Hastings Law Journal

Volume 7 | Issue 1 Article 12

1-1955

Trusts: Distribution of Trust Income--Liability for Payments to an Unqualified Beneficiary

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maintained that the legislative attitude in enacting a tort claims act was accurately reflected by Judge Cardozo in *Anderson v. John L. Hayes Construction Co.*,[21] when he said:

> "The exemption of the sovereign from suit involves hardship enough where consent has been withheld. We are not to add to its rigor by refinement of construction where consent has been announced."[22]

The general principle underlying tort liability is that when innocent parties are injured through some activity of a wrongdoer, some relief is in order. It is also generally conceded today that when innocent claimants suffer through the operation of some governmental activity, some recompense should be made. When the State of North Carolina enacted its Tort Claims Act, its intention, presumbaly, was to assume liability for torts committed against third parties through its own activities. In the principal case, the state authorized a prisoner to perform certain activities which, in effect, made him an employee, and as a result of those activities an innocent party suffered damage.

The general classification of *prisoner* should not predominate over the fact that this individual was an employee while performing these activities. The *intent* of statutory waiver of sovereign immunity is against such a narrow construction.

Louis J. Renga.

TRUSTS: DISTRIBUTION OF TRUST INCOME—LIABILITY FOR PAYMENTS TO AN UNQUALIFIED BENEFICIARY.—Should the trustee who pays the wrong beneficiary be absolutely liable for the incorrect distributions or is the test of his liability one of the use of ordinary care and reasonable skill and prudence? The Supreme Court of South Carolina has held in the case of *Rodgers v. Herron*[1] that the trustee should not be held to the standard of absolute liability but that the rule of reasonable care should govern.

The testator died in 1935 directing his executor, the defendant bank, to take charge of the corpus of his estate and pay over the income to his widow during her widowhood. On her death or remarriage the trustee was to pay the income to the seven children until the youngest child should reach 21 years of age; at which time the corpus was to be distributed among the children in equal shares. The trustee paid the income to the widow until 1949, even though a common law marriage[2] was consummated in 1940 between the life income beneficiary and a Mr. Rodgers. In 1944 the widow wrote to the trustee asking if they "can fix it with the Probate courts so I can get marred [married]. and get my income tell [until] the Baby is 21 years old."[3] A similar request was made in a conference with the trustee later in the same year. On each occasion the widow indicated that she had not remarried and would not remarry should the income cease on such an event.

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[21] 243 N.Y. 140, 153 N.E. 28 (1926).

[22] *Id.* at 147, 153 N.E. at 29. Quoted with approval in U. S. v. Aetna Casualty and Surety Co., 338 U.S. 366, 370 (1949).

[1] —— S.C. ——, 85 S.E.2d 104 (1954).

[2] A common law marriage, in opposition to a ceremonial marriage (an event, the happening of which can be fixed at some precise time), depends on the facts and circumstances evidencing a mutual agreement to live together as husband and wife, and not in concubinage. Such marriages have been recognized in South Carolina. State v. Ward, 204 S.C. 210, 28 S.E.2d 785 (1944).

[3] See note 1, *supra* at ——, 85 S.E.2d at 107.

In 1946 the trustee received a letter from one of the testator's daughters advising him that her mother had remarried. A similar letter was received by the trustee in 1948 from another child. Payments to the mother continued until suit was brought in 1949.

In the action for the monies mispaid since 1940, the children prayed for damages for $16,069.86. The Supreme Court modified the lower court's holding for the children, allowing only $6,040.64. This was the amount paid to the mother from 1946 to the date of suit, establishing that the common law marriage disentitled the widow of her share under the trust instrument. The trustee must account, therefore, for the income incorrectly distributed, from the time they could have discovered, through the exercise of ordinary care, prudence and diligence, that the widow had remarried.

In reaching their result the court recognized the two well established doctrines alluded to previously. First, that a trustee must use such diligence in the management of the trust fund as a prudent man would use in his own affairs and if he fail to use the care and skill of a man of ordinary prudence, he is liable for the resulting loss.[4] Secondly, that it is the duty of a trustee to pay the income or principal of a trust fund to the beneficiary who is entitled to it. If the trustee pays one who is neither a beneficiary nor the qualified beneficiary, he is liable, since he pays at his own risk.[5] They accepted the former rule as the basis for liability, saying that "the conflict between the rules . . . is more apparent than real."[6]

Notwithstanding its analysis, the court has failed to recognize that these two rules have dissimilar applications. One outstanding writer, in discussing these two doctrines, has said:[7]

> "The general rule as to care and diligence applied to trustees, namely, that they are protected by the use of ordinary care and reasonable skill and prudence, *does not apply to distributions of trust property to beneficiaries.* Here the duty is unqualified. No excuses will be received for its non-performance. The trustee is like a debtor who must pay his creditor and not merely use reasonable care and effort to do so." (Emphasis added.)

An examination of the two doctrines is necessary to properly evaluate their correct applications. The rule advocating that the trustee's duty is one of reasonable care and diligence finds its most frequent illustrations in the investment of trust property and the management of trust estates.[8] The conduct of these activities is primarily determined by extenuating circumstances outside the specific sphere of distributing income or principal to a beneficiary. These circumstances, which are an integral part of the trustee's activities and guide his actions, include such phenomena as the fluctuating economic markets and good business acumen. For example, this would involve activities of an investment nature[9] where, because of

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[4] 3 Bogert, Trusts and Trustees § 541 (2d ed. 1946); Restatement, Trusts § 174 (1935); Waterman v. Alden, 144 Ill. 90, 32 N.E. 972 (1893).

[5] 4 Bogert, Trusts and Trustees § 814 (2d ed. 1946); 3 Scott, Trusts § 226 (1st ed. 1939); Restatement, Trusts § 226 (1935); Prince de Bearn v. Winans, 111 Md. 434, 74 A. 626 (1909).

[6] See note 1, *supra*, at ——, 85 S.E.2d at 111. The court justified this statement in the following way: "Where the terms of the trust are free from doubt, the trustee who disregards them is guilty of negligence, . . . When they are not clear, or where there is doubt as to who is entitled to receive payment of either the principal or the income of the trust fund, it is the duty of the trustee, in the exercise of the care and diligence to be expected of a reasonable man to apply to the court for instructions. Essentially, therefore, the standard of conduct remains the same throughout the performance of the duties of the trust. *Ibid.*

[7] Bogert, Trusts § 109 (3d ed. 1952).

[8] Welch v. Flory, 294 Mass. 138, 200 N.E. 900, 106 A.L.R. 813 (1936).

[9] In re Fulton Trust of New York, 257 N.Y. 132, 177 N.E. 397, 77 A.L.R. 499 (1931) (sugar stocks); Green v. Crapo, 181 Mass. 55, 62 N.E. 956 (1902) (railway bonds).

these outside influences, the trustee must determine which is the best alternative to follow in protecting the fund. Because of these numerous outside factors the law does not impose an absolute standard of liability, but only holds the trustee to an obligation to exercise the care and skill of an ordinary man in the conduct of business of a like character who is seeking the same objects in property management as the purposes of the trust.[10] Other phases of trust management where the trustee must act according to his own discretion involve such varied business activities as managing real property,[11] which includes repairs[12] and rentals,[13] voting under the corporate stock that the trust fund holds,[14] obtaining proper security for notes taken,[15] and generally directing any affairs connected with the trust corpus.[16] In carrying on these functions, the trustee, to meet the standard created, must come up to the requirements of normal ability and diligence and use his exceptional skill and knowledge, should he be so endowed.[17]

In opposition to the aforementioned doctrine there is the rule holding a trustee absolutely liable if he pays an unqualified beneficiary. Under these circumstances this rule is more properly applied, because the trustee's duties are not influenced by outside factors requiring his discretion. He has but one duty: to pay the income to the entitled beneficiary. The application of the rule has disregarded good faith[18] or reasonable care[19] exercised by the trustee. In a leading case[20] the trustee had acted with the utmost good faith in paying one whom he reasonably supposed to be the entitled beneficiary. However, the qualified *cestui que* trust had died six years earlier and someone had been fraudulently cashing the checks during this period. Nonetheless, the court held that his liability extended from the date of the initial payment to the wrong person. Other cases dealing with forgery of the trustee's checks after the beneficiary had died[21] or had become ineligible[22] to receive the income have held that the trustee must determine the identity of the correctly entitled beneficiary at his own risk. Even a mistake of law does not excuse the trustee. Thus, liability has been absolutely imposed where the trustee took the advice of a competent lawyer who had incorrectly interpreted the trust instrument and made several incorrect payments.[23] Liability was also imposed where the supposed beneficiary was later found to be an illegitimate child not entitled to share under the provisions of the trust.[24]

Although the rule of absolute liability has been clear in its application there have been several exceptions which are notable. The first is that even though the trustee

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[10] BOGERT, TRUSTS § 93 (3d ed. 1952).

[11] In re McIntyre, 24 App.Div. 167, 28 N.Y.S. 785 (1897).

[12] Van der Veer v. Amers, 6 N.J. Super. 143, 70 A.2d 517 (1950).

[13] Pleasanton's Appeal, 99 Pa. 362 (1882).

[14] Weston v. Weston, 210 S.C. 1, 41 S.E.2d 372 (1947).

[15] Waterman v. Alden, see note 3, *supra.*

[16] Exchange Trust Co. v. Doudera, 270 Mass. 227, 170 N.E. 73 (1930).

[17] BOGERT, TRUSTS § 93 (3d ed. 1952).

[18] Moyer v. Norristown-Penn. Trust Co., 296 Pa. 26, 145 A. 682 (1929); Ellis v. Kelsey, 241 N.Y. 374, 150 N.E. 148 (1925).

[19] Surratt v. State, 167 Md. 357, 173 A. 573, 100 A.L.R. 1116 (1934); Darling Stores v. Fidelity Bankers Trust, 167 Tenn. 165, 156 S.W.2d 419 (1941).

[20] In re Sniffin's Estate, 265 App. Div. 1014, 36 N.Y.S. 527 (1942).

[21] Darling Stores v. Fidelity Bankers Trust, see note 17, *supra.*

[22] Heaney v. Riddle, 343 Pa. 453, 23 A.2d 456 (1942).

[23] Owings v. Rhodes, 65 Md. 408, 9 A. 903 (1886); Blish Trust, 350 Pa. 311, 38 A.2d 9 (1944); National Trustee Co. of Australasia Ltd. v. General Finance Co. of Australasia Ltd., (1905) A.C. 373.

[24] Ellis v. Kelsey, see note 18, *supra.*

pays the beneficiary and not the beneficiary's assignee, he is not liable if he does not have notice of the assignment.[25] This argument was relied on by the court in the principal case. It is clear, however, that this is not an exception, since the trustee is not neglecting the qualified beneficiary, but the only one who suffers here is the assignee. The second departure from the rule is an English statute,[26] also mentioned in the *Rodgers* case. Under this act the trustee is excused when paying the wrong beneficiary if he acted honestly and reasonably. The probable creation of this statute was to protect uncompensated trustees.[27] In the United States, trustees are fully compensated.[28] The third exception involves cases much like the principal one.[29] They simply do not hold the trustee absolutely liable but imply that to do so would be too harsh a burden to impose.

Accepting for brief consideration the court's contention that a trustee is only liable for his negligence, it appears that the court should have extended liability from 1944. The court in the instant case, in opposition to the Circuit Court's findings, said that there was nothing in the evidence on which the trustee could be charged with knowledge of the marriage until 1946, since the widow's letter and conference were not of such a nature as to indicate a likelihood of her remarrying. The court also said that her statements were positive in suggesting she would remain unmarried. However, it appears that it is at least arguable that the widow indicated a desire to remarry. Her letter and the conference were concerned with discussing her rights to the trust income should she alter her marital status. She made no reference to any other problem. This seems to be enough evidence to charge the trustee with knowledge that she intended to marry and should have put him on notice of a probable marriage. Then, acting in a reasonable and prudent manner, he should have stopped payments and made an investigation to determine her marital status. If it then appeared that a common law marriage had been consummated, he could have asked the court for instructions as to the distribution of the income.

In summation of the foregoing discussion it is submitted that the *Rodgers* case should have applied liability on an absolute standard, thereby holding the trustee liable from 1940, the date of the remarriage. In making distributions to a beneficiary,

[25] The cases in point hold firmly to the rule of assignments, applying the rule of Dearle v. Hall, 3 Russ. 1, where applicable, and do not even attempt to rest liability on trust concepts. Seger v. Farmers Loan and Trust, 176 N.Y. 589, 68 N.E. 1124 (1903); In re Thaw's Estate, 252 Pa. 99, 97 A. 108 (1916); Jenkinson v. New York Finance Co., 79 N.J. Eq. 247, 82 A. 36 (1911).

[26] Trustees Act, 1925, 59 & 60 Vict., c. 19 § 61. The act says that if a trustee is personally liable for a breach of trust "but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the court in the matter in which he committed the breach, then the court may relieve him either wholly or partly from personal liability for the same." The original draft of this act was in 1896, and its effect was recognized and interpreted by In re Allsop, 1 Ch. 1 (1914). The redraft of 1925 has no substantial changes in this section.

[27] In early American cases and in English law the trustee served without compensation as it was felt that if he were paid he would be too concerned with the financial aspect and think less of the interest of the beneficiary. English trustees can be paid if the instrument so provides or if they would not act without compensation. 4 BOGERT, TRUSTS AND TRUSTEES § 974 (2d ed. 1946). 2 PERRY, TRUSTS AND TRUSTEES § 904 p. 1529 (7th ed. 1929): "Nothing is better established in England than that a trustee can have no allowance or compensation for his time and trouble in the execution of a trust."

[28] In South Carolina the Code of South Carolina, 1942, § 9048, fixes a scale of fees whereby the trustee is entitled to 2½% on sums received or paid out and not over 10% on sums received by way of interest.

[29] Application of Spitzmiller, 279 App. Div. 233, 109 N.Y.S.2d 1 (1951); In re United Conclave Bldg. and Loan Ass'n, 135 N.J. Eq. 63, 37 A.2d 197 (1944); Matter of Carpenter's Estate, 154 Misc. 143, 276 N.Y.S. 754 (1935).