

1933

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W.Barton Leach

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Recommended Citation

Leach, W.Barton, "Lessons from the Depression in the Drafting of Wills and Trusts" (1933). *Minnesota Law Review*. 2469.
<https://scholarship.law.umn.edu/mlr/2469>

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LESSONS FROM THE DEPRESSION IN THE
DRAFTING OF WILLS AND TRUSTS¹

BY W. BARTON LEACH*

THE public relies upon the legal profession to create the instruments under which, about once in twenty-five years, the greater part of the wealth of the country passes to subsequent generations. To meet this heavy responsibility there is required not only skill in draftsmanship, but, more still, the ability to give sound advice as to matters of trust administration and to warn prospective testators and settlors of the pitfalls shown by experience to be attendant upon plausible types of dispositions. This paper suggests that, in some particulars, the draftsmanship practices of the Coolidge Era have not stood the test of depression years.

I. A PRELIMINARY GENERALIZATION

In a long course of decisions, the English chancellors built up safeguards to protect the beneficiaries of decedent estates. At one period the machinery became so unwieldy as to defeat its own ends and to expose the courts of chancery to Dickens' philippic in the first chapter of *Bleak House*. But, by and large, the chancery rules as to the conduct of executors and trustees crystallize the dictates of ordinary prudence applied to the situation where one person has the control and management of funds representing the sole support of women and minors. In recent years it has been the vogue among reputable firms of lawyers to produce wills containing provisions (seldom fully discussed with the client) which nullify most of the protective rules. Current records of probate courts, minutes of the grievance committees of bar associations and the front pages of the newspapers show that four centuries of chancery judges were right.

II. CLAUSES WAIVING SURETIES ON FIDUCIARY BONDS

All codes of probate practice require fiduciaries to give bond

*Professor of Law, Law School of Harvard University; member of Massachusetts Bar.

¹This paper is a combination of materials contained in addresses delivered at the Association of American Law Schools in December, 1932, and at the annual meeting of the Vermont Bar Association in October, 1933.

for the faithful performance of their duties, *with sufficient sureties*. Most states give effect to a declaration of the testator that no sureties shall be required; and it has been customary to insert in wills such a declaration.

The method by which a waiver of sureties on executors' and trustees' bonds gets into most wills can only be surmised; but the following is submitted as a fair guess.

In the conferences with the client prior to the drafting of the will the matter is not mentioned. The clause is then inserted in the first draft of the will and the majority of testators assume that it is the usual thing and make no comment upon it. If an unusual client questions the clause he is told (a) that unless he has confidence in an executor or trustee he ought not to appoint him; and (b) that surety companies increase the difficulties of administration by insisting upon joint control of securities and cash and by otherwise complicating the matter with red tape. Doubtless it does not occur to the client to reply (a) that although he has the greatest respect for the man named as executor and trustee, nevertheless he hardly cares to gamble his entire estate and the future of his family on any man's probity for life, particularly when safety can be had for a bond premium of small amount; and (b) that whatever safeguards an experienced surety company considers necessary to protect itself ought to be equally essential to protect his dependents. Again, being a perfect gentleman and not at all impertinent, he probably does not ask the draftsman of his will whether he ever heard of an executor or trustee declining office on the ground that sureties on his bond were required.

Current experience shows that it is impossible to prophesy the ability of any man to resist the temptation to misappropriate funds in his hands when he is faced with financial ruin, the inability to provide essential but expensive care for a sick wife, the necessity of cutting short his children's education. Men of reputed affluence and probity have yielded to types of pressure much less humanly appealing. In Massachusetts the list of defaulting fiduciaries includes an ex-governor of the state, two judges, several lawyers, and (not to slight mine own) a law professor. Sons have stolen from mothers; brothers have stolen from sisters—more often still from sisters-in-law.

The best post mortem insurance that a person of wealth can

buy is a financially responsible guarantor of the obligations of his executor and trustee. Moreover as a matter of self-interest the legal profession may as well recognize the situation that exists. Every time an individual fiduciary embezzles, an additional argument is placed in the hands of the corporate fiduciaries. To put it sordidly—if the profession is to retain for itself any substantial part of the business of acting as executors and trustees, it must provide to beneficiaries security equal to that provided by a trust company.

III. CLAUSES PERMITTING RETENTION OF TESTATOR'S INVESTMENTS

In the will and trust forms kept and continually referred to in most offices will usually be found a clause substantially as follows:

“Any executor of or trustee under this will may retain any investments owned by me at the time of my death, although such investments are of so speculative a character or form so large a portion of the estate that they would not otherwise be proper fiduciary investments.”

In a draft will this clause usually appears among some single-spaced provisions as to powers of executors and trustees inserted in the will without prior consultation with the client. If the matter is discussed at all, it will be explained that this is a usual testamentary provision, that it facilitates the administration of the estate and that it prevents the trustees and executors from being required to liquidate securities under unfavorable market conditions. When the client notices that clause—if he does—and hears that explanation, he may think that as a matter of course a trustee or executor derives from his letter of appointment the power infallibly to determine when market conditions are “unfavorable.” To be specific, he may think that no trustee or executor would have made the mistakes that he made in thinking that market conditions on, let us say, October 28, 1929 were unfavorable.

He is wrong.

When a person with an earning capacity and an accumulated surplus invested in stocks and bonds dies, two essential changes take place with reference to his investments. In the first place, that fund which was formerly a source of income incidental to salary or profits becomes the sole support of persons without earning capacity. Before death it is replaceable; after death it is not.

In the second place, such skill in the management of speculative or semi-speculative investments, and such particular knowledge of individual industries or companies which the testator possessed cannot be transferred to the relative, lawyer or assistant trust officer who is to have control of these assets after death.

The law crystallizes common sense in imposing requirements of conservatism in the investment of fiduciary funds.² To be sure, these requirements are often too strict, or strict in an undesirable direction, and modification is frequently desirable. But there is, to put it mildly, dubious logic in the proposition that a fiduciary is justified in keeping investments which he would not be justified in purchasing. *A priori* clauses which tend to produce this result meet obvious objections; *a posteriori* they have proved vicious in many cases.

Consider, for instance, Smith, who died in May, 1930. He was an executive of General Motors Corporation and the bulk of his estate consisted of investment in General Motors common stock. There was some little delay in the probate of Smith's will, due to a suggestion that it would be contested. After two months the will was allowed and the executors appointed. At the time of Smith's death General Motors was selling at 48, and the executors had to inventory the stock at that figure. By the time the executors were appointed and had examined the investment portfolio, General Motors was selling at 43. They examined the will and found a clause permitting the retention of investments. In their official omniscience they determined that "market conditions were unfavorable" for sale. Not a little present in their minds was the realization that if they sold at the present time, their first probate account would show a loss in six figures on the General Motors stock; and that this loss would have to be explained—chiefly to women. Anyone who has tried to explain to a woman that a loss of \$100,000 represents a brilliant coup of estate administration will realize why few executors will care to undertake the task if it is avoidable—particularly if there is a possibility that, one year later when the account is presented, the stock market will have risen so that a substantial profit would have been made by retention of the investment. If the market should go

²As to the duty of a trustee to dispose of speculative investments which come to him as part of the trust estate, see American Law Institute Restatement of Trusts, Tentative Draft No. 4, secs. 219 and 222 and the explanatory note to sec. 222 contained on pp. 186 to 189 of said Tentative Draft No. 4.

down—and down and down—the executors could distribute the bulk of the General Motors stock to the trustees or legatees in kind at inventory value. By this method no bookkeeping loss would appear. If the market should go up, everyone would be happy. So Smith's executors continued to hold the General Motors stock. And his trustees in 1932 still had the stock at its then value of 7 and its then dividend of 25c quarterly. More accurately, his trustees had the stock unless the estate was so large and the inheritance tax rate so high that liquidation of depreciated shares of General Motors was forced by the necessity of meeting inheritance taxes computed at inventory values.

This type of case, too commonly recurring in recent years, indicates that the vice in clauses permitting retention of investments is that they have a tendency to prevent liquidation of a speculative or semi-speculative estate at the very time when liquidation may be most necessary—that is, in a falling market.

IV. THE HANDLING OF MARGIN ACCOUNTS AND COLLATERAL LOANS

To a certain extent this problem is connected with the discussion as to clauses permitting retention of investments; but in large part it presents distinct questions.

The day has passed when a person who has a running account with a broker and buys and sells stocks on margin, or who does the equivalent thing of borrowing against collateral from a bank solely for investment purposes, is classified as a gambler. Many testators of reputable standing now die leaving margin accounts or collateral loans. The method of handling such items may mean the difference between an insolvent estate and a comfortable income to the testator's dependents. Yet few wills give directions as to these matters.

Brown dies in 1930 with an estate of \$80,000 in cash and \$400,000 in marketable securities. Half of the securities are held by a broker in a margin account where the debit balance is \$100,000. How shall Brown's executor act? The balance due to the broker is a debt. Discharge of this indebtedness out of cash in the estate hardly seems reasonable because that would drain Brown's bank accounts dry, leaving no ready funds to meet current administration expenses—including the executor's charges. Shall he sell securities in the account to the extent of \$100,000?

He is not compelled to, because there is a clause in the will permitting him to retain investments owned by the testator in spite of their speculative character. And besides the market has fallen since Brown's death and the sale of securities at this time would show a rather nasty loss. So the executor does nothing, and lets the margin account run. Unpredictably the market drops forty per cent and the broker calls for additional collateral or a cash payment. All of the considerations which led the executor to do nothing before have greater force at this time. The family is consulted as to whether the estate assets shall be "sacrificed." Some one suggests that "these are father's investments and he would not have wanted them to go this way"—a suggestion whose accuracy or relevancy it always seems sacrilegious to contest. So with the assent of the legatees the executor pledges additional securities to buttress the brokerage account. The process of margin calls and additional pledges is indefinitely repeated. Finally there are no further securities to meet the last call. The executor receives from the broker three or four large bookkeeper's sheets, the last item of which shows a credit balance of \$754.03 after disposal of all collateral.

It will readily be observed that in Brown's case the factor in the testamentary set-up which permitted the executor to take the first step in the direction of destruction was the clause permitting retention of investments owned by the testator at the time of his death. To some extent therefore, the present discussion of margin accounts and collateral loans is merely a subdivision of the general topic relating to such retention clauses. However, the margin account and the collateral loan raise problems sufficiently individual to require separate treatment in the will.

It is impossible to make general recommendations as to what testamentary provision the owner of any margin account or collateral loan should make. In most cases it would seem that ordinary conservatism would dictate immediate liquidation of the account. The purposes of this paper are accomplished if attention is called to the fact that the will should contain some reasonable direction as to the handling of such accounts, framed in prudent contemplation of the new factors which the testator's death must inject into the situation.

V. PROVISIONS AS TO SPECIFIC INVESTMENTS

Sound investment is not an emotional process; yet it is sur-

prising how frequently a testator will permit personal loyalty to a company with which he has long been connected to require retention of the stock or bonds of that corporation by his executors and trustees. A generous benefactor of one of our universities provided in his will that shares of National City Bank should never be sold. He may be right—but can he be sure? It is a commonplace of experience that companies, even entire industries, whose prospects seem at one time the brightest fall upon evil days. Most of us can remember the time when the natural ice business was a staple industry and Calumet & Hecla was a gilt-edged security. Plainly every effort should be made to dissuade a testator from imposing upon his executors or trustees any such rigid requirement.³

The scope of investment judgment to be given to executors and trustees is plainly one of the most serious problems which any testator has to face. "Legals" are frequently defined with undue rigidity, often with an admixture of local prejudice. Moreover in these times a restriction to legals will invariably prevent fiduciaries from hedging the trust estate against inflation. The preparation of a clause which will at once avoid unreasonable investment risks and at the same time give sufficient investment latitude with proper protection to the fiduciary is one of the draftsman's most important and most difficult problems. It is plainly a matter to be discussed at great length with the testator and to be decided largely upon the circumstances of his fortune and family situation.

VI. THE ABUSE OF THE GENERAL OR PECUNIARY LEGACY

Let us again proceed by the case-method, bearing in mind that

³For somewhat similar reasons testators should be dissuaded from requiring trustees to hold subject to the trust any specific parcel of real estate. It is not unusual for a testator to feel that the family homestead should be retained for the use of his widow or children during their lives, and a will is sometimes so drawn as to make it impossible for the trustees to sell this real estate in spite of the desire of the widow or children to move elsewhere or in spite of changes in the locality which may render the property unsuitable for residential purposes.

It is also not unusual to find a testator desiring to leave the old family homestead to his wife for life, remainder to his children or issue who shall survive the wife. For reasons similar to those discussed in the text, testators should be advised to give to the life tenant a power to sell the fee in the real estate and to transfer the present and future interests therein either to the proceeds of the sale or to other real estate which is bought in lieu thereof. Of course, statutes exist in many states which permit such sales, but frequently the procedure for invoking these statutes is needlessly cumbersome.

we are supported by good and ancient precedent if *parable* is read for *case*.

Jones in 1928 was a man past middle life, successful in business, a pillar of the church, a husband and father. He had great affection for his brother who was a professional man of moderate income. Jones, carefully appraising his assets with a view to making a will, found himself to be worth \$800,000. He bequeathed \$80,000 to his brother; \$30,000 to other relatives; \$10,000 to charity; \$2500 each to three faithful employees; the residue in trust to pay the income for life to his wife, and upon the death of his wife to pay the principal equally among his children. Jones died in October, 1931, happy in the knowledge that his family would have a comfortable income and that the depression was over. The market had at that time wiped out \$250,000 of his fortune; so his estate was inventoried at \$550,000. In the course of the next year, during which the estate was being administered, \$150,000 more was lopped off by the same process. Inheritance taxes (payable out of depreciated assets upon the inventory value) removed \$30,000; expenses of administration, \$15,000. Jones's inventory contained an item of \$65,000 representing "Equity in building at 435 Washington St." (Jones's friends had admired his sagacity when he purchased this property for only \$75,000 in late 1930, the assumption of the bank mortgage of \$185,000 being a mere formality in view of the true value of the building.) In 1932 the bank, its other assets frozen, demanded payment of the mortgage at maturity. Since the building was then less than half rented and not quite carrying its own operating charges and taxes, it seemed wise to permit the bank to foreclose. The best bid at the foreclosure sale was \$90,000. The estate paid the balance of \$95,000 and struck from the inventory the equity item of \$65,000. Now has come the time for distribution of the estate to the legatees. By familiar rule of law the general legacies to the brother, relatives, charities and employees are paid first. Since the will calls for payment in cash, all liquid assets must be sold and their proceeds devoted to this purpose. The balance of the assets represents the house in a fashionable suburb with its furnishings, two automobiles, a cottage on a lake in Maine with three acres of woods, a Chriscraft motorboat—and no income.

It will be observed that Jones's investments shrank only 50% from 1928 to 1932—a tribute to his sagacity. Had he been one

of the prophets of the new era, or had his securities consisted primarily of "businessmen's investments," the shrinkage would have been much greater. Again, Jones's estate was not subject to the increased federal estate taxes of the 1932 act, which would have added an additional tax liability of about \$50,000. Jones was also lucky in having no collateral loans or margin accounts, no Kreuger and Toll bonds, no cash in banks that failed, and no ownership of bank stocks upon which assessments were called. Add any of these items to the troubles with Jones's estate and the widow and children do not have even a roof over their heads.

Of course the poignant feature of Jones's case is that his net estate, after payment of debts, taxes and administration expense, amounted to \$195,000, of which two-thirds was liquid. The income from such a fund would have failed to leave his widow and children in the affluence which he had foreseen, but would have given them an income sufficient for modest comfort. It was not the depression that reduced Mrs. Jones to the necessity of asking her brother-in-law for permission to live in his house and assist in the housework. It was Jones's will. He committed the cardinal error of making bequests which under the rules of law are entitled to priority of payment, and making such bequests upon the assumption that the estate available for distribution among the beneficiaries of his will one year after his death would be substantially the same estate which he so carefully inventoried three years before he died.

There was a simple and sound method of drawing Jones's will. He should have provided that the general legacies to the brother and others should be paid only if his net estate after payment of debts, inheritance taxes and expenses of administration exceeded \$500,000; that if his net estate was less than \$500,000 but more than \$350,000 such legacies should be payable only to the extent of 50%; and that if his net estate was less than \$350,000 no such legacies should be payable in any amount.

The events of the last three years have indicated that unless general bequests to persons who are not the primary objects of bounty are placed upon a sliding scale with reference to the net estate ultimately available for distribution, great hardship may result.

VII.

All of the foregoing suggestions are corollaries of a single principle, almost too obvious to state yet infinitely difficult of application. Wills and trusts are drawn for the future, often for many decades in the future; and they must be fortified so far as possible against every conceivable change—among others, shifts in personal fortune, general economic upheaval, the disloyalty of friends. The enemy of competent draftsmanship is the assumption that what is, will be.