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Liability of Trustees for Retention of Speculative Stocks

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In the dissent, Cardozo, *J.*, sounds the note of distinction between such a rule and one which denies the exercise of the right to foreclose and leaves open the treatment of cases with analogous circumstances. It seems that a better rule would be the one suggested by Cardozo, *J.* Not only would it have accomplished substantial justice in the instant case but it, as well, would allow for a better analysis of future problems unhampered by a precedent of "certainty of obligation." The fear of the Court in the majority opinion that another conclusion would affect this "certainty" is unfounded. The general rule, oft enunciated, still retains its force. There is a limit, however, beyond which the rule serves no useful purpose and is not consonant with the need intended for its application. The fostering of equitable doctrines and decrees in this jurisdiction is well recognized. And the application of equitable principles in the instant case would have advanced a more just as well as practical rule.

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LIABILITY OF TRUSTEES FOR RETENTION OF SPECULATIVE STOCKS.

Society, in its early stages, was devoid of the complicated rules which, today, govern the ownership, use, and disposition of property. Modernity, assailed as it has been by the intricacies of present-day methods and the demands of constantly changing concepts, has taxed jurisprudence to the limit by its plea that old law should not suffocate new principles. The answer of the courts to this supplication is admirably typified in the law of trusts.

With the popularity of corporate trustees established beyond peradventure of doubt, an exhaustive treatment of their duties and liabilities by an authority is regarded as salutary. Such a treatment was accorded a recent case by Surrogate Slater.[1] A comprehension of its conclusions is interesting.

The action was brought to surcharge the trustee for the retention of highly speculative securities, which had declined greatly in value. Appointed as trustee under a clause in the will, permitting the trustee to continue investments made by the testator, without personal liability for so doing, the trust company qualified in March, 1923. For seven years, the trustee, in spite of the fact that the stocks slowly, but surely, were declining in value, continued to hold them. This it did in the face of knowledge that such stocks were poor trust investments —it having so advised others in a booklet, published for that purpose. The objectors charged the trustee with negligence and a breach of trust duty. The trustee sought protection under the permissive clause in the will, and further attempted to defend its position by pleading

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[1] Matter of Clark, 136 Misc. 881, 242 N. Y. Supp. 210 (1930).

advice of counsel and good faith. It was admitted at the trial that the good faith of the trustee could not be impugned. Surrogate Slater, considering the facts, held that the trustee should be surcharged for negligence in continuing to hold said highly speculative and doubtful securities, notwithstanding the permissive clause in the will. He felt that such permission did not absolve a trustee from exercising the ordinary prudence and diligence, sagacity and vigilance, commensurate with their legally required conduct.

A brief resumé of the law applicable to trustees and their duties is necessary to appreciate fully the import of such a decision. Legislators and courts of equity in their zeal to protect the rights of a beneficiary have circumscribed greatly a trustee's activity with trust funds. In the initial instance, courts, realizing that an unrestricted trustee was repugnant to the very essence of a trust arrangement, prescribed a course of conduct, which, according to many authorities, imposes upon the trustee a duty to employ such diligence, prudence, sagacity, and vigilance in the care and management of an estate, as prudent men of discretion employ in their own like affairs.[2] This exaction, coupled with the power of a court of equity to remove a trustee by properly instigated proceedings for reasons which encompass misconduct,[3] breach of trust,[4] and failure to invest as directed,[5] acted as a deterrent to trustees, who, otherwise, might have been free to dissipate negligently the trust corpus.

But abstract demands, such as diligence, prudence, and sagacity, while efficacious to an extent, were, in the minds of our legislators, relative terms, which frustrated in many instances equitable conclusions. To serve as a panacea, the legislature decreed that trustees, in the absence of a permissive and discretionary clause, were to be precluded from investing trust funds in other than certain enumerated securities.[6] These latter statutory inhibitions, however, in no way affect a trustee, who acts under a permissive clause, which gives him the privilege of using his discretion free from statutory restrictions.[7] It is settled law that a testator may obviate, by an express permission, the necessity for a trustee conforming to the above-mentioned legislative fiats.[8] As Judge Scott tersely phrased it in speaking for the court in the Matter of Reid:[9]

[2] King v. Talbot, 40 N. Y. 76 (1869); Matter of Hall, 164 N. Y. 196, 58 N. E. 11 (1900); Costello v. Costello, 209 N. Y. 252, 103 N. E. 148 (1913).

[3] *In re* McGilliuray, 138 N. Y. 308, 33 N. E. 1077 (1893).

[4] Haight v. Brisbin, 100 N. Y. 219, 3 N. E. 74 (1885).

[5] Cummings v. Williams, 193 App. Div. 596, 184 N. Y. Supp. 404 (3rd Dept., 1920).

[6] New York Laws of 1909, ch. 18, sec. 111.

[7] Matter of Hall, *supra* Note 2; Matter of Chapman, 59 App. Div. 624 (1901), *aff'd* 167 N. Y. 619, 60 N. E. 1118 (1901); Matter of Vom Saal, 82 Misc. 531, 145 N. Y. Supp. 307 (1913); Matter of Reid, 170 App. Div. 631, 156 N. Y. Supp. 500 (1st Dept., 1915).

[8] *Ibid.*

[9] Matter of Reid, *supra* Note 7 at 634, 156 N. Y. Supp. at 502, 503.

> "It is fundamental law that a testator or the creator of a trust has unlimited authority to direct how his money may be invested by his trustees, or may leave the manner of such investment completely in the discretion of such trustees."

In the absence of such directions and powers, the trustees must be governed by the general rules of the court or by the statutes and laws of the state in which the trust is to be executed.[10] In New York, the courts have imposed on the trustee the affirmative duty of changing a so-called illegal trust investment as soon as practical, or as frequently written, within a reasonable time.[11] What constitutes a reasonable time is always a question of fact.[12] So assiduously have the courts applied themselves to the protection of the rights of a *cestui que* trust that a departure from lawful investments has wrought heavy penalties on the trustee.[13] If such a departure from the trust prohibitions results in a profit, the *cestuis que* trust are entitled to such profit;[14] if it proves improvident, the *cestuis* are entitled to interest on the money;[15] and, if the investment has been made with funds of the estate, mingled with funds of the trustee, in various stocks, and the funds of the estate cannot be traced and identified in any particular stocks, the *cestuis que* trust are entitled to select those stocks which they deem most desirable.[16]

With the foregoing decisions as a background, how, then, can we justify Surrogate Slater's decision in the Clark case? Can we hold the trustee liable for negligence in spite of the permissive feature of the will and even though he was not to be personally liable? The question is not devoid of complexities.

The primary duty of a trustee is to preserve the trust funds and to procure a safe and just income therefrom.[17] The burden of proof is upon the party seeking to surcharge, to show negligence in failing to sell.[18] Advice of counsel, while pertinent to good faith, cannot relieve the trustee from the results of his acts pursuant thereto.[19] Perry, in his monumental work on trusts, in speaking of a trustee's duty in such a situation, writes:

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[10] *Supra* Note 6.

[11] Matter of Myers, 131 N. Y. 409, 30 N. E. 135 (1892).

[12] Ketchum v. Stevens, 19 N. Y. 499 (1859).

[13] King v. Talbot, *supra* Note 2; Matter of Klein, 80 Misc. 377, 142 N. Y. Supp. 557 (1913).

[14] Penman v. Slocum, 41 N. Y. 53 (1869); Adair v. Brimmer, 74 N. Y. Supp. 539 (1878).

[15] Holden v. New York & Erie Bank, 72 N. Y. 286 (1878); *In re* Nesmith, 140 N. Y. 609, 35 N. E. 942 (1894).

[16] King v. Talbot, *supra* Note 2.

[17] King v. Talbot, Matter of Hall, Costello v. Costello, all *supra* Note 2; Villard v. Villard, 219 N. Y. 482, 114 N. E. 789 (1916).

[18] Matter of Wagner, 40 Misc. 490, 82 N. Y. Supp. 797 (1903).

[19] Matter of Belcher, 129 Misc. 218 221 N. Y. Supp. 711 (1927) and cases cited; Matter of Demmerle, 130 Misc. 684, 225 N. Y. Supp. 190 (1927).

> "If a testator gives any directions in his will to continue his investments already made, trustees must of course follow such directions; and if they follow them in good faith, they will not be liable for any losses, *unless they are negligent in failing to change an investment* when it ought to be changed to save it; for it cannot be supposed that the direction of a testator to continue a certain investment relieves the trustees from the ordinary duty of watching such investments, and of calling it in when there is imminent danger of its loss by a change of circumstances." (Italics ours.) [20]

The learned author cites no precedents—apparently content to rest on the persuasive logic of such an exaction.

Yet, the instant case is not entirely without precedent, albeit analogical. In Matter of Hurlbut,[21] the will of the testator authorized the executor to invest in other than legally authorized securities. Pursuant to such authorization, the executor made an investment in bonds of a steamship corporation, which, a short time thereafter, became insolvent. In an action brought to surcharge the executor with such losses, the Appellate Division unanimously affirmed the decision rendered by Surrogate Patterson on the opinion of the Surrogate, which had held the executor liable. The Surrogate, in speaking of an executor's duty under such circumstances, wrote:

> "I think it is conceded that where such a clause is found clothing a trustee with discretion he is answerable only when he has not acted in good faith *and used the care and diligence in investments which would be exercised by a reasonably careful and prudent person.*" (Italics ours.)

Similarly, in Matter of Hall [22]—though the facts are not analogous—the Court succinctly stated the test to be applied in these words:

> "The range of so-called 'legal securities' for the investment of trust funds is so narrow in this state that a testator may well be disposed to grant to his executors or trustees greater liberty in placing the funds of the estate. But such a discretion in the absence of words in the will giving greater authority should not be held to authorize investments of the fund in *new speculative or hazardous ventures.*" (Italics ours.)

It is true that these cases speak of the degree of care demanded from a trustee when employing discretion in the investment of funds, as distinguishd from a trustee who *retains* and *holds* with permission,

[20] Perry, Trusts (1910), sec. 465.

[21] 210 App. Div. 456, 206 N. Y. Supp. 448 (2nd Dept., 1924).

[22] *Supra* Note 2 at 199, 58 N. E. at 11.

securities of the testator. But the test to be applied in both instances is perforce identical. It would be an absurdity of the law to demand in one instance prudence and sagacity in investing, and in another solely extract indifference in maintaining the securities.

Such a view was given added forcefulness in an opinion written by Chief Judge Cardozo.[23] Speaking of a trustee's duties in a case wherein the latitude given the trustee surpassed the permission extended the instant trustee, Judge Cardozo said:

> "It is true that the creator of this trust had reserved to himself the broadest rights of management. His discretion was to be 'absolute and uncontrolled.' That does not mean, however, that it might be recklessly or wilfully abused. He had made himself a trustee; and in so doing he had subjected himself to those obligations of fidelity and diligence that attach to the office of a trustee. * * * His discretion, however broad, did not relieve him from obedience to the great principles of equity which are the life of every trust."

The wisdom of such a conclusion is amplified by new features. It has never been incumbent on a trustee to retain, under a permissive clause in the will, the securities of the testator till the trust by its terms expires.[24] Courts have frequently upheld the trustee's right to sell securities, even though the trust by its terms permits the retention of unauthorized securities.[25] In a well-considered opinion by Surrogate O'Brien,[26] the learned Surrogate absolved a trustee from liability for selling securities which the will allowed him to retain, and overruled the objection of the beneficiary that the stocks had been prematurely sold. The sum and substance of his reasoning was that it was better to sell out stock too soon than too late. To quote him:

> "The trustees had before them on the one side the knowledge of the restrictions to so-called legal investments, controlling the action of trustees lacking testamentary freedom of discretion, and on the other side authority to continue the investment in said stock, and even with this authority and discretion they were always in danger of being surcharged for losses sustained. The trustees stood between these two extremes. Should they be penalized for having resisted the temptation embodied in the power given by the will to seek the greatest possible profits by retaining the stock for later disposal? They knew from their experience that the biggest

[23] Carrier v. Carrier, 226 N. Y. 114, 125, 123 N. E. 135, 138 (1919).

[24] Guaranty Trust Company of New York v. United States Steel Corporation, 107 Misc. 720, 176 N. Y. Supp. 402 (1919) and cases cited.

[25] *Ibid.*

[26] Matter of Walker, N. Y. L. J., June 30, 1930.

losses on stocks occurred from over-staying the market, and that it is better to sell out too soon than too late."

Surrogate Slater's conclusion in the Clark case is the culmination of a series of warnings expressed in a few recent decisions through the medium of dicta. To this effect is the Matter of Channing,[27] wherein the Court said, in considering such a discretion as we are here concerned with:

> "It is well to reiterate the caution frequently expressed in this court that even in the face of this authority, vigilance and alert judgment will be always required and the surcharging of losses upon the trustee in future accountings is not beyond the range of possibilities in spite of said authority."

The logic of the principle enunciated in the Clark case is persuasive. That a discretion vested in a trustee should be allowed to pervert our every concept of a trustee is repugnant to the connotation of justice. In spite of any discretion or permission, the trust company was still a trustee.[28] As such, it was bound to exercise that degree of care and fidelity which the law required.[29] Its failure so to act makes its surcharging a necessary corollary.

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LARCENY GENERICALLY, AND THE OFFICE OF A BILL OF PARTICULARS IN RESPECT TO AN INDICTMENT.*

In a recent opinion handed down by the Court of Appeals, the Court again had occasion to discuss the meaning of larceny by trick, and obtaining property by false pretense.[1] If the opinion in this case merely discussed the definition of these two crimes, then the subject could well be disregarded for it has been amply covered in the past by judicial opinion and controversial legal literature.[2] The decision, how-

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[27] 129 Misc. 393, 394, 222 N. Y. Supp. 351 (1927); see Matter of Frank, 124 Misc. 664, 208 N. Y. Supp. 254 (1925).

[28] Carrier v. Carrier, *supra* Note 23.

[29] King v. Talbot, Matter of Hall, Costello v. Costello, all *supra* Note 2.

* Reprint from (1927) 1 St. John's L. Rev. 176, which issue is out of circulation.

[1] People v. Noblett. 244 N. Y. 355 (1927).

[2] Thus, in Hilderbrand v. People, 56 N. Y. 394 (1874), the prosecuting witness handed the prisoner, who was a bartender in a saloon. a fifty-dollar bill to take ten cents out in payment for a soda. It was held that it was an incomplete transaction, to be consummated in the presence of and under the personal control of the complainant. The delivery of the bill and the change were to be simultaneous acts, and until the latter was performed, the delivery was not complete. The rule thus enunciated was further extended in a later case, Justices of Court of Special Sessions v. People. 90 N. Y. 12 (1882), where the same conclusion was reached, when the prosecuting witness gave the prisoner a twenty-dollar bill and requested him to go out and get it changed, on