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Trusts-Investment of Trust Funds by Trustee

TRUSTS—INVESTMENT OF TRUST FUNDS BY TRUSTEE.—Individual trustee was directed in the instrument creating the trust to invest $10,000 so as to produce as much income as was safe and reasonable. The trustee invested the funds in stocks of a private corporation, without getting the sanction of the court, and without any statutory permission or provision in the trust instrument permitting him to do so. At the end of the trust period, the value of the stocks had depreciated. The lower court found that the trustee was bound to pay over to the beneficiaries the full value of the original trust fund, plus simple interest. Held, decisions of lower court affirmed.[1]

What constitutes proper investments for trust funds early received the consideration of the English courts in the case of *Ex parte Cathorpe*,[2] where it was decided that public securities alone were proper trust investments. This stringent rule has been relaxed, however, by a series of statutory enactments, so that at the present time funds may be invested in Bank of England stocks, stocks of canal, railway, and public service corporations, and in first mortgages on land.[3] This is significant in that it tends to show that the English trend is to liberalize the rule in regard to depositories of trust funds.

In the United States the general rule is broadly declared to be that the trustee, in making trust investments, is bound to exercise the care of a reasonably prudent man in making his own investment, "having primarily in view the preservation of the estate and the amount and regularity of the income to be derived."[4] In addition to this general rule, the trustee is further bound by statutes in almost all of the states prescribing the type of security in which trust investments are proper.[5] Some securities, such as municipal, state, or Federal bonds,[6] and promises to pay secured by a first

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1 Sellers v. Milford et al. (1935), 198 N. E. 456.

2 1 Cox Eq. Cas. 182 (1785).

3 Trustee Act, (1850) 13 and 14 Vict., ch. 60; Trustee Act (1852), 15 and 16 Vict., ch. 55, Lord St. Leonard's Act (1859), 22 and 23 Vict., ch. 35; Lord Cranworth's Act (1860), 23 and 24 Vict., ch. 38, Act (1867), 30 and 31 Vict., ch. 132; Trustee Act (1888), 51 and 52 Vict., ch. 59; Trustee Act (1893), 56 and 57 Vict., ch. 53, Trustee Act (1925), 15 Geo. 5th, ch. 19.

4 Restatement of Trusts, sec. 227, p. 645, in which it is stated. "In making investments of trust funds, the trustee is under a duty to the beneficiary in the absence of provisions in the terms of the trust or of a statute otherwise providing, to make such investments, and only such investments, as a prudent man would make of his own property, having primarily in view the preservation of the estate and the amount and regularity of the income to be derived." King v. Talbot (1869), 40 N. Y. 76, Harvard College v. Amory (1830), 9 Pick. (Mass.) 446, Creed v. McAleer (1931), 275 Mass. 353, 175 N. E. 761; Indiana Trust Co., Guardian v. Griffith (1911), 176 Ind. 643, 95 N. E. 573, in which the court stated. "We grant that appellant (the trustee) is required to exercise only such diligence and care in discharging his duty as ordinarily prudent men exercise in reference to their own affairs. " In re Buhl's Estate (1920), 211 Mich. 124, 178 N. W 651, 654.

5 For statutes in the several states see Bogert, Trust and Trustees (1935), Vol. 3, ch. 30, sec. 616 ff.

6 Perry, Trust and Trustees (1929), Vol. 1, sec. 456, Bogert, Trust and Trustees (1935), Vol. 3, ch. 31, sec. 671.

mortgage on real estate[7] not in a foreign jurisdiction[8] and having an adequate margin of security[9] are of such a character that they are generally regarded as acceptable trust investments. This is so whether the investments are measured by the statutes or by the conduct of the ordinary prudent man. Investments regarded as not reasonably prudent and not generally allowed by statute include loans secured by second mortgages on real property,[10] purchases of land either leasehold[11] or freehold,[12] purchases of chattels,[13] unsecured loans or loans with insufficient security,[14] and loans to a firm in which the trustees are members.[15]

There is a split of authority as to the propriety of the investment of trust funds in stocks of private corporations when such is not permitted by statute or by the instrument creating the trust.[16] The Indiana Court in the principal case acknowledged the difference of opinion among the several states and at the same time reiterated the then existing rule in this state when it said: "The courts of this country are divided on the question, but in Indiana the rule is an old one that in the absence of an order from the proper court, a trustee such as the one in the instant case cannot invest trust funds in his hands in the stock of a private corporation. Such an investment is an abuse of his discretionary power." In this respect, the Indiana courts simply followed the New York rule which held that an investment of trust funds in stocks of private business corporations is improper because control of the trust *res* is transferred from the hands of the trustees to the management of the corporation and because the character of such investment is too unsafe and speculative.[17] In Massachusetts, the view prevails that such an investment

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7 Bishop v. Peoples Bank and Trust Co. (1927), 291 S. W 718, 218 Ky. 508; Bogert, Trust and Trustees (1935), Vol. 3, chap. 31, sec. 672.

8 McCullough's Executors v. McCullough (1888), 44 N. J. Eq. 313, 14 Atl. 642; In re Harmon's Estate (1899), 61 N. Y. S. 50, 45 App. Div. 196.

9 Restatement, Trust, sec. 229, "In many states statutes provide what proportion of the value of real property may be lent by trustees on mortgage. In the absence of a statute the amount depends upon the circumstances." "In general a trustee cannot properly lend on a mortgage upon real property more than from one-half to two-thirds of the value of the mortgaged property."

10 Shuey v. Latta, 90 Ind. 136 (1883); Tuttle v. Gilmore (1883), 36 N. J. Eq. 617.

11 In re Anderson (1914), 211 N. Y. 136, 105 N. E. 79.

12 Williams v. Williams (1882), 35 N. J. Eq. 100.

13 Bogert, Trusts and Trustees (1935), Vol. 3, ch. 31, sec. 678.

14 In re Foster's Will (1878), 15 Hun. (N. Y.) 387; Roach's Estate (1907), 92 Pac. 118, 50 Ore. 179; Cornet v. Cornet (1916), 190 S. W 333, 269 Mo. 298; Holmes v. Dring (1788), 2 Cox Eq. Cases 1.

15 Perry, Trusts and Trustees (1929), Vol. 1, sec. 464 and cases cited.

16 Bogert, Trusts and Trustees (1935), ch. 31, sec. 681 and cases cited.

17 King v. Talbot (1869), 40 N. Y. 76, 88, in which the court said that it does not follow that simply because prudent men may often speculate and make adventures in the hope of growing rich, that the trustees may do the same. "The moment the fund is invested in bank, or insurance, or railroad stock, it has left the control of the trustees; its safety and the hazard, or the risk of loss, is no longer dependent upon their skill, care, or discretion, in its custody or management, and the terms of the investment do not contemplate that it will be returned to the trustees." Tucker v. State ex rel. Hart (1880), 72 Ind. 242: "Facts . . . showed that company to be only a private corporation, organized as an ordinary business enterprise, and subject to all the usual vicissitudes incident to the prosecution of merely private business. An investment in the stock of such a corporation placed the money put into it

is not necessarily improper; here an investment of trust funds in stocks of a private business corporation is proper so long as the amount invested is not disproportionate to the entire amount of the trust fund and the corporation has established itself as being financially sound and permanent.[18] Although the position taken by the Indiana court in the principal case was supported by the weight of authority,[19] the adoption of the Massachusetts rule by the American Law Institute indicates that the trend may be in the other direction.[20] To hold as a rule of law that trust investments in stocks of private corporations are improper under all circumstances is inexpedient from the standpoint of trust purposes; that is, the preservation of the trust *res* plus the receipt of a reasonable income. At a time like the present, for example, when the tendency is apparently toward cheaper money, it would seem that stock investments, in lieu of bonds secured by a first mortgage or governmental bonds, would be especially desirable in order to prevent diminution of the trust fund at the termination of the trust in the future. At that time a value would be received which would not be diminished because of the increase in the general price level. Not only would the trust fund be preserved, but the current income from stocks would fluctuate according to the actual value of the money at the time. On the other hand, it would seem that to permit the uninterrupted and uncontrolled operation of the Massachusetts rule would not only lead to a result equally undesirable when the trend is toward devaluation of money, but would result in insecurity of the income and trust fund. True it is that the trustee is held to the standard of reasonableness, but this is no protection to the beneficiary who later discovers that the trustee was unreasonable when he made his stock investment and that the trustee is now judgment proof. It would be better, perhaps, to have a check on the trustee in the beginning—before the stock investment was ever made.

It appears rather clearly that each stock investment should be judged upon its merits. A general or inflexible rule of law one way or the other under all circumstances would be either too narrow or too broad. The New York rule

beyond the personal control of Tucker (the trustee), and in a condition from which no return of the principal sum could have been reasonably expected without the hazard of a sale of the stock, and of a loss which might result from such a sale. . . . An investment of such corporate stock was also nothing more than an investment in a mere personal security of a necessarily fluctuating and uncertain character, and such an investment, when not made under the direction of some competent authority, constitutes a well recognized violation of duty on the part of a trustee." Four states prohibit by their constitutions investment of trust funds in stocks and bonds of private corporations. They are Ala. Const. (1901), sec. 74; Pa. Const. (1873), art. 3, sec. 22; Colo. Const. (1876), art. 5, sec. 46, Wyo. Const. (1889), art. 3, sec. 38.

[18] Dickinson's Appeal (1890), 152 Mass. 184, 187 "trustees can invest portions of trust funds in dividend paying stocks and interest bearing bonds of private corporations, when the corporations have acquired such a reputation that cautious and intelligent persons commonly invest their own money in such stocks and bonds as permanent investments." Harvard College v. Amory (1830), 9 Pick. (Mass.) 446.

[19] Bogert, Trusts and Trustees (1935), ch. 31, sec. 679.

[20] Restatement of Trusts, sec. 227, p. 651: "The purchase of shares of preferred or common stock of a company with regular earnings and paying regular dividends which may reasonably be expected to continue is a proper trust investment if prudent men in the community are accustomed to invest in such shares when making an investment of their savings with a view to their safety."

prohibits stock investments when, by reason of the merits of the individual case, such investments should be permitted; and the Massachusetts rule permits stock investments when, by reason of the merits of the individual case, such investments should be prohibited before they are made. In order to obviate the objections to either of the aforementioned rules, and benefit by the value each rule possesses, it would seem the trustee should be permitted to invest in stocks of private corporations only by first obtaining a court order, and permission should be granted only when the court is satisfied that the corporation in whose stocks the trust funds are to be invested has successfully withstood the test of time and the scrutiny of an accurate financial examination. In Indiana the situation appears to have been that stock investments were, as a matter of law, improper, but that the trustee was relieved of liability if he was granted the permission of the court to invest in stocks.[21] However theoretical the distinction may be, it seems only reasonable that where permission to invest in stocks is given by the court, not only should the trustee be relieved of liability in case of loss, but the investment should be recognized in the first instance as a legal and proper one. An Indiana statute authorizes investment of trust funds in personal property when permission is granted by the court, and under this statute stock investments can now be regarded as legal when the court's consent has first been obtained.[22] It is submitted that the Indiana statute recognizes and adequately meets the dilemma of the trustee when faced with the problem of investing trust funds in stocks of private corporations. The statute applies only to banks and trust companies, but private trustees may be treated on the same footing.[23]

H. B.

JUDGMENT—CIVIL ACTION FOR PERJURY AS COLLATERAL ATTACK.—Appellant previously had sued appellee Pope alleging damage of $12,500 due to personal injuries caused by appellee's negligence. Appellee, Jobes, a physician, was called by Pope as an expert defense witness and testified that appllant's injuries were simulated ones. There was a verdict for Pope. In the instant complaint, appellant joined the physician, the prior defendant Pope, and an indemnity insurer as defendants and alleged that defendants had conspired to make a false and malicious defense to the prior personal injury action through perjured testimony and that the testimony of appellee Jobes was false, thus damaging appellant to the extent of $12,500. Separate demurrers by appellees for insufficient facts were sustained. Appellant refused to plead further. Held, to permit the maintenance of an action for damages against an adverse witness on the ground that a previous defeat in a tribunal of competent jurisdiction was due to false testimony, would be sanctioning collateral attack on judgments and lead to endless litigation.[1]

The instant case presents two problems: (1) Can a civil action for perjury be maintained? (2) If not, what relief is available to a party under these circumstances, assuming his allegations to be provable? Added to the first

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[21] Indiana Trust Co. v. Griffith (1911), 176 Ind. 643, 95 N. E. 573, 575.

[22] Burns (1933), sec. 18-1204.

[23] Freifield, Investment of Trust Funds, 5 Cin. L. Rev. (1931), 1, at 26 and 51.

[1] Hermon v. Jobes (1935), 198 N. E. 316 (Ind. Sup.).