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Volume 13 | Issue 4 Article 1

January 1936

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Recommended Citation
Hugh McLean, Estate Investments, 13 Dicta 83 (1936).

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ESTATE INVESTMENTS

By HUGH MCLEAN, *of the Denver Bar*

THIS rather expansive title needs definition and restriction. It is perhaps needless to say that no attempt is here made to give inside information (not possessed by the author) on investment of estate funds at the good old "6% with absolute safety," nor to present any patent methods of keeping all beneficiaries happy with investments which never default and never decline.

We must also exclude other large questions under current discussion, such as the problem whether a fiduciary is ever justified (in the absence of specific directions or authority) in buying common stocks as a hedge against inflation, or otherwise engaging in the pursuit of that rather elusive will-of-the-wisp, the purchasing power of the dollar.

The real topic is much narrower; it is merely to see whether any lessons can be drawn from recent decisions on investment questions. There is no doubt that the last few years have been very hard on fiduciaries. Without, for the most part, any fault of theirs, they have seen much of the value of their estates swept away, income drastically reduced. Beneficiaries, very humanly, have been looking for someone to blame. Probate judges and surrogates have been confronted with case after case of widows and orphans reduced to actual want, until even the judges' nerves have become jittery. As a result more cases have been brought into court raising questions of fiduciary investment responsibility, than in any like period for many years. What lessons may be learned from the decisions growing out of these troubled times? What are the things a fiduciary (using that general term to include executors, administrators, guardians and conservators) should not do?

By way of preface it goes without saying that orders of court should be secured authorizing sales and other acts regarding estate investments. It is not suggested that fiduciaries should assume to act without court order, or take the responsibility of selling estate investments without court approval. But the initiative must come from the fiduciary—obviously it cannot come from the court; and most of the trouble arises not from action but from neglect. The fiduciary holds investments and does nothing until after the damage is done. If he has sought, and the court has refused, an order of sale, he will doubtless be excused if loss occurs.

1. The fiduciary should not delay to wind up his decedent's speculations.

A margin account, retained by the executor for four months after testator's death, caused great loss to the estate in the 1929 crash. Held: Under the circumstances the delay was not unreasonable and the executor was not liable. Lazaar's Est. 247 N. Y. S. 230.

This probably pushes reasonable time to the limit. It is doubtful if an executor would ordinarily need four months to close up a clearly speculative transaction. The case at least sounds a warning.

2. The fiduciary should not act, with respect to his estates' investments, on incompetent advice, nor delegate his responsibilities to others.

The trustee for an infant consulted his attorney for investment advice, and turned estate money over to the attorney, who bought bonds technically legal but inferior in quality, which later defaulted. The trustee made no investigation. Held: The advice of counsel will protect a trustee on a question of law, but will not relieve him from exercising discretion which belongs to the trustee alone. His improvidence and supine negligence justify his surcharge and removal. Reiks Estate 18 D. C. (Pa.) 252, March 10, 1933.

An executor converted U. S. bonds into personal notes secured by second mortgages on real estate with a faulty title.

He presented his lawyer's advice as an excuse. The court said:

"While the advice of a lawyer may repel the imputation of malice and bad faith, it can furnish no other justification. If the advice be wrong and the client follow it, his conduct is as wrong as the advice. Lawyers are not privileged to advise foolishly, and their clients are not protected by their foolish advice. The court will look at the act and not at its adviser in judging of its merit or demerit." Hanscom v. Marston, 82 Me. 288, 19 Atl. 460.

In one of the numerous cases involving the Macky will, under which the University of Colorado was the chief beneficiary, it appeared that the executor was appointed in 1907 and did not file his final report until 1920—something of a record in itself. Meanwhile he had litigated to the Supreme Court and back, every possible question. Year after year during this whole period he kept sums from $10,000 to $13,000 lying idle in open account in the bank, without a cent of interest to the estate. As one excuse he pleaded advice of his attorney (who, it appeared, had used insulting language to the Regents and threatened to "get them yet"). Held: Advice of his attorney is no excuse. The executor will be surcharged for interest on the idle funds. Regents v. Wilson, 73 Col. 1.

Even a judge's advice, it seems, must be official to be effective.

Judge Gabbert in Thomas Est., 26 Colo. 110, had before him the case of a conservator who received $4,500 cash and kept it on hand seven years, making no investment. On application to surcharge him on his final account, his excuse was that the County Judge had told him it was his duty to keep the funds on hand ready to turn over promptly if his ward should be declared sane. Judge Gabbert, after saying that a conservator is not to collect the funds for the purpose of turning them over to those entitled to them, like an administrator, but to invest them in a safe and permanent manner to produce an income so that the ward's principal may not be unnecessarily depleted, has this to say about the alleged advice of the judge:

> "The advice * * * does not appear to have been given in pursuance of an application to the court. * * * It is not the duty of a (judge) to advise parties to any action regarding their rights and duties except when the matter is presented to him in his official capacity. Mere advice or suggestions on his part regarding matters in which he does not assume to act judicially, are no protection to those who choose to rely upon them."

3. If a guardian, he should not make investments maturing beyond his ward's majority.

A guardian made investments in mortgages which were legal, but which matured three years after the minor attained majority. Held: Investment improper, and objection of minor on attaining majority sustained. "The law has been settled for generations that the property of an infant should not be impounded beyond his majority." Blakes Est. (N. Y.), L. J. March 4, 1933—Perry, Trusts, Section 608.

How rigidly this principle would be enforced may be open to question. But obviously a guardian, knowing his minor will attain majority in 1937, should not invest his funds in bonds maturing in 1955. Whether it is good for him or not, the minor is apparently entitled to have his estate practically in cash when it is turned over to him, just as is a general legatee under a will. Compare the prohibition on a guardian leasing his ward's real estate beyond his majority. Colo. C. L. Sec. 5270.

4. If an executor or administrator, he should not lose sight of his primary duty: To liquidate his estate, pay debts, taxes and legacies, and pay or distribute the residue.

An executor retained the testator's stocks and other non-legal investments for a period of three years, while they steadily declined in value, until there was nothing left of the estate. Held: The executor was guilty of negligence. He should have liquidated the assets and had the estate ready for distribution a year after the grant of letters. He was, therefore, surcharged the value of the retained stocks as of one year from the date of letters. Estate of Junkersfield, Westchester Law Journal, April 30, 1935.

Executors, qualifying in 1931, found that the estate consisted of real estate and twelve mortgage participation certificates. During the whole of the first year of administration and for some time after, the mortgage certificates could have been liquidated at 90% of their face; but they were retained in the estate until final accounting, at which time they were practically worthless. On objection to the executors' account. Held: Executors surcharged in an amount of 90% of the face of the mortgage participations. "This estate should have been ready for distribution, except as to the real estate, within a year after the issuance of letters. The certificates should have been and could have been liquidated." Estate of Price, N. Y. L. J., April 8, 1935.

5. He should not hold decedent's speculative and non-legal securities longer than a reasonable time.

This assumes a jurisdiction like Colorado where a statute definitely prescribes what investments fiduciaries may make. It is also subject to several qualifications or exceptions noted later.

In a recent New York case it appeared that a testator died leaving a will with general legacies, residue to son and daughter, named executors. The estate consisted almost entirely of speculative railway and industrial stocks, actively traded on the exchange. At inventory value, the estate would have paid its claims, general legacies and a fair residue. The executors, hoping that the stocks would rise and their residue be increased, held the stocks until when they filed their account, there was not enough in the estate to pay the general legacies.

Held: They will be surcharged in an amount sufficient to pay general legacies in full. The court, brushing aside the excuses of the executors, which were that they were waiting (1) for the date for presentation of claims; and (2) the result of a tax controversy in a foreign jurisdiction—says "The testimony of the testator's son makes it clear that he and his sister, as residuary legatees, were seeking to recoup the shrinkage in value of the shares purchased at higher prices by their father, and that they were seeking to do this solely for their own benefit, and (after the value in the residuary disappeared), solely at the expense of the legatees. Happy would be the speculator who could use other people's money for his margin, and who could take all the profits if the speculation won, and who could lay any loss of capital on the helpless furnisher of money for the speculation. The trust which these executors took upon themselves was to administer the property which they received. Caution would have dictated an order to sell these shares immediately upon qualification. Nothing whatever has been shown except this wholly improper motive to benefit the executors as residuary legatees, why there was any delay in the sale. They were not justified in holding speculative securities merely because they could not make disposition of the cash realized therefrom. Whether they thought the testator had other debts or not, their duty to liquidate speculative common stocks was an urgent, immediate duty. When that duty had been performed they could have invested in legal securities, if they chose, or have held the money at interest. The courts have recognized and will continue to recognize the unusual burden cast upon fiduciaries by the unprecedented shrinkage in values beginning in the fall of 1929. The current depression, however, has not given an immunity bath to unfaithful fiduciaries. Fiduciaries who have honestly struggled with a difficult situation without seeking personal gain at the expense of the trust will be given the benefit of that consideration which should be extended to good faith and honest effort, and fair performance of the fiduciary duty. The fundamentals of fiduciary duty remain unchanged. Speculation is still forbidden, prompt liquidation of speculative assets is still the settled rule." Matter of Stumpf N. Y. Sur., N. Y. L. J., Sept. 8, 1934.

An administrator received as assets 50 shares of stock of a private corporation. He made no effort to sell; the business was continued and at the end of the administration year the stock became worthless. Held: The administrator surcharged. Lichians Est., N. Y. Sur., N. Y. L. J., Oct. 8, 1932.

The first exception to the rule requiring prompt sale of non-legals might be stated thus:

(A) Unless holding non-legals be expressly or impliedly authorized by the will.

On this Perry says: "If a testator gives any directions in his will to continue his investments already made, trustees must of course follow such directions; and if they follow them in good faith, they will not be liable for any losses, unless they are negligent in failing to change an investment, when it ought to be changed to save it, for it cannot be supposed that the direction of a testator to continue a certain investment relieves the trustees from the ordinary duty of watching such investment, and of calling it in when there is imminent danger of its loss by a change of circumstances. * * * It is true that a testator during his life may deal with his property according to his pleasure, and investments made by him are some evidence that he had confidence in that class of investments; but, in the absence of directions in the will, it is more reasonable to suppose that a testator intended that his trustees should act according to law. Consequently, in states where the investments which trustees may make are pointed out by law, the fact that the testator has invested his property in certain stocks, or loaned it on personal security, will not authorize trustees to continue such investments (even though requested to do so by the beneficiary) beyond a reasonable time for conversion and investment in regular securities (and what is reasonable time must depend upon the circumstances of each particular case). Taking all the cases together, it would appear to be a settled principle that trustees are not justified, in the absence of express or implied directions in the will, in continuing an investment permanently, made by the testator, which they would not be justified themselves in making." Perry on Trusts, Sec. 465.

(B) Unless requested and indemnified by all the beneficiaries.

A testatrix bequeathed her residuary estate to seven persons, one of whom was named executrix. A large part of the estate consisted of speculative stocks. Shortly after the testatrix's death three of the seven authorized the executrix to use her own judgment as to holding the stocks. She delayed settlement for three years, holding the stocks, which fell in value. Held: She will be charged with the value as of the date when her account should have been settled, namely, one year after the date of letters. A consent of three does not bind the others. Matter of Drake, 152 N. Y. Misc. 395.

(C) Unless sale is impossible or obviously unwise.

In the following New York case, the Surrogate dismissed objection to an executor's account for failure to sell the testator's stock in a close corporation. The court says: "It may be conceded that it would have been the duty of the executor to sell the stock if a reasonable market could have been found; but there is no proof that any such market ever existed. This is not surprising, since the purchase of a minority interest in a close corporation is a transaction which would appeal to few persons." Matter of Middleditch, N. Y. L. J., Feb. 18, 1935.

If one were to attempt, from this incomplete survey of recent depression cases, to summarize the duty of the fiduciary with respect to his estate investments, one might say:

He should not fail to meet the highest standards of fiduciary care and diligence, nor to seek court instruction in any case of doubt.