greatest exposure results from its failure to make a good faith effort to comply with the requirements of Oklahoma Statute Title 60, section 175.64.[280]

VII. CONCLUSION

With the enactment of the Uniform Prudent Investor Act and the Uniform Principal and Income Act, the legislature has provided Oklahoma trustees with flexible and complementary tools to permit successful investments. The total return approach adopted by the Uniform Prudent Investor Act permits trustees to make decisions free of the constraints of historical principles of prudence. The Uniform Principal and Income Act permits trustees to adjust between income and principal so that they are no longer constricted by the antiquated concepts of income and principal.[281] Together, these Acts empower trustees to administer trusts in the best interests of all beneficiaries.

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275. RESTATEMENT (THIRD) OF TRUSTS § 229 cmt. b (1992).

276. This must be distinguished from a situation where a trustee has given due consideration to the retention or sale of an asset and has made the conscience decision to retain that asset.

277. *See* RESTATEMENT (THIRD) OF TRUSTS § 229 cmt. b (1992).

278. *Id.*

279. *Id.*

280. This, of course, could result from a trustee's ignorance of the provision.

281. *See* Gillett & Guzman, *supra* note 179.

It is incumbent on Oklahoma practitioners and trustees to become more familiar with both Uniform Acts. Only by familiarity with the acts and appreciation for their provisions will Oklahoma practitioners be able to properly advise both settlors and trustees.