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THE LIABILITY OF TRUSTEES UNDER THE WEST VIRGINIA TRUST INVESTMENT STATUTE

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There are at present in West Virginia twenty-five national banks and twenty-eight state banks which are authorized to exercise trust powers, and these institutions have under their control approximately one hundred million dollars in trust funds.[1] Since trust business is still in its infancy in West Virginia, the subject of trust investments will assume an ever increasing importance in this state. While formerly the handling of trust funds by trust companies was sometimes looked upon by the bar as an encroachment upon the lawyers' business, a better relationship now exists and lawyers and trust men now realize that cooperation is to the advantage of both.

The bar, as well as the trust companies, has a particular interest in the West Vriginia trust investment statute, since lawyers draft the wills and trust instruments under which investment powers are conferred, and lawyers have the duty of directing trustees as to legal investments.

The early English view was that a trustee should only invest in government or real property securities[2] and this was probably due to the scarcity of good private investments. In America a number of states have followed this strict English rule,[3] while others have adopted a more liberal theory, based upon the standard of care laid down for a trustee in other activities.[4] Almost all states now have statutory lists of investments for trustees, but the construction of these statutes has given the courts some concern.

The doctrine in Virginia is stated in *Cogbill v. Boyd*[5] to be that a trustee should "act with the same discretion and judgment, in making investments of the moneys of his trust fund, that a man of ordinary prudence is accustomed to bestow upon his own private affairs." The above rule was followed in West Virginia in early

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1 Information supplied by office of State Banking Commissioner, Charleston.

2 *Ex parte* Cathorpe, 1 Cox 182, 29 Eng. Rep. R. 1119 (1785).

3 Robertson v. Robertson's Trustee, 130 Ky. 293, 113 S. W. 138 (1908).

4 Harvard v. Amory, 9 Pick. 446 (Mass. 1830).

5 77 Va. 450, 459 (1883). In that case the trustee purchased without recourse a bond for $1,250.00, secured by land worth not more than this. The trustee allowed the interest to remain in default until the debt reached $1,750.00, and the bond had depreciated $500.00.

decisions. In *Key v. Hughes's Executors*,[6] our court quotes with approval the Virginia case of *Elliot v. Carter*[7] as follows:

> ". . . . where a trustee has acted in good faith in the exercise of a fair discretion, and in the same manner in which he would probably have acted if the subject had been his own property, and not held in trust, he ought not to be held responsible for any losses accruing in the management of the trust-funds."

The West Virginia case of *Davis v. Davis Trust Co.*[8] apparently raises the standard for trustees in making investments to that of a prudent man investing *other people's money*. In that case, the trustee clearly went contrary to the directions contained in the trust instrument and invested in speculative stock with the proceeds from the sale of sound bonds which he was directed to hold. The defendant invoked the rule of the prudent man investing his own funds, but the court found that even such prudence and discretion as that was here lacking. The court then quotes the Pennsylvania case of *Hart's Estate*[9] as stating the correct rule:

> ". . . . future events are from their very nature not definitely forseeable, and a prudent man has a perfect right to venture his own money on a calculation of business chances; all fortunes are accumulated by the exercise of just that sort of very common prudence. But with a trustee the case is different; he has all the knowledge, foresight and judgment of the business man; but the money to invest is not his own but belongs to others; it is his plain duty, if he would safely keep it, to minimize risks. He is not bound to have more prudence than the other, but he must utilize his, in avoiding risks which the one who owes no duty to others is free to take. In the one case, in view of probable favorable results, prudence says, 'Take the risk;' in the other, in view of very possible disaster, prudence says, 'Take not the risk.' Common skill and common prudence, as is said in the many cases cited, are all that the law demands of a trustee; that is, the common skill prudence of an investor of money to be safely kept with such reasonable income as is commensurate with safety of the principal."

The above rule imposes a clear and just standard and is sufficient to protect any beneficiary.

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6 32 W. Va. 184, 189, 9 S. E. 77 (1889).
7 9 Gratt. 541, 559 (Va. 1853).
8 106 W. Va. 228, 145 S. E. 588 (1928).
9 203 Pa. 480, 485-486, 53 Atl. 364 (1902).

The *Davis* case also apparently rules out corporate stocks as trust investments. The court said:

> "The authorities uniformly agree that except where expressly authorized by the creator of the trust or by statute, the general rule is that trust funds can not be invested in stocks of private corporations."[10]

Thus at the time of the adoption of our West Virginia trust investment statute in 1931, a trustee in investing trust funds was held to the standard of a prudent man investing other people's money. Since the passage of the statute, trustees have been uncertain as to their duty to follow the legal list of investments and have, for the most past, rigidly adhered to it. An examination of the statute and the construction of similar statutes in other states discloses the correctness of this policy.

The West Virginia investment statute, as amended by the 1939 legislature, provides that:

> "Any executor, . . . trustee, or other fiduciary whose duty it may be to loan or invest money intrusted to him as such, may without any order of any court, invest the same or any part thereof in any of the following securities, and without liability for any loss resulting from investments therein: . . . "[11]

Then follow seven classes of legal investments, which are, briefly: obligations of the United States, obligations of the state of West Virginia, obligations of other states not in default for the previous ten years, obligations of political divisions of West Virginia, first mortgage real estate notes under prescribed conditions, savings accounts of banks to the extent insured by the Federal Deposit Insurance Corporation, and shares of building and loan associations to the extent insured by the Federal Deposit Insurance Corporation.

The statute is permissive in form, and this fact has lulled some trustees into the belief that a trustee may still use his own discretion in making investments.

The only case in which the West Virginia court has had occasion to examine our trust investment statute is *Davis v. See*.[12] In the *See* case, the defendant committee, pursuant to a decree of the circuit court (under the statutory proceeding), purchased notes secured by a deed of trust on real estate, but failed to first obtain

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10 At p. 232.
11 W. Va. Acts 1939, c. 101.
12 119 W. Va. 490, 194 S. E. 271 (1937).

the release of a prior deed of trust, as directed by the decree. He was held liable for the loss at the time he turned over the notes to his successor committee. In the course of the opinion, the court set out the statute as then in effect, and makes the following comment thereon:

> "If he [the trustee] makes any other character of investment, or makes an investment without obtaining authority from a court therefor, he does so at his own risk and is subject to the rule of prudence and good faith required upon the part of all fiduciaries with respect to funds placed in their hands."[13]

The above quotation from the *See* case is dicta since the committee in that case did obtain a court order. His negligence was in not conforming to the court order. The quotation above, therefore, is somewhat ambiguous. One construction would be that in the absence of complying with the list or obtaining a court order, the old rule of prudence and good faith would be involved. However, as will be shown, the courts of most other states consider failure to follow the list or to obtain a court order as negligence in itself. It is submitted that the statement of the court is not inconsistent with the latter view, for surely the court did not intend to say that trustees conforming to the statutory list were automatically exempt from the rule of prudence and good faith.

Our statute is similar to that of other states, and therefore it is pertinent to consider the decisions of these courts construing such statutes. It must be pointed out here that the present discussion only covers the case where the trust instrument is silent as to investment powers of the trustee.

In *Willis v. Braucher*,[14] the Ohio court had under consideration the Ohio statute:[15]

> "Executors, administrators, guardians and trustees may, when they have funds belonging to the trust which are to be invested, invest the same in the certificates of the indebtedness of this state or of the United States, or in such other securities as may be approved by the court. . . ."

The court held that this statute was permissive and under it a trustee could invest in bank stock (non-legal) without specific direction from the testator.

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[13] At p. 497.
[14] 79 Ohio St. 290, 297-298, 87 N. E. 185 (1909).
[15] OHIO REV. STATS. § 6413; OHIO COMP. CODE (1931) § 11214.

In *Wilmington Trust Co. v. Worth,*[16] the Delaware court examined the law of two states, Delaware and Pennsylvania, since there was some doubt as to which applied. The Pennsylvania constitution prohibits the legislature from allowing a trustee to invest trust funds in corporate stocks.[17] Several Pennsylvania statutes designate securities proper for trust investment, with the words "are hereby authorized", and "may" invest trust funds in certain securities.[18] The Delaware court held that under Pennsylvania law there must be express authority (here general discretion) to go outside the legal list, following *In re Taylor's Estate,*[19] construing the Pennsylvania law as mandatory.

The court also discussed the Delaware statute to the effect that

> " 'Trustees, Guardians and other fiduciaries may invest the funds of their trusts as follows:
>
> " '(A)—In accordance with the provisions pertaining to investments contained in instruments under which they are acting;
>
> " '(B)—In the absence of any such provisions, then in securities of the following classes: . . .' "[20]

The statute also provides that a trustee may hold original non-legal investments "until in the exercise of due care, it shall become no longer wise to do so." The court held this to be a permissive statute allowing non-legals.

In *Clark v. Clark,*[21] the Georgia court construed the statute in that state:[22] "Trustees may invest in. . . ." certain securities or in other securities under an order of the court. The Georgia court held that any investment in non-legals was at the risk of the trustee in the absence of authority in the trust instrument.

In *Babbitt v. Fidelity Trust Co.,*[23] the New Jersey court held that a trustee should have converted non-legal Prudential Life Insurance stock into legal securities in the absence of authority in the declaration of trust. The applicable New Jersey statute provides:

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16 19 Del. Ch. 314, 167 Atl. 848 (1933).
17 PA. CONST. art. III, § 2.
18 20 PA. STATS. §§ 801, 802; Pa. Laws 1917, 46; Pa. Laws 1917, 447; Pa. Laws 1923, 1059.
19 277 Pa. 518, 121 Atl. 310 (1923).
20 37 DEL. LAWS c. 259, § 3875, as amended.
21 167 Ga. 1, 144 S. E. 787 (1928).
22 GA. CODE (1926) § 3765 (1).
23 72 N. J. Eq. 745, 66 Atl. 1076 (1907).

> "Any executor, . . . or trustee, whose duty it may be to loan the money entrusted to him may invest the same in any of the following securities:"[24]

In *Tuttle v. Gilmore*,[25] also a New Jersey case, the trust instrument provided that the trustee should not be liable for any cause, matter or thing except his own willful breaches of trust. The court held that his investment in unauthorized securities constituted such a willful default. The investments here, however, were not only unauthorized, but speculative in nature. The New Jersey court apparently construes its statute as mandatory.

In *Robertson v. Robertson's Trustee*,[26] the Kentucky court construed a statute similar to that of West Virginia, permissive in form. The statute permits trustees to invest in bank stock where the bank has been in successful operation for ten years.[27] The court held the trustee liable although he acted in good faith and good judgment. The court held that the legislature, by mentioning one type of bank stock, thereby excluded all other. The court apparently construed the statute as mandatory if the same reasoning is used as to the other provisions.

In *In re Robbins' Will*,[28] the New York court discussed the English rule that trustees should only invest in government or real securities, and held that the same doctrine governed in New York and that any statutory specifications of investments were intended only to enlarge the scope of investments to that extent, in no way relaxing the stringent rule regarding investments. The statutes under consideration were Personal Property Law, section 21, and Decedent's Estate Law, section III, both permissive in form. This case follows *Villard v. Villard*,[29] in which the highest New York court lays down the rule that New York follows the strict English law regarding investments proper for trustees.

Upon the authority of the cases above cited, which are at least persuasive authority in West Virginia, it is submitted that where a trust instrument is silent, a trustee in West Virginia would probably be held not to have acted as a prudent man if he went outside the statute without a court order. The common law standard may very possibly be held to have been *defined* by the

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[24] 2 N. J. COMP. STATS. (1911) § 35, p. 2271.
[25] 36 N. J. Eq. 617 (1883).
[26] 130 Ky. 293, 113 S. W. 138 (1908).
[27] KY. STATS. (1903) § 4706.
[28] 135 Misc. 220, 237 N. Y. Supp. 409 (1929).
[29] 219 N. Y. 482, 114 N. E. 789 (1916).

statute. In any event a trustee would be foolish to take a chance on non-legal investments.

At this point we may consider the question of whether or not a *general discretion* in the trust instrument is sufficient to allow a trustee to invest in non-legals. In some states such a provision is held to give the trustee such authority,[30] while in most states it is held not to broaden the trustee's investment powers.[31] A review of the cases leads one to the conclusion that in most states only specific directions as to specific classes of property, some of which are cited in the footnotes, permit the trustee to go outside the legal list.

The West Virginia statute also provides:

> "When any fiduciary desires the authority or direction of the circuit court with respect to the investment of any funds in his hands, he shall file his petition in the circuit court of the county in which he qualified, setting out fully the facts, and verifying such petition by his affidavit."[32]

The method provided is by a summary proceeding and all beneficiaries shall be made parties. The only advantage of this proceeding is that the beneficiaries are put on notice of the proposed investments. The court is not an authority on investments and must make a decision upon the petition, answers, and such evidence as may be introduced by the trustee. The beneficiaries are usually not interested in the proceeding and are also unable to judge as to the wisdom of investments. In an early Virginia case, that court declined to take the responsibility for making investment decisions for the trustee,[33] and this would still seem to be a salutary rule, which should not have been changed by statute.

This part of the statute is rather ambiguous in that it could easily be construed as being either mandatory or permissive, and reference is here made to the previous discussion of the investment proper. The statute only applies where the fiduciary "desires" direction of the court, but the consequences of failure to ask for

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30 York v. Maryland Trust Co., 150 Md. 354, 131 Atl. 829 (1926); *In re* Leonard's Will, 118 Misc. 598, 193 N. Y. Supp. 916 (1922); Lawton v. Lawton, 35 App. Div. 389, 54 N. Y. Supp. 760 (1898).

31 Babbitt v. Fidelity Trust Co., 72 N. J. Eq. 745, 66 Atl. 1076 (1907); *In re* Taylor's Estate, 277 Pa. 518, 121 Atl. 310 (1923); Equitable Trust Co. v. Snader, 20 Del. Ch. 278, 174 Atl. 132 (1934); *In re* Robbins' Will, 135 Misc. 220, 237 N. Y. Supp. 409 (1929); Mobley v. Phinizy, 42 Ga. App. 33, 155 S. E. 73 (1930).

32 W. VA. CODE (Michie, 1936) c. 44, art. 6, § 3.

33 Poor v. Tayloe's Adm'r, Gilmer 336 (Va. 1821).

direction in investing in non-legals would probably be disastrous if the trust estate suffered a loss.

The 1939 legislature, in an effort to protect the trustee in holding original investments, placed upon the statute books a provision which rivals any exculpatory clause ever put in a trust instrument at the instance of a fearful trustee. The statute expressly permits the fiduciary to continue to hold securities originally received by them unless otherwise ordered by a court having jurisdiction of the matter or unless the trust instrument directs a change to be made. The statute then provides that " . . . any such fiduciary shall not be liable for any loss that may occur by depreciation of such securities."[34] This would apparently relieve the fiduciary of responsibility, although he held speculative securities indefinitely, or failed to take the slightest heed to business and market conditions affecting such original securities, and allowed the trust estate to be entirely lost. Surely this was not the legislative intent, but the statute would so indicate. It does not provide that a *court order* must be obtained in order to continue to hold original securities, though this thought may have been in the minds of the code revisers.

In view of the criticism here made of our West Virginia investment statute, some constructive suggestions should be made.

In the first place, the statute should clearly set out whether or not the legal list is mandatory or permissive. The effect of it at present is mandatory, and if the intention of the legislature is to make the list *exclusive* as to trust investments, this should be set out. On the other hand, if a trustee is still to be held to the prudence and good faith of a prudent man investing other people's money, the statute should define the relationship of the legal list to such standard of care. It is submitted that the above standard is a good one, in that it affords the beneficiaries ample protection, and it allows a trustee to exercise his own good business judgment, which was probably the reason he was selected. A trustee should not be penalized for not adhering to the legal list, if he acts in good faith and as a prudent man would act in the investment of other people's money. If there is a charge of negligence, the case should be judged by this rule, taking into consideration the facts and circumstances surrounding the original purchase and subsequent facts which might put a prudent man on notice to change the investment.

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[34] W. Va. Acts 1939, c. 101.

Government bonds might certainly constitute part of a well invested estate, but to have an entire estate so invested seems a needless sacrifice of income, when there are preferred stocks, with a consistent record of earnings, straight through the recent depression. An exclusive legal list has the effect of placing the trustee in a straight-jacket and forces him to discard as useless all of his business experience, all investment statistics and all personal judgment. If this is not the legislative intent, it should be set out in the statute that the legal list is not exclusive and that failure to follow it does not constitute negligence. The value of having a legal list at all is rather doubtful.

As to the provision allowing the circuit court to pass upon investments and indeed to promulgate further legal lists, it may only be said that the qualities and experience which make a good judge do not necessarily include experience as an investment counsel.

The statute should also state the legislative policy as to investment in corporate stocks. There would seem to be no good reason for excluding these as trust investments, when stocks may now be purchased which conform to the rule of "such reasonable income as is commensurate with safety of the principal".[35]

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[35] Davis v. Davis Trust Co., 106 W. Va. 228, 234, 145 S. E. 588 (1928).