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Recommended Citation
Robert A. Wyler Jr., The Apportionment of Proceeds from Depletable Natural Resources Held in Trust, 18 Hastings L.J. 391 (1966). Available at: https://repository.uchastings.edu/hastings_law_journal/vol18/iss2/9

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THE APPORTIONMENT OF PROCEEDS FROM DEPLETABLE NATURAL RESOURCES HELD IN TRUST

By Robert A. Wyler, Jr.

The allocation of receipts from depletable natural resources held in trust presents the discretionary trustee with a three pronged dilemma. He must deal equitably with the present interest of the tenant and the future interest of the remainderman. He must operate within the nebulous limits of his fiduciary discretion, and, from practical considerations, he must discharge his administrative duties as simply as possible. In California, the trustee clothed with discretionary power with respect to the determination of principal, income and the apportionment of receipts is protected by statute if he exercises his discretionary power in good faith and according to his best judgment. However, the vagueness of the statutory limitations placed upon the fiduciary discretion of the trustee is implicit in the phrases “good faith” and “best judgment.” In order to protect himself from a charge that he has acted beyond these ill-defined limits and thus abused his discretion, the discretionary trustee has generally followed the apportionment standard applicable where the settlor has neither granted dis-

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Footnotes:

1 Member, Second Year Class.
2 The purpose of this comment is to analyze and evaluate California’s position with respect to the duties of a trustee, the limitations on his power to apportion proceeds between tenant and remainderman when the corpus is a depletable natural resource, and the corresponding rights of the beneficiaries in these proceeds. The discussion will be limited to trusts in which the settlor, placing no duty on the trustee to convert the wasting asset, (1) has neither specified a method for allocating receipts nor granted the trustee discretion concerning distribution of proceeds, or (2) failed to specify a method for allocation of the receipts, but left the method of distribution to the discretion of the trustee.
3 Trust receipts are generally classed as principal if they represent a change in the form of the corpus, or income if they represent a return from it.
4 The term “depletable natural resource” includes coal, oil, gas, and all other natural metallic and nonmetallic deposits. These resources are distinguished from their non-depletable counterparts, such as air and products derived from it, water, sod, dirt, turf, mosses, and mineral products of the sea, in that the latter are, by their nature, inexhaustible. Int. Rev. Code of 1954, § 613.
5 A tenant is “the person to whom income is presently or currently payable, or for whom it is accumulated or who is entitled to the beneficial use of the principal presently and for a time prior to its distribution.” Cal. Civ. Code § 730.03.
6 A remainderman is “the person ultimately entitled to the principal” Cal. Civ. Code § 730.03.
7 Interview With Mr. H. B. Shultis, Vice President in charge of Trusts, Crocker-Citizens National Bank, in San Francisco, Oct. 13, 1966.

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cretion, nor specified a method for allocating receipts, nor directed that the asset be converted. In such cases the trustee merely allocates all rents, bonuses and royalties received from the exploitation of the wasting corpus to income. While this conservative approach both protects the trustee and permits simple and convenient trust administration, it is difficult to justify either as an equitable treatment of tenant and remainderman, or as a fulfillment of the settlor's purpose and intent. Since the trust corpus is a wasting asset, it is conceivable, and not at all improbable, that the tenant, allowed all proceeds under the statute, could deplete the corpus to extinction and thus seemingly frustrate the intent of the settlor by leaving nothing for the remainderman.

Apparently recognizing the inequities in the present state of the law, the California Supreme Court, in Estate of Bixby, approved a trustee's allocation of 27½% of the gross oil royalty receipts, not to exceed 50% of the net receipts, to principal, and a distribution of the balance of the proceeds to the tenant as income. In this case, the testator, after making provision for his widow, established identical residuary trusts for the benefit of each of his four children for life. His will further provided that, upon the death of any beneficiary, the corpus of his respective trust would go to augment the trust funds of the surviving beneficiaries and upon the death of the last beneficiary, the remaining trust corpus should be distributed to the then living grandchildren of the testator. The principal assets of the respective trusts were stock in the testator's ranch and oil royalty interests.

In reaching its decision, the court, citing Civil Code section 730.04, found that the testator had empowered the trustee "to make determinations contrary to 'existing law'—i.e., the provisions of the Principal and Income Law characterizing the nature of trust receipts " by investing it with the "power to determine what is principal and what is income." They reasoned that the "purpose of the four trusts was to preserve a substantial or major part of his [testator’s] trust estate for his lineal descendants beyond his four children [T]he Trustee's allocation to principal was in accordance with a reasonable construction of the testator's intent, and not contrary to it, and was not an abuse of its discretion for this reason."

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11 This is essentially the same standard of apportionment adopted by the Commissioners on Uniform State Laws in 1962, and incorporated into the Revised Uniform Principal and Income Act § 9(a)(3), (9B UNIFORM LAWS ANNOTATED 560 (1966)) (hereinafter cited as Revised Uniform Principal and Income Act).
13 Id. at 824, 13 Cal. Rptr. at 414, 362 P.2d at 46.
But while this decision recognizes one of the problems facing a trustee clothed with discretionary powers concerning the determination of principal and income, it still leaves important questions unresolved. For example, does the decision establish an upper limit on the discretion which a trustee may reasonably exercise, and thereby expand the area in which he may safely operate, or is it merely judicial approval of the discretion exercised with respect to the facts in point? Does it represent a judicial attempt to legislate a change into the present California law as to apportionment of proceeds from depletable natural resources held in trust? Would such a standard permit simple, convenient trust administration and, at the same time, provide equitable treatment of the beneficiaries? Such questions may best be resolved through an examination of the trust relationship, the nature of the depletable trust corpus and the common-law background of apportionment.

THE TRUST RELATIONSHIP

In California, two types of trusts are recognized by statute;\textsuperscript{15} the voluntary\textsuperscript{16} and the involuntary\textsuperscript{17} trust. The involuntary trust is created by operation of law\textsuperscript{18} and the rights of the beneficiaries are “absolutely fixed and determined by law”\textsuperscript{19} A voluntary trust, on the other hand, is an express trust, created through either an inter vivos or testamentary act.\textsuperscript{20} The instrument\textsuperscript{21} creating the trust must evidence an intention on the part of the settlor to create a trust, and specify its subject, purpose and beneficiaries.\textsuperscript{22}

The directions for administration, however, need not be explicitly delineated. Often the settlor’s desired administrative policies are quite unclear, and only implicitly evident from the instrument construed

\textsuperscript{14} For extended discussions on the background of the trust concept, see 4 Powell, \textit{Real Property} §§ 500-03 (1965); 1 Scott, \textit{Trusts} §§ 1.1-11 (2d ed. 1958); Bogert, \textit{Trusts and Trustees} §§ 1-7 (2d ed. 1965).

\textsuperscript{15} \textit{Cal. Civ. Code} § 2215.


\textsuperscript{17} \textit{Cal. Civ. Code} § 2217.


\textsuperscript{20} See \textit{Restatement (Second), Trusts} § 17 (1959).

\textsuperscript{21} Natural resources, before severance, are considered real property. Therefore, where the trust corpus is composed of this type asset, \textit{California Civil Code} § 852 is controlling and the trust must be created by an instrument in writing.

\textsuperscript{22} \textit{Cal. Civ. Code} § 2221.
When construing a trust document, the courts will look to the intent of the settlor, for such is the controlling consideration in determining the rights between the tenant, remainderman and trustee. But again, the intent of the settlor is not always specifically stated, or, if stated, its expression is many times ambiguous. When doubt arises, the intent and purpose of the settlor is resolved from the trust instrument taken by "the four comers" and construed in "light of the dominant dispositive plan."

Of course, where the settlor specifically advises the trustee as to the method of administration, the problem of discretionary allocation of proceeds does not arise. But in such cases the trustee, while free from the allocation problem, is often faced with the more pervasive problem engendered by a rigid administrative policy. Too little flexibility may cause a frustration of the expressed purposes of the settlor. Therefore, to provide the needed flexibility, settlors have leaned toward granting trustees discretionary powers. Such grants, by plac-

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25 A typical situation is one in which the settlor directs that the income be paid to the tenant, but does not expressly state whether income means total proceeds or proceeds less amortization deduction. See Estate of Heard, 107 Cal. App. 2d 225, 238 P.2d 810 (1951); In re Hopkins' Estate, 171 Misc. 910, 14 N.Y.S.2d 71 (Surr. Ct. 1939).
26 Title Ins. & Trust Co. v. Duffill, 191 Cal. 629, 218 Pac. 14 (1923). In the Duffill case the court found that "in seeking the true construction of a declaration of trust, the guiding principle must be the intention of the settlor—his intention as expressed. The only intention [a court] is authorized to declare is such as may be deduced from an interpretation of the instrument which was drawn and executed by the parties to express their intention" Title Ins. & Trust Co. v. Duffill, supra at 642, 218 Pac. at 18; Estate of Greenleaf, 101 Cal. App. 2d 658, 225 P.2d 945 (1951); Sears v. Childs, 309 Mass. 337, 35 N.E.2d 663 (1941).
27 Brock v. Hall, 33 Cal. 2d 885, 892, 206 P.2d 360, 365 (1949). In criticizing the majority opinion, however, Justice Edmonds pointed out that "to lift the document 'by its four corners' and construe it according to its 'general scheme', allows a court to reach any desired result by reciting generalities and stating a positive, if unexplained, conclusion therefrom. Such a rule of construction leads to the disposition of property in such a manner as a majority of the judges may determine most fully accords with their views " as to whom the distributee should be. Id. at 894, 206 P.2d at 366.
28 Courts sometimes confuse the meaning of the term discretionary trust and apply it to trusts in which the settlor merely grants discretionary powers to his trustee. In the discretionary trust the trustee has absolute power with respect to the payment or application of trust income or capital to or for a named beneficiary or beneficiaries. He is subject to censure by the courts only when his acts are contrary to the overlying purpose and intent of the settlor. The trustee with discretionary powers, on the other hand, has a more limited field in which he may exercise his discretion. In such trusts the
ing someone with judgment in the chair of decision, provide a means for offsetting detrimental changes in external conditions with ameliorative changes in administrative policy—an alternative more desirable than strict adherence to an ofttimes obsolete and ineffectual administrative policy laid out by a settlor at the creation of the trust. But the extent to which the trustee may exercise his discretion to make these ameliorative changes depends upon the limits of that discretion as construed by the courts, for the indefinite statutory terms give the trustee at best only a vague definition of permissible conduct. However, the trustee may not act arbitrarily or capriciously, and the courts, in construing the discretionary grant, will again look to the intent of the settlor, be it expressed in an inter vivos declaration of trust or a will, and limit the trustee to an exercise of his discretion in a manner consistent with that intent.

The settlor will usually grant the trustee discretionary power with respect to certain matters (e.g., apportionment of proceeds) but specifically direct him to do some other act(s) of administration. See Bogert, TRUSTS AND TRUSTEES § 228 (2d ed. 1965); 4 Powell, REAL PROPERTY § 559 (1965); 2 Scott, TRUSTS § 128.3 (2d ed. 1956).

See Doty v. Commissioner, 148 F.2d 503 (1st Cir. 1945). The court took notice of “the difficulties of a settlor of a trust in stating his intention so as to anticipate future contingencies.” They further pointed out that the discretionary device allowed for “a readjustment of distributions between the conflicting interests of the life beneficiaries and the remaindermen” so as to “conform more closely to the expressed purposes of the settlor.” Id. at 507. See also Note, What Amounts To An Exercise of Discretion In a Discretionary Trust?, 43 IOWA L. REV. 626 (1958).

In some jurisdictions, the grant of discretion to a trustee means simply that he will have the power to exercise his judgment only in situations where there is honest doubt, but honest doubt is considered not to exist where there is settled law. A decision that is not consistent with settled law, then, would be termed an abuse of discretion. See In re Talbot’s Will, 170 Misc. 138, 9 N.Y.S.2d 806 (Sur. Ct. 1939); American Security & Trust Co. v. Frost, 117 F.2d 283 (D.C. Cir. 1940), cert. denied, 312 U.S. 707 (1941); Commissioner v. O’Keeffe, 118 F.2d 639 (1st Cir. 1941); Commissioner v. Waterbury, 97 F.2d 383 (2d Cir. 1938), cert. denied, 305 U.S. 638 (1938).

Other courts hold that discretionary power, where conferred, is intended to enable the trustee to ignore the local rules of construction in the allocation of trust receipts. The trustee is not limited to situations where “there is a question of doubt or no rule of law to guide him.” Dumaine v. Dumaine, 301 Mass. 214, 222, 16 N.E.2d 625, 630 (1938). And see White v. Rose, 73 F.2d 206 (5th Cir. 1934); Colt v. Duggan, 25 F Supp. 268 (S.D.N.Y. 1939); Sears v. Childs, 309 Mass. 337, 35 N.E.2d 663 (1941).


Doty v. Commissioner, 148 F.2d 503 (1st Cir. 1945); Horne v. Title Ins. & Trust Co., 79 F Supp. 91 (S.D. Cal. 1948); Estate of Miller, 230 Cal. App. 2d 858, 41 Cal. Rptr. 410 (1964). The court pointed out “the discretion given to a trustee is never unlimited or arbitrary, such as might be exercised by an oriental prince out of the Arabian Nights, sitting at the city gate and exercising his own uncontrolled whim as to what is appropriate and just.” Id. at 907, 41 Cal. Rptr. at 422.


Estate of Ferrall, 41 Cal. 2d 166, 255 F.2d 1009 (1953); Estate of Miller, 230
California, by statute and judicial decision, draws a qualitative distinction between “extended discretion,” described by superlatives such as “absolute,” “uncontrolled,” or “sole,” and “simple discretion” described by less exclusive adjectives. The case law indicates that under a grant of extended discretion, the trustee’s decisions “cannot be reviewed or controlled by any other person or tribunal on consideration going to the soundness of the judgment exercised by him,” but his decisions “may be attacked for fraud or bad faith.” In the absence of fraud or bad faith, the court may still interfere if it finds that the trustee acted “in a state of mind not contemplated by the settlor.” On the other hand, when the trustee is granted merely simple discretion, he will be held to the exercise of reasonable judgment. Because of the nebulous limits of fiduciary discretion, the discretionary trustee generally has taken a conservative approach when faced with the allocation of trust receipts. This policy, as mentioned


“A discretionary power conferred upon a trustee is presumed not to be left to his arbitrary discretion, but may be controlled by the proper court if not reasonably exercised, unless an absolute discretion is clearly conferred by the declaration of trust.” Cal. Civ. Code § 2269. (Emphasis added.)


Dean Halbach recognizes a conservative tendency on the part of the discretionary trustee but, in contrast, finds its expression in underpayment to the present income beneficiary. The obvious reason for this he says is that “underpayment, in the absence of such serious abuse or bad faith as to warrant the trustee’s removal, would result merely in the present beneficiary’s obtaining a court order directong increased distribu-
above, both protects the trustee from the possibility of judicial reversal and permits simple and convenient trust administration, but it is difficult to justify as either an equitable treatment of tenant and remainderman or as a fulfillment of the settlor’s overlying intent. In order to facilitate equitable treatment of the beneficiaries and fulfillment of the settlor’s general purpose, limits within which the trustee may safely operate must be established. Thus, the problem of apportionment concerns the determination of what constitutes an exercise of reasonable judgment with respect to the allocation of proceeds between present and future beneficiaries of depletable trust corpora. Such determinations obviously require an understanding of the nature of the depletable trust corpus.

THE NATURE OF THE DEPLETABLE TRUST CORPUS

The principal value of a trust corpus consisting of a depletable natural resource is in the economic exploitation of the mineral deposit. However, the worth of the corpus will be greatly diminished or destroyed through such exploitation unless allowance is made for depletion through the maintenance of an amortization fund. This becomes

...tions from the fund remaining in the hands of the trustee.” Halbach, supra note 37, at 1427.

While this may generally be true, it would seem that it is not the case in California with respect to the distribution of proceeds from depletable trust corpora. Instead, as pointed out by Mr. Shultis, the conservative administrative policies of trustees have leaned toward overpayment of the present income beneficiary. The reason is that under Civil Code § 730.11(1), the trustee without discretion or specific direction from the settlor must allocate all receipts from the exploitation of the wasting corpus to income. Therefore, the reasoning has been that if discretion is exercised in accordance with this provision, it certainly will not be determined unreasonable. The lack of litigation concerning overpayment seems to indicate the safety in such a policy. In fact, in recent years, the principal cases litigated in California as to distribution of proceeds from wasting mineral trust corpora were both suits by the tenant charging underpayment. See Estate of Bixby, 55 Cal. 2d 819, 13 Cal. Rptr. 411, 362 P.2d 43 (1961) and Estate of Sloan, 222 Cal. App. 2d 283, 35 Cal. Rptr. 167 (1963).

44 Halbach, supra note 37, at 1428.

45 Professor Richard R. B. Powell notes that such treatment “disregards” the settlor’s reasonable, and often existent, intent both to have the wasting asset retained and to have the current receipts apportioned so that each successive taker shall enjoy the same quantum of wealth.” 4 Powell, REAL PROPERTY § 555, at 347 n.3 (1965). And see 3 Scott, Trusts § 241.4 (2d ed. 1956).

46 “Depletion is the using up of natural resources by the process of mining (as in the case of coal, metals, and other minerals), quarrying (as in the case of stone), drilling (as in the case of oil and gas), and felling (as in the case of timber).” 4 CCH 1987 STAND. Fed. Tax Rep. ¶ 3508. Here, however, we are concerned not only with physical depletion, the using up of the natural resource comprising the corpus of the trust, but also with economic depletion, the using up of the trust principal. Thus, physical depletion may occur without the detrimental effects of economic depletion if the corpus is amortized, e.g., if the form of the asset is changed and reinvested.
more apparent when it is observed that part of the return from the exploitation of the mineral deposit is not really income, but represents merely a change in the form of the corpus.\textsuperscript{47} If the tenant were allowed to take all the proceeds from the sale of the extracted minerals, the result could be "such depletion and impairment of the corpus as to leave it as a skeleton or ghost for the remaindermen."\textsuperscript{48} If, on the other hand, the proceeds are distributed entirely to principal and the tenant allowed only the interest from the investment, it is probable that both the intention of the settlor and the purpose of the trust would be defeated.\textsuperscript{49} However, these two extremes, one favoring the tenant at the expense of the remainderman and the other, conversely, favoring the remainderman at the expense of the tenant, are products of centuries of evolution in the common-law courts.

The origin of the law concerning present and future interest rights in minerals lies in the common law of waste. At common law it was firmly established that the intent of the grantor of the interest determined the rights of those taking from him, whether the interest granted was legal or equitable.\textsuperscript{50} This led to the promulgation of the "open mine" doctrine, by which a legal life tenant was given the right to exhaust any resource tapped prior to the creation of his estate.\textsuperscript{51} The courts inferred that grantors, by tapping the resources during their ownership, intended that such be treated as fruits of the soil to be used to extinction.\textsuperscript{52} The common law, however, made no apportionment with respect to successive interests. The rule was simple: If the mine were already opened, the proceeds were treated wholly as income; if unopened, they were treated wholly as principal.\textsuperscript{53}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{47} Powell, Real Property § 555, at 345 (1965).
\item \textsuperscript{48} White v. Blackman, 168 S.W.2d 531, 534 (Tex. Civ. App. 1942) (dictum). This case involved a life tenancy by right of homestead.
\item \textsuperscript{49} Since the proceeds do not represent only income, conversely, they do not represent only principal and to treat them as such would be injustice to the tenant.
\item \textsuperscript{50} "The grantor was absolute master of his property, and could carve the lands which were the subject of his grant into such estates and interests as he pleased." Dashwood v. Magua, [1891] 3 Ch. 306, 360 (dictum).
\item \textsuperscript{51} As early as the time of Coke it was established law that open mines could be worked by a possessor having an estate for life or for years, even to exhaustion; but that no new mines could be opened." 5 Powell, Real Property § 640, at 17 (1965) (citing Coke, Littleton 53a (18th ed. 1823)). And see Dashwood v. Magua, [1891] 3 Ch. 306, 360 where Bowen, L.J., states that "the open mine is an instance, beginning in the Roman, but familiar already to the English law as far back as the reign of Edward III." In Eley's Appeal, 103 Pa. 300, 307 (1883), the court stated "the right to operate previously opened mines, and work the same even to exhaustion, cannot be questioned." This case involved a testamentary trust.
\item \textsuperscript{52} "The reason for the general rule applicable to opened mines is that in such cases mining is a mere mode of use and enjoyment fixed by the owner, and to extract the minerals is but to take the accruing profits from the land." Daniels v. Charles, 172 Ky. 238, 241-42, 189 S.W. 192, 194 (1916).
\item \textsuperscript{53} Bogert, Trusts and Trustees § 827, at 437 (2d ed. 1965); 3 Scott, Trusts § 239.3, at 1865 (2d ed. 1956).
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\end{footnotesize}
While this is still basically the law, it is not uniformly applied in all jurisdictions because the term “opened” has undergone a process of extension from its original literal interpretation to the extended definitions, accepted in varying degrees in the different jurisdictions. The first step in the extension of the open mine doctrine recognized a right in the life tenant to lease previously opened mines. The courts reasoned that if the tenant could exploit an open mine to exhaustion, then he certainly could lease it to exhaustion. The common-law courts next stretched the doctrine to include situations where the prior owner leased mineral deposits, but where the same were not physically opened until commencement of the limited owner’s estate. Here they reasoned that

[a] mine lawfully leased to be opened is an “open mine,” within the reason of the rule . . . ; and when lawfully opened and worked . . . during the time that the freehold estate of the life tenant continues, the profits issuing therefrom, thus lawfully severed and produced, belong of right to him; for the term “profit” in law, comprehends the produce of the soil, whether it arise above or below the surface, including product of mines, as well as herbage growing on the surface.

As a further extension, the open mine doctrine was held to apply when the trustee was clothed with the power to sell or lease the trust corpus, even though the mineral deposits had not been physically opened or leased by the settlor. From here the doctrine reached its ultimate extension with little difficulty. In its extreme expression the tenant enjoys the right to exploit the mineral deposits to exhaustion where no contrary intent can be attributed to the settlor.

In 1941, the California legislature, adopted the Uniform Principal and Income Act, and, subordinating equitable treatment of the beneficiaries to administrative ease, incorporated the extended open mine apportionment standard as a modification to section nine of the Act.


56 Bruner’s Will, 363 Pa. 552, 70 A.2d 222 (1950); In re Knox’s Estate, 328 Pa. 177, 195 Atl. 28 (1937); Bedford’s Appeal, 126 Pa. 117, 17 Atl. 538 (1889) (inter vivos trust); McClintock v. Dana, 106 Pa. 390 (1884); Eley’s Appeal, 103 Pa. 300 (1883). Contra, Mairs v. Central Trust Co., 127 W. Va. 795, 34 S.E.2d 742 (1945).

57 In re Wernet’s Estate, 61 Ohio App. 304, 22 N.E.2d 490 (1938) (testamentary trust); but see In re McFadden’s Estate, 224 Pa. 443, 73 Atl. 927 (1909) (testamentary trust).

58 “Where any part of the principal consists of property in lands from which may be taken timber, minerals, oils, gas or other natural resources, and the trustee or tenant
This standard, however, is no more inequitable than its counterpart, the unopened mine rule, which directs all proceeds to principal and allows the tenant only the interest earned on reinvestment. In either case the proceeds are disproportionately distributed, favoring one beneficiary at the expense of the other. Therefore, it would appear that the proper standard for allocating receipts from a wasting asset must lie somewhere between these extremes.

Statutory Apportionment

Probably the first significant recognition of the inequity arising in the treatment of receipts from wasting assets wholly as income came in the related field of tax law. In response to the inequity, the federal government, in 1913, permitted the operator of a wasting asset to deduct from the gross proceeds "a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made." By 1918, operators of mineral deposits in possession is not under a duty to change the form of the investment of the principal, or (the duty to change the form of the investment being absent) is authorized by law or by the terms of the transaction by which the principal was established, to lease or otherwise develop such natural resources, and no provision is made for the disposition of the net proceeds thereof after the payment of expenses and carrying charges on such property, such proceeds shall be deemed income, whether received as rent or bonus on a lease or as a consideration, by way of royalties or otherwise for the permanent severance of such natural resources from the lands. A duty to change the form of the investment shall be negatived, and authority to develop such natural resources shall be deemed to exist (not excluding other cases where appropriate intent is manifested) where (a) the resources or the right to exploit them is specifically devised or granted, or (b) where development or exploitation of the resources had begun prior to the transaction by which the principal was established, or (c) where by the terms of that transaction a general authority to lease or otherwise develop is conferred, or (d) where the lands are directed to be retained. The fact that such property where held in trust and received from the testator or settlor does not fall within the category of investments which the trustee would be authorized to make under the law or the terms of the particular trust, nor the conferring of a mere authority, as distinguished from a direction, to sell such property, shall not be deemed to evidence an intent that the form of the investment shall be changed." Cal. Civ. Code § 730.11(1).

60 See Appeal of Stoughton, 88 Pa. 198 (1878); Blakeley v. Marshall, 174 Pa. 425, 34 Atl. 564 (1889). (See note 54 supra for Pennsylvania cases following the open mine rule.)

61 The need for a depletion allowance with respect to income tax on the proceeds from a wasting asset can be seen in the following situation: Taxpayer T buys the right to exploit a mineral asset for $1,000,000. The expected yield from the deposit is $1,200,000. Without the depletion deduction, T, if a corporation, would pay at least $600,000 taxes on the return of $1,200,000 (the corporate tax rate being generally in excess of 50%). Adding to the $1,000,000 original outlay the $600,000 tax assessment, and subtracting the $1,200,000 yield, T has undergone a loss of $400,000. See Borden, Taxation of Mineral Properties, in Economics of the Mineral Industries 463 (2d ed. Robie 1964).

were allowed to calculate depletion deductions by either the cost or the discovery method.\textsuperscript{63} Applying the former method, capitalization was allowed to the extent of the original capital outlay, whereas by the latter method, the operator could capitalize to the extent of the fair market value of the deposit within thirty days of discovery.\textsuperscript{64} In 1926, Congress retained both cost and discovery methods for calculating depletion deductions with respect to mines, but, with respect to oil and gas wells, the discovery method was abandoned and a percentage standard was adopted as an approximation to it.\textsuperscript{65} Under this latter method,\textsuperscript{66} operators of oil and gas deposits were given a depletion allowance of $27\frac{1}{2}\%$ of the gross income not to exceed $50\%$ of the net income.\textsuperscript{67} In 1932, the government extended the right to depletion on a percentage of receipts to operators of metal (15\%), coal (5\%), and sulphur (23\%) mines, with all limited to 50\% of net receipts.\textsuperscript{68} Today percentage depletion applies to over 100 enumerated minerals, and may be applied to any other minerals which qualify under the general provisions of the statute.\textsuperscript{69}

These present day depletion allowances have been criticized as tax subsidies for a minority of the taxpayers,\textsuperscript{70} and from all appearances, such criticism is not entirely without merit. The criticism, however, does not go to the concept of the depletion allowance, but, instead, only to its application. In their inception, these allowances were

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  \item \textsuperscript{63} 40 Stat. 1078-79 (1918).
  \item \textsuperscript{64} Both the cost and discovery methods of calculating the depletion of the asset are similar to the depreciation procedure applied to machinery, etc. The discovery method of capitalization merely increases the basis from the actual original capital outlay as used in the cost procedure, to the fair market value within thirty days of discovery. See an example of the cost procedure note \textsuperscript{71} infra.
  \item \textsuperscript{65} 44 Stat. 16, 27, 42 (1926).
  \item \textsuperscript{66} By the percentage method of depletion the operator of the wasting asset is allowed to calculate his deduction by multiplying his gross returns by a specified percentage, e.g., $27\frac{1}{2}\%$ for oil.
  \item \textsuperscript{67} This standard was designed to operate in lieu of discovery depletion allowances so as to provide approximately the same results as though every barrel produced came from a discovered property. The Joint Staff on Internal Revenue, L. H. Parker, chairman, studied all discovery valuation cases on record and, averaging their findings for each case, concluded that discovery depletion deductions on a barrel of discovered oil averaged 32\% of the gross yield of a barrel of crude. The Senate then recommended a depletion allowance of 30\%. The House Ways and Means Committee countered with a recommendation of 25\%. In a compromise, they agreed on a depletion allowance of $27\frac{1}{2}\%$ of the gross income not to exceed 50\% of the net. Borden, Taxation of Mineral Properties, in Economics of the Mineral Industries 463 (2d ed. Robie 1964). See Freeman, Per Centage Depletion For Oil: A Policy Issue, 30 Ind. L.J. 399 (1954) for an extended discussion.
  \item \textsuperscript{68} 47 Stat. 181, 202-03 (1932).
  \item \textsuperscript{69} See INT. REV. CODE OF 1954, § 613 for the various depletion deductions in effect today.
  \item \textsuperscript{70} Freeman, Per Centage Depletion For Oil: A Policy Issue, 30 Ind. L.J. 399 (1954).
\end{itemize}
merely intended to remedy the gross inequities inherent in labeling proceeds from mineral deposits exclusively income, but in application they have overrun rather than cured the malady. But, since similar inequities prevail in the area of mineral trust receipt apportionment, the various tax depletion standards should prove useful in determining the proper standard for allocation of trust receipts.

**Depletion as a Basis of Apportionment of Trust Proceeds**

When drawing an analogy from tax depletion standards to apportionment of trust proceeds, it is important to note that, of the several methods of calculating income tax depletion deductions, only the cost method gives the actual depletion of the wasting asset.\(^7\) This is readily

\(^7\) To determine the amount of depletion by the cost method, the total number of units remaining as of the year for which the computation is being made (e.g., tons of ore, barrels of oil, board feet of timber) is first estimated. (Often because of development work, etc., the periodic estimate of recoverable units will be materially different from the estimate used for the prior period and, in such case, this new estimate is used in calculating depletion.) This estimated number of units remaining is then divided into the adjusted basis, determined by subtracting depletion to date plus salvage value, from the original cost of the wasting asset, and the quotient, then, represents the unit depletion allowance or deduction. This unit depletion deduction is then multiplied by the number of units sold during the period for which the depletion is being calculated with the result representing the total depletion deduction allowable for the year. In apportioning proceeds, this amount is credited to the principal account since it represents a change in the form of the corpus, and the balance of the proceeds is distributed to the present income beneficiaries. Example: S buys a wasting mineral asset for $11,000 and estimates indicate that it contains 100,000 recoverable units (e.g., tons of coal). In the first year 12,000 tons are mined and 10,000 sold. Assuming a salvage value (property value after extraction of all minerals) of $1,000, depletion calculations are as follows:

\[
\text{Amt. to be capitalized} = \text{original cost less salvage value} = \$11,000 - \$1,000 = \$10,000
\]

\[
\text{Rate of depletion per ton} = \frac{\text{Amt. to be capitalized}}{\text{Est. recoverable units}} = \frac{\$10,000}{100,000 \text{ tons}} = \$0.10/\text{ton}
\]

\[
\text{Depletion for the year} = \text{Depletion Rate} \times \text{tons sold} = \$0.10 \times 10,000 = \$1,000
\]

Therefore, in apportioning proceeds by means of the cost method, $1,000 would be subtracted from the net receipts, and placed in an amortization fund for the remainderman. (Note: the receipts considered here are only those obtained through exploitation of the wasting asset.)

If it is assumed that at the end of the following year, revised estimates indicate 165,000 units remaining, production increased during that year to 13,000 tons, and sales totaled 15,000 tons (the two thousand tons mined but not sold the year before are sold with the present year's production), depletion calculations for the succeeding period would be as follows:
apparent when it is recognized that the cost method allows recovery of only the capital investment pro rata over the productive life of the resource. Both discovery and its ultimate successor, percentage depletion, were designed to provide a stimulus toward development of natural resources in addition to returning the operator’s capital investment.\textsuperscript{72} By analogy, then, these methods would not only apportion the actual depletion of the asset to principal, but also part of the income.

The Commissioners on Uniform State Laws, in 1962, incorporated a percentage standard (evidently derived from the percentage tax depletion standard applicable to oil and gas) into section 9(a)(3) of the Revised Uniform Principal and Income Act.\textsuperscript{73} This standard, however, applies not only to oil and gas, but to all other natural resources, with the exception of timber,\textsuperscript{74} subject instead to a cost standard, and, of course, the non-depletable natural resources. By this standard, 27\(\frac{1}{2}\)% of the gross receipts, not to exceed 50% of the net receipts, are apportioned to principal, as a depletion allowance, and the balance is distributed to the income beneficiary.\textsuperscript{75} As pointed out above, this was the same standard used in the \textit{Bixby}\textsuperscript{76} case.

\begin{equation}
\text{Est. recoverable units at beginning 2d year} = \text{Est. recoverable units at end 2d year} + \text{units mined 2d year} + \text{units unsold from 1st year} = 165,000 + 13,000 + 2,000 = 180,000 \text{ units}
\end{equation}

\begin{equation}
\text{Amt. remaining to be capitalized} = \text{Original cost less (salvage value + depletion to date)} = \$11,000 - (\$1,000 + \$1,000) = \$9,000
\end{equation}

\begin{equation}
\text{New rate of depletion per ton} = \frac{\text{Amt. rem. to be capitalized}}{\text{Est. recov. units beg. 2d yr.}} = \frac{\$9,000}{180,000} = \$0.05 \text{ per ton}
\end{equation}

\begin{equation}
\text{Depletion for 2d yr.} = \frac{\text{Rate/ton} \times \text{tons sold}}{\text{Estimated recoverable units at end 2d year} - \text{units mined 2d year} + \text{units unsold from 1st year}} = \frac{\$0.05 \times 15,000}{180,000 - 165,000 - 13,000} = \$750
\end{equation}

Thus, the cost method merely converts the form of the corpus.


\textsuperscript{73} The Revised Uniform Principal and Income Act, § 9, was patterned after the Texas Trust Act (\textit{Tex. Rev. Civ. Stat. Art.} 7425b-33 (1960)). This latter Act was in turn modeled after the federal depletion allowance provisions.

\textsuperscript{74} \textit{REvised UNIFORM PRINCIPAL AND INCOME ACT} § 10.

\textsuperscript{75} Id. § 9.

\textsuperscript{76} Estate of Bixby, 55 Cal. 2d 819, 13 Cal. Rptr. 411, 362 P.2d 43 (1961).
Although it is unclear whether the decision in *Bixby* was a judicial attempt to legislate the standard into California law, or merely an approval of the trustee's discretion as exercised with respect to the particular facts in point, it would seem certain that the decision would influence subsequent discretionary allocations by other trustees toward the direction of the percentage standard. Therefore, in the interest of both trustee and beneficiary, a comparative analysis of the various standards of apportionment would seem to be in order. The proper criteria for such an examination would appear to lie at the heart of the trustee's dilemma, namely, (1) whether or not the standard treats the beneficiaries equitably, (2) whether or not it establishes limits within which the trustee may safely exercise his discretion, and (3) whether or not it is consistent with simple, convenient trust administration.

**TRUST RECEIPT APPORTIONMENT STANDARDS**

Of the standards to be analyzed, two are creatures of statute—the percentage and the cost standards—and two are products of the common law—the open mine, and its antithesis, the unopened mine standards. This latter standard which allows the tenant only the interest gained from reinvestment of the mineral proceeds, is based upon the theory that the sale of minerals, is, in effect, a sale of part of the land or corpus of the trust.\(^7\) The receipts, then, represent principal to be reinvested, and the tenant, as income beneficiary, is entitled to the interest earned thereon. As in the case of its counterpart, the open mine rule, this standard would do little to establish limits on permissible deviations from it. The same generalization would seem to hold true for both the cost and the percentage standards, and, the reason for ineffectiveness in either of the cases, would be the failure of the standards to expressly delineate areas of permissible deviation. A trustee subject to the qualitative limits determined by the judicial construction of the settlor's grant of discretion, would be more apt to take a conservative approach and thus apportion proceeds as per the letter of the standard rather than exercise his discretion in the nebulous area surrounding the standard and thereby chance the possibility of judicial reversal.\(^8\) The effect, then, of any of the four standards would appear to be a partial extinguishment of discretion, contrary to the obvious intent of the settlor in granting discretionary powers to the trustee. Therefore, not only must there be a general standard for apportioning receipts from depletable mineral assets (applicable to trusts in which the settlor neither grants discretion nor specifies a particular method for allocating receipts), but also limits on permissible deviations from

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\(^7\) See note 60 *supra*.

\(^8\) Interview With Mr. H. B. Shultis, Vice President in charge of Trusts, Crocker-Citizens National Bank, in San Francisco, Oct. 13, 1966.
that standard within which a trustee may safely operate (applicable to trusts in which the settlor fails to specify a particular method for allocating proceeds, but grants discretion to the trustee to so determine).

When comparing these four standards as to administrative ease, it is immediately recognized that the present California rule which directs all receipts to the tenant\(^7^9\) is mechanically the least complicated. When the net receipts are determined, they are simply paid over to the tenant. Similarly, the unopened mine standard would provide little difficulty as the receipts are merely credited to the principal account. This method, however, requires one more step than the open mine standard as the trustee must pay the interest on the reinvested principal to the tenant as it accrues.

In analyzing the administrative problems created by the cost method, it is again useful to examine the income tax provisions pertaining to depletable mineral assets. By federal law, the operator of a mineral deposit is permitted to calculate income tax on the proceeds received by either cost or percentage methods.\(^8^0\) However, a percentage derived depletion deduction may not be used if it is less than the allowable deduction as calculated by the cost method.\(^8^1\) Thus, even if percentage calculations are made, cost depletion must still be calculated for comparison, and since the figures necessary for cost apportionment calculations are identical to those needed for cost depletion deduction calculations, the trustee would be put to no extra work in determining the amounts to be distributed to the respective interests.

The percentage standard of the Revised Uniform Principal and Income Act, however, would present the most difficulty, but the added mechanical operations would certainly not be sufficient to warrant a rejection of the standard on this basis alone. The differences between percentage tax depletion deduction calculations and percentage apportionment calculations would occur only when the mineral was other than oil or gas, as the Revised Act applies the 27\(\frac{1}{2}\)% standard uniformly to all minerals,\(^8^2\) whereas the allowable percentage for tax purposes varies with the mineral under consideration.\(^8^3\) Mechanically the percentage method would require only that the gross receipts be multiplied by 27\(\frac{1}{2}\)% and that the product be apportioned to principal, subject to the proviso that such product be considered equal to 50% of the net receipts whenever the actual result is greater than that amount.\(^8^4\)

\(^7^9\) Cal. Civ. Code § 730.11(1).
\(^8^0\) Int. Rev. Code of 1954, § 611.
\(^8^2\) Revised Uniform Principal and Income Act § 9(a)(3).
\(^8^3\) Int. Rev. Code of 1954, § 613.
\(^8^4\) Revised Uniform Principal and Income Act § 9(a)(3).
It therefore appears that the relatively inconsequential variations in administrative requirements between the four methods under consideration would constitute a rather arbitrary basis upon which to choose one method above the others. This also would be a reasonable conclusion if differentiation were attempted on the basis of the relative effectiveness of a particular method in establishing limits within which the trustee could safely operate. It would seem, then, that the distinguishing factors, if there be any, must lie in the relative abilities of the respective methods to treat the beneficiaries equitably.

Since the trust device is a means of transferring wealth, it would seem reasonable to presume, as pointed out by Professor Richard R. B. Powell, that a settlor, expressing no contrary desires in the trust instrument, would intend that the wasting asset be retained, and that current receipts be apportioned so that each successive taker could enjoy the same quantum of wealth.85 And it also seems reasonable that such a policy would treat the successive interests equitably. However, since apportionment is basically a method for distributing wealth between beneficiaries, an analysis of the four standards under consideration, in light of the economic factors affecting the trust, should best serve to illustrate the equitable effectiveness of each.

Before going forward with such an analysis, however, it should be noted that an equitable distribution of proceeds does not necessarily mean a per capita distribution.86 Instead, equitable considerations relate to the fairness with which the various standards treat the interests of the beneficiaries. Often, as will be shown infra, fair and equitable treatment of the conflicting interests of the successive beneficiaries can be achieved only through an unequal distribution of proceeds. But the significance of this last statement depends upon an understanding of the economic conditions affecting the trust corpus.

It will be observed that the value of a depletable mineral trust corpus at the time the settlor creates the trust is based upon two factors—the estimated number of recoverable units (barrels of oil, tons of coal, etc.) and the dollar value of the mineral per unit extracted. But as external economic conditions change, these two factors, acting together, could produce no less than nine permutations or combinations: The dollar value of the mineral per unit could remain constant, and the estimated number of recoverable units could (1) decrease, (2) increase, or (3) remain constant. The dollar value of the mineral per unit could decrease, and the estimated number of recoverable units could (4) decrease, (5) increase, or (6) remain the same. The dollar value of the mineral per unit could increase, and the esti-

85 4 POWELL, REAL PROPERTY § 555, at 347 n.3 (1965).
mated number of recoverable units could (7) decrease, (8) increase, or (9) remain constant.

These nine situations, then, represent the possible results from changes in the external conditions affecting the trust property. It is to these situations that the trustee must attempt to apply an administrative policy which is mechanically practical, within the bounds of the discretionary powers granted him and, at the same time, equitable to the interests of both present and future beneficiaries.

The Extended Open Mine Standard

It is patently obvious, even to the layman, that a trustee, in choosing to apportion by the extended open mine rule, expressed in Civil Code section 730.11(1), would unduly favor the tenant at the expense of the remainderman. When the trustee follows this rule and allocates all proceeds to the tenant, thereby providing no allowance for depletion, he leaves the remainderman with only the possibility or contingency of enjoying any of the asset left in trust by the settlor. Quite obviously, the remainderman's possibility of enjoying any of the asset, no matter which of the nine situations inures, depends upon the tenant's term expiring before the asset is totally depleted. Although there has been dicta to the effect that such a standard is justified, based upon the postulate that the tenant has had a closer relationship with the settlor than the remainderman and, a fortiori, should receive more of the settlor's bounty, the reasoning seems illogical in light of the settlor's probable purpose in creating the trust. If the settlor had really intended that the tenant have the entire proceeds, it would seem that he would have so stipulated in the trust instrument, or, in the alternative, would have created a legal estate without impeachment for waste with remainder over. When a trust is created, especially one granting the trustee discretionary powers with respect to the determination of principal and income, it is reasonable to presume that the settlor did not intend that the tenant should take all the proceeds, but that the same should be apportioned between the successive takers.8 Even in trusts in which the settlor neither specified a method of allocation nor granted the trustee discretion with respect to such matters, apportionment by the extreme policy of the extended open mine doctrine seems unwarranted and unjust.

The Unopened Mine Standard

The unopened mine rule, on the other hand, appears to tip the scales of equity to the opposite extreme. By apportioning all proceeds to principal, this rule limits the tenant's income to only the interest gained on reinvestment. The inequities in such a policy are more fully

88 See 4 Powm., REAL PROPERTY § 555, at 347 n.3 (1965).
revealed when it is recognized that the total proceeds include not only the allowance for depletion and maintenance of the corpus, but also the excess above this amount which by traditional definitions is income and, as such, seemingly distributable to the income beneficiary. In all nine situations outlined above, this policy would discriminate against the tenant, allowing him only the usual trust investment return of 5-7%, and this only on the re-invested, converted corpus. Thus this approach is somewhat analogous to the policy applied by trustees who are under a duty to convert a wasting trust asset.

However, as in the case of the open mine rule, the standard must also be considered with regard to the settlor's overlying purpose in creating the trust. Here again it would seem that if the settlor did not intend that the wasting asset be retained, he would have so stated in the trust instrument. Without such statement, and with an accompanying grant of discretion concerning the allocation of proceeds, an application of the unopened mine standard (or for that matter, the open mine standard), would indeed seem inconsistent with an equitable treatment of the beneficiaries—the basic principle dictating that proceeds be apportioned.

The Cost Standard

More in line with this principle, however, would seem to be the cost standard of apportionment, for, as noted above, it provides for a pro rata recovery of the original capital outlay over the productive life of the wasting asset. If the value factor and unit factor which determine the situation facing the trustee were to remain constant, application of a cost standard would quite obviously segregate the proceeds from the exploitation of the wasting asset into principal and income in consonance with the traditional definitions of each. Such a standard would therefore apportion receipts so as to provide that each successive taker enjoy the same quantum of wealth. This same result also obtains when the controlling factors operate so as to offset one another.

While maintaining the corpus as per the time of creation appears to do equity to the interests of the present and future beneficiaries when neither the unit nor the value factor changes, or when the factors act in opposition, such would seem not to be the case when one of the factors increases and the other remains the same, or when both increase. In these latter situations the cost method will maintain the corpus as it was at the creation of the trust, but will not provide for

90 See CAL. CIV. CODE § 730.12.
91 See note 71 supra.
an equitable apportionment of the enhanced value. This is especially noticeable where it is possible to amortize the original worth of the trust corpus and still have an income production, for example, where the settlor buys land at non-mineral bearing land prices and after the creation of the trust the mineral content of the land is discovered, thus greatly enhancing the value of the corpus. By strict application of the cost method, only the original investment of the settlor will be amortized for the remaindermen.

In *Estate of Sloan,* a case of discovery after creation, the court held that the receipts from the newly discovered mineral deposits should be apportioned between principal and income. While the decision is sound in light of the hypothesis of the court, it would appear that the reasoning is somewhat obtuse. The court recognized that the trust corpus was considered of nominal value at the time of creation. They justified application of the proceeds to principal, however, by suggesting that the great value of the trust always existed, but simply was not recognized until discovery. Since the value always existed, the court felt that the principal must be calculated with respect to it—any depletion of this new corpus principal being termed a frustration of the fundamental purpose of the trust. The court here seemingly lost sight of the basic principle that proceeds be apportioned so as to treat the interests of present and future beneficiaries equitably, and instead based its decision on a fiction in order to achieve an equitable result since a strict application of the cost method would unduly favor the remainderman.

While this was a case of an after discovered asset, the same potential inequities would hold if the asset were merely found to be significantly larger than estimated at creation or of significantly greater worth per unit. It would seem, then, that to be consistent with the policy underlying apportionment, the enhanced value of the corpus must also be apportioned. Attempting to do so by the cost standard, however, would necessitate setting up a fictitious basis for depletion, based upon the enhanced value of the corpus. Obviously, this would increase the mechanical difficulties as the cost method tax depletion deduction calculations would no longer be the same as the apportionment calculations.

**The Percentage Standard**

However, the desired equitable apportionment in the enhanced value situations would seem to be accomplished without the undesirable added mechanical operations by an application of the percentage standard of the Revised Uniform Principal and Income Act. Where

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the settlor neither knew of nor provided for the contingency of enhanced value, the percentage standard would appear more equitable since the overplus would be apportioned between tenant and remainderman, giving the remainderman the possibility of taking up to a maximum of 50% of the net returns. Since the percentage standard by nature apportions both principal and part of income to corpus, it should more nearly approximate a hypothetical cost type distribution, based on the enhanced value, than would apportionment by the cost method based upon the original capital outlay, and would therefore solve the problem facing the court in the Sloan case without unduly discriminating against the tenant.

However, while the percentage standard appears to be an equitable method of allocating receipts when the external conditions are such as to enhance the value of the corpus, it would seem to unduly favor the remainderman when the factors stay constant or operate in opposition. The same reasons which allow the standard to be applied in the enhanced value situations would tend to bar its application where there is little or no change in the value of the corpus. Since the percentage method allocates both principal and part of income to the amortization fund, it would allow an inequitable distribution of proceeds between the successive takers. It would therefore be in conflict with the traditional definitions of principal and income.

SYNTHESIS

Comparing the percentage standard with the other three standards considered above, the extended open mine, the unopened mine, and the cost standard, it is readily apparent that none of the methods provide an equitable distribution of the proceeds under all of the situations which might possibly face the trustee. In tabular form the results of an application of the various methods to the nine different situations facing the trustee could be summarized as follows:

Legend: *Same* indicates no relative change in the factor since trust creation.
*Up or down* indicates the direction of significant change in a factor since creation of the trust.
*T* indicates an operation favoring the tenant.
*R* indicates an operation favoring the remainderman.
*N* indicates an operation favoring neither beneficiary.

98 See *ibid*.
95 The value of a wasting mineral asset will appear to be enhanced when either the unit or the value factor increases (the other remaining relatively constant), or when both increase.
The above table, however, does shed some light on the problem of determining the proper standard of allocation. As the table indicates, a combination of the cost and percentage standards would tend to favor neither the present interest at the expense of the future nor the future at the expense of the present. If the cost method were applied in situations where the value and unit factors operate in opposition, or remain the same, neither beneficiary would seem to be prejudiced. On the other hand, if the percentage standard were applied where either or both of the factors increase thereby causing the value of the corpus to be enhanced, the proceeds would appear to be distributed without prejudice to either of the beneficiaries.

These observations, then, suggest that a flexible standard would be the proper standard for apportioning receipts from a wasting mineral trust corpus, as it would allow the trustee to adjust his administrative policy to fit the situation with which he is confronted in order to fulfill the settlor’s overlying purpose. And it will be remembered that a desire for increased flexibility is precisely one of the main factors influencing a settlor to grant discretionary powers to a trustee with respect to the determination and distribution of principal and income. In order to gain the full advantages of the decisions of a trustee, it would seem, as pointed out above, that not only must there be a general standard, but also limits on permissible deviations therefrom.

Since the percentage standard compensates for the inequities of the cost standard in situations where the corpus has increased in value due to external changes in conditions affecting the trust property, it would seem to be a reasonable upper limit on the exercise of discretion by the trustee. Furthermore, the percentage specified by the Revised Uniform Principal and Income Act would seem to be a reason-

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**Table:**

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<th>Situation</th>
<th>Value</th>
<th>Estimated Units</th>
<th>Open Mine</th>
<th>Unopened Mine</th>
<th>Cost Percentage</th>
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<td>R</td>
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</table>

* When the value of a trust corpus substantially decreases, the corpus is termed unproductive and is administered accordingly. See Cal. Civ. Code § 730.13.
able quantitative upper limit because it would include all allowable
tax depletion deduction percentages, and would permit the trustee
to apportion by the percentage applicable to the particular asset comprising his trust corpus and thereby eliminate a duplication of mechanical operations. While the 27½% standard as proposed by the Revised Act is derived from the patently arbitrary standard of the internal revenue oil depletion allowance, it would seem no less desirable than any other percentage which might be chosen. In fact, with mineral fuels comprising 64% of the dollar value of minerals extracted in California, and most probably a similar majority of the dollar value of minerals held in trust, it would seem desirable to adopt the 27½% standard as the upper limit on permissible discretionary conduct by the trustee clothed with such powers.

While the percentage standard of the Revised Act appears to be a desirable upper limitation on the permissible conduct of the trustee given discretionary powers concerning the distribution of proceeds, it in no way establishes or indicates what should be the lower limit. On the surface, the obvious choice would be the cost standard, however, when a longer look is taken, the usefulness of extending the lower limit on the trustee’s discretion to the present California standard of the extended open mine rule is readily perceived. That such should be a proper lower limit would seem to be supported by the following: First, it would appear that application of such a standard of apportionment would work no injustice in situations where the tenant could not appreciably deplete the trust corpus during his term either because the tenant has a short life expectancy, or the corpus is extremely large, etc. This would seem equitable since the remainderman would be left with the bulk of the corpus, which, because it has not been appreciably depleted, retains the ability not only to be converted but also to produce income from further exploitation. Of course as the number of remaindermen increases, or as the corpus begins to appreciably deplete, the trustee could vary the policy toward the upper limit of the percentage standard and thereby again bring equity into the distribution of receipts to the conflicting interests of the tenant and the remainderman.

Obviously, these limits would not bind the settlor who wished to provide for a different method of allocation of receipts in the trust document. They would, however, eliminate the qualitative limits placed on the discretion granted a trustee through judicial construction of the particular words modifying the grant. This would seem to be a desirable result since the trustee would know that his decisions, “if in good faith and according to his best judgment . . . [would] be

conclusive, irrespective of whether ... [they] be in accordance with the determination which the court having jurisdiction would have made." But because of the vagueness of the phrases "good faith" and "best judgment," it might even be advisable to carry the provision of conclusiveness a step further and find the trustee's decisions unassailable within the allowed limits except when there is fraud, misrepresentation, or some similar wrongful act. The establishment of the definite limits within which the trustee could safely operate would then hopefully eliminate whatever conservative, self-protective tendencies a trustee might have and instead spur him to exercise his discretion so as to provide the optimum fulfillment of the settlor's purpose and intent in granting discretionary powers.

CONCLUSION

It would appear, then, that the questions posed by the Bixby decision must be directed to the legislature for final resolution. If the court was attempting to adopt judicially the standard proposed by the Revised Uniform Principal and Income Act as a new standard of apportionment for California, they were not only invading the province of the legislature, but also apparently ignoring the frailties of that standard. While the standard does provide a simple convenient method of trust administration, it is no simpler in operation than the extended open mine rule, the unopened mine rule, or the cost standard. Although none of the last three standards or the percentage standard effectively establishes permissible areas within which the trustee may safely operate, such limits could be inferred from the Bixby decision if it is viewed as placing an upper limit on the quantitative discretion which the trustee may exercise. More properly, however, the Bixby case should be viewed as a judicial approval of the 27½% standard only with respect to the particular facts involved, but, quite obviously, such a conclusion would also be begging the question. The decision, however, has shown that the present standard which allows the tenant to take all the proceeds from the exploitation of the wasting mineral asset can give rise to gross inequities when the nature of the trust corpus and the basic principles dictating apportionment of receipts are considered. The decision should therefore be a stimulus to the legislature to reconsider the present statutory method of apportionment in California and attempt to formulate a policy which in operation would be more consistent with the equitable treatment of both the present and future beneficiaries and more consistent with a fulfillment of the general intent of the settlor in attempting to distribute his wealth via the trust device.

90 CAL. CIV. CODE § 730.04.