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Constitutional Law - Due Process - Retroactive Application of Uniform Principal and Income Act

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CONSTITUTIONAL LAW—DUE PROCESS—RETROACTIVE APPLICATION OF UNIFORM PRINCIPAL AND INCOME ACT—The trustee of a trust created prior to the 1957 enactment of the Uniform Principal and Income Act[1] petitioned for instructions as to whether a stock dividend received by it subsequent to the passage of the act should be allocated to principal or income. The Uniform Act provides a rule for the treatment of stock dividends contrary to the judicial rule previously adopted in Wisconsin, and is expressly made applicable to trusts existing on its date of enactment.[2] The county court, finding the act could not be constitutionally applied to trusts created prior to its enactment, ordered the allocation of the shares to income. On appeal, *held,* reversed. The application of the Uniform Principal and Income Act to stock dividends received subsequent to the passage of the act by a trust created prior to the act does not violate Fourteenth Amendment due process. *In re Allis' Will,* (Wis. 1959) 94 N.W. (2d) 226.

Two major competing rules have developed on the question whether extraordinary stock dividends received by a trust are to be treated as principal or income.[3] The so-called Pennsylvania rule treats such dividends as principal only to the extent that they are declared out of funds earned by the declaring corporation prior to the creation of the trust.[4] The Massachusetts rule simply regards all stock dividends as principal.[5] Wisconsin, previously committed by judicial decision to the Pennsylvania rule,[6] has now substituted the Massachusetts rule by adopting the Uniform Principal

1 Wis. Stat. Ann. (1957; Supp. 1958) §231.40.

2 Wis. Stat. Ann. (1957; Supp. 1958) §231.40 (12)

3 See, generally, 3 SCOTT, TRUSTS, 2d ed., §236.3 (1956). A third general rule known as the Kentucky rule, which allocated all extraordinary dividends to income, was abandoned in Kentucky in Bowles v. Stilley's Executor, (Ky. 1954) 267 S.W. (2d) 707, and has little following elsewhere. An annotation discussing the general rules may be found in 44 A.L.R. (2d) 1277 (1955).

4 3 SCOTT, TRUSTS, 2d ed., p. 1813 (1956). See, e.g., Matter of Osborne, 209 N.Y. 450, 103 N.E. 723 (1913); Baldwin v. Baldwin, 159 Md. 175, 150 A. 282 (1930).

5 See, e.g., Minot v. Paine, 99 Mass. 101 (1868). The current trend is now away from the once-favored Pennsylvania rule toward the more easily administered Massachusetts rule. 3 SCOTT, TRUSTS, 2d ed., p. 1814 (1956). The Pennsylvania rule was originally accepted by the American Law Institute in TRUSTS RESTATEMENT §236 (1935), but this has since been changed to the Massachusetts rule. TRUSTS RESTATEMENT §236 (Supp. 1948).

6 Soehnlein v. Soehnlein, 146 Wis. 330, 131 N.W. 739 (1911).

and Income Act.[7] The Wisconsin legislature altered the Uniform Act by expressly providing that it should apply to trusts created prior to its enactment,[8] thereby avoiding the situation present in several jurisdictions requiring the continued maintenance and development of the pre-statutory rule for application to trusts created prior to the statute.[9] The principal case, by sustaining the retroactive application of the Uniform Act, goes against a series of Pennsylvania decisions,[10] the only other authority directly on point. The Pennsylvania court has held that the income beneficiary acquires a vested interest in the trust income as determined by the allocation rules applicable at the trust's creation. The retroactive application of the new rule is therefore held unconstitutional under the classic doctrine that retroactive interference with vested rights violates due process.[11] In comparing the relative merits of these decisions the question would simply seem, at first glance, to be which court uses the correct meaning of vested right. But the classic definition,[12] phrased in natural law terminology,[13] only begs the question.[14] The ambiguous and indefinite nature of the con-

[7] The Massachusetts rule is found in §5 of the Uniform Principal and Income Act, which has now been adopted in 21 states. A list of these may be found in 9B UNIFORM LAWS ANNOTATED 365 (1957).

[8] Wis. Stat. Ann. (1957; Supp. 1958) §231.40(12). Section 17 of the Uniform Act makes the act applicable only to estates becoming legally effective after its enactment. Pennsylvania appears to be the only other jurisdiction making the act so applicable. Pa. Stat. Ann. (Purdon, 1930; Supp. 1958) tit. 20, §3470.15. Connecticut has simply omitted this section entirely. Conn. Gen. Stat. (1958) §45-110 to §45-119.

[9] See, e.g., In re Wehrane's Estate, 41 N.J. Super. 158, 124 A. (2d) 334 (1956); Jones Estate, 377 Pa. 473, 105 A. (2d) 353 (1954); Estate of Heard, 107 Cal. App. (2d) 225, 236 P. (2d) 810 (1951); Matter of Hagen, 262 N.Y. 301, 186 N.E. 792 (1933).

[10] Crawford Estate, 362 Pa. 458, 67 A. (2d) 124 (1949); Pew Trust, 362 Pa. 468, 67 A. (2d) 129 (1949); Warden Trust, 382 Pa. 311, 115 A. (2d) 159 (1955); Steele Estate, 377 Pa. 250, 103 A. (2d) 409 (1954); Jones Estate, note 9 supra. The Crawford case was cited as authority in In re Fera's Estate, 26 N.J. 131, 139 A. (2d) 23 (1958), taking the position that the New Jersey Principal and Income Act was not retroactively applicable. However, the New Jersey statute does not by its terms apply to trusts created prior to its enactment. N.J. Stat. Ann. (1953) §3A:14A-9. The Pennsylvania decisions are criticized in Ives, "Allocating Stock Dividends," 91 TRUSTS AND ESTATES 851 (1952); comment, 29 TEMPLE L. Q. 224 (1956).

[11] See, generally, ROTTSCHAEFER, CONSTITUTIONAL LAW 548-549 (1939).

[12] "[T]he term 'vested rights' is not used in any narrow or technical sense, or as importing a power of legal control merely, but rather as implying a vested interest which it is right and equitable that the government should recognize and protect, and of which the individual could not be deprived arbitrarily without injustice." 2 COOLEY, CONSTITUTIONAL LIMITATIONS, 8th ed., 745 (1927).

[13] Early cases suggested that retroactive legislation could be voided without respect to any express constitutional prohibition, either on the ground it violated principles of "eternal justice," Benson v. Mayor, etc. of New York, 10 Barb. (N.Y.) 223 (1850), or because it exceeded some inherent limitation on legislative power, Dunbarton v. Franklin, 19 N.H. 257 (1848). On the influence of the natural law on the question of the validity of retroactive legislation, see Smead, "The Rule Against Retroactive Legislation: A Basic Principle of Jurisprudence," 20 MINN. L. REV. 775 (1936).

[14] "When it is said that the legislature ought not to deprive parties of their 'vested rights,' all that is meant is this: that the rights styled vested are *sacred* or *inviolable,* or are such as the parties ought not to be deprived of by the legislature. Like a thousand other propositions, which sound speciously to the ear, it is either purely identical and

cept has led most commentators to conclude that the vested rights analysis is little more than a method of rationalizing decisions already reached on some other ground.[15] Any examination of these decisions must therefore go beneath the conclusory vested rights label to a more fundamental due process analysis which balances the legislative objectives in making the statute retroactive against the need for protecting some existing interest arising under the old rule. The basic disagreement between the courts is on the question whether the income beneficiary has any interest, be it called vested or otherwise, which requires the court's protection. In holding that he does not, the Wisconsin court relies on the premise that unless he expressly states otherwise the settlor is presumed to intend that the allocation of stock dividends should be governed by the rules effective when they are received.[16] Since the settlor's intent governs the extent of the beneficiary's interest the retroactive application of the statute deprives him of nothing substantial.[17] This presumption was similarly used in a recent Kentucky decision holding that judicial adoption of the Massachusetts rule could be given retroactive effect notwithstanding the fact it reversed the prior contrary rule.[18] The presumption of intent seems reasonable, particularly where, as the court in the principal case points out,[19] the social desirability of the rule in effect at the creation of the trust is the subject of considerable divergence of opinion.[20] The Pennsylvania rule creates a rigidity which in all probability the settlor never desired. The Wisconsin court by using the presumption of intent obviates consideration of whether the beneficiary's interest is sufficiently important to require the invalidation of a statute supported by sound considerations of legislative policy. The Pennsylvania court, on the other hand, makes its finding that the beneficiary has a property interest determinative of the whole due process question. Its approach

tells us nothing, or begs the question in issue. . . ." 2 AUSTIN, JURISPRUDENCE, 5th ed., 856 (1885).

15 Smead, "The Rule Against Retroactive Legislation: A Basic Principle of Jurisprudence," 20 MINN. L. REV. 775 (1936); Smith, "Retroactive Laws and Vested Rights," 5 TEX. L. REV. 231 (1927), 6 TEX. L. REV. 409 (1928); comment, 44 YALE L. J. 358 (1934).

16 Principal case at 231-232. This is a variation of the generally accepted rule that unless a settlor expresses some other desire, he is presumed to intend that the legality of his trustee's investments should be determined by the law in effect when the investment is made. 3 SCOTT, TRUSTS, 2d ed., p. 1697 (1956).

17 On this same ground it is generally held that statutes establishing the investments a trustee may legally make with trust funds can be constitutionally applied to trusts created prior to their enactment. See, e.g., Goodridge v. National Bank of Commerce of Norfolk, (Va. 1959) 106 S.E. (2d) 598; Mechanicks National Bank of Concord v. Brady, 100 N.H. 469, 129 A. (2d) 857 (1957); Fidelity Union Trust Co. v. Price, 11 N.J. 90, 93 A. (2d) 321 (1952); 35 A.L.R. (2d) 991 (1954).

18 Farmers Bank & Capital Trust Co. v. Hulette, (Ky. 1956) 293 S.W. (2d) 458, holding that the Massachusetts rule, adopted in Bowles v. Stilley's Executor, note 3 supra, could be applied to a trust created prior to the Bowles decision, notwithstanding the fact the earlier Kentucky rule would have brought a different result.

19 Principal case at 231.

20 For a discussion of the relative merits of each rule, see 3 SCOTT, TRUSTS, 2d ed., pp. 1817-1821 (1956).

is therefore subject to the additional criticism that it does not conform to the traditional due process balancing of interests analysis, under which property rights may be impaired if legislative objectives in doing so are sufficiently strong and if the property invasion is not too great.[21] One writer has suggested the Pennsylvania approach in these decisions may be acceptable because in the adoption of dividend allocation rules no legislative purpose is advanced by applying the statute to existing interests.[22] But the desirability of freeing courts and multiple trustees from the necessity of dealing with two sets of complex rules presents such a purpose. That purpose should govern in the absence of a substantial reason for denying it.

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21 See SCURLOCK, RETROACTIVE LEGISLATION AFFECTING INTERESTS IN LAND, c. 2 (1953); Greenblatt, "Judicial Limitations on Retroactive Civil Legislation," 51 N.W. UNIV. L. REV. 540 (1956). It should be noted, however, as both Scurlock and Greenblatt point out, this one-sided approach is not uncommon, particularly where interests in land are concerned.

22 Greenblatt, "Judicial Limitations on Retroactive Civil Legislation," 51 N.W. UNIV. L. REV. 540 at 562 (1956).