Fiduciary Investments-1948

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NOTES

FIDUCIARY INVESTMENTS - 1948*

Prepared in collaboration with Raymond M. Remick, Esq.†

Acts 158, 189, and 468 of the 1947 session of the General Assembly of Pennsylvania, broadening the group of approved investments for fiduciaries, suggest the advisability of a brief consideration of existing legislation on the subject.

Historical Background

The Fiduciaries Act of 1917 was the first statutory recognition of the right of Pennsylvania trustees to make investments without securing the prior authorization of the court: see Report of Commission (1917), page 204. While theretofore investments were made subject to subsequent court approval (Benade's Est., 44 D. & C. 622) in such investments as the court was authorized to direct, legislative approval of this practice was not given until 1917. See Henry's Est., 341 Pa. 439, concerning investment of proceeds of sale under the Revised Price Act of 1917. Prior to 1917, the situation apparently was very much the same as that which existed concerning investments by guardians of the estates of incompetents subject to the jurisdiction of the common pleas court before 1935: see Fiduc. Rev., Apr. 1945.

The Act of February 18, 1824, 8 Sm. L. 194, authorized the Orphans' Court, upon petition, to direct investments in the "debt of the U. S., of Pennsylvania, of the city of Philadelphia, or in real securities". Prior thereto it had been the custom of the courts to authorize fiduciaries to invest in government securities, mortgages, or ground rents.

Constitutional Limitation

Between 1832 and the constitution of 1873, several statutes authorized the court to direct investment in bonds of additional municipalities and private corporations. The constitution of 1873, Article III, §22, restricted the power of the legislature to designate appropriate trust investments by providing that "No act of the General Assembly shall authorize the investment of trust funds by executors, administrators, guardians or other trustees, in the bonds or stock of any private corporation. . . . .". This was changed by amendment on November 7, 1933, to read "The General Assembly may, from time to time, by law, prescribe the nature and kind of investments for trust funds to be made by executors, administrators, trustees, guardians and other fiduciaries." The acts of Assembly enacted between 1873 and 1933 which violated the constitutional provision (cf. life insurance for minors: Solomon's

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Petition, 77 Pitts. 545; farm loan bonds: Schollenberger's Est., 30 Schuyl. 407) were not made effective by the constitutional change: Investment of Trust Funds, No. 1, 26 D. & C. 651. See generally, Historical Sketch by the late Hon. Franklin S. Edmonds, in pamphlet published in 1935 under the direction of the Committee on Trust Investments of the Pennsylvania Bankers Association.

Unauthorized Investments

Existing legislation, summarized in the chart on page 250, is found largely in section 41 of the Fiduciaries Act of 1917, as last amended by Acts 158 (May 31, P. L. 350), 189 (June 5, P. L. 411), and 468 (June 27, P. L. 1080) of 1947. The Fiduciaries Act, as well as all other legislation ever enacted in Pennsylvania on the subject, merely lists the classes of investments which a fiduciary acting with common caution and prudence [Fid. Act §41 (a) 1 (17a)] can make without personal liability for loss: cf. Fid. Act §41 (a) 3. It does not thereby follow that investments made without legislative sanction are "unlawful" investments (Gibson's Est., 312 Pa. 359), or that there can be no surcharge for an authorized investment imprudently made: Reik's Est., 18 D. & C. 252. But a fiduciary making an unauthorized investment, in absence of authority to do so in the trust instrument, becomes an insurer thereof and assumes the risk of any loss: Taylor's Est., 277 Pa. 518; Brooke's Est., 26 Berks 173, 321 Pa. 529; Carwithen's Est., 28 D. & C. 66, 73.

Investment Difficulties

While it is perfectly clear that a fiduciary, with his eyes open, should not make an unauthorized investment, the present status of the law is not such that he can find readily what are approved investments. Most of the approved investments are found in the Fiduciaries Act of 1917, §41, but others appear in numerous miscellaneous acts as indicated in the chart on page 250. This is complicated further by the fact that certain additional types of investment, and of investment procedure, are authorized for corporate fiduciaries and their co-fiduciaries which are not available to individual fiduciaries acting alone. And, the validity of many investments depends on facts not readily available to the individual investor, except through secondary sources. Added to this is the fact that investment duties vary with the type of fiduciary making the investment, and that while the property of making the investment depends on the laws existing when the investment is made (Steeds' Trust, 56 Montg. 275), investments which appear to be authorized today may be revealed to be unauthorized by the next financial report. There can be no shifting of the responsibilities of the fiduciary to another, regardless of the competency of such other person or corporation: Iscovitz's Est., 319 Pa. 277.

Much of the confusion that theretofore existed was avoided by the Act of 1935, P. L. 540 (20 PS 814-7) which gives fiduciaries, subject to the jurisdiction of the common pleas court, the right to make the same investments as are authorized for fiduciaries subject to the jurisdiction of the orphans' court. Theretofore the rules applicable to inter vivos trustees appeared to depend on which court first acquired jurisdiction of the trust. However, the investment duties of a personal representative
(see *Fiduc. Rev.*, Nov. 1943), and of a guardian of an incompetent person (see *Fiduc. Rev.*, Apr. 1945) vary substantially from those of a guardian of a minor (cf. *Latshaw's Est.*, 17 D. & C. 27) or a trustee, and care must be exercised in evaluating legislation, case law, the circumstances of each case, and the provisions of the will or trust instrument involved, to be certain concerning the appropriate investment plan to be followed in a given case.

There does not appear to be any higher standard of care required of corporate fiduciaries (*Linnard's Est.*, 299 Pa. 32; *Reyburn's Est.*, 43 D. & C. 85; *Bailey & Regar Trust*, 29 D. & C. 215; *Hammett's Est.*, 23 D. & C. 353) or of individual fiduciaries having more than average experience: *Smoczynski's Est.*, 29 D. & C. 200. While it is recognized that a balanced investment program requires diversification, surcharge will not be imposed for lack thereof (*Saeger Est.*, 340 Pa. 73) but it "may constitute an element in determining whether the fiduciary acted with common skill, common prudence, and common caution": *Romberger's Est.*, 39 D. & C. 604.

Retention of Unauthorized Investments

Among the more difficult decisions to be made by fiduciaries is the course to be followed in the disposition or retention of unauthorized investments. These can be either investments nonlegal when made by the fiduciary, as to which he remains an insurer unless they become legal before a loss is realized (cf. *Harton's Est.*, 331 Pa. 507; *Bailey & Regar Trust*, 29 D. & C. 215, 223; *Iredell's Est.*, 51 Montg. 174); those received in kind under the trust instrument (*Casani's Est.*, 342 Pa. 468;) and those once legal which become nonlegal. In the latter case, a fiduciary, whether subject to the orphans' court [Fid. Act §41 (a) 1 (17) (c); Fid. Act §41 (a) 3], or the common pleas court [Act of 1935, P. L. 540 §4 (b), 20 PS 817] is not liable for loss if he "exercises due care and prudence in the disposition or retention of any such nonlegal investment." Substantial assistance may be given to the fiduciary by the terms of the trust instrument (*Dempster's Est.*, 308 Pa. 153), by the approval or acquiescence of the beneficiaries (cf. *Fiduc. Rev.*, Apr. 1940 and Aug. 1942), by securing the advice of competent legal counsel (Fiduc. Rev., May 1942) and investment counsel: *Hammett's Est.*, 23 D. & C. 353. But little or no assistance, contrary to the practice in other states (see 54 Am. Jur. Trust, §384), or what apparently was the privilege before 1917, is afforded by seeking court instruction (*Carwithen's Est.*, 327 Pa. 490; *Rebmann's Est.*, 338 Pa. 120, *Fiduc. Rev.*, Apr. 1940) except in the case of guardians of incompetents (cf. *Fiduc. Rev.*, Apr. 1945), or when it is desired to invest in Pennsylvania real estate or in bonds of another state or political subdivision thereof: Fid. Act §41 (a) 2. The situation is particularly difficult where a trustee retains its own stock: *Fiduc. Rev.*, Aug. 1944.

Conclusion

In the absence of a statutory rule of common prudence, existing legislation might be clarified with considerable help to fiduciaries.
AUTHORIZED INVESTMENTS FOR FIDUCIARIES*

(1948)†

("The General Assembly may, from time to time, by law, prescribe the nature and kind of investments for trust funds to be made by executors, administrators, trustees, guardians and other fiduciaries"; Pa. Constitution, Art. III, §22, as amended November 7, 1933.)

INVESTMENTS BY ALL FIDUCIARIES

A. Government Obligations

Bonds and obligations of the following governmental bodies for which the faith and credit of the respective governmental bodies is pledged:

(1) The United States, or the District of Columbia, whether the obligation bears interest, or is on a discount basis: Fid. Act §41 (a) 1 (1).

(2) The Commonwealth of Pennsylvania, if "interest bearing": Fid. Act §41 (a) 1 (2); Investment of Trust Funds, No. 2, 26 D. & C. 653; Tax Anticipation Notes as Legal Investments, 30 D. & C. 44.

(3) Any State or Commonwealth of the United States, and any political subdivision thereof, which is not in default in the payment of principal or interest owing upon any of its funded indebtedness: Fid. Act §41 (a) 1 (3). Cf. Fid. Act §41 (a) 2; Act of 1935, P. L. 540 §3, 20 PS 816.

B. Obligations of Federal Government Corporations

Bonds and obligations of the following Federal government corporations created by the Congress of the United States:

(1) Debentures issued by the Federal Housing Administrator pursuant to the National Housing Act of June 27, 1934, 12 USCA 1701: Fid. Act §41 (a) 1 (9).

(2) Bonds of any Federal Land Bank or consolidated bonds of all the Federal Land Banks, being the joint and several obligations of such banks issued pursuant to Act of Congress of July 17, 1916, 12 USCA 641: Fid. Act §41 (a) 1 (10).

(3) Obligations of any Federal Home Loan Bank or consolidated debentures of all the Federal Home Loan Banks issued pursuant to Act of Congress of July 22, 1932, 12 USCA 1421: Fid. Act §41 (a) 1 (13).

(4) Consolidated debentures of all Federal Intermediate Credit Banks, issued pursuant to Act of Congress of March 4, 1923, 12 USCA 1021: Fid. Act §41 (a) 1 (12).

† All statutory provisions set forth in this Chart, of course, are subject to the provisions of the trust instrument.

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C. Obligations of State Government Corporations

Bonds and obligations of the following State government corporations created by special act of the General Assembly of the Commonwealth of Pennsylvania:

(1) Bonds of any housing authority: Fid. Act §41 (a) 1 (15).

(2) Bonds of any municipality authority not in default and meeting specified earning requirements for the five years immediately preceding the date of the investment: Fid. Act §41 (a) 1 (18.1) being Act No. 189 approved June 5, 1947.

(3) Bonds of the general state authority pledging the full faith and credit of the authority: Act of 1937 P. L. 2687, 71 PS 1707-5a; State Authority Bonds, 31 D. & C. 100.


D. Corporate Bonds

Interest bearing obligations of corporations organized under the laws of the United States, any state or commonwealth thereof, or of the District of Columbia, meeting the test which prudent investors apply in the care of their own permanent investments; “Provided, however, That, the corporation issuing such obligations shall have earned a net profit after all expenses and taxes in eight of the preceding ten years: And provided further, That said corporations issuing said obligations shall not have suffered or committed a default in the payment of the principal or interest on any of its outstanding funded indebtedness during such preceding ten years.” Provision is made for adjustments where a merger or consolidation has occurred within ten years: Fid. Act §41 (a) 1 (7).

E. Stock

(1) Preferred stock of corporations organized under the laws of the United States, any state or commonwealth thereof, or of the District of Columbia meeting the test which prudent investors apply in the care of their own permanent investments; “Provided, however, That, such preferred stock, whether a new or an old issue, shall comply with the following requirements: (a) It shall be listed (or if unlisted, it shall be eligible for listing, and application for listing shall have been made) on the New York Stock Exchange or other principal exchange approved by the Secretary of Banking; (b) the corporation issuing such preferred stock shall have earned a
net profit after all interest, expenses, and taxes, but before preferred dividends, in eight of the preceding ten years, and shall not have suffered or committed a default in the payment of preferred dividends during such preceding ten years: (c) any new preferred stock issued by a corporation subject to the supervision of a regulatory body, either State, Federal, or both, shall have received the approval of such body or bodies." Provision is made for adjustments where a merger or consolidation has occurred within ten years: Fid. Act §41 (a) 1 (16).

(2) *Shares* of associations incorporated under Pa. or federal law "the withdrawal or repurchase value of which are insured by the Federal Savings and Loan Insurance Corporation, pursuant to" Act of Congress of June 27, 1934, 12 USCA 1724; Fid. Act, §41 (a) 1 (14); Act of 1935 P. L. 1025, 20 PS 802b; Act of 1937, P. L. 1183, 15 PS 665.

"Note: A corporation may be formed, with court approval, of a business in which a decedent was interested and shares received by fiduciaries in exchange for such interest 'shall be held by [fiduciaries] for the same uses, trusts, and persons as the estate and property were held before the organization of such corporation . . . and they shall have the right to sell such stock under the direction of the court'": Fid. Act §42.

F. Mortgages

Mortgages of one or more individuals or corporations securing bonds or other obligations meeting the following requirements:

(1) Insured by the *Federal Housing Administrator* pursuant to the National Housing Act of June 27, 1934, 12 USCA 1701: Fid. Act §41 (a) 1 (8); cf. Fiduc. Rev., June 1937, P. 2.

(2) Guaranteed or insured pursuant to the *Federal Servicemen's Readjustment Act of 1944*, 38 USCA 693: Fid. Act §41 (a) 1 (18.1), being Act No. 158, approved May 31, 1947.

(3) *Other mortgages* which are first liens on improved real estate located within the Commonwealth (cf. Gouldey's Est., 201 Pa. 491) including improved farm lands, not exceeding two-thirds of the value of the real estate as fixed by appraisal of two real estate men who actually inspect the property, and who so certify on an appraisal filed and preserved by the fiduciary, payable not more than five years after the date thereof unless amortized at a rate not less than 3% per annum over a period not exceeding twenty years. In addition it must meet all requirements and be current as to interest and taxes (cf. Beutel Est., 347 Pa. 237) at the date of investment: Fid. Act §41 (a) 1 (4); Fid. §41 (a) 1 (17d); see chart, Fiduc. Rev., Oct. 1938, P. 4, outlining the case and statutory law on mortgage investments.

(4) *Fractional interests in a mortgage* which qualifies as proper investment may be apportioned among estates of which the person or corporation creating the fractional interests is a fiduciary, or with a co-fiduciary who
is so creating such interests. A new appraisal is not required if one has been made within three years and a certificate evidencing that the mortgage meets appraisal requirements is given in writing by qualified person and filed and preserved by fiduciary: Fid. Act §41 (a) 1 (6); Banking Code of 1933, 7 PS 11091; Pauer Est., 351 Pa. 350; Fiduc. Rev., Apr. 1945.


G. Real Estate

The orphans' court upon petition of the fiduciary, in its discretion, if not contrary to the directions contained in any will in regard to the investment of such moneys” may authorize investment “in real estate in this Commonwealth other than ground rents” : Fid. Act §41 (a) 2; Act of 1935 P. L. 540 §3, 20 PS 816.

Note: Real estate may be accepted in lieu of foreclosure of a mortgage provided the "deed or deeds so made shall recite that such deed is made to save the cost of foreclosure under the terms of this act", and in the case of C. P. fiduciaries subject to court approval: Fid. Act §41 (a) 4; Act of 1941 P. L. 117, 20 PS 817; Fiduc. Rev., July 1941, p.3.

H. Ground Rents

Ground rents secured upon unencumbered improved Pennsylvania real estate, where the annual ground rent capitalized at 5% does not exceed two-thirds of the value of such real estate: Fid. Act §41 (a) 1 (5); cf. Jacobs’s Est., 320 Pa. 539.

1. Interest-bearing Deposits

Interest-bearing deposits in any bank, bank and trust company, savings bank or national banking association located in Pa., not exceeding $1,000 of the funds of any trust estate. Time for permissible withdrawal may not exceed one year and a corporate fiduciary may not make such deposits in its commercial department: Fid. Act §41 (a) 1 (11); cf. Hazelbaker’s Est., 113 Pa. Super. 32; Baer’s Ap., 127 Pa. 360; Byrnes’s Case, 325 Pa. 445.

J. Fractional Interests

Fractional undivided interests in any investment authorized for fiduciaries under section 41 of the Fiduciaries Act, apportioned among the estates of which the person or corporation creating the interests is a fiduciary or with a co-fiduciary who is creating such interests: Fid. Act §41 (a) 1 (6); Banking Code of 1933, 7 PS 819-1109.1.

INVESTMENTS BY CORPORATE FIDUCIARIES AND THEIR CO-FIDUCIARIES

A. Common Trust Funds

Corporate fiduciaries and their individual co-fiduciaries (Act of 1943, P. L. 49, 7 PS 819-1109a) may invest in a common trust fund including authorized investments established and maintained under Pa. law: Fid. Act, §41 (a) 1 (6); Banking Code of 1933, as amended, 7 PS 819-1109; see Fiduc. Rev., chart supplement.
B. Mortgage Investment Funds

Corporate fiduciaries and their individual co-fiduciaries may invest in a mortgage investment fund established and maintained under Pa. law: Fid. Act, §41 (a) 1 (6); Banking Code of 1933, as amended, 7 PS 819-1109.2-5; see chart Fiduc. Rev., Dec. 1941; cf. Act of 1935, P. L. 336, as amended, 7 PS 793.

C. Registration of Ownership

Assets held by corporate fiduciary and its co-fiduciaries (Act of 1945 P. L. 560, 7 Ps 819-1109c) may be registered in the name of the corporate fiduciary or its nominee: Banking Code of 1933, as amended, 7 PS 819-1108; Act of 1947, No. 399, 20 PS 3351; cf. Fiduc. Rev., Jan. 1937; Guthrie's Est., 320 Pa. 530.

D. Self-Dealing

Self-dealing is prohibited under Pa. case law (Saeger Est., 340 Pa. 73) and is prohibited expressly as to corporate fiduciaries, except where the investment was earmarked for trust investment at the time of acquisition and transferred to the trust estate within one year: Banking Code of 1933 as amended, 7 PS 819-1111; cf. Fiduc. Rev., Oct. 1944.

E. Limitations on Investment Action of Corporate Fiduciaries

While a fiduciary may pay a sum not exceeding .005% to "a company, authorized under the laws of this State so to do, for guaranteeing the payment of the principal and interest of such mortgage or other securities" [Fid. Act §41 (b)], the Banking Code of 1933 as amended, 7 PS 819-1021, forbids a bank, a bank and trust company or a trust company from guaranteeing mortgages or funds held by it as fiduciary. And, a corporate fiduciary cannot loan funds held by it as fiduciary to any of its directors, officers or employees except when secured by a mortgage on such person's home or where the corporate trustee is fiduciary for such person: Banking Code of 1933, 7 PS 819-1110.

INVESTMENTS BY CHARITABLE CORPORATIONS

A. Prudent Investors Rule

"Unless otherwise specifically directed in the trust instrument by which any real or personal property, money or other funds, are given, granted, conveyed, bequeathed, devised to, or otherwise vested in, corporations formed for religious, educational, scientific, or other charitable purposes, the directors thereof shall have power to invest the funds thus received, or the proceeds of any property thus received, in such investments as in the honest exercise of their judgment they may, after investigation, determine to be safe and proper investments, and to retain any investments heretofore so made": Act of 1935, P. L. 1137, 15 PS 2851-306.

B. Common Trust Funds

Any nonprofit corporation may maintain "one or more common trust funds . . . for the collective investment and reinvestment of moneys of trusts, and any other funds contributed thereto by such corporation, as fiduciary or otherwise." : Act of 1947, no. 90, 15 PS 2851-318.
LIABILITY OF THE TRUSTEE FOR THE ACTS OF HIS DELEGATE

INTRODUCTION

"If there was no mala fides, nothing wilful in the conduct of the trustee, the court will always favour him. For as a trust is an affair necessary in the concerns between man and man, and which, if faithfully discharged, is attended with no small degree of trouble, and anxiety, it is an act of great kindness in anyone to accept of it: to add hazard or risque to that trouble, and to subject the trustee to losses which he could not foresee be deterring everyone from accepting so necessary an office."\(^1\)

"This court has laid down a rule with regard to the transactions of assignees, and more so of trustees, so as not to strike a terror into mankind acting for the benefit of others... where trustees act by others hands, either from necessity, or conformable to the common usage of mankind they are not answerable for losses."\(^2\)

These are the words of Lord Hardwicke regarding the liability of a trustee in trust administration relative to his own acts and the acts of his agent or delegate. Although they express the court's general attitude toward the trustee, the questions of (1) what losses are those which the trustee could not foresee and consequently not prevent, and (2) when are the acts of the agent or delegate those of necessity or conformable to common usage of mankind remain. An examination of the Pennsylvania court decisions and legislative enactments might serve to furnish the trustee\(^3\) with a direction finder to be used in answering these questions. On the other hand, he may have to revert to the common sense logic expressed by Lord Hardwicke two hundred years ago. The purpose of this note is to discuss this problem.

As a general rule, it may be said that the trustee is under a duty to the beneficiary not to delegate to others the doing of acts which the trustee can reasonably be required to personally perform.\(^4\) A trust has been defined as "a right of property, real or personal, held by one party for the benefit of another."\(^5\) The trustee who holds this property right stands in a fiduciary relation to the beneficiary of the trust,\(^6\) and once he has accepted the trust he can not properly transfer the trust property to another person as trustee and resign from the trust, unless permitted to do so by the terms of the trust or by a proper court.\(^7\) Nor can he properly commit the entire administration of the trust to an agent or co-trustee or other

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1 Knight v. Earl of Plymouth, 3 Atk. 480, Dickens 120 (1747).
2 Ex parte Belchier (1754) Ambler 218, 219.
3 The term "trustee" includes executors, administrators, and guardians: Act of Mar. 51, 1860, P. L. 382, 18 P. S. Sec. 2594; Act of Apr. 22, 1863, P. L. 531, 18 P. S. Sec. 2595.
4 Restatement, Trusts Sec. 171 (1935).
5 Bl. Law Dick. (3d Ed.).
6 Restatement, Trusts Sec. 171, comment a (1935).
7 Restatement, Trusts Sec. 171, comment b (1935).
person unless permitted to do so by the trust instrument. However, he certainly can not be expected to personally perform all duties connected with the trust administration, for such a responsibility might require his being a "Jack of all trades." The number of details involved in the administration of the trust may be so numerous, e.g. selling, leasing, investing, conserving, collecting and disbursing, that a sensible man, faced with the prospect of having to perform personally all of these duties, would shrink from the burden and refuse to accept the trust. Thus, it becomes evident that the law must allow the trustee a reasonable degree of assistance in the management of the trust if it is to provide for such undertakings.

In determining whether the use of assistants is reasonable, the courts have divided the duties of the trustee into discretionary duties and ministerial duties, holding that the former must be carried out by the trustee personally while the latter may be delegated to third persons. The difficulty arises in attempting to classify a particular duty as delegable or non-delegable, i.e. ministerial or discretionary. Restatement of Trusts suggests that in the determination consideration should be given to (1) the amount of discretion involved in the particular duty; (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 involving professional skill or facilities possessed or not possessed by the trustee himself. A good test would seem to be whether the act is one which a hypothetical, average business man, dealing with his own property and with motives similar to trust motives, would consider so important and so within his capacity as to require his personal attention, or whether he could leave it to be done by another. Should he feel compelled to act personally, the courts will require the trustee to do likewise; if the employment of a third person seems reasonable, such freedom will be granted the trustee. Is this not, in effect, asking whether the trustee acted through another "from necessity or conformable to the common usage of mankind."? The Pennsylvania courts have not attempted to lay down any theoretical test for the determination, but have sum-

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8 Restatement, Trusts Sec. 171, comment c (1935); Istocins Estate, 126 Pa. Super 158, 164, 190 A. 382 (1937): "He paid no attention to its (estate) administration, but entrusted it entirely to his brother . . . He failed to exercise common care, prudence, caution and diligence in handling the estate, and he was responsible for and chargeable with what happened through his fault."
9 3 Bogert, Trusts and Trustees Sec. 553, p. 444 (1935).
11 Restatement, Trusts Sec. 171, comment d (1935).
12 3 Bogert, Trusts and Trustees, Sec. 553, p. 447 (1935).
13 Ex parte Belchier, op. cit.
marily dismissed the problem by requiring the trustee to conform to the reasonably prudent man standard in all matters of trust management.\textsuperscript{14}

Consequently, the cases adjudicating the liability of a trustee for the acts of his delegate fall into the following categories:

1. Liability where there has been a proper delegation of duty.
2. Liability where there has been an improper delegation of duty.

\section*{Liability Where Delegation Is Proper}

Generally, the trustee who employs an agent or delegate to assist him in the administration of the trust is not liable to the beneficiary for the acts of such agent resulting in loss or damage to the trust estate.\textsuperscript{15} The courts of Pennsylvania are in accord with this proposition and cite as "the undoubted law of the commonwealth"\textsuperscript{16} the case of \textit{Calhoun's Estate}.\textsuperscript{17} In that case executors received, as part of the testator's estate, a judgment which the testator had recovered against solvent debtors during his lifetime. They issued a \textit{sci. fa.} to revive the judgment, employing the same counsel who had been employed by the testator. Judgment on the \textit{sci. fa.} was obtained, execution issued, and certain lands were levied upon and condemned as the property of the defendants in the judgment. After several years, during which other proceedings were had, it resulted that the money was never received either because of the attorney's embezzlement or neglect in conducting the proceedings. In reversing the orphans' court and refusing to surcharge the executors, the court ruled that fiduciaries would not be held liable beyond what they actually received unless guilty of gross negligence. In \textit{Landemesser's Appeal}\textsuperscript{18} a guardian placed a claim in the hands of a reputable attorney for collection. The attorney collected the claim, embezzled the money, then gave the guardian a judgment note for the amount, which because of the attorney's insolvency proved to be worthless. The fact that the

\textsuperscript{14} \textit{Calhoun's Estate}, 6 Watts 185, 188 (1837); "It is a general principle, that whenever trustees fail in the performance of their duty, or exceed or pervert the power with which they are invested, they and their representatives, whether deriving any benefit from it or not, become responsible to those from whom the trust property should be held; and are chargeable in equity for a breach of trust. But it is not for every act of neglect that they are responsible. Thus, executors and administrators, or trustees, acting with good faith, and without any wilful default, or fraud, will not be responsible for any loss that may arise. All that a court of equity requires from trustees is common skill, common prudence, and common caution."

It would appear that the same is expected of corporate trustees. In re Trust of Bailey and Regar, 29 D. & C. 215, 227 (1936) "No higher degree of knowledge, skill, diligence and caution is required of a corporate trustee than is expected of a prudent business man." In Jones' Estate, 344 Pa. 100, 23 A. 2d 434 (1942), where the liability of a corporate trustee was in question, the court reiterated the rule of "common skill, common prudence and common caution," citing in addition Restatement, Trusts Sec. 174: "The Trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property; and if the trustee has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill as he has." See 299 Pa. 32, 39, 148 A. 192 (1935). \textit{Contra} 35 Lanc. Rev. 1, 7 Leb. L. J. 303 (1917). (Extraordinary care required of corporate trustee).

\textsuperscript{15} Restatement, Trusts Sec. 225 (1) (1935). For trustee's liability to third persons see Restatement, Trusts Sections 261 - 264.

\textsuperscript{16} Webb's Estate, 163 Pa. 330, 337, 30 A. 827 (1895).

\textsuperscript{17} Op. cit.

\textsuperscript{18} 126 Pa. 115, 17 A. 543 (1889).
guardian refused to incur costs in a fruitless effort to enforce payment of the note, or to criminally prosecute the attorney was held not such negligence on the part of the guardian as to warrant surcharging him. Nor will the trustee be held liable for the theft of trust securities and appropriation of trust money by her attorney-at-law where it is shown that the entire management of the trust was not delegated, the matters turned over to the attorney were "usual and proper," and the trustee had no knowledge as would cause her to withdraw her confidence and trust in him.  

It is interesting to note that the language of the courts is not consistent as to what degree of negligence will render the trustee liable for his agent's default. It includes "gross negligence," "supine negligence," and "gross or supine negligence or wilful default." It would seem immaterial what terminology is used in this respect as long as the conduct of the trustee is inconsistent with the affirmative duty of exercising common skill, common prudence and common caution. 

From the foregoing cases, which are examples of losses which the trustee could not foresee and consequently could not prevent it might appear that the burden on the trustee is not excessive; but an examination of exceptions to the general rule more clearly defines the real responsibility of the trustee. It will be noted in the above cases that the acts committed by the delegate were acts which, had they been committed by the trustee himself, would have constituted a breach of trust; i.e. theft, embezzlement, negligence; but because of the trustee's good faith and reasonable diligence, and because the act was properly delegated, he was not surcharged. When, however, these same acts are committed by the agent or delegate under circumstances showing bad faith or lack of reasonable diligence on the part of the trustee, the latter will be held liable to the beneficiary for the resulting loss or damage to the trust estate.

(1) Such is the case where the trustee directs or permits the act of the agent. It is obvious that such conduct would be conclusive evidence of bad faith on the part of the trustee. Once the trustee accepts the trust, he must exercise the highest degree of loyalty possible to the beneficiary. Directing or permitting the agent to commit an act which would constitute a breach of trust if the trustee committed it is in itself a breach of trust, a fortiori, a breach of loyalty. Although the particular question seems not to have been considered by the appellate courts of Pennsylvania, it would follow by implication from the adjudicated cases, that such behavior would constitute such bad faith as to negative reasonable diligence and good faith, or common skill, prudence and caution.

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19 Darlington's Estate, 245 Pa. 212, 218, 91 A. 486 (1914): "A trustee is not an insurer of trust funds against the possibility of loss, and all that is required of him is good faith and reasonable diligence."

20 Calhoun's Estate, op. cit.  
21 Bender's Estate, 278 Pa. 199, 122 A. 283 (1923).  
23 Restatement of Trusts, Sec. 225 (2) (a) (1935).  
24 "The loyalty which a trustee owes to his beneficiary is the basic factor of trust relationship." In re Union Real Estate Investing Co., 331 Pa. 569, 575, 1A. 2d 662 (1938); Restatement, Trusts Sec. 170 (1) (1935).
(2) The trustee owes to the *cestui que trust* the duty of using reasonable care in selecting and retaining the agents he employs to assist him. Though the duty delegated is one delegable, it is incumbent upon the trustee to see that he employs and retains capable persons. In the English case of *Fry v. Tapson*, the solicitor of a trustee, who desired to invest trust funds in real estate mortgages, was permitted by the trustee to employ a valuer to appraise the real estate on which the mortgage was to be given. He imprudently employed the person who also represented the mortgagor, and as a result it was found that the required fifty percent margin between the mortgage value and the amount loaned had not been met. In surcharging the trustee for the loss to the estate, after default on the mortgage, the court recognized the general rule that the trustee was not liable for the default of an agent prudently employed, but held that an "obvious" limitation to the rule was that the agent must not be employed out of the ordinary scope of his business.

Certainly no prudent trustee would employ an agent to perform act X when he knew that the agent's capabilities limited him to the performance of act A. And so would it be in retaining the agent. If at the time of employment, the trustee believed, and had reasonable grounds for believing, that the agent was capable of performing act X, but subsequently learned that the agent could perform only act A, he would be under a duty to the beneficiary to immediately terminate such employment. In passing on the propriety of a given selection, the courts have considered reputation of the agent at the time of the employment, the fact that the testator or settlor had suggested the employment of the particular agent, and even the condition of the fiduciary's health at the time of the employment. The fact that the agent has served the trustee with fidelity for a number of years previous to his theft of trust funds is a defense available to the trustee when charged with negligence. But unjustifiable reliance or leniency may result in liability to the trustee. It does, however, appear that no great burden is placed on the trustee when it comes to selection of an agent. If he acts reasonably he has fulfilled his duty. Of course he must consider the relative importance of the acts to be done by the agent and determine accordingly what qualifications he will require his prospective employee to possess. This is no more than an ordinary prudent man would do when selecting an agent to act for him.

(3) Perhaps the biggest pitfall to trustees is the matter of supervising the conduct of his delegate. Once he has concluded that the duty may be delegated and has used skill and care in selecting the delegate, he is likely to be lulled into a false sense of security and complacently sit by. Lest

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25 Restatement, Trusts Sec. 225 (2) (c) (1935); 3 Bogert, Trusts and Trustees Sec. 555 p. 451 (1935).
26 26 Ch. D. 268 (1884).
27 *Ibid* 281: It was not the ordinary business of a solicitor to choose a valuer for trustees intending to invest trust funds in mortgages.
28 Bender's Estate, 278 Pa. 199, 122 A. 283 (1923).
30 Webb's Estate, op. cit., 338: "If any false sentiment about exposing the insolvency or dishonesty of their own attorney should deter them from a thorough exhibition of the matter, they must take without complaining whatever consequences may result."
this be the case, he is charged with an added duty of supervising the conduct of the delegate. 31

In Skeer's Estate 32 the estate of the testator included an interest in a partnership which was in the process of being liquidated at the time of his death. His wife, the executrix, executed a power of attorney authorizing the liquidator to act for her, and some years later executed a second power of attorney to a successor liquidator who misappropriated large amounts of money and became insolvent, thus causing a substantial loss to the estate. In the period of nine years no action had been brought by the executrix to compel a settlement, or to secure an accounting from either of the liquidators, and testimony showed that she had entertained serious doubts as to the integrity of the second liquidator, having agreed with her own attorney that a suit was necessary; but because of social and personal relations with the liquidator and his family, and because of promises made to her, nothing was done. In surcharging the executrix the court cited the general rule laid down in Calhoun's Estate, 33 and held that the failure of the defendant to inspect the accounts, to investigate the condition of the firm assets, to compel settlement within a reasonable time, or to ask for security could be characterized as gross negligence. The same result was reached in Smith's Estate where an agent employed by the trustee to collect rents on trust property, 34 by an ingenious, but not foolproof, system of accounting embezzled large amounts of money. Testimony showed that inspection of the agents records would have brought to light the defalcation, but that no such examination had been made by the trustee, who instead placed implicit confidence in the agent. The court held the trustee guilty of "supine and culpable negligence." 35

No definite standard of supervision, other than reasonable care, can be set, because each case must, of necessity, be decided on its own particular facts; but even that requirement precludes the careless and indifferent attitude of the trustee exhibited in the above cases. It might reasonably be concluded that the trustee should so acquaint himself with the duties he has delegated as to be able to make periodic inspections of what the agent is doing, or when his own capabilities are limited, to call upon some skilled third person to aid in the performance of his supervisory duties. 36 Such action on the part of the trustee might be considered meddlesome by the agent, but might also save the trustee from unfortunate consequences.

31 Restatement, Trusts Sec. 225 (2) (d) (1935); 3 Bogert, Trusts and Trustees Sec. 555, p. 451 (1935).
34 "The collection of rents involves no delegation of discretion but is a mere ministerial act which a trustee may do by agent or attorney as any other person." Quinn's Estate, 342 Pa. 509, 21 A. 2d 78 (1941).
35 "What is folly when a man is acting for himself becomes negligent when he is trustee.
• • • We are of the opinion that the accountant was guilty of supine and culpable negligence in entrusting the entire management of the collection of rents to his agent in a way that almost amounted to an invitation to commit embezzlement." 24 D. 435, 437 (1915). See Adam's Estate, 221 Pa. 77, 70 A. 436 (1938) (supervision by cotrustees). But see Beck's Estate, 12 Phila. 74, 35 L. I. 153 (1873) (Trustee not liable for rents which might have been collected over a number of years had his real estate agent been more efficient). Proper supervision by the trustee should prevent inefficiency of the agent.
36 Trustees should seek advice of counsel in the performance of their duties, and not to do so may amount to negligence. Bradley's Appeal, 89 Pa. 514, 7 W. N. C. 181 (1879).
(4) Although the exact question has not been considered by the Pennsylvania appellate courts, their holdings on delegation would imply surcharging the trustee where upon learning of the agent's act, which if done by the trustee would have been a breach of trust, the trustee gave his approval, concealed the act, or merely tolerated it. Such would be as much a breach of loyalty and breach of trust as directing or permitting the agent to act unlawfully. Once he becomes aware of the illegitimate conduct of the agent, the trustee must act immediately to repair the damage and to prevent further loss to the trust estate. In *Marcus et al* a trustee (trust company) in bankruptcy employed the Marcus brothers (bankrupts) to aid its own employees in the operation of several stores. On various occasions the trustee received anonymous letters charging the Marcus brothers with being "crooks" and warning the trustee against employing them. The letters were ignored, on advice of counsel, but after three months, the trustee closed the stores being convinced that the brothers were guilty of stealing large quantities of merchandise. Criminal proceedings were instituted immediately by the trustee whose subsequent final account was excepted to by certain creditors of the Marcus firm. In its decision the Federal Court cited *Darlington's Estate* and *Bender's Estate* as the "correct rule" holding the receiver liable to surcharge "only when guilty of fraud or supine negligence equivalent to fraud." The immediate action taken by the receiver undoubtedly saved it from being surcharged for a large amount of money.

(5) As stated in (4) above, the trustee is under a duty to take action when the trust estate is damaged at the hands of his agent. This duty includes compelling the agent to rectify the wrong committed. Hence, where an administratrix indorsed a check representing the proceeds of an insurance policy on the intestate's life and handed it over to her attorney, who, contrary to her instructions, deposited it to his own account and soon thereafter died insolvent, the court held on a bill of review filed by the administratrix two and a half years after her accounting in which she had charged herself with the amount of the insurance proceeds, that she had been guilty of negligence in not attempting to ascertain what had happened to the money, and in failing to compel prompt deposit of the check to her account as required by her bond. Such failure of the trustee is another example of lack of due diligence and might, under certain circumstances, be evidence of bad faith. The trustee must be loyal to the beneficiary and protect the trust estate from any type of attack. A failure in this duty is a breach of trust.

Through all the cases runs a common thread of language which, in spite of the maize of complicated facts, firmly fixes the responsibility of the trustee who has seen fit to employ agents to aid in the administration of the trust:

87 Restatement, Trusts Sec. 225 (2) (e) (1935).
41 Restatement, Trusts Sec. 225 (2) (f) (1935).
42 *In re Bickford's Estate, 16 Pa. Super 572 (1901)* Review allowed for other reasons.
"Thus, executors and administrators, or trustees, acting with good faith, and without any wilful default, or fraud, will not be responsible for any loss that may arise. All that a court of equity requires from the trustee is common skill, common prudence and common caution." 42

LIABILITY WHERE DELEGATION IS IMPROPER

Although the extent of the trustee's liability in cases of proper delegation seems fairly well established, such cannot be said regarding cases in which the trustee has improperly turned over trust duties to an agent. Both the text writers and the courts, with a few exceptions, 44 refrain from defining the degree of liability, and probably with justification. In most cases involving improper delegation where the trustee is surcharged for a loss to the trust estate, the loss has been due to an act committed by the agent and the act has been one which would have constituted a breach of trust had it been committed by the trustee. 45 However, it is conceivable that the loss may not be the result of an act of the agent, or that the act, if committed by the agent, is not of the "breach of trust" type. It is in such cases that the uncertainty exists. In England it has long been held that when the trustee improperly delegates a duty which requires the exercise of his own discretion, he becomes responsible for all losses, whether or not they can be traced back to the improper delegation. 46 There is also authority to this effect in the United States. 47 The theory advanced is that upon accepting the trust, the trustee is vested with certain powers which he alone is to exercise; and that it is so against public policy for him to delegate these powers that if he does so, he will not be heard to say, after trust property is lost, that the loss would have occurred regardless of the improper delegation. 48 This, in effect, makes the trustee an insurer of the trust res immediately upon the improper delegation. 49 Such liability is harsh and yet it might be justified in that it would obviously discourage trustees from taking lightly the trust imposed in them. 50 It must be remembered that there are available to the trustee legal methods by which he may be

42 Note 14 supra.
43 See Note 47 infra.
44 Restatement, Trusts Sec. 225 (2) (b) (1935).
45 White v. Baugh (1835) 9 Bligh. N. R. 181, 5 Eng. Reprint 1261. Re Speight, 22 Ch. D. 727, 756 (1883) Lindley, L. J.: "A trustee has no business to cast 'upon brokers and solicitors, or anybody else, the duty of performing those trusts and exercising that judgment and discretion which he is bound to perform and exercise himself." Ibid 763, Bowen, L. J.: "The proposition as to trustees and agents that they cannot delegate means this simply - that a man employed to do a thing himself has not the right to get somebody else to do it, but when he is employed to get it done through others he may do so."
46 Meck v. Behrens, 141 Wash. 676, 50 A. L. R. 207, 252 Pac. 91 (1927); McCollister v. Bishop, 78 Minn. 228, 80 N. W. 1118 (1899); Re Wood, 159 Cal. 466, 36 L. R. A. (N. S.) 252, 114 Pac. 992 (1911); United States Fidelity Co. & G. Co. v. Taggart, - Tex. Civ. App., 194 S. W. 482 (1917).
48 Ibid: Unlawful surrender of discretion with reference to control and management of the trust renders the trustee a "guarantor."
49 Ibid, Trusts and Trustees Sec. 555 pp. 465, 466 (1935); In re Iscovitz's Estate, 319 Pa. 277, 280, 179 A. 548 (1935): "The obligation resting on fiduciaries can not be lightly discharged."
relieved of the trust duties. This being so, he should be required to apply for that type of relief under the threat of being held as an insurer should he resort to self help. Nor can it be said that the latitude afforded the trustee in cases of proper delegation is inconsistent with liability as an insurer in cases of improper delegation, because the mala fides in the latter instance creates a different picture.

The courts of Pennsylvania have not expressly defined the degree of liability to be imposed on the trustee in cases of improper delegation probably because the particular facts have not required them to do so. However, some holdings might reasonably be used as authority for the proposition that once the trustee delegates to another the performance of acts which he is under a duty to personally perform he becomes liable for all subsequent losses to the trust estate - especially where there is a causal connection between the improper delegation and the loss, and perhaps even where no causal relation exists.

In Istocin's Estate an executor turned over the entire administration of an estate to an agent. At a delayed public sale held by the agent, property of the estate was purchased by a third person at a price much below the appraised value, and on the same day resold to the agent at the same price. On the accounting the auditor found the executor guilty of gross negligence in dealing with the assets of the estate and held him "responsible for and chargeable with what happened through his fault." In affirming the auditor's report, the Superior Court held that by entrusting the agent with the entire control of the estate he became liable for the "unbusinesslike and unjustifiable manner in which it was handled" in spite of the fact that the executor's position was the result of "acts of omission rather than acts of commission." Though the act done by the agent was one which would have constituted a breach of trust if done by the executor, the court seems not to have based its decision on that point alone, but intimates that liability for any acts of the agent arose when the executor improperly turned over the entire administration of the estate to his agent. In Weldy's Appeal cotrustees were held to be sureties for one another, having, without security, divided the trust fund between themselves - each to be responsible for only three of six named beneficiaries - in face of a direction in the will to invest the entire fund for the benefit of all the beneficiaries. The court in Will's Appeal held that a guardian "takes the whole peril on himself" when he puts another in his place to do what he himself should do.

To this effect also is Iscovitz's Estate. There a guardian took funds

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63 102 Pa. 454 (1883). See "The Liability of A Trustee For Misconduct By His Cotrustee" 41 Dick.LR 239 (1937).
64 22 Pa. 325 (1853) (Guardians permitted administrator of estate to collect rents and took a note from him for rents falling in arrears knowing of his difficult financial status). Ibid. 329, Black, C. J.; "Whether he was expressly appointed to collect them for the guardian or not, makes no difference. Their tacit permission was as good as a written power of attorney. A payment to him was a payment to them, and they were as absolutely bound for all he received as if they themselves had received it in their own hands. No matter what they did afterwards, or what they omitted to do. Subsequent negligence could not put them in a worse, nor diligence in a better condition."
of his ward's estate and invested them in what was called a certificate of trust agreement of the Central Trust Savings Company of Philadelphia. The certificate provided for the investment of the funds by the trust company in first mortgages on Philadelphia real estate. On the guardian's final account the auditor held the certificate not an investment, but merely a "receipt" showing a delegation of the duty to invest to the trust company for which he surcharged the guardian. On affirming the auditor's report the court in banc stressed the fact that a duty to invest involved a duty of personal selection which could not be delegated to another, and that it was of no concern that the mortgages held by the trust company (delegate), properly earmarked for the various certificate holders, would be prudent investments for fiduciaries. On appeal, this holding was affirmed by the Supreme Court. Perhaps the most definite language to be found is that in Noble's Estate. Irwin's Appeal where Judge Hawkins, delivering a lower court opinion, which was subsequently affirmed per curiam said:

"A rule applicable to the administration of every trust is that any departure from the ordinary course is at the trustee's risk. The policy of the law is to insure safety, facilitate investigation, and take away from the trustee, as far as possible, the opportunity of abuse."

A reasonable conclusion to be drawn from the above instances of improper delegation is that the courts consider the matter a very serious one upon which they look with great disfavor. Although it is often difficult to determine the exact basis upon which the court has surcharged the trustee, it does seem apparent that (1) if there is an improper delegation of trust duties to an agent; (2) an act by the agent; and (3) a subsequent loss to the trust estate, the trustee will be liable to the cestui que trust for the loss. And this is so regardless of what the delegate has done, as long as he has done something; the theory being that but for the improper delegation by the trustee the loss would not have occurred. It is doubted, however, that liability would be extended to the case where there has been an improper delegation and a subsequent loss without some intervening act on the part of the delegate. e.g., A trustee holding a mortgage on an apartment building as the trust res turns over the mortgage and all trust duties to an agent. Shortly thereafter, and before the agent has acted in any manner, the building is destroyed by fire. Though the improper delegation might be classed as wilful default, gross negligence, or bad faith, it is inconceivable that the trustee would be held liable for the loss which, under no circumstances, could have been prevented by him. The rule that a trustee will not be liable for losses in the absence of gross negligence or wilful default may not, by sound reasoning, be interpreted to mean that when he is guilty of gross negligence or wilful default he becomes liable for all subsequent losses to the trust estate.

57 178 Pa. 460, 461, 35 A. 859 (1896).
58 Detre's Estate, 273 Pa. 341, 350, 117 A. 54 (1922): "A trustee will not be held personally liable . . . in the absence of supine negligence or wilful default, for the result of an intervening world calamity, beyond his power to foresee or prevent."
CONCLUSION

The pivotal question considered by the courts in all cases in which the liability of the trustee for the acts of his delegate is to be determined is whether the trustee has acted reasonably, first in delegating trust duties to another, and second in selecting, instructing and supervising the delegate when the particular delegation has been held to be proper. If, in either instance, the courts are satisfied that the trustee has acted prudently in all matters, they will not surcharge him for loss to the trust estate. If, on the other hand, the trustee is found to be guilty of imprudent behavior, lack of due diligence, or bad faith, he will be held liable to the beneficiary for the loss caused through the act of the delegate. As noted heretofore, the question of liability for losses not due to the acts of either the trustee or the agent, where there has been an improper delegation, seems not to have been settled by the courts of Pennsylvania. It is apparent that the courts favor the trustee and will go to rather extreme limits before subjecting him to liability; and yet they also express their strong disfavor for the trustee who willfully or negligently makes a loss to the trust estate possible. Since each case must be decided on its own particular facts, thus making it impossible to lay down a standardized or inflexible rule to apply to all circumstances, the words of Lord Hardwicke seem as applicable today as when they were spoken, and probably furnish as good a test as any to be used in determining what duty the courts will impose upon the trustee:

“If there was no mala fides, nothing wilful in the conduct of the trustee, the court will always favour him. For as a trust is an affair necessary in the concerns between man and man, and which, if faithfully discharged, is attended with no small degree of trouble, and anxiety, it is an act of great kindness in any one to accept of it: to add hazard or risque to that trouble, and to subject the trustee to losses which he could not foresee and consequently not prevent, would be a manifest hardship, and would be deterring everyone from accepting so necessary an office.”

Harvey H. Heilman

60 Calhoun’s Estate, note 14 supra.
61 Istock’s Estate, note 52 supra; Skeer’s Estate, note 32 supra; Reik’s Estate, 18 D. & C. 252 (1923); Istock’s Estate, note 56 supra.
62 See Webb’s Estate, 165 Pa. 330, 30 A. 827 (1895); Casani’s Estate, 342 Pa. 468, 21 A. 2d 59 (1941). (Trustee’s agreement with trust company whereby trust company takes possession of securities, collects all income, distributes income, and makes investments on approval of the trustees held not on improper delegation or breach of trust); Clabby’s Estate, 338 Pa. 305, 12 A. 2d 71 (1940); Kohler’s Estate, 348 Pa. 55, 33 A. 2d 920 (1943).
63 Note 60 supra.
65 Knight v. Earl of Plymouth, op. cit.