

TRUSTS: INFLATIONARY CHANGE IN ECONOMIC CONDITIONS HELD NOT TO WARRANT DEVIATION FROM RESTRICTIVE INVESTMENT PROVISIONS OF CHARITABLE TRUST

THE Duke Endowment, a charitable trust for the benefit of institutions of higher education, hospitals, orphanages, retired preachers, widows, and orphans, was established in 1924 with a corpus of forty million dollars. Today, the corpus is valued at over four hundred and seventy million dollars. Due to the restrictive investment provisions of the trust indenture,¹ over eighty percent of the Endowment's assets are presently limited to Duke Power Company common and preferred stock.² In *Cocke v. Duke Univ.*,³ the trustees brought suit to obtain discretionary investment powers to diversify the trust assets.⁴ They argued that diversification was needed since Duke Power was now a mature corporation which lacked the growth potential necessary to maintain the economic value of the trust assets and the purchasing power of the income relative to an inflationary economy. The Supreme Court of North Carolina, however, found no actual or foreseeable inflationary loss, and applying New

¹The investment provisions of the indenture restricted investment by the trustees to securities of "Duke Power Company, or of a subsidiary thereof, or in bonds validly issued by the United States of America, or by a State thereof, or by a district, county, town or city which has a population in excess of fifty thousand people according to the then last Federal census, which is located in the United States of America, which has not since 1900 defaulted in the payment of any principal or interest upon or with respect to any of its obligations, and the bonded indebtedness of which does not exceed ten percent of its assessed values." The indenture further required a unanimous affirmation of the trustees to sell Duke Power securities. THE DUKE ENDOWMENT—INDENTURE OF JAMES B. DUKE § 3, pp. 8-9.

²The remainder of the Endowment's assets is invested as follows: 12.21% in common and preferred stock of Aluminum Company of America and Aluminum, Limited; .65% in other stocks; 3.25% in bonds of Duke Power Company; 3.68% in bills or notes of the United States. Brief for Appellee, p. 7.

³260 N.C. 1, 131 S.E.2d 909 (1963).

⁴Specifically the trustees asked the court to add the following clause to the original investment provisions, which would allow investments "in such other securities, including common and preferred stocks, bonds and debentures of private corporations, and other property, real or personal, as said trustees shall, in their discretion, deem advisable, without being restricted to such investments or reinvestments as are permissible for executors and trustees under any present or future applicable law, rule of court or court decision." Brief for Appellee, p. 20.

Jersey law,⁵ held that it is necessary to show more than mere change in economic conditions before deviation will be permitted.⁶

The power of equity courts to authorize deviation from the administrative terms⁷ of a trust is derived from their inherent jurisdiction over the administration of trusts.⁸ Under certain circumstances equity can authorize an act which is specifically forbidden⁹ if essential to preserve the trust and not merely advantageous to the beneficiaries.¹⁰ Courts generally justify such deviation either on the theory that they are doing what the settlor would have done had he foreseen the present circumstances or on the ground that they are carrying out the dominant purpose of the settlor.¹¹ Deviation is

⁵ "This indenture . . . is intended to be made, administered and given effect under and in accordance with the *present existing laws and statutes* of [New Jersey] . . . notwithstanding it may be administered and the beneficiaries hereof may be located in whole or in part in other states, and the validity and construction thereof shall be determined and governed in all respects by such laws and statutes." *THE DUKE ENDOWMENT—INDENTURE OF JAMES B. DUKE* § 8, p. 27. (Emphasis added.)

"Present existing laws and statutes" was held by the court to mean those laws and statutes applicable at the time the trust was formed. A New Jersey Superior Court has held that a provision substantially identical to this one was limited in application to the general administration of the estate and did not apply to a provision relating specifically to investment or reinvestment. *Fidelity Union Trust Co. v. Price*, 18 N.J. Super. 578, 87 A.2d 565 (Ch. 1952). As to provisions relative to investment and reinvestment the law effective at the time of the litigation governs. 260 N.C. at 17, 131 S.E.2d at 919.

⁶ *Cocke v. Duke Univ.*, 260 N.C. 1, 20, 131 S.E.2d 909, 921 (1963).

⁷ Every trust indenture contains two parts: administrative terms, which provide the methods the trustee is to use in the management of the trust property (such as provisions for new investments), and dispositive terms, which usually provide who is to get the benefit of the trust income and often state the settlor's purpose in creating the trust. *BOGERT, TRUSTS & TRUSTEES* § 561, at 128-29 (2d ed. 1960) [hereinafter cited as *BOGERT*].

⁸ See *BOGERT* § 561, at 134-35; *SCOTT, TRUSTS* § 167, at 1168 (2d ed. 1956) [hereinafter cited as *SCOTT*]; *Scott, Deviation from the Terms of a Trust*, 44 HARV. L. REV. 1025, 1034-35 (1931). Some states have confirmed the inherent equity jurisdiction by statute. See, e.g., N.H. REV. STAT. ANN. § 498:4 (1955); N.J. STAT. ANN. § 3A:15-15 (1953).

⁹ See, e.g., *Foust v. William E. English Foundation*, 118 Ind. App. 484, 80 N.E.2d 303 (1948) (authorized forbidden sale of property); *Long v. Simmons Female College*, 218 Mass. 135, 105 N.E. 553 (1914) (allowed trustee to mortgage property); *American Academy of Arts & Sciences v. President & Fellows of Harvard College*, 78 Mass. (12 Gray) 582 (1832) (investment of corpus in other than specified goods); *BOGERT* § 562; *SCOTT* §§ 167, 381.

¹⁰ Where strict adherence to the administrative terms of a trust will accomplish the trust's purpose, deviation will not be authorized merely to benefit beneficiaries or corpus. See *Stanton v. Wells Fargo Bank & Union Trust Co.*, 150 Cal. App. 2d 763, 310 P.2d 1010 (Dist. Ct. App. 1957); *Rogers v. English*, 130 Conn. 332, 33 A.2d 540 (1943); *Johns v. Johns*, 172 Ill. 472, 50 N.E. 337 (1898); *Hackett's Ex'rs v. Hackett's Devises*, 180 Ky. 406, 202 S.W. 864 (1918); *BOGERT* § 561, at 136 n. 26.

¹¹ See *Louis Trust Co. v. Ghio*, 240 Mo. App. 1033, 222 S.W.2d 556 (1949); *Trust Co. v. Greenwood Cemetery*, 21 N.J. Misc. 169, 32 A.2d 519 (Ch. 1943); *SCOTT* § 167, at 1176-77; *Scott, supra* note 8, at 1027.

usually permitted where compliance is impossible¹² or illegal,¹³ or where there has been an unforeseen change of circumstances which would defeat or impair the dominant purpose of the trust.¹⁴

Courts applying the unforeseen change of circumstances rule to private trusts, as distinguished from charitable trusts, usually require that there be an emergency or necessity which seriously threatens the trust.¹⁵ This strict application of the rule is attributable to the fact that courts have difficulty in ascertaining the purpose of the settlor beyond the generalization that it is to preserve corpus or provide income.¹⁶ On the other hand, courts have shown a tendency to be more liberal in applying this rule to charitable trusts.¹⁷ In a charitable trust the purpose is usually clearly stated.¹⁸ Moreover, there is a more apparent need for flexible investment powers in charitable trusts which lack competing interests between temporary income beneficiaries and remaindermen¹⁹ and have a perpetual

¹² RESTATEMENT (SECOND), TRUSTS §§ 165, 381, comment *b* (1959); SCOTT § 165. See, e.g., *Simon v. Reilly*, 126 N.J. Eq. 546, 10 A.2d 474 (Ch. 1940) (trustee directed to invest in guaranteed mortgages but no guaranty company in state); *In re Thomson's Will*, 43 N.Y.S.2d 392 (Surr. Ct. 1943) (trustee directed to buy specific bonds which were subsequently called for payment).

¹³ RESTATEMENT (SECOND), TRUSTS §§ 166, 381, comment *c* (1959); SCOTT § 166. See, e.g., *Stout v. Stout*, 192 Ky. 504, 233 S.W. 1057 (1921); *Joe Gouy Shong v. Joe Chew Shee*, 254 Mass. 366, 150 N.E. 225 (1926).

¹⁴ BOCERT § 561, at 131; RESTATEMENT (SECOND), TRUSTS §§ 167, 381, comment *d* (1959); SCOTT § 167.

¹⁵ See *Stanton v. Wells Fargo Bank & Union Trust Co.*, 150 Cal. App. 2d 763, 310 P.2d 1010 (Dist. Ct. App. 1957); *Thompson v. Union Nat'l Bank*, 291 S.W.2d 178 (Mo. 1956); *Lambertville Nat'l Bank v. Bumster*, 141 N.J. Eq. 396, 57 A.2d 525 (Ch. 1948); RESTATEMENT (SECOND), TRUSTS § 167, comment *c* (1959).

¹⁶ See cases cited note 15 *supra*.

¹⁷ See *Estate of Loring*, 29 Cal.2d 423, 175 P.2d 524, *modifying*, 168 P.2d 224 (Dist. Ct. App. 1946); *First Nat'l Bank v. Stevens*, 9 N.J. Super. 324, 74 A.2d 368 (Ch. 1950); 4 POWELL, REAL PROPERTY ¶ 579, at 488 (1954); SCOTT § 381, at 2741.

In several recent decisions the English courts have recognized a distinction between charitable and private trusts in applying the deviation doctrine. See, e.g., *In re Shipwrecked Fishermen & Mariners' Royal Benevolent Soc'y*, [1959] 1 Ch. 220; *In re Royal Soc'y's Charitable Trusts*, [1956] 1 Ch. 87.

Several state legislatures have enacted statutes giving charitable trustees wider investment powers than ordinary trustees. See, e.g., PA. STAT. ANN. tit. 15 § 2851-306 (1958); W. VA. CODE ANN. § 4216 (1) (1961); WIS. STAT. § 36.065 (1961).

The courts' tendency to be more liberal in the case of charitable trusts is illustrated by the historical development of the *cy pres* doctrine. In applying this doctrine to charitable trusts the courts allow deviation in the purposes of the trust as well as its administrative terms. See SCOTT § 381, at 2741-42.

¹⁸ See, e.g., *John A. Creighton Home v. Waltman*, 140 Neb. 3, 299 N.W. 261 (1941).

¹⁹ In a private trust the temporary beneficiaries are interested in getting as much income as possible while the remaindermen are mainly interested in the preservation of the corpus. Thus the income beneficiaries are more willing to allow the trustees to speculate in corporate stock. See *First Nat'l Bank v. Stevens*, 9 N.J. Super. 324,

existence.²⁰

The inflationary economy of the past two decades and the resulting devaluation of the dollar is an additional factor in favor of a more liberal application of the deviation doctrine. Most charitable trusts with restrictive investment provisions were established at a time when securities yielding a fixed rate of interest and having a set redemption value were thought to be safe trust investments since they produced a steady income and did not fluctuate in value.²¹ The demands made upon the earning power of a trust in an extended period of inflation, however, require that the corpus include a relatively large segment of growth assets.²² As a result of this change in trust investment needs, investment provisions which were originally economically sound no longer fully exploit investment potential.²³

74 A.2d 368, 369 (Ch. 1950); *Middleton Estate*, 1 Pa. D. & C.2d 162 (Orphans' Ct. 1954); 109 U. PA. L. REV. 908, 910 (1961). Compare *John A. Creighton Home v. Waltman*, 140 Neb. 3, 299 N.W. 261 (1941) and *Morris Community Chest v. Wilentz*, 124 N.J. Eq. 580, 3 A.2d 808 (Ch. 1939), with *Reiner v. Fidelity Union Trust Co.*, 127 N.J. Eq. 377, 13 A.2d 291 (1940), reversing 126 N.J. Eq. 78, 8 A.2d 175 (Ch. 1939) and *Bliss v. Bliss*, 126 N.J. Eq. 308, 8 A.2d 705 (Ch. 1939), *aff'd*, 127 N.J. Eq. 20, 11 A.2d 13 (1940).

²⁰ "The typical charitable trust is intended to last a very long time. Thus more extensive and more flexible powers in the trustees are reasonable and needed." 4 POWELL, REAL PROPERTY ¶ 579, at 488 (1954). See *Maxcy v. City of Oshkosh*, 144 Wis. 238, 128 N.W. 899 (1910); SCOTT § 381, at 2741.

²¹ The Nebraska Supreme Court, allowing deviation from the restrictive investment provisions of a charitable trust, stated that: "The requirement as to the investment of the funds was one which, at the time the will was made, had been demonstrated to be safe by economic standards and practices then in force. It had received, not only sanction as a safe business practice, but the approval of legislative bodies and courts. It is likewise obvious that the economic situation now existing is one which could not reasonably have been foreseen by Mr. Creighton at the time the trust was created." *John A. Creighton Home v. Waltman*, 140 Neb. 3, 8, 299 N.W. 261, 265 (1941).

See, e.g., *Morris Community Chest v. Wilentz*, 124 N.J. Eq. 580, 3 A.2d 808 (Ch. 1939) (charitable trust created in 1931); *In re Kirby Memorial Health Center*, 36 Luz. Leg. Reg. 70 (Luzerne County Ct., Pa. 1941) (deviation allowed in non-growth charitable trust created in 1928). Since the recent inflationary trend in the economy there has been a great increase in discretionary trusts. Stevenson, *Why the Prudent Man?*, 7 VAND. L. REV. 74 *passim* (1953).

²² See Buck, "Qualified" Trustee Performance Calls for Full Investment Freedom, 99 TRUSTS & ESTATES 864 (1957); Fingar, *Changing Concepts of Trust Investments*, 96 TRUSTS & ESTATES 864 (1957); Flacker, *Managing Fiduciary Funds*, 89 TRUSTS & ESTATES 32 (1950); Scully, *Changing Concepts of Trust Investments*, 97 TRUSTS & ESTATES 912 (1958); Shattuck, *The Trustee's Duty to Invest*, 86 TRUSTS & ESTATES 119 (1948); Comment, *Trusts—Trustees—Investment Duties of Trustees and the Problem of Unduly-Conservative Trust Investments*, 61 MICH. L. REV. 1545 (1963).

²³ See cases cited note 21 *supra*. Courts have generally authorized deviation where a non-growth charitable trust has suffered an actual inflationary loss in economic

In private trust cases, courts generally have held that an inflationary reduction in income and corpus is not such an emergency as to require deviation.²⁴ However, one recent case, involving a non-growth private trust created prior to the inflationary change in the economy, authorized investment in growth assets where the trust had sustained an actual economic loss.²⁵ If inflation resulting in detriment is a valid reason for allowing deviation in private trusts, it is even more significant in cases involving charitable trusts because of their perpetual nature and importance to society.²⁶

A New Jersey Chancery Court case, *Morris Community Chest v. Wilentz*,²⁷ illustrates the protracted effect inflation has on non-growth charitable trusts.²⁸ In *Wilentz*, inflation had substantially reduced both the purchasing power of the income and the economic value of the corpus. Taking judicial notice of the change in economic conditions since the creation of the trust, the court permitted the trustees to invest in corporate stock,²⁹ thus giving the trust growth potential necessary to effectuate more efficiently the trust's purpose of providing income for charity. *Wilentz* also illustrates that in permitting deviation from the administrative terms of charitable trusts, courts talk in terms of dominant intent and purpose, while in fact their concern is in protecting the economic value of charitable trusts against major changes in economic conditions.³⁰

value. *John A. Creighton Home v. Waltman*, 140 Neb. 3, 299 N.W. 261 (1941). *Contra*, *Toledo Trust Co. v. Toledo Hosp.*, 174 Ohio St. 124, 187 N.E.2d 36 (1962).

²⁴ See, e.g., *Stanton v. Wells Fargo Bank & Union Trust Co.*, 150 Cal. App. 2d 763, 310 P.2d 1010 (Dist. Ct. App. 1957); *Bliss v. Bliss*, 126 N.J. Eq. 308, 8 A.2d 705 (Ch. 1939), *aff'd*, 127 N.J. Eq. 20, 11 A.2d 13 (1940).

²⁵ *In re Trusteeship Under Agreement With Mayo*, 259 Minn. 91, 105 N.W.2d 900 (1960), 109 U. PA. L. Rev. 908 (1961). See also *Citizens Nat'l Bank v. Morgan*, 94 N.H. 284, 51 A.2d 841 (1947).

²⁶ The effect inflation can have on a charitable trust the trustees of which lack flexible investment powers is illustrated by the present plight of the Girard Estate which was established to maintain a school for orphan boys. The Girard Estate is a "legal" trust (limited to non-growth securities) under the laws of Pennsylvania. "As a result, the postwar period of inflation played havoc with the once impregnable financial position of the Girard Estate. In 1940 the net income of \$1,889,000 supported 1,733 boys and maintained the plant in excellent style and yet in 1959 the net income of \$2,235,000 was sufficient to care for 800 boys only, and this after severe economies and a drawing upon reserves." Tashjian, *Future of Charitable Trusts*, 99 TRUSTS & ESTATES 1090, 1092-93 (1960).

²⁷ 124 N.J. Eq. 580, 3 A.2d 808 (Ch. 1939).

²⁸ The endowment was limited to "legal" investments as specified in N.J. STAT. ANN. § 3A:15-1 (1953). 124 N.J. Eq. at 582, 3 A.2d at 809.

²⁹ Investment experts generally agree that corporate stocks are the best hedge against inflation, although not a perfect one. Flacker, *supra* note 22.

³⁰ In *Wilentz*, the court apparently felt that since the settlor had not specified the

Although courts have allowed deviation only in cases where an inflationary economy has already had an obvious adverse effect on a charitable trust,³¹ several state legislatures have enacted statutes which appear to empower courts to authorize deviation when it is merely foreseeable that future detriment will result if the original investment provisions are not changed.³² The New Jersey statute³³ allows a court to permit deviation if it is shown that by reason of a change in conditions "which may be reasonably foreseen" the objects and purposes of the trust "might be defeated in whole or in part." This liberal statute, however, is inapplicable to a charitable trust such as *Cocke* which has not suffered any actual inflationary loss and has grown tremendously in dollar value over the past forty years. Thus, the North Carolina court in refusing to permit deviation was within the confines of existing law.³⁴

If, however, the Endowment were to suffer an inflationary loss or if the trustees were able to prove that such was foreseeable, the instant decision would not seem to foreclose a subsequent action.³⁵ In that event, the court could logically allow deviation. *Wilentz*, the only reported New Jersey decision with a fact situation similar to

amount of income the charity was to receive, he therefore meant the maximum amount in a given economy.

³¹ See generally Annot., 170 A.L.R. 1219 (1947).

³² However, when a state has a statute which so limits trust investments as to prohibit the purchase of corporate stock unless authorized by the terms of the trust, the court cannot properly authorize deviation. On the other hand, several states which have legal lists have statutes that provide such lists shall not limit the power of a court of competent jurisdiction to permit a fiduciary to deviate from the terms of the trust as to investments. SCOTT § 167, at 1170 n.14. E.g., N.J. STAT. ANN. § 3A:15-1 (v) (1953).

³³ This statute applies to both private and charitable trusts. It specifically authorizes a court of competent jurisdiction to allow investment of the whole or some part of a trust in any class of investments, including common and preferred stocks. N.J. STAT. ANN. § 3A:15-15 (1953).

³⁴ This case raises important questions which the court did not have to answer. That is, what factors should be considered in determining whether a public utility such as Duke Power Company lacks the growth potential necessary to maintain the value of the trust in the face of an inflationary economy? If such a test were adopted, what would be necessary to show a reasonably foreseeable loss?

The court in reaching this decision apparently did not consider the relationship of the Endowment, Duke Power Company, and the settlor. From the indenture it appears that the settlor planned a close mutually beneficial relationship between Duke Power and the Duke Endowment. If in a later action this relationship is construed to be a dominant purpose of the settlor, it could be a strong factor in favor of refusing deviation even though the trust might face a reasonably foreseeable loss.

³⁵ Any substantial change in circumstances in the Duke Endowment, such as actual loss in economic value of the corpus, would seem to make this decision inoperative as to *res judicata*. See *Lasasso v. Lasasso*, 1 N.J. 324, 63 A.2d 526 (1949); *Flynt v. Flynt*, 237 N.C. 754, 75 S.E.2d 901 (1953).

Cocke, recognized the distinction between private and charitable trusts and authorized deviation where a charitable trust had suffered an actual inflationary loss of income and corpus.³⁶ Moreover, despite the narrow construction given the New Jersey statute in two *private* trust cases,³⁷ its terms are broad enough to allow deviation from the terms of a *charitable* trust such as the Duke Endowment, if an inflationary loss were foreseeable.

There are strong policy factors which would call for such a holding. A charitable trust has a perpetual existence and therefore needs more flexible investment provisions in order to meet changing conditions. Since the underlying purpose of a charitable trust is to benefit the public³⁸ and considering the fact that any inflationary loss by the Duke Endowment would be largely borne by the people and institutions of North Carolina, the North Carolina court should have a special incentive to allow deviation.

³⁶ The authority of *Wilentz* as to modification of investment provisions of charitable trusts has never been questioned. See *Citizens Nat'l Bank v. Morgan*, 94 N.H. 284, 51 A.2d 841 (1947); *First Nat'l Bank v. Stevens*, 9 N.J. Super. 324, 74 A.2d 368 (Ch. 1950) (recognized that *Wilentz* applied to charitable trusts and not to private trusts); *Scott* § 167, n.14.

The supreme court record of the instant case includes the complaint and final decree of the following unreported New Jersey cases with fact situations and holdings similar to *Wilentz*: *Blair Academy v. Trustees of the Presbytery*, No. 121/238, Ch. N.J. (1938); *Smith v. Hardin*, No. 121/83, Ch. N.J. (1938); *Askew v. Fidelity Union Trust Co.*, No. 119/190, Ch. N.J. (1937). Record, pp. 297-347, 359-92, *Cocke v. Duke Univ.*, 260 N.C. 1, 131 S.E.2d 909 (1963).

³⁷ *Bliss v. Bliss*, 126 N.J. Eq. 308, 8 A.2d 705 (Ch. 1939), *aff'd*, 127 N.J. Eq. 20, 11 A.2d 13 (1940); *Reiner v. Fidelity Union Trust Co.*, 126 N.J. Eq. 78, 8 A.2d 175 (Ch. 1939), *rev'd*, 127 N.J. Eq. 377, 13 A.2d 291 (1940). In *Bliss*, where a private trust had suffered inflationary loss of income and corpus, deviation was not allowed. The court felt that the investment provisions were broad enough and was afraid that harm might result to the remaindermen if the trustees were given discretionary investment powers. In *Reiner*, having a fact situation similar to *Bliss*, the court of errors and appeals relied on *Bliss* in reversing a chancery court decision which had allowed deviation. In *Cocke* the North Carolina Supreme Court relied on these cases as representing New Jersey law.

³⁸ "The essential idea of a charitable trust is that its benefit is to be for the whole public, or some large class of the public as distinguished from private persons." *Johnson v. Bowen*, 85 N.J. Eq. 76, 95 A. 370, 372 (Ch. 1915).