

Diversification Under the Uniform Prudent Investor Act

by Anthony Vaida

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Trustees are obligated to follow the dictates of a trust and also to diversify assets in portfolios under their management. This article discusses the rules that govern trust management. It also covers case law and analyzes how diversification rules may be applied.

Trustees often find that the trust agreement appointing them contains inconsistent provisions regarding the retention of certain assets that produce limited income, and the direction to provide enough income to meet the needs of the trust beneficiaries. For example, the settlor may convey to the trust one asset that has a low basis and sentimental value to the settlor but is unlikely to fulfill the trust's long-term income production and distribution goals. In such a situation, the trustee is put in the difficult position of deciding if the asset is to be retained or sold and whether the trust agreement clearly authorizes the sale of the asset.

Holding a disproportionate amount of a particular asset may hamper the trustee's ability to produce a market return. In addition, retaining the asset can significantly limit the trustee's ability to diversify the trust's overall holdings. Diversification is encouraged under most modern portfolio management policies in order to produce a market return on the investments. Of more importance, diversification is necessary to protect the value of the trust assets, as much as possible, from market fluctuations. The grist for case law on the issue of diversification is the tug of war between the trustee's responsibilities to: (1) diversify the investment of assets; (2) meet projected income distribution goals; and (3) adhere to the settlor's wishes to have the trust retain a particular asset.

This article traces the origin of the modern requirement for diversification of trust fund assets and examines the history of diversification under the Prudent Person Rule ("PPR") and also discusses the evolution of the Uniform Prudent Investor Act ("UPIA")¹ along with its adoption in Colorado. Finally, the article makes some assumptions about and analyzes future diversification issues.

Definition of Diversification

Under modern guidelines, a trustee has an obligation to diversify the trust's holdings in most circumstances. The diversification theory is based on the assumption that a "balanced portfolio" (one that has the trust assets invested in a wide variety of stocks, bonds, and other assets) will be better protected against discrete investment sector declines. Thus, a balanced portfolio will produce a better return of income than would a portfolio consisting of investments in only a few types of assets.² Although diversification was encouraged, it was not statutorily identified as a required management policy prior to the UPIA, which was adopted in Colorado in 1994.

History of Diversification

Diversification as a discretionary trust management tool has been used for many years. In a 1946 case, *Security Trust Co. v. Appleton*, the Kentucky Court of Appeals

opined, "It is entirely true that many financial authorities advocate wide diversity of investment. It is equally true that others as strenuously affirm the contrary. . . ." ⁴ (*Internal citation omitted.*) In *Appleton*, the court concluded that absent a specific direction from the settlor to diversify, the trustee had no independent obligation to do so.

The question of whether to diversify trust investments had its beginnings in *Harvard College and Massachusetts General Hospital v. Amory*.⁵ In this 1830 case, the plaintiffs brought suit to challenge the trustee's investment of most of the trust assets in South Sea Trading Companies. The plaintiffs argued that the substantial investment in trading companies exposed the trust to the potential for great losses. In analyzing the plaintiffs' claim, the court looked to the language of the trust instrument. The Massachusetts Supreme Court concluded that the language gave the trustee authority to invest in trading companies even if they were a "risky investment."

The *Amory* court fashioned the rule that if the settlor gave substantial discretion to the trustee in making investment decisions, judges should be reluctant to overrule the trustee's decision unless the court found gross negligence or willful mismanagement. The court stated:

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

The standard articulated by the *Amory* court became the majority rule and was used to measure the prudence of a trustee's selection and retention of investments for the next 150 years. The standard became known first as the "Prudent Man Rule," and later as the PPR. Although a common law standard, the PPR was codified by several states. New York was one of the states to take the lead in this area of the law and adopted the following version of the PPR:

Fiduciary holding funds for investment may invest the same in the kinds and classes of securities . . . provided that investment is made only in such securities as would be acquired by prudent . . . [persons] of discretion and intelligence in such matters who are seeking a reasonable income and the preservation of their capital.⁷

The Prudent Person Rule

After *Amory*, decisional law gave general guidance on the exercise of "prudence" in making investments, but did not directly address the diversification issue for many years. For example, in *In the Matter of Rowe*,⁸ the court interpreted the PPR as requiring that when analyzing a trustee's investment decisions, the court should

engage in "a balanced and perceptive analysis of [the trustee's] consideration and action in the light of the history of each individual investment, viewed at the time of its action or its omission to act."⁹ (*Internal citation omitted.*)

Further, the court held that under the PPR, investment decisions should not be analyzed in a vacuum. Instead, they should be viewed in terms of the effect of the decision on the entire portfolio. The *Rowe* court held, as had the *Amory* court, barring "negligent inattentiveness, inaction or indifference" that resulted in losses in trust assets, a trustee's investment decisions would not be considered imprudent.¹⁰ Thus, most courts adopted a position of ordinarily supporting the trustee's decision to retain an asset, even when the decision resulted in a substantial diminution in the value of the trust. Nevertheless, where the trustee's decision was the result of self-dealing or was so grossly inappropriate that no competent and responsible person would have made the same decision, the courts would not hesitate to hold the trustee liable.

The subjective standards of the PPR gave trustees little guidance as to when they should retain the assets granted to the trust or reallocate the portfolio. The only guideline was to manage the asset as one would manage one's own assets.¹¹ Additionally, the courts were reluctant to find that a trustee had acted imprudently by retaining a large position in a particular asset, except when the trustee's management demonstrated self-dealing, bad faith, reckless indifference, overreaching, or a breach of the fiduciary or confidential relationship.¹²

Thus, when the trust instrument gave the trustee complete discretion on investment choices or directed that a favorite investment be kept in the trust, most fiduciaries would hold such assets even if such investments did not produce income or did not appreciate in value over time. For instance, in a 1945 case, *New England Trust v. Paine*,¹³ the trust instrument contained an exculpatory clause that relieved the trustee from liability for negligence or failure to exercise sound judgment.¹⁴

After analyzing the trustee's conduct, the Massachusetts Supreme Court held that if the trustee had not acted in bad faith or demonstrated reckless indifference to the interest of the beneficiaries, the trustee would not be liable for retaining a disproportionate amount of one asset class.¹⁵ The Court held that on issues of whether to diversify the assets of the trust, there were no bright-line rules.¹⁶

In *Paine*, the Court also considered whether it was a negligent omission for the trustee to fail to sell railroad stock when the tax laws changed and to more fully diversify the trust portfolio. The Court took note of the then-current market conditions and held that the trustee was acting prudently in holding an asset, even though it was declining in value. The Court reasoned that there were limited opportunities for trust investments, and it was prudent for the trustee to conclude that the stock eventually would recover.¹⁷ There was no evidence that the trustee engaged in self-dealing or reckless conduct in the management and procurement of the investments or in the creation of the exculpatory clause.

In more recent PPR cases, some courts have articulated the need for trustees to consider diversification as a management technique. In *In re Estate of Cavin*,¹⁸ the beneficiaries of the trust contended that the trustees had been negligent in not selling a large parcel of real estate. The trial court agreed, finding that "the Trustees' decision to retain such a high percentage of non-income producing unimproved land, when the settlor had established the trust to provide for the welfare of the income beneficiary, was improper."¹⁹ However, adhering to the majority view, the appellate court overruled the trial court and concluded that

courts should generally be slow to entertain attacks on decisions of trust administrators except when it is made to appear that they have acted out of fraud, malice, bad faith, or in an arbitrary abuse of their discretionary powers.²⁰ (*Quotation marks and citation omitted.*)

Beginning in the 1980s, trust industry professionals were finding more opportunities available to diversify trust assets. Both trust officers and others responsible for fiduciary management began suggesting that a more uniform standard of prudent investment guidelines should be adopted, including a requirement for portfolio diversification. The National Conference of Commissioners on Uniform State Laws ("Commissioners") took up the sub-

ject and adopted the UPIA in 1994. The principles enumerated in the *Restatement (Third) of Trusts: Prudent Investor Rule* ("Restatement (Third) of Trusts"), became the basis for the UPIA.²¹ The UPIA also takes into consideration "modern portfolio theory," which includes diversification as one of its key portfolio management techniques.²²

The Uniform Prudent Investor Act

Since its approval by the Commissioners, the UPIA has been adopted in thirty-seven states, including Colorado.²³ The UPIA is modeled on the Prudent Investor Rule, as described in the *Restatement (Third) of Trusts*.²⁴ In enumerating the objectives of the UPIA, the drafters describe the Prudent Investor Rule as the "replacement" for the PPR.²⁵ To clarify the extent of the trustee's duty to diversify assets, the Commissioners added a section that specifically addressed diversification:

A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.²⁶

Thus, diversification is now a management policy instead of an informal technique, as it was under the PPR. Its placement in a separate section (versus its inclusion in the more general language at the beginning of the UPIA) emphasizes the importance of the duty to diversify.²⁷ The UPIA as a whole has been described as a minimum standard ("Default Rule") for trust asset management. The settlor may expand, restrict, or eliminate applicability of the UPIA in the provisions of the trust.

Recent court decisions demonstrate that under the UPIA, the trustee's investment decisions will be evaluated in the context of the entire trust portfolio, including the extent to which a particular investment is part of an overall investment strategy.²⁸ When trustees are making investment decisions, the UPIA instructs them to consider, among other factors: (1) general economic conditions; (2) the possible effect of inflation or deflation; (3) the expected tax consequences of the investment decisions or strategies; and (4) the expected total income and appreciation of capital. Also, part of the decision process is a determination of the extent and timing of diversification of the assets to meet the intended purposes of the trust.²⁹ The *Restatement (Third) of Trusts* provides further guidance:

In the absence of contrary statute or trust provision, the requirement of caution ordinarily imposes a duty to use reasonable care and skill in an effort to minimize or at least reduce diversifiable risks. Often called non-market risk, or somewhat less precisely "specific" or "unique" risk, these are risks that can be reduced through proper diversification of a portfolio. . . . What has come to be called "modern portfolio theory" offers an instructive conceptual framework for understanding and attempting to cope with non-market risk.³⁰

Evolution of the Prudent Investor Rule in Colorado

Colorado followed the PPR until 1995, when it adopted the UPIA.³¹ Colorado adopted the UPIA without variation from the version adopted by the Commissioners.³² The requirement regarding diversification can be found in CRS §§ 15-1.1-103 *et seq.*³³

In addition to the exceptions to the requirement for diversification found in CRS §§ 15-1.1-102 and 15-1.1-103, under CRS § 15-1-804, which was enacted prior to the adoption of the UPIA, during administration of an estate, a fiduciary may retain the initial assets without incurring liability for any loss.³⁴

The Colorado courts have no reported cases testing either the Default Rule under the UPIA or the use of CRS § 15-1-804 as a basis for non-diversification. The only recent Colorado case is a 1989 case, *Buder v. Sartore*, which was decided while the PPR was in effect.³⁵ The trustee in *Buder* also was the father of the minor beneficiaries. He argued that because he had invested the beneficiaries' funds in the same manner as he had invested his own, in new stock issues,³⁶ he had met his obligations under the investment management standards found in the Uniform Gift to Minors Act ("UGMA").³⁷

The Colorado Supreme Court did not agree. Applying the standards found in the UGMA as well as the subsequently adopted Uniform Transfer to Minors Act ("UTMA")³⁸ and the PPR, the Court held that a trustee must meet a higher standard of care than simply investing as one would invest one's own money.³⁹ In addressing the interrelationship of the UGMA, UTMA, and the PPR, the Court concluded that a fiduciary's management responsibilities were the same under all three statutes.⁴⁰

Therefore, in *Buder*, the Court held that the standard for assessing the prudence of

a fiduciary's management decisions should be how a prudent person would invest funds of *another*, not how the trustee would invest his or her own funds.⁴¹ The Court also opined that the legislature had recognized that a person dealing with his or her own property might consider certain investment hazards warranted, whereas it would be imprudent to expose property of another, managed in a fiduciary capacity, to such dangers.⁴²

It appears that, in Colorado, a fiduciary is only required to invest trust funds as one would invest the funds "of another." However, from the following review of recent cases in other jurisdictions, it is apparent that when losses occur and the trustee has not diversified assets, the trustee may be subject to heightened judicial scrutiny.

Diversification Decisions In Other States

Numerous treatises on investment methodology state that diversification has become a widely adopted management tool.⁴³ Thus, when a trust portfolio has not been diversified, lack of diversification is appearing more frequently as a claim of mismanagement.⁴⁴ In some cases involving diversification issues, courts have concluded that the trustee should be absolved because: (1) there was no statutory requirement for diversification under the applicable state law; or (2) the settlor specifically gave the trustee discretionary authority not to diversify.

In other cases, courts have held that the failure to diversify was negligent conduct. In such cases, the trustee usually had an internal policy favoring or recommending diversification as a management policy or has received a report from an investment professional recommending diversification of the portfolio.

In a 2001 Minnesota case, *In re Trusteeship of Williams*,⁴⁵ the trust originally owned the stock of a closely held dairy company. The trust sold the company to Borden Company and acquired in return 600,000 shares of Borden common stock. After the sale, Borden stock represented 39.3 percent of the total market value of the trust holdings.⁴⁶ With regard to investments, the trust gave broad discretion to the trustees, who were two individuals and one corporate trustee (who was responsible for investment policy for the trust). The applicable state statute did not establish a separate duty to diversify assets.

After the sale and exchange of the dairy stock for Borden stock, the Borden stock

dropped substantially in value.⁴⁷ The lower court held that the trustees had an "independent duty to diversify unless clearly exempted" by the language of the trust and failure to diversify was negligence *per se*. The lower court then imposed a \$4 million surcharge on the corporate trustee.⁴⁸

The Minnesota Court of Appeals reviewed whether there is a separate duty to diversify, apart from the general duty of prudent management practice. The court concluded that under Minnesota law, there was no independent duty to diversify.⁴⁹ The court recognized that there *may* be a duty to diversify in *some* cases, but that diversification is not required in *every* case.⁵⁰ Therefore, the failure to diversify in the *Williams* case was not negligence *per se*.

The standard for evaluating a trustee's actions . . . [is] whether the trustee prudently managed trust assets in light of the settlor's intent and beneficiaries' interests. . . . [T]rust cases present unique facts and circumstances that are difficult to analogize to other seemingly similar cases.⁵¹ (Citation omitted.)

The court then remanded the matter to the lower court for a determination of whether the corporate trustee's failure to diversify constituted ordinary negligence.

In *Atwood v. Atwood*,⁵² the Oklahoma Civil Court of Appeals reviewed the appropriateness of granting summary judgment in favor of the trustee. The court considered the question of whether the trustee's failure to diversify the trust assets had led to a loss in asset value of the trust portfolio.⁵³ In *Atwood*, the trust was funded at its inception in 1957 with stock in AMP, a publicly traded company. The AMP stock comprised 70 to 80 percent of the trust's assets. The trustee kept the AMP stock until 1998, when much of it was sold. Plaintiff beneficiaries claimed that if the trust assets had been diversified, the value of the trust in 1998 would have been substantially higher.⁵⁴

The trust instrument provided that the trustee was to have broad discretion to retain the stock originally placed into the trust by the settlors. Further, the trust instrument stated that the trustee was to use appropriate judgment in making investment decisions and was not to be constrained by any present or future statute, decision, or rule of law.⁵⁵ The court, although recognizing a duty to diversify under both the Prudent Investor Rule and the UPLA, held that the Prudent Investor Rule "does not make an *absolute* requirement that the trustee diversify."⁵⁶ (Emphasis added.)

The *Atwood* court relied on the language of the UPLA, which describes the management standards as "default" rules that "may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust."⁵⁷ In conclusion, the court upheld the lower court's grant of summary judgment in favor of the trustee, based on the exculpatory language in the trust instrument.

In *Donato v. BankBoston N.A.*,⁵⁸ the U.S. District Court for the District of Rhode Island held that under Rhode Island law, where the trust instrument authorized a disproportionately large investment in one stock, the trustee would not be considered to have acted imprudently *per se* for failing to diversify the portfolio.⁵⁹ In *Donato*, at the time the trustee assumed management of the trust in 1990, the trust contained a security (CML convertible debentures, later converted to CML stock) that constituted only 1.37 percent of the total market value of the trust's assets. However, three years later, mostly because of appreciation, this stock constituted 69.2 percent of the trust.

The trustee sold approximately 25 percent of the security in November 1993, near its market high, and sold some additional shares at lesser prices over the next year. By early 1994, when the remaining shares were sold, the value had declined to approximately one-third of the value it had held in November of the previous year. The trust contained provisions giving the trustee "the broadest discretion" in making investment decisions, as well as exculpatory provisions absolving the trustee from all liability except for actions in bad faith, reckless indifference, or in abuse of its discretion.⁶⁰ The executor of the beneficiary's estate filed suit against the trustee, claiming that all the CML stock or security in question should have been sold at its high three years earlier. The court held:

[A] permissive provision does not relieve the trustees from scrutiny under a "prudence" standard for their investment decisions: it means only that a trustee cannot be found to have acted imprudently *per se* for holding a particular type of investment or for holding a disproportionately large amount of one investment.⁶¹

The court then concluded that under the facts, the trustee's management was proper.

In *In re Estate of Scharlach*,⁶² the Pennsylvania Supreme Court considered, but did not adopt, the theory that failure to diversify is negligence *per se*. The Court not-

ed that the fiduciary received a report from a financial advisor who had been hired by the fiduciary at the expense of the trust. The financial advisor recommended that the fiduciary reallocate the portfolio from all government bonds to half bonds and half equities.⁶³ The fiduciary would have needed a court order to change the portfolio allocation. Nonetheless, at the time of the establishment of the fiduciary account, the court had advised that under certain circumstances (including a change in market conditions), the court would approve a different allocation of investments.

Instead of seeking a court order to change allocation of the portfolio, the trustee retained the original investment for ten years after receiving the recommendation to reallocate the portfolio. The results were negative for the portfolio, and the beneficiary's representative sued the trustee. The *Scharlach* court held that the trustee was negligent in failing to follow the advice of its own financial advisor and, although it is dictum, went on to state that under certain circumstances, the failure to diversify would be *per se* negligence.⁶⁴

In a number of similar recent New York cases, the courts have made it clear that in certain situations, the trustee's failure to diversify will be considered negligence *per se*.⁶⁵ This doctrine most likely will apply where the trustee has an internal diversification policy or has received a professionally qualified report regarding the need for diversification of a portfolio.⁶⁶

For example, in *In the Matter of Saxton*,⁶⁷ the trust was initially funded with 100 percent IBM stock, which the trust held for thirty years. When the trustee sought approval of its final accounting, trust objections were filed by the remainder persons based on the failure to diversify out of IBM into other investments. The trustee had a well-established written policy requiring all portfolios under management to be diversified. The court found that the retention of one security in light of the written policy was imprudent and awarded damages to the plaintiff.⁶⁸

Similarly, in *In the Matter of Rowe*,⁶⁹ the trust was funded solely with shares (30,000) of IBM stock, valued at the time (1989) at \$117 per share. The trust committee of the fiduciary made an initial review of the trust in 1989 and concluded that diversification should be applied to the trust, but should not be implemented until the stock reached a higher price. Although some shares were sold in subsequent years, the trust still owned a substantial block of IBM stock in 1994. The

remainder beneficiaries brought an action for an accounting, claiming that the trustee's failure to diversify the trust assets had resulted in a loss. At trial, the plaintiff produced uncontroverted evidence that the trustee had a written, established policy requiring diversification of all trust portfolios under management, and that the trustee failed to follow its own written policy requiring diversification. As in *Saxton*,⁷⁰ the court held the trustee liable.⁷¹

Current Diversification Policies and Practice

Under modern fiduciary practices, diversification is a key element in designing an investment program for the assets of a trust.⁷² According to the Uniform Fiduciary Standards of Care, as established by the Center for Fiduciary Studies and the American Institute of Certified Public Accountants, diversification is the standard that shapes investment management policy under the UPIA:

[D]iversifying the portfolio assets to account for the specific risk/return profile of [the] client is the second step in the portfolio management for a fiduciary after fully familiarizing oneself with the trust terms and what standards and laws apply.⁷³

Because diversification is now a standard practice for trust asset management, it would appear that even if a trust instrument gives the trustee wide latitude regarding investment choices, including the authority not to diversify, diversification must at least be considered for all assets under management. Thus, it would be appropriate for a trustee to include a written recommendation to diversify when developing an asset management plan, even if not requested to do so by the settlor or the beneficiaries.⁷⁴

The rationale for diversification is to reduce non-market risks. The general duty to diversify expresses guidance to trustees to avoid taking the risk of over-allocating investments in one sector or one asset.⁷⁵ The level of understanding of courts in applying the diversification requirement, to adhere to the goal of reducing risk, is well illustrated in *Leigh v. Engle*.⁷⁶ This Seventh Circuit Court case frequently is referenced in treatises on the subject of prudent fiduciary investment management.

When investment advisors make decisions, they do not view individual investments in isolation. Rather, the goal is to create a diversified portfolio that balances appropriate levels of risk and return for the investor. . . . Ideally, after diversi-

fication only market risk remains. Likewise, the return from a portfolio over time should be more stable than that of isolated investment within that portfolio.⁷⁷

Thus, if a trustee is faced with an instrument where diversification is not in accordance with the wishes of the settlor, the trustee should either: (1) request an amendment to the trust permitting diversification; or (2) obtain a separate agreement signed by the settlor (if living) and beneficiaries, reconfirming that the trustee has no obligation to, or liability for, not diversifying the trust assets. Additionally, if the trustee has an internal policy that recommends portfolio diversification as a routine management procedure, the trustee would be wise to have all parties, particularly all beneficiaries, present and future consent to the decision not to diversify the portfolio, regardless of the provisions in the trust.

The Prudent Investor Rule is a Default Rule. Therefore, when analyzing whether the trustee's management performance under the UPIA meets current judicial standards, it is expected that the court will first review the trust instrument to determine whether the trustee has been given discretionary authority not to diversify. The failure to diversify assets ordinarily will not be a *per se* violation of the trustee's duties, if the trustee does not have an established policy requiring diversification that has been ignored.

Conclusion

Despite the addition of diversification as a separate section of the UPIA,⁷⁸ the requirement is not absolute and may be overcome by several factors. These may include the: (1) settlor's intent, as expressed in the trust agreement; (2) beneficiary's best interests; or (3) imprudence of diversifying in unique circumstances that apply to the trust in question.⁷⁹ As one court expressed, "[T]here is no hard and fast rule as to the extent of diversification required."⁸⁰

There also is no "bright-line" standard for how much is "too much" to invest in a particular investment. Thus, when facing a claim of failure to diversify, it can be expected that a court will look to the existing body of case law in determining whether the trustee's decision will pass muster. Additionally, the court likely would consider standards such as the Uniform Fiduciary Standards of Care when determining whether a fiduciary's allocation and diversification decisions were prudent.⁸¹

A claimant will have the initial burden to establish that: (1) the trustee had a duty to diversify; (2) the trust did not direct the trustee not to diversify; (3) the trustee failed to diversify; and (4) as a result of the lack of diversification, the portfolio suffered a loss. The burden then will shift to the defendant trustee to defend either on the basis that a broad reading of the trust instrument gave the trustee discretionary authority not to diversify or, the more difficult defense, that special circumstances made diversification imprudent.

Finally, it is probable that more cases will arise in which the court rules that the failure to diversify is *per se* negligence. For example, such negligence may be found where the trust assets have not been diversified and the fiduciary has an established policy requiring diversification of portfolios.⁸² Similarly, *per se* negligence may arise when the fiduciary has received a recommendation from an outside professional to diversify the assets of the trust but failed to follow those recommendations and, subsequently, there is a loss.⁸³

This leaves for discussion issues such as when a portfolio should be diversified and how much diversification is "enough." Also unanswered is the question of whether past management practices regarding tax avoidance and actuarial assumptions still apply when a court later scrutinizes trust management policies. These issues will be covered in a future article on the subject.

NOTES

1. The PPR (and Prudent Man Rule) had its origins in *Harvard College and Massachusetts General Hospital v. Amory*, 26 Mass. 446 (Mass. 1830), Uniform Prudent Investor Act, Uniform Laws Annot., Art. 9, Conference of Commissioners on Uniform State Laws (1994) (hereafter, "UPIA").

2. *Restatement (Third) of Trusts: Prudent Investor Rule* (Wash., DC: American Law Inst., 1992) (hereafter, "Restatement (Third) of Trusts") at § 227.

3. *Restatement (Third) of Trusts*, supra, note 2 at § 227, cmt. f ("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 applies even within a portion of a trust portfolio that is limited to assets of a particular type or having special characteristics.").

4. *Appleton*, 197 S.W.2d 70, 73 (Ky.Ct.App. 1946).

5. *Amory*, supra, note 1.

6. *Id.* at 461.

7. N.Y. Est. Powers & Trusts Law former § 11-2.2(a)(1), Laws of 1948. New York later made some minor changes and amended the statute, which now reads "A fiduciary holding funds for investment may invest the same in such securities as would be acquired by prudent men of discretion and intelligence in such matters who are seeking a reasonable income and preservation of their capital. . . ." N.Y. Est. Powers & Trusts Law § 11-2.2(a)(1) (1983). In 1995, New York also adopted the UPIA, *supra*, note 1, which is codified in N.Y. Est. Powers & Trusts Law § 11-2.3.

8. *In the Matter of Rowe*, 712 N.Y.S.2d 662 (N.Y.App.Div. 2000).

9. *Id.* at 665.

10. *Id.*

11. *See, e.g., Amory*, *supra*, note 1; *Appleton*, *supra*, note 4.

12. *New England Trust Co. v. Paine*, 59 N.E.2d 263, 269 (Mass. 1945) ("[E]xculpatory provisions inserted in the trust instrument without any overreaching or abuse by the trustee of any fiduciary or confidential relationship to the settlor are generally held effective except as to breaches of trust committed in bad faith or intentionally or with reckless indifference to the interest of the beneficiary and as to any profit which the trustee has derived from a breach of trust."): *Id.*

13. *Id.*

14. *Id.* at 269.

15. *Id.* at 270.

16. *Id.* at 272.

17. At the time the railroad stocks were purchased for the trust, railroad stock was exempt from local taxation. The beneficial tax nature of such stocks changed when the law affecting local taxation changed in 1916. However, this trust also was affected by World War II and the Great Depression. The *Paine* court recognized the decision of the trustee that "whether to sell an investment of trust funds in a falling market is a perplexing one." *Id.* at 272.

18. *Cavin*, 728 A.2d 92 (D.C. Cir. 1999).

19. *Id.* at 97.

20. *Id.*

21. UPIA, *supra*, note 1 at § 1 (Prefatory Note).

22. *Restatement (Third) of Trusts*, *supra*, note 2 at § 227, cmt. e.

23. CRS §§ 15-1.1-102 through -105 (Colorado Uniform Prudent Investor Act).

24. *Restatement (Third) of Trusts*, note 2 at § 227 (Comments and Illustrations); UPIA, *supra*, note 1 at § 1 (Prefatory Note).

25. UPIA, *supra*, note 1 at § 1 (Prefatory Note).

26. *Id.* at § 3; *see also id.* at § 1.

27. "The long familiar requirement that fiduciaries diversify their investments has been integrated into the definition of prudent investing." Schlesinger and Mark, "Diversification and Other Investment Issues of Charitable and Other Trusts," 28 *Estate Planning* (No. 2) 92 (Feb. 2001).

28. *Id.*

29. UPIA, *supra*, note 1 at § 2(a).

30. *Restatement (Third) of Trusts*, *supra*, note 2 at § 228.

31. *Supra*, note 23.

32. UPIA, *supra*, note 1.

33. *See* official comments at the time of adoption in S.B. 95-121.

34. CRS § 15-1-804(2)(b).

35. *Buder*, 774 P.2d 1383 (Colo. 1989).

36. *I.e.*, funds were invested in initial public offerings ("IPOs").

37. *Buder*, *supra*, note 35 at 1385.

38. The UTMA is found at CRS §§ 11-50-101 *et seq.*

39. CRS §§ 11-50-113(2) and 15-1-304 (1973), respectively.

40. *Buder*, *supra*, note 35 at 1385.

41. *Id.*

42. *Id.*

43. *Prudent Investment Practices, A Handbook for Investment Fiduciaries* (Pittsburgh, Pa.: Found. for Fiduciary Studies, 2003) (*hereafter*, "Prudent Investment Practices"); *Prudent Investment Practices* may be ordered from <http://www.cfstudies.com>.

44. *See, e.g., In the Matter of Saxton*, 712 N.Y.S.2d 225 (N.Y.App.Div. 2000); *Rowe*, *supra*, note 8.

45. *Williams*, 631 N.W.2d 398 (Minn.Ct.App. 2001).

46. *Id.*

47. The stock dropped from approximately \$6.38 to \$14.25 a share.

48. *Williams*, *supra*, note 45 at 405.

49. *Id.*

50. *Id.*

51. *Id.*

52. *Atwood*, 25 P.3d 936 (Okla.Ct.App. 2001).

53. *Id.* at 941, 947-70 to 80 percent of trust's assets held in one company's stock.

54. *Id.* at 940.

55. *Id.*

56. *Id.*

57. *Id.*, quoting Okla. Stat. Title 60, § 175.61(B) (2000); *see also* CRS § 15-1.1-101(b); UPIA, *supra*, note 1 at § 1(b).

58. *Donato*, 110 F.Supp.2d 42, 49 (D.R.I. 2000).

59. *Id.* at 53.

60. *Id.* at 49.

61. *Id.*

62. *Scharlach*, 809 A.2d 376 (Pa.Super.Ct. 2002).

63. *Id.*

64. *Id.* at 387.

65. *See, e.g., Saxton*, *supra*, note 44; *Rowe*, *supra*, note 8.

66. *Id.*

67. *Saxton*, *supra*, note 44.

68. *Id.* at 49-50.

69. *Rowe*, *supra*, note 8.

70. *Saxton*, *supra*, note 44.

71. *Rowe*, *supra*, note 8 at 664.

72. *Prudent Investment Practices*, *supra*, note 43 at 20-24.

73. *Id.* at 13.

74. *Id.* at 27.

75. *Id.* at 27.

76. *Leigh*, 858 F.2d 361 (7th Cir. 1988).

77. *Id.* at 368 ("This discussion is greatly simplified for a somewhat more technical explanation. *see* R. Brealey & S. Myers, *Principles of Corporate Finance* 119-32 (2d ed. 1984).")

78. CRS § 15-1.1-103.

79. *Restatement (Third) of Trusts*, *supra*, note 2 at § 227, cmt. g ("Risk and the Requirement for Diversification").

80. *Paine*, *supra*, note 12 at 272.

81. *Prudent Investment Practices*, *supra*, note 43 at 12.

82. *See Rowe*, *supra*, note 8; *Saxton*, *supra*, note 44.

83. *Scharlach*, *supra*, note 62. ■

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