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NOTES

UNDERPRODUCTIVE TRUST ASSETS IN NEW YORK

When an income trust is established, two interests are created—that of the income beneficiary and that of the remainderman. It is the duty of the trustee to strike a fair balance between these interests in his investment of the trust assets.[1] This fair balance involves the production of income on the one hand,[2] and the preservation of the integrity of the trust corpus on the other.

When a portion of the trust corpus is unproductive of income, there sometimes arises a duty in the trustee to convert the unproductive asset into an income producing asset—one which would maintain this fair balance.[3]

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[1] See Redfield v. Critchley, 252 App. Div. 568, 573, 300 N.Y. Supp. 305, 310 (1st Dep't 1937), *aff'd*, 277 N.Y. 336, 14 N.E.2d 377 (1938); In the Matter of Dwight, 204 Misc. 204, 128 N.Y.S.2d 23 (Sup. Ct. 1952) (surcharge granted for breach of that duty); *In re* Simpson's Will, 33 N.Y.S.2d 614, 616 (Surr. Ct. 1942) (dictum); 3 SCOTT, TRUSTS § 232 (2d ed. 1956). From this duty of impartiality flows the duty to convert and reinvest unproductive property. RESTATEMENT (SECOND), TRUSTS § 232, comment *b* (1959). The trustee may easily violate the impartiality rule through imprudent investments. See, *e.g.*, In the Matter of Young, 249 App. Div. 495, 293 N.Y. Supp. 97 (2d Dep't), *aff'd mem.*, 274 N.Y. 543, 10 N.E.2d 541 (1937); In the Matter of Flint, 240 App. Div. 217, 269 N.Y. Supp. 470 (2d Dep't 1934), *aff'd mem.*, 266 N.Y. 607, 195 N.E. 221 (1935); *cf. In re* Woodin's Estate, 118 N.Y.S.2d 465 (Surr. Ct. 1952).

[2] See In the Matter of Sinclaire, 201 Misc. 189, 191, 104 N.Y.S.2d 826, 828 (Surr. Ct. 1951); 3 SCOTT, TRUSTS § 240, at 1875 (2d ed. 1956).

[3] See In the Matter of Hubbell, 302 N.Y. 246, 255-56, 97 N.E.2d 888, 892 (1951). While the income beneficiary would object to unproductive or underproductive assets as part of the corpus, the remainderman often is more than content with their retention. His complaints will be heard, however, when "wasting assets" are procured or retained by the trustee. Wasting assets are "such interests as terminate or necessarily depreciate in course of time either because of the nature of the interest or because of the character of the subject matter of the interest." RESTATEMENT (SECOND), TRUSTS § 239, comment *a* (1959). Common examples of wasting assets are annuities, royalties and patents, exhaustible deposits of natural resources, and various term interests. 4 POWELL, REAL PROPERTY ¶ 555, at 345-46 (1954). In these instances, rather than the income beneficiary receiving too meager a return, he is receiving too much—and it is at the expense of the remainderman whose interest is being depleted. In such an instance the trustee is under a duty to sell the wasting asset and reinvest the proceeds in assets benefiting both parties or, in the alternative, to retain the asset and amortize or apportion the receipts. In the Matter of Will of Haldeman, 208 Misc. 419,

It often happens that an immediate conversion is either inadvisable or impossible, with the result that the sale is delayed.[4] During this interim period no income is produced, and upon the ultimate sale, the income beneficiary may seek compensation for this lost income by demanding an apportionment of the proceeds between income and remainder.[5] The apportionment, if granted, would allocate to the income beneficiary that amount which would have been earned had the conversion and reinvestment been immediate.[6]

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143 N.Y.S.2d 396 (Surr. Ct. 1955); RESTATEMENT (SECOND), TRUSTS § 239 (1959).

However, this rule is not rigid, yielding readily to the testator's contrary intention as indicated by the will or by the circumstances surrounding its execution. See In the Matter of Estate of Goetzinger, 12 Misc. 2d 197, 176 N.Y.S.2d 899 (Surr. Ct. 1958); In the Matter of Estate of Hopkins, 171 Misc. 910, 14 N.Y.S.2d 71 (Surr. Ct. 1939). The circumstances relied upon as indicative of such contrary intent are the same as those relied upon to find an intent to have unproductive property converted. *Compare In re* Bruen's Estate, 83 N.Y.S.2d 197 (Surr. Ct. 1948) (wasting asset), *with In re* Brown's Estate, 65 N.Y.S.2d 624, 628-29 (Surr. Ct. 1943) (unproductive asset).

[4] See In the Matter of Pennock, 285 N.Y. 475, 484-86, 35 N.E.2d 177, 181 (1941), where the court discusses both the inability to convert the unproductive assets and the inadvisability of an immediate conversion. See RESTATEMENT (SECOND), TRUSTS § 231, comment *c* (1959) for circumstances bearing upon the advisability of a delay.

[5] Great impetus was given to the apportionment theory by the depression. See Skilton, *The Rights of Successive Beneficiaries in Unproductive Trust Assets Not Bearing Interest*, 15 TEMP. L.Q. 241 (1941); see, *e.g.*, In the Matter of Estate of Pelcyger, 157 Misc. 913, 938, 285 N.Y. Supp. 723, 749 (Surr. Ct. 1936).

[6] Relying on the leading case of Edwards v. Edwards, 183 Mass. 581, 67 N.E. 658 (1903), the New York Court of Appeals verbalized the apportionment formula as follows: "Take a sum, which invested [when the duty to sell arose] . . . at such a rate, as the trustees would probably have received would amount on the day of the sale to the net amount received. That sum is principal. The balance is income." Furniss v. Cruikshank, 230 N.Y. 495, 508-09, 130 N.E. 625, 629, *modified mem.*, 231 N.Y. 550, 132 N.E. 884 (1921). See RESTATEMENT (SECOND), TRUSTS § 241 (1959). A different approach is used when granting compound rather than simple interest from the date of the duty to sell. The two methods expressed mathematically are found in 4 BOGERT, TRUSTS AND TRUSTEES § 287, at 289-90 (1948).

The Uniform Principal and Income Act differs from the *Restatement* formula in two important aspects. It sets the rate of return at 5% rather than the "current rate" and designates one year from the receipt of the property by the trustee or from the time of unproductiveness, whichever is less, as the presumed time at which the duty arises. The mathematics of the rule is, however, the same. *Compare* RESTATEMENT (SECOND), TRUSTS § 241 (1959), *with* UNIFORM PRINCIPAL & INCOME ACT § 11.

The method of apportionment employed in cases which involve salvage operations on defaulted mortgages is unique. See 3 SCOTT, TRUSTS § 241.3A (2d ed. 1956); Skilton, *The Rights of Successive Beneficiaries in Un-*

In a recent New York case, *Estate of Sheridan,*[7] the estate of an income beneficiary, who had been a co-trustee, sought an apportionment of the proceeds from the delayed sale of low yield common stock. Although in prior cases a duty to sell totally unproductive trust assets had often been found, the question of the existence of a duty to sell low yield or underproductive assets —assets which produce income below the current or normal rate of return—was unresolved. In addition, the New York courts have indicated an apparent reluctance to extend the theory of apportionment from realty to personalty. Hence, a second question arose concerning whether there should be an apportionment of the proceeds from the sale of common stock. Initially, the Surrogate's Court granted the apportionment. However, on reargument the original opinion was withdrawn, and the apportionment denied on the ground that an income beneficiary, when a co-fiduciary, is estopped from asserting a breach of duty.[8] The disposal of the case left the implication, albeit a weak one, that had the estoppel not existed, the apportionment of the proceeds of the underproductive common stock might have been granted.

In the light of this possibility, it is the purpose of this note to inspect these problems, namely, when and how the duty to convert arises; what are the effects of failing to convert as soon as the duty arises; and, upon the conversion, when does the right to apportionment exist.

Duty to Convert

The finding of a duty to sell a particular trust asset is the essential first step toward the allowance of an apportionment of the proceeds. From the duty to convert, coupled with a justifiable delay in the conversion, the apportionment will normally flow.[9] Nothing more will be required before the right to apportionment will be granted, although the presence of certain circumstances, to be discussed subsequently, may bar the relief. For this reason the duty to sell and the consequent right to apportionment are often difficult to separate, the courts seldom dealing with the questions individually.

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productive Trust Assets Bearing Interest, 15 TEMP. L.Q. 378, 390-94 (1941).

The question of whether the income or principal account will bear the carrying charges of the unproductive property is closely aligned to the apportionment question. See 3 SCOTT, *op. cit. supra* § 233.4.

[7] 146 N.Y.L.J., July 17, 1961, p. 6, col. 8 (Surr. Ct., N.Y. County), *opinion withdrawn on reargument,* 222 N.Y.S.2d 751 (Surr. Ct. 1961).

[8] *In re* Estate of Sheridan, 222 N.Y.S.2d 751 (Surr. Ct. 1961).

[9] 4 POWELL, REAL PROPERTY ¶ 556, at 356 (1954).

The ascertainment of the duty to sell is basically a construction problem, and realizing that no two wills, with their surrounding circumstances, are likely to be identical, the value of precedent is diminished.[10]

The powers and duties of the trustee flow from the instrument creating the trust, and if the instrument itself expressly commands the sale of an asset, a duty to sell exists.[11] By the same token, if the settlor instructs that an asset be retained, normally there will not be a duty to sell.[12] But where the instrument lacks explicit directions, *i.e.,* where no specific duty to sell or retain is imposed, mere discretionary power to sell or retain being granted, the difficulties arise. To a greater or lesser degree in this situation, the settlor's *implied* intent must be relied upon.

According to the *Restatement of Trusts,* the existence of a trust creating successive interests coupled with the unproductiveness of an asset, gives rise to a duty to sell. These circumstances standing alone are considered a sufficient basis for assuming an

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[10] See Furniss v. Cruikshank, 230 N.Y. 495, 505, 130 N.E. 625, 628, *modified mem.,* 231 N.Y. 550, 132 N.E. 884 (1921); In the Matter of Lott, 251 App. Div. 333, 335, 296 N.Y. Supp. 43, 45-46 (2d Dep't 1937).

[11] Fraser v. The Trustee of the Gen. Assembly of the United Presbyterian Church, 124 N.Y. 479, 26 N.E. 1034 (1891); In the Matter of Estate of Schuster, 175 Misc. 1072, 27 N.Y.S.2d 413 (Surr. Ct. 1941); In the Matter of Estate of Cohn, 153 Misc. 757, 276 N.Y. Supp. 59 (Surr. Ct. 1934). See Haggerty, *Some Aspects of the Obligations of New York Fiduciaries With Respect to the Making and Retention of Investments, II,* 16 FORDHAM L. REV. 153, 163-64 (1947).

The same problems would appear to exist with regard to whether the trust is inter vivos or testamentary. See *In re* Cantagalli, 92 N.Y.S.2d 829 (Sup. Ct. 1949), quoting Rockland-Rockport Lime Co. v. Leary, 203 N.Y. 469, 480, 97 N.E. 43, 46 (1911). "The conversion usually becomes effective at the date of the instrument expressing the intention, if a deed or contract, and if a will, at the date of testator's death."

[12] See In the Matter of Satterwhite, 262 N.Y. 339, 186 N.E. 857 (1933). If it is in the best interests of the estate, the court can grant the *power* to sell where no power is given. *In re* Minden's Will, 138 N.Y.S.2d 340 (Surr. Ct. 1954) (construing N.Y. SURR. CT. ACT §250-a). This power can also be granted where there are express directions to retain the asset. In the Matter of Roche, 233 App. Div. 236, 251 N.Y. Supp. 347 (4th Dep't 1931), *modified,* 259 N.Y. 458, 182 N.E. 82 (1932); In the Matter of Estate of Wander, 141 Misc. 584, 252 N.Y. Supp. 813 (Surr. Ct. 1931); In the Matter of Estate of Pulitzer, 139 Misc. 575, 249 N.Y. Supp. 87 (Surr. Ct. 1931), *aff'd mem.,* 237 App. Div. 808, 260 N.Y. Supp. 975 (1st Dep't 1932). The court in *Pulitzer* also indicated that there may be a *duty* to sell the asset if it appears likely to become worthless. *Id.* at 577, 249 N.Y. Supp. at 91. Although a duty to sell may arise regardless of the direction to retain, such direction would at least negate any intention to apportion upon the sale. The court can also grant the power to invest beyond the limitations set forth in the trust instrument when the directions therein are impossible of compliance. In the Matter of Sinclaire, 201 Misc. 189, 104 N.Y.S.2d 826 (Surr. Ct. 1951).

intention to allow an apportionment, and on them the duty to convert is predicated.[13] This assumption of a duty from the successive interests plus unproductiveness has been employed on occasion in New York.[14] However, the weight of authority in this state is to the contrary,[15] and generally more is required. At times little more is required, the duty being assumed upon the showing of close familial relationships between the settlor and the income beneficiaries.[16] But the tendency of the New York courts has been to look to all the circumstances, and to find a duty only if the intention of the testator to exact one might reasonably be imputed.[17] This imputation of the settlor's intent was stretched to its limit in *In the Matter of Rowland*.[18] In that case, the trust assets were productive at the death of the settlor, becoming unproductive subsequent to his demise. The court held that had the settlor foreseen the future unproductivity he *would have intended* a duty to convert.[19] It was pointed out in *In the Matter of Estate of Knox* exactly how close the *Rowland* decision verged on adopting the *Restatement* rule which finds the duty to convert in *all* cases of unproductivity.[20]

Although the tendency is to liberalize the treatment of the income beneficiary through the munificent finding of a duty to

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[13] RESTATEMENT (SECOND), TRUSTS § 240 (1959). "In some jurisdictions, this development appears to have gone so far that nothing but a clear testamentary expression to the contrary will change the procedure of charging the burden arising because of unproductivity of an asset to corpus and thus favoring the life beneficiary." *In re* Johnson's Will, 73 N.Y.S.2d 621, 626 (Surr. Ct. 1947).

[14] In the Matter of Will of Rosenzweig, 4 Misc. 2d 142, 144, 148 N.Y.S. 2d 371, 372 (Surr. Ct. 1955), *aff'd mem.*, 7 App. Div. 2d 969, 183 N.Y.S.2d 992 (1st Dep't 1959).

[15] Furniss v. Cruikshank, *supra* note 10, at 501, 130 N.E. at 626; Spencer v. Spencer, 219 N.Y. 459, 466, 114 N.E. 849, 850-51 (1916); Lawrence v. Littlefield, 215 N.Y. 561, 582, 109 N.E. 611, 617-18 (1915); see DODGE AND SULLIVAN, ESTATE ADMINISTRATION AND ACCOUNTING 438-39 (1940).

[16] See In the Matter of Will of Shepard, 186 Misc. 564, 59 N.Y.S.2d 803 (Surr. Ct. 1945); In the Matter of Estate of Knox, 163 Misc. 264, 296 N.Y. Supp. 745 (Surr. Ct. 1937).

[17] Authorities cited note 15 *supra*.

[18] 273 N.Y. 100, 6 N.E.2d 393 (1937). See In the Matter of Jackson, 258 N.Y. 281, 291, 179 N.E. 496, 500 (1932), for its liberalizing language in this area.

[19] In the Matter of Rowland, 273 N.Y. 100, 109, 6 N.E.2d 393, 396 (1937).

[20] 163 Misc. 264, 268, 296 N.Y. Supp. 745, 749 (Surr. Ct. 1937). The *Rowland* rationale was followed in *In re* Craft's Estate, 3 N.Y.S.2d 377 (Surr. Ct. 1938), and applied to carrying charges in In the Matter of Estate of Reese, 173 Misc. 510, 18 N.Y.S.2d 125 (Surr. Ct. 1939).

convert,[21] the courts have not embraced the broad *Restatement* position.

> The question in New York still remains . . . whether the . . . [settlor] has disclosed an intent to command a sale of unproductive property. . . . [This intention] must be gathered from the language of the will, the circumstances surrounding its execution, the relationship of the testator to the object of his bounty, a consideration of the nature of the trust property and its extent in relation to the other assets of the trust.[22]

Whether the duty to sell is assumed, as in the *Restatement,* or inferred, as in the majority of New York cases,[23] it is made to rest upon the settlor's intention. The difference in approach seems to be the readiness with which a court will find such an intention.

The New York cases which have found a duty to convert have all involved trust assets which were *totally* unproductive of income. Although the *Restatement,*[24] the Uniform Principal and Income Act[25] and text writers[26] approve the inclusion of underproductive property in the scope of this duty to convert, no New York case has clearly reached this conclusion.[27] On the other hand, the New York case law has not rejected the possibility of an intention being found to impose a duty to convert underproductive assets. Indeed, the theory employed in New York would seem to warrant their inclusion, since the intention that is found, as expressed by a number of leading New York cases, is not merely that there be a sale of totally unproductive trust assets but rather that "a provision of income for a life beneficiary shall [not] be rendered nugatory. . . ."[28]

Applying this test, which looks to the intended benefit to the life tenant rather than to the degree of productivity of the asset,

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[21] See, *e.g., In re* Johnson's Will, 73 N.Y.S.2d 621, 626 (Surr. Ct. 1947).

[22] *In re* Brown's Estate, 65 N.Y.S.2d 624, 628-29 (Surr. Ct. 1943).

[23] Professor Powell views the New York position as involving "circuitous reasoning," which requires "the setting up of an unnecessary and irrelevant prerequisite, [the duty,] and . . . the finding of its presence by a strained bit of construction." 4 POWELL, REAL PROPERTY ¶ 556, at 358 (1954).

[24] RESTATEMENT (SECOND), TRUSTS § 240, comment *b* (1959).

[25] UNIFORM PRINCIPAL & INCOME ACT § 11(1).

[26] 4 BOGERT, TRUSTS AND TRUSTEES § 829, at 305 (1948); 3 SCOTT, TRUSTS § 240, at 1876 (2d ed. 1956).

[27] A distinction must be made between underproductive and partially unproductive, the latter term being applied to a trust corpus which, as a whole, is productive, but which contains an asset which of itself is totally unproductive.

[28] Laurence v. Littlefield, 215 N.Y. 561, 569, 109 N.E. 611, 613 (1915); see In the Matter of Jackson, 258 N.Y. 281, 289, 179 N.E. 496, 499 (1932); Furniss v. Cruikshank, 230 N.Y. 495, 500, 130 N.E. 625, 626, *modified mem.*, 231 N.Y. 550, 132 N.E. 884 (1921); Spencer v. Spencer, 219 N.Y. 459, 467, 114 N.E. 849, 851 (1916).

it can be seen that trust assets need not be totally unproductive in order to violate the testator's scheme. Retention of assets returning a small fraction of one per cent would be as far beyond the settlor's wishes as would retention of assets producing nothing. If the settlor did not intend a conversion and apportionment of only those assets which have become *totally* unproductive, it becomes necessary to determine at what point he did intend a sale. Two other possibilities remain: the intention that there be a sale of assets producing *any* amount less than the normal return, or the intention that there be a sale at some other point of underproductiveness between total unproductivity and normal productivity.

Whether an intention will be imputed to the settlor to require the sale of an asset unproductive to *any* degree, *i. e.,* producing *any* amount less than the normal return, or whether a line will be drawn, above which the settlor will not be deemed to have intended a conversion, involves an inquiry into formidable theoretical and practical problems.[29] In theory, it is difficult to fix a point between total unproductivity and normal productivity at which it can be said that the settlor intended to require a sale. Yet the tendency to grasp the normal rate of return as that which is intended must be tempered by the strong practical considerations which bear upon this decision. Serious questions can arise concerning both the actual per cent return being earned[30] and the

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[29] The period for which an apportionment is allowed extends from the time at which the duty to sell arises to the date of the reinvestment in income-producing assets. It is far more difficult to designate a point of decline in an asset's return at which a duty to sell is intended than it is to ascertain the intended time to sell a totally unproductive asset. And yet, when finding the time at which the duty to sell a totally unproducive asset had arisen, the courts have not been in agreement. As stated by Surrogate Delehanty, "there is no established rule as to that time"; he cites cases holding the effective date of the duty to be: (1) one year after the trusts were constituted, (2) at the end of three years (the time expressed by the settlor), and (3) the date of death of the settlor. In the Matter of Estate of Andreini, 165 Misc. 297, 300, 300 N.Y. Supp. 1224, 1229 (Surr. Ct. 1937); 4 POWELL, REAL PROPERTY ¶ 556, at 361 (1954). One year from the issuance of letters has also been chosen. In the Matter of Estate of Clarke, 166 Misc. 807, 3 N.Y.S.2d 60 (Surr. Ct. 1938). Real property used as a residence is not unproductive. In the Matter of Estate of Brewster, 148 Misc. 390, 393, 266 N.Y. Supp. 573, 576-77 (Surr. Ct. 1932), *modified,* 246 App. Div. 190, 283 N.Y. Supp. 706 (4th Dep't 1935). It becomes unproductive, and the duty to sell arises, when the residential use ceases. *In re* Fahnestock's Estate, 70 N.Y.S.2d 456 (Surr. Ct.), *aff'd mem.,* 273 App. Div. 747, 75 N.Y.S.2d 332 (1st Dep't 1947), *aff'd mem.,* 267 N.Y. 647, 82 N.E.2d 38 (1949).

[30] "[A]n estate may become unproductive either because the income has decreased while the value has remained constant, or because the value has increased and the income remained constant." Webster Realty Co. v. Delano, 135 App. Div. 488, 493, 120 N.Y. Supp. 440, 443 (1st Dep't 1909).

normal or average return possible under the existing market conditions.[31] As a result, the trustee would initially be confronted with a troublesome task in determining when an asset is, in fact, producing less than the normal return. In addition, if the productivity borders on the normal return, the asset must be constantly attended in fear of its earnings falling unnoticed, below the proper productivity. It is clear, then, that the demands of a "normal return" requirement greatly increase the burdens of trusteeship.[32] Consequently, the adoption of this test, which appears to be as a practical matter unworkable, would be highly inadvisable.

Thus, each of the alternatives offered is, to some degree, objectionable. A sale upon nothing less than total unproductivity is clearly contrary to the settlor's intention; a sale of any asset which produces less than the normal return presents insurmountable practical difficulties; a sale at some point of underproductiveness between these two poles presents the further problem of clearly fixing that point.

Two approaches have been made to the problem of designating the conversion point between total unproductivity and productivity commensurate with the normal return. The *Restatement*[33] and some text writers[34] have adopted what is essentially a "fairness" test. Under this, there will be a duty to sell, and if proper, to apportion the proceeds from assets which are "substantially unproductive." The line of substantial unproductiveness is said to lie somewhere between totally unproductive and "somewhat less than the ordinary return. . . ."[35]

The Uniform Principal and Income Act, on the other hand,

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[31] See In the Matter of Estate of Pelcyger, 157 Misc. 913, 937-38, 285 N.Y. Supp. 723, 748-49 (Surr. Ct. 1936), for objections to the concept of an "average" rate of return. The rate of 4% was deemed the current return in some cases. Furniss v. Cruikshank, *supra* note 28; In the Matter of Estate of Hovelaque, 176 Misc. 869, 29 N.Y.S.2d 200 (Surr. Ct. 1940); In the Matter of Estate of Clarke, 166 Misc. 807, 3 N.Y.S.2d 60 (Surr. Ct. 1938). A 3% return was employed in others. In the Matter of Sinclaire, 201 Misc. 189, 104 N.Y.S.2d 826 (Surr. Ct. 1951); *In re* Johnson's Will, 73 N.Y.S.2d 621 (Surr. Ct. 1947). The 5% rate allowed in the Uniform Principal and Income Act is not responsive to market conditions. See UNIFORM PRINCIPAL & INCOME ACT § 11(2). Most common stocks yield less than 5%. Flynn, *Rising Tide of Interest in Income*, 98 TRUSTS & ESTATES 1236 (1959).

[32] 4 BOGERT, TRUSTS AND TRUSTEES § 829, at 305 (1948). See the discussion of the surcharge remedy in text accompanying notes 39-45 *infra*.

[33] RESTATEMENT (SECOND), TRUSTS § 232, comment *b*, 240 (1959). The provision for wasting assets also allows the income beneficiary a "fair return." *Id.* § 239, comment *b*.

[34] 4 BOGERT, *op. cit. supra* note 32; 3 SCOTT, TRUSTS § 240, at 1876 (2d ed. 1956).

[35] RESTATEMENT (SECOND), TRUSTS § 240, comment *b* (1959); 3 SCOTT, *op. cit. supra* note 34.

has arbitrarily set the requisite return at one per cent, below which a duty to convert will arise.[36]

It can be seen that both these tests strike a middle ground, denying the need for total unproductivity before a duty to convert will arise, and yet rejecting, for practical reasons, an assumption that the settlor intended that the normal return be produced.

Some of the practical difficulties which prompted the rejection of the current return as being that which the settlor intended, thereby giving rise to a duty to convert assets producing less than that amount, would appear to exist under the Uniform Act. By setting a definite per cent return, the complex question of the "normal rate of return" is perfunctorily bypassed. Many serious issues which could conceivably arise concerning the actual amount of income being produced by the contested asset have also been resolved by the act in designating the market value or the fair inventory value at the time the asset was acquired as the principal upon which this one per cent return is based.[37]

However laudable this definiteness may be, the very definiteness of the actual numerical percentage undermines the discretion normally granted the trustee. Stripped of this discretion, when confronted with trust assets, the returns of which border on the required one per cent, the trustee would be required to exercise a good deal more attention than would ordinarily be warranted by the circumstances. Professor Bogert's objection that the burdens of trusteeship would be greatly multiplied would appear to be particularly apt in this regard.[38]

Objection may also be leveled at the "substantially unproductive" test advocated by the *Restatement*. An exact definition of this flexible and shifting standard is impossible, with the result that it might easily be said to suffer from vagueness. However, any criticism of this proposal must be made in the light of the alternate solutions offered: finding the duty to convert (a) only totally unproductive property; (b) any property producing less than the "normal return"; (c) assets producing less than one per cent. Each of these rules is either inequitable, impractical or too rigid, and none allows the exercise of discretion.

As case law on the subject develops, the line of substantial unproductiveness will be brought into sharper focus, removing the objection of vagueness. Under these circumstances, New York might profit by the adoption of a "substantially unproductive" test

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[36] UNIFORM PRINCIPAL & INCOME ACT § 11(2).

[37] *Ibid.* Compare this with Webster Realty Co. v. Delano, *supra* note 30. This act has been adopted, albeit with modifications, in twenty-two states. 4 POWELL, REAL PROPERTY ¶ 551, at 323 n.2 (1954).

[38] 4 BOGERT, *op. cit. supra* note 32.

in its determination of the time at which a duty to convert trust assets arises.

Failure to Convert — Surcharge

From the general duty requiring the trustee to deal impartially with the successive interests,[39] the duty to employ the trust funds profitably naturally flows.[40] "As a corollary to that general duty—to employ the estate's assets profitably—there arises the further duty to sell or convert unproductive assets and reinvest the proceeds."[41]

Once a duty to sell the asset has been found to exist, the sale may be delayed. This procrastination may be justifiable or the result of the trustee's improvidence. In the latter instance, a surcharge may be imposed against the trustee to the extent of the injury suffered as a result of the delay. If, however, justification for the belated sale exists, the income beneficiary might still be compensated for the income lost as a result of the delay by the granting of an apportionment of the proceeds upon the sale. In this instance, the income beneficiary is made whole at the expense of the remainderman.

The justification for a delay in the sale is found in the normal allowance of a reasonable time in which to effect the conversion.[42] This test of reasonableness ultimately revolves around the criterion of prudence. A recognition of the trustee's difficult posi-

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[39] Redfield v. Critchley, 252 App. Div. 568, 573, 300 N.Y. Supp. 305, 310 (1st Dep't 1937), *aff'd*, 277 N.Y. 336, 14 N.E.2d 347 (1938); In the Matter of Estate of Cohn, 153 Misc. 757, 276 N.Y. Supp. 59 (Surr. Ct. 1934) (dictum); RESTATEMENT (SECOND), TRUSTS § 232, comment *b* (1959). The line of impartiality may, at times, be difficult to draw. *Compare In re* Kilmer's Will, 186 N.Y.S.2d 120 (Surr. Ct. 1959) (remainderman's request for surcharge refused where tax free bonds benefited income but harmed remainder), *with* In the Matter of Dwight, 204 Misc. 204, 128 N.Y.S.2d 23 (Sup. Ct. 1952) (surcharge granted under similar facts).

[40] In the Matter of Hubbell, 302 N.Y. 246, 255, 97 N.E.2d 888, 892 (1951); In the Matter of Flint, 240 App. Div. 217, 226, 269 N.Y. Supp. 470, 480 (2d Dep't 1934), *aff'd mem.*, 266 N.Y. 607, 195 N.E. 221 (1935). In *In re* Soss' Estate, 71 N.Y.S.2d 23 (Surr. Ct. 1947), a surcharge was granted where the trustee invested in 2% government bonds when he could as easily have invested in 2½% government bonds.

This duty to invest productively is not limited to the trustee, but can be extended to administrators and executors. "[O]ne of the primary duties of a fiduciary is to make productive the fund in his hands and not to keep it 'laid up in a napkin.'" *In re* Rathbone's Estate, 78 N.Y.S.2d 457, 460 (Surr. Ct. 1947). See *In re* Kruger's Estate, 249 N.Y. Supp. 772 (Surr. Ct. 1931) for a comprehensive collection of authority on this point.

[41] In the Matter of Hubbell, *supra* note 40 at 256, 97 N.E.2d at 892.

[42] See In the Matter of Clark, 257 N.Y. 132, 139, 177 N.E. 397, 399 (1931); In the Matter of Estate of Lazar, 139 Misc. 261, 262, 247 N.Y. Supp. 230, 231 (Surr. Ct. 1930); RESTATEMENT (SECOND), TRUSTS § 230, comment *b* (1959).

tion when required to sell on a declining market has led to the granting of broad discretion in the determination of the proper time to sell.[43] However, if the delay is unreasonable and imprudent, the personal liability of surcharge will be imposed.[44]

The further one moves from totally unproductive property with an unlimited market to substantially unproductive property with a buyer's market or no market at all, the more vague and undefined the duty to sell becomes, and consequently the harsher the surcharge remedy when employed.

The Uniform Act has attempted to alleviate the burden of immediate ascertainment of the duty by providing that the duty to sell does not arise until one year after the income return on trust assets has fallen below one per cent.[45] Although of unquestioned assistance to the harried trustee, this provision is at the expense of the income beneficiary who will have lost the income the settlor intended he receive for that year.

In contrast to the definite standard set forth in the Uniform Act, the suggested test of substantial unproductivity is incapable of exact definition. Thus, the adoption of this standard by New York would impose upon the trustee a less-clearly defined duty than would exist under a test which finds a duty to convert only those assets which have become *totally unproductive*. In view of this significant extension of the trustee's duty, it would appear to be necessary that the present prudence requirements be relaxed and the trustee's discretion extended, resulting in a less frequent imposition of the surcharge remedy.

The Right to Apportionment

The first step toward the allowance of an apportionment is to find a *duty* to convert the assets. As outlined above, various points, ranging from total unproductivity to slightly less than normal productivity, might be chosen as the point at which this duty arises. Without regard to *when* the duty to sell arises, in the last analysis the duty must be found to exist before there can be an apportionment. Normally, upon the finding of the

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[43] *In re* Lawrence's Estate, 116 N.Y.S.2d 237 (Surr. Ct. 1952); *In re* Feinberg's Estate, 82 N.Y.S.2d 879 (Surr. Ct. 1948); see In the Matter of Sinclaire, 201 Misc. 189, 191, 104 N.Y.S.2d 826, 828 (Surr. Ct. 1951); *In re* Balch's Estate, 84 N.Y.S.2d 841, 845-46 (Surr. Ct. 1947).

[44] In the Matter of Hubbell, *supra* note 40, at 258-59, 97 N.E.2d at 894 (trustees guilty of gross negligence as a matter of law); In the Matter of Garvin, 256 N.Y. 518, 177 N.E. 24 (1931) (executor surcharged); In the Matter of Buck, 184 Misc. 29, 52 N.Y.S.2d 294 (Surr. Ct. 1944) (administrator c.t.a. surcharged).

[45] UNIFORM PRINCIPAL & INCOME ACT § 11(1). For a discussion of the evaluation of the trust assets see text accompanying note 37 *supra*.

duty to convert, the right to apportionment is secured without more. Yet, totally apart from the productivity of the assets, which bears only upon the duty to convert, the existence of additional circumstances may operate to deny the right to the apportionment.

It is possible, although unlikely, for the trust instrument to indicate an intent to have a sale and reinvestment of the proceeds of unproductive property, but *not* to have an apportionment of the proceeds if the sale is delayed.[46] In such a case the settlor's intent would be followed, and no apportionment allowed.

Apportionment has been denied in other instances, however, on the basis of a distinction in the character of the asset—whether it is realty, the traditional context in which apportionment is granted,[47] or whether the asset is personalty.

The earliest nonrealty apportionment case in New York was *In the Matter of Estate of Clarke*,[48] involving an art collection which constituted a major portion of the trust corpus. The court, in allowing the apportionment of the proceeds, considered factors relied upon in the unproductive realty cases—"the expression of intent, the surrounding circumstances of the will, the close relationship of the beneficiaries, and . . . the magnitude of the asset as compared with other assets in the estate." [49] However, the fact that the case involved personalty prompted the court to exact a further requirement—one of uniqueness. They stated that "no general rule directing an apportionment should be made as to *ordinary personalty*" [50] and grounded their allowance of the remedy upon "the *peculiar and distinctive* character . . . [of the asset]." [51]

In 1940, two years after having written the opinion in *Clarke*, Surrogate Foley, in *In the Matter of Estate of Hovelaque*,[52] extended the *type* of personalty in which apportionment would be allowed to notes bearing no interest; but more important, he assumed the intention to have an apportionment from the mere creation of a trust for successive interests, in the absence of indications of a contrary intent. No uniqueness test was applied, the mere unproductiveness being sufficient. However, in the fol-

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[46] See 4 BOGERT, TRUSTS AND TRUSTEES § 829, at 301 (1948); 3 SCOTT, TRUSTS § 241.2, at 1896-97 (2d ed. 1956).

[47] See authorities cited note 15 *supra*.

[48] 166 Misc. 807, 811, 3 N.Y.S.2d 60, 64 (Surr. Ct. 1938).

[49] *Id.* at 812, 3 N.Y.S.2d at 65. Compare text accompanying note 22 *supra*.

[50] In the Matter of Estate of Clarke, 166 Misc. 807, 812, 3 N.Y.S.2d 60, 65 (Surr. Ct. 1938) (emphasis added).

[51] *Ibid.*

[52] 176 Misc. 869, 29 N.Y.S.2d 200 (Surr. Ct. 1940).

lowing year, the Court of Appeals in *In the Matter of Pennock* [53] affirmed the *Clarke* distinction by granting apportionment of a unique chose in action, disregarding the absence of uniqueness test in *Hovelaque.*

In 1947, In re *Ebbets' Will* [54] refused apportionment of the proceeds from the sale of unproductive stock in a closely held corporation.[55] The court stated:

> [T]he cases in which apportionment [has] been decreed involved non-productive . . . realty . . . choses-in-action and personalty of an unique character. No case has been cited wherein common stock of a non-realty corporation has been determined to be a proper subject of apportionment.[56]

In the same year, however, the proceeds from the settlement of a claim were apportioned, the court relying upon the testator's intent and the large proportion this asset bore to the entire estate. No mention of a uniqueness requirement or realty-personalty distinction was made.[57] This holding was shortly followed by one which denied an apportionment of personalty, relying on two conditions found lacking, namely, uniqueness and large proportion.[58]

Since that time, the requirement that personalty be unique as a prerequisite to an apportionment has not been stressed, the distinction apparently being abandoned. Apportionment of the proceeds upon the sale of stock in a closely held corporation was

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[53] 285 N.Y. 475, 35 N.E.2d 177 (1941). The chose in action involved was the right to commissions on renewal insurance premiums.

[54] 74 N.Y.S.2d 94 (Surr. Ct. 1947).

[55] *Id.* at 100. The court did, in fact, apportion the proceeds upon the sale, but only to the extent that the sales price was enhanced by undeclared dividends to which the testator intended the life beneficiaries be entitled. *Accord,* In the Matter of Kreitner, 187 Misc. 747, 65 N.Y.S.2d 691 (Surr. Ct. 1946). *But see* In the Matter of Estate of Lander, 162 Misc. 201, 294 N.Y. Supp. 58 (Surr. Ct. 1937). The theory of apportionment employed where earnings are not distributed must be distinguished from the theory granting apportionment of the proceeds of unproductive property. See In the Matter of Estate of Lander, *supra* at 203, 294 N.Y. Supp. at 61. For a discussion of the theory employed in *Ebbets,* see 4 BOGERT, *op. cit. supra* note 46, § 824.

[56] *In re* Ebbet's Will, 74 N.Y.S.2d 94, 98 (Surr. Ct. 1947). The effect of the court's extension of the uniqueness requirement is somewhat weakened by the apparent alternate holding that there was no *intent* to apportion. *Id.* at 99.

[57] *In re* Rosenwasser's Estate, 74 N.Y.S.2d 387 (Surr. Ct. 1947).

[58] *In re* Bishop's Estate, 79 N.Y.S.2d 220 (Surr. Ct. 1948). "There is here present no sale of an asset which constituted a major or even a large fraction of the trust estate and surely there is nothing unique about collateralized defaulted promissory notes or about claims for tax refunds." *Id.* at 224. The mere fact that the unproductive asset is a minor item in the estate will not, of itself, bar apportionment. *In re* Johnson's Will, 73 N.Y.S.2d 621, 629 (Surr. Ct. 1947) (unproductive real property). *Contra,* In the Matter of Estate of Marshall, 136 Misc. 116, 238 N.Y. Supp. 763 (Surr. Ct. 1930) (unproductive real property).

allowed in In re *Cuff's Will*,[59] and implicitly approved by In re *Godfrey's Will*.[60] In *Godfrey*, the court rejected a realty-personalty distinction, implying that the treatment of unproductive common stock and unproductive realty should be identical. The apportionment, however, was refused for lack of an intent for apportionment, the settlor's indications being to the contrary.[61] The apportionment of unproductive common stock was also approved by implication in *Central Hanover Bank & Trust Co. v. Brown*,[62] where the remedy was denied upon a failure to find unproductiveness rather than upon any distinction between realty and common stock.[63]

Payments made in settlement of a claim [64] and proceeds of a "relatively" unproductive mortgage [65] were also apportioned without searching for the element of uniqueness, which in earlier cases had been the essence of the distinction between realty and personalty.[66]

In *Estate of Sheridan*,[67] discussed earlier, common stocks were the object of the attempted apportionment. The remaindermen argued against the apportionment of the proceeds, urging that the remedy is limited to "real property, choses in action or . . . tangible personal property of a unique character and only then if the will evidences an intent that there should be an apportionment." [68] The court allowed the apportionment. However, on a reargument of the case, the first opinion was withdrawn and the apportionment denied on the basis of estoppel.[69]

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[59] 118 N.Y.S.2d 619 (Surr. Ct. 1953).

[60] 114 N.Y.S.2d 864 (Surr. Ct. 1952).

[61] *Id.* at 867.

[62] 30 N.Y.S.2d 85 (Sup. Ct. 1941).

[63] *Id.* at 92-93. See In the Matter of Hubbell, 302 N.Y. 246, 256, 97 N.E.2d 888, 892 (1951) (dictum) for further approval of the apportionment of the proceeds from the sale of common stocks.

[64] In the Matter of Will of Rosenzweig, 4 Misc. 2d 142, 148 N.Y.S.2d 371 (Surr. Ct. 1955), *aff'd mem.*, 7 App. Div. 2d 969, 183 N.Y.S.2d 992 (1st Dep't 1959). In that case, the court not only failed to distinguish realty from personalty, but allowed the apportionment from the very fact of unproductiveness without more.

[65] *In re* Rosenwasser's Estate, 84 N.Y.S.2d 306 (Surr. Ct. 1948). The court stressed the presence of an intention to prefer the income beneficiaries. *Id.* at 307.

[66] See also In the Matter of Becker, 204 Misc. 523, 123 N.Y.S.2d 589 (Surr. Ct. 1953), stressing the usual real property requirements, and omitting mention of a uniqueness test or a personalty distinction. *Id.* at 532, 123 N.Y.S.2d at 599.

[67] 146 N.Y.L.J., July 17, 1961, p. 6, col. 8 (Surr. Ct., N.Y. County).

[68] *Ibid.* It was also urged that the estate of the income beneficiary was estopped from objecting to the delayed sale as the decedent had been a co-trustee.

[69] *In re* Sheridan's Estate, 222 N.Y.S.2d 751 (Surr. Ct. 1961). The second opinion did not deny the possibility of apportionment of this *type* of

From the foregoing discussion it is apparent that the objection to apportionment based on the character of the asset has been sustained at best in a sporadic manner. No clear line of authority upholds the distinction. New York[70] and other jurisdictions[71] expressly and implicitly deny its existence. Authority outside New York, notably England, grants apportionment as readily when dealing with personalty as with realty,[72] and both the *Restatement of Trusts*[73] and the Uniform Principal and Income Act[74] fail to distinguish the two.

No strong theory behind the distinction would appear to exist. Perhaps the concept of "uniqueness" arose from an attitude that unless the personalty were unique, there would be a ready market for it, and therefore no justification for a delay in the conversion. Under these circumstances, if there were a delay, the remedy would more likely lie in surcharge rather than in apportionment.

Whatever may have prompted the distinction, and whatever may be its extent today, it stands on tenuous ground. There can be no question that both realty and personalty can become unproductive, and that the monetary loss will not vary with the character of the asset. In addition, the settlor surely cannot be said to have intended that a fair return be earned from realty, thereby justifying a sale and apportionment if it is unproductive, but not if the assets are personalty.

Since the effect of unproductiveness and the implied intention of the settlor do not vary with the character of the asset, there is no reason to impose different standards for the allowance of the apportionment. The same tests should apply in both instances, regardless of the character of the assets, and subject only to qualifications expressed by or imputed to the settlor.

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asset, but left open the question of whether a *duty* to sell existed. If there was a duty, the court reasoned that "nothing stood in the way of its discharge except the act or omission of the trustees" which would result in an estoppel, since the income beneficiary was a co-trustee. *Id.* at 754.

[70] See cases cited notes 52, 59, 60, 64, 65 and 66 *supra.*

[71] See Equitable Trust Co. v. Kent, 11 Del. Ch. 343, 101 Atl. 875 (Ch. 1917); Rhode Island Hosp. Trust Co. v. Tucker, 52 R.I. 277, 160 Atl. 465 (1932); Gate v. Hamilton Nat'l Bank, 178 Tenn. 249, 156 S.W.2d 812 (1941).

[72] See Skilton, *The Rights of Successive Beneficiaries in Unproductive Trust Assets Not Bearing Interest,* 15 TEMP. L.Q. 241, 258 (1941).

[73] RESTATEMENT (SECOND), TRUSTS § 241, comment *b* (1959).

[74] UNIFORM PRINCIPAL & INCOME ACT § 11. See DODGE & SULLIVAN, ESTATE ADMINISTRATION AND ACCOUNTING 443 (1940).

Conclusion

Traditionally, the apportionment remedy had been limited to totally unproductive realty. The reluctance to expand this remedy to include unproductive personalty has, at present, been largely overcome. At the same time, the theory extending apportionment to underproductive property has received greater extrajudicial expression and support. It is this latter issue of underproductivity, however, with which the New York judiciary and the legislature have been loath to deal, possibly due to the formidable practical problems asociated with it. The adoption by the courts of a test which grants apportionment of the proceeds from the sale of those assets which have become substantially unproductive would resolve, in a practical and sound manner, the theoretical inconsistency which exists in limiting apportionment to *totally* unproductive property.

THE FTC AND TELEVISION:

A NEW RULE FOR MISREPRESENTATION BY TEST AND DEMONSTRATION

The Federal Trade Commission was established to further the national interest by preserving and promoting a free enterprise economy, the natural development of which was being hampered because of increasing disregard for ethical conduct in the market place.[1] Among the chief armaments available to the Commission is Section 5 of the Federal Trade Commission Act which renders unlawful "unfair methods of competition . . . and unfair or deceptive acts or practices in commerce. . . ."[2] Recently, the Commission invoked this section and found deceptive a televised commercial which, in purporting to prove the moistening qualities of a shaving cream through an actual demonstration of its ability to soften sandpaper, substituted a mock-up of sand adhered to plexiglass. While momentarily conceding the product to be in fact capable of softening sandpaper, the following rule is implied

[1] Federal Trade Commission Act of 1914, 38 Stat. 717, 15 U.S.C. § 41 (1958); Moore, *Deceptive Trade Practices and the Federal Trade Commission*, 28 TENN. L. REV. 493, 494 (1961). See Note, *The Regulation of Advertising*, 56 COLUM. L. REV. 1018, 1019 (1956).

[2] Wheeler-Lea Amendment of 1938, 52 Stat. 111, 15 U.S.C. § 45 (1958).