Some Aspects of the Obligations of New York Fiduciaries with Respect to the Making of Investments, II

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A Fiduciary's Transactions with Itself

PROBABLY no transaction in which a fiduciary may engage is subject to such adverse criticism as one where the fiduciary acts as both buyer and seller, in its representative capacity on the one hand and in its individual capacity on the other. Unless expressly authorized, any such transaction is voidable even though the fiduciary may have acted in good faith, with the best of motives and impelled by a desire to aid the estate.\(^{165}\) It is not necessary to prove fraud. The doctrine is enforced \(\ldots\) to avoid the possibility of fraud and to avoid the temptation of self interest."\(^{166}\) The very fact that a fiduciary has done business with itself means that it has \(\ldots\) placed itself in a position where its interest was or might be in conflict with its duty. Either is sufficient to cause surcharging of the trustee."\(^{167}\) The doctrine is by no means new. In 1875, the Court of Appeals, in discussing it, said:

"The rule is founded in the highest wisdom. It recognizes the infirmity of human nature, and interposes a barrier against the operations of selfishness and greed. It discourages fraud by taking away motive for its perpetration. It tends to insure fidelity on the part of the trustee, and operates as a protection to a large class of persons whose estates, by reason of infancy, infirmity, or other causes, are intrusted to the management of others."\(^{168}\)

The doctrine that a fiduciary may not deal with himself has been observed and enforced by the courts in accordance with the spirit, and

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\(^*\) Part I of this article which appeared in the March, 1947, issue of the Ford L. Rev. dealt primarily with the making of investments by fiduciaries. Part II deals primarily with their management and retention.

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167. Id. at 407, 52 N. E. 2d at 923.

over and above the letter of the rule. A fiduciary will not be permitted to do indirectly what he is barred from doing directly. Thus, a trustee was held liable for a mortgage loan made with trust funds to his own wife\(^9\) and for investments purchased from a corporation of which he was an officer and director.\(^{170}\) Corporate fiduciaries may not purchase investments from affiliated companies and if there are interlocking directors and officers, and a unity of stock ownership between corporate buyers and sellers, the veil of corporate entity will be pierced.\(^{171}\)

The only current exception to the absolute prohibition against transactions between a fiduciary and itself arises when the testator or grantor himself has authorized such a practice. For although it has been said that it is against public policy for a trustee to act as both buyer and seller when dealing with trust funds\(^{172}\) a direction in a will permitting transactions between a fiduciary and the trust estate has been held to be valid, the court saying:

"The decedent was willing that the trustee should act under conditions of divided loyalty. He had the power and right so to provide. That which he did with his own money did not impinge upon public policy or involve the doing of anything \textit{malum per se} or \textit{malum prohibitum}. [Since the transactions were in good faith, they were not disallowed.]"\(^{173}\)

But no matter how broad may be the authority which the testator has given the fiduciary to deal with himself, he still remains subject to the "... great principles of equity which are the life of every trust..."\(^{174}\) and remains "... nevertheless bound to exercise this power in the best of faith and to evince the highest degree of disinterestedness, loyalty and honor."\(^{175}\) And the court cannot be deprived by exculpatory clauses from exercising its own jurisdiction over the administration of the trust.\(^{176}\)


A grant of power to engage in self-dealing is strictly construed. Thus, not only is a fiduciary barred from lending trust funds to himself without express authority to do so177 but an authorization to engage in self-dealing does not include the right to lend trust funds to oneself.178 And even if a fiduciary is given the broadest powers to deal in the purchase and sale of securities for the trust estate with any firm in which he himself might be a member or have an interest, the transactions must be based on market values and the profit to the firm must be limited to usual and customary commissions or compensation.179

It should be noted, however, that it is permissible for the trustee of one trust to sell securities to itself as trustee of another trust, provided the sales are at fair prices.180 In such instances, the trustee has no interest of its own and the transaction is between two strangers.

Transactions Under Subdivision 7 of Section 188 of the Banking Law

From 1917 until 1936, a trust company acting as a fiduciary was permitted to deal with itself to a limited extent. The practice was sanctioned in the first instance by the court in a case where it appeared that a trust company combined funds from several trusts and invested them in one mortgage which was held by the trust company in its own name.181 But although the trust company was not surcharged, the court criticized it for making the investment in its individual name, rather than as trustee.182 The decision was followed by the enactment in 1917 of subdivision 7 of Section 188 of the Banking Law, which permitted a trust company acting as a fiduciary to apportion to any of its trusts a part interest in a bond and mortgage which it held individually or in a representative capacity. The trust company was required to notify promptly each adult income beneficiary of the fact that the investment had been made.183

The amendment met with some judicial disapproval or begrudging

177. Matter of Petrie, 5 Dem. 352, 355 (N. Y. Co. 1886) Rollins, S.
182. But when a corporate fiduciary acquired a mortgage in its own name through a clerical error and its records showed clearly that the investment was made for an estate, it was held not liable. Matter of Montant, 117 N. Y. L. J. 1897 (N. Y. Co. May 14, 1947) Collins, S.
183. N. Y. Laws 1917, c. 385.
sanction but the legality of mortgage investments made by trust companies for their trusts was upheld. However, the law was interpreted strictly. Thus, it was held in a number of instances that a trust company could not transfer to one trust an entire mortgage which it owned and this finding was upheld by the Court of Appeals when the issue was presented to it. Moreover, the courts lost little time in holding that the failure to give notice of the transaction to the beneficiaries as required by the statute went to the legality of the entire investment and, if the required notice was not given as directed, the trustee was subject to surcharge for the full amount of the investment.

It is not necessary to prove that the loss resulted from the failure to give the statutory notice; the very failure to give it is sufficient to establish liability on the part of the trustee.

Subdivision 7 to Section 188 was repealed in 1936. Its importance is now limited to those trusts which continue to hold participations made pursuant to the statute.

This comparatively brief period of deviation from the rule against self-dealings by a fiduciary has served to strengthen the rule. The doctrine that a trustee may not act in its individual and in its representative capacity as both buyer and seller is more strongly established today than ever before. The slightest deviation from the rule, however innocent in purpose, will result in a surcharge.

It follows, therefore, that if there is a suspicion of self-interest in any transaction between a fiduciary and his estate, the transaction should be avoided as the fiduciary will only become the guarantor of the investment. If the transaction is for the best interests of the estate, the fiduciary may obtain judicial permission to enter into it, and thus be protected against attack.


189. N. Y. Laws 1936, c. 898.


The Right of a Fiduciary to Hold Its Own Stock

From time to time, corporate fiduciaries have held shares of their own stock as part of trust estates.\textsuperscript{192} The practice was denounced by the Court of Appeals in 1943 in \textit{Matter of Cannon}, on the ground that ownership by a trustee of shares of its own stock violated the rule of undivided loyalty. The court applied to such a situation the same doctrine applicable to self-dealing, saying:

"... for when the trustee has a selfish interest which may be served the law does not stop to inquire whether the trustee's action or failure to act has been unfairly influenced. It stops the inquiry when the relation is disclosed and sets aside the transaction or refuses to enforce it, and in a proper case, surcharges the trustee as for an unauthorized investment."\textsuperscript{193}

This, it is submitted, reads well and sounds well but is a dangerous over-simplification of the problem. The application of this doctrine to out and out self-dealing by a fiduciary, a practice always considered objectionable, is one thing; its application to the ownership by a trustee of its own stock, is something else again and resembles law by judicial clichè. The practice is not shocking in itself, or at least, it did not shock the Appellate Division of the Fourth Department in 1935 when it ruled expressly that ownership by a trustee of its own stock was not objectionable in itself.\textsuperscript{194} Nor is the practice \textit{malum in se} as is evidenced by the established doctrine that it is permitted if expressly authorized. As a matter of fact, in \textit{Matter of Cannon} itself, the fiduciary was not subjected to any surcharge because the trust was revocable and the grantor had emphatically approved the act of the trustee in holding its own stock. It seems unfortunate that the casual circumstance that the trust was revocable was determinative of the issue of liability while the admitted good faith of the fiduciary was deemed immaterial.

Considered realistically, the doctrine that the very existence of a selfish interest to be served makes a transaction voidable has an unreal foundation and can hardly be given universal application. The fact

\textsuperscript{192} Or an individual fiduciary may hold in the trust estate, though at greater risk, stock of a corporation in which he has an interest, as in \textit{Matter of Richardson}, 149 Misc. 192, 268 N. Y. Supp. 388 (Kings Co. 1928) Wingate, S.

\textsuperscript{193} \textit{City Bank Farmers Trust Co. v. Cannon}, 291 N. Y. 125, 132, 51 N. E. 2d 674, 676 (1943).

that a fiduciary may be surcharged for losses on investment is in itself sufficient to create a selfish interest. Thus, when a fiduciary with broad powers of investment is called upon to make investments and to choose between the common stocks which the testator may have preferred for his beneficiaries and government bonds, he may select the latter for the purely selfish reason that the risk of being surcharged for such an investment is practically nil. Yet the existence of such a selfish interest would not be deemed grounds for voiding an investment in government bonds or other "legals" that happened to result in a loss.

It should also be realized that a corporate fiduciary has no financial interest in the market value of its own shares. Its assets are not increased or decreased by any changes therein. If the interest which it may have, if there be any at all, is sufficient to create the "selfish interest" which is the object of the court's condemnation, it would seem that a more direct and a more selfish interest exists when a fiduciary, whether corporate or individual, buys for his trust in the open market a bond of the same issue in which the fiduciary has invested his own funds. The benefits gained by the fiduciary for his own account may be infinitesimal and highly theoretical, particularly if the security which is common to the trust holdings and to the individual holdings is a government bond. But the courts have yet to apply the "De Minimis" rule to the rule against "selfish interest," and the latter is applied, not because the trust estate has actually suffered a loss but because it might have been damaged.

It is, therefore, submitted that the excellent teaching that the standards of a fiduciary should be of the highest and not of the lowest, is weakened by a ruling that admitted good can ever be immaterial. Such a ruling savors of a regulation by the kind of administrative board which cannot be bothered by considerations of justice in individual cases because of "administrative difficulties." Just because there is no machine which will X-ray and bare the motives of fiduciaries as they exist in fact, it is not necessary to proceed on the theory that they are evil and base as a matter of law.

Nor is an unyielding rigid and unreasonable enforcement of the doctrine of "undivided loyalty" which disregards actual good faith conducive to efficient estate management on a long range basis. It should be remembered that one of the reasons why the courts have measured the liability of fiduciaries by the norm of ordinary prudent men, rather than of supermen, was that otherwise, no prudent men would accept the responsibility of a fiduciary. For the same reason good

faith of fiduciaries or lack thereof should be measured by facts rather than by rhetoric and formulae.

The rule in the *Cannon* case was applied to the strictest possible extent by the Court of Appeals in a recent case.\(^{196}\) And yet at the same time, the court placed a surprising limitation on its applicability. The testator had given his residuary estate to three trustees, to wit, a trust company, the testator’s own attorney and the testator’s brother-in-law who was the president of the trust company and had granted to them the power to invest his estate “... with all the authority, and powers in connection with the same, I would possess if living.” Included in the residuary estate were shares of stock of the trust company which the testator had received from his father who had been one of its organizers. The testator himself had been one of its directors. The trustees not only retained the shares which they received but added to them by exercising subscription rights to new stock. The stock depreciated substantially in value and the Court of Appeals, reversing the Appellate Division, held that the trustees were liable for the loss. The finding was based upon the holding that the corporate fiduciary had breached the rule against undivided loyalty promulgated in *Matter of Cannon*. The majority opinion stated that while the will gave the trustees broad powers, the language did not serve to relax the rule against undivided loyalty. In the opinion as originally handed down, the court said that if the testator had intended to permit his trustees to disregard the “... fundamental rule of absolute loyalty and fidelity prohibiting any purchase or retention of securities involving a divided loyalty, the authority should have been explicitly stated by an express grant of power to retain the shares of the corporate trustee and to purchase additional shares.” But later, the court omitted the word “explicitly” and the entire clause “... by an express grant of power to retain the shares of the corporate trustee and to purchase additional shares.” Consequently, the opinion now reads that “if the testator intended that all these things could be done without regard to the fundamental rule of absolute loyalty and fidelity prohibiting any purchase or retention of securities involving a divided loyalty, the authority should have been stated.” Any number of interpretations can be placed upon the revised language, particularly in the light of the elisions referred to. Some interpretations go to lessening the severity of the doctrines, others go to making it harsher to the point of unreasonableness. It is hoped that the court itself will sometime explain the significance of the change of language.

In any event, so far as Matter of Durston is concerned, it can hardly be doubted that it was the express desire and wish of the testator that the stock be retained, even though the fiduciaries whom he selected might have a selfish interest in its retention and it is suggested that the judicial determination that he did not intend to give his trustees the power to retain the stock would surprise most of all the testator himself.

The court was just as strict in enforcing responsibility upon the testator’s attorney as a co-trustee and gave no weight to the fact that his approval of the retention and purchase of the Trust Company’s own stock was admittedly “entirely disinterested and uninfluenced by any consideration other than the interest of the beneficiaries.” His estate was surcharged because he had approved an investment prohibited to his co-trustees. The ruling on this point raises several questions which will not be discussed here.

The surprising limitation made by the court to the Cannon case was with respect to the applicability of Section 111, subdivision 6, of the Decedent Estate Law and of Section 21, subdivision 6, of the Personal Property Law to the doctrine of undivided loyalty in relation to the retention by a trustee of its own stock. These subdivisions were added in 1938 and provide in effect that a fiduciary is not liable for losses on ineligible investments which have been received under a will or other instruments, provided the fiduciary exercises due care in their retention or disposition. The court ruled that the amendments did not serve to protect the fiduciaries either in the Cannon case or in the instant case because the transaction involved in both had occurred before the enactment of the statutes in 1938. If this negative pronouncement is changed to an affirmative one, it would seem that a fiduciary is not liable for a loss arising out of the retention of its own stock if the stock has been received from a testator or grantor of a trust after Sections 111 and 21 of the two statutes were amended by the addition of subdivision 6 to each of them. This is surprising in itself because the language of the amendments is not in any sense as broad as the direction of the testator that his trustees could invest “with all the authority and powers in connection with the same, I would possess if living.” And it might also be argued that the doctrine of the Cannon case has no applicability to a stock received from a testator or grantor even prior to the amendments on the ground that the amendments were little more than statutory codifications of a doctrine already established.

It is, therefore, gratifying to note that in determining the liability of a fiduciary for holding its own stock, the lower courts have paid attention to the real facts and have not slavishly followed the rule of thumb suggested by Matter of Cannon.197

Liability of Fiduciary for the Investments of Corporations Controlled by Fiduciary

A fiduciary who controls a corporation may be surcharged for losses to the estate arising from the corporation's losses on its investments. Thus, fiduciaries who, under direction of the will, organized a corporation, transferred to it assets of the testator and administered its affairs as its directors were held liable in the Surrogate's Court for the losses to the corporation arising from its purchase of non-legal securities, not for negligence but on the theory that the testamentary limitation to legal investments applied to investments by the corporation as well.103 The decree was reversed upon appeal on the ground that the powers of the corporation to invest its funds came from the state which granted the corporate charter and not from the testator and that hence it was authorized to invest in non-legals.199 But the reversal was limited to the question of the power to invest and there is nothing in the decision of the higher court to cast doubt on the proposition that fiduciaries may be held liable for losses sustained by a corporation under their control, if the losses are due to their negligence. This is in keeping with the case in which a fiduciary was held liable to his trust estate for losses which it sustained through the embezzlement by the fiduciary of the funds of a corporation, part of whose stock was held in the trust.200 It might be mentioned here that if a fiduciary controls a corporation, he must account for its operations as well as for his own acts201 and that in determining if he has control, any shares which he may hold individually must be added to the estate holdings.202 The rule does not apply if the fiduciary has only a minority interest.203 In a case where the fiduciaries had become officers and directors in their individual capacities and had only a minority interest as fiduciaries, it was held that they could not be examined as to the affairs of the corporation by a beneficiary of the estate.204

204. Matter of Ebbets, 149 Misc. 260, 266, 267 N. Y. Supp. 268, 276 (Kings Co. 1933)
Questions may arise as to the extent to which a fiduciary is responsible for the investments made by the Board of Directors which he put into office or by the officers whom such directors proceeded to elect. In one instance, the court severely criticized three fiduciaries who elected themselves and three others as directors of a corporation, all the stock of which was owned by the fiduciaries. But a single fiduciary would seem to have no alternative under Section 5 of the Stock Corporation Law of New York than to elect two other directors in which event it is suggested that his liability for their acts should be limited to the care which he exercised in selecting them.

Validation of Improper Investment

If a fiduciary makes an investment which is improper at the time of making for one or more reasons, he may escape liability if the defect is cured and the investment becomes a permissible one before a loss has been realized. The fact that later on there may be a loss or depreciation in value will not interfere with the application of this doctrine. Thus, fiduciaries who made mortgage investments in incompleted buildings were saved from surcharges when the buildings were finished and became valid investments before any loss occurred. One reason for the rule is that the fiduciary might have sold the investment when it had become a proper one and immediately re-purchased it.

There are, however, certain exceptions to the application of the rule. Thus, if a fiduciary makes a mortgage investment in property which is subject to a prior lien in the form of unpaid taxes, and if the tax default was casual or unintentional, the subsequent payment of the taxes will relieve the fiduciary from liability. But if the default arose because


Matter of Kirkman, 143 Misc. 342, 348, 156 N. Y. Supp. 495, 501 (Kings Co. 1932) Wingate, S.

Matter of Woodin, 186 Misc. 857, 65 N. Y. S. 2d 630 (N. Y. Co. 1945) Foley, S., suggested that in administering a corporation owned by trustees, life tenants of the trust might be given representation on its board of directors but warned against permitting them to constitute a majority of the board, as they might favor investments yielding a high income at the expense of principal.

RESTATEMENT, TRUSTS § 230, comment f (1935).


the rentals of the property were less than its operating charges, the curing of the tax default will not necessarily relieve the fiduciary from surcharge. This, because if the fiduciary had made the inquiry which was incumbent upon him and had discovered that taxes were in arrears because of an inability to pay them, the investment would never have been made. As a result, the curing of the default would not excuse the basic negligence which attended the making of the investment.210

In another somewhat analogous case, a city official had received funds for deposit "subject to the further order of the court." He invested the funds in 1927 without a court order and later sought protection under Chapter 837 of the Laws of 1928211 on the ground that this statute cured any defects which might have been inherent in the original investment. But the court held that since the original investment was improper when made, the act of making it was a conversion and not merely a dereliction of duty and hence was not validated by the 1928 statute.212

**Mandatory Directions to Sell**

Occasionally, a testator will direct his executor to sell a given asset on or before a specified date, as a result of which the fiduciary will find himself called upon to sell at an unfavorable time. In one such instance, when the fiduciary was required by the terms of the will to sell real estate within a period which expired in January, 1934, he applied to the court for permission to postpone compliance with the testamentary direction. The court held that while the power of sale was imperative, the best interests of the estate required that the sale be postponed until a better market might be found.213 But when another executor, who was required to sell listed securities at the end of a period which expired in August, 1934, applied for permission to hold them longer, the court held that no question of sacrificing assets was involved as the stocks were readily saleable and the executors should not speculate on a rise in market value.214

The two decisions are not necessarily in conflict. The complete doctrine would seem to be that if the asset to be sold is one for which a free market exists, the direction must be obeyed; but that if there is no free


211. Now N. Y. FINANCE LAW § 182.


or actual market for the asset in question, the time may be further extended for the best interests of the estate. But the fiduciary should not attempt to decide the matter himself. He should ask for the instructions of the court as was done in the two cases cited.

**Mandatory Directions Not to Sell**

A testator may fail to grant to his fiduciaries any power of sale whatsoever, or he may go further and expressly prohibit the sale of some given asset. But in either event, the fiduciary is not relieved from responsibility for retaining the investment and may not stand by idly while the asset becomes worthless. If he decides in the exercise of his judgment that the property should be sold, he must apply to the court for permission to do so, regardless of his own lack of power and in spite of testamentary directions that the property should not be sold.

The power to direct a sale is inherent in the court.\(^{215}\) If it appears to the court that the interests of the estate require that the sale be made, it will grant the necessary power to do so.\(^{216}\)

**Impossibility of Compliance with Mandatory Directions as to Investments**

Occasionally, a testator will impose mandatory investment directions upon his fiduciary who later finds that by reason of changed economic circumstances, compliance with them is either impossible of performance or else will defeat or substantially impair the accomplishment of the purposes of the trust. In such a case the rule that a fiduciary must invest in conformity with the terms of the instrument under which he acts will be waived and he will be excused from compliance.\(^{217}\) Thus, a fiduciary who was required to invest in mortgages on property which must be worth twice the amount of the loan was excused from compliance upon proof that no mortgage loans of such a character were available,\(^{218}\) as was the fiduciary who reported to the court his inability to find any real estate mortgages at all.\(^{219}\) One fiduciary had to apply for judicial relief because he was called on to function under a will which limited investments to "legals" which yielded 5%, and learned that none was available,\(^{220}\) and another fiduciary found that he was limited to

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\(^{217}\) Matter of Goebels, 177 Misc. 552, 31 N. Y. S. 2d 27 (N. Y. Co. 1941) Foley, S.

\(^{218}\) Matter of Young, 178 Misc. 378, 34 N. Y. S. 2d 468 (Ontario Co. 1942) Cleere, S.

\(^{219}\) Matter of Norvell, 35 N. Y. S. 2d 496 (Richmond Co. 1942) Boylan, S.

\(^{220}\) Matter of Cohn, 158 Misc. 96, 285 N. Y. Supp. 279 (Kings Co. 1936) Wingate, S.
Liberty Bonds of happy memory.\textsuperscript{221}

But although these fiduciaries were naturally excused from doing the impossible, they were not permitted to go beyond the legal range and were confined to statutory investments.

\textbf{Right of Fiduciary to Exercise Rights to Subscribe to Stock}

In the absence of testamentary authority to do so or to invest outside the legal field, a fiduciary has no right to exercise subscription rights to new stock issued by a corporation whose stock he already holds, in spite of the fact that he may have the right to retain the original stock.\textsuperscript{222} However, executors who lacked the power to sell the rights before their expiration date by reason of a delay in the probate of the will, but who managed to exercise such rights and thus saved them from extinction were not surcharged.\textsuperscript{223} Nor were they held liable when they exercised rights to subscribe which were of value but for the sale of which there was no market.\textsuperscript{224}

Even though a fiduciary lacks the power to exercise rights to subscribe, he remains liable for their value as rights and if he permits them to expire without selling them, he will be surcharged for their market value.\textsuperscript{225}

\textbf{Exercise of Conversion Rights}

A fiduciary may not exercise a conversion right contained in a security, even though he has the right to retain the security itself, unless he has been granted the express power to exercise the conversion privilege or unless he has the power to invest outside of the legal field.

Thus, a fiduciary who, without power to do so, converted a bond of a corporation into stock of the same company in accordance with the conversion rights provided for therein was held liable for the loss which was sustained.\textsuperscript{226}

\textsuperscript{221} Matter of Thompson, 43 N. Y. S. 2d 392 (Westchester Co. 1943) Millard, S.
\textsuperscript{223} Ibid.
\textsuperscript{224} Ibid.
\textsuperscript{225} Matter of Belcher, 129 Misc. 218, 220, 221 N. Y. Supp. 711, 713 (N. Y. Co. 1927) Foley, S.
\textsuperscript{226} Matter of McCafferty, 147 Misc. 179, 264 N. Y. Supp. 38 (Kings Co. 1933) Wingate, S.
Lack of Diversification as Grounds for Surcharge

The generally accepted doctrine of investment policy in the financial world that there should be diversification in the manner of investing an estate of any substantial amount is generally accepted by the courts as correct. It is true that one judge referred with some degree of approbation to the admonition "to put all your eggs in one basket and watch the basket," but the older and better known adage that "it is unwise for a man to put all his eggs in one basket" has the greater number of judicial adherents.

But the courts have been reluctant to hold that lack of diversification in and of itself is a basis of a surcharge. There have been cases in which failure to diversify was mentioned as one among other reasons why a surcharge should be made. There have been cases in which the courts have dismissed objections based on lack of diversification because they found as a fact that a sufficient degree of diversification actually existed, and from this, it may be inferred that the objections would have been sustained had the facts supported them. Whether there has been any case in which lack of diversification has been the exclusive reason why the fiduciary was surcharged is debatable. There have been so many dogmatic utterances that lack of diversification is not in itself a basis of surcharge that the conclusion might be reached that the time is not yet here when failure to diversify is in itself cause for a surcharge. But it would seem that that time is not far distant.

Consider first those cases in which lack of diversification was given as a contributing cause for a surcharge. In Durant v. Crowley, decided in 1922, the Appellate Division of the First Department surcharged a fiduciary for making a mortgage loan. It appeared that he had ignored the financial responsibility of the mortgagor and that the mortgaged property was highly speculative in its nature and difficult to rent. But the court also referred in its opinion to "... this investment of $25,000., nearly one-half of the whole of the trust fund, in one mortgage. ..." The remark might perhaps seem incidental to the main issue but it was given importance by the Appellate Division of the Second Department in Matter of Flint, when, in refusing to surcharge a fiduciary, it said:

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Wingate, S. For arguments in support of this point of view, see Matter of Balfe, 152 Misc. 739, 756, 274 N. Y. Supp. 284, 302 (Orange Co. 1934) Taylor, S.


"We do not have here the investment of the whole or greater part of a trust fund in a single property, coupled with other elements of hazard, which sustained a finding of imprudence or negligence because of undue concentration. Durant v. Crowley, 197 App. Div. 540, 189 N. Y. Supp. 385, aff'd, 234 N. Y. 581."

And in a case where the liability of a fiduciary for an investment was unquestioned because of self-dealing, the court nevertheless saw fit to add that:

"The gross improvidence of the action here taken is obvious. In the first place, the entire fund was invested in a single security, which, in view of its not inconsiderable size, was a matter of questionable wisdom."

Then, there are the cases in which the courts have overruled objections based on lack of diversification by concluding that diversification did in fact exist. Thus in Matter of Flint, where a fund of $45,000. had been split up among eleven mortgages, the court, after stating that "a partiality for first mortgage securities on a sound value basis has never been deemed an imprudent thing," held that spreading the fund among eleven different mortgages had provided the very diversification which was claimed to be lacking; and in another instance, the court held that under the circumstances of the situation, the investment of $9,800. out of a fund of $10,000., in two guaranteed mortgages "will be held to have accomplished sufficient diversification."

It seems natural to assume that these courts would have surcharged the fiduciaries if they had found them guilty, and not innocent, of failing to diversify, as otherwise the acquittals would be meaningless.

And yet there have been unequivocal statements on many occasions to the effect that lack of diversification is not itself a ground of surcharge, although different reasons have been expressed. One court said tersely that "lack of diversity is not a basis of surcharge."

In other instances, the court said that "There is no law in this State requir-


231. Matter of Harbeck, 142 Misc. 57, 64, 254 N. Y. Supp. 312, 314 (Kings Co. 1931) Wingate, S.


ing diversification of investments,"235 or based their refusal to surcharge on the fact that there was no judicial authority for surcharging for lack of diversification.236 One court refused to surcharge because of the absence of any statute indicating the degree of diversification which was required.237 In a case where the trustee had invested about 40% of the estate in a single security, the court did not affirmatively approve it but said that it was "... no such demonstration of improvidence on the part of the trustees ... as to justify the court in declaring as a matter of law that their action was improper."238

Before discussing the correctness of these various pronouncements, it might be well to set forth the mathematical facts on which some courts have refused to surcharge fiduciaries. Since these cases must be considered in the light of all their facts and circumstances as well, they are not guides which may be blindly followed.

No surcharges were made: where 80% of the estate was invested in railroad stocks and 68% in the stock of one single corporation;239 where $50,000. out of a fund of $75,000. was invested in a single mortgage;240 where $17,000. out of a trust of $39,000. was invested in two guaranteed mortgages;241 where the entire fund of $10,000. was invested in a


236. Matter of First Nat'l Bank, supra note 235; Matter of Balfe, 152 Misc. 739, 755, 274 N. Y. Supp. 284, 302 (Orange Co. 1934) Taylor, S. The court said: "No New York case has been cited in support of this proposition [lack of diversification as being improper management] and it is doubted if our courts would so hold in the absence of controlling statute." The decision was affirmed, with an immaterial modification, 245 App. Div. 22, 24, 280 N. Y. Supp. 128, 130 (2d Dep't 1935). But the court limited its discussion of the factor of lack of diversification to the statement that the concentration of investments in mortgages was not proof of bad faith on the part of the fiduciary (this being an important issue in the case), because the decedent himself turned over the securities in a non-diversified form. It is submitted, therefore, that the opinion of the Appellate Division in Matter of Balfe is of no importance, except as applicable to the precise set of facts before the court.


240. Matter of Nugent, 280 N. Y. 505, 19 N. E. 2d 918 (1939). No opinion in any court; the facts are found in the record of appeal.

single guaranteed mortgage; where a fund of $45,000. was invested in eleven guaranteed mortgages; where $9,800. out of $10,000. was invested in two guaranteed mortgages; where about 40% of an estate was invested in the one security; and where 89% of the fund was invested in one mortgage participation and the remaining 11% in another.

Up to April, 1941, there seemed to have been no decision with respect to which it might be convincingly argued that lack of diversification had been the sole basis for surcharging a fiduciary. As had been said by one court in an opinion handed down on February 4th, 1941:

"I have not been referred to any case, nor have I found any, holding that the mere lack of diversification in and of itself constitutes negligence."

But in April, 1941, the Appellate Division of the Second Department decided Cobb v. Gramatan National Bank and what was said in its per curiam opinion seems to be the present high-water mark in treating lack of diversification per se as grounds for surcharge. The fiduciary had invested an entire trust fund of $25,000. in a single mortgage. The lower court surcharged it for negligence in failing to investigate the merits of the loan, and in relying exclusively upon the guarantee of a mortgage company. The Appellate Division affirmed the surcharge. It cannot be said dogmatically that in so doing, it excluded completely from consideration the undesirable character of the mortgage and the failure of the fiduciary to examine into the investment it was making. But there is no doubt that the surcharge was predicated to a very great extent upon the ground that diversification was obligatory not only under the terms of the particular trust involved but also as a matter of law. Thus, the opinion pointed out that the maker of the trust had directed that it be invested in "certificates" and that the use of the plural denoted an intention that more than one investment should be made. It did not, 242

244. Matter of Kirby, 35 N. Y. S. 2d 651 (Westchester Co. 1942) Millard, S.
however, rest on this none too conclusive reason but went on to say immediately thereafter:

"Apart from that, the law likewise imperatively requires diversity."\(^{250}\)

The court then referred to the contention of the fiduciary that it had the right, as a matter of law, to rely on the assurances and representations of the guarantor and said:

"These grounds of justification do not touch the breach of duty by the trustee in respect of making the investment of such a large sum, representing the entire corpus of the trust fund in a single security. The trustee in doing so was grossly negligent as a matter of fact and as a matter of law. An additional finding of fact and conclusion of law . . . will be made."\(^{251}\)

There was a strong dissent.\(^{252}\) To what extent *Cobb v. Gramatan National Bank* will be followed remains to be seen.\(^{253}\) In one recent case, the court held that lack of diversification was not improvident or negligent as a matter of law and attempted to distinguish the facts from the *Cobb* case on the ground that the fiduciary before the court, a guardian, was acting under a statute whereas the fiduciary in the *Cobb* case was acting under a trust agreement which required diversification by express terms.\(^{254}\) But it is expressly stated in the *Cobb* case that diversification was required as a matter of law, as well as by the terms of the particular instrument involved. In another recent case, the court ruled that diversification was not required as a matter of law but indicated that lack of diversification might constitute negligence under a certain state of facts.\(^{255}\) The court was dealing with a trust, the principal of which was subject to invasion. The court found as a fact that the trustee had acquired sufficient readily saleable investments to meet the payments of principal required, but it gave unmistakable indications that if there had been a failure to diversify so as to include liquid assets, the fiduciary would have been surcharged for negligence.\(^{255}\)

To summarize the situation, it seems that the economic theory that diversity should exist in the investments of a fund or estate has been accepted by the courts to a limited extent. As a general rule, courts

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250. *Id.* at 1086, 26 N. Y. S. 2d at 918.
251. *Id.* at 1086, 26 N. Y. S. 2d at 919.
have refused to consider lack of diversification as a basis of surcharge, if there are no other elements of negligence present. But in the light of *Cobb v. Gramatan National Bank* and considering the trend to discuss lack of diversification as a possible basis of surcharge for negligence, the careful and prudent fiduciary should seek diversification where it is reasonably possible both for the benefit of the estate and for his own protection.\(^{256}\)

There is, however, the further question for consideration namely the extent to which a fiduciary should be held liable for failure to diversify. It was pointed out by one court that there was "nothing in the record establishing that lack of diversification was the cause of the loss complained of."\(^{257}\) Conceivably, however, such proof could be supplied. If the court applies the doctrine that the act complained of "must be shown to have been the proximate cause of the loss"\(^{258}\) then it follows that any surcharge for lack of diversification should not be for the entire amount invested but only for that portion of it which is found to be excessive.\(^{259}\)

**Investment in a Single Security Beyond Testamentary Limitation**

Testator may direct that his fiduciary shall not invest more than a stated amount in a single security or class of securities. If the instruction is violated, the fiduciary is not liable for the entire investment but only for that portion of it which is in excess of the permitted amount.\(^{260}\) In such an instance, no loss need be established. The fiduciary, upon paying the surcharge, would be entitled to take over the excessive interest in the investment.

**Desirable and Undesirable Types of Investments for Fiduciaries**

Even though a fiduciary is authorized to invest the funds of his estate in his discretion and is not confined to legal investments, he is not thereby freed from responsibility for the investments which he makes. He will be held liable for those which are made imprudently or

\(^{256}\) Unless the size of the estate makes it inadvisable. When an estate amounted to only $1,000, the court properly said that any attempt to diversify its investments bordered on the ridiculous, *Matter of Froelich*, 150 Misc. 371, 375, 269 N. Y. Supp. 541, 546 (Kings Co. 1934) Wingate, S.


improvidently. As the Court of Appeals aptly stated many years ago:

"Surely, there is a mean between a government bond and the stock of an Alaskan gold mine and the fact that a trustee is not limited to one does not authorize him to invest in the other." \(^{262}\)

The courts have naturally been more explicit in stating what types of investments are unsuitable for fiduciaries than they have been in making affirmative recommendations. The negative rule of *King v. Talbot* still prevails that every fiduciary must avoid:

"... all speculations, all investments for an uncertain and doubtful rise in the market, and of course, everything that does not take into view the nature and object of a trust and the consequences of a mistake in the selection of the investment to be made." \(^{263}\)

This, of course, is broad and general language. The courts have been more precise however in condemning the investment of trust funds in certain types of investments such as:

"... in trade, or as loans to persons engaged in such business or in the prosecution of mercantile commercial and manufacturing enterprises." \(^{264}\)

Today, it would be a rash fiduciary who without express authority violated such a prohibition, unless the investment was in a listed security or one with a ready market over-the-counter. And even if the investment is one which is listed or readily saleable, it should not be in a newly organized company. Courts do not like them, and a fiduciary should be diligent in avoiding them. The ban applies not only to investments in common stocks of new concerns, but to their bonds\(^{265}\) and preferred stocks as well.\(^{266}\) And it might be mentioned here that it does not add to the attractiveness of an investment of any security if shares of common stock are thrown in as a bonus for their purchase.\(^{267}\)

\(^{261}\) Matter of Maloney, 120 Misc. 456, 198 N. Y. Supp. 788 (N. Y. Co. 1923) Foley, S.  
\(^{262}\) Matter of Hall, 164 N. Y. 196, 200, 58 N. E. 11, 12 (1900).  
\(^{263}\) King v. Talbot, 40 N. Y. 76, 86 (1869); Matter of Leonard, 118 Misc. 598, 601, 193 N. Y. Supp. 916, 918 (Westchester Co. 1922) Slater, S.  
\(^{266}\) Matter of Hall, 164 N. Y. 196, 200, 58 N. E. 11, 12 (1900).  
\(^{267}\) Matter of McDowell, 102 Misc. 275, 293, 169 N. Y. Supp. 853, 864 (Chemung Co. 1918) Swartwood, S.
tion against investing in a newly organized corporation does not apply, however, when the company in which the investment is made is not initiating a new business but is taking over an established and going concern.\textsuperscript{268}

Correspondingly, the fact that the company in which the fiduciary has made an investment is one which has been functioning for many years on a profitable basis is a factor which will appeal to the courts if the investment is under attack. It may be well to repeat that the Court of Appeals long ago indicated its approval of investments by fiduciaries in a:

"... railroad, manufacturing, banking or even business corporation, which, by its successful conduct for a long period of time, [has] achieved a standing in commercial circles, and acquired the confidence of investors..."\textsuperscript{259}

Other factors into which the courts will examine are whether the company pays the dividends on its stock;\textsuperscript{270} the nature of its capital structures;\textsuperscript{271} and ratings by financial manuals.\textsuperscript{272} Safety of principal is paramount to income return\textsuperscript{273} and hence investments which yield large returns are not apt to meet with too much favor. On the other hand, a security which yields no income at all, the kind characterized as "ample assured to yield an income"\textsuperscript{274} should be avoided as it obviously would be purchased only for a speculative rise. The distinction between an investment and a speculation should be observed at all times.\textsuperscript{275}

Were it not for the fact that fiduciaries have actually invested in them and have been surcharged for so doing, it would seem hardly necessary to point out that trust funds should not be invested in wild-cat oil stocks\textsuperscript{276} nor second mortgages;\textsuperscript{277} nor common stocks which pay no

\textsuperscript{268} Guaranty Trust Co. v. Fisk, 244 App. Div. 260, 203, 278 N. Y. Supp. 509, 813 (1st Dep't 1935).

\textsuperscript{269} Matter of Hall, 164 N. Y. 196, 200, 58 N. E. 11, 12 (1900).

\textsuperscript{270} King v. Talbot, 40 N. Y. 76, 86 (1889); Matter of Leonard, 118 Misc. 593, 601, 193 N. Y. Supp. 916, 918 (Westchester Co. 1922) Slater, S.

\textsuperscript{271} Matter of Winburn, 140 Misc. 18, 22, 249 N. Y. Supp. 758, 763 (Westchester Co. 1931) Slater, S.

\textsuperscript{272} Ibid.

\textsuperscript{273} Matter of Jacobs, 152 Misc. 139, 273 N. Y. Supp. 279 (Delaware Co. 1934).

\textsuperscript{274} Matter of Leonard, 118 Misc. 593, 601, 193 N. Y. Supp. 916, 918 (Westchester Co. 1922) Slater, S.

\textsuperscript{275} In Matter of Hirsch, 116 App. Div. 367, 376, 101 N. Y. Supp. 893, 900 (1st Dep't 1906), aff'd mem., 188 N. Y. 584, 81 N. E. 1165 (1907), the court said: "The investment being for the purpose of securing an income for the beneficiaries; while a speculation is for the purpose of a profit from the transaction."

\textsuperscript{276} Matter of Cady, 211 App. Div. 373, 376, 207 N. Y. Supp. 385 (4th Dep't 1925).

\textsuperscript{277} N. Y. DECEDENT ESTATE LAW § 111 (1); N. Y. PERS. PROP. LAW § 21 (1). But the
dividends and bonds whose interest is in default, even though they are acquired in an effort to control a railroad system; nor in an unsecured promissory note;

"... nor in any other manner where the only security for the safekeeping and proper return depends entirely upon individual or personal responsibility which today may be ample and tomorrow may be worthless."279

If a testator elects to make fiduciaries of his business associates, with respect to a venture in which they are commonly engaged, he should give them express and broad administrative powers as otherwise there will be a conflict between their interests as fiduciaries and as individuals because:

"The courts have always looked with disfavor upon the investment of trust funds in enterprises where the interests of the trustees as individuals may come into conflict with their interests in the fiduciary relation."280

Unimproved real estate is a permissible investment under the statute but it is suggested that the most careful consideration be given before such an investment is made.

Bank Accounts as Investments

If a fiduciary maintains a bank account for the cash balance which he will almost invariably have on his hands and if the bank should fail, the fiduciary will not be held responsible for any resultant loss unless he has been negligent in the matter or had actual knowledge of the fact that the bank was financially unsound, or unless he kept the estate account in a bank outside of the State of New York. But if


284. Matter of Poulson, 155 Misc. 625, 627, 280 N. Y. Supp. 350, 351 (N. Y. Co. 1935), Surrogate Delehanty said: "... the rule is that an administrator who takes the funds of an estate beyond our own jurisdiction and subjects them to other laws and the risk and inconvenience of distance and of foreign tribunals does so at the peril of being held responsible for the safety of the funds." Matter of Fricke, 166 Misc. 443, 2 N. Y. S. 2d 654 (N. Y. Co. 1938) Delehanty, S.
he has maintained an interest-bearing account for the estate for a pro-
longed period which is in the nature of an investment or perhaps in lieu
thereof, and the bank fails, there is some conflict of opinion as to his
liability for any loss. The earlier cases held that a bank account was
not a form of investment permitted to fiduciaries, and hence that they
maintained them as investments only at their peril. Thus, when a
trustee opened an account for his trust in 1880, not for the purpose of
paying estate charges but as an investment for the funds in his hands he
was held liable for the loss sustained when the bank failed in 1882. The
court held dogmatically that “the law does not permit a trustee to deal
with moneys in his hands in that capacity in this manner,” and that
a testamentary provision that the fiduciary was not to be held liable for
losses arising out of a bank failure was applicable only during the
period when funds were on deposit awaiting investment and that such
period could not extend beyond a reasonable while.285 The same result
was reached several years later in connection with a trustee who, with
the consent of the income beneficiary, deposited funds with a private
banker at 4% interest in 1900. When the banking house failed in 1910,
he had to bear the loss.286

But in recent years, different results have been reached by the courts.
When the Veterans Administration sought to compel the committee of
an incompetent to invest the estate funds in the investments permitted
to committees by statute, in place of the savings accounts which the
committee maintained, it was denied relief. The court held that the
question was not presently justiciable and should await an accounting. It
going on to say, however, that the statutes relative to investments were
not exclusively controlling, that committees were subject to an obliga-
tion to act with prudence, foresight and vigilance and to keep estate
funds “in a state of security productive of interest and subject to re-
call”; that a committee must use its own judgment as to the time to
invest and that it was only when prudence demanded that an invest-
ment be made that the statutes governing them became operative.287
There was a strong dissent on the ground that a deposit in a bank was
not an investment of funds288 and that the language of the statutes ap-
licable to committee investments was mandatory in its nature.

286. Matter of Donahue, 88 Misc. 359, 363, 364, 151 N. Y. Supp. 1034, 1037 (Sarato-
ga Co. 1914) Ostrander, S.
1937).
New York & Erie Bank, 13 Hun 269 (N. Y. 1878).
The rule of prudence was followed also in a case where moneys de-
posited in a bank in 1930 were lost by the bank failure in 1933. The
court stressed the fact that the same loss might have accrued had the
trustee invested in certain of the types of securities permitted by the
statute. It said:

"Should they have invested in real estate mortgages or purchased railroad
bonds? We know the results of such investments. As we have noted, economic
conditions were such that even a greater loss might have been sustained by
such investments. In my opinion the Trustees acted as men of prudence, dis-
ccretion and intelligence in like matters employ in their own affairs and failure
to withdraw the deposit from the Bank of Lancaster and invest it elsewhere
was not negligence."

And another court, in holding that the fiduciary had the right to invest
the income which was being accumulated, took it for granted that the
investment thereof might be in the form of a bank account, holding that
it was within the discretion of the fiduciary.

As of today, the risk of loss with respect to bank accounts which do
not exceed $5,000. is eliminated by the federal statute, providing for
insurance of bank accounts up to that amount. But the rights of the
income beneficiary will continue to be a constant factor for the con-
sideration of any fiduciary who contemplates a bank account as a per-
manent investment for the funds of his estate.

Real Estate Mortgages as Investments for Fiduciaries

Real estate mortgages have always found favor with the courts and
the legislatures as investments for fiduciaries. Before the enactment
of legislation on the subject, the courts held that government bonds and
real estate securities were the only forms of investments which fiduci-
aries were permitted to make. When the legislature undertook to
establish "legal" investments, it included:

"... bonds and mortgages on unincumbered real property in this state worth
fifty per cent more than the amount loaned therein."

The value of the realty, however, and its freedom from encumbrances
are not the only factors for consideration. Fiduciaries have been sur-
charged for failing to take into consideration the financial responsi-

290. Matter of Gordon, 40 N. Y. S. 2d 888, 891 (Orange Co. 1943) Taylor, S.
292. King v. Talbot, 40 N. Y. 76, 97 (1869). Three judges concurred in this view;
four dissent from it.
293. N. Y. DECEDENT ESTATE LAW § 111 (1); N. Y. PERS. PROP. LAW § 21 (1).
bility of the obligors on the bonds. There has, however, come into recent being what might be termed the heretical doctrine that the financial responsibility of the obligor is not a necessary factor for consideration. Thus, in a recent case, the court, in dismissing an objection to a mortgage investment which was based on an alleged failure to investigate the financial responsibility of the obligor, said that:

"... there is no requirement in law that the obligor on a mortgage bond shall have independent financial resources. The trustee was justified in relying entirely on the value of the mortgaged property. Matter of Beebe, 52 N. Y. S. 2d 736, affirmed 268 App. Div. 1051, 52 N. Y. S. 2d 796; Matter of Ralston, 162 Misc. 194, 294 N. Y. S. 112," and also,

"In making the loan, the trust company was bound to look at the value of the property and not to the financial responsibility of the bondsman."

The earnings of the particular property involved at the time that the mortgage investment was made justified the rejection of the objections to it which had been filed. But an analysis of the Beebe case and the Ralston case, which are cited in support of the doctrine that a trustee may rely entirely on the value of the property, discloses that they are not convincing authorities.

In the Beebe case, the court overruled an objection to a mortgage investment based on the acceptance by the fiduciary of an individual described as "an impecunious dummy." As the obligor on the bond, the court found that the rent-rolls of the property at the time of the investment made the property self-sustaining and thus distinguished it...
from other cases, in which surcharges had been made. The court then added:

"In confirming a referee's report which dismissed an objection that the trustee's failure to obtain a financially responsible obligor and to investigate into its responsibility warranted a surcharge, Surrogate Foley recognized that in 1929, and before and since, many modern buildings were financed by conservative investment institutions through the issuance of mortgages to corporations which possessed no other assets than the property covered by the mortgage. Matter of Ralston, 162 Misc. 194, 200."

Thus, it appears, both Matter of City Bank Farmers Trust Co. and Matter of Beebe depend on Matter of Ralston, decided in 1937 by Surrogate Foley. It might be well, therefore, to quote everything that was said in that case with respect to the mortgage investment which was before the court. It was as follows:

"The remaining question involves the claim of the objectants that the trustee should be surcharged with respect to an investment of $5,000. made by it on July 6, 1929, in a bond and mortgage of the 'Madison-60th Street Corporation,' the investment being presently held in the capital of the trust by way of a proportionate interest in the securities of 650 Madison Avenue Corporation, a corporation formed to take title to the real estate formerly securing the mortgage and acquired through foreclosure. The referee's finding that the investment was not unlawful, improper, or improvident and that the trustee was not negligent is sustained by the evidence. His finding that the amendments of 1932 (Laws of 1932, c. 623, §§ 1, 2) to section 111 of the Decedent Estate Law and to section 21 of the Personal Property Law did not expressly limit the organization of corporations for the purpose of holding title to foreclosed properties to individual trustees, but applied also to corporate trustees, and that the organization of the '650 Madison Avenue Corporation' was authorized by law, is correct and is likewise confirmed. In re Estate of Frances L. Lockwood, 161 Misc. 877, 293 N. Y. S. 242."

It seems unnecessary to add that Matter of Ralston is hardly authority for the doctrines attributed to it. It merely holds that on its facts, one particular mortgage investment was not made negligently or unlawfully. It may well be that in many instances, a fiduciary will be justified in looking to the property alone for income on the investment and the return of the principal. If a property is owned by and constitutes the only asset of a corporate obligor and is rented to one or more tenants

on a basis which makes it self-sustaining, a fiduciary may properly ignore the lack of other assets of the corporation. But if the property is occupied by the owner as his residence, and is his only assets, then obviously, the ability of the owner to pay taxes, interest, maintenance charges, to say nothing of the principal debt, is a factor for consideration.

In determining the value of the property, the date of the appraisal should be reasonably close to the making of the investment. When corporate fiduciaries were permitted to sell mortgage participations to their trusts, however, it was inevitable that there should be gaps of time between the original appraisal upon which the entire mortgage loan was made and the subsequent resales to some one or more trusts. One court held that a trustee was not required to have a new appraisal every time a participation was sold to a trust. But the courts did not agree on the amount of time that might lapse. It was held in one case that an appraisal made in November, 1930, would suffice for a participation sold in September, 1931, while another court said that an appraisal made in November, 1930, would not suffice for a sale of a participation in July, 1931.

It is doubtful if the time between the appraisal and the loan may be limited with anything like precision. With real estate values stable and firm, the period can be extended far beyond the time permissible in a shifting, changing market.

The fact that the property must be "unencumbered" will naturally bar second mortgages as investments unless express authority is granted to acquire them. Real estate taxes are, of course, encumbrances but if the default is casual and subsequently cured, the investment will be validated. Restrictive covenants present another problem. In one case, the court applied the doctrine that a restrictive covenant was an encumbrance if it affected the way the land could be enjoyed or the use to which the owner might put it and consequently surcharged a fiduciary for investing in a mortgage or property, part of which was subject to a height restriction. It is suggested, however, that the underlying doc-

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trine itself needs modification and that a restrictive covenant will often add to the value of property. It would seem, also, that if a parcel is appraised in the light of its restricted use and a mortgage loan made on the basis of such appraisal, the restrictive covenant should not be deemed an encumbrance within the meaning of the statute. 304

Another statutory limitation on a mortgage investment is that the mortgaged property must be in the State of New York. Otherwise, and in spite of whatever care and prudence may have been employed by the fiduciary, he will be liable for any losses that may be sustained. 305 There are, however, exceptions to the rule. It does not apply:

a—If the mortgage investment was made by the testator and not by the fiduciary. 306

b—When an executor after carrying out a contract to purchase property made by the testator, sells the property and takes back a purchase money mortgage as part of the purchase price. 307

c—When the fiduciary is not limited to legal investments. 308

Surrogate Foley held that in addition a fiduciary who was not limited to "legals" was freed from the statutory limitation of the amount of the mortgage to the value of the property. 309

Mortgages on unimproved property are not prohibited by the statute and are not objectionable *per se*, 310 but it would seem that a fiduciary who invests in such a mortgage, except under the most favorable circumstances, is looking for trouble. 311

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304. The effect of a restrictive covenant on a mortgage investment is discussed in Matter of Lewisohn, 294 N. Y. 596, 63 N. E. 2d 589 (1945). It would seem that in Matter of Balch, 117 N. Y. L. J. 1479 (N. Y. Co. April 16, 1947) Collins, S., one of the mortgaged properties was subject to restrictive covenants but objections on that score were overruled.


308. Matter of Pollack, 134 Misc. 212, 236 N. Y. Supp. 149 (Kings Co. 1929) Wingate, S., where the fiduciary sought the higher interest rates obtainable in another state. In Matter of Clark, 165 Misc. 801, 1 N. Y. S. 2d 629 (Kings Co. 1938) Wingate, S., the corporate fiduciary functioned in Connecticut and invested the trust in Connecticut mortgages. The court pointed out that it could supervise local investments more efficiently than if they were in another state. In Matter of Pessano, 269 App. Div. 337, 55 N. Y. S. 2d 786 (1st Dep't 1945) the trustees lived in Pennsylvania and invested in Pennsylvania and New Jersey mortgages.


311. In Matter of Reed, 45 App. Div. 196, 61 N. Y. Supp. 50 (4th Dep't 1899), the
In addition to the statutory limitations, there are other factors to be considered in a mortgage, such as the date of its maturity. Objections have been made to mortgages investments because they did not mature until after the termination of the trust for which they were purchased. But it seems to be now established that it is not negligent for a fiduciary to invest in a bond or other fixed obligation which does not mature until after the date when the fiduciary must turn over the principal of the estate to the remainderman unless the investment was made only a short period of time before the date of termination of the trust and would not, by its terms, become due until substantially later on. But even when the latter set of circumstances prevailed to some extent, a fiduciary was exonerated from liability when it appeared that he had obtained a collateral agreement from a third party to purchase the mortgage at the termination of the trust, despite the fact that a subsequent ruling of the Banking Department prevented the carrying out of the agreement.

The decisions, however, in which these doctrines were enunciated involved investments in mortgages or participations in mortgages which were made at a time when there was a ready market for their resale. In more recent years, mortgages are not as readily marketable. Hence, the acquisition of a mortgage for a trust which will not mature for some years after the termination of the trust may not receive the favorable consideration of the courts if objections are made to the transaction. This does not apply, of course, to an investment in mortgage bonds which are listed on an exchange and hence readily saleable.

Fiduciaries would be wise if they avoided the types of mortgages that court took occasion to criticize adversely a mortgage investment because it was on unimproved property, even though it was also unquestionably objectionable because it was on property outside the State of New York.


for which other fiduciaries have been surcharged. In one instance, the
trustee had invested in a purchase money mortgage on a property which
had been bought on a speculation, which was not earning interest on
taxes, and where the building was antiquated and partly vacant. It
might be mentioned that purchase money mortgages as a class are not
apt to be suitable investments as they are generally measured by the
cash which the buyer is willing to put up, rather than by the value of
the property.

The fact that prior mortgages on the same property have been fore-
closed should be considered and the operations of similar properties
in the same locality are also pertinent. It appeared in one surcharge
case that the apartments in the mortgaged premises were of a size for
which the demand is decreasing, that when the investment was made
for the trust involved, five suits to foreclose mortgages on surrounding
property had been started, constructions on a nearby building had been
stopped, one action had been brought to foreclose a mechanic’s lien on
a nearby property and two other owners had assigned their rents to their
respective mortgages.

The Retention of Securities

If a trustee or other fiduciary whose function it is to invest and keep
invested the funds committed to his care, receives or makes an author-
ized investment, there is, obviously, no fixed limitation upon the period
during which it may be retained. It is subject only to the dictates of pru-
dence and diligence. If he has received securities which he is not author-
ized to retain, it would seem that the period of retention must await a ju-
dicial interpretation by the highest court of subdivisions 6 of Section 111
of the Decedent Estate Law and of Section 21 of the Personal Property
Law, added in 1938, which provide that no fiduciary shall be liable for
any loss incurred with respect to an ineligible investment if received
under a will, decree or other instrument creating a fiduciary relationship,
or if eligible when received or purchased, “. . . provided such fiduciary
exercises due care and prudence in the retention of any such ineligible
investment.” If this is merely a codification of the doctrine judicially
established prior to 1938 to the effect that a fiduciary is not held to the

1940); Matter of Walsh, 171 Misc. 231, 12 N. Y. S. 2d 298 (N. Y. Co. 1939) Delehanty, S.
hantry, S. For an opinion in which mortgage investments are discussed in their respective
details and objections to them are dismissed, see Matter of Balch, 117 N. Y. L. J. 1479
(N. Y. Co. April 16, 1947) Collins, S.
same degree of liability with respect to an investment made by a testator or grantor of a trust as he is with respect to one which he himself has selected, it would follow that the 1938 amendments do not eliminate completely from consideration the time factor as such. But if they are construed to mean that a fiduciary may retain an ineligible investment until the facts and circumstances in relation to it demanded its sale as a matter of careful and prudent investment administration, it would follow that the time factor as such would cease to be of importance and there would be no greater risk of surcharge through retaining an unauthorized investment than would pertain to the retention of a "legal" investment or one expressly authorized by the will or other instrument. Certainly, the Court of Appeals indicated in a recent case that a corporate fiduciary may retain shares of its own stock, if received after the 1938 amendments and in the manner therein provided. If they are sufficiently broad to overcome the rule against undivided loyalty, it should follow that they are broad enough to eliminate the time factor as well. No doubt, there will soon be a definite holding one way or another on the matter. But to the executor or administrator, the time factor is of primary importance regardless of his right to retain the securities in his hands, because he must meet fixed obligations at fixed times and if the decedent failed to leave sufficient cash to meet those obligations the assets of the estate must be sold to provide the necessary funds, regardless of their investment character.

The Period of Retention by Executors and Administrators

In the earlier cases at least, the courts were reluctant to be specific in stating how long an executor or administrator could retain securities without becoming liable for their value. They emphasized that an executor or administrator must convert the estate into cash within a reasonable time but they emphasized just as strongly that what constituted a reasonable period of time varied with the facts in each case. Thus, in the leading case of Matter of Weston, decided in 1883, the court, in refusing to surcharge an executor who had retained a large block of speculative common stock for four years, during which it dropped in market value from $80. to $15. per share, said:

"There is, and there can be, no rigid and arbitrary standard by which to measure the reasonable time within which the discretion of an executor directed to convert an estate into money must operate. . . . Even where there is a direc-

319. Matter of Durston, 297 N. Y. 64, 74 N. E. 2d 310 (1947). Some of the relevant cases decided prior to 1938 are discussed or cited in Part I of this article, on pages 26, 27 and 28 of the March, 1947, issue.
tion to sell, reasonable time must be given and what that is must be determined in each case by its own surroundings.\textsuperscript{320}

It must be admitted that no matter how sound might be the doctrine so promulgated, the time element was left "wide open."

In \textit{Matter of Thompson}, decided in 1903, the court reiterated the doctrine in refusing to surcharge an administrator who had retained securities for fifteen months and in addition warned against the sale of speculative securities "... without regard to the market or the demand for them or the ruling prices or the possibility of an advance in their value." This, of course, is sound and correct but the warning that a fiduciary may be held liable if he sells too soon, or if he ignores a possible increase in the market value, may have unfortunate results.\textsuperscript{321} It is suggested that the question of how long an executor may retain securities was better answered when Surrogate Foley said that the period was "not a matter of mathematical calculation."\textsuperscript{322}

There are, however, certain limitations on what constitutes a reasonable period of time. It must be fixed by the circumstances of the case and not by the fiduciary's "caprice or conclusion."\textsuperscript{323} There has been, moreover, a trend in recent years and particularly in New York County to limit sharply the period during which an executor or administrator may retain securities if certain conditions exist as, for instance,

\begin{itemize}
  \item[a] If they are held in a margin account.
  \item[b] If cash is needed to pay legacies.
  \item[c] If cash is needed to pay debts.
  \item[d] If cash is needed to pay taxes.
\end{itemize}

These classes will be discussed separately.

\textit{Retention of Stocks in a Margin Account}

An executor or administrator may not be called upon to administer a margin account today as frequently as was the case before margin requirements became subject to governmental control, but if he finds he

\begin{itemize}
\item[320.] Matter of Weston, 91 N. Y. 502, 510, 511 (1883).
\end{itemize}
has to deal with one, the safest course for him to follow is to sell enough securities to pay off the debit balance as soon as it is reasonably possible to do so. Attempts in the past by executors with the best of faith and with the best of motives to hold on to securities in a falling market in the hope that prices would rise, have proved highly expensive. But once the fiduciary has sold sufficient securities to pay off the debit balance, the retention of the remaining securities will be subject to the same rules and standards as if they had been owned outright by the testator at his death.

Sales to Pay Debts

There are two conflicting decisions with respect to the obligation of an executor or administrator to sell sufficient securities within a fixed period of time in order to pay debts. In Matter of Strasenburgh, decided in 1937, the court held that "The duty of an executor to pay the testator's debts does not mean he must sell against his best judgment, nor within seven months, or at any other time . . . ," particularly when market conditions were unsettled. But in Matter of Witkind, decided in 1938, Surrogate Delehanty arrived at a contrary result. The executors had sold sufficient securities to pay a substantial part of, but not all of, the testator's debts within the then statutory period of one year allowed for the payment of claims. They refrained from making additional sales because they decided that from an investment stand-

324. In Matter of Hirsch, 116 App. Div. 367, 101 N. Y. Supp. 593 (1st Dep't 1905), aff'd mem., 183 N. Y. 584, 81 N. E. 1165 (1907) an executor with broad powers not only retained a margin account for two years, but poured good money of the estate into it, in the vain hope of saving it. For this and other reasons, he was removed. No question of surcharge was presented to the court. In Matter of Solomon, 72 N. Y. L. J. 1497 (N. Y. Co. Jan. 20, 1925) O'Brien, S., the fiduciary who had retained a margin account for 13 months was charged with the value of the securities as of 30 days from the time of his appointment. In Matter of McKee, 147 Misc. 889, 265 N. Y. Supp. 47 (N. Y. Co. 1933) Delehanty, S., the fiduciary was surcharged for maintaining a margin account for four weeks. But in Matter of Lazar, 139 Misc. 261, 247 N. Y. Supp. 230 (Bronx Co. 1930) Henderson, S., the court refused to surcharge an administrator who qualified in June 1929, and did not start selling out the margin account until October 30, 1929. Matter of Lazar was the first of the long line of decisions exonerating fiduciaries for losses arising out of the 1929 market crash. It has been cited time and again, but on general issues rather than with respect to margin account. Matter of McIlwaine, 255 App. Div. 978, 8 N. Y. S. 2d 1 (2d Dep't 1938), aff'd, 250 N. Y. 775, 21 N. E. 2d 615 (1939), is an illustration of what can happen to fiduciaries who try their best to help an estate at a time when the market is declining.


point, it was not advisable to sell. The court found that the decision not to sell more securities had been reached in a prudent manner from the standpoint of security administration, but that they were obligated as a matter of law and not a matter of judgment to sell sufficient securities to pay the debts within the specified time. Consequently, it surcharged the executors with the difference between the price eventually received for the securities and their value one year after death.\textsuperscript{327}

Sales to Pay Legacies

There are also two conflicting decisions with respect to the obligation of executors to sell securities in order to pay legacies, but they may be reconciled on their facts. The time element in both cases was subordinate, however, to the conflict between the rights of general legatees and residuary legacies.

In the earlier of the decisions, \textit{Matter of Andrews}, the testator created general legacies of about $1,150,000, and left the rest of his estate, about $350,000, to a hospital. The chief asset of the estate was a block of 17,000 shares of an insurance company. The stock was regarded as a conservative and high-grade investment. The executors qualified in January, 1931. They naturally found that selling the 17,000 shares of stock was a problem. They consulted with three men described by the court as being "of great repute in financial matters." They started selling the stock in February, 1931, and had disposed of 10,000 shares by April when the market value dropped to a point which, by almost unanimous consent, was less than its intrinsic value. No further sales were made and the remaining shares were eventually distributed in kind to the general legatees at such reduced values that their legacies were not paid in full. Nothing was left for the residuary legatee.

The residuary legatee filed no objections but the general legatees objected on the ground that the executors owed a different duty to them than to the residuary legatee, and should have sold enough of the stock to pay the general legacies, regardless of the effect upon the residuary estate. The Appellate Division of the Second Department emphatically repudiated the theory that there was any difference between executors' duty toward the general legatees and toward the residuary legatees, and refused to surcharge the fiduciaries.\textsuperscript{328}

In \textit{Matter of Stumpf}, two of the three executors were also residuary legatees. They retained common stocks over the accounting period, not

\begin{footnotesize}
\begin{enumerate}
\item[327.] Matter of Witkind, 167 Misc. 885, 2 N. Y. S. 2d 933 (N. Y. Co. 1938) Delehanty, S.
\item[328.] 233 App. Div. 32, 265 N. Y. Supp. 386 (2d Dep't 1933).
\end{enumerate}
\end{footnotesize}
because some of them at least could not have been sold at prices equal to their value at date of death, but because, according to the finding of the court, they hoped that the stocks would regain their cost to the testator. But in fact, they depreciated to the extent that the general legacies could not be paid in full and the executors were surcharged for the resultant defect in the payment of the general legacies.\textsuperscript{329}

\textit{Matter of Andrews} and \textit{Matter of Stumpf} are not in conflict on their facts. In the \textit{Andrews} case, the executors started to sell promptly; they ran into a declining market; they acted diligently and prudently and their judgment was not affected by any selfish consideration. In the \textit{Stumpf} case, at least some stocks could have been sold at their value at time of death; the executors sought the original cost and a selfish interest existed. The ruling in \textit{Matter of Stumpf} does not contravene the general doctrine of \textit{Matter of Andrews} that a fiduciary owes the same duty to both general and residuary legatees and that the interests of neither are preferred.

\textit{Sales to Pay Taxes}

The varying opinions with respect to the retention of securities in the face of an obligation to pay estate taxes are well illustrated in \textit{Chemical Bank and Trust Co. v. Ott}.\textsuperscript{330} The fiduciary was trustee under an \textit{inter vivos} trust, consisting chiefly of a large block of stock of an industrial corporation, listed on the Stock Exchange. The trust was revocable and hence the principal was taxable as part of the grantor's estate. The grantor did not die possessed of sufficient assets to pay the tax on her individual estate and the trust combined and hence it became necessary to sell some of the stock held in the trust to obtain the cash required for tax purposes.

Upon the accounting, the issue was raised as to the time or times when the trustee should have sold the stock in order to pay the tax. The settlor had died on June 23, 1930; a dispute among the beneficiaries of the trust was settled by an agreement made on August 2, 1930; the executor was appointed in September, 1930, and the stock was not sold until 1932 and 1933.

The referee held that the stock should have been sold about the middle of September, 1930, which would fix the date at less than three months from the date of death. The Appellate Division reversed. Three justices held that it should have been sold eighteen months after death; a minority of two justices thought it should have been sold over a period commencing four months and ending eighteen months after death.

\textsuperscript{329} 153 Misc. 92, 274 N. Y. Supp. 466 (N. Y. Co. 1934) Delehanty, S.

These three conflicting opinions were not solved in the slightest degree by the Court of Appeals when it reversed the Appellate Division. In a per curiam opinion, five judges held that "under the peculiar facts of this case the trustee was not negligent in the exercise of its judgment." Two judges voted to affirm the decision of the referee. Thus, out of thirteen judges who passed on the matter, the voting as to the liability of the trustee was

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<tr>
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<td>3</td>
</tr>
<tr>
<td>Liable for value of stock over 4 to 18 months period</td>
<td>2</td>
</tr>
<tr>
<td>Liable for value of stock at end of 3 months</td>
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But in spite of the indecisive character of the outcome of the Ott case, it remains clear that every fiduciary who is called upon to pay taxes must provide himself with whatever amount of cash he will need for that purpose, and that if he must sell securities to obtain the cash, he should make his plans well in advance. It is suggested that the fiduciary who starts selling three or four months after date of death, and avails himself of favorable markets over the next ten or twelve months to obtain the necessary funds will not only have the cash to pay the federal taxes fifteen months after death, but will in the absence of other factors have smooth sailing on his accounting.

**Retention After a Decision to Sell**

If a fiduciary decides that a security should be sold he must sell it within a reasonable time thereafter or else hold it at his peril, assuming, of course, that he does not change his judgment as to the advisability of selling. Thus, when a fiduciary decided in September to sell a security but delayed the sale until the following February for reasons which the court found inadequate, he was surcharged for the difference between the sale price and the price at which it could have been sold at the expiration of a reasonable period for making the sale.\(^{881}\)

**Retention in Times of Panic and Depression**

Judging from the reported cases, it would seem that a fiduciary is seldom held liable for losses arising out of the retention of securities through a period of financial panic and of the depression that may follow it. This is not coincidental but the result of the operation of the doctrines that govern the administration of securities by a fiduciary. A

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panic is by its very nature an unexpected happening. If it were something that could be foreseen, it would not be a panic. And being unforeseen, it brings disaster to the wise and prudent investor as well as to the careless and reckless speculator. Consequently, a fiduciary whose estate has suffered by a panic can invoke the doctrine that he should not be held liable for a result that he could not foresee and was unable to prevent. Moreover, since the standard by which he is to be judged is not one absolute in itself but a comparative one, fixed by the conduct of other men deemed wise, diligent and prudent, he can claim that he is not to be held liable for losses when many, if not perhaps all the admittedly wise and prudent administrators of securities, were no wiser nor more prudent than he. The courts, however, will be lenient in applying these protective doctrines only if the conduct of the fiduciary has been marked with honesty, diligence and prudence in other respects.

The comparatively early case of Matter of Weston affords a good illustration of how the courts treat losses which were occasioned by a financial panic. The testator died on May 7, 1873, owning 1,500 shares of a speculative stock which he had bought in 1872 at 59 and which had risen to 94 in January, 1873. When he died, the stock was selling at 85. When his executors qualified in June, 1873, the stock was selling at 80. The testator had left a memorandum directing that the stock “was to be held firmly; a dividend expected in two years.” The executors were advised to hold the stock and did so. One of the executors continued to retain the same stock for his personal account. In September, 1873, the panic of “Black Friday” occurred and the stock dropped to 55. The executors held on to it and their judgment received the later approbation of the Court of Appeals which said:

“Certainly it was no time to sell. The stock was paid for and the estate strong and able to carry it throughout the expected emergency.”

333. In Matter of Thompson, 41 Misc. 420, 422, 84 N. Y. Supp. 1111, 1112 (Saratoga Co. 1903) Lester, S., aff’d mem., 87 App. Div. 609, 83 N. Y. Supp. 1117 (3d Dep’t 1903), aff’d mem., 178 N. Y. 554, 71 N. E. 1140 (1904), the lower court said: “It is to be noted that the depreciation was not in a single stock, through some particular loss, or as the result of some mismanagement of the affairs or the unsuccessful operation of the business of a particular corporation. It was a depreciation of the stocks of several different corporations, and was due to influences that affected the market generally. To foresee such periods of general depression, or periods when high prices prevail, is the constant efforts of the keenest intellects in the financial world, but notwithstanding their vigilance and tireless efforts, stimulated by the hope of great gains, they frequently find such knowledge too high for them. The law does not require such prescience of administrators.”
334. 91 N. Y. 502 (1881).
335. Id. at 509.
By February, 1874, the stock had risen to 67 and the executors con-
tinued to hold on to it. Their judgment was deemed to be justified, the
Court of Appeals saying that:

"The indications pointed to an eventual restoration of value and we cannot
say that it was imprudent or unwise to wait for it."336

But in April, 1874, the stock was selling at 30; when the accounting
was started in June, 1874, it was appraised at 20; shortly after, it was
selling at 15. The court, nevertheless refused to hold the executors
liable, not only because the investment was one inherited from the tes-
tator337 but because the test of their liability did not exceed "... the
diligence and prudence of prudent and intelligent men in the handling
of their own affairs."338 The court added the very delightful chîcîè that:

"... stocks of variable value ought not to be timidly and hastily sacrificed,
nor unwisely or imprudently held."339

The court then laid down a doctrine referred to, which continues to
have universal application that:

"Even when there is a direction to sell, reasonable time must be given and
what that is must be determined in each case by its own surroundings."340

In a later case, the courts went even further in refusing to hold a
fiduciary liable for losses occasioned in part by the closing of the New
York Stock Exchange in August, 1914, because of the outbreak of World
War I; so far, in fact, that the decision cannot be used with any degree
of safety as a guide or standard. The testator died in the summer of
1913, leaving a will in which he directed his executor to convert his
assets into cash "as soon as may be after my decease." The executor
qualified on September 30, 1913. The stocks declined somewhat in Janu-
ary, 1914, but he retained them upon investment advice to do so. He
sold some stocks in March and April, 1914, at the insistence of some
of the legatees but a number of shares were still in his possession
when war broke out in August, 1914, and the exchanges shut down.
The stocks were sold later on at substantial losses.

It will, of course, be noted that ten months had elapsed from the
date of letters testamentary until the outbreak of the war during which
the stocks could have been sold without difficulty. The court, never-
theless, refused to hold the executor liable for the losses sustained, say-

336. Id. at 510.
337. Id. at 511.
338. Ibid.
339. Ibid.
340. Ibid.
ing that they were the result of errors in judgment. The phrase “as soon as may be after my decease” was interpreted to mean “as soon as reasonably may be,” a construction which would probably have surprised the testator greatly but which may be just punishment for his employment of cryptic phrases when unequivocal language was readily at hand.

Needless to say, the losses which beneficiaries of estates suffered by the market crash of October, 1929, and the depression which followed led to many contested accountings. But almost without exception, the fiduciaries were exonerated from liability. The first of the reported 1929 crash cases seems to be Matter of Lazar. The decedent died intestate and hence, there was no possible grant of the right to retain his securities. Letters of administration were issued on June 18, 1929, and the administrator found that the bulk of the estate consisted of common stocks in a margin account. Acting on advice received, he held on to them, saw them increase in value during the summer of 1929 and saw them start to crash in October of that year. He started selling on October 30 and had disposed of all of the stocks by November 14 but at prices far less than the inventory values. The Surrogate refused to hold him liable for the losses sustained, stating that they were due to errors of judgment and that the crash could not have been foreseen, as was attested by the fact that many men of financial shrewdness and ability were also caught in the market collapse.

The same results were reached in numerous other cases where the losses were due to a stock market crash and to an ensuing depression. The table in the footnote lists some of the cases in which the


342. This would not apply, naturally, where other factors were involved such as obligations to pay debts or taxes or legacies, or where the interests of beneficiaries had been subordinated to the interests of the fiduciaries. The presence or absence of any express power to retain the securities with respect to which the loss had occurred does not appear to have been any important factor in the results arrived at by the courts.

343. 139 Misc. 261, 247 N. Y. Supp. 230 (Bronx Co. 1930) Henderson, S.

343a. Character of Fiduciary Power of Retention Period of Retention

PANIC OF 1873—BLACK FRIDAY
Matter of Weston, 91 N. Y. 502 (1883), Executor Yes 13 Mos.

DEPRESSION OF 1902
Matter of Thompson, 41 Misc. 420, 54 N. Y. Supp. 114 (Saratoga Co. 1903), aff'd, 87 App. Div. 609, 83 N. Y.
Supp. 1117 (3d Dep't 1903), aff'd, 178 N. Y. 554, 71 N. E. 1140 (1904).

DEPRESSION OF 1907


CLOSING OF STOCK EXCHANGE—1914


PANIC OF 1929 AND SUBSEQUENT DEPRESSION


Matter of Winburn, 140 Misc. 18, 249 N. Y. Supp. 758 (Westchester Co. 1931).


fiduciary escaped surcharge for losses, with notations as to the type of fiduciary involved and whether or not he had power of retention—if such fact appears—and the length of time during which he retained the securities on which the losses occurred.

**Retention Without Valid Reasons Therefor**

It would be a serious mistake to decide that the courts seek after reasons whereby they can exonerate fiduciaries from liability for losses suffered by the estates committed to their care. For one thing, a fiduciary must be able to advance a reason why he has retained securities in a falling market, and the reason must be one sound in law as well as in fact. If, for instance, a fiduciary without power to retain securities, holds on to them under the belief that he is the owner of them for his individual account, and if the claim to ownership is rejected by the court, the fiduciary may be held liable for the loss in value which they sustained while being retained. In another instance, the executors retained securities because of a will contest and on the alleged ground of acquiescence. But the court held that the will contest was an immaterial consideration and that there had been no acquiescence; consequently, with the disappearance of the reasons for the retention of the securities, the fiduciaries found that they were liable for the losses which had been sustained. Another trustee who was empowered to retain those securities which the testator owned at his death, kept certain stocks which it thought came within that category. It was discovered, however, that the stock had, in fact, been purchased by the executor and hence the trustee, having retained it on an erroneous theory, became liable for the depreciation in value which the stock happened to have sustained. And, of course, if the fiduciary is unable to give any reason at all for the retention of securities over a period when they are depreciating, he will be held liable for the loss without question.

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<td>Matter of Horton, 166 Misc. 768, 3 N. Y. S. 2d 217 (Bronx Co. 1938).</td>
<td>Guardian</td>
<td>No</td>
<td>5 Yrs.</td>
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<td>DEPRESSION OF 1937</td>
<td>Executor</td>
<td>No</td>
<td>9 Mos.</td>
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347. Matter of Baker, 249 App. Div. 263, 292 N. Y. Supp. 122 (4th Dep't 1936); Mat-
What Constitutes a Reasonable Period of Retention of Securities

Although the courts have repeatedly said that the period within which an executor or administrator must reduce the estate to cash is not a fixed and set number of days or months or years, they have nevertheless stated what they consider a reasonable period to be in the absence of unusual circumstances. The comparatively early case of Matter of Weston suggested eighteen months as a reasonable time and other courts have suggested the same period. However, as the time within which an executor or administrator may be required to account has been shortened, there have been expressions of opinion that a reasonable period of the retention of securities is one year. Today, an executor or administrator may be required to account at the end of seven months. And it may well be that "the reasonable period of time" will be reduced accordingly. As one court pointed out, in some cases, it might be only two months.

The courts have adopted the same general rule with respect to the retention by trustees of securities which they lack the power to retain. In an early and leading case, the trustee had retained certain bonds without authority to do so, for a period of nine years, but since no objections were filed with respect to the loss which ensued, it cannot be said that any issue was presented for determination. The court, however, undertook to discuss the situation, saying:

"We are not inclined to lay down a hard and fast rule in respect of this matter. When a trustee finds the estate committed to him already invested in interest bearing securities, we are not inclined to say that it is his absolute duty at once to dispose of them without regard to the market, or the demand for them or the ruling price or the probability of an advance in their value. It is
sufficient to say, however, that ordinarily if a trustee sees fit to continue such investments after he shall have had a reasonable opportunity to sell them without loss, and to invest them in those securities which by law he is authorized to hold, it must be an exceptional case which will justify him in his failure to do so, where as a result of such failure there has been a loss.\textsuperscript{352}

In spite of the unsatisfactory character of the decision, by reason of the failure of any beneficiary to object, the doctrine remains unchanged.\textsuperscript{353} Sometimes, however, as with executors a court will indicate what constitutes a reasonable time. Thus, a trustee who held preferred stocks without authority for eleven years was told that he should have sold them within six months of their receipt and the surcharge was computed on the basis of their value six months after their receipt.\textsuperscript{354} On the other hand, when a trustee who had no authority to retain stocks asked for the instructions of the court, he was told that in the absence of modifying circumstances, eighteen months might be reasonable.\textsuperscript{355} In another instance, a trustee who had held foreign bonds from March 1, 1931, until October 1, 1935, without authority, was not surcharged for any loss, but as the loss actually was sustained by June, 1931, or within four months of acquisition, the retention for the next five and a half years was immaterial.\textsuperscript{356}

However, these transactions occurred prior to the enactment in 1938 of the amendments to the Decedent Estate Law and the Personal Property Law and the decisions may be obsolete if, as is possible, it is held that the amendments eliminate the factor of time as an element in determining liability.

It might be added that when a trust terminated in January, 1933, and the trustee did not file its account until August of that year, during which time certain investments dropped from 45 to 50 points, the trustee was surcharged with their value as of their value when the trust terminated.\textsuperscript{357}


\textsuperscript{353} In 1939, the Court of Appeals said, in Guaranty Trust Co. v. Lewis, 279 N. Y. 396, 400, 18 N. E. 2d 635, 637 (1939), "In the absence of a provision in the trust indenture authorizing the trustee to retain the securities which are non-legals, the trustee would have been under a duty to dispose of them within a reasonable time unless special circumstances warranted retention. Ordinarily, a trustee may not retain securities in which he would not be permitted to invest."

\textsuperscript{354} Matter of Hamersley, 180 N. Y. Supp. 887 (N. Y. Co. 1920) Foley, S.

\textsuperscript{355} Matter of Watson, 145 Misc. 245, 261 N. Y. Supp. 327 (Nassau Co. 1931) Howell, S.

\textsuperscript{356} St. Louis Trust Co. v. Stoffreagen, 40 N. Y. S. 2d 527 (Sup. Ct. N. Y. Co. 1942).

\textsuperscript{357} Matter of Jacobs, 152 Misc. 139, 273 N. Y. Supp. 279 (Delaware Co. 1934) O'Connor, S.
Retention After Investments Cease to Be "Legals"

A fiduciary who purchased bonds in 1928 when they were legal investments, retained them until 1934, although they were dropped from "the legal list" in 1930. The court held that they should have been sold within eighteen months after they ceased to be "legals," computed their market value over the eighteen months period and surcharged them for the amount by which such average price exceeded the sales price. The court did not refer to the applicability of subdivision 6 of Section 111 of the Decedent Estate Law and of subdivision 6 of Section 21 of the Personal Property Law to an ineligible investment which "was eligible . . . when the investment was made by the fiduciary." This may have been due to the fact that the transactions took place before 1938 when subdivision 6 of these Sections came into force and effect. Or it may have been due to the fact that the court considered that the amendments did not eliminate the time factor from consideration in disposing of securities which were "legal" when bought and which were later dropped from the legal list. It is, however, possible that some other court may hold that if an investment which was on the legal list when bought is subsequently dropped, there is no time limit at all to its continued retention, but only the exercise of care and prudence.

Basis of Computation of Surcharge When Liability Has Been Established

It is not possible to lay down a general rule as to how a court will fix the amount of a surcharge, once it has determined that an investment has been improperly retained. In one case already referred to, when a trustee held on to preferred stocks without authority for a number of years, he was held liable for their value at the end of six months from the date of their receipt. In another case, a trustee retained bonds of the Interborough Rapid Transit Company during World War I when earnings were declining in the face of a fixed fare and rising operating costs. The court held that the New York City Administration was hostile to the subway company and sought to wreck it, that the only hope of relief would come from legislative action granting an increased fare and that when the 1918 Legislature adjourned in April without taking such action, the fiduciary should have sold the bonds within two months thereafter. Consequently, he was surcharged with the excess of their June market values over the selling price. When an executor was sur-

360. Matter of Jarvis, 110 Misc. 5, 180 N. Y. Supp 324 (Westchester Co. 1920) Slater, S.
charged for retaining stocks without authority for six years during which
time they rose greatly in value and then suffered a substantial loss, it
was surcharged on the basis of their value at time of death regardless
of intervening rises.\footnote{303} In another somewhat similar case, an executor
retained stocks for ten years although he could have sold them above
the values at time of death for a period of eighteen months thereafter.
He was surcharged on the basis of their inventory value.\footnote{302} The same
result was reached in another case where an executor retained various
stocks for a period from 21 to 30 months during which time they fluctu-
ated greatly in value. Since the court could not fix the exact date as
of which they should have been sold, it established liability on the values
as of date of death.\footnote{303}

**General Principles Affecting Improper Retention of Securities**

Each and every case must be decided on its own facts. The important
thing to remember is that if a security is not one that should be re-
tained, whether because of lack of power to retain it or because of its
own lack of worth, the sooner the fiduciary disposes of it, the better off
he will be. Occasionally, factors will exist which make the security
difficult to dispose of. This is particularly true of unlisted securities.
In another instance, the market may be so "thin" that the security must
be offered in small lots for fear of driving the price down.\footnote{304} Or the
security may be selling at depressed prices and there may be reason to
believe that its intrinsic value is substantially greater than its market
value. When considerations such as these exist, the time within which
securities must be sold may be fixed by the courts in terms of many
months. But if the security enjoys a ready market, and, for instance,
is a bond selling above its call price so that it cannot very well go up
and can only come down in value, it is not impossible that a court might
fix the time for sale in period of weeks. It is well to keep in mind at
all times that a fiduciary holds a security which he is not authorized
to retain at his own risk\footnote{305} and should guard himself accordingly.

\footnotesize
\begin{enumerate}
\item Matter of See, 38 N. Y. S. 2d 47 (Westchester Co. 1942) Millard, S.
\item Matter of Buck, 55 N. Y. S. 2d 841 (Westchester Co. 1945) Griffiths, S.
\item Matter of Mercantile Trust Co., 156 App. Div. 224, 141 N. Y. Supp. 469 (1st
Dep't 1913) where the court complimented the corporate fiduciary for its skill in selling
a large block of volatile stock in a fluctuating market.
\item Matter of King, 130 Misc. 296, 224 N. Y. Supp. 283 (N. Y. Co. 1927) O'Brien, S.
\end{enumerate}
Retention of Securities Received in Exchange for Testator's Investments

It is not uncommon for a testator to empower his fiduciary to retain such securities as the testator may leave but to limit all re-investments to "legals." If, thereafter, it becomes necessary to exchange one of the testator's own investments for a new security, pursuant to a merger, a corporate reorganization or the like, the question will naturally arise as to the right of the fiduciary to retain the new security. The doctrine of law is well established that this can be done only if the new security is substantially the same as the original investment, and the issue thus becomes one of fact. The issue raised in *Mertz v. Guaranty Trust Co.* \(^{366}\) involved the question of a power of sale but the doctrine enunciated is applicable to the question of retention. The trustee involved held shares of common stock of a corporation which had no preferred stock. It merged with another corporation with the intention of changing both the product sold and the method of selling it, and the trustee received shares of common stock in the new corporation which were subject to certain priorities enjoyed by the preferred stock. The Court of Appeals ruled that the identity of the old company had been destroyed by the merger, Judge Cardozo saying in his felicitous style that:

"The old investment has been subordinated to alien priorities. The ancient venture has exposed itself to strange and unexpected hazards." \(^{367}\)

The court also held that a fiduciary authorized to retain stock of the Farmers Loan and Trust Company lacked power to retain the stock of the National City Bank when the two institutions merged, as the original company functioned primarily in New York City as a trust company whereas the National City Bank carried on a commercial banking business with branches all over the world. \(^{368}\) But when, in spite of a corporate reorganization, the business and the management remained unchanged and the rights of the original security holders were not subordinated to other forms of securities, the fiduciary was authorized to retain the new securities received in exchange. \(^{369}\)

Burden of Proof

As a general rule, the party who objects to the purchase or retention of an investment by a fiduciary on the ground that it was bought

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366. 247 N. Y. 137, 159 N. E. 888 (1928).
367 Id at 142, 159 N. E. at 889 See also Matter of Whittemore, 41 N. Y. S. 2d 823 (Kings Co. 1943) McGarey, S.
or retained negligently has the burden of proof on the issue of negligence. 370 If the investment complained of is a mortgage, then:

"The burden of proof so far as the legality of the investment is dependent upon the facts of title, value of the mortgaged property, percentage of mortgage to such values, the general nature of the mortgaged property, etc., is upon the objectant." 371

In accordance with general doctrines, the burden of going forward will shift to the fiduciary if the objectant makes out a prima facie case of negligence. But merely showing that there has been a loss or depreciation in value is not sufficient to shift the burden. 372 However, if not only a loss appears but an apparent breach of duty as well, the burden of going forward will pass to the accounting party. This distinction is well exemplified by two fairly recent cases. When an executor who was limited to "legals" retained the common stock of a corporation for eight years, during which time its value dropped from $100 a share to $1 a share, the court said:

"A prima facie case of negligence having been made out, it would hardly seem unreasonable to ask the executor, if it seeks to overcome the inference which might otherwise arise from its conduct, to come forward and frankly disclose what it had done, if anything, in regard to selling this security." 373

But where an executor sold securities with due diligence but nevertheless at a loss, the court said:

"Proof only of loss or shrinkage in value without any proof of want of care of prudence, the sales having taken place within a year of the executor's appointment does not establish negligence and does not present a prima facie case." 374


There is another distinction which must be observed. If the losses which are the subject of a controversy were sustained in connection with the purchase or retention of non-legal securities and the question at issue is not one of negligence but power and authority of the fiduciary to make or keep the investment, then, in the language of one court:

"The burden of proof is strictly imposed upon any fiduciary who continues non-legal investments to demonstrate the testamentary authority for such holding beyond the time necessary for prudent liquidation." 375

If the accounting shows on its face that the fiduciary has made unauthorized investments, the objectant need prove nothing more. 376

**Extent of Inquiry and Investigation Demanded of Fiduciaries**

A fiduciary who seeks advice from worthwhile sources in connection with the making of investments will find that the practice will be of help to him, should his judgment in making the investments be subsequently attacked. 377 It is equally true that the seeking of advice with respect to the sale of investments will go a long way toward escaping a surcharge for losses on retention, providing, again, that the issue is one of care, prudence and diligence. 378 But the inquiry must be made from an unbiased source. Thus, the fiduciary who in purchasing bonds for his estate relied on the recommendations of the bank which had underwritten them, found that while he was relieved from any charge of bad faith, he was not protected from responsibility for making an improvident investment 379 and the trustee who bought securities, relying on the statement of the salesman, was also surcharged. 380 It is true

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375. Matter of Stulman, 146 Misc. 861, 874, 263 N. Y. Supp. 197, 212 (Kings Co. 1932) Wingate, S.
378. E.g., Matter of Clark, 257 N. Y. 132, 177 N. E. 397 (1931); Matter of Andrews, 239 App. Div. 32, 265 N. Y. Supp. 386 (2d Dep’t 1933); Matter of McCafferty, 147 Misc. 179, 264 N. Y. Supp. 38 (Kings Co. 1933) Wingate, S. In Matter of Bunker, 184 Misc. 316, 318, 56 N. Y. S. 2d 746, 748 (N. Y. Co. 1944) Foley, S., the court in exonerating the fiduciary of negligence stressed the testimony that the fiduciary "... before buying or selling any of the investments, sought the advice of experienced and high officials of a bank in this city. He consulted the partners and subordinates of two firms of bankers and brokers who were members of the New York Stock Exchange. He continuously studied recognized financial periodicals. ..."
that the Chamberlain of the City of New York was held to have been justified in relying on the representations of a mortgage guarantee company, functioning under the supervision of the State Superintendent of Insurance, but in another case in which the fiduciary pleaded reliance on the supposed worth of a mortgage guarantee company, he was held liable for the ensuing loss, the court saying:

"That reliance is not a substitute for investigation. No inquiry was made about the building. The word of the salesman was accepted as to the completion of the building and its occupancy. Nothing is shown of actual investigation as to its earnings or as to its capacity to pay its carrying charges."

Moreover, in making an investigation, facts are more important than opinions. Thus, a fiduciary purchased bonds for his trust, relying upon the editorial opinion of a standard investment manual that the bonds were legal for trust fund. But unfortunately, the figures which appeared in the same manual negatived the opinion so expressed and he was surcharged for the making of an unauthorized investment.

Like other facts which are involved in the matter of making and retaining investments, the question of investigation and inquiry resolves itself into the standards of a prudent man handling his own affairs.

**Limitation of Surcharge to Successful Objectants**

Not everyone will benefit by a judicial determination that a fiduciary must account for a loss sustained by the estate. If a beneficiary refrains from filing objections to an account, he will not be permitted to share in any surcharge arising out of the objections of other interested parties. Thus, when fiduciaries were surcharged for retaining securities in a falling market under circumstances which rendered them liable, the amount of the surcharge was limited to the loss sustained by those who had objected. And if some legatees have acquiesced in the actions of a fiduciary and others have not, the liability will be limited to the actual loss sustained by those who are not estopped to object.

**Balancing Profits Against Losses**

If a fiduciary is otherwise liable to an estate for investments improperly made, he may not offset the amount of the surcharge by the
profits accruing from other investments which he made for the estate. In King v. Talbot, the court said:

"The rule is perfectly well settled, that a cestui que trust is at liberty to elect to approve an unauthorized investment and enjoy its profits or reject it at his option; and I perceive no reason for saying, that when the trustee has divided the fund into parts and made separate investments, the cestui que trust is not at liberty, on equitable as well as legal grounds, to approve and adopt such as he thinks it for his interest to approve."386

The doctrine has continued in full force and effect and is currently applied.387 But if the issue is limited to care and diligence and does not involve lack of investment power, the fact that profits were made as well as losses sustained will not be overlooked. As one court said, the fiduciary:

"... should receive the benefit of the care and prudence with which he has administered the estate, and [should] not be mulcted in damages when the whole estate has been administered so as to result in a profit, because certain of the investments may not have turned out as well as had been anticipated."388

Employment of Investment Counsel

There are conflicting decisions on the right of a fiduciary to employ investment counsel at the expense of the estate. It was held in New York County that it could not be done389 but in a later case, decided in Suffolk County, the court held that a fiduciary other than a corporate fiduciary might employ investment counsel at the expense of the estate.390

Additional Responsibilities of Corporate Fiduciaries

The question as to whether corporate fiduciaries are held to a higher degree of responsibility than individual fiduciaries is not yet definitely settled. It has been answered in the affirmative and in the negative. It would seem, however, that the trend is toward holding the corporate fiduciary to a degree of liability commensurate with its special knowledge and its wider sources of information. Thus, about ten years ago the Appellate Division of the First Department approved the ruling of a referee that:

[References]

386. 40 N. Y. 76, 90 (1869).
OBLIGATIONS OF NEW YORK FIDUCIARIES

"... a great trust company, having at its command special knowledge of markets and financial conditions and an organization skilled in the investment of funds must in the exercise of ordinary care bring to the management of estates entrusted to its care this special knowledge since an ordinary prudent man in the exercise of ordinary care would not fail to do this in the management of his own affairs if such advantages were available to him."391

A few months later, the Appellate Division of the Fourth Department, in surcharging the corporate fiduciary for the negligent retention of some common stocks, said:

"It is very true that, unless otherwise prescribed by statute, a corporate executor is subject to no greater liability than that which devolves upon an individual executor. Matter of Peoples Trust Co., 169 App. Div. 699, 701, 155 N. Y. Supp. 639. Nevertheless a bank has certain advantages over an individual in determining the wisdom of retaining or disposing of securities belonging to an estate. It not only has its trust officer, who is supposed to be more or less familiar with market prices of securities, and whose business it is to be posted concerning market conditions, but over the trust officer are the officials of the bank, and the directors, men of affairs, assumed to be chosen because of their sound business judgment. The advice of these men is at the disposal of the trust officer."392

The reference to the People's Trust Company case is curious. The one issue involved in that case was the rate of interest which a corporate fiduciary was required to pay on funds which it held as executor and deposited with itself in its banking capacity. The court held that it was obligated to pay not the six percent fixed by the Surrogate, but the rate which it paid its other depositors. In the course of its opinion, the court said that:

"A [trust company] is subject to a liability no greater than that which devolves upon an individual executor except as prescribed by statute."393

But the statement has no bearing on the factors of care, prudence and diligence.

In a more recent case, the court, in passing upon the liability of a trustee for investing in mortgage participations, said, citing Matter of Ryan,394 Matter of Union Trust Co.395 and Matter of Clarke,396 that:

394. 291 N. Y. 376, 52 N. E. 2d 909 (1943).
396. 257 N. Y. 132, 177 N. E. 397 (1931).
generally speaking and in the absence of any agreement to the contrary, a corporate trustee has no greater duty or responsibility than an individual acting in the same capacity."

But, it is submitted, none of the cases so cited is authority to any such effect. In Matter of Union Trust Co., the court was discussing the right of a corporate fiduciary to allocate to trusts participations in a mortgage which was held in its own name. In discussing the established doctrine that a fiduciary may not engage in self-dealing, the court said:

"... there is no difference between a corporate trustee and an individual trustee in its or his duty with respect to investments."

This was repeated by the court in Matter of Ryan where self-dealing was again at issue. But it is submitted that a declaration that a corporate fiduciary must live up to the same standards of conduct as is imposed upon an individual fiduciary, when the issue is one of self-dealing, is not authority for the proposition that a corporate fiduciary should not be subjected to even higher standards than an individual where the issue is one of prudence and diligence. And a court may well hold that a large corporate fiduciary in a large city should be held to a higher standard of care and prudence than a smaller institution in a rural community, which lacks the facilities and means of obtaining information enjoyed by the larger bank.

It would seem that what the Appellate Divisions said in Chemical Bank and Trust Co. v. Ott, and in Matter of Baker was sound and logical and probably reflects the tacit, if not the expressly promulgated views of most of the courts. In any event, it is suggested that it would be good business for corporate fiduciaries to welcome, rather than oppose the idea that they should be held to a higher degree of diligence and alertness than the individual fiduciary.

**Liability for Co-Fiduciary**

A fiduciary is not only liable for his own acts and omissions but may become liable as well for what his co-fiduciary does or fails to do. Sometimes, the difficulty will arise out of an honest difference of opinion. In one instance, a testatrix appointed her sister and a bank as trustees with directions that if they disagreed on investments, the wishes of the sister should prevail. When a disagreement arose, the corporate trustee asked for the instructions of the court. It was told that when differences arose, the written decision of the sister would prevail.

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399. 291 N. Y. 376, 52 N. E. 2d 909 (1943).
and that the corporate fiduciary would have no responsibility with respect to it unless it believed that the decision of the sister amounted to gross negligence, in which event, it should again seek the instructions of the court. In a later case, when the corporate and the individual fiduciaries disagreed as to investments, and the judgment of the former proved to be correct, it was surcharged because it had failed to apply to the court for instructions as to how to act. It appeared that in October, 1930, the corporate trustee arrived at the opinion that certain securities should be sold. The co-trustee, the widow of the testator, refused to join in selling them. Subsequent requests in December, 1930, and in March, 1931, that they be sold were also refused and by the time the trustees accounted, the depreciation feared by the bank had taken place. The court held the bank liable for the loss, based on December, 1930, values, stating that it owed to the decedent a duty greater than merely to be pleasant to his family and that when the widow refused to sell in October, 1930, the bank should have sought the instructions of the court.

It is not always safe for one fiduciary to rely upon the special knowledge of another, particularly if the latter has a selfish interest to serve. This was illustrated in a case when a corporate and an individual fiduciary held among the assets of the trust shares of stock of the company of which the individual fiduciary was president. The original investment was made by the testator and additional stock was purchased by the trustees at the instance of the individual fiduciary, the corporate trustee acquiescing reluctantly. The company failed and both trustees were held liable. The individual fiduciary was obviously aware of the weak condition of the corporation of which he was the chief executive but retained the stock nevertheless. The corporate fiduciary was held liable upon the ground that it was not permitted to rely upon the assurances of its co-trustee as to the stock, but on the contrary was called upon to exercise even greater caution in dealing with an investment in which the co-trustee had a personal interest.

Courts have been lenient in dealing with the liability of one fiduciary for losses occasioned by the deliberate theft of a co-trustee and when

402. Matter of Richardson, 149 Misc. 192, 265 N. Y. Supp. 383 (Kings Co. 1928) Win-gate, S. In Matter of Durston, 297 N. Y. 64, 74 N. E. 2d 310 (1947), the Court of Appeals held a corporate fiduciary liable for losses arising out of the retention of its own stock because it violated the rule of undivided loyalty; and held the two co-trustees, one of whom was president of the corporate fiduciary, equally liable, because they acquiesced in the violation of the rule.
403. Wilmerding v. McKesson, 103 N. Y. 329, 8 N. E. 665 (1856); Matter of Mann, 147
one fiduciary was ill, he was not surcharged for relying on his co-fiduciary. The issue as to the liability of one trustee for the sins of another arises most frequently where one or more fiduciaries sits back and entrusts the administration of the estate to a co-fiduciary whose administration proves unprofitable to the trust estate, whether through carelessness or recklessness or outright neglect. Under these circumstances, it will be difficult for any of the fiduciaries to escape a surcharge.

**Continuing Business of Decedent**

For all practical purposes, the decision of the Court of Appeals in a case decided many years ago, sets forth everything that one ought to know about the power and liability of a fiduciary to operate the business of the decedent. The court laid down the general rule that an executor had no authority by virtue of his office to continue the business of the decedent except to convert the assets into money; that testamentary authority to do so must be granted by direct, explicit and unequivocal language of the will or else will not be deemed to have been conferred, and that even if the power to continue the business is given,

"[It] will be construed as an authority simply to carry on the trade or business with the fund invested in it at the time of testator's death, and to subject that fund only to the hazards of the trade and not the general assets of the estate."

The court also reiterated the common law doctrine that:

"... a debt contracted by an executor after the death of his testator, although contracted by him as executor, binds him individually, and does not bind the estate which he represents, notwithstanding it may have been contracted for the benefit of the estate. ... It has been held in numerous cases that an executor, carrying on a trade under the authority of the will, binds himself individually by his contracts in the trade. He is not bound to carry on the trade and incur this hazard, although authorized or directed to do so, but if he does carry it on, the contracts of the business are his individual contracts."

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405. A somewhat striking illustration will be found in Gould v. Gould, 126 Misc. 54, 231 N. Y. Supp. 286 (Sup. Ct. N. Y. Co. 1926) where one trustee who was noted for her philanthropies and whose integrity was never questioned was held jointly liable for the administration of her father's estate by her brother, a co-trustee.


407. Id. at 590, 21 N. E. at 708.

408. Id. at 591, 21 N. E. at 708.
With this decision as a foundation, there is not much to add. The doctrine that the authority to carry on the testator's business must be plain and unequivocal was put to the test by the testamentary statement by a business woman that "It is my wish that my husband continue the clothing business as long as he remains sober and of good habits to properly conduct the same." The court found the language insufficient. An oral request to carry on his business made by the testator before he died to the executor named in the will is obviously insufficient.

The courts will pierce the veil of corporate entity and invoke the doctrine when the testator's business is carried on in corporate form. And this, even though the testator did not own all the stock of a company. As one court phrased it:

"The equitable powers of a Surrogate's Court permit it to penetrate into the inner verities of the situation. Thus where the business in question is actually within the sole control of the testator, his testamentary fiduciaries will be held to a strict accountability in this regard, whether or not the formality of incorporation has taken place. In the absence of unequivocal authority for continuance contained in the will, an executor or administrator has no authority virtue of officii to continue it, except for the temporary purpose of converting the assets employed. . . ."

A most important thing for a fiduciary to remember is that even though he may have necessary testamentary right and authority to carry on the testator's business, he is not compelled to do so. Consequently, if he elects to exercise his power, he must take the consequences of his voluntary act and run the risk of becoming personally liable to those with whom he does business. And the potential liability to the beneficiaries of the Estate is not to be overlooked, regardless of the extent of the authority granted by the testator.


413. In Matter of Kellner, 66 N. Y. S. 2d 727 (Erie Co. 1946), the Surrogate ruled that the language of the will authorizing his executors to "manage, control and operate any property or business owned by me" applied to two ice companies in which the testator had a controlling interest. But the court proceeded to warn the fiduciaries that the business was a hazardous one and suggested and directed that they devise a plan within three months "whereby this increasing danger to the Estate and themselves be removed."