

1-1-1980

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Recommended Citation

Evelyn G. Abravanel, *Apportioning Receipts from Wasting Assets under the Uniform Laws: A Proposal for Legislative Reform*, 58 N.C. L. REV. 255 (1980).Available at: <http://scholarship.law.unc.edu/nclr/vol58/iss2/4>

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APPORTIONING RECEIPTS FROM WASTING ASSETS UNDER THE UNIFORM LAWS: A PROPOSAL FOR LEGISLATIVE REFORM

EVELYN GINSBERG ABRAVANEL†

Because the value of a wasting asset deteriorates over time, serious inequities between beneficiaries can arise when wasting assets are placed in trust. In this Article, Professor Abravanel surveys the judicial and legislative responses to the problems posed by wasting assets held in trust. In particular, the author points to the defects in the approaches taken by the Uniform Principal and Income Act and the subsequent Revised Act. The Article concludes by proposing a novel solution to the problem of wasting assets held in trust.

I. INTRODUCTION

The hallmark of the modern trust¹ device is the division of ownership between legal and equitable title. The legal title to the trust corpus is in one party, the trustee, while the equitable title to the assets of which the trust is composed is in the beneficiaries. Concurrently with this division of ownership, certain recognized fiduciary responsibilities are imposed on the trustee for the benefit of the holders of the equitable title. These fiduciary responsibilities include, among others, the duty to deal impartially as between the income beneficiaries and the remaindermen² and the duty to produce a normal trust yield while at the same time preserving the trust corpus intact.³

The trustee will be held to the proper performance of these fiduci-

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The author wishes to acknowledge with gratitude the editorial assistance of the following individuals in commenting upon the various drafts of this manuscript: Martin D. Abravanel; D. Barlow Burke, Jr.; James B. Hamlin; Paul G. Haskell; and A. Allen King.

1. The term "trust," as used in this Article, is intended to refer only to the trust device as a vehicle for the donative disposition of wealth. No reference is made by the use of this term to such devices as the resulting or constructive trust. See note 14 *infra*.

2. 2 A. SCOTT, THE LAW OF TRUSTS § 183, at 1471 n.1 (3d ed. 1967).

3. *Id.* § 232. There is a plethora of academic and judicial commentary that seeks to rank the relative rights of the income beneficiaries and the remaindermen of a trust. Professor Bogert, for example, has stated that the typical settlor evinces a "recognized partiality toward income beneficiaries" of a trust. Bogert, *The Revised Uniform Principal and Income Act*, 38 NOTRE DAME

ary responsibilities.⁴ The spectre of potential liability in the event he should fail to discharge them properly requires the trustee to attempt to reconcile the divergent interests of the income and principal beneficiaries. The difficulty of the trustee's task in this regard is compounded by the tension, which typically inheres in the trust relationship, between the competing interests of these two classes of beneficiaries. The present income beneficiary is primarily interested in having trust assets invested in a manner that will maximize the current yield on trust investments. He is not overly concerned with the question of whether the trustee's investment practices are such as to ensure the safety of principal. The remainderman, by way of contrast, is primarily concerned with the safety, and possible enhancement, of trust capital.⁵ This tension is exacerbated when the trust corpus consists in whole or in part of wasting property.

Wasting property has been defined as "consist[ing] of such interests as terminate or necessarily depreciate in course of time either because of the nature of the interest or because of the character of the

LAW, 50, 57 (1962). By way of contrast, the Kentucky Supreme Court, in a case involving the duties of a trustee in regard to the corpus of a trust consisting of unproductive property, stated that

[i]n the early period of trusts it appears that the prevailing thought, with reference to the trustee's duty, was simply the preservation of the trust for the benefit of remaindermen. A trustee's duty, where there are present beneficiaries of income and successive interest, has been a subject of much controversy and has produced divergent judicial opinions. However, it seems to be a well settled principle that a trustee, in administering an estate for present beneficiaries of income and for remaindermen, is bound as much to secure the usual rate of income upon sale investments for the present beneficiary of income as to preserve the corpus for the benefit of the remaindermen. The creator of the trust obviously had two objects in view; first, the payment of the income to the life tenant, and, second, the preservation of the corpus for the remainderman. Certainly, the preservation of the corpus is an essential element of the trust, and any depletion thereof tends to frustrate the creator's purpose. Likewise, failure to invest in income producing investments, thereby defeating the benefits to the life tenant, would also tend to frustrate the settlor's purpose. It, therefore, follows that a trustee is charged with the duty to invest so as to produce income, and at the same time use a sound discretion in regard to the preservation of the corpus. . . .

So, it follows that each beneficiary, and not one of them, has a right to expect a performance of the trust.

Security Trust Co. v. Mahoney, 307 Ky. 661, 668-69, 212 S.W.2d 115, 119 (1948). It is the opinion of this writer that, absent an express direction or a clearly inferable intention that the interest of a particular beneficiary be given priority, the principle that the trustee is under a duty to act impartially towards the different beneficiaries requires that the trustee view them on an equal footing. See text accompanying notes 124-27 *infra*.

4. 3 A. SCOTT, *supra* note 2, at §§ 201-212.3.

5. The enhancement of trust capital can come about if the trustee pursues a policy of investing in assets that are likely to yield capital appreciation. This proposition is premised on the notion that proceeds realized on the sale of a principal asset by the trustee remain principal, even though a gain is realized on the sale. Traditionally, capital gains realized on the sale of trust corpus have been held to constitute principal for purposes of trust law. *Id.* § 233.1, at 1898.

subject matter of the interest."⁶ Stated somewhat differently, a wasting asset is an asset having a limited duration that produces revenues for the period of its useful life, but after that ceases to be of value. Common examples of wasting property are leasehold interests⁷; copyrights⁸; patents⁹; terminable annuities¹⁰; and interests in natural resources that are subject to depletion, such as coal, oil and gas, and timber.¹¹

This characteristic of a wasting asset, namely that the worth of the trust corpus will be, in the main, extinguished over the asset's useful life, has led many courts to observe that the revenues produced by wasting assets "partake of the nature both of principal and income."¹² This notion assumes added significance when one considers the results that would flow from a finding that the proceeds of wasting property

6. RESTATEMENT (SECOND) OF TRUSTS § 239, Comment a (1959). Professor Scott writes that "[t]he common element in the case of all such property is that its value will necessarily depreciate or be destroyed." 3 A. SCOTT, *supra* note 2, at § 239.

7. See, e.g., *Minot v. Thompson*, 106 Mass. 583 (1871); *Frankel v. Farmers' Loan & Trust Co.*, 152 A.D. 58, 136 N.Y.S. 703 (1912), *aff'd mem.*, 209 N.Y. 553, 103 N.E. 1124 (1913); *Gould v. Gould*, 126 Misc. 54, 213 N.Y.S. 286 (Sup. Ct. 1925).

8. See, e.g., *In re Elsner's Will*, 210 A.D. 575, 206 N.Y.S. 765 (1924); *In re Estate of Pryor*, 51 Misc. 2d 993, 274 N.Y.S.2d 427 (1966); *Pickering v. Evans*, [1921] 2 Ch. 309.

9. See, e.g., *Union County Trust Co. v. Gray*, 110 N.J. Eq. 270, 159 A. 625 (1932). In this case, the corpus of the trust included stock in a corporation whose assets were composed of a patented process for treating gasoline. It is well settled that, when the corpus of a trust consists, in whole or in part, of stock in a corporation having wasting assets, the same principles apply as though the trust owned the wasting property directly. 8 G. BOGERT, *THE LAW OF TRUSTS & TRUSTEES* § 827, at 430 nn.20 & 21 (2d ed. 1962).

10. See, e.g., *Tickner v. Old*, L.R. 18 Eq. 422 (1874); *Morgan v. Morgan*, 51 Eng. Rep. 214 (M.R. 1851); *Howe v. Earl of Dartmouth*, 32 Eng. Rep. 56 (Ch. 1802).

11. See, e.g., *In re Will of Koffend*, 218 Minn. 206, 15 N.W.2d 590 (1944); *Cadbury v. Parish*, 89 N.H. 464, 200 A. 791 (1938); *Leach v. McCreary*, 183 Tenn. 128, 191 S.W.2d 176 (1945).

The topic of apportioning receipts from natural resources held in trust is beyond the proper scope of this Article. The rules concerning this category of depleting assets have had a very different evolution from those with which we are here concerned. So as not to constitute too great a digression, an example will have to suffice. Suppose a testator created a trust of his residuary estate, the corpus of which included an interest in certain mining properties. By analogy to principles that have developed in the law of waste as between holders of successive legal interests, the question of how receipts from these properties are to be distributed will turn on whether the mine was "opened" at the time of the creation of the trust. If, under the facts of a particular case, this question is answered affirmatively, then the income beneficiary of the trust will be entitled to all revenues derived from the operation of the mine. See *Millikin Trust Co. v. Jarvis*, 34 Ill. App. 2d 180, 180 N.E.2d 759 (1962); *Mitchell v. Mitchell*, 151 Tex. 1, 244 S.W.2d 803 (1951). Otherwise, all such revenues are allocable to trust capital. *Id.*; *Mairs v. Cent. Trust Co.*, 127 W. Va. 795, 34 S.E.2d 742 (1945). Some courts, as well as § 9 of the Revised Uniform Principal and Income Act, have seen fit to apportion receipts between principal and income in the context of depleting natural resources. See, e.g., *Bixby v. Security First Nat'l Bank*, 55 Cal. 2d 819, 13 Cal. Rptr. 411 (1961); *In re Will of Beeler*, 203 Misc. 100, 121 N.Y.S.2d 202 (1952). For an extended treatment of this topic, see Comment, *The Apportionment of Proceeds from Depletable Natural Resources Held in Trust*, 18 HASTINGS L.J. 391 (1967).

12. *In re Elsner's Will*, 210 A.D. 575, 576, 206 N.Y.S. 765, 767; *accord*, *Raffety v. Parker*, 241 F.2d 594 (8th Cir. 1957); *In re Pennock's Will*, 285 N.Y. 475, 35 N.E.2d 177 (1941).

are entirely allocable to income or entirely to principal. Assume, for example, that the corpus of a trust consists of a copyright having a duration of fifteen years at the time of the trust's creation. If the trustee were to allocate all the revenues produced by the copyright to the income account, such mode of distribution would have horrendous consequences for the ultimate remaindermen.¹³ If, on the other hand, these revenues were entirely allocable to the principal account, the income beneficiary would receive only the income earned on the revenues derived from the copyright. The ultimate objective, therefore, is to devise a method by which receipts from wasting assets held in trust can be apportioned equitably between principal and income.

For the past two centuries, courts and legislatures have pursued this objective, with varying degrees of success. The purpose of this Article is to analyze those efforts, and to propose a novel method of apportioning receipts from wasting assets held in trust. The first section of the Article will discuss the approach taken by the English and American courts. Thereafter, the solutions proposed by the 1931 Uniform Principal and Income Act, and the 1962 Revised Act, will be discussed and criticized. The Article concludes by proposing a new method of apportioning receipts from wasting assets that overcomes the defects of both the common law and statutory formulations.

As the various apportionment methods are discussed, the reader should gauge the extent to which each method fulfills the following three criteria: (1) whether the apportionment method allows the trustee to administer the trust assets in a manner consistent with the general fiduciary duties imposed on him by operation of law; (2) whether it treats the differing classes of beneficiaries in an equitable fashion; and (3) whether it allows convenient trust administration.

II. THE ENGLISH ORIGINS: THE DOCTRINE OF *HOWE V. EARL OF DARTMOUTH*¹⁴

To place the topic of trustees' duties with respect to wasting assets

13. See also *White v. Blackman*, 168 S.W.2d 531 (Tex. Civ. App. 1942). In *White*, testator's widow sought to have set aside to her a homestead right in the lands of which her husband died seized and to recover all the oil and gas royalties and proceeds that had accrued subsequent to her husband's death. The court noted the injustice of using the "open mine doctrine," which would "result in such a depletion and impairment of the corpus as to leave it as a skeleton or ghost for the remainderman," *id.* at 534, but nevertheless affirmed the lower court's ruling awarding the proceeds to the widow. The court rested its decision on the Supreme Court's refusal of an application for writ of error in a controlling case. *Id.* at 534.

14. The content ascribed to the term "trust" at note 1, *supra*, is in need of refinement. First, the class of trusts with which the common law decisions have been concerned consists of trusts

in an historical perspective, one must begin consideration of the relevant decisional law with the landmark opinion rendered by Lord Eldon in *Howe v. Earl of Dartmouth*.¹⁵ The case involved the construction of the Earl of Strafford's will. By the terms of his will, the testator disposed of his real and personal estate, which included long- and short-term annuities, to persons for successive life estates with remainder over upon the termination of the final life estate.¹⁶ The particular issue presented to the Lord Chancellor concerned the estate source from which the gifts in question were to be satisfied.¹⁷ Specifically, the question was whether, under the terms of the testator's will, there was merely a specific bequest of the personal property that the testator had owned at the time the will was executed. An affirmative answer to this question would have given the life interest holders the enjoyment of the property as it existed at the testator's death. Lord Eldon concluded that the will revealed no intention to bequeath the annuities specifically. Instead, the natural inference from the will was that the testator intended both the life interest holders and the remaindermen to benefit equally from the gift of the annuities. In order to effectuate this intent, Lord Eldon held that the annuities, as "perishable" assets, would have to be converted into a more permanent form of investment.¹⁸

that were established pursuant to the terms of a settlor's will. Second, the universe of testamentary trusts must be further restricted to encompass only those trusts whose corpus is composed of the settlor's general or residuary estate. This refinement is necessary because different rules have evolved depending on the estate source from which the testator intends the trust to be created. For example, when a testator establishes a trust, the corpus of which consists of *specific* property, the courts have almost uniformly held that the receipts derived from such property, even when it is of a wasting nature, are entirely allocable to the income account. 3 A. SCOTT, *supra* note 2, § 239.1 n.2. The question of the apportionment of receipts from wasting assets in order to maintain the value of the trust corpus intact would, accordingly, never arise in this context.

15. 32 Eng. Rep. 56 (Ch. 1802). In the argument of counsel, it appeared that the court's decision in *Howe v. Earl of Dartmouth* was the first *reported* decision pertaining to the duties of trustees with respect to wasting assets. *Id.* at 58. By the same token, however, it also appeared in argument that the rule enunciated by the court had been established for many years. *Id.*; accord, *Macdonald v. Irvine*, 8 Ch. D. 101, 113 (Ch. App. 1878) (Bagallay, L.J. dissenting); *Pickering v. Pickering*, 41 Eng. Rep. 113, 116 (Ch. 1839).

16. 32 Eng. Rep. at 57.

17. *Id.* at 60.

18. The Lord Chancellor wrote:

It is given as all his personal estate; and the mode, in which he says it is to be enjoyed, is to one for life, and to the others afterwards. Then the Court says, it is to be construed as to the perishable part, so that one shall take for life, and the others afterwards; and unless the testator directs the mode so that it is to continue, as it was, the Court understands, that it shall be put in such a state, that the others may enjoy it after the decease of the first;

...

... I am clearly of opinion therefore, that this is not a case, in which the personal estate is in this sense specifically given, with a direction, that it shall remain specifically such as it was at the testator's death; and the purposes, for which it is given, are those, for which

The reasoning behind the decision in *Howe v. Earl of Dartmouth* and its progeny¹⁹ has sometimes been misunderstood. It is not that there is a presumption that the testator, in establishing the trust, had in mind the wasting nature of the assets constituting the trust corpus and, therefore, intended that they be converted into a nonperishable form in order to preserve the value of the trust corpus intact for those ultimately entitled to it. On the contrary, if a testator has created a trust of his residuary estate for successive beneficiaries, the natural inference, in the absence of an expression of a contrary intent on the part of the testator, is that the testator intended that those persons entitled in remainder should, at the expiration of the preceding interests, come into the possession of the entire residuary estate, undiminished by reason of the enjoyment of income by the prior interest holders. In order to actualize the testator's presumed intention, it is incumbent upon the trustee to convert wasting assets into permanent, income-producing investments at the inception of the trust.²⁰ In short, *Howe v. Earl of Dartmouth* established a rule of construction to the effect that, in the absence of language or circumstances indicating a contrary intention, the testator is presumed to have intended that the wasting property was to be converted and the proceeds of sale reinvested in such a manner as to ensure the enjoyment by the successive beneficiaries of a trust in an undiminished trust corpus.

Perhaps the best explication of the rule of *Howe v. Earl of Dartmouth* is contained in a dissenting opinion by Lord Baggallay in *Macdonald v. Irvine*.²¹ The estate of the testator included certain

it is admitted there is a general rule, that these perishable funds are to be converted in such a way as to produce capital, bearing interest.

Id. at 60-61. Some of the chancellor's reasoning is obsolete in light of modern legal principles. Thus, the notion that every devise of land necessarily constitutes a specific gift by reason of the doctrine that a will could not operate to pass the title to after-acquired land, *id.* at 60, is no longer viable. The prevailing view is, of course, that a will operates on all property forming part of the testator's estate at the time of his death, whether acquired before or after the execution of the will. See T. ATKINSON, HANDBOOK OF THE LAW OF WILLS §85 (2d ed. 1953).

19. The rule of conversion of wasting assets laid down in *Howe v. Earl of Dartmouth* has been adhered to in many subsequent English decisions. See, e.g., *Game v. Young*, [1897] 1 Ch. 881; *Macdonald v. Irvine*, 8 Ch. D. 101 (1878); *Tickner v. Old*, L.R. 18 Eq. 422 (1874); *Morgan v. Morgan*, 51 Eng. Rep. 214 (M.R. 1851); *Pickup v. Atkinson*, 67 Eng. Rep. 797 (Ch. 1846); *Sutherland v. Cooke*, 63 Eng. Rep. 516 (Ch. 1844); *Lichfield v. Baker*, 48 Eng. Rep. 1267 (M.R. 1840); *Benn v. Dixon*, 59 Eng. Rep. 763 (Ch. 1840); *Mills v. Mills*, 58 Eng. Rep. 929 (Ch. 1835).

20. An alternative means to achieve the dual goals of producing a reasonable yield for the income beneficiary while at the same time preserving trust corpus intact is to apportion receipts from wasting assets between the income and principal accounts in some fashion. See text accompanying notes 66-76 *infra*.

21. 8 Ch. D. 101 (1878).

Egyptian bonds as well as a leasehold estate in a house.²² By the terms of a codicil to his will, the testator gave his wife a life interest in all his property,²³ thereby postponing the ultimate distribution of his estate until the termination of the preceding life interest. In a suit for construction of the will and codicil, the widow claimed to be entitled to the income of the testator's entire personal estate as it was invested at the time of his death.²⁴ The court held, without further discussion, that the rule of *Howe v. Earl of Dartmouth* was applicable to the facts of the case.²⁵ The property in the residuary estate had to be converted, with the life tenant being entitled to only the income on the reinvested proceeds of the sale.

In a dissenting opinion Lord Baggallay asserted that the widow was entitled to the enjoyment of the property *in specie*, and set forth the following exposition of the rule of *Howe v. Earl of Dartmouth*:

[W]here there is a residuary bequest of personal estate to be enjoyed by several persons in succession, a Court of Equity, in the absence of any evidence of a contrary intention, will assume that it was the intention of the testator that his legatees should enjoy the same thing in succession, and, as the only means of giving effect to such intention, will direct the conversion into permanent investments of a recognized character of all such parts of the estate as are of a wasting or reversionary character, and also all such other existing investments as are not of the recognized character and are consequently deemed to be more or less hazardous.

But it must be borne in mind that the rule when acted upon is based upon an implied or presumed intention of the testator, and not upon any intention actually expressed by him, and Courts of Equity have consequently always declined to apply the rule in cases in which the testator has indicated an intention that the property should be enjoyed *in specie*, though he may not in a technical sense have specifically bequeathed it.²⁶

It is, of course, a fundamental principle of will construction that, to the extent to which the testator's intention can be ascertained, it will control.²⁷ The paramount importance attached to the testator's inten-

22. *Id.* at 102.

23. *Id.* at 104.

24. *Id.* at 109.

25. *Id.* at 107.

26. *Id.* at 112. Lord Baggallay speaks of the necessity of converting property "of a wasting or reversionary character." The reason for requiring that a reversionary interest be converted is that such an interest will not generate any revenues until it becomes possessory. As such, it must be converted in order to allow the income beneficiary a fair yield on that portion of the trust corpus.

3 A. SCOTT, *supra* note 2, § 240.

27. Intentions can be ascertained either from the language of the instrument itself or from

tion in controlling the disposition of his estate is manifest in the present context of allocating receipts from wasting assets held in trust. When, for example, the property owner's intention to allocate all the revenues derived from a wasting asset to the income beneficiary is discernible,²⁸ that intention should be given effect. That intention should in turn be operative to rebut the presumption established in *Howe v. Earl of Dartmouth*. A few illustrations will clarify this point.²⁹

In *Pickering v. Pickering*,³⁰ the testator gave his wife a life estate in "all the interest, rents, dividends, annual produce and profits, use and enjoyment of all [his] estate and effects,"³¹ with remainder over upon her death to his son-in-law. The testator's estate included a leasehold estate for an extended term of years and an annuity of 100 pounds annually.³² In a suit for construction of the will,³³ it was held that the widow was entitled to the enjoyment, for her life, of the perishable property in the testator's estate *in specie*, without a conversion for the benefit of the person ultimately entitled to the property in remainder.³⁴ More particularly, Lord Cottenham found in the will a sufficient indi-

extrinsic evidence which is admissible to show what the testator meant by the words used in the will. See T. ATKINSON, *supra* note 18, § 146.

28. The term, "discernible," in this context, is somewhat of a misnomer. The courts have demonstrated a marked propensity for discovering an intention to allocate all receipts from wasting assets to income even though no real indication of intention can be "discerned." Lord Baggallay, dissenting in *Macdonald*, recognized this proclivity of the courts in his statement that "[t]hese authorities, for the most part, turn upon the special circumstances of the particular cases under consideration, but they nevertheless, upon the whole, shew an inclination on the part of successive Judges to allow small indications of intention to prevent the application of the general rule." 8 Ch. D. at 112-13; *accord*, *Hinves v. Hinves*, 67 Eng. Rep. 523, 524 (Ch. 1844).

29. *E.g.*, *Brandreth v. Colvin*, [1896] 2 Ch. 199; *Gray v. Siggers*, 15 Ch. D. 74 (1880); *Hinves v. Hinves*, 67 Eng. Rep. 523 (Ch. 1844); *Daniel v. Warren*, 63 Eng. Rep. 127 (Ch. 1843); *Vaughan v. Buck*, 41 Eng. Rep. 559 (Ch. 1841); *Goodenough v. Tremamondo*, 48 Eng. Rep. 1280 (M.R. 1840); *Pickering v. Pickering*, 48 Eng. Rep. 1090 (M.R.), *aff'd*, 41 Eng. Rep. 113 (Ch. 1839); *Be-thune v. Kennedy*, 40 Eng. Rep. 320 (Ch. 1835); *Collins v. Collins*, 39 Eng. Rep. 1113 (Ch. 1833); *Alcock v. Sloper*, 39 Eng. Rep. 1111 (M.R. 1833).

30. 48 Eng. Rep. 1090 (M.R.), *aff'd*, 41 Eng. Rep. 113 (Ch. 1839).

31. 48 Eng. Rep. at 1090.

32. *Id.* at 1091.

33. The *Pickering* case arose in a rather complex factual situation. The life tenant had received the income from the leasehold estate for some time after the testator's death, but had not received any payments from the annuity, because both the obligor and the surety on the annuity were thought to be insolvent. After the death of the surety, however, the remainderman discovered that the surety's estate was actually solvent. The remainderman instituted a suit against the surety's estate and recovered the unpaid obligation on the annuity. He then obtained an opinion of counsel that the annuity and the leasehold estate should have been converted at the testator's death, pursuant to the rule of *Howe v. Earl of Dartmouth*. The life tenant apparently acquiesced in this opinion, and agreed to a suitable settlement of the estate. At the death of the life tenant, however, her executor brought this action to challenge the settlement, on grounds that the rule of *Howe v. Earl of Dartmouth* should not apply. 41 Eng. Rep. at 114-16.

34. *Id.* at 118.

cation of the testator's intent that his widow was to have the enjoyment of the property in the state in which it was found at the testator's death. Thus, the case was removed from the operation of the rule of conversion of wasting assets established in *Howe v. Earl of Dartmouth*.³⁵

This intention was evinced in a number of ways. First, the testator had specifically enumerated the property his wife was to have for life. The Lord Chancellor found that this enumeration of particulars manifested the testator's intention to specifically devise the property described. Further, the testator's use of the terms, "rest and residue of my estate," militated in favor of a finding that the property of which the residuary estate was composed, and to which the remainderman was entitled, was to be ascertained only *after* the termination of the life estate.³⁶

The chancellor's decision in *Pickering v. Pickering* clearly recognized, however, the continuing vitality of the constructional preference established in *Howe v. Earl of Dartmouth*. Lord Cottenham emphasized that the rule of *Howe v. Earl of Dartmouth* was controlling *unless* a contrary intention of the testator could be found within the four corners of the instrument.³⁷ This position should be compared with the decision in *Hinves v. Hinves*,³⁸ which illustrates the lengths to which the courts have gone in attempting to discern an intention on the part of the testator that the life tenant should have the enjoyment of the wasting property *in specie*.

In *Hinves v. Hinves*, the testator, by the terms of his will, gave his wife a life income interest in his entire estate,³⁹ which included leasehold estates and long-term annuities.⁴⁰ Upon the death of the life tenant, the property was to pass in equal shares to the brothers of the testator.⁴¹ In determining whether the life tenant was entitled to the enjoyment of the testator's property *in specie*, Vice-Chancellor Wigram remarked that "in the more modern cases . . . , the Court, in applying

35. *Id.*

36. *Id.* at 117-18. This phrase appeared in the dispositive provisions of the will only in connection with the disposition of the remainder interest after the termination of the life tenant's interest. *Id.* at 117.

37. *Id.* at 118.

38. 67 Eng. Rep. 523 (Ch. 1844).

39. More particularly, the testator's will provided that his wife was to have the "income of [his] property of all descriptions whatsoever, for her natural life, at her own disposal, but not to sell witt [sic] the . . . consent of all parties" *Id.* The reporter indicated that the word "witt" was "[i]llegible, but resembl[ed] either 'with' or 'without.'" *Id.* at 523 n.2 (footnotes omitted).

40. *Id.* at 524.

41. *Id.* at 523.

the rule [of *Howe v. Earl of Dartmouth*], has leant against conversion as strongly as is consistent with the supposition that the rule itself is well founded."⁴² After carefully reviewing the previous decisions holding that the application of the rule of conversion of wasting assets was negated under the particular fact situation at issue, the court indicated that, so as not to rule against the weight of authority, it felt constrained to hold that the life tenant was entitled to all the revenues derived from the property in the state in which it was found at the testator's death.⁴³ This result obtained notwithstanding the court's determination that there were a multiplicity of factors present that tended to confirm the constructional preference established in *Howe v. Earl of Dartmouth*.⁴⁴

Within the line of cases examined to this point, a subset of cases having particular relevance to the present inquiry⁴⁵ requires extended discussion. A series of cases has addressed the question whether a provision in the governing instrument empowering the trustee to retain investments received as part of the original trust estate was a sufficient indication, in and of itself, of the testator's intention that the life tenant was to have all the revenues derived from the wasting assets initially received as a distribution from the testator's estate.⁴⁶

*Brown v. Gellatly*⁴⁷ was the first reported decision to address this narrower issue.⁴⁸ The testator's estate consisted, in part, of a large

42. *Id.* at 524; *accord*, *Mackie v. Mackie*, 67 Eng. Rep. 831, 834 (Ch. 1845); *see* *Macdonald v. Irvine*, 8 Ch. D. 101, 113 (1878) (dissenting opinion); *Morgan v. Morgan*, 51 Eng. Rep. 214, 218 (M.R. 1851).

43. 67 Eng. Rep. at 525. It is probably not inaccurate to say that the English courts relied primarily on precedent to find the rule of *Howe v. Earl of Dartmouth* inapplicable to the facts of the particular cases presented to them for decision. *See, e.g.*, *Hunt v. Scott*, 63 Eng. Rep. 1041 (Ch. 1847). The courts, for the most part, do not appear to have been overly concerned with whether the testator had sufficiently manifested his intention that the life tenant was entitled to have the enjoyment of his property *in specie*. Given the fact-specific nature of this inquiry, it would appear that the English courts' reliance on precedent was misplaced.

44. The court stated that "[i]n the present case the gift is of the testator's 'property' generally; there is no specification of particulars: and the property described in this general way is to go to persons in succession. Stopping here, there is no doubt that the rule of the Court would require conversion" 67 Eng. Rep. at 525.

45. The special relevance of this line of cases to the present inquiry will only become apparent in connection with the consideration of § 10 of the Uniform Principal and Income Act. *See* text accompanying notes 119-27 *infra*.

46. *Eade v. Nicholson*, [1909] 2 Ch. 111; *Brandreth v. Colvin*, [1896] 2 Ch. 199; *Wood v. Thomas*, [1891] 3 Ch. 482; *Gray v. Siggers*, 15 Ch. D. 74 (1880); *Porter v. Baddeley*, 5 Ch. D. 542 (1877); *Tickner v. Old*, L.R. 18 Eq. 422 (1874); *In re Sewell's Estate*, L.R. 11 Eq. 80 (M.R. 1870); *Brown v. Gellatly*, L.R. 2 Ch. 751 (Ch. 1867). *See also* *Hodgson v. Bates*, [1907] 1 Ch. 22; *Nixon v. Sheldon*, 39 Ch. D. 50 (1888). In addition, there are a number of cases in which the court placed no apparent reliance on the trustee's authority to retain original trust investments. *Gabelini v. Woods*, [1904] 2 Ch. 4; *In re Llewellyn's Trust*, 54 Eng. Rep. 592 (M.R. 1861).

47. L.R. 2 Ch. 751 (1867).

48. The earlier case of *Green v. Britten*, 46 Eng. Rep. 257 (1863), may be readily distin-

number of securities, some of which were not authorized investments for fiduciaries.⁴⁹ The testator, by the terms of his will, gave his executors the power to retain as investments certain specified securities.⁵⁰ In a suit between the life tenants of shares of the residuary estate and the remaindermen, it was held that the life tenants were entitled to receive all the revenues produced by the securities that formed part of the original trust estate.⁵¹ This holding was predicated upon the notion that the power of retention given to the executors under the testator's will transformed the wasting property into authorized investments.⁵²

It would appear that the reasons proffered by the court for its holding in *Brown v. Gellatly* are not analytically sound. To hold, as the court did, that the mere authorization to the fiduciary to retain assets delivered in trust evinces a sufficient intention on the part of the testator that the property is to be enjoyed by the tenant *in specie*, thereby rebutting the presumption established in *Howe v. Earl of Dartmouth*, does not comport with modern notions of trust administration.⁵³ To-

guished because in that case there was an absolute prohibition against conversion of the wasting property for a specified period. This express prohibition was the premise for the court's holding that the life tenant was entitled to the enjoyment of the wasting property *in specie*. 46 Eng. Rep. at 259.

49. L.R. 2 Ch. at 753. In England, a trustee historically could invest trust assets only in government securities, absent broader authorization under the terms of the governing instrument. The breadth of the trustees' investment authority has since been enlarged by statute. See 3 A. SCOTT, *supra* note 2, § 227.4.

In the United States, most jurisdictions have statutes designating the permissible types of investments that a fiduciary may make. *Id.* § 227.13 n.1. When the terms of the document enlarge or restrict the available investment opportunities, the terms of the instrument control. In the absence of a contrary provision in the will or the trust, the statutes in "legal list" states enumerate all the categories of assets in which the fiduciary may invest. *Id.* § 227.13. Historically, and in a few states today, these statutes limited fiduciaries to investments in debt securities only. See, e.g., ALA. CODE tit. 19, § 3-120 (1975). Today, many statutes provide that a certain fraction of the trust estate may be held in the form of common stocks. See, e.g., W. VA. CODE § 44-6-2(h) (Supp. 1979); WIS. STAT. ANN. § 881.01 (West 1979).

50. The testator's will provided, in pertinent part: "I give [my executors] full power to invest at their discretion, or allow to remain as at present invested, all my funds in government and colonial government securities, guaranteed railway stock and debentures, *East India* bonds and stock, marine insurance shares, and shares in the *London Chartered Bank*." L.R. 2 Ch. at 753 (emphasis in original).

51. *Id.* at 758.

52. Lord Cairns wrote that

while any such securities form part of the testator's estate the tenant for life is, in my opinion, entitled to the specific income of the securities, just as if they had been £3 per Cent. Consols. I understand the words of the will as amounting to the constitution by the testator of a larger class of authorized securities than this Court itself would have approved of, and the Court has merely to follow his directions, and treat the income accordingly, as being the income of authorized securities.

Id. at 758-59.

53. Arguably, the ruling in *Brown v. Gellatly* did not even comport with notions of trust administration extant at the time the case was decided. In *Wood v. Thomas*, [1891] 3 Ch. 482, for

day, a majority of jurisdictions provide by statute that fiduciaries may retain investments received from the testator even though they would not be proper investments for a fiduciary to make in the first instance.⁵⁴ The intended effect of a retention provision, whether contained in a statute or the controlling instrument, is to bring assets received from the estate within the permissible categories of investments that a fiduciary may make.⁵⁵ Thus, when the trust instrument or applicable statute authorizes the retention of assets held by the decedent or settlor, the assets are automatically transformed into legal investments for fiduciaries, even if they are outside the legal list. Merely to say that the wasting assets have been converted into authorized investments for fiduciaries, however, is not tantamount to a demonstration of the intention necessary to rebut the constructional preference established in *Howe v. Earl of Dartmouth*.⁵⁶

Another case in which the trustees were authorized to retain in-

example, Justice Kekewich, in reference to *Brown v. Gellatly*, stated that, "I do not think that that will carry you far enough; I think you must find a direction that the tenant for life shall enjoy in specie. The mere fact that it is authorized is not, standing alone, sufficient." *Id.* at 487.

Indeed, most of the cases that have adopted the holding of *Brown v. Gellatly*, will not withstand analysis. For example, in *In re Sewell's Estate*, L.R. 11 Eq. 80 (M.R. 1870), the court found the rule of *Howe v. Earl of Dartmouth* to be inapplicable because of the inclusion of the following provision in the testator's will: The testator directed his trustees "as soon as conveniently may be after [his] decease [to] sell and convert into money so much and such part thereof as in their sole discretion they may think necessary for the purpose of paying and discharging all [his] mortgage and other just debts and funeral testamentary expenses." *Id.* at 81. It appears anomalous that the court found this general directive in the will for the trustees to pay the testator's debts to be tantamount to a positive intent that the wasting property was to be enjoyed by the life tenants *in specie*. By means of such a clause, the testator was simply attempting to vest his trustees with discretion to control the order in which his property was to abate. For a discussion of the doctrine of abatement, see T. ATKINSON, *supra* note 18, at § 136. Similarly, in *Gray v. Siggers*, 15 Ch. D. 74 (V.C. 1880), the court, without benefit of analysis, concluded that "the case is entirely taken out of *Howe v. Earl of Dartmouth* and *Macdonald v. Irvine*, because of this power which gives the trustees the right to retain the property in specie." *Id.* at 77.

Still other cases that have been cited as support for the principle enunciated in *Brown v. Gellatly* are readily distinguishable on their facts. Thus, in *Nixon v. Sheldon*, 39 Ch. D. 50 (1888), the holding of the court was expressly limited to a case in which the trust res was not composed of any wasting assets. *Id.* at 53. In *Hodgson v. Bates*, [1907] 1 Ch. 22, the court found that the property in question was of a hazardous, and not of a wasting, nature. *Id.* at 25.

54. These statutes typically apply to both trustees and personal representatives. *E.g.*, CAL. CIV. CODE § 2261 (West Supp. 1979); CONN. GEN. STAT. ANN. § 45-89 (1979); DEL. CODE ANN. tit. 12, § 3304 (1974); GA. CODE ANN. § 113-1518 (1975); S.C. CODE § 21-11-30 (1976); WASH. REV. CODE ANN. § 30.24.060 (Supp. 1978).

55. *See, e.g.*, *Watson v. Craven*, [1914] 1 Ch. 358, 373; *Hodgson v. Bates*, [1907] 1 Ch. 22, 27. Although beyond the scope of the present inquiry, other effects that have been attributed to retention provisions include: (1) the fiduciary does not have to dispose of the otherwise unauthorized asset as soon as possible; and (2) although not relaxing the fiduciary's duty to exercise reasonable care, it does afford the fiduciary a bit more flexibility. *In re Mereto Estate*, 373 Pa. 466, 468-69, 96 A.2d 115, 116 (1953); *In re Stirling's Estate*, 342 Pa. 497, 504, 21 A.2d 72, 75-76 (1941). For an extended treatment of this topic, *see* Annot., 47 A.L.R.2d 187 (1956).

56. *See* note 53 *supra*.

vestments received as part of the original trust estate is *Wood v. Thomas*.⁵⁷ The testator's residuary estate included certain bonds that were deemed to constitute wasting property because, although they were redeemable at par at a future date, their market value was then considerably above par.⁵⁸ In a suit to determine the disposition of the income arising from those bonds pending their ultimate conversion, it was held, in an opinion by Justice Kekewich, that the life tenants were entitled to the whole net income of the bonds.⁵⁹ The court in dictum, however, made the following pronouncement, which is of special relevance to the present inquiry:

I am not prepared to hold that where there is a direction for conversion of personal estate, followed by a power of retention of existing securities in the absolute discretion of the trustees, and then there are trusts for tenants for life, and afterwards for remaindermen, the power of retention necessarily gives the tenants for life the enjoyment in specie of the securities retained by the trustees in the exercise of their discretion. I believe that so to hold would be against the law as laid down in many cases and many text-books, and against the practice of conveyancers, . . . and I think that no such doctrine receives any support from the decisions of Mr. Justice North in *In re Sheldon* and Lord Cairns in *Brown v. Gellatly*. I do not think either Mr. Justice North or Lord Cairns intended to decide, or did decide, any abstract question of the kind.⁶⁰

Lest it appear as if there has been anything approximating unanimity in the courts' rulings regarding this question, it should be noted that, quite to the contrary, substantial diversity of opinion exists. For instance, in *Porter v. Baddeley*,⁶¹ the testator gave his wife a life interest in his residuary estate with remainder over to five individuals in equal shares.⁶² The residuary estate consisted, in part, of four leasehold es-

57. [1891] 3 Ch. 482. The court's statement of facts indicates that the testator's will provided that

it should be lawful for his trustees or trustee in their or his absolute discretion to retain any securities or property which should belong to him at his decease, unconverted and in the state of investment or security in which the same should then be, for such period or periods as they or he should think fit, without being answerable for any loss which might be occasioned thereby.

Id. at 483.

58. *Id.* at 484. Bonds have a market value above par because they pay interest above the current market rate. As the time for redemption (at par) approaches, the market value approaches par. Thus, when bonds have a market price above par, there is a built-in decline in the value of the bonds until the time of redemption.

59. *Id.* at 487-88.

60. *Id.* at 486 (emphasis in original).

61. 5 Ch. D. 542 (1877).

62. *Id.* at 542-43.

tates and several long-term annuities.⁶³ There was no direction in the will that any portion of the testator's estate be converted; instead, the testator empowered his trustees to retain any property received as part of the original trust estate in the state in which it was found at the date of the testator's death.⁶⁴ In a suit to determine whether the life tenant was entitled to receive all the income derived from the long-term annuities that formed part of the original trust estate, the court held that the power of the trustees to retain wasting assets delivered as part of the original trust estate was not a sufficient indication of the testator's intention to overturn the rule of *Howe v. Earl of Dartmouth*.⁶⁵

Certain practical disadvantages inhered in the rule requiring that wasting assets be converted and the proceeds of sale reinvested in a permanent form from which the life tenant was to have the income and the remainderman receive the principal intact upon the termination of the preceding interest. For example, the wasting assets might prove to be unmarketable, or difficult to sell other than at a severe loss, which would inure to the detriment of all persons beneficially interested in the trust estate.⁶⁶ Because of these practical difficulties, a natural and logical modification took effect by which, in lieu of disposing of the wasting asset, an apportionment of the revenues derived from the asset was made in a manner that at least ostensibly secured to the life tenant and remainderman the economic equivalent of their respective interests.⁶⁷

63. *Id.* at 543.

64. *Id.* at 542-43.

65. The court stated that

[t]he clause expressly authorizing and empowering the trustees to allow all moneys to remain in the same state of investment on which they should find the same as at the testator's decease is a general one, and a general provision of that kind I cannot consider as being, as between the beneficiaries, applicable to that part of his personal estate which was invested in terminable annuities.

Id. at 544; accord *Tickner v. Old*, L.R. 18 Eq. 422 (1874). See also *Gabellini v. Woods*, [1904] 2 Ch. 4; *In re Llewellyn's Trust*, 54 Eng. Rep. 592 (M.R. 1861).

66. "It is often very difficult to carry out the principle of *Howe v. Lord Dartmouth*," *Pickering v. Pickering*, 41 Eng. Rep. 113, 118 (1839). On a more contemporary note, Professor Judith T. Younger has written that

[t]he very features which give rise to the duty to sell, however, make it difficult to sell without loss to the trust. In consequence, a sale may never take place, or only after years of delay. Nonetheless, when the trustee receives the proceeds from a delayed sale or collects receipts from wasting assets he is required to make some immediate adjustment between the rights of income beneficiary and remainderman: he does this by apportioning the money between them.

Younger, *Apportioning Receipts from Wasting and Unproductive Assets: A Comment on the New Principle and Income Act*, 40 N.Y.U. L. Rev. 1118, 1119 (1965).

67. For cases in which apportionment principles were applied, see, e.g., *Pickering v. Evans*, [1921] 2 Ch. 309; *Wareham v. Brewin*, [1912] 2 Ch. 312 (Ch. App.); *Gabellini v. Woods*, [1904] 2 Ch. 4; *Porter v. Baddeley*, 5 Ch. D. 542 (1877); *Brown v. Gellatly*, L.R. 2 Ch. 751 (Ch. App. 1867); *In re Llewellyn's Trust*, 54 Eng. Rep. 592 (M.R. 1861); *Meyer v. Simonsen*, 64 Eng. Rep. 1316

This apportionment procedure has been variously denominated "amortization" and "notional conversion."⁶⁸

For example, in *Pickering v. Evans*,⁶⁹ the testator's estate included copyrights on his aunt's literary works, which she had bequeathed to him.⁷⁰ By the terms of his will, the testator bequeathed all his real and personal estate, with the exception of certain specified property, to his trustees, who were directed to pay the income derived therefrom to the testator's widow. Upon the death or remarriage of the first life tenant, the trustees were directed to divide the trust fund into three equal shares and to pay the income from each share to one of the testator's siblings for life, with remainder over to the children of the life tenant.⁷¹

During the course of administering the trust estate, the trustees petitioned for declaratory relief and requested instructions on the treatment to be accorded royalties received from the copyrights belonging to the trust estate.⁷² The court concluded that there was not a sufficient indication of the testator's intention to take the case outside the purview of the rule established in *Howe v. Earl of Dartmouth*.⁷³ The court did not, however, order the conversion of the wasting assets. Instead, an apportionment remedy was decreed. Specifically, the value of the copyright would be ascertained as of one year after the testator's death, and the life tenants would be entitled to interest on that value at the rate of four per cent per annum.⁷⁴ Any revenues produced by the copyrights in excess of the amount allocable to the income beneficiaries were deemed to constitute the trust corpus.⁷⁵ The court also allowed

(V.C. 1852); *Glengall v. Barnard*, 49 Eng. Rep. 571 (M.R. 1842); *Caldecott v. Caldecott*, 62 Eng. Rep. 903 (V.C. 1842); *Taylor v. Clark*, 66 Eng. Rep. 990 (V.C. 1841); *Gibson v. Bott*, 32 Eng. Rep. 37 (Ch. 1802); *Sitwell v. Bernard*, 31 Eng. Rep. 1174 (Ch. 1801).

68. The phrase "notional conversion" appears in many of the earlier cases, *see, e.g.*, *Gabelini v. Woods*, [1904] 2 Ch. 4, 12, whereas the adoption of the term "amortization" seems to be of comparatively recent origin.

69. [1921] 2 Ch. 309.

70. *Id.* at 314.

71. *Id.*

72. *Id.* at 312.

73. *Id.* at 315-16.

74. *Id.* at 316.

75. *Id.* at 317. By allocating a portion of the revenues derived from the wasting property to the trust principal, it is contemplated that, over the asset's useful life, the fair market value of the asset at the time it was received in trust will be put back into the trust. For example, assume that the corpus of a certain trust includes a copyright having a duration of 15 years. The trustee, under the doctrine of notional conversion, is required to treat the wasting asset as though it had been sold at its fair market value on the date the trust was created. Assume further that the fair market value of the wasting asset, as determined by the trustee, equals \$100,000. If the average return on trust investments is, let us say, 5% per annum, the trustee would have to allocate to the income account \$5,000 annually out of the revenues produced by the wasting asset. The balance of such

the income beneficiaries to receive the amount of income produced from the reinvestment of sums previously allocated to principal.⁷⁶

III. THE RECEPTION OF THE RULE OF *HOWE V. EARL OF DARTMOUTH* IN THE UNITED STATES

In the United States, the development of trustees' duties with respect to wasting assets held in trust essentially parallels that of England. By the late nineteenth century, many American courts had adopted the principle that, when the trust estate is composed of general or residuary assets that are perishable in nature, the trustee is required to dispose of the assets with reasonable promptness and reinvest the proceeds of sale in legal securities,⁷⁷ absent an indication of a contrary intention in the will. Just as in England,⁷⁸ the American rule requiring the conversion of wasting assets was deemed to be a rule of construc-

receipts would be allocated to trust principal. Assuming that the trustee correctly valued the copyright, that portion of the revenues produced by the asset that is allocated to the amortization fund over the asset's useful life should be equal to \$100,000, the value of the corpus at the commencement of the trust, but only if interest earned on the amount set aside for principal is credited to the principal account. This can be illustrated by the following calculations. In arriving at a fair market value of \$100,000 for the copyright the trustee theoretically discounts back all the predicted future payments from the copyright at the assumed annual rate of return of 5%. For ease of calculation, further assume that these future payments are to be equal annual payments for the next 15 years. Using this assumption we can calculate that a fair market value of \$100,000 represents 15 annual payments of \$9,634.23. This figure is obtained by multiplying \$100,000 times .0963423, which is the annuity that if paid annually for 15 years would have a present value of 1. See C. REEVES, HANDBOOK OF INTEREST ANNUITY AND RELATED FISCAL TABLES 75 (1966) [hereinafter cited as INTEREST TABLES]. Each year, as the \$9,634.23 comes in, \$5,000 is allocated to the income beneficiary ($5\% \times \$100,000$) and the remainder, \$4,634.23, to principal. If the amounts allocated to principal were not allowed to receive interest, at the end of 15 years there would be \$69,513.45 in the principal account ($\$4,634.23 \times 15$). If, on the other hand, the amounts allocated to principal were allowed to earn interest at the assumed rate of 5% compounded annually, at the end of 15 years there would be \$100,000 in the principal account thus wholly preserving the principal intact. This figure is obtained by multiplying \$4,634.23 times 21.578564, which is the amount one dollar received annually will accumulate to over a 15 year period at a 5% annual compound interest. See *id.* at 46.

76. *Id.* at 317. But see note 75 *supra*.

77. See, e.g., *Burnett v. Lester*, 53 Ill. 325 (1870); *Healey v. Toppan*, 45 N.H. 243 (1864); *Union County Trust Co. v. Gray*, 110 N.J. Eq. 270, 159 A. 625 (1932); *Ott v. Tewksbury*, 75 N.J. Eq. 4, 71 A. 302 (1908); *Howard v. Howard*, 16 N.J. Eq. 486 (1864); *Ackerman v. Vreeland*, 14 N.J. Eq. 23 (1861); *Rapalye v. Rapalye*, 27 Barb. 610 (N.Y. Sup. Ct. 1857); *Spear v. Tinkham*, 2 Barb. Ch. 211 (N.Y. 1847); *Emmons v. Cairns*, 2 Sand. Ch. 369 (N.Y. 1845); *Covenhoven v. Shuler*, 2 Paige Ch. 122, 21 Am. Dec. 169 (N.Y. 1830); *Bryan v. Harper*, 177 N.C. 308, 98 S.E. 822 (1919); *Ritch v. Wilson*, 78 N.C. 377 (1878); *Saunders v. Haughton*, 43 N.C. 217, 57 Am. Dec. 581 (1852); *Jones v. Simmons*, 42 N.C. 178 (1851); *Smith v. Barham*, 17 N.C. 420 (1833); *Robertson v. Collier*, 10 S.C. Eq. 370 (1833); *Patterson v. Devlin*, 76 S.C. Eq. 459 (1827); *Golder v. Littlejohn*, 30 Wis. 344 (1872).

78. See text accompanying notes 19 & 20 *supra*.

tion.⁷⁹ Accordingly, the applicability of the rule to the facts of a particular case was made subject to the testator's contrary intention.⁸⁰

Another point at which the English and American precedents converge is the relative ease with which the presumption established in *Howe v. Earl of Dartmouth* can be overcome.⁸¹ An example is *Britt v. Smith*.⁸² The testator gave his wife an estate in all his real and personal property, which was to terminate upon her death or remarriage.⁸³ Upon the termination of the wife's interest, the testator left "the balance of . . . [his] personal property of every description" to his sister.⁸⁴ At his death, the personal property in the testator's estate consisted of farming implements, crops, livestock and the like.⁸⁵

To determine the respective rights of the life tenant and remainderman, the testator's personal representative maintained an action for construction of the will. Specifically, the executor sought a determination of whether the life tenant was entitled to have the enjoyment *in specie* of the testator's personal estate.⁸⁶ After a discussion of the gen-

79. *E.g.*, *In re Will of Koffend*, 218 Minn. 206, 224-25, 15 N.W.2d 590, 600 (1944); *Haywood v. Wright*, 152 N.C. 403, 413-14, 67 S.E. 982, 987 (1910); *Britt v. Smith*, 86 N.C. 305, 308-09 (1882).

80. *Gay v. Focke*, 291 F. 721 (9th Cir. 1923); *Harrison v. Foster*, 9 Ala. 955 (1846); *Buckingham v. Morrison*, 136 Ill. 437, 27 N.E. 65 (1891); *Nelligan v. Long*, 320 Mass. 439, 70 N.E. 2d 175 (1946); *Dexter v. Dexter*, 274 Mass. 273, 174 N.E. 493 (1931); *Old Colony Trust Co. v. Shaw*, 261 Mass. 158, 158 N.E. 530 (1927); *New England Trust Co. v. Eaton*, 140 Mass. 532, 4 N.E. 69 (1886); *In re Will of Koffend*, 218 Minn. 206, 15 N.W. 2d 590 (1944); *Cadbury v. Parrish*, 89 N.H. 464, 200 A. 791 (1938); *Langley v. Town of Farmington*, 66 N.H. 431, 27 A. 224 (1891); *Bonbright v. Bonbright*, 142 N.J. Eq. 642, 61 A.2d 201 (1948); *Corle v. Monkhouse*, 47 N.J. Eq. 73, 20 A. 367 (1890); *In re James*, 146 N.Y. 78, 40 N.E. 876 (1895); *Frankel v. Farmers' Loan & Trust Co.*, 152 A.D. 58, 136 N.Y.S. 703 (1912), *aff'd mem.*, 209 N.Y. 553, 103 N.E. 1124 (1913); *In re Will of Pollak*, 208 Misc. 988, 145 N.Y.S.2d 415 (Sur. Ct. 1955); *In re Will of Sampson*, 193 Misc. 166, 83 N.Y.S. 2d 200 (Sur. Ct. 1948); *In re Bruen's Estate*, 83 N.Y.S.2d 197 (Sur. Ct. 1948); *In re Estate of Hopkins*, 171 Misc. 910, 14 N.Y.S.2d 71 (Sur. Ct. 1939); *In re Estate of Hilliard*, 164 Misc. 677, 299 N.Y.S. 788 (Sur. Ct. 1937), *aff'd*, 254 A.D. 879, 5 N.Y.S.2d 92 (1938); *In re Estate of Hall*, 127 Misc. 238, 216 N.Y.S. 598 (Sur. Ct. 1926); *Burwell v. Raleigh Banking & Trust Co.*, 186 N.C. 117, 118 S.E. 881 (1923); *In re Estate of Knowles*, 148 N.C. 461, 62 S.E. 549 (1908); *Britt v. Smith*, 86 N.C. 305 (1882); *Kinnard v. Kinnard*, 45 Pa. 108 (1836); *Calhoun v. Furgeson*, 24 S.C. Eq. 160 (1850); *Leach v. McCreary*, 183 Tenn. 128, 191 S.W.2d 176 (1945); *McFadden v. Blair*, 42 Tenn. App. 434, 304 S.W.2d 93 (1957); *Golder v. Littlejohn*, 30 Wis. 344 (1872).

81. Compare cases discussed at text accompanying notes 38-44 *supra* with *Britt v. Smith*, 86 N.C. 305, 307 (1882) and *Leach v. McCreary*, 183 Tenn. 128, 132, 191 S.W.2d 176, 178 (1945). Indeed, one court has even reversed the presumption of *Howe v. Earl of Dartmouth*. In *Gay v. Focke*, 291 F. 721 (9th Cir. 1923), the court stated the applicable rule in the following terms: "The general rule is firmly settled that in order to work a conversion while the property is yet actually unchanged in form, there must be a clear and imperative direction in the will to convert." *Id.* at 725.

82. 86 N.C. 305 (1882).

83. The eventual disposition of the estate was also subject to certain specific gifts that are not relevant to the present inquiry.

84. *Id.* at 306.

85. *Id.*

86. *Id.* at 305-06.

eral rule of conversion of wasting assets as it had developed in the courts of the jurisdiction, the court stated that the rule

has never been a favorite one with [the English] courts; and the effect of the later cases has been to allow very slight indications of a contrary intention, on the part of a testator to prevent its application . . . , and such certainly has been the tendency of the decisions made in this Court⁸⁷

The court then limited the application of the rule to only those cases in which the gift of the residue was given under that name.⁸⁸ Indeed, the court even suggested that the rule of *Howe v. Earl of Dartmouth* is inoperative in all cases in which the bulk of a person's estate is disposed of by means of a residuary bequest.⁸⁹

American jurisdictions are split on whether the life tenant is entitled to the actual income of the wasting investments forming part of the original trust estate when the will empowers the trustee to retain those assets.⁹⁰ The courts of Massachusetts,⁹¹ Minnesota⁹² and Tennessee⁹³ have consistently held that such a grant of authority evinces a sufficient indication of the testator's intention that the life tenant was to have all revenues derived from the wasting assets constituting part of the original trust estate.⁹⁴ Contrary results have been reached by the courts of

87. *Id.* at 307.

88. The court stated that "no operation has in any instance been given to the rule, save in the case of a *residuary bequest*, given *eo nomine*, as such." *Id.* (emphasis in original).

89. *Id.* at 307-08; *accord*, *Patterson v. Devlin*, 16 S.C. Eq. 459 (McMul. Eq. 1827). Viewed in light of the standards that had been enunciated, the *Britt* court found that the testator's will evinced a sufficient indication of his intention that the life tenant was entitled to the enjoyment of the perishable property in the testator's estate *in specie*. 86 N.C. at 309-10. Its holding in this regard was premised upon the following lines of analysis. First, the gift of the residue to the wife encompassed the bulk of the testator's property. *Id.* at 309. Second, the court found that the individual items in the testator's estate, rather than the residue itself, were the subject of the gift to the widow. *Id.* at 308.

90. This split mirrors the division of opinion that existed in the English decisions that had addressed the question. See text accompanying notes 46-65 *supra*.

91. *Nelligan v. Long*, 320 Mass. 439, 70 N.E.2d 175 (1946); *Dexter v. Dexter*, 274 Mass. 273, 174 N.E. 493 (1931); *New England Trust Co. v. Eaton*, 140 Mass. 532, 4 N.E. 69 (1886).

92. *In re Koffend's Will*, 218 Minn. 206, 15 N.W.2d 590 (1944).

93. *Leach v. McCreary*, 183 Tenn. 128, 191 S.W.2d 176 (1945); see *McFadden v. Blair*, 42 Tenn. App. 434, 304 S.W.2d 93 (1956).

94. Other cases apposite to the present inquiry may be found as well. In *Buckingham v. Morrison*, 136 Ill. 437, 27 N.E. 65 (1891), the court found a provision in the testator's will, which permitted his executors to continue a partnership business in which the testator was interested, to be a sufficient indication of his intention that the life tenant was entitled to receive all profits arising from that interest. Similarly, in *Gay v. Focke*, 291 F. 721 (9th Cir. 1923), a provision in the testator's will, which provided that his trustees could, in their discretion, dispose of certain real property, was deemed to constitute an implied power of retention. As such, the court affirmed the exercise of the trustees' discretion in paying all the net rentals received from that property to the life income beneficiary of the testamentary trust.

New Jersey,⁹⁵ Rhode Island⁹⁶ and South Carolina.⁹⁷

The opinion of the court in *Old Colony Trust Co. v. Shaw*⁹⁸ illustrates the line of cases in Massachusetts holding that, when the trustee is authorized to retain original trust investments, the case is removed from the operation of the general rule of conversion of wasting assets.⁹⁹ This case arose upon a petition by trustees for instructions under the testator's will.¹⁰⁰ More particularly, the trustees requested instruction regarding the manner in which dividends from stock of a mining corporation forming part of the corpus of the residuary trust were to be distributed.¹⁰¹ In rejecting the trustees' contention that some portion of the dividends ought to be allocated to the principal account in order to preserve the principal intact,¹⁰² the court set forth its rationale as follows:

[T]he stock held by the trustees in the Consolidated Company is an authorized investment and no duty has ever rested upon the trustees either to convert the stock which was in the estate into another form of investment or to hold and administer the stock interest as if a conversion had been made at the date of its acquisition. The effect upon the rights of the life beneficiaries and the remaindermen in the residue of the estate which resulted from the exercise of the powers con-

95. *Union County Trust Co. v. Gray*, 110 N.J. Eq. 270, 276-77, 159 A. 625, 628-29 (1932).

96. *Industrial Trust Co. v. Parks*, 57 R.I. 363, 382, 190 A. 32, 40-41 (1937). *Contra*, *Rhode Island Hosp. Trust Co. v. Bradley*, 41 R.I. 174, 192, 103 A. 486, 492 (1918).

97. *Robertson v. Collier*, 10 S.C. Eq. 370 (1 Hill Eq. 1833). The New York courts have adopted a similar, though not identical, position. These courts have consistently found that an authorization to retain original investments is simply one factor to consider in determining whether the instrument evinces a sufficient indication of the testator's contrary intention to overcome the constructional preference of *Howe v. Earl of Dartmouth*. Thus, though a retention power may be given some weight, it is not the dispositive factor. *In re Will of Sampson*, 193 Misc. 166, 83 N.Y.S.2d 200 (Sur. Ct. 1948); *In re Bruen's Estate*, 83 N.Y.S.2d 197 (Sur. Ct. 1948); *In re Estate of Hopkins*, 171 Misc. 910, 14 N.Y.S.2d 71 (Sur. Ct. 1939).

98. 261 Mass. 158, 158 N.E. 530 (1927).

99. See cases cited notes 91-94 *supra*.

100. 261 Mass. at 160, 158 N.E. at 531.

101. The testator's will provided, in pertinent part:

I authorize and empower my Trustees in their discretion to continue as long as they think wise to hold stock in mining companies and any other securities or property of any kind which may be found in my estate at my death, even though the same be unproductive of income or be of a kind not usually considered suitable for Trustees to select or hold, or be a larger proportion in one investment than the Trust Estate should hold.

Id. at 163, 158 N.E. at 532.

102. The trustees had assumed that the stock of a mining corporation constituted a wasting asset. Accordingly, it was their contention that

the life beneficiaries should receive in any year out of the dividends received by the trustees from these mining shares a fixed net return of five per cent, computed upon the market value of the shares on the day preceding the commencement of the trust year, as being equivalent to a fair net income for customary trust funds and that the net income excess should be added to the trust capital.

Id.

ferred upon the trustees . . . was to convert the . . . stocks into permanent authorized investment

In a situation like the case before this court there is no room for the operation of the equitable doctrine that personal property given in general terms in trust to be enjoyed by several persons in succession imports an intent on the part of the testator that the gift should be converted into authorized investments and the income of the property so invested, or retained, be so divided or apportioned between the life beneficiaries and the remaindermen that the corpus of the fund shall be kept intact.¹⁰³

The result that was arrived at in *Old Colony Trust Co. v. Shaw* may be meaningfully compared with that which obtained in a New Jersey case, *Union County Trust Co. v. Gray*.¹⁰⁴ In this case, the testator's estate included shares in a corporation, whose sole asset was a patented process for treating gasoline.¹⁰⁵ The testator, by the terms of his will, authorized his executors and trustees to retain as trust investments any property of which he died possessed.¹⁰⁶ In a suit maintained by the executors for instructions on how to disburse the dividends on those shares, the court found that the will did not evince a sufficient indication of the testator's contrary intention to take the case out of the purview of the general rule.¹⁰⁷ With respect to the specific question whether the authorization to retain original investments, without more, is sufficient to rebut the presumption of *Howe v. Earl of Dartmouth*, the court clearly answered in the negative. It stated that the clause empowering the executors and trustees to retain assets that were received as part of the original trust estate

is merely an indemnity to the trustees that, by continuing the voting certificates as assets of the estate, they will incur no personal liability, and the power to retain them as part of the trust estate, without responsibility, etc., as provided in the residuary clause, is simply by way of further assurance; in truth, the power given to the trustees to "invest and reinvest" the estate implies that it should be converted. There is no indication of intention to vary the relative rights of the legatees, or that the rule of conversion should not obtain.¹⁰⁸

Hence, just as in England,¹⁰⁹ there is a division of authority in this

103. *Id.* at 167, 158 N.E. at 533-34.

104. 110 N.J. Eq. 270, 159 A. 625 (1932).

105. *Id.* at 273, 159 A. at 627.

106. *Id.* at 272, 159 A. at 627.

107. *Id.* at 277, 159 A. at 629.

108. *Id.* at 277-78, 159 A. at 629; *accord*, *Industrial Trust Co. v. Parks*, 57 R.I. 363, 382, 190 A. 32, 40-41 (1937). *See also* text accompanying notes 53-56 *supra* (criticizing *Brown v. Gellatly*).

109. *See* text accompanying notes 61-65 *supra*.

country on the effect of a retention provision with respect to the rule of conversion.

The modification of the rule of *Howe v. Earl of Dartmouth* that permits the apportionment of receipts from wasting property in lieu of their sale is illustrated by the oft-cited case of *In re Elsner's Will*.¹¹⁰ There the testator, an author, had entered into a contract with a publisher to write a medical treatise. By the terms of the contract, he assigned to the publisher all rights to the work, including the exclusive right to take out copyrights. The consideration received by the testator was the right to receive from the revenues derived from sales, after payment of the cost of publication, a certain percentage of the retail price of books sold at a profit.¹¹¹

On February 17, 1916, soon after the book had been completed and, apparently, after it had been published, the testator died.¹¹² By his will he created trust estates, the principal of which consisted, in part, of the right to the royalties under the contract.¹¹³ The income of the trust estates was directed to be paid to certain beneficiaries, with remainder over after their demise.¹¹⁴ The royalties under the contract totalled approximately \$4,000 for the year of 1916, but declined precipitantly to as little as \$13.50 for the last six months of 1923.¹¹⁵

The task before the court was to determine an appropriate means to disburse these royalties.¹¹⁶ Applying the doctrine of notional conversion, the court held, in substance, that the royalties received under the contract should be apportioned between principal and income in some fashion.¹¹⁷ In the course of its opinion, the court stated that in the event the trust estate consists of wasting property that is not the subject of a specific gift,

the rule has long been established that the person given the use or income is entitled to receive only the income on the value of the property at the death of the testator . . . , with a duty to account for the principal to the remaindermen Ordinarily, it is regarded the duty of the executors or trustees to convert such property into money and invest it in permanent securities, paying the income over

110. 210 A.D. 575, 206 N.Y.S. 765 (1924).

111. *Id.* at 576, 206 N.Y.S. at 766.

112. *Id.*

113. The terms of the will did not contain any specific reference to the book or the rights under the contract. *Id.* at 576, 206 N.Y.S. at 767.

114. *Id.* at 576, 206 N.Y.S. at 766.

115. *Id.* at 577, 206 N.Y.S. at 767.

116. *Id.* at 576, 206 N.Y.S. at 766.

117. *Id.* at 580, 206 N.Y.S. at 770.

to the person entitled thereto for life, or a term of years, retaining in their hands the principal sum for the benefit of the remaindermen. . . . If such property is retained by the executors, then there should be an apportionment of value between the principal and the income.¹¹⁸

Having traced the evolution of the duties of trustees at common law with respect to the treatment to be accorded wasting assets held in trust, we can now examine the statutory formulation of those duties.

IV. THE STATUTORY FORMULATION OF THE RULE OF CONVERSION OF WASTING ASSETS

A. *The Uniform Principal and Income Act*

The first attempt to achieve uniformity among the states with respect to their laws governing the disposition of revenues derived from wasting assets held in trust was made in 1931. In that year the National Conference of Commissioners on Uniform State Laws promulgated, and sent to the states for adoption, the Uniform Principal and Income Act.¹¹⁹

Section ten of the Act¹²⁰ governs the treatment to be accorded wasting assets that constitute the corpus of a trust. It provides for the

118. *Id.* at 579, 206 N.Y.S. at 769; *accord*, *In re Estate of Hall*, 130 Misc. 313, 224 N.Y.S. 376 (Sur. Ct. 1927); *Gould v. Gould*, 126 Misc. 54, 213 N.Y.S. 286 (Sup. Ct. 1925); *In re Estate of Golding*, 127 Misc. 821, 216 N.Y.S. 593 (Sur. Ct. 1924). The rule of apportionment adopted in the principal case has been adhered to in other jurisdictions. *E.g.*, *Gaede v. Carroll*, 114 N.J. Eq. 524, 169 A. 172 (Ch. 1933); *Union County Trust Co. v. Gray*, 110 N.J. Eq. 270, 159 A. 625 (Ch. 1932); *In re Estate of Wells*, 156 Wis. 294, 144 N.W. 174 (1913).

119. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONS ON UNIFORM STATE LAWS AND PROCEEDINGS OF THE FORTY-FIRST ANNUAL CONFERENCE 120 (1931). As of August 31, 1978, the UNIFORM PRINCIPAL AND INCOME ACT, 7 UNIFORM LAWS ANN. 633 (1970) (hereinafter referred to as "the Act"), had been adopted in 24 states. NATIONAL CONFERENCE OF THE COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS OF THE ANNUAL CONFERENCE MEETING IN ITS EIGHTY-SEVENTH YEAR 320 (1978).

120. The full text of § 10 is as follows:

Principal Subject to Depletion

Where any part of the principal consists of property subject to depletion, such as leaseholds, patents, copyrights and royalty rights, and the trustee or tenant in possession is not under a duty to change the form of the investment of the principal, the full amount of rents, royalties or return from the property shall be income to the tenant; but where the trustee or tenant is under a duty, arising either by law or by the terms of the transaction by which the principal was established, to change the form of the investment, either at once or as soon as it may be done without loss, then the return from such property not in excess of five per centum per annum of its fair inventory value or in default thereof its market value at the time the principal was established, or at its cost where purchased later, shall be deemed income and the remainder principal.

UNIFORM PRINCIPAL AND INCOME ACT § 10, 7 UNIFORM LAWS ANN. 682 (1970).

apportionment of receipts from wasting property "where the trustee . . . is under a duty . . . to change the form of the investment."¹²¹ When the trustee is not under such a duty,¹²² however, the Act stipulates that "the full amount of rents, royalties, or return from the property shall be income to the tenant."¹²³

Significantly, section ten makes no provision for amortization of principal to offset the diminution in value incurred as a result of the wasting away of the principal account when the trustee was not under a duty to change the form of investment of the trust assets. The draftsman of the Act apparently proceeded on the assumption that the settlor wished to confer the greatest benefit on the income beneficiaries of the trust.¹²⁴ That assumption, in the context of proposing a uniform act, is remarkable in a number of respects. First, this provision contravenes existing common law principles, which hold that the income beneficiary is not necessarily entitled to the actual income of the investments forming part of the original trust estate merely because the instrument empowered the trustee to retain the assets.¹²⁵ Second, it adopts, in essence, a rule of construction with regard to the settlor's intention when a number of equally plausible hypotheses can be constructed. When the trust instrument authorizes the retention of assets, that authorization might have been made with or without reference to whether the receipts from those assets should be apportioned between the principal and income accounts in some fashion.¹²⁶ For example, the settlor

121. *Id.*

122. This would be the case, for example, when the instrument empowered the trustee to retain wasting assets received as part of the original trust estate.

123. UNIFORM PRINCIPAL AND INCOME ACT § 10, 7 UNIFORM LAWS ANN. 682 (1970). The allocation scheme mandated by § 10 of the Act controls absent an indication of a contrary intention under the terms of the governing instrument. *Id.* § 2. Similarly, the applicability of the provisions of the Revised Uniform Principal and Income Act is also subject to the property owner's contrary intention. REVISED UNIFORM INCOME AND PRINCIPAL ACT § 2(a)(1), 7A UNIFORM LAWS ANN. 429 (Master ed. 1978).

124. Thus, Professor Clark, the draftsman of the Act, stated that

the general theory . . . was that where the testator has created or left [wasting] property, he probably wishes his tenants, those who are dependent on him, to receive the full benefit of all the return without trying to apportion it a certain part to principal and a certain part to income. So where that is apparently contemplated and the property is properly held as a part of the trust we are giving all to the tenant.

Proceedings of the 41st Annual Meeting of the National Conference of Commissioners on Uniform State Laws, at E-69 (1931).

125. At the very least, this provision fails to take cognizance of the substantial diversity of opinion that exists concerning this question. See text accompanying notes 46-65 & 90-109 *supra*.

126. RESTATEMENT (SECOND) OF TRUSTS § 239, Comment e (1959) provides in pertinent part:

Where by the terms of the trust there is a general authorization to retain trust property included in the trust at the time of its creation, it is a question of interpretation whether such authorization permits the trustee to retain wasting property, and if so

might authorize the retention of a particular asset simply because of his conviction that the asset is likely to yield a higher return than is true of trust investments generally.

In addition to these difficulties, a serious tension exists between the allocation scheme mandated by section ten of the Act, on the one hand, and the fiduciary duties imposed on all trustees, on the other. Specifically, the trustee's duty to deal impartially as between the income beneficiaries and the remaindermen, and his duty to preserve trust corpus intact, have arguably been compromised by this provision. The remaindermen have hardly received fair treatment at the hands of a trustee who distributes all the revenues derived from a wasting asset to the income account, absent an express direction, or clearly inferable intention, that the interest of the life tenant should predominate. Assuming that the tenant outlives the asset's useful life, the remaindermen will succeed to a trust corpus whose fair market value has been absolutely destroyed. This result cannot possibly be consonant with the trustee's duty to preserve trust corpus intact. Yet that is precisely the result that would obtain in some factual situations under section ten of the Act.¹²⁷ When the rule of construction that has been chosen operates to contravene important fiduciary duties that are imposed on trustees, the wisdom of the election that was made, as between the two competing hypotheses, comes into serious question.

B. The Revised Uniform Principal and Income Act

The impetus for reexamination of the Act came from a number of

whether it permits him to pay to the life beneficiary the whole of the receipts from the property. Such a general authorization may be interpreted merely to permit the trustee to retain investments which would not otherwise be proper trust investments because of their hazardous character, and not to permit the trustee to retain such property as is of a wasting character. It may be interpreted to permit the trustee to retain all the property including wasting property, but not to dispense with the requirement of amortization. On the other hand, it may be interpreted to permit the trustee not only to retain wasting property but to pay to the life beneficiary the whole of the receipts from the property without regard to the ordinary requirement that the trust property shall be so invested as to preserve the principal.

127. The presumption established by this provision of the Act is even more curious when viewed against the backdrop of prior drafts of a similar provision. In earlier drafts of the Act, the proposed language would have required a trustee to first apply the receipts from wasting property in such a fashion as to replenish the value of the principal account. Only after the amount necessary for amortization of the principal had been provided could the income available for distribution to the tenant be computed. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS OF THE THIRTY-EIGHTH ANNUAL MEETING 214 (1928); NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS OF THE THIRTY-NINTH ANNUAL MEETING 294 (1929).

quarters. Most importantly, although the Act had been enacted in approximately half of the jurisdictions,¹²⁸ it had frequently been subject to modification,¹²⁹ with the result that the elusive goal of uniformity had yet to be realized. In addition, revision was needed in order to adapt the legislative treatment of principal and income issues to changes in the law and business experience that had transpired since the promulgation of the Act. The most notable of these changes came about in the area of trustee investment practices, particularly because of the spread of the prudent man investment rule, with the concomitant elimination of legal list provisions.¹³⁰

Section eleven of the Revised Act provides for the disposition of revenues derived from wasting property in the following manner:

[Other Property Subject to Depletion]

Except as provided in sections 9 and 10, if the principal consists of property subject to depletion, including leaseholds, patents, copyrights, royalty rights, and rights to receive payments on a contract for deferred compensation, receipts from the property, not in excess of 5% per year of its inventory value, are income, and the balance is principal.¹³¹

Although not of a magnitude paralleling other, more discussed changes brought about by the Revised Act,¹³² some significant substan-

128. As of December 1, 1961, the Act had been adopted in 24 jurisdictions. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS OF THE ANNUAL CONFERENCE MEETING IN ITS SEVENTIETH YEAR 281 (1961).

129. For example, the prefatory note to the Revised Act indicates that "[w]hen the various states considered and adopted the original Act there were a lot of changes made in the section concerning disposition of natural resources." UNIFORM PRINCIPAL AND INCOME ACT, Commissioner's Prefatory Note to 1962 Act, 7 UNIFORM LAWS ANN. 430 (Master ed. 1978).

130. For an extended treatment of the legislative trend away from restricted legal lists and the development of the prudent man rule, see Fleming, *Prudent Investments: The Varying Standards of Prudence*, 12 REAL PROP., PROB. & TR. J. 243 (1977); Langbein & Posner, *Market Funds and Trust-Investment Law*, 1 A.B. FOUNDATION RESEARCH J. 1 (1976); Shattuck, *The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century*, 12 OHIO ST. L.J. 491 (1950).

131. REVISED UNIFORM PRINCIPAL AND INCOME ACT § 11, 7A UNIFORM LAWS ANN. 452 (Master ed. 1978). Sections 9 and 10 of the Revised Act provide for the manner in which receipts from natural resources and timber are to be allocated, respectively. *Id.* §§ 9, 10. The first phrase of § 11 exempts these assets from the coverage of the section. *Id.* § 11.

132. Some of the most significant changes effected by the Revised Act include the following: (1) section 2 renders the Revised Act inapplicable within the context of legal estates; (2) section 6(c) governs distributions made by mutual funds and real estate investment trusts; and (3) sections 9 and 10 drastically alter the treatment accorded receipts from mineral interests and timber lands. REVISED UNIFORM PRINCIPAL AND INCOME ACT §§ 2, 6(c), 9, 10, 7A UNIFORM LAWS ANN. 429 (Master ed. 1978). For a comparative treatment of the two Uniform Acts, see Bogert, *The Revised Uniform Principal and Income Act*, 38 NOTRE DAME LAW. 50 (1962); Bogert, *Uniform Principal and Income Act Revised*, 101 TR. & EST. 787 (1962); Note, *The Revised Uniform Principal and Income Act—Progress, But Not Perfection*, 1963 U. ILL. L.F. 473 (1963).

tive changes did occur with respect to the treatment accorded receipts derived from wasting assets held in trust. The most egregious portion of section ten of the Act—which provided for disbursement of all receipts to the income beneficiary when the trustee was not under a duty to change the form of the investment—was entirely deleted.¹³³ Under section eleven of the Revised Act, an apportionment of receipts is mandated in all circumstances, regardless of whether the trustee is authorized to retain the wasting asset. This change worked to bring the Revised Act more into conformity with accepted common law principles.¹³⁴

In analyzing section eleven of the Revised Act, it is necessary to refer to the definitional provision in which the meaning of the term, "inventory value," is set forth.¹³⁵ This reference is necessitated by the section eleven requirement that a trustee compute the income distributable to the tenant as a percentage of this value.¹³⁶ Section 1(2) of the Revised Act defines "inventory value" as "the cost of property purchased by the trustee and the market value of other property at the time it became subject to the trust, but in the case of a testamentary trust the trustee may use any value finally determined for the purposes of an estate or inheritance tax." Therein lies the major difficulty with section eleven of the Revised Act.

The trustee's action in attaching a value to the wasting asset is, at best, a risky business. Notwithstanding the exercise of the requisite due care, the trustee's appraisal of a given asset may prove to be incorrect. The accuracy of the appraisal might be adversely affected by subsequent events. For example, at the time of the creation of a trust, a patent may appear to have a remaining economic life of fifteen years, and the trustee will value the asset accordingly. If, however, a competing invention comes on the market soon thereafter, the trustee's original appraisal will greatly exceed the patent's actual market value.

Under section eleven of the Revised Act, a mistaken valuation can have a severe effect on the rights of the trust beneficiaries. A paradigmatic example can be seen in the case of George Bernard Shaw's

133. Despite the beneficial changes brought about by § 11 of the Revised Act, § 10 of the original Act remains in force in thirteen jurisdictions. 7 UNIFORM LAWS ANN. 396 (Supp. 1978).

134. See text accompanying notes 46-65 and notes 90-109 *supra*.

135. REVISED UNIFORM PRINCIPAL AND INCOME ACT § 1(2), 7A UNIFORM LAWS ANN. 429 (Master ed. 1978).

136. *Id.* § 11. The term assumes its primary significance in connection with depletable property. Other applications arise in connection with probate income and unproductive property. *Id.* §§ 5(b)(2), 12(a).

will.¹³⁷ At the time of Shaw's death, the copyright value of *Pygmalion* was insignificant. The following year, however, *My Fair Lady* was produced, with the result that the copyright value rose appreciably. Under the mechanics of section eleven, an assessment of the copyright's "inventory value" at Mr. Shaw's death would have seriously prejudiced the income beneficiary. Conversely, in the case of an overvaluation of a wasting asset, the income beneficiary would reap a windfall gain at the expense of the remaindermen.

If there has been a mistake, of whatever kind, made in the trustee's appraisal of a wasting asset held in trust, that mistake should not prejudice the rights of one class of trust beneficiaries to the benefit of the other. Yet that is precisely the result that obtains under the formulation set forth in section eleven of the Revised Act. The task, therefore, is to construct a formula that will be sufficiently flexible to remedy this defect while, at the same time, being consistent with the criteria outlined above.¹³⁸

C. Proposed Revision

From the preceding discussion, it would appear that section eleven of the Revised Act constitutes a substantial improvement over the similar provision contained in the original Act. This conclusion is predicated upon the notion that the omission in section eleven of the Revised Act of any reference to the situation in which the trustee is empowered to retain original trust investments is more in keeping with recognized fiduciary duties of impartiality and preservation of trust corpus. There is still room, however, for significant improvement.

The principal failing of the present statutory scheme is that it requires a trustee to attach a *fixed* and *absolute* valuation to the wasting asset as of the date it was received in trust. Such an attempt at valuation ignores the hazards that inhere in the nature of the wasting asset itself. Given the fallibility of human nature and the unpredictability of future events, it is not at all unlikely that the trustee's efforts will result in a mistaken valuation of the underlying asset, with consequent detriment to one of the classes of beneficiaries in favor of the other. Because the value of the underlying asset can be known only as its actual realizations are known from year to year, why not allow the value of the asset to float up or down depending upon the revenues derived

137. Cf. *Speelman v. Pascal*, 10 N.Y.2d 313, 178 N.E.2d 723 (1961).

138. See text following note 13 *supra*.

from the asset? In this manner the worth of the wasting investment could be ascertained currently with a year by year demonstration of its actual worth.

This aim can be realized by means of the following formula for apportionment. First, the trustee should assign a tentative capital value to the underlying asset.¹³⁹ Tentative interest on this tentative capital value will then be allowed to the income account at the rate of five percent per annum.¹⁴⁰ The annual payment due to the income account will be tentatively ascertained on the basis of this computation. The annual payment due to the principal account will tentatively be the amount that must be allocated to principal each year in order to have the principal account equal the tentative capital value at the end of the asset's economic life if the principal account earns interest compounded annually. The combination of the tentative principal payment with the tentative income payment will yield a sum that should represent the participations in actual revenues received annually.¹⁴¹ It is likely, however, that there will be variances in the net return each year from the figures thus tentatively ascertained. *The figures, nevertheless, serve to establish the ratio between the two accounts.* This ratio is to be applied to each year's earnings as actually ascertained.¹⁴² In good years, the capital value of the asset will rise because of its larger productivity and, accordingly, the amount transferred to the principal account will exceed the tentatively fixed principal payment. Similarly, in good years, the amount payable to the income account will be greater than the five percent computed on the tentative principal value. Conversely, in bad years, the percentage allocations will result in both principal and income receiving their ratable share. In actual figures, each will get less than it would take if an absolute standard were attempted for an unpredictable future.

To illustrate the operation of this formula, assume the following factual situation. A trustee holds in trust a leasehold estate, having a

139. The tentative capital value assigned to a given asset could be computed in much the same way that the trustee currently determines the inventory value of an asset. Theoretically, the trustee values an asset at the discounted present value of future earnings.

140. The five percent figure is simply continued from § 11 of the Revised Act.

141. See note 75 *supra*. A deduction for any expenses incurred by the trust in connection with the wasting investment would have to be made in order to determine the net revenues.

142. On a somewhat analogous question, some courts have apportioned the proceeds realized upon a delayed sale of unproductive property in a similar manner. See, e.g., *Fidelity Union Trust Co. v. Doyle*, 135 N.J. Eq. 514, 39 A.2d 173 (1944); *In re Chapal's Will*, 269 N.Y. 464, 199 N.E. 762 (1936).

remaining duration of ten years.¹⁴³ The trustee assigns a tentative capital value to the leasehold estate of \$250,000. The annual payment due to the principal account, as tentatively ascertained under this proposal, equals \$19,876.15.¹⁴⁴ At five percent per annum, the annual payment tentatively due the income account is \$12,500. Thus the ratio that the amount payable to the principal account bears to the total amount received in any one year is 61.392 percent.¹⁴⁵ On the basis of this ratio, all revenues derived from the wasting asset will be apportioned between the principal and income account. If, in a given year, the net revenues produced by the leasehold estate totalled \$50,000, by applying the constant percentage determined above, \$30,695.67 would be allocable to the principal account with the remaining \$19,304.33 being allocable to the income account. But, regardless of the specific amount that the wasting property produces in a given year, this flexible formula seeks to assure that each account will take its share of good and bad years.

This result can be demonstrated through the following calculations. The tentative fair market value is arrived at by discounting predicted future payoffs to present value using the five percent rate of return. A \$250,000 fair market value means the trustees expect an equal annual payoff of \$32,376.15 (\$250,000 multiplied by .1295046, the annuity that has a present value of one at the end of ten years), or unequal payoffs whose present value also equals \$250,000. Suppose, however, the leasehold does better than expected, thus generating payoffs greater than \$32,376.15 per year. The results are demonstrated in the table that follows. As the table shows, under the proposed method, at the end of ten years there will be an amount in the principal

143. As compared with the existing statutory scheme, the only additional duty imposed on trustees is to compute the useful life of the wasting investment. In the case of a leasehold estate, whether for life or for years, this determination should present no real difficulty. With respect to the corpus of a trust that consists, in whole or in part, of rights under a copyright or a patent, relevant statutory provisions that govern the duration of these interests should be determinative. See 17 U.S.C. app. §§ 302-305 (1976); 35 U.S.C. § 154 (1976).

144. This figure is arrived at by calculating the annual contribution to principal necessary in order to have the principal account equal the tentative fair market value of \$250,000 at the end of the ten-year remaining useful life, assuming the annual allocations earn interest at 5% compounded annually. That amount is \$250,000 multiplied by .0795046, or \$19,876.15. The figure .0795046 is the annuity that at compound interest of 5% per year will accumulate to one in ten years. See REEVES, INTEREST TABLES, *supra* note 75, at 68.

145.

$$\frac{19,876.15}{19,876.15 + 12,500} = \frac{19,876.15}{32,376.15} = 61.391\%$$

Note that the \$32,376.15 denominator equals the expected annual payoff necessary to arrive at the \$250,000 present fair market value if the payoffs were equal each year.

account equal to the fair market value as recomputed after knowing all the payoffs. Moreover, the amounts allocated to income will have an accumulated value equal to what the accumulated value would have been if the true fair market value was known at the outset and the income account received five percent of that value each year.

Under the proposed method, as the annual payoffs come in higher than originally expected, higher amounts are allocated to both income and principal by applying the constant ratio to the actual payoffs received. Under the method in the current Uniform Principal and Income Act the income account would receive five percent of the original inventory value, or \$12,500 every year, regardless of an increase in payoffs. The income beneficiaries thus will suffer the consequences of the erroneously low initial valuation. The proposed method would also fairly distribute the payoffs if they turned out to be lower than originally expected.

Therein lies the major difference between the tentative valuation scheme and the existing statutory scheme. Under the existing method, depending upon whether the valuation adopted by the trustee is high or low, the gain or loss will inure solely to the advantage or disadvantage of one of the classes of beneficiaries.¹⁴⁶ By spreading the risk of loss among all the trust beneficiaries, this proposal enhances the likelihood that equality of treatment between tenant and remainderman will be achieved.¹⁴⁷

Judged in light of the criteria enunciated in the introductory portion of this article,¹⁴⁸ this proposal more nearly realizes these objectives than does the present statutory scheme. Let us examine each in turn.

The first criterion is whether the mode of apportionment allows the trustee to administer the trust property in a manner that is consistent with general fiduciary duties. In this instance, the trustee's duty of

146. See text accompanying notes 137-138 *supra*.

147. Although the proposed tentative valuation formula is tied to the appraised value of the wasting asset in much the same fashion as is the existing statutory scheme, an important difference does exist. Under § 11 of the Revised Act, the asset's inventory value will actually determine the amount of revenues allocable to the income account and, by necessary implication, that portion allocable to the capital account. Here, by way of contrast, the asset's tentative capital value is merely being used as a mechanism by which to establish the applicable ratio.

148. See text following note 13 *supra*.

PROPOSED METHOD—RESULTS IF PAYOFFS HIGHER THAN INITIALLY EXPECTED

YR. N	(1) ANNUAL PAYOFFS	(2) PRINCIPAL RATIO	(3) AMOUNT TO PRINCIPAL	(4) AMOUNT TO INCOME	(5) P.V. FACTORS*	sum of (1)×(5) FMV AFTER THE FACT	(6) P.V. FACTORS**	sum of (3)×(6) AMT. IN PRINCIPAL ACCT. AFTER 10 YEARS	sum of (4)×(6) TOTAL OF AMTS. ALLOCATED TO INC. IF REINVESTED @ 5%
1	\$50,000	61.39133%	\$30,695.66	\$19,304.33	.9523810	\$47,619.05	1.551328	\$47,619.04	\$29,947.35
2	50,000	61.39133%	30,695.66	19,304.33	.9070295	45,351.47	1.477455	45,351.46	28,521.28
3	60,000	61.39133%	36,834.80	23,165.20	.8638376	51,830.26	1.407100	51,830.25	32,595.75
4	60,000	61.39133%	36,834.80	23,165.20	.8227025	49,362.15	1.340096	49,362.17	31,043.59
5	60,000	61.39133%	36,834.80	23,165.20	.7835262	47,011.57	1.276282	47,011.59	29,565.33
6	70,000	61.39133%	42,973.93	27,026.07	.7462154	52,235.08	1.215506	52,235.07	32,850.35
7	70,000	61.39133%	42,973.93	27,026.07	.7106813	49,747.69	1.157625	49,747.69	31,286.05
8	70,000	61.39133%	42,973.93	27,026.07	.6768394	47,378.76	1.102500	47,378.76	29,796.24
9	70,000	61.39133%	42,973.93	27,026.07	.6446098	45,122.69	1.050000	45,122.63	28,377.37
10	80,000	61.39133%	49,113.06	30,886.94	.6139133	49,113.06	1.000000	49,113.06	30,886.94
						<u>\$484,771.78</u>		<u>\$484,771.72</u>	<u>\$304,870.25†</u>

* Present value of \$1 receivable at end of year. N. REEVES, INTEREST TABLES, *supra* note 75, at 33.

** Accumulation of \$1 at compound interest for 9, 8, 7, 6, 5, 4, 3, 2, 1 and 0 years. *Id.* at 22.

† Compare this figure with the amount the income beneficiary would have received if it was known that the true value of the property was \$484,771.78. He would have been allocated 5% times the fair market value of \$484,771.78 or \$24,238.58 per year. If this amount had been invested annually by the income beneficiary at 5% it would have accumulated to \$24,238.58 times 12.577893 or \$304,870.26. (The difference is due to rounding.) (12.577893 is the amount resulting from an investment of \$1 per year for 10 years at 5% interest. *Id.* at 46.)

preserving trust corpus intact assumes primary significance.¹⁴⁹ Under the tentative valuation scheme, it is not at all improbable that, if the tentative capital value initially assigned to the wasting asset by the trustee is too high, the amount that will ultimately be allocated to the principal account will diminish the principal value of the asset. The argument might, therefore, be made that such a result, inasmuch as it effects a "depletion" of the trust corpus, is injurious to the remainderman. But, has the value of the trust corpus really been impaired? The fact of the matter is that, as things turned out, the appraisal value was altogether too high; it never really reflected the true worth of the underlying asset. In fact, it was nothing more than a bookkeeping entry that was used to establish the necessary ratio. Shall we artificially inflate the value of the asset in order to validate the trustee's erroneous appraisal?

The second criterion, namely that of dealing impartially with the differing classes of beneficiaries, has already been addressed.¹⁵⁰ To reiterate, by means of the ratio established as between the tentative principal and the tentative income accounts, both the upside and downside risks that inhere in a wasting asset are spread evenly between the principal and income beneficiaries of the trust.

Finally, with respect to the third criterion, namely convenience of administration, it is difficult to understand how the proposed system would impose any greater burden on the trustee than currently exists.¹⁵¹ Even if one were to assume, *arguendo*, that there would be some administrative inconvenience resulting from the implementation of this proposal, the goal of achieving greater equity as between tenant and remainderman should more than offset whatever costs were entailed.

A proponent of the existing statutory scheme might very easily contend that the inequities generated by that scheme are not sufficiently great to justify revision. It cannot be gainsaid, however, that the existing uniform legislation has a very real effect on important property rights. To the extent to which the existing legislation has a differential effect upon the interests of the principal and income beneficiaries, ineq-

149. The trustee's duty of dealing impartially with the differing classes of beneficiaries will be discussed in conjunction with the second criterion. See text accompanying note 150 *infra*.

150. See text accompanying notes 148-49 *supra*.

151. See note 143 *supra*. It is arguable that this task is already comprehended by the trustee's duty to appraise the value of the wasting asset.

uities result. If such inequities can be ameliorated by the tentative valuation scheme proposed herein with few, if any, costs, there would seem to be little justification for its not receiving favorable legislative treatment.

