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# Reversing the Nondelegation Rule of Trust-Investment Law

John H. Langbein\*

The nondelegation rule has been a familiar feature of the doctrinal landscape of the Anglo-American law of trusts. In the formulation of the Restatement of Trusts (Second) of 1959, the rule places the trustee "under a duty to the beneficiary not to delegate to others the doing of acts which the trustee can reasonably be required personally to perform."<sup>1</sup> The nondelegation rule was thought to apply with particular force to the trustee's investment responsibilities. The Restatement (Second) says flatly: "A trustee cannot properly delegate to another power to select investments."<sup>2</sup>

The new Restatement of Trusts (Third): Prudent Investor Rule, completed in 1992, rejects the nondelegation rule of the 1959 Restatement. The 1992 Restatement—hereafter, Restatement (Third)—is a partial revision of the Restatement (Second), limited to matters bearing on trust-investment law. Not only does the Restatement (Third) approve delegation, it imposes upon the trustee a positive duty to act prudently in considering "whether and how to delegate" investment functions.<sup>3</sup> A projected Uniform Prudent Investor Act (UPIA), scheduled for approval by the Uniform Law Commission in 1994, implements the prodelegation position taken in the Restatement (Third) and articulates standards for effective delegation.<sup>4</sup> The changed attitude toward delegation that characterizes the Restatement (Second) and UPIA was foreshadowed across the previous decades in a series of influential enactments that endorsed the delegation of fiduciary investment responsibilities: the Uniform Trustees' Powers Act in 1964, the Uniform Institutional Management of Funds Act (UMIFA) in 1972, and ERISA, the federal pension law, in 1974.<sup>5</sup>

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1. RESTATEMENT (SECOND) OF TRUSTS § 171 (1959). The Restatement (Second) carries this language forward from the Restatement (First). See RESTATEMENT OF TRUSTS § 171 (1935).

2. RESTATEMENT (SECOND) OF TRUSTS § 171 cmt. h (1959). For supporting authority see 2A AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS § 171.2, at 446-47 & n.8 (4th ed. 1987) (1987-91) [hereafter cited as SCOTT & FRATCHER].

3. RESTATEMENT (THIRD) OF TRUSTS § 227(c)(2) (1992).

4. Discussed *infra* in Part III of this Article.

5. These legislative developments are discussed *infra*, text accompanying notes 25-41.

This movement from nondelegation to delegation seems to entail a doctrinal *volte face*. A main theme of the present Article, however, is that there is less to this change than meets the eye. Practice under the nondelegation rule has led to the repudiation of the rule. Nevertheless, the new delegation rule may affect future patterns of trusteeship. By making it easier for trustees to externalize the investment function, the reformed law will encourage persons who lack investment expertise—for example, family members and lawyers—to serve as trustees.

The nondelegation rule is a fitting subject to address in a *Festschrift* for William Fratcher. Throughout his illustrious career as a scholar of trust and estate law, Fratcher took a special interest in the delegation question. In an influential article published three decades ago, he drew attention to the benign experience of the English and Commonwealth jurisdictions in largely ridding themselves of the nondelegation rule.<sup>6</sup> Fratcher's revision of *Scott on Trusts*<sup>7</sup> contains the authoritative account of delegation questions on the eve of the Restatement (Third). As a member of the American Law Institute's Board of Advisors for the Restatement (Third),<sup>8</sup> Fratcher contributed his experienced hand to the reform that is discussed in this Article.

## I. THE NONDELEGATION RULE

### A. Purposes of the Rule

It's hard to quibble with the idea that a trustee has a duty "not to delegate to others the doing of acts which the trustee can reasonably be required personally to perform,"<sup>9</sup> which is the way that the Restatement (Second) expresses the nondelegation rule. The trouble is that this formulation begs its own question: When, indeed, is it "reasonable" to require the trustee to perform some act of trust administration in person? The standard of reasonableness directs attention to the purposes of the nondelegation rule. Only by identifying the purposes can we ascertain whether particular conduct is reasonable.

1. *Trustee succession.* The most important function that the nondelegation rule serves is to reinforce the well-settled requirement of trust

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6. William F. Fratcher, *Trustees' Powers Legislation*, 37 N.Y.U. L. REV. 627, 639-40, 660 (1962). Regarding the modern English law, see Dennis Paling, *The Duty to Act Personally*, 125 NEW L.J. 56 (1975); Gareth H. Jones, *Delegation by Trustees: A Reappraisal*, 22 MODERN L. REV. 381 (1959). For recent judicial authority, see *Steel v. Wellcome Custodian Trustees, Ltd.*, [1987] 1 W.L.R. 167 (Ch. Div.).

7. 2A SCOTT & FRATCHER, *supra* note 2, § 171, at 437-51.

8. See *preface to* RESTATEMENT (THIRD) OF TRUSTS, at v (1992).

9. RESTATEMENT (SECOND) OF TRUSTS § 171 (1959).

law that a trustee may not resign the trusteeship without permission of the court.<sup>10</sup> This protective requirement operates to assure that trustee succession will occur in an orderly fashion, with notice to interested parties, usually incident to a fiduciary accounting. By forbidding the trustee to delegate the "whole responsibility for the administration of the trust,"<sup>11</sup> the nondelegation rule prevents a trustee from evading the rule against unsupervised resignation of the trust. If total delegation of the trust were permitted, the trustee could effectively install a successor trustee in the guise of agency without complying with the safeguards for trustee succession.

Notice, however, that this concern has nothing to do with the question of whether a trustee might intelligently delegate a particular function, in order to take advantage of an agent's superior skill, facilities, economies of scale, or the like. Delegation of trust investing responsibilities to an outside investment advisor typifies such a situation.

2. *Personal trusteeship.* Another value that lurks in the nondelegation doctrine is the notion that the personality of the trustee is sometimes central to the purpose of the trust. In such a case, allowing the particular trustee to delegate the office would defeat the purpose and the reliance of the settlor in creating the trust.<sup>12</sup> However, the case in which the creation of the trust is conditioned upon the personality of the trustee is in general rare, and is as a practical matter unknown in trust-investment matters. We can write the terms for such a trust (e.g., "This trust shall fail of creation or shall terminate if George Smith shall be unwilling or unable to conduct the trust's investments"), but it is easy to understand why people do not create such conditions. Investment professionals abound. The settlor may prefer one over others, just as I might prefer one surgeon over others, but if that surgeon is unavailable, I am likely to accept a close substitute rather than to decline cure.

The question of policy for trust law is, therefore, whether the default rule ought to presume this special concern with the personality of the trustee. If the default rule of the Restatement (Second) were reversed, and the power to delegate were presumed, as the Restatement (Third) and the draft UPIA have now done, the settlor of any particular trust would still be able to impose the opposite rule, insisting by apt drafting that the investment function or some other attribute of the administration of the trust be nondelegable.

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10. *Id.* § 106.

11. 2A SCOTT & FRATCHER, *supra* note 2, § 171.1, at 439. *See id.* at 440-41 (regarding special measures to facilitate total delegation in the case of a trustee called to active military duty).

12. Scott hints at this notion in explaining the nondelegation rule: "This duty [to perform the trust personally] is imposed on the trustee not because of any provisions in the terms of the trust, but because of the relationship that arises from the creation of the trust." 2A SCOTT & FRATCHER, *supra* note 2, § 171, at 437-38.

3. *Cost.* Yet another issue that underlies the nondelegation doctrine is concern about "double dipping." If the trustee is charging for investment services, the trust should not have to pay again to have an outside investment manager do the job. But the nondelegation rule is a clumsy tool for protecting against overcharging. Trust law already imposes upon the trustee an independent duty of reasonableness in incurring expenses.<sup>13</sup> Both the Restatement (Third) and the proposed Uniform Prudent Investor Act look to that safeguard for protecting against overcharging in delegation settings.<sup>14</sup>

4. *Discretionary functions.* No version of the nondelegation rule proscribes all delegation. Because the traditional rule applies to acts that the trustee "can reasonably be required personally to perform,"<sup>15</sup> the inference follows that some acts need not be performed personally. And indeed, it has been commonplace under the nondelegation rule for trustees to employ lawyers, accountants, investment advisors, brokers, and other specialized service providers. When a piece of residential real estate is held in trust for family members, the list of agents whom the trustee may employ can lengthen to include the panoply of household providers—gardeners, plumbers, cleaning staff, house painters, and so forth. The trustee does not have to take out the garbage or paint the house in person. These are tasks that, in the parlance of the Restatement (Second), the trustee cannot "reasonably be required to perform."<sup>16</sup>

The Restatement (Second) supplies little guidance on what makes some delegation reasonable and some not. The official comment admits that the drafters could identify no "clear-cut line dividing the acts which a trustee can properly delegate from those which he cannot properly delegate."<sup>17</sup> Instead of a standard, the Restatement (Second) points to some illustrative factors, including "the amount of discretion involved," the size of the assets in question, and the trustee's ability to deal with the matter.<sup>18</sup> The emphasis on

13. RESTATEMENT (SECOND) OF TRUSTS § 188 (1959). The Restatement (Third) incorporates this obligation in its revised prudent investor rule. RESTATEMENT (THIRD) OF TRUSTS § 227(c)(3) (1992).

14. RESTATEMENT (THIRD) OF TRUSTS § 227 (1992); UNIFORM PRUDENT INVESTOR ACT §§ 7, 10, and comments (August 23, 1993, draft).

15. RESTATEMENT (SECOND) OF TRUSTS § 171 (1959), reproduced *supra* text accompanying note 1.

16. *Id.*

17. *Id.* § 171 cmt. d, at 374.

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

In considering what acts a trustee can properly delegate the following circumstances, among others, may be of importance: (1) the amount of discretion involved; (2) the value and character of the property involved; (3) whether the property is principal or income; (4) the proximity or remoteness of the subject matter of the trust; (5) the character of the act as one

distinguishing between "ministerial" functions that the trustee may delegate from "discretionary" functions that are nondelegable has proved to be a labeling game, because "even the most menial of tasks involves *some* discretion."<sup>19</sup>

Whatever the difficulty of distinguishing the discretionary from the ministerial elsewhere in trust administration, the Restatement (Second) treats the investment function as an easy case. "A trustee cannot properly delegate to another power to select investments."<sup>20</sup> Nevertheless, the nondelegation rule of the Restatement (Second) allows the trustee to employ outside investment advisors, so long as the trustee forms an independent judgment about the merits of the investment that the advisors recommended. Often enough, this results in de facto delegation. "When the investment advisor 'recommends' and the trustee routinely 'decides' to follow the advice, the trustee in reality is delegating the selection of investments."<sup>21</sup> In these cases the nondelegation rule, by promoting makework, collides with the policy of minimizing expenses. Thus, the nondelegation rule that is bottomed to some extent on a policy against double dipping actually promotes double dipping.

### B. Questioning the Default Rule

We have seen that, although it makes sense to forbid total delegation of the trust, the rule preventing the trustee from delegating particular functions, especially trust investing, is hard to justify. The inability to distinguish effectively between discretionary functions that are nondelegable and ministerial tasks that can be delegated reflects the inability to articulate clear purposes for the nondelegation rule.

Virtually all trust law is default law—rules that the settlor can overturn by apt drafting—and nondelegation is no exception. A well-drafted trust instrument can easily defeat the nondelegation rule. Model trust instruments in current formbooks authorize broad delegation.<sup>22</sup> Because trust profession-

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involving professional skill or facilities possessed or not possessed by the trustee himself.

19. William L. Cary & Craig B. Bright, *The Delegation of Investment Responsibility for Endowment Funds*, 74 COLUM. L. REV. 207, 224 (1974) (emphasis in original).

20. RESTATEMENT (SECOND) OF TRUSTS § 171 cmt. h (1959), discussed *supra* text accompanying note 2.

21. John H. Langbein & Richard A. Posner, *Market Funds and Trust-Investment Law*, 1976 AM. B. FOUND. RES. J. 1, 20.

22. *E.g.*, 18 HENRY J. LISCHER JR. & DONALD J. MALOUF, WEST'S LEGAL FORMS: ESTATE PLANNING WITH TAX ANALYSIS: WILLS, TRUSTS AND RELATED DOCUMENTS § 22.3(10), at 556 (1985).

als are hostile to the nondelegation rule, the rule works mostly as a trap for the unwary—that is, for persons served by bad lawyers or by no lawyers.

The case for permitting trustees to delegate various aspects of trust administration, especially investment functions, is straightforward. The circumstances of modern life that have resulted in ever greater specialization and expertise elsewhere in economic and administrative life affect trust administration as well. The trust originated as a relatively passive or inactive stakeholder's device, primarily used for conveying real property within the family. Over the last century or so, awesome changes have occurred in the patterns of private wealthholding.<sup>23</sup> When ancestral land was the characteristic trust asset, trust administration required of the trustee relatively little expertise or authority. Trustees were mostly stakeholders, and the family lived on the estate and managed its affairs. Today, by contrast, financial instruments have become the typical assets of the trust, and these assets require active fiduciary administration. Managing a portfolio of marketable securities is as demanding a specialty as stomach surgery or nuclear engineering. There is no more reason to expect the ordinary individual serving as a trustee to possess the requisite investment expertise than to expect ordinary citizens to possess expertise in gastroenterology or atomic science.

It is inevitable, therefore, that well-intentioned trustees will seek out and rely upon outside advisors in the conduct of the investment function. When the law forbids the trustee from delegating the investment function, the trustee engages expert advice but purports to make an independent decision about whether to follow that advice. If the investment is subsequently challenged, the legal dispute then concerns the delegation question—that is, "Did the trustee exercise a judgment independent of the advisor?" By contrast, when trust law permits the trustee to delegate investment responsibilities to outside professionals, the delegation doctrine directs attention to a more useful question, which is whether the trustee used due care in selecting, instructing, and monitoring the agent.<sup>24</sup> The traditional rule forbidding delegation disserved trust beneficiaries by preventing open discussion of the standards and safeguards appropriate to delegation.

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23. I have discussed these matters at some length in John H. Langbein, *The Twentieth Century Revolution in Family Wealth Transmission*, 86 MICH. L. REV. 722 (1988).

24. The standards of the Restatement of Trusts (Third) and the draft Uniform Prudent Investor Act, discussed in Part III of this Article, *infra*.

*C. Landmarks on the Path Away from  
the Nondelegation Rule*

Three important legislative initiatives presaged the movement from nondelegation to delegation of investment responsibilities in trust law.

1. *Uniform Trustees' Powers Act*. The Uniform Trustees' Powers Act (1964)<sup>25</sup> embodies a broad liberalization of the law of trustee powers. The Act is designed to facilitate the management of modern trust assets, especially financial assets. Section 3(24) of the Act effectively abrogates the nondelegation rule for specialized service providers. It authorizes trustees

to employ persons, including attorneys, auditors, investment advisers, or agents, even if they are associated with the trustee, to advise or assist the trustee in the performance of his administrative duties; to act *without independent investigation* upon their recommendations; and *instead of acting personally*, to employ one or more agents to perform any act of administration, *whether or not discretionary* . . . .<sup>26</sup>

The Uniform Trustee Powers Act has not been widely adopted,<sup>27</sup> probably because most jurisdictions already had a developed statutory set of trustee powers by the time the Uniform Act was drafted in 1964. But section 3(24) of the Act is a notable milestone: the Uniform Law Commission<sup>28</sup> was persuaded to reverse the default rule and authorize delegation of investment and other specialized functions only a few years after the Restatement (Second) had perpetuated the contrary rule.

2. *UMIFA*. The Uniform Law Commission returned to the delegation question in a slightly different setting less than a decade later. The Uniform Management of Institutional Funds Act (UMIFA) (1972)<sup>29</sup> authorizes the governing boards of eleemosynary institutions, who are trustee-like fiduciaries, to delegate investment matters, either to a committee of the board or to outside investment advisors, investment counsel, managers, banks, or trust

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25. 7B U.L.A. 743 (1985 & 1993 Supp. at 189).

26. UNIFORM TRUSTEES' POWERS ACT § 3(24) (emphasis supplied); 7B U.L.A. 748 (1985).

27. Sixteen states, mostly smaller ones, have adopted the Act. See 7B U.L.A., 1993 Supp. at 188. The Uniform Probate Code (UPC) § 3-715 incorporates much of the Uniform Trustees' Powers Act. UPC § 3-715(21) republishes § 3(24) of the Uniform Trustees' Powers Act, extending its reach to the fiduciary responsibilities of personal representatives.

28. Shorthand for the National Conference of Commissioners on Uniform State Laws.

29. 7A U.L.A. at 705 (1985) & 1993 Supp. at 237.

companies.<sup>30</sup> This provision has been enacted in 34 states and the District of Columbia.<sup>31</sup>

UMIFA shows the response of a sophisticated set of "consumers" of fiduciary-investment law who felt themselves unable to take the ordinary path around an unwanted default rule. When trust law gets the wrong default rule, specialist counsel usually countermand the rule by tailoring a contrary term in the trust instrument. "Opting out" in this way leaves the mistaken default rule on the books as a snare for others but eliminates the obstacle for counsel's own client. This strategy is sometimes awkward for an existing charitable trust, foundation, or charitable corporation to pursue. Many nonprofit charters and trust instruments were drafted decades, even centuries ago, before there was occasion to foresee the need to countermand the irritants of an inadequate trust-investment law. Furthermore, because charitable trusts and the like are quasi-public institutions, and subject to regulatory oversight by the attorney general or other authorities,<sup>32</sup> it is not always clear that the charitable organization can unilaterally opt out of unwanted default law. Thus, in the case of UMIFA, nonprofit organizations led by the Ford Foundation agitated for uniform legislation to reverse the default rule.<sup>33</sup>

3. *ERISA*. The most important development in the decline of the nondelegation doctrine was its repudiation in the Employee Retirement Income Security Act (ERISA),<sup>34</sup> the federal pension regulatory law. ERISA governs the affairs of pension and employee benefit plans. The statute mandates that the assets of plans that do not take the form of insurance contracts must be held in trust.<sup>35</sup> This regime of mandatory trusteeship governs one and a half trillion dollars in plan assets.<sup>36</sup>

For its federal law of pension and employee benefit trusts ERISA carries forward from the common law of trusts the fundamental duties of loyalty, prudent administration, and diversification of investments.<sup>37</sup> However, ERISA forthrightly repeals the nondelegation rule. Section 403(a)(2) allows a pension or employee benefit plan to provide that "authority to manage,

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30. UMIFA § 5, 7A U.L.A. at 720 (1985) & 1993 Supp. at 239.

31. See 7A U.L.A., 1993 Supp. at 235 for list of adopting jurisdictions.

32. RESTATEMENT (SECOND) OF TRUSTS § 391 (1959).

33. See generally WILLIAM L. CARY & CRAIG B. BRIGHT, THE DEVELOPING LAW OF ENDOWMENT FUNDS: "THE LAW AND THE LORE" REVISITED: A REPORT TO THE FORD FOUNDATION (1974 ed.); CARY & BRIGHT, *supra* note 19.

34. 29 U.S.C. § 1001-1461 (1988 & Supp. III 1991).

35. ERISA § 403(a), 29 U.S.C. § 1103(a)(b) (1988 & Supp. III 1991).

36. JOSEPH S. PIACENTINI & JILL D. FOLEY, EBRI DATABOOK ON EMPLOYEE BENEFITS 114 (2d ed. 1992).

37. ERISA § 404(a)(1)(A)-(C), 29 U.S.C. § 1104(a)(1)(A)-(C) (1988 & Supp. III 1991).

acquire or dispose of assets of the plan is delegated to one or more investment managers . . . .<sup>38</sup> The logic of ERISA's regime has been described in this way:

ERISA . . . invites the dissolution of unitary trusteeship. . . . ERISA's fractionation of traditional trusteeship reflects the complexity of the modern pension trust. Because millions, even billions of dollars can be involved, great care is required in investing and safekeeping plan assets. Administering such plans—computing and honoring benefit entitlements across decades of employment and retirement—is also a complex business. . . . Since, however, neither the sponsor nor any other single entity has a comparative advantage in performing all these functions, the tendency has been for pension plans to use a variety of specialized providers. A consulting actuary, a plan administration firm, or an insurance company may oversee the design of a plan and arrange for processing benefit claims. Investment industry professionals manage the portfolio (the largest plans spread their pension investments among dozens of money management firms).<sup>39</sup>

ERISA is careful to deal with the consequences of its prodelegation regime. The statute attaches its system of fiduciary liability not only to the trustee, but to all persons who exercise discretion<sup>40</sup> over plan assets; investment advisors are especially singled out as fiduciaries.<sup>41</sup> When ERISA trustees have been derelict in selecting and monitoring agents, the federal courts have rightly imposed liability.<sup>42</sup>

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38. ERISA § 403(a)(2), 29 U.S.C. § 1103(a)(2) (1988).

39. JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 496 (1990).

40. Contrast the peculiar interest in testing for discretion under the traditional nondelegation rule, discussed *supra* text accompanying notes 17-21, where the consequence of finding that an agent's function was discretionary was to deem the trustee in violation of the nondelegation rule. The purpose of ERISA's discretion standard is to cast an appropriately broad net of fiduciary duty over those persons to whom delegation is encouraged.

41. ERISA § 3(21), 29 U.S.C. § 1002(21) (1988).

42. Compare *Whitfield v. Cohen*, 682 F. Supp. 188 (S.D.N.Y. 1988) (finding imprudent selection of investment advisor) with *In re Masters, Mates & Pilots Pension Plan*, 11 E.B.C. 2629 (S.D.N.Y. 1990) (serious issues of fact justify refusing summary judgment on allegation that selection of investment advisor was improper); both cases noted in Bernard M. Baum, *Trustees and Their Professionals*, 18 EMPLOYEE BENEFITS J. 7 (1993).

4. *Overview on the eve of the Restatement (Third)*. The nondelegation rule of the law of trusts entered the 1990s considerably weakened. Special legislation reversed the rule for the most important trusts, pension trusts and charities. The nondelegation rule survived as default law for private trusts in most jurisdictions that had not enacted the Uniform Trustees' Powers Act, but counsel in those jurisdictions routinely countermanded the rule for professionally drafted trust instruments.

### III. THE NEW RESTATEMENT AND THE PROPOSED UNIFORM ACT

#### A. *Restatement (Third)*

The Restatement (Third), promulgated in 1992, repeals the nondelegation rule of the Restatement (Second) and supplies the following substitute black letter rule:

A trustee has a duty personally to perform the responsibilities of trusteeship except as a prudent person might delegate those responsibilities to others. In deciding whether, to whom, and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a prudent person would act in similar circumstances.<sup>43</sup>

The 1992 Restatement integrates this delegation standard into its revised prudent investor rule, which provides that "the trustee must . . . act with prudence in deciding whether and how to delegate authority to others."<sup>44</sup>

Two fundamental principles characterize the delegation regime of the Restatement (Third). *First, the default rule is reversed: delegation substitutes for nondelegation.* Indeed, the trustee not only has the power to delegate, the trustee "may sometimes have a duty . . . to delegate [investment] functions . . . in such manner as a prudent investor would delegate under the circumstances."<sup>45</sup> This prodelegation standard of the Restatement (Third) eliminates the need under Restatement (Second) to limit the use of agents to "ministerial" functions, and the Restatement (Third) explains that delegation is not "precluded because the act in question calls for the exercise of considerable judgment or discretion."<sup>46</sup>

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

44. *Id.* § 227(c)(2).

45. *Id.* § 227 cmt. j, at 38.

46. *Id.* at 39.

*Second, however, the Restatement (Third) applies a fiduciary regime to the trustee's delegation determinations, much as is done in ERISA. The standard of prudent administration attaches to (1) the trustee's decision to delegate, (2) the trustee's selection of agents, and (3) the trustee's oversight ("supervising") of agents' performance. Judicial oversight is available on the familiar abuse-of-discretion standard of trust law.<sup>47</sup> The official comment explains:*

A trustee's discretionary authority in the matter of delegation may be abused by imprudent failure to delegate as well as by making an imprudent decision to delegate. Abuse of discretion may also be found in failure to exercise prudence in the degree or manner of delegation. Prudence thus requires the exercise of care, skill, and caution in the selection of agents and in negotiating and establishing the terms of delegation. Significant terms of a delegation include those involving the compensation of the agent, the duration and conditions of the delegation, and arrangements for monitoring or supervising the activities of agents.<sup>48</sup>

The Restatement (Third) was drafted by a skillful reporter, Professor Edward C. Halbach Jr. The reform of delegation law undertaken in the Restatement (Third) arises from Halbach's larger project, which is to update the prudent investing standard of trust-investment law for the purpose of accommodating developments in fiduciary investment practice that have occurred in recent decades under the influence of so-called Modern Portfolio Theory (MPT). The new Restatement absorbs from MPT a set of precepts for enhancing investment results. It treats the portfolio as a whole rather than individual investments as the relevant entity.<sup>49</sup> In place of the categorical restrictions upon types of investments suitable for fiduciaries that characterized older trust law, the Restatement (Third) follows MPT in directing attention to the risk/return curve.<sup>50</sup> Responding to the central concern of MPT to squeeze

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47. *Id.* § 171 cmt. a, at 141 (citing RESTATEMENT (SECOND) OF TRUSTS § 187 (1959)).

48. RESTATEMENT (THIRD) OF TRUSTS § 171 cmt. a, at 141 (1992).

49. The prudent investing standard of the Restatement (Third) "is to be applied to investments not in isolation but in the context of the trust portfolio and as part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust." RESTATEMENT (THIRD) OF TRUSTS § 227(a) (1992).

50. On risk/return, see the extract from Restatement (Third) of Trusts § 227(a) (1959), reproduced *supra* note 49; on the repudiation of categorical restrictions, see *id.*, comment f, at 24: "Specific investments or techniques of investment are not per se prudent or imprudent. The riskiness of a specific property, and thus the propriety of

out the uncompensated risk of inadequate diversification, the new Restatement emphasizes the duty to diversify trust investments. It incorporates a strongly worded duty to diversify trust investments within the definition of prudent investing.<sup>51</sup>

This reorientation in trust-investment law toward highly diversified, large-portfolio investing presupposes increasing professionalization of the investment function, which is why the Restatement (Third) abrogates the nondelegation rule as part of its larger enterprise. For most small trusts, the path of the future will be greater use of pooled investment vehicles such as common trust funds and mutual funds. For larger trusts that continue to do individualized investing, investment professionals will increasingly be in command. And thus the decision to reverse the former nondelegation rule of Restatement (Second)<sup>52</sup> and to incorporate within the new prudent investor rule of Restatement (Third) the duty to decide "whether and how to delegate . . ."<sup>53</sup>

### B. UPIA

Although officially promulgated in 1992, the Restatement (Third) was approved by the American Law Institute at its 1990 plenary meeting, subject to final editing. Interest in adapting the principles of the new Restatement to legislation was immediate. Illinois enacted a revision of its prudent investor statute patterned loosely on the Restatement (Third) in 1991,<sup>54</sup> and Virginia enacted a modest version in 1992.<sup>55</sup> In 1991 the Uniform Law Commission authorized the drafting of a Uniform Prudent Investor Act (UPIA). I have served as the reporter for a drafting committee drawn from the Joint Editorial Board for the Uniform Probate Code, with Professor Richard Wellman as chair. The UPIA project has advanced through several versions of the draft act. At the present writing, the current draft of UPIA is dated August 23, 1993. That draft incorporates changes resulting from a first reading at the 1993 annual meeting of the National Conference of Commissioners on Uniform State Laws. Further revisions will be undertaken before a projected second and final reading at the 1994 annual meeting. There is, of course, no guarantee that the Commissioners will approve this or any version of UPIA.

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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."

51. *Id.* § 227(b).

52. RESTATEMENT (SECOND) OF TRUSTS § 171 (1959), reproduced *supra* text accompanying note 1.

53. RESTATEMENT (THIRD) OF TRUSTS § 227(c)(2) (1992).

54. 760 ILL. COMP. STAT. ANN. 5/5 (Smith-Hurd 1993).

55. VA. CODE ANN. § 26-45.1 (Michie 1992).

Nevertheless, it seems worthwhile to expose the pending draft for comment, so long as readers are aware that the projected text may change.

Like the Restatement (Third) that it tracks, the draft UPIA treats delegation in consequence of its revision of the prudent investor standard. The UPIA undertakes to implement the main principles of the 1992 Restatement: portfolio as opposed to individual investment standard, sensitivity to the risk/return curve as opposed to categoric restrictions on types of investments, intensified duty to diversify investments, and abrogation of the nondelegation rule as applied to trust investing. Section 9 of the UPIA sets forth the regime for delegation:

(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 the agent; (2) establishing the scope and terms of the delegation consistent with the purposes and terms of the trust; and (3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the scope and terms of the delegation.

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

(c) The trustee who complies with the requirements of subsection (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.<sup>56</sup>

Subsection (a) of this text closely follows the Restatement (Third) in treating the decision of whether and how to delegate as a part of the trustee's overall responsibility for prudent investing. Prudent delegation requires appropriate care in selecting, instructing, and monitoring the agent.

Subsection (c) makes it clear that the trustee who delegates prudently is not an insurer.<sup>57</sup> Not every decision to delegate investment responsibilities

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56. UPIA § 9 (August 23, 1993, draft). A further subsection (d), not reproduced above, provides that the agent who accepts "the delegation of a trust function from the trustee of a trust that is subject to the law of [this State], . . . submits to the jurisdiction of the courts of [this State]."

57. See also UPIA § 8 (August 23, 1993, draft), regarding the standard of review, which declares: "The prudent investor rule imposes a standard of conduct, not outcome. Compliance with the prudent investor rule is determined in the light of the facts and circumstances prevailing at the time of the trustee's decision or action." The

will turn out successfully. If the trustee exercises prudence in complying with the standards of subsection (a) regarding the selection, instruction, and supervision of the agent, then the trustee is not liable for the conduct of the agent. Under the former nondelegation rule, quite a different result could be reached. An old Washington case concluded that the trustee who delegated "becomes a guarantor and is responsible for any loss that may have resulted, whether or not such loss can be shown to be the result of the delegation . . . ."<sup>58</sup> The purpose of such a standard—to deter any variety of delegation—is quite contrary to the modern policy, which is to encourage trustees to lodge investment functions with professionals.

#### IV. CONCLUSION

I conclude this Article by returning to a theme sounded at the outset: that the seeming flip-flop in black letter trust law from the nondelegation rule of the Restatement (Second) to the prodelegation rule of the Restatement (Third) and UPIA entails a much less radical change of direction than appears at first blush.

The core of the nondelegation rule abides. For reasons that make good sense, the Restatement (Second) proscribes total delegation of the trust. The Restatement (Third) perpetuates that rule, continuing to impose upon the trustee "a duty personally to perform the responsibilities of the trusteeship except as a prudent person might delegate those responsibilities to others."<sup>59</sup> We have seen<sup>60</sup> why total delegation of the trust is imprudent. But careful delegation for the purpose of taking advantage of external expertise and economies, especially in investment matters, unambiguously benefits the trust and its beneficiaries. Thus, the Restatement (Third) and the draft UPIA encourage trustees to delegate trust investment responsibilities. We have seen, however, that there is little novelty in trustees' using investment advisors under the traditional nondelegation rule. Either the drafter of the trust instrument waived the default rule and authorized the trustees to delegate investment activities; or trustees who engaged investment advisors went through the motions of forming a supposedly independent judgment to follow the advice of these "ministerial" persons.

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official comment to UPIA § 8, *id.*, says: "Trustees are not insurers. Not every investment or management decision will turn out in the light of hindsight to have been successful. Hindsight is not the relevant standard."

58. *Meck v. Behrens*, 252 P. 91, 95 (Wash. 1927), *superseded by statute as stated in Gillespie v. Seattle-First National Bank*, 855 P.2d 680 (Wash. Ct. App. 1993).

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

60. *Supra* text accompanying notes 10-11.

The real state of the law of delegation has been for many decades that any trust settlor sophisticated enough to want delegation authority for a private trust could get it. Delegation on demand has been the actual law during the time that nondelegation has been the nominal law. Accordingly, it seems right to see the Restatement (Third) and the string of legislative initiatives reversing the nondelegation rule as reforms directed as much to candor as to substance. Honesty may be a modest gain, but a gain it surely is.

