

PROBLEMS OF TRUST ADMINISTRATION IN NEW JERSEY†

PREFACE

The powers, duties, liabilities, privileges, rights and immunities of trustees have received careful attention within the last two decades. Expansion of the use of the trust form has been attended by problems of construction and adaptation which are characteristic of any growing branch of the law. The result of uncertainty has often had undesirable consequences from the viewpoint of trustees and cestuis alike in the years since 1929. The interest in exactly what course must be pursued by a trustee in the proper discharge of his duties has consequently heightened.

The authors have attempted in the following discussion to summarize the chief problems which beset trustees and, analogously, administrators and executors. The discussion will follow as nearly as possible a temporal and functional scheme. The duty of the fiduciary begins upon acceptance of the trust, pursuant to the appointment by decedent, or by a court of competent jurisdiction. What must he then do? Obviously, he has to get possession of the corpus; then he has to insure, to defend suits, and to pay taxes. Next he must invest; subsequently, he must distribute, and finally he must account, whereupon he will be paid.

A thorough investigation of the New Jersey cases has been made. The reports until quite recently are meagre, consisting often of a syllabus with a skeleton statement of the facts. The Court of Errors and Appeals has passed upon trust questions relatively infrequently and certain of the statements by the Vice-Chancellors and Vice-Ordinaries must therefore be taken to be law in the state. The cases and discussions of Professor Powell comprising chapters 30 to 32 of his "Cases and Materials in the Law of Trusts and Estates"* have been invaluable in the ensuing analyses.

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†This is the first part of an article; remaining portion will appear in the next issue.

SECTION I. FORMAL REQUIREMENTS

A. *Acceptance and Appointment.*

Temporally, the duties of a trustee¹ commence with his acceptance of the trust.² Acceptance may be in pais as well as by formal act and where a trust officer received documents from decedent's brother and gave the following receipt: "above-listed items are received as part of (deceased's) estate," it was held that the trust company had accepted.³ So also, a formal defect in an appointment does not affect trustees' rights as against third persons.⁴

B. *Security.*

Generally trustees⁵ do not have to post a bond.⁶ But the contrary is true of foreign executors.⁷ The Statute⁸ was held, however, not to apply to foreign trustees (as distinguished from executors) where it was shown that the trustee was of high repute. In this case the trustee was required to file an irrevocable power of attorney with the Attorney General permitting him to accept service for it in any process concerning the estate.⁹ A court may, however, require security upon a showing by an interested party that the property is "unsafe, insecure, or in danger of being wasted".¹⁰

¹ "Trustee" is used in this essay so as to include executors and administrators unless otherwise indicated.

² "Trust" is used to include the transaction or transactions giving rise to the privileges, powers, rights, duties, liabilities, and immunities of the above-mentioned fiduciaries.

³ *Donnelly v. Slaughter*, 114 N.J.Eq. 302, 168 Atl. 762 (1933); see also *Romaine v. Hendrickson's Ex'rs*, 27 N.J.Eq. 162, *aff.* 28 N.J.Eq. 275 (1876) (Joining co-trustee in giving notice of sale of trust property held to constitute acceptance.)

⁴ *Budd v. Hiler*, 27 N.J.L. 43 (1858).

⁵ Administrators are required, however, to give security. C.S. (1910), p. 3828, §45.

⁶ C.S. (1910) §51, p. 3829; §140 and 141, p. 3868.

⁷ See *supra* note 6.

⁸ See *supra* note 6.

⁹ *Price v. United Hebrew Charities*, 3 N.J.Misc. 706, 129 Atl. 712 (1925).

¹⁰ See *supra* note 6, §140. The same procedure governs petitions for additional security where an interested party shows the original security is inadequate.

SECTION II. PRELIMINARY FUNCTIONS

A. *Securing the Res.*

Having complied with the formal requirements and entered a bona fide trust relationship, there follows a duty to reduce the estate, which forms the subject matter of the trust, to possession without any promptings by the cestuis.¹¹ It is irrelevant in what capacity the trustee purports to take custody of funds properly a part of the res.¹²

B. *Duty to Insure.*

There is an unqualified duty on the part of a trustee to insure the trust res whether or not testator or intestate in like position insured.¹³ In case of failure to insure the trustee is chargeable with the value of the property destroyed.¹⁴

C. *Duty to Pay Transfer and Inheritance Tax.*

Trustee is under a duty to pay transfer and inheritance taxes and is personally liable for failure to do so though he has distributed the assets and has made a final accounting.¹⁵ Moreover this duty is one of the conditions of an administrator's bond.¹⁶

D. *Litigation Affecting Trust Res.*

The trustee has, of course, the power, in preserving and executing the trust, to engage in litigation and to use the process of the courts. In such case he is said to represent the cestuis.¹⁷ And he is a necessary party in litigation affecting the enforcement or execution of the trust.¹⁸

The various duties thus far mentioned and those which are to be discussed naturally involve the fact that the trustee may

¹¹ *Speakman v. Tatem*, 48 N.J.Eq. 136, 21 Atl. 466 (1891), *aff. per curiam* in 50 N.J.Eq. 484, 27 Atl. 636. The same rule applies to failure to collect interest payments on a mortgage, *Backes v. Crane*, 87 N.J.Eq. 229, 100 Atl. 900 (1917).

¹² *Allen v. Allen*, 88 N.J.Eq. 575, 103 Atl. 169 (1918); *In re Oliver*, 3 N.J.Misc. 453 (1925), 129 Atl. 424. (Proceeds of insurance policy paid to administrator as a relative under a "facility of payment" clause.)

¹³ *In re Ramsey's Estate*, 66 Atl. 410 (Prerog. Ct. 1907).

¹⁴ *Ibid.* p. 411.

¹⁵ *Martin v. Underhill*, 115 N.J.Eq. 526 (Prerog. Ct. 1934).

¹⁶ *Ibid.*

¹⁷ BOGERT, TRUSTS, p. 317 (1921).

¹⁸ See 65 CORPUS JURIS, p. 1032, note 40.

have to go to the courts in order to perform them. His duty to sue is, therefore, to be considered as one means which he may have to utilize in the proper execution of the functions of his office. New Jersey courts have recognized this in the first place, in allowing him to bring possessory¹⁹ and personal actions.²⁰

In connection with this power to sue, the courts have stated that he may,²¹ and indeed that he has the duty²² in many circumstances to employ skilled counsel.

SECTION III. POWER OF TRUSTEE TO CHANGE FORM OF RES

A. *Power of Sale.*

1. *Express.*

The trust instrument generally speaking must be rigidly complied with. Where we find express language conferring a power of sale upon a trustee, courts encounter little difficulty.²³ Moreover, such explicit authorization devolves upon a substituted trustee²⁴ and survives in spite of partial invalidity of a testamentary disposition.²⁵ If the express power is limited by a requirement that the equitable life tenant concur in its exercise and such life tenant dies, the power continues unqualified for the duration of the trust.²⁶

An express power of sale may be limited (a) by the expressed intent of the testator, (b) by implication from the instrument and surrounding circumstances, (c) by a change in circumstances subsequent to testator's death, (d) and also by rules of law such as the rule against perpetuities.

¹⁹ Keneaster v. Erb, 83 N.J.Eq. 206, 89 Atl. 995 (1916).

²⁰ Stevens v. Burch, 54 N.J.Eq. 59, 33 Atl. 293 (1895); see also *In re Corn Exchange Bank*, 109 N.J.Eq. 169, 156 Atl. 455 (1931) (power to move for receivership of corporation in which trust had stock); *In re Braunstein*, 112 N.J.Eq. 315, 164 Atl. 431 (1933) (power of administrator *pendente lite* to compromise claim).

²¹ *In re Starr*, 103 Atl. 392 (1918); *In re Dreiers Estate*, *infra* note 270 at p. 619; *Babbitt v. Fidelity Union Trust Co.*, *infra* note 90 at p. 753.

²² "and he will be entitled to obtain skilled services of experts where necessary and advisable * * * and would probably be censurable and perhaps personally liable if he failed to do so." *Hagedorn v. Arens*, *infra* note 193.

²³ *Albright v. Taylor*, 139 Atl. 711 (1928); *Brinzel v. O'Toole*, 103 N.J.Eq. 339, 143 Atl. 361 (E.&A. 1928); *Magil v. Kirkpatrick*, 92 N.J.Eq. 386, 112 Atl. 725 (1921).

²⁴ C.S. 1910, p. 2261, §10; *Magil v. Kirkpatrick*, *supra* note 23.

²⁵ *Murphy v. Morrissey & Walker*, 99 N.J.Eq. 238, 132 Atl. 206 (1926).

²⁶ *Nelson v. American Trust Co.*, 104 N.J.Eq. 594, 146 Atl. 460 (1929).

(a) Thus, specific performance of a contract to sell land executed three years after testator's death where the will empowered the trustee to sell only after the expiration of five years, was denied.²⁷

(b) In the case of *Doyle v. Blake*²⁸ a sole devisee and legatee successfully maintained a bill to secure the land in specie and to restrain the sale thereof by an executor.²⁹ The same rule was held to apply where a trust with an imperative power of sale was created and the proceeds were directed to be paid to cestuis.³⁰ But where an equitable life tenant objects to sale by trustee of trust property, her objection in absence of fraud or bad faith on part of trustee will not prevail,³¹ since other equitable interests may be prejudiced.

(c) "If a power is given to a trustee, it is obviously given to him for the purpose of enabling him to carry out the duties imposed upon him by the will and for no other purpose."³² Hence in the case of a trust for the education and maintenance of a minor, her death prior to the termination of the minority extinguishes the power.³³ But the birth of a posthumous child only disturbs a power so far as is necessary to assure it a proper share in the estate.³⁴

2. *Implied.*

In the absence of express provision courts have nevertheless found, by implication from other language or other directions in the instrument, a power in the trustee to sell. This is done typically when from the entire will it appears evident that the duties of the trustee require conversion.³⁵ The cases may, for convenience, be aligned into five type situations though of

²⁷ *Oak Investment Corporation v. Martin*, 107 N.J.Eq. 123, 151 Atl. 874 (1930); see also *McKiernan v. McKiernan*, 74 Atl. 289 (1909).

²⁸ 77 N.J.Eq. 142 (1910).

²⁹ The petitioner proffered security that the administration and funeral expenses would be taken care of.

³⁰ *Camden Safe Deposit & Trust Co. v. Guerin*, 87 N.J.Eq. 72, 79 and 80, 99 Atl. 105 (1917).

³¹ *Browning v. Stiles*, 65 Atl. 457 (1906).

³² *Foley v. Devine*, 95 N.J.Eq. 473, 123 Atl. 248 (1924), per Buchanan, V.C.

³³ *Ibid.*

³⁴ *Pashkow v. Frankel*, 101 N.J.Eq. 510, 139 Atl. 56 (1927).

³⁵ *Lindley v. O'Reilly*, 50 N.J.L. 636, 649 (1888).

course we may find in any given litigation varying combinations thereof.

(a) To remedy a manifest oversight. Thus where a testator appoints an executor and thereafter appoints an administrator, directing the latter to divide the property remaining after payment of a specific legacy, the court found an implied power of sale in the executor, saying that the naming of an administrator would have no significance were a contrary interpretation followed.³⁶ Similarly, where the testator directs that "so much of the share of said cestui as shall be reduced to personalty" is to be turned over to any good trust company,³⁷ and where testator directed the trustee to consult with the cestuis regarding the advisability of selling property.³⁸

(b) From a direction to use the corpus for the benefit of the life beneficiary. Obviously where the trustee is directed "to apply the income together with so much of the principal thereof as my said trustees . . . see fit for support, maintenance, and education of my . . . niece, Eleanor . . . until (she) shall . . . reach 21,"³⁹ the power of sale is implied from the privileged power to use the corpus.⁴⁰

(c) From a direction to invest and reinvest. The earlier cases⁴¹ said that the direction to invest and reinvest would ground an implication only as to personalty. But in *Girard Trust Co. v. Cheeseman*⁴² the court extended the doctrine to include estates consisting of both personalty and realty. A *fortiori* where the trustee was given the right "from time to time as often as it becomes necessary to change the investment".⁴³

(d) From a direction to divide. A suggested rationale for this line of cases appears to be grounded in the injustice which

³⁶ *Sturm v. Hackensack Trust Co.*, 106 N.J.Eq. 308, 148 Atl. 917 (1930).

³⁷ *Wright v. Keasbey*, 87 N.J.Eq. 51, 100 Atl. 172 (1917); see also *Bressman v. Retsky*, 96 N.J.Eq. 222, 124 Atl. 529 (1924) where in a holographic will the testator directed the executor life tenant to divide as much of the realty as remained unexpended.

³⁸ *Haggerty v. Lanterman*, 30 N.J.Eq. 37 (1878).

³⁹ *Baer v. Booz*, 96 N.J.Eq. 535, 125 Atl. 567 (1924).

⁴⁰ *Accord*, *Vrooman v. Virgil*, 81 N.J.Eq. 301, 88 Atl. 372 (1913).

⁴¹ *Chandler v. Thompson*, 62 N.J.Eq. 723 (1900).

⁴² 93 N.J.Eq. 266, 115 Atl. 745 (1921).

⁴³ *Moore v. Wears*, 87 N.J.Eq. 459, 100 Atl. 563 (1917).

may well result from a division of realty in specie. But where there is also personalty it would seem that the injustice could be remedied by varying the monetary distribution.⁴⁴

A more cogent explanation can be found in two factors, namely, the added convenience to the fiduciary and the judicial policy favoring freedom from restraints on the fact of alienability.

The power of sale was implied where the direction was "to divide equally";⁴⁵ "to divide in equal shares";⁴⁶ or merely "to divide".⁴⁷ And it seems to have been found whether the necessary number of shares were many or few. Thus on the one hand, in *Smith v. Mooney*⁴⁸ some of the shares would have been as small as 1/72 of the whole, while on the other hand in *Wood v. Lembcke*⁴⁹ there were only six shares and in *Varich v. Smith*⁵⁰ but five shares. It would appear, therefore, that the decision in *Dreir v. Senger*⁵¹ is out of line unless the learned Vice-Chancellor relied on the language "to divide into five equal parts as nearly as may be" as indicating that the implication, if made here, would not be in accord with expressed intent.

3. *Implications made despite express language to the contrary.*

In the exercise of its general equitable powers, where there has been a change in circumstances subsequent to the creation of the trust such as to endanger the beneficial interests under the trust if the manifest intent of the testator were carried out, a court will decree a sale. So in the case of *Price v. Lang*⁵² the fact that for three years a cheap jewelry business, shares in which comprised the subject matter of the trust, had earned no profits, because of a general business depression, the loss of testator's services and the uncertainty owing to the World War,

⁴⁴ *Dreir v. Senger*, 3 N.J.Misc. 769, 130 Atl. 5 (1925).

⁴⁵ *Belcher v. Belcher*, 38 N.J.Eq. 126 (1884); *Smith v. Mooney*, 5 N.J.Misc. 1087, 139 Atl. 513 (1927).

⁴⁶ *Varich v. Smith*, 69 N.J.Eq. 505, 61 Atl. 151 (1903).

⁴⁷ *Wood v. Lembcke*, 72 N.J.Eq. 651, 66 Atl. 903 (1907); *Casselman v. McCoolley*, 73 N.J.Eq. 253, 67 Atl. 706 (1907).

⁴⁸ *Supra* note 45.

⁴⁹ *Supra* note 47.

⁵⁰ *Supra* note 46.

⁵¹ *Supra* note 44.

⁵² 87 N.J.Eq. 578, 101 Atl. 195 (1917).

was held to be enough to allow a deviation from the express direction to retain.⁵³

4. *Analogous functions of pledging, mortgaging and exchanging.*

(a) Privilege to pledge assets of the estate. As against a pledgee with notice, it has been held that an attempted pledge of a mortgage to secure a loan, the greater part of which was not applied to the use of the estate, was ineffective.⁵⁴ While the court broadly stated that no power to pledge existed, there followed dictum that a bona fide pledgee would have been protected.⁵⁵

(b) Power to mortgage. Ordinarily a trustee cannot mortgage the trust⁵⁶ unless power to do so is expressly given him by the trust deed,⁵⁷ or an intent to confer the power can be implied from its terms and the circumstances surrounding the trust.⁵⁸

Though an express power be conferred, it will be strictly construed as to the purpose for which it may be exercised. Thus where the power could be exercised if the property could not be sold advantageously and could only be exercised to raise funds to keep up or repair the property, it was said that no power to mortgage existed if there was a ready market for the property and it was held that the trustee could not mortgage to pay off indebtedness created by testator.⁵⁹

Although the authors have been unable to find a controversy in New Jersey in which the court implied a power to mortgage, it is believed that the holding⁶⁰ of the court in a foreign jurisdiction illustrates the rationale with which a New Jersey dictum is in accord.⁶¹ There, upon the trustee's demon-

⁵³ See also, *Matter of Pulitzer's Estate*, 139 N.Y.Misc. 575, 249 N.Y.S. 87 (1931).

⁵⁴ *Goodell v. Monroe*, 87 N.J.Eq. 328, 100 Atl. 238 (E.&A. 1917) *rev'd* 86 N.J.Eq. 18, 97 Atl. 152.

⁵⁵ *Ibid.* 336 (per Trenchard, J.).

⁵⁶ See 63 A.L.R. 795 (1929).

⁵⁷ *Mulford v. Mulford*, 42 N.J.Eq. 68, 6 Atl. 609 (1886).

⁵⁸ *Schulting v. Schulting*, 41 N.J.Eq. 130, 3 Atl. 526 (1886) (refusing to make the implication).

⁵⁹ *Mulford v. Mulford*, *supra* note 57.

⁶⁰ *Fergusson v. Fergusson*, 148 Ark. 290, 229 S.W. 738 (1921); see 63 A.L.R. 795, 797.

⁶¹ *Schulting v. Schulting*, *supra* note 58.

strating the necessity of funds for cultivation and maintenance of the farm, and the danger to the property if the funds were not forthcoming, the court made the implication.

(c) Power of exchange. New Jersey is in accord with the general rule⁶² that the grant of a power of sale does not confer upon trustee the power to exchange.⁶³

B. Investment by trustee.

1. Introduction.

Any fiduciary entrusted with the management of funds coming into his hands is under a duty to invest them.⁶⁴ Such investment must be made within a reasonable time.⁶⁵

The investment of trust funds presents a conflict of interest between those presently entitled to the income and those to whom the corpus will ultimately go. The former group seek as high a yield as possible; the latter are primarily interested in safety. It is the function of a trustee to strike a balance between the two with a view also to facility and convenience in management. As Holgate⁶⁶ says, the ideal investment should have the following characteristics:

(1) Security of principal, (2) stability of income, (3) marketability, (4) value as collateral, (5) tax exemption, (6) exemption from care, (7) acceptable duration, (8) acceptable denomination, (9) potential appreciation.

At best, a trustee can only strive for a compromise of all of these elements.⁶⁷

2. Permissible investments.

The common law rule restricted investments by trustees to public funds.⁶⁸ Early New Jersey cases relaxed the rules so as to include landed security in view of the scarcity of public

⁶² 63 A.L.R. 1004 (1929).

⁶³ *Tzeses v. Green*, 105 N.J.Eq. 12, 146 Atl. 593 (1928).

⁶⁴ *McKnight's Ex'rs v. Walsh*, 23 N.J.Eq. 136, *aff'd* 24 N.J.Eq. 478 (1872), *cf.* C.S. 1910, p. 3863, §136.

⁶⁵ *Backes v. Crane*, *supra* note 11. He is liable for interest if he fails.

⁶⁶ TYPE OF INVESTMENT WHICH SHOULD BE USED FOR TRUST FUNDS, 41 T.C.M. 177 (1925), cited Powell, *op. cit.* II, p. 603.

⁶⁷ See also Wright, *Measure of Trustee's Liability For Improper Investments*, 80 U. OF PA. L. REV. 1105, 6.

⁶⁸ *Gray v. Fox*, 1 N.J.Eq. 259 (1831) at p. 265.

funds.⁶⁹ Second mortgages,⁷⁰ purchases of realty,⁷¹ private securities⁷² were forbidden.

Statutes authorize nine different types of investment:

- (1) United States bonds.⁷³
- (2) New Jersey bonds.⁷⁴
- (3) Bonds of any county, city, town, township in New Jersey where the indebtedness does not exceed 15% of the assessed valuation and where the issue is authorized by the state.⁷⁵
- (4) Bonds secured by first mortgage on real estate where the loan does not exceed 60% of the estimated worth of the real estate covered by such mortgage and the interest rate is between 3% and 6% per annum.⁷⁶ It is questionable whether this section authorizes investments in mortgages on property located outside the state.
- (5) Participating certificates in bonds secured by first mortgage on bond subject to the same qualifications as above (4), provided also that such bond, mortgage, insurance, guarantees, etc., shall be held in trust for participants by a trust company.⁷⁷ This was amended to include investment in participating certificates where the trustee is given discretion to substitute other real estate security for the original security subject to the same qualifications as above.⁷⁸
- (6) Bonds of other states in the union which for ten years

⁶⁹ *Ibid.*, p. 266.

⁷⁰ *Wilson v. Staats*, 33 N.J.Eq. 524 (1881); *Tuttle v. Gilmore*, 36 N.J.Eq. 617 (1883) *rev'd* 32 N.J.Eq. 611 (1884).

⁷¹ *Holcomb v. Holcomb*, 11 N.J.Eq. 281 (1857); *Quick v. Fisher*, 9 N.J.Eq. 802 (1852).

⁷² *Ward v. Kitchen*, 30 N.J.Eq. 31, 90 Atl. 1063 (1878).

⁷³ C.S. 1910, p. 2271, §35, P.L. 1899, p. 237.

⁷⁴ *Ibid.*

⁷⁵ *Ibid.*

⁷⁶ *Ibid.* p. 3864, §137 VI, P.L. 1907, p. 383. Prior to statute under the ruling in *McCullough Ex'rs v. McCullough*, 44 N.J.Eq. 313, 14 Atl. 123 and 642 (1888) where trustees brought a bill for instructions, the court held an investment in mortgages in Minnesota would be improper. Construing a similar statutory provision, the Court of Appeals in New York has held that investments outside the state would be improper in the absence of unusual circumstances. *Ormiston v. Olcott*, 84 N.Y. 339 (1881). P.L. 1933, C. 204, p. 444, §3, permits trustees to retain investments in mortgages where the value of the security has depreciated under requirements fixed by C.S. 1910, p. 3864.

⁷⁷ Cum. Supp. (1924), p. 1213, §72, ¶37(a).

⁷⁸ C.S. 1930, p. 705, §72, ¶37(a).

previous to the investment have not defaulted as to principal or interest.⁷⁹

(7) Bonds of the cities of New York and Philadelphia.⁸⁰

(8) First mortgage bonds of any railroad which has paid dividends (not less than 4%), regularly for a period of five years next preceding the investment, and, under the same restrictions, consolidated mortgage bonds retiring previous debts.⁸¹

(9) Investment in loans and securities in which savings banks are permitted to invest.⁸²

These statutes do not apply where the instrument directs the manner of investment.⁸³

Under the statutes it has been held that purchases of realty,⁸⁴ unsecured loans to legatees,⁸⁵ investment on "non-legal" private security,⁸⁶ investment in second mortgages⁸⁷ are improper.

A trustee depositing money in a bank pending distribution or investment qua trustee⁸⁸ is not liable for a supervening bank failure provided that he does so in good faith, and that the bank is in good credit standing. In the opinion of the writers, permanent investment in banks is not permissible since it is not expressly allowed by the statutes. However, when market conditions are extremely unfavorable, the courts may extend the period during which a trustee may keep bonds on deposit.

3. *Retention of investments coming into the hands of a trustee.*

In absence of direction to retain in the instrument the trustee may apply to a court of competent jurisdiction for direc-

⁷⁹ C.S. 1910, p. 3864, §136 III.

⁸⁰ *Ibid.*, IV.

⁸¹ *Ibid.*, V.

⁸² C.S. 1910, p. 2272, §37.

⁸³ *Ibid.*, p. 2271, 2, §36.

⁸⁴ *In re Ahrend*, 3 N.J.Misc. 746, 130 Atl. 219 (1925) appeal dismissed 99 N.J.Eq. 328, 133 Atl. 758; *Smith v. Robinson*, 83 N.J.Eq. 384 (1904).

⁸⁵ *Jenkinson v. N. Y. Finance Co.*, 79 N.J.Eq. 247, 253, 82 Atl. 236 (1911).

⁸⁶ *Macy v. Mercantile Trust Co.*, 68 N.J.Eq. 235, 59 Atl. 596 (1904); see also *wieters v. Hart*, 67 N.J.Eq. 507, 63 Atl. 241, *aff'd* 68 N.J.Eq. 796, 64 Atl. 1135 (1904).

⁸⁷ *Durkin v. Connelly*, 84 N.J.Eq. 66, 92 Atl. 906 (1914).

⁸⁸ *Cox v. Roome*, 38 N.J.Eq. 259 (1884), *aff'g* 37 N.J.Eq. 17 (1883), *Woodruff v. Freehold Trust Co.*, 112 N.J.Eq. 405, 164 Atl. 411 (1933).

tions as to the retention or sale of securities or other investments in his hands. Such direction shall relieve him from liability.⁸⁹ Otherwise, a trustee may only in exercise of good faith and sound discretion retain "legals" and is under a duty to convert "non-legals"⁹⁰ though he is given a reasonable time in which to convert.⁹¹

Although a trustee is expressly permitted to retain,⁹² he is nevertheless liable for losses which result from failure to dispose of securities if such disposal would have been demanded by the exercise of the requisite degree of care and foresight. Exactly what constitutes the requisite degree of care is not easily determinable. Four factors have been considered in this connection.

(1) The market value of the security is inflated considerably above its intrinsic worth.

(3) The trustee is a corporate fiduciary holding itself forth as a specialist.

(3) The security has sharply fallen off in market value.

(4) The ratio between earnings and market value is well below the usual return on trust investments.

These cases as may be seen involve considerable decline in values caused by general business depression. The Court of Errors and Appeals has ruled on this point only once.⁹³ The Beam Case contained the second and third of the above elements. There the values dropped sharply with the 1905-1906 stock-market decline. The lower court⁹⁴ felt that the rapid decline should have put trustees on notice of the speculative nature of the security. The highest court however felt that this rule would constitute trustees ticker-watchers and that permanent

⁸⁹ C.S. 1910, p. 2267, §28; see also *In re Brown*, 112 N.J.Eq. 497, 164 Atl. 692 (1933).

⁹⁰ *Babbitt v. Fidelity Trust Co.*, 72 N.J.Eq. 745, 66 Atl. 1076 (1907); *Brown v. Brown*, 72 N.J.Eq. 667, 65 Atl. 739 (1907).

⁹¹ He is not obliged to sell in a market panic. *Peoples National Bank v. Bichler*, 115 N.J.Eq. 612, 172 Atl. 367 (1934).

⁹² The power to retain includes the power to exercise pre-emptive rights with extraordinary dividends declared for that purpose. *Ballentine v. Young*, 79 N.J.Eq. 70, 81 Atl. 119 (1911); but the trustee may not buy stock in subsidiary corporation. *Hewitt v. Hewitt*, 113 N.J.Eq. 199, 166 Atl. 528 (1933).

⁹³ *Beam v. Paterson Safe Deposit & Trust Co.*, 83 N.J.Eq. 628, 92 Atl. 351 (1914), *rev'd* 82 N.J.Eq. 818, 91 Atl. 731 (1913).

⁹⁴ 82 N.J.Eq. 518, 91 Atl. 731 (1913).

investment could not be made with this restriction. The Pettigrew Case⁹⁵ in which the 1929 debacle was involved is in accord with the result in the Beam Case. There the Court, referring to exceptions taken to the accounting by trustees, in which the legatees claimed that stocks were sold at too low a price, said that "for the precipitous decline in the market and the general economic depression which followed the executors cannot be held to account. To have sold the securities under such conditions and at a time when even financial geniuses were literally pouring their fortunes into stock market coffers so that they might be able to hold rather than sacrifice their securities would probably have rendered the executors surchargeable for what there appeared to be but a shrinkage of values."

"In not then selling they merely acted as hundreds of thousands of other prudent and cautious persons. To surcharge them for so acting would be to exact of them the exercise of a far greater degree of care, caution, and foresight than would have been exercised by the ordinarily prudent and cautious person under similar circumstances, which of course the law does not require."⁹⁶ In *Harris v. Guarantee Trust Co.*⁹⁷ the first two elements above listed, that is, inflated values⁹⁸ and a corporate trustee, were present. There the investment was in stock in a corporation whose business was the development of real estate. The crash in values was caused by a curtailment of credit by banks. The case thus seems logically decided on the ground that, as the court felt, the decline was entirely unforeseeable.

The *Harris Case* seems inconsistent with the holding in *In re Chamberlain*⁹⁹ in which the mere fact of over-inflated values was held to be sufficient notice to the trustee of the uncertainty of the investment. The court relied on the fact that the trustee had held itself out as an expert, and stated that it was a matter of common knowledge that an adjustment in values was bound

⁹⁵ *In re Pettigrew*, 115 N.J.Eq. 401, 171 Atl. 152, *aff'd* 116 N.J.Eq. 566 (1934). *Accord*: *Peoples National Bank v. Bichler*, *supra* note 91.

⁹⁶ Per Lewis, V.O.

⁹⁷ 115 N.J.Eq. 604, 172 Atl. 209 (1934).

⁹⁸ This factor is invariably present in recent cases.

⁹⁹ 9 N.J.Misc. 809, 156 Atl. 42 (1931).

to occur.¹⁰⁰ Trustee should thus have disposed of its holdings. In view of the Beam Case¹⁰¹ the authority of this holding is questionable. There seems no doubt but that the burden placed upon the trustee by this court is excessive—especially in view of the fact that the decline in value was only approximately 20 %.¹⁰²

A recent case¹⁰³ illustrates a rather extreme case of speculation with trust funds by a trustee. All four factors enumerated above were there present. Moreover, though the stock had in 1930 mounted until its value was greatly in excess of the inventory appraisal of early 1929, the trustee still retained the security. The only mitigating factor was that appellant corporate trustee needed consent of testator's brother, a co-trustee, for sale, and that this brother had influenced the testator's financial steps throughout testator's lifetime. Evidence showed that the brother had brought to appellant's attention his desire that the trust become "a hundred-thousand dollar" trust. The court held that failing to obtain consent, appellant should have come to court for relief. Not having done this it was as guilty of speculation with trust funds as was the brother. The appraisal value of the security was \$46,000, and at the time of the accounting its value was \$9,000.¹⁰⁴

4. *Effect of express provision (a) as to extension of privileged investment groups (b) as to exemption from liability for lack of due care.*

Apparently clauses restricting the type of security in which trustee is authorized to invest will be strictly construed, and strong language is needed to empower trustee to invest in non-legals. Power to invest in "proper funds on good security" was held to permit investment only on lawful security as laid down

¹⁰⁰ Berry, V.O., p. 810.

¹⁰¹ *Supra* note 93.

¹⁰² *Supra* note 99, p. 810, \$258,000 to \$200,000.

¹⁰³ *In re Westfield Trust Co.*, 115 N.J.Eq. 611, 172 Atl. 212. The Court of Errors and Appeals has reversed the decision of the Prerogative Court in an opinion which is not yet available.

¹⁰⁴ The peak price was \$71,000 and the 1930 value was \$62,000 (well above appraisal value).

by judicial precedent.¹⁰⁶ And under the statute, power to invest in "improved or productive real estate or in sound productive securities, such as they may deem best" was held¹⁰⁶ not to authorize investment in non-legals.

Clauses exempting trustee from liability except for willful or intentional breaches are similarly construed. So, where trustee invested proceeds from sale of trust property in second mortgages the exemption clause did not avail him.¹⁰⁷ And where trustee in a participation certificate case acted in contravention of trust instrument in substituting other security for that originally in his portfolio, the same rule was applied.¹⁰⁸ The rationale of the courts seems to be that the clause does not exempt liability for deviation from the terms of the trust. The line between ordinary negligence and such deviation seems indeed illusory. The safer way to rationalize the holdings is to say that only the most trivial of breaches of trust will be excused because of the clause.¹⁰⁹

5. *Liability for breach of duty to invest.*

Wright¹¹⁰ summarizes seven different types of breaches of which the first four enumerated below have been involved in litigation in New Jersey.

(1) Selling property which the trustee is under a duty to retain.¹¹¹

(2) Failing to sell property which trustee was under a duty to sell.¹¹²

(3) Purchasing property which trustee was under a duty not to purchase.¹¹³

¹⁰⁶ Ward v. Kitchen, *supra* note 72.

¹⁰⁶ Brown v. Brown, *supra* note 90.

¹⁰⁷ Tuttle v. Gilmore, *supra* note 70.

¹⁰⁸ Conover v. Guarantee Trust Co., 88 N.J.Eq. 450, 102 Atl. 844 (1917).

¹⁰⁹ *In re Leup*, 108 N.J.Eq. 49, 153 Atl. 842 (1931) (misallocation of expenses).

¹¹⁰ *Op. cit.*, *supra* note 67.

¹¹¹ RESTATEMENT OF LAW OF TRUSTS, Tent. Draft No. 3 §199 (1932); *Huston v. Cassidy*, 14 N.J.Eq. 320 (1862); *Feld v. Kantrovitz*, 102 N.J.Eq. 307, 140 Atl. 426 (1928).

¹¹² *Ibid.*, Sec. 200; see *supra* notes 90 to 104, incl.

¹¹³ *Ibid.*, Sec. 201; see e.g. *In re Ahrend*, *supra* note 84.

¹¹⁴ *Ibid.*, Sec. 202; see also *McKnight's Ex'rs v. Walsh*, *supra* note 64, and *Backes v. Crane*, *supra* note 66.

(4) Failing to purchase property which trustee was under a duty to purchase.¹¹⁴

(5) Selling property which he should not have sold and purchasing property which he should not have purchased.¹¹⁵

(6) Purchasing property which trustee was under a duty not to purchase and failing to purchase property which trustee was under a duty to purchase.¹¹⁶

(7) Failing to sell property which trustee was under a duty to sell and failing to purchase property which he was under a duty to purchase with the proceeds of the sale.¹¹⁷

The rules of damage as to (1) are:

(a) The trustee may be charged with the value of the property at time of sale with interest.¹¹⁸

(b) The trustee may be charged with value of property at time of decree, with income which would have accrued thereon if he had not sold, or be required to make specific reparation if reasonable under the circumstances.¹¹⁹

(c) He may be required to account for the proceeds of sale.¹²⁰

These three alternative rules allow the cestui to take advantage of a rise or decline in prices subsequent to the improper sale.

As to (2) the measure of damage is what the trustee would have received if he had properly sold the property.¹²¹ But note that in the Westfield case¹²² this strict prophylactic rule was relaxed and the trustees were surcharged only in that amount which represented the difference between the value as of the time of the inventory appraisal and the market value at the time of the decree.

As to (3), the trustee may be surcharged with the amount of the trust fund wrongfully expended plus interest or be re-

¹¹⁵ *Ibid.*, Sec. 203 (1).

¹¹⁶ *Ibid.*, Sec. 203 (2).

¹¹⁷ *Ibid.*, Sec. 203 (3).

¹¹⁸ *Supra* note 111.

¹¹⁹ WRIGHT, *op. cit.*, p. 108, *supra* note 110.

¹²⁰ *In re Oatway*, 2 Ch. 356 (1903).

¹²¹ *E.g. In re Chamberlain*, *supra* note 99; *Babbitt v. Fidelity Trust Co.*, *supra* note 90.

¹²² *Supra* note 104.

quired to account for the property so purchased and the income received.¹²³

As to (4), the trustee may be surcharged with the value of the property which he failed to purchase as of the time of the decree plus the income which would have accrued, or be required to purchase the property if reasonable under the circumstances and be surcharged with the income which would have accrued.¹²⁴

As to (5), (6) and (7), varying combinations of the rules just discussed have been applied,¹²⁵ but no litigation in this state has involved these considerations.

SECTION IV. OTHER DUTIES ARISING OUT OF THE NATURE OF THE RELATIONSHIP

The conduct of persons whose relationship to others is characterized by the term "fiduciary" has always received careful scrutiny by courts. Cestuis are protected zealously, therefore, against conduct which savors of unlawful profit at the expense of the trust res. Notable among the types of behavior which have been condemned universally are commingling of trust assets with private assets of the trustee, double agency, and purchase by trustee of trust assets or sale to the trust of private property owned by the trustee.

A. *Mingling.*

Various acts have been construed as wrongful since their tendency was to render trust assets indistinguishable from other assets, for example, depositing trust funds in trustee's private account,¹²⁶ mingling of trust funds by depositing them in account wherein were deposited funds of other trusts,¹²⁷ and purchasing property with trust funds and taking title in trustee's own name.¹²⁸

¹²³ Cf. *Fidelity Union Trust Co. v. Fera*, 115 N.J.Eq. 451, 171 Atl. 379 (1934); *Holcomb v. Holcomb*, 11 N.J.Eq. 281 (1856).

¹²⁴ See *supra* note 114.

¹²⁵ See RESTATEMENT LAW OF TRUSTS, op. cit. §203 (a), (b), (c), (d) and (e).

¹²⁶ *Smith v. Combs*, 49 N.J.Eq. 420, 24 Atl. 9 (1892); *In re Hallett's Estate*, 58 N.J.Eq. 696 (1899).

¹²⁷ *First National Bank of Paterson v. Jersey Central Power & Light Co.*, 115 N.J.Eq. 242 (1934). (Liability in case of bank failure.)

¹²⁸ *Stoker v. Burlington County Trust Co.*, 91 N.J.Eq. 39, 108 Atl. 63 (1892); *McCulloch v. Tompkins*, 62 N.J.Eq. 262, 49 Atl. 474 (1901).

Where it is possible to trace the property in specie or to identify the particular proceeds, the cestui is preferred over the creditors of the trustee or trustee's estate.¹²⁹ The evidence which will be deemed sufficient to constitute an identification either of the fund in specie¹³⁰ or the property improperly bought with the funds or the proceeds of the sale of the assets,¹³¹ varies with the circumstances. A different rule applies to bank deposits since money is not easily identifiable. Withdrawals are presumed to be against trustee's own funds and the cestui is entitled to a priority at least up to that amount which represent the lowest point to which the balance has fallen.¹³² If the court is unable to identify the funds, the cestui is in the position of a general creditor.¹³³

B. Double Agency.

The well founded principle¹³⁴ of the law of agency that an agent cannot serve two principals, has been adopted by courts in their supervision of the conduct of trustees; so that, when some of the directors of trustee corporation were also directors of the Public Service Corporation, the cestui was able to restrain proposed exchange of bonds of independent utility corporation for Public Service bonds.¹³⁵ The mere inference of duplicity of interest was enough to move the court in that case.

C. Purchase of trust assets by trustee.

These transactions follow certain well known patterns:

(a) Sale by trustee directly to himself. This is always unlawful¹³⁶ except upon application to and consent of a court of proper jurisdiction.¹³⁷ Analogously, if a trustee allowed

¹²⁹ See e.g. *Smith v. Combs*, *supra* note 126.

¹³⁰ *McCulloch v. Tompkins*, *supra* note 128.

¹³¹ *Stoker v. Burlington Trust*, *supra* note 128; *Smith v. Combs*, *supra* note 126.

¹³² *In re Hallett's Estate*, *supra* note 126.

¹³³ *Acuntes v. Steneck Trust*, 111 N.J.Eq. 81, 161 Atl. 349 (1932); *Elliot v. Kuhl*, 60 N.J.Eq. 333 (1900).

¹³⁴ *Keeler v. Black*, 90 N.J.Eq. 439, 107 Atl. 825 (1919).

¹³⁵ *Shanley v. Fidelity Union Trust Co.*, 5 N.J.Misc. 783, 138 Atl. 388 (1927), 157 Atl. 570.

¹³⁶ *Romaine v. Hendrickson*, 27 N.J.Eq. 162, *aff'd* 28 N.J.Eq. 275 (1876); *Carson v. Marshall*, 37 N.J.Eq. 216, *aff'd* 38 N.J.Eq. 250 (1883); *Deegan v. Capner*, 44 N.J.Eq. 339 (1888); *Roderer v. Fox*, 84 N.J.Eq. 359, 94 Atl. 393 (1915); *Flett v. South Jersey Title Co.*, 94 N.J.Eq. 244, 125 Atl. 237 (1924).

¹³⁷ See *Scott v. Gamble*, 9 N.J.Eq. 218 (1852); *Bassett v. Shoemaker*, 46 N.J.Eq. 538, 20 Atl. 521 (1890).

foreclosure of trust property and buys it in at the sale¹³⁸ he holds as trustee.

(b) Sale to spouse. A sale by trustee to her spouse has the same consequences.¹³⁹

(c) Sale to trustee through a third person acting as a conduct of title.

When the sale is part of a pre-arranged scheme with a third person that such person is to buy for the trustee, courts treat the transaction as if it were a sale direct to the trustee.¹⁴⁰

(d) Exceptions. Although generally the transaction is voidable at the option of the cestui,¹⁴¹ the interposition of a bona fide purchaser for value without notice makes it inequitable to void the transaction.¹⁴² The cestui may be barred as against the trustee by laches,¹⁴³ or by way of the doctrine of ratification if he accepts the consideration or otherwise acquiesces.¹⁴⁴ Where testator expressly,¹⁴⁵ or by implication from the circumstances,¹⁴⁶ provides otherwise, a contrary rule applies. The disability to purchase trust assets does not continue after discharge by a competent court,¹⁴⁷ and a trustee in good faith may purchase from a bona fide purchaser by arrangement made after the sale.¹⁴⁸

(e) Remedies. As against a bona fide purchaser without notice the cestui has no remedy,¹⁴⁹ and where there is an inter-

¹³⁸ Van Alstyne v. Brown, 77 N.J.Eq. 455 (1910).

¹³⁹ Bassett v. Shoemaker, *supra* note 137; Hartman v. Hartle, 95 N.J.Eq. 123, 122 Atl. 615 (1923); see National Manufacturer's Corporation v. Bird, 97 N.J.Eq. 242, 127 Atl. 819 (1924) for extreme position.

¹⁴⁰ Mulford v. Bowen, 9 N.J.Eq. 797 (1852) and Mulford v. Minch, 11 N.J.Eq. 16 (1855) (involving same transaction); Viden v. Edson, 85 N.J.Eq. 65, 98 Atl. 635 (1911); Giehrach v. Rupp, 112 N.J.Eq. 296, 164 Atl. 465 (1923).

¹⁴¹ Bassett v. Shoemaker, *supra* note 137 cit. p. 542.

¹⁴² Stever v. Hall, 95 N.J.Eq. 169, 122 Atl. 441 (1923); see also Perth Amboy v. Ramsay, 60 N.J.L. 1, 37 Atl. 446 (1897).

¹⁴³ See Giehrach v. Rupp, *supra* note 140.

¹⁴⁴ See Scott v. Gamble, *supra* note 137.

¹⁴⁵ Creveling v. Fritts, 34 N.J.Eq. 134 (1881).

¹⁴⁶ Weber v. Heath, 96 N.J.Eq. 624, 126 Atl. 477 (1924) (testator had employed trustee to manage the corporation which constituted the trust *res*); Hill v. Hill, 79 N.J.Eq. 521, 82 Atl. 338 (1911) (testator had leased property to trustee for a long term but he is denied profits from surrender of lease to estate recovering only costs. *Quaere*—is this approval of the transaction?)

¹⁴⁷ Clark v. Denton, 36 N.J.Eq. 419 (1883), *aff'd* 36 N.J.Eq. 534 (1883).

¹⁴⁸ Pa. Co. v. Doughy, 98 N.J.Eq. 578, 131 Atl. 611 (1924).

¹⁴⁹ *Supra* note 142.

position of such person, the cestui as against the trustee must be content with damages. Cestui may recover as damages, the sale price, or the proceeds of resale, or he may recover the value of the property as of the time of sale, or of the decree, as cestui elects, with the income which would have accrued had the trustee not sold.¹⁵⁰ Where there has been no bona fide purchaser interposed, the cestui is entitled to have the sale voided,¹⁵¹ and a resale ordered, or at his option may ratify the transaction.¹⁵²

(f) Other remedies for nonfeasance, malfeasance and misfeasance. In the first place, an executor may be restrained from handing over to the trustee other assets of the estate where it appears that trustee has dissipated trust assets.¹⁵³ Under certain circumstances he may be removed. The statutory¹⁵⁴ grounds for removal are failure after order by a court of competent jurisdiction to file an inventory or account, to give security or additional security, to do any other thing which such court orders. Other grounds are embezzlement, waste, or misapplication of funds, and abuse of trust.

Apparently removal will not be decreed in every case. *Pfefferle v. Herr*¹⁵⁵ holds that sections 140 and 141 of the Orphans Court Act¹⁵⁶ which provide for additional security signifies a legislative policy that a trustee will not be removed for every misstep. This interpretation has been followed and, therefore, friction between cestui and trustee is not sufficient cause for removal.¹⁵⁷ Minor abuses of trusts similarly do not justify removal, and where executor refused to pay legacies before receiving his commission, the court in *Lathrop v. Smalley*¹⁵⁸ refused to remove him. The same position was taken in the case of failure to collect interest on bank balances where

¹⁵⁰ See *supra* notes 119 and 120; the same rules, of course, apply to property which is unidentifiable and wrongfully mingled.

¹⁵¹ See *supra* cases cited notes 136-140.

¹⁵² *Supra* note 137.

¹⁵³ *In re Sweetland's Estate*, 105 N.J.Eq. 603, 148 Atl. 744, *aff'd* 107 N.J.Eq. 504, 153 Atl. 907 (1930).

¹⁵⁴ C.S. 1910, p. 3868, §149.

¹⁵⁵ 75 N.J.Eq. 219, 71 Atl. 687 (1909), *aff'd per curiam* in 77 N.J.Eq. 271, 79 Atl. 19 (1910).

¹⁵⁶ *Supra* note 6.

¹⁵⁷ *In re Hanretty*, 2 N.J.Misc. 55 (1923); *Stark v. Wiley*, 89 N.J.Eq. 79, 103 Atl. 865 (1918).

¹⁵⁸ 23 N.J.Eq. 192 (1872).

the estate was a stockholder of the bank.¹⁵⁹

When the abuse of trust is serious, as where the trustee wrongfully voted for a dividend in a corporation which was a part of the trust, voted for excessive compensation to himself and was negligent in his duties, the court ruled otherwise and ordered a removal.¹⁶⁰

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¹⁵⁹ Stark v. Wifey, *supra* note 157.

¹⁶⁰ Lister v. Weeks, 60 N.J.Eq. 215 (1900).