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Veblen attributed this hangover to the respectable status of archaism and waste. "Where a conventional usage rests on the canons of archaism and waste," he said, "the spokesmen for the usage instinctively take an apologetic attitude. It is contended in substance that a punctilious use of ancient and accredited locutions will serve to convey thought more adequately than would a straightforward use of the latest form of spoken English. . . . They are reputable because they are cumbrous and out-of-date."

Is it not time that we exploded the theory that anything which is gnarled and ancient is of necessity right? The horrors of legal verbiage, *Better English* suggests, must go!

#### ALLOCATION OF RECEIPTS FROM WASTING TRUST PROPERTY: MINING STOCK TRUSTS

Since the adoption of the Restatement of Trusts by the American Law Institute in 1935 its appearance in the Supreme Court of Pennsylvania has been frequent, and on each occasion the Supreme Court has hastened to approve the particular section under consideration. This unanimity and consistency of decision was broken on November 12, 1937, when, for the first time, the court of last resort of this Commonwealth refused to follow a doctrine of the Restatement of Trusts. The case was *Knox's Estate*,<sup>1</sup> and the relevant section of the Restatement was section 239. Mr. Chief Justice Kephart wrote the opinion of the court.

The applicable section of the Restatement reads:

"Unless it is otherwise provided by the terms of the trust, if property held in trust to pay the income to a beneficiary for a designated period and thereafter to pay the principal to another beneficiary is wasting property, the trustee is under a duty to the beneficiary who is entitled to the principal, either

- (a) to make provision for amortization, or
- (b) to sell such property."<sup>2</sup>

Comment (g) of the section states that the rule applies where the subject matter of the trust is mines, and further reads:

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<sup>1</sup>328 Pa. 177, 195 A. 28 (1937).

<sup>2</sup>Sec. 239. See also Tentative Draft No. 4, sec. 231, comment (g) and explanatory notes on pages 213-220.

"The mere fact that the mines . . . were opened by the settlor prior to the creation of the trust does not necessarily indicate an intention that the receipts therefrom should be treated wholly as income; nor on the other hand, does the fact that they were not so opened prior to the creation of the trust indicate an intention that the receipts should be treated wholly as principal. In either case in the absence of a manifestation by the settlor of a different intention, the receipts are to be apportioned by the trustee in such a way as will preserve the value of the principal at the time of the creation of the trust".

The comment then lists some eight different items which may be taken into consideration in determining the intent of the testator.

Briefly the facts of the Knox case were these: Senator Philander C. Knox died in 1921 and by his will set up a trust in his residuary estate. The trustees were directed to divide "any and all remainder of the net income arising from such trust fund" in equal shares among his widow and four children for life, with gifts over to be distributed per stirpes among the living issue of testator's daughter and two of his sons, and, there being no issue, to his heirs at law. Among the assets retained in the trust were 1600 shares of common stock of the Cerro de Pasco Copper Corporation, which owned and operated mines in South America. Since 1915 the company had pursued a regular dividend basis, with normal variations due to business changes. Reports of the company showed that some of these dividends had been paid in whole or in part out of the reserves for depletion set up from surplus earnings. The question before the court was whether such dividends were "income" payable to the life beneficiaries of the testamentary trust.

The court decided that such dividends were "income" payable in full to the life beneficiaries, basing their conclusion on three points: (1) The terms and circumstances of the trust showed the testator's intention that such dividends should be treated as "income";<sup>3</sup> (2) A Pennsylvania rule of property required such decision;<sup>4</sup> (3) The interposition of a corporate entity did not change the rights of the respective beneficiaries.<sup>5</sup> After discussion of the second of these bases, the court said, in effect, that although the Pennsylvania rule of property had not been adhered to in the Restatement, *stare decisis* bound them not to depart from the rule, and for this reason "it would be unavailing to embark upon a discussion of the merits or demerits of the principle enunciated by the Restatement."<sup>6</sup>

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<sup>3</sup>328 Pa. 177, 182-183, 195 A. 28, 31 (1937).

<sup>4</sup>*Id.*, 183-184, 195 A. at 31-32.

<sup>5</sup>*Id.*, 184-186, 195 A. at 32.

<sup>6</sup>*Id.*, 186, 195 A. at 33.

It has long been the rule in apportionment cases, that the controlling feature of first importance shall be the intention of the creator of the trust, as manifested by the instrument creating it and the circumstances surrounding such creation.<sup>7</sup> In the *Knox* case the court determined the testator's intention that these dividends paid from depletion reserves were "income" payable to the life beneficiaries almost solely from the fact that in his lifetime testator received dividends paid from such source and himself treated them as income, and that the testator was a lawyer conversant with the nature of the corporation and the rules of property in force in this state. It is submitted that this alone does not make a strong case for proving the intention of the testator. The same argument was suggested in the case of *Hewitt v. Hewitt*,<sup>8</sup> and the contention seems to carry some weight. This evidence of the attitude of the creator seems inadequate to overcome the presumption usually acted upon by the courts, that where there is a bequest in trust for successive beneficiaries, the testator is presumed to have intended both to benefit equally.<sup>9</sup> There are several other considerations, however, which seem to support the court's interpretation of testator's intention. Although not specifically mentioned in the reported case, a careful reading shows that the trustees had a discretionary power to retain or to sell any or all of the trust res. In several decisions this factor has been held indicative of the testator's intent that dividends such as those involved in this case should be treated as "income".<sup>10</sup> Two other recent pronouncements of the Pennsylvania Supreme Court also lend support to the conclusion reached in the *Knox* case as to the testator's intent. The first is found in *Opperman's Estate (No. 1)*,<sup>11</sup> where it is said:

"In determining the relative rights of life tenants and remaindermen we will, wherever possible, protect with jealous care the interests of the widow and children who are usually made the primary objects of testator's bounty."

The second, in terms even a bit broader, is found in *Nirdlinger's Estate*,<sup>12</sup> which says that generally in cases of long continuing trusts the life beneficiary is the

<sup>7</sup>*Robinson's Trust*, 218 Pa. 481, 486, 67 A. 775, 777 (1907); *Boyer's Appeal*, 224 Pa. 144, 153, 73 A. 320, 323 (1909).

<sup>8</sup>113 N.J. Eq. 299, 166 A. 528 (1931).

<sup>9</sup>*In re Wells' Estate*, 156 Wis. 294, 144 N.W. 174 (1914); *Industrial Trust Co. v. Parks*, — R.I. —, 190 A. 32 (1937); *Union Trust Co. v. Gray*, 110 N. J. Eq. 270, 159 A. 625 (1932); *Hewitt v. Hewitt*, 113 N.J. Eq. 299, 166 A. 528 (1931); 4 Bogert: "Trusts and Trustees," sec. 828, page 2412.

<sup>10</sup>*In re Bates*, (1907) 1 Ch. 22; *Old Colony Trust Co. v. Shaw*, 261 Mass. 158, 158 N.E. 530 (1927); *Dexter v. Dexter*, 274 Mass. 273, 174 N.E. 492 (1931); *Poole v. Union Trust Co.*, 191 Mich. 162, 157 N.W. 430 (1916).

<sup>11</sup>319 Pa. 455, 459, 179 A. 729, 732 (1935).

<sup>12</sup>327 Pa. 171, 173, 193 A. 30, 32 (1937).

primary object of the testator's bounty. The conclusion as to Senator Knox's intention seems quite consistent with these rulings, and not at all improbable.

The rule of property to which the court refers in the *Knox* case<sup>13</sup> had its origin in *Neel v. Neel*,<sup>14</sup> where it was held that a legal life tenant of land containing coal mines opened before testator's death may mine even to the exhaustion of the minerals.<sup>15</sup> It is now also settled that "the imposition of a trust does not alter the intention of a testator to have treated as income all the profits derived from the operation of open mines."<sup>16</sup>

Therefore, the court reasoned, if Senator Knox had died possessed of an undivided interest in the mines the life beneficiaries would have been entitled to his share of the royalties therefrom, and the mere fact that this interest is represented by shares of stock cannot change the interests of the respective life tenants and remainderman.<sup>17</sup> This is carrying the analogy one step farther than any other decision coming to this writer's attention, but the step does not seem improper. It is harmonious with the prior discussion as to the intention of the testator.

In order to take this step the court disregarded the corporate entity of the Cerro de Pasco Copper Corporation. The court found its precedent in the case of *Roberts' Estate*.<sup>18</sup> Since in the latter case the corporation was merely a convenient form of administration, the testator being the sole owner, it has been suggested that the analogy is imperfect and that the *Roberts* case is little support for the view that a corporate entity the size of the Cerro de Pasco Copper Corporation, in which testator was less than 16-10,000ths owner, similarly can be disregarded.<sup>19</sup> The point seems more interesting than important. A fair reading of the *Knox* case would limit the application of the principle to similar cases, and certainly could not soundly be asserted as a basis for a general disregard of corporate entities in all future cases.

It has also been suggested that "under the broad language of the opinion in *Knox's Estate* it could be argued that extraordinary dividends, paid out of the earnings of mines opened by the corporation after the death of the testator, would be income of the trust estate even though the corporation maintains no reserve for depletion."<sup>20</sup> This assumption is based primarily upon the fact that

<sup>13</sup>328 Pa. 177, 183, 195 A. 28, 31 (1937).

<sup>14</sup>19 Pa. 323 (1852).

<sup>15</sup>Affirmed in many subsequent cases: cases cited in 328 Pa. at 184, 195 A. at 32. This holding is expressly contrary to sentence two of comment (g) of sec. 239 of the Restatement of Trusts.

<sup>16</sup>328 Pa. 177, 184, 195 A. 28, 32 and cases there cited.

<sup>17</sup>328 Pa. 177, 184-185, 195 A. 28, 32 (1937).

<sup>18</sup>2 D. & C. 667 (1923).

<sup>19</sup>Robert Brigham: "Pennsylvania Rules Governing the Allocation of Receipts Derived By Trustees From Wasting Property," 86 U. of Pa. L.R. 471, 475-476 (Mar. 1938).

<sup>20</sup>*Ibid.* at 476.

in the *Knox* case the court failed to distinguish in its language between ordinary and extraordinary dividends. The point does not seem well taken. There was no reason for the court to talk in terms of extraordinary dividends in the *Knox* case, for admittedly the dividends under consideration were ordinary. The contention that the doctrine of the *Knox* case might be so extended seems even more untenable in the light of other statements emanating from our courts, notably the very recent pronouncement of our Supreme Court in *Nirdlinger's Estate* (No. 1),<sup>21</sup> a decision scarcely four months old when the opinion was written in the *Knox* case. In the *Nirdlinger* case the court said:

"Cash disbursements by 'wasting asset' companies, engaged in businesses necessitating the consumption and ultimate exhaustion of their assets in order to operate at a profit, have been apportioned as extraordinary dividends where they represent, in part at least, distribution of the proceeds of capital assets. Such corporations are permitted to declare dividends out of surplus without making any deduction for depletion in their assets caused by normal business operations . . . In these cases apportionment is a vital necessity to the preservation of intact value."<sup>22</sup>

Admitting that this statement is not strictly concerned with extraordinary dividends paid *entirely* out of net earnings, as suggested in the problem by Mr. Brigham, it does definitely illustrate that at the present time our Supreme Court is not ready in apportionment cases to throw to the winds the distinction between ordinary and extraordinary dividends, and the broad language of the *Knox* case should not be misconstrued as representing the opinion of the court on a subject not before it for consideration. It is hardly to be supposed that the same court within so brief a space of time meant by implication in the *Knox* case to wipe out an express line of distinction between ordinary and extraordinary dividends such as that quoted above from the *Nirdlinger* case.

As a general proposition there seems to be little authority in support of the view taken by the Restatement in comment (g) of section 239. The explanatory notes of the Tentative Draft of the Restatement illustrate the different approaches and attitudes of the various courts, but in fact give no citation of a case which supports the view of comment (g).<sup>23</sup> These notes, after citing decided cases, say—

"It would seem, however, that in accordance with the principle stated in section 231 (sec. 239 of Final draft) the fairer rule is to allocate the proceeds regardless of whether the mines were opened

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<sup>21</sup>327 Pa. 160, 193 A. 33 (1937). See also, note 26 of Brigham, *supra*, 86 U. of Pa. L.R. 471.

<sup>22</sup>327 Pa. 160, 169; 193 A. 33, 37.

<sup>23</sup>Tentative Draft No. 4, pages 217-218.

prior to the creation of the trust, by deducting from the total receipts a part thereof for depletion and paying the balance to the life beneficiary."<sup>24</sup>

No less an authority than Bogert<sup>25</sup> states a rule in harmony with the proposition of the Restatement, section 239, but admits the courts have not approved the rule. He states:

"Where a settlor gives to a trustee mineral land with an opened mine thereon, and makes no express direction with respect to the disposition of the income thereof, it would seem that the courts should find a duty resting on the trustee to convert this wasting asset into a legal trust investment and to apportion income pending conversion so as not to give the remainderman cestui an asset of much less value than that from which the life cestui is to enjoy income. But the cases seem either to find an intent that the life cestui shall have all the income or to follow the analogy of the legal life tenancy and to give to the life cestui of the opened mine or existing mineral lease the entire income flowing therefrom, at the risk of giving the remainderman cestui a much shrunken or valueless asset."<sup>26</sup>

To date some few cases have reached the result proposed by section 239 of the Restatement as applied to mines, but none of these cases have been decided on the "wasting asset" principle, but rather on the basis of the intention of the testator or other considerations, so that in reality these decisions do not lend support to the view of the Restatement. In *In Re Wells' Estate*<sup>27</sup> mining and lumbering stock was left in trust. Under the peculiar facts of the case and the extensive directions of the will the court properly found that the testator's primary intention was to maintain intact for as long a time as possible his vast fortune as a monument to his business achievements, that this was inconsistent with the argument that all income from the wasting assets should go to the life tenant, that in such case the intent of the testator should control, and consequently ordered an apportionment of the profits produced by the mining stock.

The case of *Hewitt v. Hewitt*<sup>28</sup> seems to adopt the rule of the Restatement. There it was stated that where a testator bequeaths the residue of his property which includes property of a perishable nature, the tenant for life will

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<sup>24</sup>Tentative Draft No. 4, page 218.

<sup>25</sup>Bogert: "Trusts and Trustees."

<sup>26</sup>4 Bogert: "Trusts and Trustees," sec. 828, page 2416.

<sup>27</sup>156 Wis. 294, 144 N.W. 174 (1913).

<sup>28</sup>113 N.J.Eq. 299, 166 A. 528 (1931).

not be entitled to the annual product which the property is actually making, but to interest from the testator's death on the value thereof, estimated as of that time, the reason being the presumed intention of the testator that the successive beneficiaries should have equality of enjoyment. However, the principal reason for directing apportionment here seemed to be the fact that the dividends were paid from surplus accumulated before testator's death. In view of this fact the case offers little authority for section 239, comment (g).

In a somewhat analogous case decided by the same court in the next year<sup>29</sup> apportionment was decreed, but again there were circumstances which lessen the value of the case as authority for the Restatement's proposition. Here there was a specific gift of shares of stock in a corporation whose assets consisted of a patented process for treating gasoline. Its sole income was from license fees and royalties from the patent. Apportionment had to be decreed to carry into effect the obvious intention of the testator. Testator had directed a conversion, and thereby had shown his wish to be that the life tenant should not enjoy all the receipts to the possible detriment of the remainderman.

The decision in a recent New Jersey case,<sup>30</sup> later than either of the two just cited, is based solely on the intention of the creator of the trust and holds that all payments by a mining company made after deducting operating costs are "income" within the meaning of the creator of the trust and should go to the life tenant. This was a case of an inter vivos trust, and although the case came before the court after the creator's death, the evidence was unusually clear as to the intent of the creator.

Cases from other jurisdictions which do not decree apportionment include *In Re Bates*,<sup>31</sup> a case from England where the rule of *Howe v. Earl of Dartmouth*<sup>32</sup> directing apportionment has been practically wiped out by the innumerable exceptions allowed to it. In the *Bates* case it was held that the authority to the trustees to retain the investments showed a sufficient contrary intention of the testator to exclude the operation of the rule of *Howe v. Earl of Dartmouth*, and the shares of stock here were merely hazardous, not wasting, due to the varied purposes of the company as expressed in the articles of association. *In*

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<sup>29</sup>*Union City Trust Co. v. Gray*, 110 N.J.Eq. 270, 159 A. 625 (1932).

<sup>30</sup>*De Brabant v. Commercial Trust Co. of N.J.*, 113 N.J.Eq. 215, 166 A. 533 (1933).

<sup>31</sup>(1907) 1 Ch. 22.

<sup>32</sup>(1802) 7 Ves. Jr. 137, 32 Eng. Rep. 56. In 6 B.R.C. 207 at 211 it is said, "The theory of the rule (of *Howe v. Earl of Dartmouth*) is that when the testator has failed to indicate how the property is to be enjoyed it is to be presumed that he had the interest of the successive takers equally in view; and that to protect the remainderman the property must be converted and invested as a permanent fund so that each shall enjoy it in equally productive capacity." To the effect that the rule is hardly recognized in the United States at all, see 77 A.L.R. 762.

*Re Inman*<sup>33</sup> presents a well reasoned point as to the effect of authority to the trustee to retain the investments. There it was said:

"The real point in such cases is whether the power to continue or retain is to be construed as a power to continue or retain permanently, or only until the trustees can sell advantageously. In the first case, the inference is that the power was for the benefit of the tenant for life; in the latter the inference is that it was merely for the convenient administration of the estate."

The point is well taken, although, it is submitted, in the average case it would be purely guesswork on the part of the court, as to the reason the power to retain was included by the creator of the trust.

Massachusetts cases seem rather uniformly to refuse apportionment in cases similar to the recent Pennsylvania case, but they are of little value in this discussion, for they are decided on the basis of the Massachusetts rule that cash dividends however large are to be treated as income; stock dividends however large, as capital.<sup>34</sup>

In *Poole v. Union Trust Co.*<sup>35</sup> the Michigan court decided against apportionment on the basis of testatrix's intent as expressed by the terms and circumstances surrounding the trust document.

In conclusion it is submitted that, with the few criticisms hereinbefore noted, the Pennsylvania decision in the *Knox* case<sup>36</sup> is on the whole a proper one and in accord with the majority of similar cases in the United States. In this instance the promulgators of the Restatement seem to have stated the rule which they felt *should* be the rule, but certainly not that adopted generally in the courts. No case has been found since the adoption of the Restatement of Trusts which cites and approves section 239, comment (g), and the drafters themselves could find no such supporting decision when they drafted the Restatement.<sup>37</sup> In the studied consideration of the various state judiciaries human experience seems to have determined that the better rule is not that proposed by the Restatement, and that usually the intention of the testator does not accord with said rule.

Robert McK. Glass.

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<sup>33</sup>(1915) 1 Ch. 187.

<sup>34</sup>*Old Colony Trust Co. v. Shaw*, 261 Mass. 158, 158 N.E. 530 (1927); *Dexter v. Dexter*, 274 Mass. 273, 174 N.E. 492 (1931).

<sup>35</sup>191 Mich. 162, 157 N.W. 430 (1916).

<sup>36</sup>328 Pa. 177, 195 A. 28 (1937).

<sup>37</sup>Tentative Draft No. 4, page 217.