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# Beneficiary's Code Remedy Against Converting Trustee and Bankruptcy Policy

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# RECENT DEVELOPMENTS

## BENEFICIARY'S CODE REMEDY AGAINST CONVERTING TRUSTEE AND BANKRUPTCY POLICY

The recently enacted Indiana Trust Code<sup>1</sup> is primarily a reorganization and restatement of Indiana's trust law. Pre-Code law was, in certain areas, either modernized or supplemented.<sup>2</sup> Sections 22(b) and (c) of chapter 3 of the Code<sup>3</sup> deal with a beneficiary's remedies against a trustee who has converted trust property.<sup>4</sup> These sections may adversely affect defrauded beneficiaries since, under certain circumstances, these claimants may recover less than under pre-Code law.

### PRE-CODE LAW

Pre-Code determination of a beneficiary's remedies against a breaching trustee required judicial consideration of two questions: (1) Under what circumstances might a beneficiary's claim against his trustee's assets take precedence over those of other claimants? (2) When these circumstances are met, how is the beneficiary to be indemnified?

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1. Pub. L. No. 416, [1971] Ind. Acts 1910; IND. ANN. STAT. § 31-1301 *et seq.* (Supp. 1971) [hereinafter referred to as Code].

2. REPORT OF INDIANA TRUST CODE STUDY COMMISSION iii (1970) [hereinafter cited as REPORT]. See Ard, *A Proposed Trust Code for Indiana—An Effort at Reform*, 45 NOTRE DAME LAW. 427, 428 (1970). The Trust Code Study Commission's comments form the legislative history. Pub. L. No. 416, ch. 1, § 7, [1971] Ind. Acts 1913; IND. ANN. STAT. § 31-1307 (Supp. 1971).

3. (b) If the trustee acquires property and wrongfully holds it outside the trust, a beneficiary is entitled at his option to either:

(1) require the property to be transferred to the trust or

(2) impose an equitable lien upon it to secure his claim for damages for breach of trust.

(c) If the trustee commingles the trust funds or property with his own funds or property or converts the trust fund or property into another form which is wrongfully held outside the trust:

(1) if the fund or property can be traced and identified, the beneficiary is entitled to restoration of the fund or property to the trust; or

(2) if the fund or property cannot be traced and identified,

(A) In a case of commingling of funds or property, the beneficiary is entitled to a lien against the trustee's individual property from the date and in the amount of the fund or the value of the property at the time of the commingling.

(B) In a case of conversion of property, the beneficiary is entitled to a lien against the trustee's individual property from the date and according to the value of the property at the time of the conversion.

Pub. L. No. 416, ch. 3, §§ 22(b), (c), [1971] Ind. Acts 1931; IND. ANN. STAT. §§ 31-1522(b), (c) (Supp. 1971). Unless otherwise indicated, all sections mentioned in footnotes or text will be from ch. 3 of the Code.

4. While subsection (b) does not mention conversion, and subsection (c) speaks of conversion and commingling as independent wrongs, it is correct terminology to define any wrongful taking of property as "conversion." See BLACK'S LAW DICTIONARY 402 (4th ed. 1968).

A beneficiary's priority may be established in three ways.<sup>5</sup> First, priority may be based on the initial augmentation of the trustee's personal assets. Under this theory the beneficiary must show that the trustee has wrongfully withdrawn assets from the trust estate.<sup>6</sup> Once the initial augmentation is shown, the beneficiary is able to obtain a general priority over the trustee's assets ahead of all other claimants.<sup>7</sup> A second possible avenue of recovery requires a showing that the trustee's estate has been ultimately augmented by the value of the converted assets. This method, known as the swollen assets theory,<sup>8</sup> permits recovery if the beneficiary can demonstrate that the trust res<sup>9</sup> has either remained in the trustee's possession or has been used to pay a debt which the trustee would otherwise have paid with his own assets.<sup>10</sup> Finally, a beneficiary's recovery may be based on tracing. This test requires the beneficiary "to trace his property into a product in the hands of the wrongdoer at the time when he seeks to enforce his claim."<sup>11</sup>

The tests require varying degrees of proof. Under the initial augmentation test the beneficiary will obtain priority whenever he can prove that his trustee misappropriated trust assets. The swollen assets theory is more stringent since it requires proof that the trustee used trust assets in a certain, limited manner. The greatest burden is placed on the beneficiary who must trace and prove that his misappropriated asset remains in the trustee's possession.

While an early Indiana case appeared to favor the swollen assets

5. A. SCOTT, *THE LAW OF TRUSTS* § 521 (3d ed. 1967) [hereinafter cited as SCOTT]. Prof. Scott actually lists four methods. The initial augmentation of the trustee's estate is regarded as a separate basis for recovery, distinguished from a trustee's immediate dissipation of the trust funds. The three methods explained in text are similar to those listed in 8 *IND. L.J.* 571, 572-73 (1933).

6. SCOTT, *supra* note 5, § 521, at 3647-48.

7. All three situations provide the beneficiary with priority should he meet the requisite standards of proof. This would give him priority over any lien or judgment creditor who also has an interest in the assets. While this priority must be kept in mind throughout this discussion, the question of the "secret lien" aspects involved when this priority is granted is not covered in this note.

8. For an extensive treatment in support of this theory see Taft, *A Defense of a Limited Use of The Swollen Assets Theory Where Money has Wrongfully Been Mingle with Other Money*, 39 *COLUM. L. REV.* 172 (1939). See also G. BOGERT, *TRUSTS AND TRUSTEE* § 922 (2d ed. 1962) [hereinafter cited as BOGERT].

9. This term refers to either the trust property itself or any subsequent product of that property.

10. Thus, under this view, if the wrongdoer obtained money by fraud and used it in paying his debts, the victim would be entitled to priority if the wrongdoer, had he not obtained the victim's money, would have used his own money in paying his debts.

SCOTT, *supra* note 5, § 521, at 3648-49.

11. *Id.*, at 3649.

theory,<sup>12</sup> subsequent decisions<sup>13</sup> have adopted the tracing test. *Windstanley v. Second National Bank*<sup>14</sup> provides the reasoning behind this choice:

The trust property rightfully belongs to the *cestuis que trust* [*sic*] and a change in its form does not change its ownership. So long as either the original or substituted property can be traced or followed, equity will always attribute the ownership to the beneficiary and will not allow the right to be defeated by the wrongful act of the fiduciary, no matter what form it may assume.<sup>15</sup>

Conditioning a beneficiary's recovery over other creditors on his ability to trace assets vitiates any need to argue equities. Since a person was logically entitled to his own property, proving that certain assets in the trustee's possession were actually trust property provided adequate justification for the beneficiary's priority.<sup>16</sup>

Prior to the enactment of the Code three remedies were available to a beneficiary with a valid claim: the tracing remedy,<sup>17</sup> the lien remedy and the general damage action. Under the first, a beneficiary able to show that the trust res was among the trustee's assets could recover the property itself.<sup>18</sup> Under the lien remedy a beneficiary satisfying the same condition could obtain a secured damage claim so that the trustee was held liable for the value of the misappropriated property.<sup>19</sup> When a

12. *State v. Farmers & Merchants Nat'l Bank*, 71 Ind. App. 216, 124 N.E. 501 (1919).

13. See *Ross v. Thompson*, 128 Ind. App. 89, 146 N.E.2d 259 (1957), and cases cited therein. *McCabe v. Grantham*, 108 Ind. App. 695, 31 N.E.2d 658 (1941), granted recovery under a tracing rationale. *Union Sec., Inc. v. Merchants' Trust & Sav. Co.*, 205 Ind. 127, 186 N.E. 261 (1933), denied recovery for failure to trace.

14. 13 Ind. App. 544, 41 N.E. 956 (1895).

15. *Id.* at 547, 41 N.E. at 957.

16. This property orientation becomes exceedingly important during the discussion of the beneficiary's rights when the trustee is insolvent. See text accompanying notes 40-42 *infra*.

17. This term may be somewhat confusing to the reader since "tracing" has already been discussed as a basis for priority. The difference between the two uses is this—when a beneficiary traces his asset, he is simply showing that his asset is present among those of the trustee; the "tracing remedy" is the term employed to denote the beneficiary's remedy for obtaining the specific asset traced. See BOGERT, *supra* note 8, § 565, at 47. Cf. J. DAWSON & G. PALMER, *CASES ON RESTITUTION* 174 (2d ed. 1969).

18. See, e.g., *Ross v. Thompson*, 128 Ind. App. 89, 146 N.E.2d 259 (1957). Part of the plaintiff's claim was for bank stock which was allegedly trust property. It is not clear, however, that the stock was obtained while the trustee was acting in a fiduciary capacity.

19. *Union Sec., Inc. v. Merchants' Trust & Sav. Co.*, 205 Ind. 127, 139, 186 N.E. 261 (1933). Authorities appear to agree on permitting the beneficiary to choose between the tracing remedy and the lien remedy. See BOGERT, *supra* note 8, § 865; III

beneficiary was unable to identify his assets he was relegated to maintaining an unsecured damage action.<sup>20</sup> These remedies were mutually exclusive. The theoretical difference between the tracing remedy and the other two damage remedies prevented the beneficiary from relying on both damages and recovery of the trust res. As Professor Bogert has noted:

[i]f the beneficiary chooses to rely on money liability plus this equitable lien on the trust property or its proceeds, he has obviously made an election inconsistent with tracing the trust property and claiming it as his equitable property. Under this lien theory the property is that of the defendant. . . . Under the tracing plan the plaintiff claims that legal title . . . is held by the defendant but that it is equitably owned by the plaintiff.<sup>21</sup>

The susceptibility of the res to fluctuation in value requires that a beneficiary be given the right to choose between the two secured remedies.<sup>22</sup> Limiting him to the tracing method would deprive him of the difference between the assets' original value and the value of the recovered res whenever the trust res has depreciated. On the other hand, denying him use of the tracing method could result in unnecessary and expensive litigation if the property is worth at least as much as it was at the time of the breach.

#### § 22(c)(1): A POSSIBLE LIMITATION ON BENEFICIARY'S RECOVERY

While the Code retains the pre-Code tracing requirements, the remedies afforded beneficiaries in § 22 differ from those previously available. The Code differentiates between the beneficiary whose trust

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SCOTT, *supra* note 5, § 202; RESTATEMENT (SECOND) OF TRUSTS § 202 (1959) [hereinafter cited as RESTATEMENT].

20. BOGERT, *supra* note 8, § 868, at 58.

It is fundamental that damages may be assessed in favor of a beneficiary against a defaulting trustee either to compensate the beneficiary for such loss as he may have sustained as a result of the breach of trust, or to prevent the faithless trustee from unjustly enriching himself as a result of his breach of fiduciary duty.

Standard Mach. Co. v. Duncan Shaw Corp., 208 F.2d 61, 65 (1st Cir. 1953). The beneficiary naturally prefers to obtain a secured claim whenever possible. Thus, while the beneficiary may always maintain a damage claim when property has depreciated, the beneficiary will opt for the lien remedy if the asset can be traced.

21. BOGERT, *supra* note 8, § 865, at 46-7 (footnotes omitted). Naturally, this analysis is equally applicable when there is a desire to obtain unsecured damages and recovery of the traced asset.

22. *Id.*, § 865, at 47; RESTATEMENT, *supra* note 23, § 202, comment on subsection (1) (a) at 444; SCOTT, *supra* note 5, § 516.

asset has been wrongfully retained by the trustee<sup>23</sup> and the beneficiary whose trust asset was either commingled or converted.<sup>24</sup> Section 22(b) is applicable when "the trustee acquires [trust] property and wrongfully holds it outside the trust."<sup>25</sup> The beneficiary may then either "require the property to be transferred to the trust" or "impose an equitable lien upon it to secure his claim for damages for breach of trust."<sup>26</sup> But when a trustee commingles or converts trust assets, §22(c) (1) limits the beneficiary to recovery of the trust res. There is no mention of an alternative remedy. Section 22(c)(1), therefore, may force the beneficiary to bear the risk of depreciation since recovery of the trust property would preclude any further damage recovery.<sup>27</sup> Indeed, he will usually bear this risk since a defaulting trustee most often commingles or converts trust funds.<sup>28</sup> Thus, the Code effectively denies most beneficiaries who choose to recover the trust res use of the lien remedy.

The only justification for distinguishing § 22(b) from § 22(c)(1) beneficiaries is that under § 22(c)(1) the trustee has changed the trust property's identity, whereas under § 22(b) the trust property has been retained. This seems to be inadequate justification for such differentiation.<sup>29</sup>

It must be noted that a beneficiary who is denied the lien remedy

23. Pub. L. No. 416, ch. 3, § 22(b), [1971] Ind. Acts 1931; IND. ANN. STAT. § 31-1522(b) (Supp. 1971).

24. Pub. L. No. 416, ch. 3, § 22(c)(1), [1971] Ind. Acts 1931; IND. ANN. STAT. § 31-1522(c)(1) (Supp. 1971). Indeed, commingling assets presents a particular problem for the trustee's beneficiary. The beneficiary, called on to prove that his asset is among the trustee's assets to which he has traced its product, uses various fictions which "prove" that it still exists in the commingled fund. See, e.g., *Terre Haute Trust Co. v. Scott*, 94 Ind. App. 461, 181 N.E. 369 (1932) (trust money commingled with the trustee's own cash assets). For a full discussion of these fictions see Scott, *The Right to Follow Money Wrongfully Mingled with Other Money*, 27 HARV. L. REV. 125 (1913).

25. Pub. L. No. 416, ch. 3, § 22(b), [1971] Ind. Acts 1931; IND. ANN. STAT. § 31-1522(b) (Supp. 1971). It is unclear what is meant by "acquires property." Ostensibly acquisition could occur in two different ways. First, it could occur when the trust property is simply converted to the trustee's use. It may also occur when the trustee exercises his trust duties by purchasing new assets and then wrongfully retains them as his own.

26. These options, it should be noted, are the same ones provided under pre-Code law.

27. See text accompanying note 21 *supra*.

28. The only Indiana case which seems to fall under § 22(b) is *Ross v. Thompson*, 128 Ind. App. 89, 146 N.E.2d 259 (1957), where only part of the claimed trust assets were in the original trust estate.

29. There is no legislative history of the Code except for the Commission comments. Section 22(c) represents a change from pre-Code law. Unfortunately, the Commission failed to explain why these changes were made. See REPORT, *supra* note 2, ch. 3, § 22, comment (c).

under § 22(c)(1) may avoid a depreciation loss by obtaining an unsecured damage claim for the value of the trust assets at the time of their conversion. The Code has retained various sections under which the use of an unsecured damage claim may be a viable remedy. Section 11(b) provides that the trustee is liable for: (1) any depreciation caused by his breach of trust; (2) any profit made on the breach; and, (3) any reasonable profit which would have occurred in the absence of a breach.<sup>30</sup> In addition, § 3 preserves Indiana's prudent man rule,<sup>31</sup> while §§ 6(b)(4) and (5) direct the trustee to preserve the trust and make it productive.<sup>32</sup> An unsecured damage claim will, however, result in full recovery only when the trustee is solvent. Unfortunately, Indiana cases indicate that defaulting trustees are usually insolvent.<sup>33</sup> In these cases bankruptcy proceedings are inevitably involved. As a result, scores of claimants clamor for those assets which remain in the trustee's possession.

To provide an equitable order of compensation for these claims, the Bankruptcy Act<sup>34</sup> permits certain claimants priority status.<sup>35</sup> A beneficiary's unsecured damage claim will be satisfied after these priority claims on a pro rata basis with other general claims.<sup>36</sup> The dividend, however, is usually quite small. Indeed, it is not unusual for general claimants to obtain no compensation whatsoever. This unattractive probability is ameliorated, to some extent, by the fact that claims arising from

30. Pub. L. No. 416, ch. 3, § 11(b), [1971] Ind. Acts 1926; IND. ANN. STAT. § 31-1511(b) (Supp 1971).

31. In acquiring, investing, reinvesting, exchanging, retaining, selling and managing property for any trust heretofore or hereafter created, the trustee thereof shall exercise the judgment and care under the circumstances then prevailing which men of prudence . . . exercise in the management of their own affairs, not in regard to speculation. . . .

Pub. L. No. 416, ch. 3, § 3(c), [1971] Ind. Acts 1921; IND. ANN. STAT. § 31-1503(c) (Supp. 1971).

For a pre-Code use of the rule, see *Gavin v. Miller*, 222 Ind. 459, 54 N.E.2d 277 (1944). For a thorough discussion of the origins of this rule and its uses see Shattuck, *The Massachusetts Prudent Man in Trust Investments*, 25 B.U.L. REV. 307 (1945).

32. Pub. L. No. 416, ch. 3, §§ 6(b)(4), (5), [1971] Ind. Acts 1923; IND. ANN. STAT. §§ 31-1506(b)(4), (5) (Supp 1971).

33. See, e.g., *Union Trust Co. v. Ralston*, 101 Ind. App. 548, 191 N.E. 94 (1934); *Union Sec., Inc. v. Merchants' Trust & Sav. Co.*, 205 Ind. 127, 186 N.E. 261 (1933); *Rottger v. First Merchants' Nat'l Bank*, 98 Ind. App. 139, 184 N.E. 267 (1933); *Pearce v. Dill*, 149 Ind. 136, 48 N.E. 788 (1897). See also cases cited in I L. WALLACE, *INDIANA ANNOTATIONS TO THE RESTATEMENT OF THE LAW OF TRUSTS* 114-15 (1953).

34. 11 U.S.C. §1 *et seq.* (1970).

35. Bankruptcy Act, § 64; 11 U.S.C. § 104 (1970).

36. A "general claim" is one which does not qualify as either a "claim entitled to priority," a "preferred claim" or a "lien claim." It is, thus, a claim which is entitled to no special treatment. Should the beneficiary find himself in this position he takes only a pro rata share of whatever assets remain after priority, preferred and lien claimants take their full claims, to the extent that those claims are secured. C. NADLER, *THE LAW OF BANKRUPTCY* §§ 182-85 (2d ed. M. Nadler & S. Nadler 1969).

fiduciary breaches survive bankruptcy.<sup>37</sup> In most cases, however, the beneficiary is not provided a useful remedy. The possibility of future recovery seldom outweighs the loss of time and money involved in further proceedings. Furthermore, the beneficiary may not be inclined to forego recovery of the property's present value under § 22(c)(1). Thus, the beneficiary is likely to choose § 22(c)(1)'s tracing method over the less attractive damage remedy.

A literal application of § 22(c)(1) will, therefore, result in denying the beneficiary complete restitution. While it may be argued that this was the desired result, the wording of § 11(b) indicates otherwise.<sup>38</sup> It must be assumed, therefore, that the legislature intended full restitution for all beneficiaries and that the omission of the lien remedy from § 22(c)(1) was an oversight.

#### THE EFFECT OF BANKRUPTCY ON A BENEFICIARY'S LIEN UNDER § 22(c)(2)

While § 22(c)(1) withdraws one of the pre-Code remedies, § 22(c)(2) appears to afford beneficiaries some additional security. Under this section a beneficiary's inability to trace trust assets no longer precludes him from obtaining a secured claim. However, a more thorough analysis of § 22(c)(2) indicates that this secured status is illusory.

Indiana's pre-Code trust law followed the most widely accepted view of a beneficiary's right to priority status.

The claim of the beneficiary against the trustee for breach of trust does not of itself entitle him to priority over the general creditors of the trustee. . . . The beneficiary is entitled to priority only if and to the extent that he can trace the trust property into a product. He must prove not only that the trustee once had the trust product, but that he still holds the trust property, or property which is in whole or in part the product of the trust property.<sup>39</sup>

There are two interrelated justifications for this view. The first, based upon a concept of unjust enrichment, is most succinctly stated in Professor

37. Bankruptcy Act, § 17; 11 U.S.C. § 35 (1970). See Scott, *supra* note 5, § 221.

38. See text accompanying note 30 *supra*.

39. RESTATEMENT, *supra* note 19, § 202, comment on subsection (2) at 454. See also BOGERT, *supra* note 8, at 862; SCOTT, *supra* note 5, §§ 202, 521; 4A W. COLLIER, COLLIER ON BANKRUPTCY ¶ 70.25 [2] (14th ed. J. Moore & L. King 1969) [hereinafter cited as COLLIER]; 8 IND. L.J. 571, 572 (1933). The leading pre-Code case following this principle is *Terre Haute Trust Co. v. Scott*, 94 Ind. App. 461, 181 N.E. 369 (1932), in which the plaintiff was permitted to recover the value of the converted assets from the trust company's funds only when he was able to trace the trust assets to those funds.



Scott's treatise.<sup>40</sup> Scott contends that no beneficiary should be denied priority status if he is able to trace. He reasons, however, that if the trust assets cannot be traced, the beneficiary would be unable to distinguish his claim from those of general creditors. Thus, the beneficiary is entitled to priority compensation only when these creditors would otherwise benefit unreasonably from the trustee's misappropriation. Whenever there is no proof that the other general creditors would be unjustly enriched, relegating the beneficiary to general creditor status is justified.

The second justification for affording priority status only to beneficiaries able to trace their trust assets is based upon concepts of property rights and title.<sup>41</sup> These concepts inextricably underlie Professor Scott's reasoning. Providing a beneficiary priority over general creditors effectively establishes the superiority of his rights in those assets traced. When the beneficiary is unable to trace those assets, however, he has no superior property rights and thus should not have priority over general creditors.

A bankruptcy trustee takes title to all property in which the bankrupt has title . . . , but when it appears that a bankrupt is only a trustee . . . the court should turn it over to its true owner where possible . . . [citations omitted].

No creditor of a bankrupt can demand that the estate of the bankrupt be augmented by the wrongful conversion of the property of another, or the application to the general estate of property which never rightfully belonged to the vendor.<sup>42</sup>

Notwithstanding this historical and theoretical context, the Indiana General Assembly chose to grant priority status to any beneficiary falling under § 22, whether or not he could trace his misappropriated assets. Section 22(c)(2) establishes the presumption that beneficiaries have superior property rights in the trustee's assets. However, the Bankruptcy Act's main purpose is to prevent inequities in the distribution of estates in bankruptcy.<sup>43</sup> Since this state-created priority gives rise to such an inequity, this attempt at priority distribution will be invalidated by the provisions of the Bankruptcy Act.

The Bankruptcy Act invalidates preferences,<sup>44</sup> and certain statutory<sup>45</sup>

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40. Scott, *supra* note 5, § 521, at 3649.

41. See text accompanying notes 13-16 *supra*.

42. *In re Tate-Jones & Co.*, 85 F. Supp. 971, 981-82 (W.D. Pa. 1949).

43. *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945); *In re Dearborn Mfg. Corp.*, 92 F.2d 417, 418 (6th Cir. 1937). See also 4 COLLIER, *supra* note 39, ¶ 67.12 [5].

44. Bankruptcy Act, § 60; 11 U.S.C. § 96 (1970).

and judicial liens.<sup>46</sup> Since the lien on traced assets provided under § 22(b) falls in none of these categories, it will not be invalidated by the Bankruptcy Act.<sup>47</sup> However, in providing the beneficiary with a priority when he is unable to trace his trust assets, § 22(c)(2) creates a statutory lien.<sup>48</sup> Section 67c(1)(B) of the Bankruptcy Act invalidates:

every statutory lien which is not perfected or enforceable at the date of bankruptcy against one acquiring the rights of a bona fide purchaser from the debtor on that date. . . .<sup>49</sup>

Chapter 4, § 2 of the Code makes the beneficiary's claim invalid against bona fide purchasers.<sup>50</sup> Thus, a beneficiary's lien will be unenforceable against a bona fide purchaser unless it was obtained prior to the date of bankruptcy. Since the beneficiary's action for breach of trust will most often take place after bankruptcy, the lien will usually fail against a trustee in bankruptcy.

Federal court decisions provide further support for this conclusion. In *John Deere Plow Co. v. McDavid*,<sup>51</sup> the Eighth Circuit Court of Appeals held that a beneficiary was entitled only to those trust assets which he was able to trace. Since *John Deere Co.*<sup>52</sup> was decided long before congressional enactment of § 67c, no federal statutory provision was available to prevent a beneficiary's priority recovery under a state statute. Nonetheless, the court held that bankruptcy policies would not

45. Bankruptcy Act, §§ 60, 64, 67; 11 U.S.C. §§ 96, 104, 107 (1970).

46. Bankruptcy Act, § 67; 11 U.S.C. § 107 (1970).

47. 3A COLLIER, *supra* note 39, ¶ 64.02, at 2065.

48. It may be difficult to distinguish the statutory lien created by § 22(c)(2) from the equitable lien created by § 22(b). The difficulty probably lies in a misapprehension about codification. A statutory lien is a very limited lien whose sole purpose is as a bankruptcy priority. Property which is traced (as long as tracing fictions are accepted) does not fall under the Bankruptcy Act at all, for tracing permits the beneficiary to identify property which should not be in the bankrupt trustee's possession. However, when tracing is impossible, the beneficiary cannot maintain that he falls outside the Act since he is in the same position as other general creditors. A statute which removes a party from his proper class in bankruptcy and places him in a better position creates a statutory lien.

49. 11 U.S.C. § 107c(1)(B) (1970). See Stageman, *Section 67c Primer*, 73 COM. L.J. 237, 240 (1968); Comment, *Statutory Liens Under Section 67c of the Bankruptcy Act: Some Problems of Definition*, 43 TUL. L. REV. 305 (1969).

50. Pub. L. No. 416, ch. 4, § 2(b), [1971] IND. ACTS 1935; IND. ANN. STAT. § 31-1602(b) (Supp. 1971).

51. 137 F. 802 (8th Cir. 1905).

52. The statute was not enacted in its present form until 1966. Act of July 5, 1966, Pub. L. No. 89-495, §§ .3, 4, 80 Stat. 268, *amending* 11 U.S.C. § 67 (1964) (codified at 11 U.S.C. § 67c (1970)). For an excellent presentation of the reasons behind congressional enactment of this statute, see 1966 U.S. CODE CONG. & ADMIN. NEWS 2456-68.

permit this beneficiary priority if he were unable to trace.<sup>53</sup> Similarly, the federal court in *Elliott v. Bumb*<sup>54</sup> found that both bankruptcy policies and § 67c(2), the predecessor of § 67c(1)(B), would not permit such a claim since a state statute could not impress a trust on all assets of the bankrupt's estate to the extent due the beneficiary.<sup>55</sup>

Section 22(c)(2) of the Trust Code, by impressing a lien on all the trustee's individual property, serves exactly the same function as the statute in *Elliott*.<sup>56</sup> This attempt to place the beneficiary in a better position than other general creditors constitutes an illusory priority. Thus, both bankruptcy principles and § 67c(1)(B) of the Bankruptcy Act will deny priority to the beneficiary should he make his claim under § 22(c)(2) of the Code.

### CONCLUSION

It appears that § 22 was improperly drafted. The Code is inconsistent in determining the availability of remedies to beneficiaries whose converted or commingled assets can be traced since § 22(c)(1), in dealing with the remedies available to such beneficiaries, omits the lien remedy. However, this remedy might be available through use of other Code sections.

Should the beneficiary's recovery of the trust res under § 22(c)(1) be insufficient, the beneficiary might maintain a separate cause of action for the breach of the trustee's duty to preserve the trust. Such a breach constitutes a violation of § 6(b).<sup>57</sup> Thus, courts could find two separate causes of action and permit a two-pronged recovery. Of course, the unsecured portion of the claim must still be satisfied out of the trustee's general assets. Still, the unsecured claim will have survived and the beneficiary will have the same secured claim as a claimant basing recovery on § 22(b).<sup>58</sup>

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53. 137 F. at 812. See also *U.S. v. Randall*, 401 U.S. 513 (1971); *In re Tate-Jones & Co.*, 85 F. Supp. 971 (W.D. Pa. 1949).

54. 356 F.2d 749 (9th Cir. 1966).

55. *Id.* at 755.

56. Note the similarity between the Code's "lien against the trustee's individual property" (*supra* note 3) and the emphasized words in the following excerpt from a recognized authority on bankruptcy:

If the trust fund or property cannot be identified in its original or substituted form, the *cestui* becomes merely a general creditor of the estate, for the prevailing rule in trusts is that "a beneficiary who cannot find the trust property has *no lien or charge spread over the entire estate of the faithless trustee.*"

4A COLLIER, *supra* note 39, ¶ 70.25 [2], at 356 (emphasis added; footnotes omitted).

57. Pub. L. No. 416, ch. 3, § 6(b), [1971] Ind. Acts 1923; IND. ANN. STAT. § 31-1506(b) (Supp 1971).

58. Since the lien remedy secures the beneficiary's claim only up to the value of the secured property, the unsecured portion is not entitled to priority.

Without the use of this two-pronged recovery the Indiana Trust Code places the beneficiary in a less attractive position than did pre-Code law. Perhaps codification of a beneficiary's remedial rights should not fall within the province of the legislature. Indeed, there is only one other state code which provides a comprehensive remedial section.<sup>59</sup> Besides, courts are much better equipped to determine the proper choice of remedies. Often, codification precludes courts from fully recompensing a claimant. Codification also ossifies the law and eliminates the possibility of innovative change. Indiana should, therefore, either amend the present remedies section or, preferably, delete it from the Code.

R. CLIFFORD POTTER

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59. Georgia Trust Code, 108 GA. CODE ANN. §§ 423-31 (1959).

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