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## TRUSTS-CORPORATE TRUSTEE'S DUTY OF LOYALTY-MERGER OF THE TRUSTEE CORPORATION WITH A CORPORATION IN WHICH THE TRUST HELD SHARES

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TRUSTS—CORPORATE TRUSTEE'S DUTY OF LOYALTY—MERGER OF THE TRUSTEE CORPORATION WITH A CORPORATION IN WHICH THE TRUST HELD SHARES—Securities delivered to the trustee under provisions of a will included stock in the

corporate trustee and in a bank. Subsequently, the bank and the trust company affiliated, under an agreement whereby the bank acquired substantially all the stock of the trust company, to be held for the benefit of the shareholders of the bank. The holders of the trust stock and the old bank stock exchanged their shares for new stock in the bank. The trust authorized the trustee to retain stocks in the trust estate, to invest in securities other than of the character prescribed by law for trust investments, and to participate in the reorganization of corporations in which the testator held stock. Trustees brought a bill in equity for instructions relative to the will. *Held*, the corporate trustee was precluded by the "undivided loyalty" rule from acquiring stock created by the affiliation in exchange for stock held by the testator in the trust company and in the bank. *City Bank Farmers Trust Co. v. Taylor*, (R.I. 1949) 69 A. (2d) 234.

One of the primary duties of a trustee in the administration of a trust is the duty of loyalty.<sup>1</sup> This duty is imposed upon the trustee because of the fiduciary relationship arising from the creation of a trust.<sup>2</sup> The trustee must administer the trust solely for the advantage of the beneficiaries, and he is not allowed to place himself in such a position that his own interests would conflict with those of the beneficiaries. A corporate trustee is subject to this same duty of loyalty,<sup>3</sup> and the court here is concerned with the extent to which the loyalty rule should be applied. Conflicts of interest may range from those which are direct and substantial to the borderline cases where any conflict of interest is remote and unsubstantial. However, if the strict rule, as laid down by Cardozo in *Meinhard v. Salmon*,<sup>4</sup> is adhered to, any possible conflict of interest, no matter how remote, will amount to a breach of duty on the part of the trustee. The courts appear to be applying the "undivided loyalty" rule strictly. Because of this duty, it is held that a corporate trustee can neither purchase its own shares nor retain them in the trust estate.<sup>5</sup> The courts point out a conflict of interests in that it may be to the advantage of the beneficiaries to sell stock when the market is falling, while it will be to the advantage of the corporate trustee to retain its own shares to prevent the further depression of the market.<sup>6</sup> However, it has been suggested that any possible conflict of interest here is very remote; the corporation itself is not usually concerned with the market price or ownership of its shares.<sup>7</sup> The logical extension of this rule, against retention of its own shares by a corporate trustee, appeared in the New York case of *City Bank Farmers Trust Co. v. Cannon*,<sup>8</sup> which involved the same affiliation as in this case. The New York court said that the acquisition of a beneficial interest in its own stock by a corporate trustee would result in a conflict

<sup>1</sup> BOGERT, TRUSTS, 2d ed., §99 (1942); 2 SCOTT, TRUSTS §170 (1939).

<sup>2</sup> *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928), is the leading case discussing the loyalty duty of fiduciaries.

<sup>3</sup> 2 SCOTT, TRUSTS §§170.11, 170.13, 170.15 (1939); 39 COL. L. REV. 528 (1939).  
<sup>4</sup> 249 N.Y. 458, 164 N.E. 545 (1928).

<sup>5</sup> *Matter of Durston's Will*, 297 N.Y. 64, 74 N.E. (2d) 310 (1947); *In re Trusteeship of Stone*, 138 Ohio St. 293, 34 N.E. (2d) 755 (1941).

<sup>6</sup> *People by Kerner v. Canton National Bank*, 288 Ill. App. 418, 6 N.E. (2d) 220 (1937).

<sup>7</sup> Niles and Schwartz, "Breach of Trust—Recent Developments," 20 N.Y. UNIV. L.Q. 165 (1944).

<sup>8</sup> 291 N.Y. 125, 51 N.E. (2d) 674 (1943).

of interests. And, in strong dictum, it indicated that the duty of loyalty would be breached if the corporate trustee acquired new shares of the bank in exchange for old, after the affiliation in which the bank acquired almost all the stock of the trust company. However, it was held that the trustee was not liable on the ground that the beneficiaries were barred by the consent of the settlor, who had a power to revoke the trust, to the acts of the trustee. Although at least one authority seems to favor this decision and its implications,<sup>9</sup> there is a strong argument, in opposition, that the New York court was pressing the principle of "undivided loyalty" too far and imposing unnecessary hardship on the trustee.<sup>10</sup> The *Taylor* case is merely an application of the dictum of the *Cannon* case, an acceptance of the strict loyalty rule laid down there. However, there are added factors which distinguish this case from the *Cannon* case. Here the trustee received some of its own shares as part of the trust estate,<sup>11</sup> and the testator may have given the trustee power to retain its own stock; the court did not decide this question, assuming that the facts here were identical with those in the *Cannon* case. It is generally agreed that a settlor may waive the benefit of the loyalty rule and allow a corporate trustee to purchase or retain its own shares.<sup>12</sup> Just when this has been done is a matter of interpretation of the trust instrument.<sup>13</sup> And, several courts have held that where a corporate trustee is authorized to retain its own stock, it may also hold new stock issued in reorganization.<sup>14</sup> Therefore, in this case, if the testator had authorized the retention of the shares of the corporate trustee in the trust estate, the trustee should have been permitted to hold the new stock acquired in exchange for its own shares, even if the authorization could not be construed to permit the trustee to retain those new shares acquired in exchange for the bank stock held by the testator.

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<sup>9</sup> Scott, "Retention of Its Own Shares by a Corporate Trustee," 57 HARV. L. REV. 601 (1944).

<sup>10</sup> Nils and Schwartz, "Breach of Trust—Recent Developments," 20 N.Y. UNIV. L.Q. REV. 165 (1944).

<sup>11</sup> Statutes may permit the trustee to continue investments made by the testator. Cal. Gen. Laws (Deering, Supp. 1944) Act 652, §105; 13 N.Y. Consol. Laws (McKinney, 1949) §111(6); 41 N.Y. Consol. Laws (McKinney, 1949) §21(6). Held not applicable in case of corporate trustee holding its own stock, *People v. Canton National Bank*, 288 Ill. App. 418, 6 N.E. (2d) 220 (1937). *Contra*: *In re Riker*, 124 N.J. Eq. 228, 1 A. (2d) 213 (1938).

<sup>12</sup> *Matter of Balfe*, 245 App. Div. 22, 280 N.Y.S. 128 (1935); *In re Easton's Estate*, 178 Misc. 611, 35 N.Y.S. (2d) 546 (1942); *Matter of Roche*, 233 App. Div. 236, 251 N.Y.S. 347 (1931).

<sup>13</sup> "Clauses enlarging the trustee's investment powers are strictly construed." 3 BOGERT, TRUSTS AND TRUSTEES §683 at 377 (1935).

<sup>14</sup> *In re Riker*, supra, note 11; *Robison v. Elston Bank & Trust Co.*, 113 Ind. App. 633, 48 N.E. (2d) 181, 49 N.E. (2d) 348 (1943); *In re Dimond*, 37 Ohio Abs. 248, 46 N.E. (2d) 788 (1942); *In re Greenawalt's Estate*, 343 Pa. 413, 21 A. (2d) 890 (1941).