Michigan Law Review

Volume 35 | Issue 3

1937

TRUSTS-BREACH BY TRUSTEE--LIABILITY OF TRUSTEE TAKING TITLE TO NOTE AND MORTGAGE IN INDIVIDUAL NAME

Milton M. Howard
University of Michigan Law School

Recommended Citation
Milton M. Howard, *TRUSTS-BREACH BY TRUSTEE--LIABILITY OF TRUSTEE TAKING TITLE TO NOTE AND MORTGAGE IN INDIVIDUAL NAME*, 35 MICH. L. REV. 516 (1937).
Available at: https://repository.law.umich.edu/mlr/vol35/iss3/24

TRUSTS—BREACH BY TRUSTEE—LIABILITY OF TRUSTEE TAKING TITLE TO NOTE AND MORTGAGE IN INDIVIDUAL NAME—A corporate trustee, authorized to invest trust funds in mortgage loans, made such an investment, taking title to the mortgage and note securing the same in its individual name. The beneficiary sought to surcharge the trustee for the full amount of the funds so invested, the property having declined in value due to a world-wide depression. The trustee defended on the ground that the trust had been declared in a separate instrument recorded in its files, that such was an established practice, that it acted on expert advice, in good faith and for the best interests of the beneficiary. *Held*, that the trustee had violated its duty, but since there was entire good faith and the breach was in no way the proximate cause of the loss, the court would not inflict a penalty by surcharging the trustee. *Chapter House Circle v. Hartford Nat. Bank & Trust Co.*, (Conn. 1936) 186 A. 543.

The cardinal rules of trusteeship require that the trustee indicate the trust on the fact of mortgages and notes (and appropriate public records thereof) purchased out of trust funds.[1] Violation of this duty involves breach of other duties as well.[2] Primarily, the temptation to allocate losses from individual investments to investments allegedly held in trust, the difficulty of tracing on the part of the beneficiary in case of nonperformance of the trust obligation, and the conflicting claims that may arise due to reliance by third parties on the trustee's apparent title are the basic reasons for the rule.[3] The breach is none the less complete despite the presence of good faith and proper motives.[4] Though such conduct is universally held to be a violation of duty, there is much conflict as to the extent of liability where the breach has not contributed in any way to the loss. Whether proximate cause is the yardstick of liability is an open question,[5] at

[1] 3 BOGERT, TRUSTS AND TRUSTEES, § 596 (1935); Mitchell v. Moore, 195 U. S. 587, 24 L. Ed. 492 (1877); 1 TRUSTS RESTATEMENT, § 179, comments a, b, and d (1935).

[2] Namely the duty not to mingle trust funds with his individual property, and the duty to earmark and separate. 1 TRUSTS RESTATEMENT, § 179 (1935).

[3] 3 BOGERT, TRUSTS AND TRUSTEES, § 596 (1935); In re Union Trust Co., 219 N. Y. 514 at 518, 114 N. E. 1057 (1916), affg. 86 Misc. 324, 149 N. Y. S. 324 (1914): "otherwise he would be able to play fast and loose with his cestui que trust, and throw the hazards of his own business on them. . . ." 3 WHITE and TUDOR, LEADING CASES IN EQUITY, 3rd Am. ed., p. 475 and cases cited (1859).

[4] 1 TRUSTS RESTATEMENT, § 201 (1935); In re Guthrie's Estate, 320 Pa. 530, 182 A. 248 (1936).

[5] See notes in 46 HARV. L. REV. 725 (1933); 32 COL. L. REV. 1446 (1932); 19 VA. L. REV. 630 (1933), commenting upon proximate cause as a test of the extent of liability where a nonlegal investment was converted into a legal one by oper-

least, this appears to be true from a view of the older cases. An analysis of the decisions as contrasted with the opinions will serve to reconcile some of the apparently conflicting decisions in this field. The cases may be roughly divided into three groups. In the first group are those cases stating that for violation of this duty there is absolute liability, or that there is a conclusive presumption that an investment in the trustee's name as an individual was made for himself. However, in many of the cases relied on for this strict rule, the loss was clearly due to the violation.[6] In others relied on for the rule, there simply is no legal basis supporting any such doctrine, as the trustee was freed from liability despite his violation (and not on grounds of notice, or consent).[7] As quickly as such rules are laid down, the courts inevitably recover their judicial balance and proceed to refuse a surcharge for the reason that the "loss . . . is not due to the conduct of the [trustee]" [8] or hold that the trustee may show extenuating circumstances relieving him of apparent liability.[9] Still other cases are based on statutes providing for such strict liability.[10] It has been contended that where the trustee's duty turns on a statute, breach of which is conclusive on the question of negli-

ation of law and the loss occurred thereafter, it having been held the trustee was not liable.

[6] See cases cited in In re Yost's Estate, 316 Pa. 463 at 467, 175 A. 383 (1934), and in 3 BOGERT, TRUSTS AND TRUSTEES, § 596, footnotes 58, 59 and 61 (1935). Most of the cases relied on were bank deposits of trust funds made in the trustee's individual name, which presents other reasons why there is a strict rule of liability here. See the principal case, 186 A. 543 at 550 and 45 L. R. A. (N. S.) 1 (1913). Even in the bank cases the trustee is not always held liable if he acted in good faith. See Cornet v. Cornet, 269 Mo. 298, 190 S. W. 333 (1916). The Yost case was apparently overruled by In re Guthrie, 320 Pa. 530, 182 A. 248 (1936), and the Connecticut court relied heavily on the latter case in freeing the trustee of liability. Both cases are on all fours with the principal case. The author of a note to the Guthrie case in 49 HARV. L. REV. 1381 (1936) seems to say that release of the trustee was based on notice to and consent by the beneficiaries. The Pennsylvania court, however, in that case expressly repudiated this as the basis of its decision, which it planted solely on the ground that the breach occurred in good faith and was in no way the cause of the loss.

[7] See cases cited in In re Yost's Estate, 316 Pa. 463, 175 A. 383 (1934), and in 3 BOGERT, TRUSTS AND TRUSTEES, § 596, notes 58, 59, 61 (1935). Some of the cases therein involved fraud and wilful mingling, others represent losses directly resulting from the breach; and in the remaining, despite the language used, the trustee was held *not* liable.

[8] Springfield Deposit & Trust Co. v. Unitarian Church, (Mass. 1936) 200 N. E. 541 at 545; In re Freas' Estate, 231 Pa. 256, 79 A. 513 (1911); and In re Union Trust Co., 219 N. Y. 514, 114 N. E. 1057 (1916).

[9] Miller v. Proctor and Anderson, 20 Ohio St. 442 (1870); In re Darlington's Estate, 245 Pa. 212, 91 A. 486 (1914).

[10] The trustee taking title in his individual name "is liable for its safety *in all events*." N. D. Comp. Laws (1913), § 6289 [italics ours]; "absolutely liable for *wilful* and unnecessary mingling." Cal. Civ. Code (1931), § 2236; 2 Mont. Rev. Code (1921), § 7896. Most statutes merely affirm the common-law duty, leaving untouched the question of extent of liability. See the relevant statute in the principal case, Conn. Gen. Stat. (Cum. Supp. 1935), c. 206, § 1459 c. But see 4 N. J. Comp. Stat. (1911), § 7, p. 5658, which relieves the trustee who has not acted in bad faith.

gence, the test of proximate cause will be applied.[11] In many of the cases the investment was a non-legal one, a circumstance presenting wholly different elements.[12] It would seem, then, that despite the absence of language of proximate cause the courts in this group use it as the yardstick. In the second group are those cases surcharging the trustee without any mention of proximate cause. Their major premise is that the trustee, being placed by his confidential relationship in a very favorable position to shift losses, will not be permitted to say that the loss was not due to his fault. But it will be found that these cases presented proper situations for the infliction of a penalty by way of surcharge. The facts show acts, such as attempts to allocate losses to trust funds by juggling of various sorts, conduct bordering on fraud, or neglect, which contributed to the loss.[13] In general, there was lack of any bona fide attempt to keep the trust property separate, or even treat it as trust property. In the third group are those cases adopting a functional approach to the problem. In accordance with such authority as Bogert[14] and the American Law Institute,[15] the rule here is that the trustee is not liable for losses not caused by his taking title to trust investments in his own name when done in good faith.[16] It will be found that in these cases there was entire good faith, the action being based on expert advice and widespread banking practice. Further, the beneficiary was probably to some extent protected, as in the principal case, by declarations of trust on the trustee's records.[17] Other cases suggest that losses due to a general shrinkage in values are

[11] Re Adriance's Estate, 145 Misc. 345, 260 N. Y. S. 173 (1932).

[12] Nyce's Estate, 5 Watts & Serg. (Pa.) 254 (1843), cited in 3 WHITE and TUDOR, LEADING CASES IN EQUITY, 3d Am. ed., p. 475 (1859); Webb v. Jonas, 63 L. T. R. N. S. (Ch.) 882 (1888), often cited for this proposition; Re Massingberd's Settlement, 63 L. T. R. N. S. (Ct. of App.) 296 (1890). Significant in defining this difference is the statement of Lindley, J.: "But a trustee is not a surety, nor is he an insurer. . . . We have here to deal with authorized investments, and this must never be lost sight of; everything turns upon it. . . ." Re Chapman, [1896] 2 Ch. 763 at 775. Recent cases have applied the doctrine of proximate cause here also: Springfield Nat. Bank v. Couse, 288 Mass. 262, 192 N. E. 529 (1934); Johnson v. Webster, 168 Md. 568, 179 A. 831 (1935).

[13] Royer's Appeal, 1 Jones (11 Pa.) 36 (1849); Stanley's Appeal, 8 Barr. (8 Pa.) 431 (1848); In re Eckert's Estate, 93 N. Eq. 598, 117 A. 40 (1922); Mason v. Whitthorn, 2 Cold. (42 Tenn.) 242 (1865). See Cornet v. Cornet, 269 Mo. 298, 190 S. W. 333 (1916), as to the result of mingling trust funds in the trustee's individual bank account when done in good faith.

[14] 3 BOGERT, TRUSTS AND TRUSTEES, § 703, p. 2085 (1935), discussing the measure of damages for breach of duty.

[15] 1 TRUSTS RESTATEMENT, § 179, d, and § 204 (1935): "The trustee is not liable to the beneficiary for a loss or depreciation . . . not resulting from a breach of trust."

[16] Re Adriance's Estate, 145 Misc. 345, 260 N. Y. S. 173 (1932); Re McCafferty's Estate, 147 Misc. 179, 264 N. Y. S. 38 (1933); 39 LAW NOTES 4-8 (1935); Springfield Deposit & Trust Co. v. Unitarian Church, (Mass. 1936) 200 N. E. 541, this, after stating (at 545) that a trustee who violates his duty is "held to strict liability"; Gibson County v. Fourth & First Nat. Bank, (Tenn. 1936) 96 S. W. (2d) 184 at 192.

[17] See In re Guthrie's Estate, 320 Pa. 530, 182 A. 248 (1936), noted 49 HARV. L. REV. 1381 (1936), and Springfield Deposit & Trust Co. v. Unitarian

chargeable to the trustee who has violated this duty, since the shrinkage, *if a loss*, had nothing to do with the *form* of the investment.[18] The decision in the principal case indicates again the tendency to display leniency towards trustees upon whom their beneficiaries seek to place the burdens of world-wide depression, the technical violation being but a fortuitous circumstance upon which they endeavor to base their disaffirmance of the investment.[19] The conclusion to be drawn from all the cases would seem to be that for violation of this duty the courts will use proximate cause as a test of liability for loss either in express terms or by implication; if, however, bad faith is present, they may ignore the element of causation and allow the beneficiary the traditional option of affirming or disaffirming the transaction [20] on the theory of "absolute liability."

Milton M. Howard

Church, (Mass. 1936) 200 N. E. 541 at 546; In re Union Trust Co., 219 N. Y. 514 at 518, 114 N. E. 1057 (1916).

[18] In re Gibson's Estate, 312 Pa. 359 at 361, 167 A. 282 (1933), and Craven's Estate, 25 D. & C. (Pa.) 289 (1936).

[19] See notes in 49 HARV. L. REV. 1381 (1936); 36 LAW NOTES 7 (1932); 39 LAW NOTES 4 (1935); Gibson's Estate, 312 Pa. 359, 167 A. 282 (1933).

[20] See, In re Frea's Estate, 231 Pa. 256, 79 A. 513 (1911), and Mitchell v. Moore, 95 U. S. 587, 24 L. Ed. 492 (1877).