Liabilities of Trustees for Bondholders in Excess of Their Express Undertakings

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to place their funds at higher interest rates on the Stock Exchange. Now they carry their process of pauperization a step further, by making money more easily available when their customers wish to purchase speculative securities. The question will be asked: How can the state prevent such transactions? Frankly, to us it seems possible only by legislation. And we claim that this legislation now exists. We must adopt one of two attitudes: (a) Are we going to encourage stock speculation, or (b) are we going to encourage legitimate business transactions? The court seems to have spoken. The restraint of the statute has been ruled out, and now by judicial legislation a situation has been brought about which, in view particularly of the present financial depression, is economically unsound.

We cannot close our eyes to the unique position which banks occupy in society. That the Legislature never intended to allow banks to deal with other people's moneys as they (the banks) saw fit has hitherto been unquestioned. All the statutes dealing with the banks and banking powers stand in formidable array as authority.

To us it seems that courts should be more wary of throwing overboard the safeguards which sound conservative economics and policies have placed on the statute books, in favor of the radical practices of the school of "new economics" that flamed so brightly during the hectic days of our "bull market," but are visible now, if at all, by a subdued blush.

SIDNEY E. COHN.

LIABILITIES OF TRUSTEES FOR BONDHOLDERS IN EXCESS OF THEIR EXPRESS UNDERTAKINGS.

The instrument which creates an express trust specifies the powers of the trustee and in the main furnishes the measure of his obligations. A trust deed or trust mortgage is such an instrument. The trustee, with regard both to his powers and duties, is required to act with the utmost good faith and diligence in protecting the interests of both obligor and the bondholders. He may not transcend the

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5 As an indication that conservative banks regard this practice with apprehension, see the circular published by the Central Hanover Bank & Trust Company, New York, under the title, "No Securities For Sale."


2 See, however, Rhinelander v. Farmers Loan & Trust Co., 172 N. Y. 512, 65 N. E. 499 (1902), where the Court finds an implied duty arising from the relationship alone.


4 Davenport v. Vaughn, 193 N. C. 646, 137 S. E. 714 (1927); Goode v. Comfort, 39 Mo. 313 (1866); Sherwood v. Saxton, 63 Mo. 79 (1876); Central Trust Co. v. Owsley, 188 Ill. App. 505 (1914); Merchants Loan Co. v. Trust Co., 250 Ill. 86, 95 N. E. 59 (1911).
powers expressed in the trust indenture for that is an obvious breach of trust.4 In this discussion, however, we are concerned not with the trustee's powers but rather with his duties to the bondholders in the care and maintenance of the security and with the limits which exculpatory provisions in the trust indenture may place upon the trustee's liabilities.

A duty common to all such trustees is the certification of the bonds issued by them. The certification is usually in some such form as this: "This bond is one of a series of bonds mentioned and described in the mortgage within referred to." This statement appears upon the bond over the signature of the trustee and is usually by an express provision in the bond made the sine qua non to its validity. The question naturally arises: What force and effect has such a certification? The question arises most frequently when the plaintiff seeks to enforce an alleged liability against the certifying trustee.5 Tschetinian v. City Trust Company 6 and McCauley v. Ridgewood 7 were cases in which it was attempted to hold the trustees liable as for a false and negligent representation by reason of the endorsement upon the bonds by the mortgagor that they were first mortgage bonds when in fact they were not. The defendants had merely certified each of the bonds as being one of a series. The court in each case held that the certification merely identified the bonds as genuine and was not intended to guarantee their validity or the sufficiency of the security. Other cases cited hold to the same effect.8 Professor Jones, in his Corporate Bonds and Mortgages, has said: "The limited and guarded terms of a trustee's certificate cannot be held to embrace a representation or guaranty of the truthfulness of the description of

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4 1 Perry, Trusts (8th ed.), sec. 460; Conover v. Guarantee Trust Co., 88 N. J. Eq. 450, 102 Atl. 844 (1917), aff'd 89 N. J. Eq. 584, 106 Atl. 890 (1918). Birrell, Duties and Liabilities of Trustees, 28 Am. & Eng. Encyc. Law 1063 (1896): "Trustees are bound to observe the limits placed upon their powers either by law or by the trust instrument, and if they transcend such powers and cause damage to the estate they will be held responsible therefore although they may have acted in perfect good faith."
6 Supra Note 5.
7 Supra Note 5.
8 In Bell v. Title Trust & Guaranty Co., 292 Pa. 228, 140 Atl. 900 (1928) the Court says, "The error is in assuming that the brief recital in form of a certificate on the bonds by the Title Trust & Guaranty Co. over the signature of its secretary was in fact a certification and guaranty of the validity of the bonds and which therefore rendered the trustee liable for his loss. A certificate of this character carries with it no such burden and creates no such obligation. It is merely a bare declaration that the bonds in this dispute were of the issue of bonds by the Savage Fire Brick Company."
the obligation as made by the obligor. Trustees act for a comparatively trifling consideration, limiting their ability to their own acts of negligence and misconduct and it would be unfair to put so serious a burden as a guaranty upon them."  

Where, however, the gravamen of the charge is some negligent act on the part of the trustee in certifying the bonds, he will be held liable. Thus, trustees have been held liable for certifying bonds upon securities differing from those called for by the trust indenture, for certifying bonds without calling for and receiving a statement of the purposes for which the bonds were to be appropriated, for issuing bonds upon insufficient security and for certifying more bonds than were called for by the trust agreement. In each case the trustee's abuse of the powers conferred upon him rendered him liable to the party injured for the damage done and he was not allowed to plead a contract for immunity from liability as a defense.

It is generally conceded that the parties creating a trust may agree to limit the liability of the trustee for negligent acts or omissions. This right to contract is not unlimited, however, for a total immunity from liability for one's faults is repugnant to the law. So that it has been held that an exculpatory provision in a trust indenture cannot protect one from liability for gross negligence or bad faith. Conover v. Guarantee Trust Co. establishes another limitation, viz.: That an exculpatory clause can never exempt a trustee from liability for transcending or abusing his powers, as distinguished from abusing his discretion in the exercise of powers actually conferred. But the distinction escapes us. A casual inspection of the provisions of modern trust mortgages will reveal the fact that the intention is to limit the liability of the trustee to the minimum permitted by the law. In some of these, nearly every grant of power is qualified by a clause relieving the trustee from liability for its abuse. We cannot see how the learned Court can deduce any intent to save the trustee harmless only for errors of judgment and not for exceeding his power. We think, rather, that if there is any such limitation upon the power of a trustee to contract for immunity, it is because such a contract is repugnant to the law and contrary to public policy. And it may be that the sole effect of the decisions in Conover v.

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13 Mullen v. Eastern Trust Co., 108 Me. 498, 81 Atl. 948 (1911).
14 Tuttle v. Gilmore, 36 N. J. Eq. 617 (1883); Browning v. Fidelity Trust Co., supra Note 2.
Guaranty Trust \(^{16}\) and Doyle v. Chatham & Phenix Nat. Bank \(^{17}\) is to supply a further definition of gross negligence.\(^{18}\)

Doyle v. Chatham & Phenix Nat. Bank \(^{19}\) was a case in which a trustee was held liable for its negligence in unauthorizedly authenticating an issue of bonds. The trust indenture provided that the bonds were to be authenticated by the trustee when the proper collateral was delivered and pledged with it, \textit{viz.}:

"B. Trade acceptances or notes of dealers * * * or note of purchasers in part payment for motor vehicles * * *."

The trustee was given the power to demand of the obligor corporation the names and addresses of the makers of the notes and other pertinent data concerning them. The defendant made no such demand but certified the bonds without investigating the identities of the makers of the notes delivered to it. They were not made by dealers or purchasers and proved to be worthless. The plaintiff, a purchaser of some of the bonds certified by the defendant, sued, charging it with negligence. The trust indenture contained a provision exempting the defendant from liability for its acts and omissions to act. Says the Court (quoting from Conover v. Guaranty Trust Co.) \(^{20}\):

"It accordingly seems impossible to construe an immunity clause as intended to exempt a trustee from liability for transcending his powers as clearly defined by the trust agreement; his engagement is to exercise the powers and only the powers conferred upon him and the appropriate office and purpose of an immunity clause forming a part of a trust agreement which specifically and clearly defines the trustee’s powers appears to be to limit his responsibility in matters of judgment and discretion committed to him in the execution of those defined powers."

If such is the rule of liability for the negligent acts of the trustee, what is the rule in cases of omission to act? In Green v. Title Guar-

\(^{16}\) \textit{Supra} Note 10.

\(^{17}\) Doyle v. Chatham & Phenix Nat. Bank, \textit{supra} Note 10.

\(^{18}\) Gross negligence has been defined as “the intentional failure to perform a manifest duty in reckless disregard of the consequences as affecting the life or property of another.” McDonald v. The Railway Co. (Tex. Civ. App.), 21 S. W. 775 (1893), and Schindler v. Railway Co., 87 Mich. 400, 49 N. W. 670 (1891); also as "such a gross want of care and regard for the rights of others as to justify the presumption of wilfulness or wantonness." 2 Thompson, Negligence, 1264. For a thoughtful analysis of the whole problem and a collection of all the cases, see Posner, \textit{Liabilities of the Corporate Trustee}, (1928) 42 Harv. L. Rev. 198.

\(^{20}\) \textit{Supra} Note 10.

\(^{21}\) \textit{Supra} Note 10.
antee and Trust Co.\textsuperscript{21} the trustee failed to demand from the mortgagor a further conveyance which would have cured a defective mortgage, and to re-file the chattel mortgage. While it was held that the immunity paragraph\textsuperscript{22} was effective to absolve the defendant from liability for not procuring the conveyance, it was stated by way of dictum that the defendant could not have been absolved from liability for not re-filing the mortgage. It may be that the first obligation involved the exercise of discretion and judgment, and that the second was a duty to be performed independently of any exercise of discretion, and the non-performance of such a duty, affecting as it does the validity of the mortgagee's lien, constitutes gross negligence. It is our opinion that the Title Guarantee & Trust Company was grossly negligent in the exercise of its discretion. This case has been severely criticized.\textsuperscript{23}

In Rhinelander v. Farmers Loan & Trust Co.,\textsuperscript{24} which was decided before Glanzer v. Shepard\textsuperscript{25} and International v. Erie Railroad Co.,\textsuperscript{26} the relationship existing between the trustee and those who at the time of the negligent act or omission are not yet bondholders, but who later acquire bonds, is referred to as a trust relationship. It seems to have been taken for granted in all the decisions on the subject\textsuperscript{27} that future bondholders were \textit{cestuis que trustent}. Mullen v. Eastern Trust Co.\textsuperscript{28} is the only exception. There the liability was represented to be a liability for deceit, a position which could not be sustained in New York in the absence of evidence of intent to defraud.\textsuperscript{29} In Doyle v. Chatham & Phenix Nat. Bank\textsuperscript{30} the Court of Appeals for the first time raised the question: How can a trustee, in incorrectly certifying bonds to prospective takers in order that they may become \textit{cestui que trust}, at that moment and before the relationship is established, have violated a trust duty owed to them? It is at this point that Glanzer v. Shepard\textsuperscript{31} and International v. Erie Railroad\textsuperscript{32} are called in to save the day. The liability is for negligence. The plaintiff, relying upon the negligent representation of the defendant, invested his money upon the faith of its certificate. Here was a

\textsuperscript{22} "the trustee is under no obligation to record or file this indenture in any office whatsoever or to procure any additional instrument or further assurance or to do any act for the continuance or conservation of the lien hereof or for giving notice of the existence of such lien."
\textsuperscript{23} (1928) 28 Col. L. Rev. 829.
\textsuperscript{24} 172 N. Y. 512, 65 N. E. 499 (1902).
\textsuperscript{25} 233 N. Y. 236, 135 N. E. 275, 23 A. L. R. 1425 (1922).
\textsuperscript{27} \textit{Supra} Note 5.
\textsuperscript{28} 108 Me. 498, 81 Atl. 948 (1911).
\textsuperscript{29} Kountze v. Kennedy, 147 N. Y. 124, 41 N. E. 414, 29 L. R. A. 360 (1895).
\textsuperscript{30} \textit{Supra} Note 10.
\textsuperscript{31} \textit{Supra} Note 25.
\textsuperscript{32} \textit{Supra} Note 26.
duty of care to one party arising out of a contractual relationship with another. This comes very close to being an extension of the principle involved in Lawrence v. Fox. By the contract the defendant has assumed the performance of a duty and the relationship of the plaintiff is such that he may in morals and good conscience rely upon the defendant to perform that duty properly.

The Doyle case raises yet another problem. It would seem that under its ruling Rhinelander v. Farmers Loan & Trust Co. must go by the board. If the relationship between the defendant and the future bondholders was not a trust relationship there can be no "implied duty or obligation springing from the trust." Will we say that the Rhinelander case was incorrectly decided or can we find some other source from which the same legal duty is to be implied? It might be possible to say that the duty to the bondholders is an implied term of the contract the intent of which was to create a trust relationship. And yet the majority opinion, after considering a number of cases on the subject of implied covenants, holds as follows:

"* * * there is nothing in the language of the mortgage before us to warrant reading into that instrument an implied covenant, imposing upon the trustee the affirmative obligation, already discussed, in paying out these bonds or their proceeds."

The problem presented by this case is recommended for a more extended consideration.

It may be that some of the rulings in the Rhinelander case has been overruled by Doyle v. Chatham & Phenix Nat. Bank. If so, the Court of Appeals has corrected two errors made by it in Rhinelander v. Farmers Loan & Trust Co. Doyle v. Chatham & Phenix Nat. Bank stands as the law measuring the obligations of corporate trustees.

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23 Lawrence v. Fox, 20 N. Y. 268 (1859).
24 International v. Erie Railroad Co., supra Note 26. In Glanzer v. Shepard (supra Note 25), Judge Cardozo quotes from Coggs v. Bernard, 2 Ld. Raymond 909: "It is ancient learning that one who assumes to act even though gratuitously may thereby become subject to the duty of acting carefully if he acts at all."
25 Supra Note 24.
26 Supra Note 30.
27 Supra Note 24.
28 Supra Note 30.