A TRUSTEE'S DILEMMA AS TO PRINCIPAL AND INCOME*

To sell or not to sell, that is the question.

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It is well-known that trustees and executors face a great many difficult problems during the course of administration. This unhappy fact cannot be dismissed with the thought that it is for this reason that they are paid their compensation. For man (even corporate trustee's use men) being what he is, a trustee, most likely will attempt to pursue a course of conduct which avoids a problem before it arises. Thus there is a not uncommon belief among trustees that a problem of apportioning receipts from stocks between principal and income can be avoided before it arises by selling the stock as soon as knowledge of the possible distribution is available.[1]

In the Dupont anti-trust litigation in Chicago, a trust officer testified for the defense that if Dupont were ordered to distribute its General Motors stock as a dividend, as the Department of Justice proposed, he envisaged such a difficult problem of allocation of the dividend between principal and income that he would advise avoiding the problem by selling Dupont stock now held in trust before the distribution occurred.[2]

How is it that selling avoids the problem? Under the Massachusetts rule[3] and the Uniform Principal and Income Act[4] receipts from the sale of corporate stock must all be allocated to trust corpus[5] even though part of the price received for the stock represents value attributable to accumulated corporate earnings. In many states which have the old Pennsylvania rule this was also the case.[6] To the extent then that a trustee is not required to apportion receipts

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[1] See Browning, Extraordinary Corporate Distributions Under the New York Law of Trusts, 4 Syracuse L. Rev. 293 (1953). "[M]ost trustees can entirely avoid the problem by selling the stock as soon as the prospective distribution is announced." Id., at 304.

[2] See transcript for March 20, 23, and 24.

[3] See generally on the Massachusetts rule, 4 Bogert, Trusts and Trustees § 851 (1935); 4 Powell, Real Property § 553 (1954); 3 Scott, trusts § 236.3 (2d ed., 1956).

[4] Drafted for the Commissioners on Uniform State Laws by Judge Charles E. Clark. It was approved for submission to the states in 1931 and has now been approved by the legislatures of some 20 states. See P-H Wills, Estates, and Trust Service § 3945 (1959).

[5] Uniform Principal and Income Act § 3(2).

[6] See generally on Pennsylvania rule, Bogert, op. cit. supra note 3, §§ 848–50; Powell, op. cit. supra note 3, § 553; Scott, op. cit. supra note 3, § 236.6. Pennsylvania itself requires apportionment of proceeds received from the sale of stock. See Nirdlinger's Estate, 290 Pa. 457, 139 Atl. 200 (1927), noted in 26 Mich. L. Rev. 555 (1928), and 76 U. of Pa. L. Rev. 589 (1928).

from the sale of stock, between principal and income, a sale avoids any problem[7] of determining whether an unusual[8] distribution to be received on the stock is to be allocated to principal, income or apportioned between both.

The magnitude of a trustee's difficulty may be seen from the facts of a corporate distribution in England after nationalization by the Socialist government in 1947.[9] After the Transport Act of 1947,[10] Thomas Tilling, Ltd., a large operator of motor transport and also of other enterprises, sold its transport business to the government transport commission for £24,800,000 to be paid in British Transport 3% Guaranteed stock at 101%. In November 1948 the Tilling company sent a circular to its stockholders describing the above transaction and informing them that at a special stockholders meeting it would be proposed that on April 1, 1949, the bulk of the British Transport stock be distributed to the stockholders as a "capital distribution" at the rate of £5 of Transport stock for each £1 par share held. On February 21, 1949, formal notice of the special meeting was given and on March 17, the stockholders in special meeting passed the resolution that a "capital distribution" be paid April 1, 1949, to stockholders of record on February 21, the date of the notice.

Attention should be focused on what happened to the market between the November circular and the stockholders meeting. After the circular the mean price of the stock was six pounds 4 shillings per £1 of stock until the close of security business on February 15, at which time the stock went "ex dividend." On the following morning the stock was priced at one pound 8 shillings, roughly a five pound loss in value. Consider now the problem of trustees during this period. Under the English law the distribution of British Transport stock would be considered by trusts as a distribution of income in spite of the label attached by the corporation,[11] while proceeds from the sale of stock would be allocated

[7] Problems still remain for trustees under the Uniform Principal and Income Act. While all stock and cash "dividends" are governed by a single rule, the trustee must still determine whether a distribution is to be classified as a "dividend" under Sec. 5(1), as a "liquidation" under Sec. 5(3), or with "all other amounts paid upon corporate shares" under Sec. 5(3). Apparently a distribution of "treasury" stock is not a "stock" dividend; see Leland v. Hayden, 102 Mass. 542 (1869).

[8] The word "unusual" is used in this paper so as not to confuse our problem with that of the Pennsylvania rule concerning "extraordinary" dividends. An "unusual" distribution, for purposes of this paper, may be treated by some distribution rules as ordinary and by others as extraordinary. All that is meant is that the distribution is sufficiently out of the ordinary so that the trustee ponders what to do with it.

[9] The facts of this distribution have been reconstructed from the factual statements in the following cases involving the distribution: In re Rudd's Will Trusts, [1952] 1 All. E.R. 254 (Ch.D.); In re MacLaren's Settlement Trusts, [1951] 2 All. E.R. 414 (Ch.D.); In re Kleinwort's Settlement Trusts, [1951] 1 Ch. 860; In re Sechiari, [1950] 1 All E.R. 417 (Ch.D.). See also Bland, The Thomas Tilling Stock Cases, 17 Convey. (n.s.), 22 (1953).

[10] 10 & 11 Geo. IV, c. 49.

[11] See Hill v. Permanent Trustee Co. of New South Wales, [1930] A.C. 720; Bouch v. Sproule, 12 App. Cas. 385 (1887); In re Sechiari, [1950] 1 All E.R. 417 (Ch.D.). This would also be the result under the Massachusetts rule in the United States. Under the Uniform

to corpus. A trustee, before the stock went "ex dividend," and fully cognizant of the probable consequences would be faced with this choice: (*a*) If he retained the Tilling stock, the British Transport stock received would belong to the income beneficiary and the value of the corpus of the trust would fall from six pounds to one pound; in effect a transfer of 5/6 of the value of the corpus from remainderman to income beneficiary. (*b*) If he sold the stock "cum dividend" the six pounds per share received would all belong to corpus or the remainderman. In effect the prospect of the large dividend for the income beneficiary would be wiped out to the benefit of the remainderman. Thus whichever decision a trustee makes, with these facts before him, *must of necessity* be partial to one beneficiary or the other. A suggestion in a few cases that in this event the trustee seek instructions from a court solves no problems; it merely transfers from trustee to court the burden of behaving partially toward one beneficiary or the other.

While the consequences may not be so drastic as in the Tilling cases, American trustees face similar difficulties when a corporation voluntarily or involuntarily by court order of divestiture, distributes stock in another corporation. It is the purpose of this paper to consider whether a trustee really avoids his difficulty by selling the stock. Primarily the question is whether it is a breach of the trustee's duty to act impartially between successive beneficiaries for him to sell or retain the stock on which an unusual distribution is forthcoming. There are at least five possible solutions to the problem: (1) The duty to act impartially could be applied with inexorable rigor so that whichever decision a trustee made put him in breach of trust. Thus he would be required to make up the loss to corpus if he retained the stock, or to income if he sold. (2) The duty to act impartially could be modified by a rule which states that whenever a trustee is placed in a situation so that he must choose between alternatives, one of which prefers the life tenant and the other the remainderman, then the trustee may honestly choose either with immunity from liability for breach of a duty of impartiality.[12] (3) The duty to act impartially could be modified by an allocation rule which provides that whether the trustee elects to receive an unusual distribution or to sell the underlying stock, that which is received must be allocated to income (or corpus).[13] (4) The duty to act impartially could provide that a trustee is privileged to allow the normal allocation rule to take its course (i.e., retain the stock) but if he makes an affirmative decision which has the

Principal and Income Act presumably the corporate label would control; see Sec. 5(3). The designation "capital distribution" was used by Tilling in England for obvious income tax reasons.

[12] Bogert proposes this solution in 4 Bogert, Trusts and Trustees § 801 (1935).

[13] This is the solution adopted by the Uniform Principal and Income Act for dividends payable in cash or stock at the stockholder's option (Sec. 5[1] allocates to income either stock or cash) and for stock rights (Sec. 5[2] allocates to corpus either the stock received on exercise or the proceeds of sale).

effect of influencing the operation of the allocation rules, his conduct is not privileged if he makes the decision to act affirmatively with knowledge of the consequences of the decision.[14] (5) The duty to act impartially could be applied so that the trustee must impose a loss and a gain on both beneficiaries by a "Solomon-like" decision. Under this rule the trustee must sell one-half of his stock cum dividend and retain one-half so as to receive an income dividend.[15]

Consideration of allocation problems has so frequently taken the form of discussing the relative merits of competing rules for allocation (Pennsylvania v. Massachusetts rule) or the problem as one in trust administration that we may sometimes forget that the whole problem of allocating is essentially one of acting impartially.[16] The old Pennsylvania rule, for example, required the allocation of receipts so as to give impartial treatment to income and corpus beneficiaries. Because of its complexity, that rule has given way to the Massachusetts rule, now incorporated in the Uniform Principal and Income Act. This rule, which in its application looks only to the form of the receipt, is admittedly one recommended more for its convenience than its impartiality.

It is, however, such a rule of convenience based on the form of distribution which produces the difficult problem of choice in stock distributions. Under the old Pennsylvania rule as applied in *Nirdlinger's Estate*,[17] a trustee would not be compelled to choose between beneficiaries. Under that rule, whether the stock in the *Tilling* case had been sold or retained, the receipts would have been apportioned between income beneficiary and remaindermen so that the income beneficiary received only income earned by the corporation since the trust was created or the stock acquired. This was apparently considered too difficult for trustees to apply,[18] so the following was substituted in the interest of simplicity: if the receipt was from a sale it was corpus; if from a dividend it was income, unless it was a dividend in stock of the declaring corporation in which case it was corpus.

The purpose of the rules of convenience should not be lost sight of: to relieve trustees of an allegedly intolerable burden of calculation when they find that a corporation in which the trust owns stock had made an unusual distribution. Unfortunately rules of convenience which make the allocation of a receipt turn on the form of the transaction also have the effect of permitting a trustee to make his allocation choices simply by putting the transaction in a particular form. This, however, was not its purpose. The rules of convenience

[14] This is the author's interpretation of In re Rudd's Will Trust, [1952] 1 All E.R. 254 (Ch.D.). For elaboration of this point see text following note 28 infra.

[15] Counsel argued for this solution in the Kleinwort case and Bland, op. cit. supra note 9, urged it in his discussion of the problem.

[16] Underhill treats allocation problems as part of the duty to act impartially. Underhill, Law of Trusts and Trustees 261 (10th ed., 1950). Cf. Scott, op. cit. supra note 3, where topic 6, entitled "Successive Beneficiaries," is prefaced by a section on impartiality. Thereafter, allocation problems are discussed.

[17] 290 Pa. 457, 139 Atl. 200 (1927).

[18] As to the difficulty, see Browning, op. cit. supra note 1.

were a direction to the trustee as to the method of procedure *after* he had decided to retain or sell for reasons apart from the fact of distribution. These rules were not designed to permit him to control the character of a future receipt. If the trustee *has* a receipt, the rule serves to immunize him from a claim of partiality; the rule does not tell him that if he wants a future receipt to be of a particular character he may choose a course of conduct to produce that character. Indeed, where the corporate action compels a trustee to choose the form of the receipt, the rule of convenience does not permit a trustee to choose the character of the receipt for trust purposes. Although the Uniform Act provides that cash dividends are income and stock dividends are corpus, it also says that where the situation compels choice as in an optional cash or stock dividend, the consequences of the choice are to be the same. The receipt *after choice* is income whether it is in the form of stock or of cash.

With this purpose of the Massachusetts and other rules of convenience in mind we can now look at the possible rules for the Tilling stock situation. The first possibility is, of course, completely unacceptable. Rules of convenience designed to help trustees in their administration should not be used so that a trustee cannot be helped because of the rule of impartiality. The effect of the first proposal would be to make the trustee an insurer against loss from decisions of corporate management over which he has no control in the usual situation.

Each of the other possible rules has received support of a court or commentator. The proposal that the trustee must sell one-half cum dividend and retain one-half is easily disposed of. If the rules of convenience are designed to relieve a trustee from liability in a situation in which he finds himself by reason of decisions unrelated to allocation, the rules should not be applied to compel him to take affirmative action, even for one-half the property. It is only the nature of the unit of measurement (several shares of stock) that makes this choice possible; and the proposed rule mistakenly assumes that because a life tenant and remainderman are both entitled to some consideration they are both entitled to one-half. This assumption is not made in solving other allocation problems (e.g., receipts from fire insurance proceeds) and it should not be made here.

The third rule (the receipt from either choice is the same) has been applied by case law and statute to two situations which have elements of similarity. If a corporation declares a dividend payable at the option of the stockholder in cash or stock, whichever option the trustee elects he must treat the receipt as income.[19] If a corporation offers its stockholders stock rights, whether the trustee sells the rights for cash or exercises the option for stock, the receipt is corpus.[20] In a jurisdiction which has the Uniform Act this principle probably could not be adopted for the situation under consideration without statutory

[19] See Bogert, op. cit. supra note 3, § 846; Powell, op. cit. supra note 3, § 553; Scott, op. cit. supra note 3, § 236.3.

[20] See Bogert, op. cit. supra note 3, § 854; Powell, op. cit. supra note 3, § 554; Scott, op. cit. supra note 3, § 236.9.

amendment. Furthermore the distinction which is built into the present statutes between optional dividends and stock rights on the one hand and the alternatives of sale or retention of stock on the other hand seems sound in light of the policy behind the rule of convenience. In the optional dividend and stock right cases, it is the corporate management, not the trustee, which compels choice as to form of receipt. It is the fact of ownership of stock which compels choice and because the choice is compelled by reason of continued ownership of the stock, the consequences of either choice are made the same. This is not the same type of choice as that involved in a choice of owning or selling.

Two possible rules remain to be considered: the rule that there is no breach of the duty of impartiality under either choice (rule 2) and the rule that there is no breach if the trustee retains the stock but there may be if he sells (rule 4).

Professor Bogert has suggested that *In Re Buist*[21] adopts rule 2, which he states to be thus:

> Occasionally the trustee must make a choice which will inevitably benefit one cestui at the expense of another, as where he is obliged to choose between taking a cash or stock dividend, and the former would inure to the benefit of the life cestui entirely while the latter would be of advantage to both life cestui and remainderman. In such a case, if the trustee honestly exercises his discretion, no one can complain.[22]

In Re Buist involved the following facts: A corporate merger occurred and the trustee accepted new stock in exchange for his old. Under the applicable corporate laws a dissenting stockholder in a merger had a right to demand and receive the value of his stock in cash. Under the rules of allocation for trusts the stock received on a merger would all be corpus but cash would be apportioned between income and principal according to the availability of corporate earnings accumulated since the creation of the trust. The income beneficiary argued that the trustee breached his duty of impartiality by failing to become a dissenting stockholder. The court rejected this contention, stating:

> The discretion which is lodged in the trustees must be a liberal one, and as long as the life tenant's rights, or those of the remaindermen, are not prejudiced, there is no abuse of discretion. . . . The life tenant lost nothing to which she was entitled, neither did the remaindermen; consequently it cannot be held there was an abuse of discretion in electing to take new shares of stock.[23]

But a merger as the court saw it was a *continuation* of the existing ownership and it was for this reason that the life tenant "lost nothing to which she was entitled." The case may therefore only mean that there is no breach if a trustee decides to retain his existing position.

The weakness of the rule proposed by Professor Bogert is made evident if we consider another situation in which a trustee "must" make a choice concerning an unusual distribution. In the case of *In Re MacLaren's Settlement Trusts*[24] a

[21] 297 Pa. 537, 147 Atl. 606 (1929).

[22] Bogert, op. cit. supra note 3, § 801.

[23] 297 Pa. 537, 542, 147 Atl. 606, 608 (1929).

[24] [1951] 2 All E.R. 414 (Ch.D.).

trustee, after he became aware of the probability of the unusual dividend, purchased some Tilling stock. In a sense the trustee's option to buy or not to buy is as real and as inevitable as his option to take stock in exchange on a merger or cash as a dissenting stockholder, or his option to retain or to sell. Although the case went off on another point there is a strong dictum that if the trustee had purchased the Tilling stock with knowledge of the probable benefit to the life tenant and detriment to the remainderman he would be violating his duty of impartiality.[25] It would appear certain, nevertheless, that the trustee could not be held to break his duty of impartiality by failing to buy the Tilling stock. If so then the true principal of *In Re Buist* would seem to be that where a trustee "must" choose, there is no breach of the duty of impartiality if he chooses to continue the situation in which he finds himself and allows the allocation rules to operate in normal course. If, however, he takes affirmative action (e.g., buying, in the *MacLaren* case) knowing that he will thereby change the allocation rules, he is very likely to be in breach of his duty of impartiality.

We may now consider the trust cases involving the Tilling motor transport unusual dividend in more detail. We have already noted *In Re MacLaren's Settlement Trust* where the trustee purchased Tilling stock after he became aware of the forthcoming unusual distribution. But for the fact that the trustee treated the distribution as corpus with the consent of the income beneficiary, the court would have found a breach of trust at the request of the remainderman. In a previous case, *In Re Sechiari*,[26] which held the distribution on the Tilling stock to be income, the court's order was made "without prejudice to any question whether in the circumstances . . . the court would exercise jurisdiction to apportion the dividend on equitable principles between income and capital." In the *MacLaren* case the court implied that it would have apportioned if there had been a breach of trust. *In Re Kleinwort's Settlement Trusts*,[27] which defined the court's power to apportion, throws more light on what is a breach of the duty of impartiality. In this case the remaindermen argued that the trustees might have sold the Tilling stock or sold the rights to the Transport stock in either of which cases the proceeds would have been capital. Instead they retained the stock and received the unusual distribution as income. Therefore, said the remaindermen, it is impossible for the trustees to act without benefiting the life tenant by retaining the stock or the remainderman by selling the stock; consequently the trustees should have asked the court for instructions. The trustees having failed to make such a request, the court should now apportion proceeds of the unusual distribution between income and corpus. The court rejected this argument. It stated that the jurisdiction to apportion contrary to the generally applicable allocation rules was limited to the situation "where the trustees could be said to have committed a breach of trust consisting either of some action or inaction on their part." The court found no breach of trust in failing to ask for instructions or in retaining the Tilling stock.

[25] Id., at 420. [26] [1950] 1 All E.R. 417 (Ch.D.). [27] [1951] 1 Ch. 860.

The last of the Tilling stock cases was *In Re Rudd's Will Trusts*,[28] in which the trust suffered a capital loss overnight when the market price went ex dividend of £47,000 on February 15. After the dividend in Transport stock was received, the remaindermen argued that the dividend should be allocated to principal. They argued that there was a breach of the duty of impartiality in the failure of the trustees to decide, after receipt of the November circular from the corporation, whether it was desirable to continue to retain the stock. The court refused the requested apportionment because it found no breach of trust:

That, however, in my judgment does not mean that the trustees ought necessarily to have taken the opportunity of realizing the stock in order to make a large profit for capital at the expense of income, as they must always act impartially between the two. In my judgment, it is not sufficient to show that the trustees ought to have met and considered a sale or that they misunderstood the legal effect of the circular. It is further necessary to show, that being properly advised on the law, they ought to have sold the whole or some part of the company's stock cum dividend. Except for the large sums involved, no reason was advanced to me why the trustees should have sold the stock cum dividend, *nor why*, accepting the expression that the distribution, was a windfall, *it was wrong to allow the law to take its course* with the result that the windfall belongs to income.[29] (Italics added.)

These cases seem to establish the following points applicable to our general problem: (1) It would be a breach of the duty of impartiality for a trustee to purchase stock on which an unusual dividend was about to be paid if he knew of the probable effect of the purchase or corpus. (2) It would not be a breach of the duty of impartiality for a trustee to "allow the law to take its course" and to retain stock on which the unusual dividend is to be declared if the primary reason against retention is the probable effect of the large distribution on corpus.

There appear to be no cases squarely dealing with the question whether it is a breach of trust to sell for no reason other than that implied in knowledge of the probable consequences of sale to the income beneficiary and to corpus. The closest case is a Scottish case, *Thomson's Trustee v. Thomson*,[30] also involving nationalization of the transport industry in the United Kingdom. After the company had sold its transport business in return for Transport stock, the stockholders voted, subject to court confirmation, to reduce its capital by cancelling the outstanding shares held by the national transport commission and to distribute the Transport stock to the remaining stockholders of record on a specified date after court approval. The stockholders meeting was held in September 1949. On May 18, 1950 trustees of a testamentary trust sold stock in the company. On June 7, 1950 the court confirmed the plan of capital reduction. Thereafter the distribution of Transport stock was made to the stockholders then of record. The income beneficiary claimed that the proceeds of the sale

[28] [1952] 1 All E.R. 254 (Ch.D.).

[29] Id., at 260.

[30] [1955] Scot. L. T. 427.

should be apportioned. The Scottish court upheld the contention of the income beneficiary that the proceeds of the sale should be apportioned. It was then agreed that, if the trustees had retained the stock, the value of the Transport stock received as a dividend would have been income. It was also agreed that, if the sale had been made before the notice of the meeting proposing the distribution, all of the proceeds would have been corpus since the trustees would have had no basis of knowing what the company intended to do with the stock. Because the sale was made after passage of the resolution, the court held that it was in effect a sale of a capital asset and of a right to receive transport stock, albeit contingent on court approval. The court thought that the right to Transport stock had accrued at the time of sale. The court did not apportion the receipt in the manner of dividend apportionment. Rather it awarded to income that part of the proceeds which equalled the value of the Transport stock on the date of sale of the underlying stock. It cannot be maintained that a right to the dividend had accrued to the income beneficiary after the stockholder's meeting because the record date was much later. Rather it would seem that if there is a critical event which brings home to the trustee the probable consequence of a forthcoming distribution to trust beneficiaries, thereafter he may not sell without breaching his duty of impartiality unless there is some reason for sale apart from the forthcoming distribution. One main point of the case is the implicit conclusion that the alternative rules of convenience (proceeds of sale are corpus; dividends are income) do not give a trustee the privilege of selling even though he has knowledge of the effect of the sale on the trust.

The American case most on point seems to be *Long v. Rike.*[31] There the trust owned controlling interest in a closely held manufacturing company, of which the trustee was a managing officer. In this capacity he decided to accumulate a substantial part of the corporate earnings and put them back into the business. After many years the trustee received an offer of purchase of all of the shares held by the trust at a price which reflected the accumulated earnings. The court granted permission to sell and no appeal was taken from this order. Thereafter the income beneficiary commenced a proceeding in which she claimed that part of the proceeds of sale should be allocated to income, (1) on the basis that this was the proper rule of allocation and, (2) on the theory that the trustee had exercised his control of corporate decisions concerning distribution of earnings so as to prefer the remaindermen, who were his wife and children. The trial court found against the beneficiary on both contentions; on the exercise of control in particular, it held that there were bona fide business reasons for the accumulation of corporate earnings. The Court of Appeals for the Seventh Circuit affirmed on both points. Judge Evans dissented on the disposition of the second contention, arguing that the trustee could have voted his stock to declare cash dividends; having chosen to accumulate, he still could have declared

[31] 50 F.2d 124 (C.A.7th, 1931).

an extraordinary cash dividend prior to selling the stock. "In short he could by action or non-action commit the corporation to a course which would have a distinct bearing upon the rights of the contesting parties in and to the undistributed earnings of the corporation. Because of his direct and indirect control of the affairs of the corporation and because of his relationship to the remainderman, he was, notwithstanding his previous excellent record no longer qualified to act as trustee."[32] In these circumstances said Judge Evans the court must distribute the earnings by apportionment of the proceeds. Judge Evans thus adopted the argument that was rejected by the English court in the *Kleinwort* case. As the case was presented the issue discussed by Judge Evans was not really before the court and could not be, for the court, in a previous unappealed decision, had approved of the sale of the stock. The only attack remaining for the income beneficiary was to attack the method of allocation (Massachusetts v. Pennsylvania rule) or the acts of the trustee-director prior to the decision to sell. The court did not decide that there could be no breach of the duty of impartiality from a decision to sell with knowledge of alternative methods of sale and their consequences. The most the case seems to stand for is that if there is a reason for accumulation and sale unrelated to the effect on the income beneficiary, that action is privileged.

In any event, it would seem to follow a fortiori that if it is a breach of trust to buy stock "cum" unusual dividend with knowledge of the probable consequence of the distribution to the remainderman, then it should also be a breach of trust to sell with similar knowledge of the consequence of sale to the income beneficiary where there is no reason unrelated to the distribution of the sale. Although those cases which found no breach of trust in the retention of stock with similar knowledge might appear to cast doubt on this conclusion, it has already been suggested that there is a distinction between a decision to retain and let the normal allocation rules take their course and a decision to sell or buy where such affirmative action will influence the allocation of a receipt.

Suppose that a trustee defends his decision to sell on the ground that the unusual distribution would be a windfall to the income beneficiary and he therefore has either the privilege or the duty of selling to preserve the previous relationship of the beneficiaries. As the English court said in the *Rudd* case, it is difficult to find a privilege of sale from the fact that the normal rules of allocation will produce an incongruous result. As has been suggested above, the decision to sell cannot be predicated primarily on the consequence of the distribution to the successive beneficiaries. This is not to say that the fact of the unusual dividend or distribution may not produce a duty to sell. If it does then the sale would be privileged against a claim of partiality but probably only if there is an apportionment. The Uniform Principal and Income Act recognizes some situations where the normal allocation rules are so partial to one benefi-

[32] Id., at 137.

ciary or the other that a deviation from these rules is required.[33] Thus if a corporate policy of paying stock dividends is established, a trustee may have a duty to sell arising out of his duty to make the property productive. But in selling pursuant to this duty the trustee is required to allocate part of the receipts from sale to income in order to give the income beneficiary that to which he would have been entitled had the property been productive.[34]

There is a similar rule for some kinds of *over-productive* property. If a trustee owns a wasting asset, or stock in a corporation owning wasting assets, a trustee may have a duty to sell the asset because of its wasting nature. If he has such a duty, then receipts pending sale must be apportioned between principal and income to preserve corpus.[35] In short, when some other rule of trust law imposes a duty to sell on the trustee the normal rules of allocation of the proceeds of sale may not be followed.

Can stock on which an unusually large dividend is declared be classified as over-productive property just as stock on which a large number of stock dividends are declared can be classified as under-productive property? In neither case can a single distribution of an unusual character put the stock in one or the other category. A duty to sell, if one arises, arises from a likelihood of a continued course of conduct rather than the single instance.

Perhaps we should resign ourselves to a conclusion that any stock in a corporation likely to be subject to a divestiture order under some statute such as the anti-trust laws is really stock in a corporation having wasting assets. To date we have not reached this conclusion. But where a trustee may reasonably believe that there is a new corporate policy of distributing unusual dividends he may then consider the effect of this *policy* on the relationship between income beneficiary and remainderman. If it appears likely that the result of a series of unusual distributions will affect adversely the continued ability of the corporation to make earnings, then a sale may be prudent. There must be reason for the sale apart from the immediate effect on income and corpus to justify a trustee selling in face of knowledge that sale converts probable income into corpus. If the only reason for sale is to avoid an allocation problem or to prevent a windfall to the income beneficiary, then it would seem that a trustee is breaching his duty to act impartially.

Where such a sale in breach of the trustee's duty has been contemplated or accomplished, what are the remedies of the income beneficiary? It would appear that he has three alternatives: he may, if he has information in time, enjoin

[33] See Uniform Principal and Income Act § 11.

[34] Thus in Rhode Island Hospital Trust Co. v. Tucker, 52 R.I. 277, 160 Atl. 465 (1932), the court followed the general rule and allocated to corpus stock dividends received pursuant to a general corporation policy of paying stock dividends, but it then imposed on the trustee a duty to sell the unproductive property and allocate part of the receipts to income beneficiary as "delayed income."

[35] 3 Scott, Trusts § 239, especially at p. 1845, (2d ed., 1956).

the sale by the trustee; he may seek reimbursement from the corpus of the trust, i.e., an apportionment of the proceeds of the sale; or he may seek to hold the trustee personally liable for the amount of his damage.[36] If the beneficiary seeks monetary relief under one of the latter two alternatives, the measure of recovery would seem to be the value of the distribution which would have been received had no sale taken place. There is then a question as to the time of this valuation. There are at least three possible solutions: (1) value of the property which would have been received in distribution, on date of the wrongful sale; (2) value of this other property at the time the distribution becomes firm, such as the record date; or (3) value at the time the distribution is made to stockholders. *Thompson's* case[37] selected the first of these choices.

If the injured beneficiary elects to proceed against the trustee personally the question arises whether the trustee may reimburse himself by apportioning the proceeds of sale and withdrawing the income portion for himself after he has paid the injured income beneficiary. It is well-known that on an accounting or at other times a trustee may change the allocation of a receipt where it was erroneous to credit the receipt as he originally did.

Thus if a trustee mistakenly pays capital to an income beneficiary, he may withhold future income from the life beneficiary until capital is restored or he may proceed against the beneficiary to recover the illegal sum. He may do this as trustee and it would seem there is no reason why he cannot do this when he has paid damages and is seeking to reimburse himself.[38]

Our problem, however, is a slightly different one. In the usual instance of reimbursement for erroneous allocations, it is the allocation which is erroneous. Here this is not the case. The allocation of the receipt from sale is technically correct; it is the sale itself which violates the trustee's duty of impartiality. If a court can allocate the receipt at the request of the beneficiary where the trustee has breached his duty, as the English cases state, there would appear to be no reason why the trustee cannot make a similar allocation for his own account if he has paid damages to the injured beneficiary. Perhaps the trustee should lose any commissions received because of his mistaken allocation to capital and certainly he should not be allowed to reimburse himself if he acted dishonestly.

If there is a risk of surcharge on sale after knowledge of a forthcoming unusual distribution, the trust instrument can of course help the situation. Where there is no blocking rule concerning accumulations, the simplest expedient might be a clause giving the trustee discretionary power to accumulate and then a discretionary power to invade corpus for the benefit of the income beneficiary. Clauses giving a trustee discretion as to allocation of receipts to principal and

[36] Id., at § 254.

[37] Thomson's Trustee v. Thomson, [1955] Scot. L. T. 427. See text following note 30 supra or further discussion of this case.

[38] Scott, op. cit. supra note 3, § 2002.

income also should help. Or if the draftsman and settler anticipate the possibility of a particular unusual distribution they may deal with it expressly. Thus the trust instrument could provide its own rule for distributions made pursuant to some kind of compulsory divestiture proceeding.

In conclusion it would appear that the situation herein considered is a case where non-action was clearly safer for a trustee than action. If a trustee decides to sell stock on which an usual dividend is forthcoming, he is likely to be violating his duty of impartiality to the income beneficiary unless he has some strong reasons independent of the effect of the particular distribution on income and corpus which can justify his action. On the other hand, if he decides to keep such stock and let the normal allocation rules take their course, he is not violating his duty of impartiality unless the distribution is part of a plan of distribution which may itself make it improper for a trustee to hold such stock. As long as a trustee makes his decision to buy or to sell without regard to the unusual distribution but for independent reasons, he should not be surcharged for making either choice.