

LETTER OPINION
94-L-73

March 30, 1994

Mr. Rick D. Larson
Acting Land Commissioner
P.O. Box 5523
Bismarck, ND 58502-5523

Dear Mr. Larson:

Thank you for your February 28, 1994, letter requesting an opinion on whether the Board of University and School Lands (Land Board) can completely delegate its investment responsibility for the common schools trust fund and the various other trusts that the Land Board manages. In connection with this, I understand that the Land Board is looking at the possibility of contracting with the State Investment Board to manage the Land Board's investments and that the Land Board is concerned as to the extent to which investment authority may be delegated.

Article IX, Section 1 of the North Dakota Constitution establishes "a perpetual trust fund for the maintenance of the common schools of the state." Under Article IX, Section 11, the Legislature is to "pass suitable laws for the safekeeping . . . of the state school funds."

North Dakota Century Code (N.D.C.C.) ? 15-01-02(2) grants the Land Board "[f]ull control of the investment of the permanent funds derived from the sale of any of the lands described in [N.D.C.C. ? 15-01-02(1)]." N.D.C.C. ? 15-03-05 provides that "[a]t least one-half of the whole amount of the several permanent funds, as computed by the commissioner of university and school lands at the end of each fiscal year, must be invested in first mortgages on farmlands and rangelands in this state if there is a sufficient demand for investment in farm loans." Consistent with this provision, the Land Board must "apply the prudent investor rule in

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investing the permanent funds under its control." N.D.C.C. ? 15-03-04. The prudent investor rule requires the Board to "exercise the same judgment and care, under the circumstances then prevailing and limitations of North Dakota and federal law, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income." Id. The State Investment Board is also charged with "apply[ing] the prudent investor rule in investing for funds under its supervision." N.D.C.C. ? 21-10-07.

The powers and duties of the Land Board require the exercise of judgment and discretion. Letter from Attorney General Nicholas J. Spaeth to Lieutenant Governor Lloyd Omdahl (May 29, 1990). See also Fuller v. Board of University and School Lands, 129 N.W. 1029 (N.D. 1911). The principles governing the administration of trusts apply to the Land Board acting as trustee. Letter from Attorney General Nicholas J. Spaeth to State Land Commissioner Tim Kingstad (August 19, 1992).

Under the prudent investor rule, a trustee as a fiduciary is "entitled to consult advisors in making investment decisions." Ewing v. Ruml, 892 F.2d 168 (2d Cir. 1989), cert. denied, 495 U.S. 949 (1990). Generally, "a trustee may delegate those duties which a person of ordinary prudence might in like circumstances in the management of his own affairs entrust others to perform." City of New Orleans v. Cheramie, 509 So.2d 58, 60 (La. App. 1987). See also Indian Head Nat'l Bank v. Theriault, 84 A.2d 828, 830 (N.H. 1951); Restatement (Third) of Trusts ? 227(c)(2) (fiduciary must act with prudence in deciding whether and how to delegate authority), and comment j thereto (trustee has power and "may sometimes have a duty" to delegate investment functions). Comment j provides:

j. Duty with respect to delegation. In

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administering the trust's investment activities, the trustee has power, and may sometimes have a duty, to delegate such functions and in such manner as a prudent investor would delegate under the circumstances. See generally ? 171. On the trustee's duty to select agents with care and to exercise prudence in monitoring or supervising their activities, see *id.*, Comments *a*, *h*, and *k*. On the trustee's duty to avoid excessive costs generally, see ? 188, Comment *f*; with respect specifically to the trustee's right to be reimbursed for agents' compensation, see ? 188, Comment *c*; and compare the discussion of layered management costs in Comment *m*, below.

The trustee is not required personally to perform all aspects of the investment function. The trustee must not, however, abdicate the responsibilities of the office and must not delegate unreasonably. Prudent behavior in this matter, as in other aspects of prudent investment management, cannot be reduced to a simple, objective formula.

With professional advice as needed, the trustee personally must define the trust's investment objectives. The trustee must also make the decisions that establish the trust's investment strategies and programs, at least to the extent of approving plans developed by agents or advisers. Beyond these generalizations, expressed in terms that are necessarily imprecise, there is no invariant formula concerning functions that are to be performed by the trustee personally.

Many factors affect the nature and extent of prudent and therefore permissible delegation. These factors include the almost infinite variety that exists in trustees and trusteeships, as well as in investment objectives and techniques and in the types, circumstances, and goals of trusts. For example, it would be impractical for delegation decisions not to take account of the scale of a trust's operations and the nature of the trustee's operating structure. Corporate trustees necessarily act through their employees; between that situation and the individual who acts as a trustee or co-trustee, however, there are many variations of trusteeship, encompassing, for example, institutional governing bodies, law firms, and panels of individuals operating with the support of full-time staff.

The trustee's authority to delegate is not confined to acts that might reasonably be described as "ministerial." Nor is delegation precluded because the act

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in question calls for the exercise of considerable judgment or discretion. The trustee's decisions with regard to delegation are themselves matters of fiduciary judgment and responsibility falling within the sound discretion of the trustee.

As in other matters of fiduciary discretion (see ? 187), the trustee must not abuse the discretion to delegate. Accordingly, a court may substitute its judgment for that of the trustee in a matter of delegation if and only if the trustee has acted unreasonably, or has unreasonably failed to act. Similarly, a trustee's liability in a matter of delegation depends on a failure to exercise the required degree of care, skill, or caution.

In deciding what as well as whether to delegate and in selecting, instructing, and supervising agents, the trustee has a duty to the beneficiaries to act as a prudent investor would act under the circumstances. The trustee must exercise care, skill, and caution in establishing the scope and specific terms of any delegation, and must keep reasonably informed in order to monitor the execution of investment decisions or plans.

In all of these matters the trustee has a duty to the beneficiaries to take account of all relevant circumstances. These include the knowledge, skill, facilities, and compensation of both the trustee and the prospective agents. Also of importance are such considerations as the size of the trust estate and the burdens and complexity of both the assets to be managed and the strategies to be implemented. Active investment strategies, for example, especially in low efficiency markets such as real estate and venture capital, are likely to require the hiring of agents with special skills not possessed by many trustees, often not even by professional or corporate fiduciaries.

For further explanation and clarification, I have enclosed a copy of the above provisions referenced in comment j.

Further, there are practical reasons why an agency, such as the Land Board, should be able to use private consultants in helping it make financial decisions. Each of the Board's five members has a broad range of other responsibilities. It is difficult for the Board to satisfy its duty of a trustee to actively manage the fund to benefit its beneficiaries. The Board

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needs assistance. It is not only common, but necessary for agency heads to delegate some of their responsibilities to others.

Sound principles of organization demand that those at the top be able to concentrate their attention upon the larger and more important questions of policy and practice, and that their time be freed, so far as possible, from the consideration of the smaller and less important matters of detail.

K. Culp Davis and R. Pierce, I Administrative Law Treatise 85 (3d ed. 1994). The courts recognize this wisdom and it is reflected in their opinions. Id. See also Earnest v. Moseley, 426 F.2d 466, 469 (10th Cir. 1970); Thompson v. Dep't of Treasury, 533 F. Supp. 90, 98 (D. Utah 1981).

However, the Land Board may not completely delegate its statutorily imposed investment responsibilities. Restatement (Third) of Trusts ? 171, comment f; IIA Scott, The Law of Trusts (1987), ? 171.1. The complete delegation of investment responsibility without statutory authorization would be a violation of the Land Board's fiduciary responsibilities. See Letter from Nicholas J. Spaeth to Lieutenant Governor Lloyd Omdahl (May 29, 1990). It is therefore my opinion that the Land Board may contract with the State Investment Board as to the investment of the various trusts that the Land Board manages consistent with the delegation provisions outlined in comment j.

Sincerely,

Heidi Heitkamp
ATTORNEY GENERAL

dec/pg
Enclosures