Surcharging the Fiduciary

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"Surcharge" is the term broadly applied to the order or decree of the court imposing liability on a fiduciary as the result of a successful exception to his cash or property account upon his intermediate or final accounting. In this paper consideration will be limited to the liability of the fiduciary for breaches of duty with respect to investments, and special emphasis will be placed on certain unusual factors which may affect that liability.

The claims of the beneficiary against the trustee may arise from a great variety of circumstances.[1] For example, the trustee may have breached his duty to invest trust funds by unreasonable delay or by not investing at all. He may have made an improper or illegal investment which he later sold at a profit or at a loss or retained until the accounting. He may have received an investment which was improper for him as a fiduciary when he received it or which subsequently became improper due either to changes in the law governing investments or to changes in the quality of the investment. In either event he may have delayed converting the investment into a proper security for more than a reasonable time or until a bad market condition prevailed or he may never have converted it. He may have invested all or an overly large proportion of the funds of the trust in a single security in violation of his duty reasonably to diversify the investment portfolio. In many of these situations further variety may be provided by the fact that the trustee acted honestly and in good faith or in bad faith or in the advancement of his own self interest. Then, too, the provisions of the trust instrument may have directed or permitted him to do as he did or to do something quite different.

While the various combinations of ingredients which make up the beneficiary's claim pose a series of problems, the general principle governing surcharge for breach of an investment duty is not difficult to state. That which the trustee loses by such breach he loses for himself; that which he gains he gains for the trust. This generality is usually described as giving the beneficiary alternative remedies against the trustee to force him to make good any loss, or to yield any gain or to compel him to put the trust in as

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[1] See generally, RESTATEMENT, TRUSTS §§ 205-216 and 227-231 (1935); BOGERT, TRUSTS AND TRUSTEES §§ 671-689 and 701-708 (1946); SCOTT, TRUSTS §§ 205-216 and 227-231 (1939).

good a profit position as if no breach had occurred.[2] While these alternatives are not confined to breaches of investment duties they find their most frequent application in the investment situation.

It follows that if the trustee has delayed unreasonably in investing or has not invested at all, he is surchargeable with "interest" representing the approximate average yield from approved securities during the period of the breach as determined by the court.[3] In the event that he violated his duty to purchase certain specific securities he may be surcharged with the return which was paid to holders of those securities during his breach,[4] together with any appreciation in the value of the securities up to the time of the decree.[5] If he invests in a non-legal which turns out fortunately, the beneficiaries may affirm the purchase and require the trustee to account for the investment and the profit therefrom;[6] but if the non-legal investment turns out badly, the trustee may be compelled to refund the purchase price, plus interest, to the trust, thus in effect buying the investment for himself.[7] In such a case the court has wide discretion in deciding whether the interest shall be an approximation of the yield from authorized investments or the legal

[2] See RESTATEMENT, TRUSTS § 205 (1935); BOGERT, TRUSTS AND TRUSTEES §§ 703 *et seq.* (1946); SCOTT, TRUSTS §§ 205 *et seq.* (1939). The additional alternatives of specific enforcement and specific reparation are not considered to be applicable here. See SCOTT, TRUSTS § 208 (1939); BOGERT, TRUSTS AND TRUSTEES § 703 (1946).

[3] Board of Regents v. Wilson, 73 Colo. 1, 213 Pac. 131 (1923); Collins v. Collins, 168 Ore. 666, 126 P. 2d 512 (1942); *In re* Ayvazian's Estate, 153 Misc. 467, 275 N.Y. Supp. 123 (1934). In the New York case, for twelve years trustees had on hand, uninvested, about $3700. In surcharging them the court said (p. 136):

> "Their obligation in this connection is to place the cestuis que trustent in the same position which they would have been had their acts conformed to their primary obligations of diligence and prudence. If this sum had been placed in United States Liberty bonds or even in a savings bank, it would have yielded at least 4% per annum compounded semi-annually. This is the amount by which the trust beneficiaries have suffered by reason of the dereliction of the trustees and, consequently, is the measure of their damage in this connection."

[4] *In re* Nola's Estate, 333 Pa. 106, 3 A. 2d 326 (1939); *In re* Listman's Estate, 57 Utah 471, 197 Pac. 596 (1921); Church v. Church, 112 Me. 459, 120 Atl. 428 (1923).

[5] See BOGERT, TRUSTS AND TRUSTEES §§ 707-8 (1946); SCOTT, TRUSTS § 211 (1939).

[6] Pennsylvania Co. Etc. v. Gillmore, 142 N.J. Eq. 27, 59 A. 2d 24, 37 (1948); Russell's Extrs. v. Passmore, 127 Va. 475, 103 S.E. 652, 662 (1920); City Bank Farmers Trust Co. v. Evans, 255 App. Div. 135, 5 N.Y.S. 2d 406 (1938). *See also* Eisenlohr's Estate, 258 Pa. 431, 102 Atl. 115 (1917); *In re* Gurkin's Will, 142 Misc. 271, 254 N. Y. Supp. 494 (1931).

[7] *In re* Jones Estate, 163 Pa. Super. 129, 60 A. 2d 366 (1948); *In re* Fouk's Estate, 213 Wis. 550, 252 N.W. 160 (1934); *In re* Sanders Estate, 304 Ill. App. 57, 25 N.E. 2d 923 (1940); Kinney v. Uglow, 163 Ore. 539, 98 P. 2d 1006 (1940). The trustee will of course be credited with the income, if any, received by the trust from the non-legal.

rate or some other rate.[8] Frequently the determining factor has been the trustee's good or bad faith in making the unauthorized investment.[9]

For breach of a duty to convert, the surcharge will be the difference between the value of the security at the time the court determines the fiduciary should have sold and its value when he did sell.[10] If he retains the investment until the accounting, he may be charged with the value when he should have sold, thus forcing the trustee to purchase for himself,[11] or the court may order the investment sold and the difference charged to the trustee.[12] Since normally the non-converting fiduciary is under twin duties to sell and to reinvest the proceeds, there should be added to the surcharge a sum approximating the income he would have received if he had carried out both duties.[13] If his breach consists of a failure to diversify investments, the court may, and should, determine the maximum which could reasonably have been invested in the security in question and surcharge the trustee for loss occasioned by investment in excess of that amount.[14]

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[8] Albright v. Jefferson County Natl. Bank, 292 N.Y. 31, 53 N.E. 2d 753 (1944) ("rate of interest commensurate with average earnings of trust funds"); Miller v. Pender, 93 N.H. 1, 34 A. 2d 663 (1943) (3-½% held "equitable in view of present low interest rates"); Sellers v. Milford, 101 Ind. App. 590, 198 N.E. 456 (1935) (6% allowed as "reasonable income").

been the trustee's good or bad faith in making the unauthorized

[9] Pennsylvania Co., Etc. v. Gillmore, 142 N.J. Eq. 27, 59 A. 2d 24, 37-8 (1948); St. Germain v. Tuttle, 114 Vt. 263, 44 A. 2d 137 (1945). The Vermont court said, citing RESTATEMENT, TRUSTS § 207, comment *a* (1935):

> "Ordinarily if a breach of trust consists in an improper purchase of property for the trust, the trustee is chargeable with interest at the current rate of return on trust investments, unless the breach of trust was intentionally committed, in which case he is ordinarily chargeable with interest at the legal rate. The real question is what the equities of the particular case demand."

See also Scott § 207.1 (1939).

[10] Babbitt v. Fidelity Trust Co., 72 N.J. Eq. 745, 66 Atl. 1076 (1907); *In re* Baker, 249 App. Div. 265, 292 N.Y. Supp. 122 (1936); Paul v. Girard Trust Co., 124 F. 2d 809 (7th Cir. 1941); McInnes v. Whitman, 313 Mass. 19, 46 N.E. 2d 527 (1943).

[11] *In re* See's Estate, 38 N.Y.S. 2d 47 (N.Y. Surr. 1942); *In re* Lewis' Estate, 344 Pa. 586, 26 A. 2d 445 (1942); *In re* Blish Trust, 350 Pa. 311, 38 A. 2d 9, 12 (1944); Cameron Trust Co. v. Leibrandt, 229 Mo. App. 450, 83 S.W. 2d 234 (1935).

[12] Pollack v. Bowman, 23 N.J. Misc. 63, 41 A. 2d 253 (1945).

[13] Paul v. Girard Trust Co., 124 F. 2d 809 (7th Cir. 1941); *In re* North's Will, 235 Wis. 639, 294 N.W. 15, 17 (1940). *See also* Dickerson v. Camden Trust Co., 1 N.J. 459, 64 A. 2d 214, 218 (1949); *In re* Nola's Estate, 333 Pa. 106, 3 A. 2d 326 (1939). Again, as in the case of investment in a non-legal, the trustee is credited with any income received by the trust from the security he improperly retained. *In re* See's Estate, *supra* note 12.

[14] Pennsylvania Co., Etc. v. Gillmore, *supra* note 10 (25% of fund determined reasonable maximum; trustee surcharged with loss from excess); *In re* Toel's Estate, 39 N.Y.S. 2d 896 (N.Y. Surr. 1943) (trustee, directed not to invest more than $10,000 in any single investment, invested $18,000; surcharged as to $8,000); RESTATEMENT, TRUSTS § 228, comment *h* (1935).

Such is a brief sketch of surcharge for breach of investment duties in some of the more or less standard situations. It is now proposed to examine the results of the cases where there is an added factor present: (1) the market is distorted by panic, depression and the like; (2) the trust instrument contains an exculpatory clause; (3) the beneficiary consents to or acquiesces in the breach; and (4) the breaching trustee seeks to balance loss against gain.

WHERE THE LOSS IS THE RESULT OF A DISTORTED MARKET

From the vantage point of 1951 it is possible to critically appraise the effect of a fluctating market or a market distorted by panic, depression and the like on the liability of a trustee for loss in the value of trust assets. The depression of the thirties resulted in widespread litigation in which attempts were made to surcharge trustees for losses resulting from depressed economic conditions. While the courts generally reached a sound result, the precise factors which control that result remain clouded.[15] An attempt will be made to analyze the elements which the courts emphasized in concluding that the trustee was either responsible or not responsible.

A trustee is bound to exercise such care and diligence in performing the duties of trust administration as a prudent man would exercise in dealing with the property of others, adhering to the rule that he is primarily a conserver. This is basically true whether the trustee is operating in a state which has a so-called "legal list" or not.[16] The test or a variation of it is also the yard-stick by which courts determine the liability for losses due to disrupted economic conditions. Under such a test it is clear that the decision to surcharge or not will depend on the circumstances of the particular case,[17] but as will appear there are certain critical facts which in-

[15] For an excellent discussion of the problems involved see Moore, *A Rationalization of Trust Surcharge Cases*, 96 U. OF PA. L. REV. 647 (1948); 10 ST. JOHN'S L. REV. 75 (1938). While it is apparent that inflated markets may have an equally disastrous effect on the intrinsic value of investments, the courts have not been faced with the problem in the surcharge cases, for the face value of the investment either remains firm or rises with the market. Trustees, however, are faced with the problem of the proper type of investment in view of inflation, and recently this has been the subject of widespread discussion by those in the trust field.

[16] RESTATEMENT, TRUSTS § 174 (1935); BOGERT, TRUSTS AND TRUSTEES § 541 (1946); See Note, 77 A.L.R. 505 (1932).

[17] Hatfield v. First National Bank of Danville, 317 Ill. App. 169, 46 N.E. 2d 94 (1942); *In re* Pate's Estate, 84 N.Y.S. 2d 853 (N.Y. Surr. 1948). In the latter case the court said, at page 858:

> "The books are replete with surcharge cases, and the governing law is as simple as it is deeply rooted. Seemingly, therefore, the solution to the problems presented should be readily at hand. Yet each case rests on its own peculiar facts. And the elements composing prudence are so human and imponderable, there is no scientific or precise gauge for measuring it. Again, after the event, the line of distinction between negligence and mere error of judgment, and between lack of care and prevision, is not always clearly discernible."

fluence the decision.

The courts generally state that if the trustee has acted in good faith and has not been guilty of a clear breach of trust, has acted with ordinary prudence, and the loss is due solely to "unforeseen and violent" curtailment of income, or depression, the trustee is not surchargeable.[18] Consideration of the cases demonstrates that if on the facts the courts do not wish to surcharge, this formula is applied. In every case where a trustee has been surcharged for loss due to depression, he has committed a plain breach of trust as outlined in the introductory section of this paper.

At the outset it may be noted that the courts are hesitant to surcharge a trustee for loss due to depression, for as courts of equity they are impressed with the hardship of surcharging for losses which result largely from the general disintegration of the commercial community and which are fundamentally the fault of the economic system rather than the individual. Sometimes the courts find justification for not surcharging in the existence of an exculpatory clause in the instrument,[19] discretionary investment powers,[20] power to retain,[21] or a direction to retain or not to sell the particular investment.[22] Sometimes the justification is based on acquiescence or estoppel,[23] or laches.[24] This general reluctance to surcharge is clearly illustrated by the tendency of the depression

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[18] First National Bank of Birmingham v. Basham, 238 Ala. 500, 191 So. 873 (1939); Day v. First Trust and Savings Bank, 47 Cal. App. 2d 470, 118 P. 2d 51 (1941); Cox v. Camden Safe Deposit and Trust Co., 124 N.J. Eq. 490, 2 A. 2d 473 (1938); *In re* Winburn's Will, 140 Misc. 18, 249 N. Y. Supp. 758 (1931); SCOTT, TRUSTS § 204 (1939). It may be noted that a trustee must act in good faith, and that this factor alone should not warrant a court in refusing surcharge. Yet note *In re* McCann's Will, 212 Minn. 233, 3 N.W. 2d 226 (1942) where trustee held stock in the same company and received no compensation, the court appeared more lenient because of this positive proof of good faith.

[19] New England Trust Co. v. Paine, 317 Mass. 542, 59 N.E. 2d 263 (1945), 320 Mass. 482, 70 N.E. 2d 6 (1946); *In re* City Bank Farmers Trust Co., 270 App. Div. 572, 61 N.Y.S. 2d 484 (1946); *In re* Winburn's Will, *supra* note 19; *In re* Clark's Will, 257 N.Y. 132, 177 N.E. 397 (1931). For discussion see section 2 of this paper.

[20] *In re* City Bank Farmers Trust Co., *supra* note 20. *In re* Beadlestone's Estate. 146 Misc. 548, 262 N.Y. Supp. 507 (1933); *In re* Detre's Estate, 273 Pa. 341, 117 Atl. 54 (1922); St. Germain's Admr. v. Tuttle, *supra note* 10; see note, 99 A.L.R. 909 (1935).

[21] *In re* Winburn's Will, *supra* note 19; *In re* Jones' Estate, 344 Pa. 100, 23 A. 2d 434 (1942); Peck v. Searle, 117 Conn. 573, 169 Atl. 602 (1933); Fairleigh v. Fidelity National Bank and Trust Co., 335 Mo. 360, 73 S.W. 2d 248 (1934).

[22] Nelligan v. Long, 320 Mass. 439, 70 N.E. 2d 175 (1946); *cf.* Estate of Weston, 91 N.Y. 502 (1883).

[23] Discussed *infra* in section 3 of this paper.

[24] Pollack v Bowman, 139 N.J. Eq. 47, 49 A. 2d 881 (1946); SCOTT, TRUSTS § 219 (1939).

cases to depart from the well settled view that a trustee who takes trust property in his individual name without ear-marking it, is responsible for any loss or decline in the value of the property, irrespective of the cause of loss.[25] Where the depreciation is due solely to general economic conditions, the courts in refusing to surcharge emphasize the good faith of the trustee and lack of causal connection between the loss and failure to ear-mark.[26] Similarly, while a trustee may be held liable under a positive duty to diversify investments, he has been held not liable for loss resulting from a combination of failure to diversify and a depression.[27]

On the other hand, the courts do not hesitate to surcharge if the trustee's breach of trust is patent and is the direct and inducing cause of a loss which might have been avoided, even though there was a depression. Thus, in *Tannenbaum v. Seacoast Trust Co.*,[28] the trust company sold its bonds to investors and secured payment of principal and interest by the deposit and pledge with trustees of assets of the trust company. The trust instrument provided that the trust company should keep on deposit with the trustees at all times securities worth 110 per cent of the principal face value of all outstanding participation bonds. Because of the depressed market conditions, securities held by the trustees fell considerably below these amounts, and as a result, on the trust company's insolvency the bondholder-beneficiaries suffered loss. The court surcharged the trustees, emphasizing that it was their lack of diligence in failing to examine the value of pledged securities that resulted in loss. The additional fact appeared that the trustees were officers of the trust company and thus had special knowledge of the circumstances which led to the loss. The decision of the court is clearly correct since the requirement of adequate security was for the very purpose of guarding the beneficiaries against loss due to market decline and other conditions. So, too, where a trustee ignored the settlor's express direction to sell certain real estate in 1926 and reinvest in certain bonds, the court held the trustee

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[25] Trustees who fail to segregate or earmark trust property are generally held responsible for any loss which results regardless of the cause of loss. This is based on the theory that the practice should be discouraged and that penalizing the trustee will further such purpose. RESTATEMENT, TRUSTS § 179 (1935); BOGERT, TRUSTS AND TRUSTEES § 596 (1946).

[26] Miller v. Pender, 93 N.H. 1, 34 A. 2d 663 (1943); Chapter House Circle of King's Daughters v. Hartford National Bank and Trust Co., 124 Conn. 151, 199 Atl. 110 (1938); Rotzin v. Miller, 134 Neb. 8, 277 N.W. 811 (1938); BOGERT, TRUSTS AND TRUSTEES § 596 (1946); SCOTT, TRUSTS § 205.1 (1939).

[27] First National Bank of Boston v. Truesdale Hospital, 288 Mass. 35, 192 N.E. 150 (1934).

[28] 16 N.J. Misc. 234, 198 Atl. 855 (1938), *aff'd*, 125 N.J. Eq. 360, 5 A. 2d 778 (1939).

surchargeable for loss that resulted from failure to convert.[29] In determining the amount of such surcharge, the court said it would have to consider the market value of the real estate during the year or two after it came into the trustee's possession and what the present financial position of the estate would have been if the trustee had bought the bonds as directed. Similarly, a trustee must bear the loss which results if he fails to sell "non-legal" securities within a reasonable time during periods of prosperity and then sells in a depression at a great loss,[30] invests in "non-legals" during the depression,[31] fails to sell during a declining market when he has knowledge of facts which indicate that holding the securities is extremely hazardous,[32] ignores expert advice to sell,[33] or retains investments in order to profit personally.[34] In short, in the foregoing situations in which the trustee has been surcharged, the facts clearly showed a breach of trust which directly resulted in loss.

In other situations in which there is no clear breach of trust resulting in loss, the court's determination of liability depends on a balancing of delicate factors indicating whether the trustee has acted reasonably. A variety of elements are considered. Reasonable care requires the trustee to be "enlightened and guided by the approved rules applicable to investment of trust funds, not by his uninformed personal judgment. . . ."[35] A diligent fiduciary should examine the investments with care in light of the economic conditions and desire of the settlor. He should study financial statements and current business reports of the companies whose securities are held.[36] He should consult with persons experienced in the investment field,[37] as well as considering investment services and the like.[38] Thus, where trust investments "were examined and con-

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[29] *In re* Nola's Estate, 333 Pa. 106, 3 A. 2d 327 (1939).

[30] Paul v. Girard Trust Co., 124 F. 2d 809 (7th Cir. 1941); *In re* Frances' Estate, 245 App. Div. 675, 284 N. Y. Supp. 153 (1935).

[31] Merchant's National Bank of Aurora v. Frazier 329 Ill. App. 191, 67 N.E. 2d 611 (1946).

[32] *In re* Conover's Trusteeship, 50 Ohio Supp. 330 (1933).

[33] *In re* Busby's Estate, 288 Ill. App. 500, 6 N.E. 2d 451 (1937).

[34] *In re* Stumpp's Estate, 153 Misc. 92, 274 N.Y. Supp. 466 (1934).

[35] *In re* Allis' Estate, 191 Wis. 23, 209 N.W. 945 (1926); *rehearing denied,* 210 N.W. 418 (1927); *In re* Taylor, 277 Pa. 518, 121 Atl. 310 (1931).

[36] *In re* Kent's Estate, 146 Misc. 155, 261 N.Y. Supp. 698 (1932), *aff'd,* 246 App. Div. 604, 284 N. Y. Supp. 976, *leave to appeal denied,* 270 N. Y. 675 (1936); *In re* Stirling's Estate, 342 Pa. 497, 21 A. 2d 72 (1941).

[37] *In re* Bunker's Estate, 184 Misc. 315, 56 N.Y.S. 2d 746 (1944); Casani's Estate, 324 Pa. 468, 21 A. 2d 59 (1941).

[38] *In re* Bunker's Estate, *ibid; In re* Kent's Estate, *supra* note 37; Welch v. Welch, 235 Wis. 282, 290 N.W. 758 (1940).

sidered by a committee of the trustee's directors at least once in every six months," and the committee was composed of financiers who were members of the New York Stock Exchange, the court refused to surcharge.[39] In *Lentz's Estate*,[40] the investments were considered daily by the research department of the trustee's trust department; a special investment committee of the trust department met several times each week and considered the trust portfolio. From 1926 to 1941 the investments were examined some 679 times. This was the critical factor in the court's refusal to surcharge in spite of expert testimony that the trustee failed to do its duty. But in another situation in which no such meeting was held for over two and one-half years to consider the trust investments, the trustee was held surchargeable.[41]

While it is obvious that a trustee might make a prudent decision as to investment, retention or sale of securities based simply on his own judgment, the courts have emphasized the above noted circumstances in refusing to surcharge in the depression cases. Whether the decision was in fact prudent will depend on the state of facts existing at the time the trustee acts.[42]

The trustee may not speculate with trust funds, but may invest in or retain "seasoned" securities.[43] Where the trustee has invested in such securities which are gradually declining along with practically all other investments, it would be unsound to require that the trustee sell them and attempt to find a better investment in view of his duty to conserve over extended periods of time involving both periods of depression and inflation.[44] Moreover, while "seasoned" securities may decline in monetary value, in terms of extrinsic value or purchasing power, their value usually remains firm.[45] As one court said, the "decision to sell in a declining market is perhaps the most difficult decision to make in the administration of a trust,"[46] and the courts have been unable to state at just what

[39] *Re* Fulton Trust Co. of New York, 257 N.Y. 132, 177 N.E. 397 (1931).

[40] 364 Pa. 304, 72 A. 2d 276 (1950).

[41] *In re* Junkersfeld's Estate, 244 App. Div. 260, 279 N.Y. Supp. 481 (1935).

[42] First National Bank of Boston v. Truesdale Hospital, 288 Mass. 35, 192 N.E. 150 (1934).

[43] A determination as to whether a stock is "seasoned" may be made by looking to these factors: "What has been the history of the companies during a period of years? Have they paid dividends of regular amounts? Have they a proper capital structure? Are they wisely officered? Has a successful business continued over a period of time? Have they achieved a standing in commercial circles? Have they behind them an established dividend record over a period of years?" *In re* Winburn's Will, 140 Misc. 18, 249 N.Y. Supp. 758 (1931).

[44] *In re* Cross' Estate, 117 N.J. Eq. 429, 443, 176 Atl. 101, 103 (1935).

[45] *See In re* Busby's Estate, 288 Ill. App. 500, 6 N.E. 2d 451 (1937); *In re* Linnard's Estate, 299 Pa. 32, 148 Atl. 912 (1930).

[46] *In re* Feinberg's Estate, 82 N.Y.S. 2d 879, 883 (N.Y. Surr. 1948).

point a sale must be made to avoid liability. In *Lazar's Estate*,[47] the trustee sold "seasoned" securities soon after the depression started, and he was held not surchargeable. Failure to sell until late in the depression has also been held a reasonable exercise of discreation.[48] The difficulties of making a decision to sell seasoned securities is well illustrated by *In re Pate's Estate*.[49] Included in the trust assets were 10,000 shares of securities valued at $10,000 in 1919 when the trust was created. By 1928 the stock had risen in value to some $400,000 and in 1929 to $900,000. During this period dividends of $42,000 had been paid. In 1946 the trustee sold the stock for $30,000. The beneficiaries claimed the trustee should be surcharged, but the court refused. It said the trustee had acted reasonably when viewed prospectively "unaided or unenlightened by subsequent events." Where, however, the securities are highly speculative, a trustee is usually liable for failure promptly to sell.[50] But even here when the trust came into existence during a period of depression, great sympathy for the plight of the trustee is shown. Thus, in *St. Louis Trust Union Co. v. Stoffregen*,[51] the trustees obtained certain German and Chilean bonds from the estate of the settlor. Trustee failed to sell and the bonds depreciated in value. On the beneficiaries seeking to surcharge, the court said: "When the defendants became the trustees on February 26, 1931, we were in the midst of the 1929-32 world-wide depression. They were faced with a dilemma — a dilemma not easily soluble. Should they sacrifice the securities in the existing panicky feeling and put the trust to loss, or should they retain the securities with the hope that a return to normal conditions would restore the value of the securities." Certainly, the lack of a market or the existence of an extremely small market is a defense to surcharge, even though the securities may be speculative.[52]

In *Busby's Estate*,[53] the trust estate arose during the depression and consisted of speculative stock bought on margin. The trustee failed to sell promptly, and as a result the estate became insolvent. The court, distinguishing other cases, surcharged the trustee on the theory that prompt sale was necessary and urgent to meet debts. Similarly, when a trustee invests in non-speculative stocks

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[47] 139 Misc. 261, 247 N.Y. Supp. 230 (1932).

[48] Central Hanover Bank and Trust v. Brown, 30 N.Y.S. 2d 85 (1941).

[49] *In re* Pate's Estate, 84 N.Y.S. 2d 853 (N. Y. Surr. 1948).

[50] *In re* Ward's Estate, 121 N.J. Eq. 555, 192 Atl. 63 (1936), *aff'd*, 121 N. J. Eq. 606, 191 Atl. 772 (1937); Miller's Estate, 345 Pa. 91, 26 A. 2d 320 (1942).

[51] 40 N.Y.S. 2d 527 (1942), *aff'd.*, 43 N.Y.S. 2d 511 (1943). *See also* Pollack v. Bowman, 139 N. J. Eq. 47, 49 A. 2d 40 (1946).

[52] *In re* Stumpp's Estate, 153 Misc. 92, 274 N. Y. Supp. 466 (1934); Blauvelt v. Citizens Trust Co., 3 N. J. 545, 71 A. 2d 184 (1950).

[53] 288 Ill. App. 500, 6 N.E. 2d 451 (1937).

on a margin account, he may be held liable for resulting loss, since this is speculation and violates his duty of conservation.[54]

While some courts have held that there will be no surcharge if the decline in values and resulting loss was caused by a "sudden and unexpected" catastrophe (as distinguished from a gradual decline) so that there is neither time nor opportunity to sell,[55] this factor should be important only if the trustee is under some duty to sell, as where the investment is speculative, and the fulfillment of this duty is thwarted by lack of time. In any event if he sells at a proper time and price, he is not liable if the investment sold later rises in value.[56]

The courts have indicated that a distinction must be drawn between the cases where the trustee retains stock on a declining market awaiting the arrival of a more favorable time to sell, and the cases where he purchases stock on a declining market. Such a distinction seems justified since, in the former case, in order to carry out his primary duty of conservation he should be given discretion to retain without liability in the hope of a more favorable market;[57] but in the latter situation the trustee, as a reasonable man, must invest in a more stable investment, such as bonds, for he is only secondarily interested in profits which might result if the stocks were later to rise.[58] It has been held, however, in a state where "the prudent man rule" is followed, that the power of a trustee to retain investments in a violently fluctuating market is not greatly dissimilar to his power to invest, so the trustee must exercise reasonable care in disposing of such securities and reinvesting, and if he does not, he is liable for loss.[59] In *Dickerson v. Camden Trust*

[54] Mellier's Estate, 312 Pa. 157, 167 Atl. 358 (1933).

[55] *In re* Ward's Estate, *supra* note 51. There the trustee was given $60,000 in trust for certain specified purposes. After the depression started the trustee accepted, in lieu of cash, shares of stock at their appraised value although their actual value was much lower. The court in surcharging emphasized that the stocks declined gradually, and distinguished cases where there had been a sudden and unexpected catastrophe. However, the trustee was guilty of breach of trust in accepting stock instead of cash, and in failing to diversify. *See also* Security Trust v. Appleton, 303 Ky. 328, 197 S.W. 2d 70 (1946) where dividends were paid until the crash, and the stock had an excellent reputation; *In re* Paterson National Bank, 125 N. J. Eq. 73, 4 A. 2d 59 (1939) where stock enjoyed a gradual rise for more than a quarter of a century and continued to rise until 1933, when it suddenly dropped. *See also* Welch v. Welch, 235 Wis. 282, 290 N.W. 758 (1940); *In re* Stafford's Estate, 69 N.E. 2d 208 (Ohio App. 1946).

[56] *In re* Ryan's Will, 188 Misc. 61, 69 N.Y.S. 2d 416 (1945), *aff'd*, 272 App. Div. 799, 77 N.Y.S. 2d 926 (1947).

[57] *In re* Weinberg's Will, 69 N.Y.S. 2d 748 (1946); *In re* Kent's Estate, 146 Misc. 155, 261 N.Y. Supp. 698 (1932).

[58] *In re* Ward's Estate, *supra* note 51.

[59] McInnes v. Whitman, 313 Mass. 19, 46 N.E. 2d 527 (1943); Clark v. Clark 167 Ga. 1, 144 S.E. 781, 158 S.E. 297 (1931).

Co.,[60] the trust instrument specifically directed the executor-trustees to invest the residue of the estate in legal securities. The trust arose during the depression and values were declining rapidly. The executors, instead of selling non-legals and reinvesting the proceeds, retained the investments which came to them from the settlor's estate, and turned them over to themselves as trustees at their inventory, instead of depreciated market value. The court, in surcharging the trustees for the difference between inventory and market value, stressed the failure to obey the express direction of the settlor to invest in legals, and distinguished contrary cases where no such express direction appeared. The court said the test of reasonableness did not apply here since the trustees acted beyond the limits of their power by accepting non-legals. This seems unwarranted, for while it is the duty of a fiduciary to dispose of non-legals in all cases, he should be, and usually is, given reasonable discretion in determining a favorable time to sell. As pointed out in *Feinberg's Estate*,[61] where certain securities were declared non-legals in 1929 and 1930, there was no imperative duty to sell at any particular time during the depression in view of optimistic predictions of recovery.

In a number of cases the courts have emphasized that the investment in question was made by the settlor.[62] The fact that the settlor invested in such securities reflects his confidence in them, and implies a desire that such securities be retained, and may be a justification for retention by the trustees in a declining market, in the absence of other factors which might compel sale. Similarly, if the testator has been active in the corporation whose securities are involved, the courts tend to refuse surcharge.[63] However, a trustee is to be guided by the standard of reasonable care, and the mere fact that the settlor may have been imprudent in his own investments should be no defense. Moreover, the conditions of the corporation may have drastically changed between the time settlor invested and the time at which trustee must make a decision either to sell or retain. Certainly, in the usual case, this factor should have little weight.

The question as to whether the corporate fiduciary should be held to a stricter rule of accountability than the individual in the

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[60] 1 N.J. 459, 64 A. 2d 214 (1949).

[61] 82 N.Y.S. 2d 879 (N.Y. Surr. 1948). *See also* SCOTT, TRUSTS § 230 (1939).

[62] *In re* Winburn's Will, 140 Misc. 18, 249 N.Y. Supp. 758 (1931). For summary of cases arising out of earlier depressions see Note, 77 A.L.R. 505 (1932).

[63] Poor v. Hodge, 311 Mass. 312, 41 N.E. 2d 21 (1942); *In re* McCann's Will, 212 Minn. 233, 3 N.W. 2d 226 (1942); *In re* Easton's Estate, 178 Misc. 511, 35 N.Y.S. 2d 546 (1942), *aff'd*, 41 N.Y.S. 2d 190 (1943).

depression cases has not definitely been passed upon,[64] although there has been some indication that a stricter rule should apply. The courts, however, generally fail to consider the question.

In conclusion, it may be said that in a period of economic abnormality, a trustee who invests in or retains seasoned securities, who makes frequent examination of their status, and who informs his beneficiaries of the problems involved, acting throughout in good faith, need not fear surcharge by a court of equity.

WHERE THE TRUST INSTRUMENT CONTAINS *AN* EXCULPATORY CLAUSE

Should a fiduciary whose conduct with respect to investments would ordinarily be regarded as a breach of trust be protected against surcharge by exculpatory language in the trust instrument? Or is the standard of ordinary care and prudence such a basic incident of the fiduciary relation that an attempt to exempt a trustee from the requirement should be held nugatory as a matter of policy?

In general the courts, particularly if attention is paid to what they say rather than to what they do, have chosen the first alternative and have held exculpatory provisions to be valid and enforceable.[65] Thus, courts have recognized as effective clauses which provided that the trustee shall be under no liability for investment losses occurring without "wilful default,"[66] "malfeasance in office,"[67] "wilful fraud or neglect,"[68] "gross neglect or wilful malfeasance"[69] and "gross negligence or wilful and intentional breach of trust."[70] Approval has likewise been given to provisions inserted in clauses giving the trustee powers of investment or retention of investments to the effect that he shall be under "no liability" for acts done in

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[64] SCOTT, TRUSTS § 174.1 (1939); BOGERT, TRUSTS AND TRUSTEES § 541 (1946). RESTATEMENT, TRUSTS § 227, comment *d; In re* Busby's Estate, 288 Ill. App. 500, 6 N.E. 2d 451 (1937); *In re* Baker's Estate, 249 App. Div. 265, 292 N.Y. Supp. 122 (1936). *In re* Stirling's Estate, 342 Pa. 497, 21 A. 2d 72 (1941).

[65] On the general effect of exculpatory provisions see 42 YALE L. J. 359 (1932); 26 CORNELL L. Q. 165 (1940); 22 VA. L. REV. 455 (1936); RESTATEMENT, TRUSTS § 222 (1935); BOGERT, TRUSTS AND TRUSTEES § 542 (1946); SCOTT, TRUSTS § 222 (1939). The comparable question of exculpatory clauses limiting the liability of corporate trustees under bond security indentures is omitted as not relevant to investment problems. See 42 HARV. L. REV. 198 (1928); 31 ILL. L. REV. 1060 (1937); 48 YALE L. J. 533 (1939); 19 CORNELL L. Q. 171 (1934); 29 MICH. L. REV. 355 (1930); 36 MICH. L. REV. 996 (1938); 37 COL. L. REV. 130 (1937).

[66] New England Trust Co. v. Paine, 317 Mass. 542, 59 N.E. 2d 263 (1945), 320 Mass. 482, 70 N.E. 2d 6 (1947).

[67] Gardner v. Squire, 38 Ohio L. Abs. 234, 49 N.E. 2d 587 (1942).

[68] *In re* Comfort's Estate, 176 Misc. 807, 29 N.Y.S. 2d 166 (1941).

[69] *In re* Jarvis' Estate, 110 Misc. 5, 180 N.Y. Supp. 324 (1920).

[70] Gouley v. Land Title Bank & Trust Co., 329 Pa. 465, 198 Atl. 7 (1938).

that connection[71] or shall be excused for all such acts "done in good faith."[72] The New York legislature, however, has taken the other view. A statute passed in 1936[73] provides that the attempted grant to an executor or testamentary trustee of exoneration from liability for failure to exercise reasonable care, diligence and prudence shall be deemed contrary to public policy and be void.

Even though the approach of the courts has been that exculpatory clauses are valid and effective, it is clear that they will not perform the function of broadening the investment powers of the trustee. This is illustrated by *In re Rushmore's Estate.*[74] The account of trustees was attacked because of their investment in, and retention of, non-legals. They claimed to have authority to go outside the legal list by virtue of a clause in the trust instrument directing that they were not to be held liable for any act done in good faith. The court held them liable. It said the exculpatory language did not enlarge their investment powers but only restricted liability for acts done in good faith within the powers and authority conferred on the trustees. Hence it did not protect them when they did not abide by the list of legals.[75]

The investing fiduciary, moreover, cannot rely on the general approval of exculpatory language as a protection against potential surcharge. There is an area of action in which such provisions will avail him nothing. The most succinct description of the area appears in the *Restatement of Trusts.*[76] It states that an exculpatory clause is not effective to relieve a trustee if he acted in bad faith, or with intent to breach, or with reckless indifference to the beneficiary's interest. Nor will such a clause permit the trustee to retain a profit he made from a breach of trust.[77] Most of the courts seem to agree with these limitations whether they have considered

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[71] *In re* City Bank Farmer's Trust Co., 270 App. Div. 572, 61 N.Y.S. 2d 484 (1946); Liberty Title & Trust Co. v. Plews, 6 N.J. Super. 196, 70 A. 2d 784 (1950).

[72] North Adams Bank v. Curtiss, 278 Mass. 471, 180 N.E. 217 (1932).

[73] N.Y. Laws 1936, c. 378, § 125 (Decedent Estate Law), as amended Laws 1938, c. 392. It is clear from the statutory language that the act does not apply to living trusts. Application of Central Hanover Bank & Trust Co., 176 Misc. 183, 26 N.Y.S. 2d 924 (1941).

[74] 21 N.Y.S. 2d 526 (N.Y. Surr. 1940).

[75] The court cited with approval SCOTT, TRUSTS § 222.1 (1939) and BOGERT, TRUSTS AND TRUSTEES § 542 (1946).

[76] § 222.

[77] In addition, an exculpatory clause may be disregarded or stricken out by reformation if its presence in the trust instrument is accounted for by fraud, overreaching or abuse of a fiduciary relation on the part of the trustee. *Ibid,* subsection (3); Jothann v. Irving Trust Co., 151 Misc. 107, 270 N.Y. Supp. 72 (1934).

them together or separately.[78]

The general approval of and limitations upon exculpatory provisions give the courts a wide interpretive power in deciding whether to surcharge the trustee. In the first place, was his act or omission within the exempting language of the provision? Here the courts continue to adhere to the doctrine of "strict construction" of the clause.[79] Secondly, was the act or omission of the trustee within the area in which it is deemed against policy to permit exculpation?

In an Ohio case[80] a clause in the instrument stated that the trustee was not to be liable except for "malfeasance in office." He retained some hotel bonds even though he may have had actual knowledge that the security for them was in a precarious condition. The bonds became worthless. The court held that the trustee was not liable. It said, rather technically, that the loss resulted from the trustee's failure or omission to act but not from malfeasance, so the clause protected him. The court might well have considered the question of whether the trustee had committed a reckless or intentional breach of trust and hence should not be protected as a matter of policy. However, the fact that the beneficiaries prepared the trust instrument carried great weight with the court.

In *Jarvis Estate*[81] trustees invested in rapid transit bonds early in 1916 and retained them until late 1918. The market had steadily declined due to war conditions, price and wage inflation and the act of the Government in granting fare and freight increases to the standard carriers under its control. The will exempted the trustees from liability except for "gross neglect or wilful malfeasance." The court nevertheless surcharged them with a portion of the loss. It said it was gross neglect to retain the bonds so long under such conditions. The result is somewhat questionable. The trustees might have been held to have failed to exercise ordinary judgment and prudence and thus to have been protected by the exculpatory language, particularly in view of the reluctance of most courts to choose a point in a market disturbed by unusual conditions when the trustees should have sold.[82]

Further illustration of the interpretive power is found in an early and leading American case.[83] The will exempted the trustees

[78] *In re* Kramer's Estate, 172 Misc. 598, 15 N.Y.S. 2d 700 (1939); Gouley v. Land Title Bank & Trust Co., 329 Pa. 465, 198 Atl. 7 (1938); New England Trust Co. v. Paine, 317 Mass. 542, 59 N.E. 2d 263 (1945); BOGERT, TRUSTS AND TRUSTEES § 542, pp. 370 *et seq.* (1946).

[79] Farr v. First Camden National Bank & Trust Co., 4 N.J. Super. 89, 66 A. 2d 444 (1949); Blauvelt v. Citizens Trust Co., 3 N. J. 545, 71 A. 2d 184 (1950).

[80] Gardner v. Squire, 38 Ohio L. Abs 234, 49 N.E. 2d 587 (1942).

[81] 110 Misc. 5, 180 N.Y. Supp. 324 (1920).

[82] See discussion preceding sub-topic.

[83] Crabb v. Young, 92 N.Y. 56, 65, 66 (1883).

from any loss or damage except that occurring from "their own wilful default, misconduct or neglect." The lower court surcharged them for loss in connection with the investment in some real estate bonds and mortgages. In reversing, the appellate court said, "It is quite clear that they cannot be held liable to replace the moneys lost through even an improvident or careless investment unless they have acted wilfully and have intentionally disregarded the rules which control and regulate the action of prudent and careful men in conducting their own business affairs."[84]

The conclusion seems justified that the language of the exculpatory clause is simply another factor to be weighed by the courts in deciding the question of surcharge according to what they believe to be the equities of the particular case.

Should a corporate trustee gain the same immunity from surcharge under exculpatory clauses as would be given to an individual trustee in similar circumstances? Professor Scott says that there has been a "growing feeling" of late that the answer should be negative.[85] Professor Bogert agrees, finding such clauses of "questionable ethical quality" when applied to a corporate trustee.[86] Other writers have expressed comparable sentiments.[87] So far, there is little direct authority. The courts in a number of cases have inferentially answered the stated question in the affirmative by recognizing the validity of exoneration provisions in cases which in fact involved corporate trustees.[88] At least one court has held, when the point was squarely raised, that there is no distinction between the professional and the amateur. In *New England Trust Co. v. Paine*,[89] an exculpatory clause provided that the corporate trustee was not to be liable for "involuntarily losses" nor to make good to the estate anything lost except by its "own wilful default." The trustee was guilty of a protracted delay in selling shares of the New

[84] Compare another leading American case decided the same year, Tuttle v. Gilmore, 37 N. J. Eq. 617 (1883) where a trustee who took second mortgages without proper investigation was held to have committed a wilful and intentional breach and hence derived no protection from a clause exempting him from liability except for "wilful and intentional breaches of trust."

[85] SCOTT, TRUSTS § 222.3 p. 179 (1939).

[86] BOGERT, TRUSTS AND TRUSTEES § 541 p. 362 (1946); BOGERT, CASES ON TRUSTS, 395n (2d ed. 1950).

[87] See Shinn, *Exoneration Clauses in Trust Instruments*, 42 YALE L. J. 359, 374 *et seq.* (1932); Kramer, *Effect of Exculpatory Clauses on the Liability of Corporate Trustees*, 36 MICH. L. REV. 996, 999 (1938).

[88] Farr v. First Camden National Bank & Trust Co., 4 N.J. Super. 89, 66 A. 2d 444 (1949); Liberty Title & Trust Co. v. Plews, 6 N. J. Super. 196, 70 A. 2d 784 (1950); Blauvelt v. Citizens Trust Co., 3 N. J. 545, 71 A 2d 184 (1950).

[89] 317 Mass. 542, 59 N.E. 2d 263 (1945); 320 Mass. 482, 70 N.E. 2d 6 (1947); *Compare In re* Clark's Will, 136 Misc. 881, 242 N. Y. Supp. 210, 220 (1930), *rev'd*, 257 N. Y. 132, 177 N.E. 397 (1931).

Haven Railroad and had a disproportionately large investment in the securities of the Boston & Maine system. The court held that the trustee was not subject to surcharge. It said that the acts of the trustee were at most failures to exercise the degree of judgment ordinarily required, but did not amount to bad faith or to intentional breaches of trust. Hence the exculpatory language exonerated the trustee. The court admitted that the safeguards equity supplies for trust beneficiaries "should not be softened first for the benefit of trust companies and professional trustees who hold themselves out as fully conversant with the duties of trustees and fully competent to perform them." But, it said, exculpatory provisions are, with certain limitations, valid and there is nothing in the law withholding their protection from a corporate trustee when it would be granted to an individual.

The writers submit that the courts should hold it to be against public policy for a corporate trustee to avoid liability for a breach of trust through the presence of an exculpatory clause in the trust instrument. Surely there is a wide difference between the amateur trustee and the professional in this regard. The amateur is usually a relative or friend of the settlor, chosen for reasons of personal confidence or familiarity with family relationships. In such a case it is natural for the settlor to recognize that the fiduciary is a person of ordinary ability and to desire the administration of the trust not to be an undue burden. Accordingly, if exoneration provisions are placed in the trust instrument, it is perfectly proper to hold them effective within the limits previously indicated. The professionals, however, seek the business. Corporate trustees advertise or represent that they specialize in fiduciary administration, employ experts and have systems of checks and balances between their trust officers and their investment and other committees. It seems improper for them to seek to escape the responsibility which they have thus invited.

One or two analogies for the result advocated do not seem too remote. In cases not involving exculpatory clauses, recognition has been given to the fact that corporate trustees who hold themselves out as having special skill and special facilities should be held for the skill and facilities they profess to have.[90] In the law of security, the doctrine of *strictissimi juris*, inherent in the situation of the individual surety is held by the courts to be inapplicable to the corporate surety.[91] It should therefore not require a statute to forbid the shelter of exculpatory provisions to the professional trustee.

[90] *See In re* Allis Estate, 191 Wis. 23, 209 N.W. 945 (1926); SCOTT, TRUSTS § 174.1 (1939); BOGERT, TRUSTS AND TRUSTEES § 541 p. 360 (1946).

[91] The Royal Indemnity Co. v. The Northern Ohio Granite & Stone Co., 100 Ohio St. 373, 126 N.E. 405 (1919); Meyer v. Building & Realty Service Co., 209 Ind. 125, 196 N.E. 250 (1935); Forest City Building & Loan Assn. v. Davis, 192 N.C. 108, 133 S.E. 530 (1926); Note, 12 A.L.R. 382 (1921).

WHERE THE BENEFICIARY CONSENTS TO OR ACQUIESCES IN THE BREACH

A beneficiary who is not under a legal incapacity may be precluded from surcharging a trustee for breach of an investment duty because of what may broadly be termed "consent." Conceivably the courts might have hesitated to entertain consent of the beneficiary as a defense by the trustee.[92] At least one of the main purposes of the average settlor in creating the trust is to substitute the judgment of the trustee concerning the investment and preservation of the estate for that of the beneficiaries. This purpose is frustrated if the trustee is permitted to escape liability when he either yields to the demands of the beneficiary or secures his consent, in making or retaining an improper investment. Nevertheless, the spectacle of a beneficiary turning on his trustee with a demand for surcharge after he has approved the breach is not an attractive one. Therefore the courts have chosen to permit the defense with strict limitations as to the capacity and knowledge of the beneficiary and the conduct of the trustee.[93]

The consent of the beneficiary may have been given before or at the time of the breach,[94] or after the breach.[95] In the former situation the common basis of refusing surcharge is "estoppel," or the "clean hands doctrine."[96] In the latter, the result is said by Professor Bogert to be grounded on ratification, although here, too, the courts frequently speak in terms of estoppel.[97] In most cases where there is ratification, the elements of estoppel are present, for normal-

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[92] Especially is this true in the spendthrift trust cases. Yet even there the beneficiary may be precluded from holding the trustee on the basis of "consent". See SCOTT, TRUSTS § 216.1 (1939).

[93] See generally, RESTATEMENT, TRUSTS §§ 216-219 (1935); BOGERT, TRUSTS AND TRUSTEES §§ 941-944 (1946); SCOTT, TRUSTS §§ 216-219 (1939).

[94] Blauvelt v. Citizens Trust Co., 3 N.J. 545, 71 A. 2d 184 (1950); Washington Loan and Trust Co. v. Colby, 108 F. 2d 743 (D. C. Cir. 1939); Mann v. Day, 199 Mich. 88, 165 N.W. 643 (1917); Baker v. Thompson, 181 App. Div. 469, 168 N. Y. Supp. 871 (1918); *In re* Mattison's Will, 17 N.Y.S. 2d 734 (1940); RESTATEMENT, TRUSTS § 216 (1935); 19 MINN. L. REV. 347 (1935); UNIFORM TRUSTS ACT § 18.

[95] Washington Loan and Trust Co. v. Colby, 108 F. 2d 743 (D.C. Cir. 1939); Alexander v. Kotzen, 19 N.Y.S. 2d 400 (1940); *In re* Walton's Estate, 348 Pa. 143, 34 A. 2d 484 (1943); 348 Pa. 143, 34 A. 2d 484 (1943); Rodick v. Piner, 120 Me. 160, 113 Atl. 45 (1921); Blauvelt v. Citizens Trust Co., 3 N. J. 545, 71 A. 2d 184 (1950); 14 So. CALIF. L. REV. 355 (1941); RESTATEMENT, TRUSTS § 218 (1935).

[96] *In re* Wildenburg's Estate, 117 Misc. 49, 29 N.Y.S. 2d 896 (1941); Boon v. Hall, 76 App. Div. 520, 78 N. Y. Supp. 557 (1902); BOGERT, TRUSTS AND TRUSTEES § 941 (1946). See cases cited in note 95, *supra*.

[97] BOGERT, TRUSTS AND TRUSTEES § 942 p. 146 (1946); *In re* Wildenburg's Estate, 117 Misc. 49, 29 N.Y.S. 2d 896 (1941); Pollack v. Bowman, 39 N. J. Eq. 47, 49 A. 2d 40 (1946); Liberty Title and Trust Co. v. Plews, 6 N. J. Super. 196, 70 A. 2d 784 (1949), 6 N.J. 28, 77 A. 2d 219 (1950).

ly after ratification the trustee in reliance either acts positively or fails to take steps to repair the breach.[98] Professor Scott, on the other hand, supports the cases involving post-breach consent on the theory that the beneficiary has made an election of remedies to affirm the transaction, rather than set it aside.[99] It is believed unnecessary to choose between these points of view for the decisions amply demonstrate that it is an adoption of a *course of action* by which the beneficiary is bound. A beneficiary may also be precluded from objecting to a breach on the basis of contract or release of his right of action.[100]

It is frequently stated that a competent beneficiary who with full knowledge of the facts and of his legal rights expressly consents to or affirms an investment by the trustee cannot, in the absence of fraud, thereafter question its propriety.[101] When the basis of consent is a release of the trustee he must, in addition, show the fairness of the transaction and adequate consideration.[102] Similarly, where consent is urged as a defense and the breach complained of is a sale of property by the trustee to himself, the last two factors must be shown.[103] This is but another application of the rule that a trustee who dealt for himself with his beneficiary must prove that he acted not only in utmost good faith and after full disclosure, but fairly.[104]

The requirement that the beneficiary have full knowledge of his legal rights is an extraordinary one and somewhat difficult to prove. Perhaps it may be more accurately stated as requiring that the beneficiary either know or should know of his rights.[105] How-

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[98] BOGERT, TRUSTS AND TRUSTEES § 942 p. 146n (1946).

[99] SCOTT, TRUSTS § 218 (1939). See BOGERT, TRUSTS AND TRUSTEES § 945 (1939) for criticism.

[100] *In re* Peck's Estate, 323 Mich. 11, 34 N.W. 2d 533 (1948); Riggs v. Lowree, 189 Md. 437, 56 A. 2d 152 (1947); Burns v. Skogstad, 69 Idaho 227, 206 P. 2d 765 (1949); RESTATEMENT, TRUSTS § 217 (1935).

[101] *In re* Clabby's Estate, 338 Pa. 305, 12 A. 2d 71 (1940). See also Merchant's National Bank of Aurora v. Frazier, 329 Ill. App. 191, 67 N.E. 2d 611 (1946); Liberty Title and Trust Co. v. Plews, 6 N.J. Super. 196, 70 A. 2d 784 (1949), 6 N.J. 28, 77 A. 2d 219 (1950); Pennsylvania Co. Etc. v. Gillmore, 142 N.J. Eq. 27, 59 A. 2d 24 (1948); Burns v. Skogstad, 69 Idaho 227, 206 P. 2d 765 (1949); BOGERT, TRUSTS AND TRUSTEES §§ 941, 943 (1946); SCOTT, TRUSTS § 216 (1939).

[102] Ingram v. Lewis, 37 F. 2d 259 (10th Cir. 1930); Wool Growers Service Corporation v. Ragan, 18 Wash. 2d 655, 140 P. 2d 512 (1943), *rehearing denied*, 141 P. 2d 875 (1943).

[103] BOGERT, TRUSTS AND TRUSTEES § 942 p. 140 (1946).

[104] Goldman v. Kaplan, 170 F. 2d 503 (4th Cir. 1948); *In re* Dawes' Estate, 12 N.Y.S. 2d 6 (N.Y. Surr. 1939); Liberty Title and Trust Co. v. Plews, 6 N.J. Super. 196, 70 A. 2d 784 (1949), 6 N.J. 28, 77 A. 2d 219 (1950); SCOTT, TRUSTS § 216.3 (1939).

[105] Pennsylvania Co., Etc. v. Gillmore, 142 N.J. Eq. 27, 59 A. 2d 24 (1948).

ever, the courts appear to place little emphasis on this factor in the actual decision of the cases, and seem to assume that if the beneficiary is competent and knows all of the relevant facts, he is cognizant of his legal position. The real elements, therefore, which control the decisions of the courts are the beneficiary's knowledge of the facts and his approval or assent.[106]

Knowledge on the part of the beneficiary may of course be shown by written[107] or oral evidence[108] or implied from the circumstances of the case. Proof that the beneficiary received monthly statements which contained an account of principal and income has been held to be a sufficient showing of knowledge.[109] But in another case it was held that the mere fact that the beneficiaries were informed of the investments by an annual statement was not sufficient.[110] The receipt of income by the beneficiaries without objection to the non-legal securities which were its source did not create an estoppel when the trustee failed to show affirmatively that the beneficiaries were competent and aware of the facts.[111] A similar problem may arise as a result of an accounting by the trustee. Thus, in *Isham v. Union County Trust Co.*,[112] the trustee field an account in 1940, which was approved by the court. Exceptions were made to a second account filed in 1949 on the ground that the trustee prior to 1940 had been guilty of self-dealing in buying certain mortgages. The court said that the fact that the vouchers of the 1940 account, if examined, would have revealed the challenged transactions, was not enough in the absence of disclosure by the trustee or other circumstances which would put the beneficiary on notice.

Assuming that knowledge is shown, the courts find the require-

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[106] *A Rationalization of Trust Surcharge Cases*, 96 U. OF PA. L. REV. 647 (1948).

[107] *In re* Clabby's Estate, 338 Pa. 305, 12 A. 2d 71 (1940).

[108] *In re* Linnard's Estate, 16 Pa. D. and C. 143 (1931).

[109] *In re* Curran's Estate, 17 Pa. D and C. 435 (1932), *aff'd*, 312 Pa. 416, 167 Atl. 597 (1933); *In re* Wilbur's Estate, 334 Pa. 45, 5 A. 2d 325 (1939).

[110] Merchant's National Bank of Aurora v. Frazier, 329 Ill. App. 191, 67 N.E. 2d 611 (1946).

[111] Paul v. Girard Trust Co., 124 F. 2d 809 (7th Cir. 1941).

[112] 7 N.J. Super. 488, 71 A. 2d 902 (1950). It should be noted in this connection that the beneficiaries may be precluded from holding the trustee liable for breach of trust by the approval of the court of the trustee's account. In general the settlement of an account renders res judicata all matters in dispute and determined by the court in the settlement of the account, and all matters which were open to dispute although not actually disputed, and this although the account was an intermediate and not a final account. The account may be reopened if the trustee was guilty of concealment or misrepresentation in presenting his account or gaining approval. *See* Bogert, Trusts and Estates § 973 (1935). *But see In re* Edward's Estate, 360 Pa. 504, 62 A. 2d 763 (1948); *In re* Solomon's Will, 175 Misc. 64, 23 N.Y.S. 2d 72 (1940).

ment of approval or assent in various acts of the beneficiary. Express assent, either written[113] or oral,[114] is, of course, the desired objective of the trustee. While the courts are not all in accord, usually assent is not found in mere failure to object[115] unless the circumstances placed the beneficiary under a duty to speak.[116] As the New Jersey court put it, to find assent in such failure, the beneficiary must be shown to have acted deliberately in not objecting to an investment to which he knew he could object.[117] In any event, failure to object may continue so long that the beneficiary is barred on the basis of laches, especially if the trustee acts to his detriment.[118] If failure to object is combined with receipt of benefits, it is generally held that assent has been given.[119] In the cases which depend on estoppel, assent may be retracted at any time before the trustee has acted to his detriment.[120]

If there are several beneficiaries,[121] or if there are successive beneficiaries, consent is operative only against those who have in fact assented. In *Dodge's Estate*[122] the life beneficiary approved an improper investment but remaindermen did not. A loss resulted. The trustee was forced to replace the value of the investment in the trust estate for the benefit of the remaindermen but any income arising therefrom belonged to the trustee rather than to the life beneficiary who had approved the investment. This is not so, however, if the consenting beneficiary and the non-consenting bene-

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113 Boon v. Hall, 76 App. Div. 520, 78 N.Y. Supp. 557 (1902); Carrigan v. Drake, 36 S.C. 354, 15 S.E. 339 (1892); Butler v. Gazzam, 81 Ala. 491, 1 So. 16 (1886); *In re* Willenburg's Estate, 177 Misc. 49, 29 N.Y.S. 2d 896 (1941).

114 Ellig v. Naglee, 9 Cal. 683 (1858).

115 Day v. First Trust and Savings Bank of Pasadena, 47 Cal. App. 2d 470, 118 P. 2d 51 (1941); *In re* Walton's Estate, 348 Pa. 143, 34 A. 2d 484 (1943); Summers v. Summers, 339 Pa. 170, 14 A. 2d 120 (1940); 19 MINN. L. REV. 348 (1935); SCOTT, TRUSTS § 216 p. 1151 (1939); BOGERT, TRUSTS AND TRUSTEES § 942 (1946).

116 Minot v. Baker, 147 Mass. 348, 17 N.E. 839 (1888); Hoyt v. Latham, 143 U.S. 553, 570, 12 Sup. Ct. 568 (1892).

117 Pennsylvania Co. Etc. v. Gillmore, 142 N.J. Eq. 27, 59 A. 2d 24 (1948).

118 Naselli v. Mullholland, 89 F. Supp. 943 (D.C.D.C 1950); Schurman v. Pegau, 136 Neb. 628, 286 N.W. 921 (1939); Winn v. Shugart, 112 F. 2d 617 (10th Cir. 1940); RESTATEMENT, TRUSTS § 219 (1935); 63 HARV. L. REV. 1214 (1950).

119 *In re* Clabby's Estate, 338 Pa. 305, 12 A. 2d 71 (1940); *In re* Schlicht's Estate, 231 Wis. 324, 285 N.W. 730 (1939); Herpolsheimer v. Michigan Trust Co., 261 Mich. 209, 246 N.W. 81 (1933). *But see* Paul v. Girard Trust Co., 124 F. 2d 809 (7th Cir. 1941); People by Kerner v. Canton National Bank of Canton, 288 Ill. App. 418, 6 N.E. 2d 220 (1937).

120 Willis v. Holcomb, 83 Ohio St. 254, 94 N.E. 486 (1911); *In re* Goldman's Estate, 142 Misc. 790, 255 N.Y. Supp. 533 (1932).

121 Crews v. Willis, 195 Okla. 475, 159 P. 2d 251 (1945).

122 39 N.Y.S. 2d 186 (1943), *aff'd*, 266 App. Div. 845, 43 N.Y.S. 2d 512 (1943), *leave to appeal denied*, 291 N.Y. 828, 52 N.E. 2d 119 (1944).

ficiary are in privity,[123] or if the non-consenting beneficiary in any way derives title from the consenting beneficiary.[124] An unusual application of this principle occurred in *City Bank Farmers Trust Co. v. Cannon.*[125] The settlor created a trust naming herself life beneficiary and reserving powers to revoke and amend, with remainder over to her five named children. She consented to the improper retention of certain shares of stock. A loss occurred. The court held that the settlor's consent precluded the children from complaining since the reservation of the powers made her in substance the owner of the property.

In the consent situation, then, the courts, "while not departing from the fundamental rule of strict responsibility, excuse a trustee from the consequences of an act done fairly and in good faith if it has been done with the consent of the beneficiary, who was sui juris, fully acquainted with the relevant facts and his legal rights, and was not improperly influenced by the trustee."[126]

WHERE THE BREACHING TRUSTEE SEEKS TO BALANCE LOSS AGAINST GAIN

"If *A* holds a dog and a cat on trust for *B*, and in breach of trust loses the cat, it will be no answer to *B's* claim to produce the dog and a litter of puppies.[127] This quaintly illustrates the well settled doctrine that a fiduciary cannot balance losses against gains: if he has incurred a loss through a breach of trust he cannot satisfy or reduce his liability by a gain from another breach of trust nor by a gain from another transaction which is not a breach.[128] Thus, if the trustee breaches his duty with respect to one investment he must stand the surcharge for a resulting loss even though the estate has profited from other investments, proper or improper.

The basic reason for this harsh result seems to be one of deterrence, *i.e.*, to remove the temptation from trustees in general to breach their trusts by emphasizing the fact that it will be a losing

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[123] *In re* Bunker's Estate, 183 Misc. 523, 49 N.Y.S. 2d 619 (1944).

[124] *In re* Perkin's Trust Estate, 314 Pa. 49, 170 Atl. 255 (1934). *But compare In re* Post's Estate, 56 Ohio L. Abs. 240, 91 N.E. 2d 698 (1949).

[125] 291 N.Y. 125, 51 N.E. 2d 674 (1943), *reargument denied* 293 N.Y. 858, 59 N.E. 2d 445 (1944). See Scott, *The Effects of a Power to Revoke a Trust,* 57 HARV. L. REV. 362 (1944).

[126] Judge Soper in the case of Goldman v. Kaplan, 170 F. 2d 503, 506 (4th Cir. 1948).

[127] 1 RES JUDICATAE 106 (1940), citing HANBURY, MODERN EQUITY 314 (1946).

[128] RESTATEMENT, TRUSTS § 213 (1935), especially comments *a* and *b* BOGERT, TRUSTS AND TRUSTEES § 702 (1946); SCOTT, TRUSTS § 213 (1939); Pennsylvania Co. Etc. v. Gillmore, 142 N. J. Eq. 27, 59 A. 2d 24, 36 (1948); State v. Bartling, 149 Neb. 491, 31 N.W. 2d 422, 428 (1948); Schuster v. North American Mortgage Loan Co., 44 Ohio L. Abs. 577, 65 N.E. 2d 667 (1942); Note, 171 A.L.R. 1422 (1947).

proposition.[129] In this respect, it has a kinship with the loyalty rule where "uncompromising rigidity"[130] has been the pattern. Indeed, it has frequently been explained as another application of the loyalty principle. It is said that the trustee must act properly with respect to each investment; so the gain in each case belongs to the trust estate and the trustee cannot be permitted to reap a personal advantage by using it to offset his liability for loss.[131]

The rule has not, however, been free from attack. It has been stoutly contended that the trustee should be permitted to balance losses against gains made from separate but substantially contemporaneous improper investments, regardless of the intent of the trustee; that if the improper investments are separated by intervals of time the general rule should be applied only where deterrence would protect the estate from risk, as where the trustee wilfully misappropriates trust property, hazards it for his own benefit or knowingly breaches his trust; and that it should not be applied when it would not forestall the risk, as where the trustee acts honestly and in ignorance of any wrongdoing.[132] The chief weakness of this rather appealing thesis is found in the fact that it would place a trustee in a better position if his first investment is in breach of trust than if it is not, for obviously a trustee is not allowed to use a loss from breach to reduce a gain made from an authorized act.[133]

The severity of the general rule that a trustee cannot ordinarily balance losses against gains is tempered by the limitation that he may do so if the profit and loss occur as part of the same general transaction. "Where there is only one transaction equity simply watches through all its vicissitudes and adjusts accounts according to the final result."[134] Or, in the words of the *Restatement*, "if the breaches of trust are not distinct, the trustee is accountable only for the net gain or chargeable with the net loss. . . ."[135]

What will constitute one general transaction? When are the breaches of the trustee "not distinct"? Each case must, of course, stand on its own facts[136] but a number of fact situations which have

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129 See SCOTT, TRUSTS § 213.1 p. 1137 (1939).

130 Cardozo's classic statement will be recalled. Meinhard v. Salmon, 249, N. Y. 458, 464, 164 N.E. 545 (1929).

131 Creed v. McAleer, 275 Mass. 353, 175 N.E. 761 (1931); BOGERT, TRUSTS AND TRUSTEES § 702 (1946).

132 Harris, *Liability of a Trustee: Balancing Gains Against Losses*, 23 KY. L. J. 338 (1935).

133 See SCOTT, TRUSTS § 213.1 p. 1138 (1939). *But see* Harris's statistical answer, 23 Ky. L. J. 351, (1935).

134 1 RES JUDICATAE 106 (1940), citing HANBURY, MODERN EQUITY 320 (1946).

135 RESTATEMENT, TRUSTS § 213 (1935). See 36 COL. L. REV. 1015, 1016 (1936)

136 See RESTATEMENT, TRUSTS § 213 comment e (1935) for a list of seven factors which may be of importance in determining whether the breaches are distinct.

been judicially approved are included in the Comments to the *Restatement.* There is but one transaction (1) where a single property has been bought for a lump sum and sold in parts, some at a profit and some at a loss;[137] (2) where the improper investment is in stock and the trustee receives stock dividends or rights which are sold;[138] (3) where the trustee buys securities to protect securities improperly retained;[139] (4) where the trustee wrongfully pledges trust property with a broker to secure a margin account which he uses for speculation with varying success,[140] (5) where the trustee breaches by carrying on the business of the testator, first making profits and then losses;[141] and (6) where an improper investment or reinvestment passes through a number of stages, some of which are profitable and others are not.[142]

Although governed by similar considerations, the "same general transaction" problem is somewhat more difficult when the breaches by the trustee do not involve purchase or manipulation of investments but only improper retention. In *McInnes v. Goldthwaite,*[143] an executor appointed in 1931 was under the duty of paying minor bequests and turning over the bulk of the estate to trustees for charity. All of the properties were readily marketable. Among them were fifteen securities which were non-legals. He delayed selling or transferring the property to the residuary trust for some twelve years. His excuse was his erroneous impression that he was privileged to wait for a demand by the residuary trustees. As of the date of disposition, compared with the value one year after the executor's appointment, when presumably he should have sold, two of the securities showed a loss. The remaining thirteen showed such a large profit that the value of all fifteen had approximately doubled. The New Hampshire court held that it was improper to surcharge the executor with the loss on the two securities. It found that he had acted in good faith and said that there was but one breach of trust with respect to all fifteen securities. He was accountable only for the net gain because he had "followed a settled and consistent policy concerning the securities left by the deceased,

137 See MacBryde v. Burnett, 132 F. 2d 898, 901 (4th Cir. 1942); RESTATEMENT, TRUSTS § 213, comment *f* (1935).

138 Creed v. McAleer, 275 Mass. 353, 175 N.E. 761, 765 (1931); RESTATEMENT, TRUSTS § 213, comment *g* (1935).

139 Lacey v. Davis, 5 Redfield Surr. 301 (N.Y. 1882); RESTATEMENT, TRUSTS § 213, comment *h* (1935).

140 English v. McIntire, 29 App. Div. 439, 51 N.Y. Supp. 697 (1898); RESTATEMENT, TRUSTS § 213, comment *i* (1935).

141 Heathcote v. Hulme, 1 Jac. & Walker 122 (1819); RESTATEMENT, TRUSTS § 213, comment *j* (1935).

142 Baker v. Disbrow, 18 Hun. 29 (1879), aff'd. 79 N.Y. 631 (1880); RESTATEMENT, TRUSTS § 213, comments *k* and *l* (1935).

143 94 N.H. 331, 52 A. 2d 795 (1947).

which as a whole resulted advantageously. . . .Whatever the plaintiff's reason for delaying his accounting, his one policy of holding the securities during the economic depression of the thirties not only resulted in practically doubling their worth from the time of one year after his appointment but yielded a very substantial profit over the inventory values."

A court could hardly fail to take note of the apparent greed of beneficiaries who seek more than the net gain on facts like these.[144] Nevertheless, if the *McInnes* case is considered apart from its depression setting, it is difficult to sustain it on principle. While the pursuance of a "single policy" by the breaching trustee is admittedly a factor which may be weighed in deciding whether his acts were part of one transaction or not,[145] it is doubtful whether inaction alone constitutes such a policy. Even assuming it does, mere delay with respect to different securities does not seem to be a thread substantial enough to tie the conduct of the trustee into one general transaction. A consistent habit of breaching one's trust will not do. Uniform procrastination affecting a number of independent investments can scarcely stand in a better light.

In *Buck's Will*[146] an executor received from himself as committee of the property of the testatrix a number of different securities, including several non-legals. He ultimately converted all of the securities, realizing a substantial net profit. The court found, however, that he had delayed unreasonably in converting a railroad bond and some utility and automotive stocks. It surcharged him with the losses caused by the retention of these securities and refused to permit him to reduce the losses by gains made through the retention, proper or improper, of the other securities. The court said, "A trustee who is liable for a loss resulting from a breach of trust with respect to one portion of the trust property cannot reduce his liability by reason of a gain with respect to another portion of the trust property occasioned by a separate and distinct breach of trust. The retention of trust property, some of which has been sold at a loss, and the balance of which has been disposed of at a profit, is within the application of this rule."

The New York court did not consider whether the fiduciary pursued a "single policy" of delay. He had simply held the various

144 Since the *McInness* case involved a charitable trust, the accounting was sought by an Attorney General and others. See *In re* Porter's Estate, 5 Misc. 274, 25 N.Y. Supp. 822 (1893) where a fiduciary delayed selling various speculative securities because of high income returns. The court said it did not accord with its "notions of equity" to allow the beneficiaries more than the net gain.

145 See RESTATEMENT, TRUSTS § 213, comment *e* (1935).

146 55 N.Y.S. 2d 841 (N.Y. Surr. 1945).

securities beyond a reasonable time. If that alone constitutes a "policy," he had one.

The *Restatement* at first appears to support a view at variance with the *McInnes* decision. It says: "If the trustee originally receives as a part of the trust estate several securities which are not proper trust investments and which he is under a duty to sell, and he sells none of them, and some of them appreciate in value and others depreciate, the beneficiary is entitled to the profit accruing on those which appreciate and can hold the trustee liable for a loss on those which depreciate."[147]

However, subsequently a *caveat* is inserted: "No opinion is expressed on the question whether the trustee can offset profits against losses when in pursuance of a single policy he has improperly delayed selling securities of the same character received by him as a part of the trust estate, and subsequently sells some at a profit and others at a loss; as for instance where he receives shares of a particular corporation or shares of stock of similar corporations which it is his duty to sell within a year and which he sells after the expiration of a year, some at a profit and others at a loss."[148]

It will be noted that the *caveat* does not state that delay without more constitutes a "single policy." Indeed, the two quotations when read together infer quite the opposite. Further, it is possible that the doubt expressed in the *caveat* is confined to a situation where the securities are similar in nature, *e.g.*, utilities or railroads or automotives, and does not apply to a mixed portfolio.

At any rate, it is the view of the writers that the *McInnes* case is supportable only when considered in its depression setting. It is another instance where a court has been reluctant to surcharge a fiduciary who acted in good faith and, on the whole, did a creditable job during a period of great economic stress.

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147 Comment *a*, p. 594 (1935).

148 p. 599.