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LIABILITY OF A TRUSTEE: BALANCING GAINS AGAINST LOSSES

By Benjamin Har-Ris, Jr.*

“A trustee who is liable for a loss occasioned by a breach of trust with respect to one portion of the trust property cannot reduce the amount of his liability by deducting the amount of a gain which has accrued with respect to another part of the trust property through another and distinct breach of trust.

“Thus, if the trustee improperly invests part of the trust funds in securities he sells at a profit and improperly invests another part of the trust funds in other securities which he sells at a loss, the beneficiary can accept the securities on which there was a loss; he can compel the trustee to account for the profit on the former securities and charge the trustee with the loss on the latter securities.

“Illustration: A is trustee of $10,000 for B. By the terms of the trust A is directed to invest the money in bonds. A invests $5,000 in shares of the X Company and $5,000 in shares of the Y Company. The shares of the X Company become valueless and the shares of the Y Company rise in value and A sells them for $10,000. B can charge A with $5,000 and interest for the breach of trust in purchasing shares of the X Company, and hold A accountable for the proceeds of the shares of the Y Company.”

A personally bears a loss of $5,000; B gains $5,000, a surplus above the fund the law seeks to secure to him. What is the basis of A’s liability, the policy of imposing such a burden on him? By well settled rules, from the time A made the improper investment, A has been personally liable for the full $10,000 with interest; for the shares of X and Y purchased; or for any particular bonds he should have purchased. Why the further liability? The text-writers do little more than announce the broad rule set out in the first paragraph quoted above, citing as authorities cases which are generally inapposite.²

The origin of the rule against allowing set-off of gains against losses seems to have been in the combining of two prin-

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²American Law Institute: Restatement of Trusts, Tentative Draft No. 3, sec. 204.
²Lewin on Trusts, 13 ed., p. 954; Perry on Trusts, 7 ed., sec. 847. Authorities cited: Wiles v. Gresham, 2 Drew. 258 (1854), involving a proper and an improper investment; Re Barker, 77 L. T. (N. S.) 712 (1898), a supporting decision which does not advert to the point; Fletcher v. Green, 33 Beav. 426 (1864) a contrary decision; Dimes v. Scott, 4 Russ. 195 (1828), a payment to a life tenant instead of to the succeeding beneficiary; Palmer v. Jones, 1 Vern. 144 (1882), not in point.
principles of law: A trustee is liable for losses from unauthorized investments; and, a trustee is not allowed to make personal profit out of the trust; and arriving at a broad principle which was applied to cases where in fact there had been no net loss to the estate, nor personal profit to the trustee. This formulation and application of the rule is still followed. In Cuyler's Estate that result was based on a supposititious case which the court should have distinguished from the case before it. The court argues:

"Now, if, in the present case, the trustee is permitted to set off the gains which he has made in certain non-legal investments against the losses which he has incurred in others, that would be nothing else but his making a profit out of his dealings with property which is not his own. I can see no difference between putting the profits in his own pocket and using them to defray his debts. It seems to me to be inconsistent to maintain that the consequences of one unauthorized act should be mitigated by the more fortunate results of another, and if we consider the case from the standpoint of public policy, on which all these principles ultimately rest, this conclusion is greatly strengthened, for if a trustee who has made an unauthorized and losing investment knows that he may recoup the loss by better luck in another, he would certainly be tempted to embark on another enticing speculation, which, as holding out a prospective profit, would be attended with further and perhaps even greater risk to the trust funds."

On the facts of such a case, one should agree with the result. It is not clear in Cuyler's Estate, when the various investments were made, but it is quite as likely that the unprofitable investments were made at the same time or after the profitable ones. In such case there was no loss to be recouped by the trustee and no profiting by the improper investment to which the court's argument of deterrence could be applied. The courts have lost sight of a sharp line of distinction, that between a case in which the trustee in good faith errs in the investment or retention of securities, and a case like the one imagined by this court, wherein the trustee willfully or carelessly subjects the trust fund to further risk. This distinction will be shown later to divide the cases in which set-off should or should not be allowed.

In Creed v. McAleey, the rule is arrived at by stating that

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3 Hypothetical Case of Restatement, supra; Adye v. Feuilleteau, 3 Swanst. 84 n, 1 Cox Eq. 24 (1783); Creed v. McAleer, 275 Mass. 353, 175 N. E. 761 (1931); Cuyler's Estate, 5 D. & C. (Pa.) 317 (1924).
4 Cuyler's Estate, supra, note 3; similarly, Creed v. McAleer, supra, note 3.
5 Cuyler's Estate, supra, note 3; similar approach in Gillespie v. Brooks, 2 Redf. Surr. (N. Y.) 349 (1876).
6 Supra, note 3.
the gain in each investment belongs to the trust estate, and that in no way can a trustee reap a personal profit from it, citing two cases in which a trustee actually attempted to make personal profits for himself, by purchasing land for his own benefit, and taking dividends from stock purchased with trust funds, respectively. In the next sentence, without citing any authorities (nor were there any cited in the briefs): "A trustee cannot offset a loss for which he is liable for a gain belonging not to him but to the cestui que trust", failing to see that there was clearly unjust enrichment of the trustee in the two cases cited, while there was a loss in the case before the court. The trustee has had no opportunity to profit, since he is governed by the first rule stated by the court. It is only by an argument assuming the rule against set-off that one can aver that the trustee has a loss which he might avoid by a set-off of the profitable investments. In our principal hypothetical case, if the trustee were to account for $10,000, he would not have profited in the sense of the cases cited to sustain the rule against set-off, nor in any true sense.

Another argument for the rule against set-off proceeds on an analogy to the agency doctrine of affirmation of an agent's unauthorized act. A principal may affirm one transaction and disaffirm another so long as they are separate and distinct transactions. The emphasis and endeavor of the Restatement of Trusts

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2 See King v. Talbot, 40 N. Y. 76 (1869): "The rule is perfectly well-settled, that a cestui que trust is at liberty to elect to approve an unauthorized investment, and enjoy its profits, or to reject it at his option; and I perceive no reason for saying that, where the trustee has divided the fund into parts and made separate investments, the cestui que trust is not at liberty, on equitable as well as legal grounds, to approve and adopt such as he thinks it for his interest to approve. The money invested is his money; and in respect to each and every dollar, it seems to me, he has an unqualified right to follow it, and claim the fruits of its investment, and that the trustee cannot deny it. The fact that the trustee has made other investments of other parts of the fund, which the cestui que trust is not bound to approve, and disaffirms, cannot, I think, affect the power. For example suppose in the present case, the cestui que trust, on delivery to him of all the securities and bonds in which his legacy had appeared invested, had declared: Although these investments are improperly made, not in accordance with the intent of the testator, nor in the due performance of your duty, I waive all the objection on that account, except as to the stock of the S. & W. R. R. Co. That, I reject, and return to you. It is doubtful, that his position must be sustained?"
to set out what is and what is not a distinct breach of trust would suggest that this analogy accounts for its rule. There seems to be little doubt that, by the set legal principles of agency, if I send my agent to the store with two nickels to buy two lemons, and he comes back having purchased, at five cents each, one fine orange worth ten cents, and a rotten worthless orange, I can affirm the former purchase, and require the return of my other nickel by disaffirming the latter. It is a result which might be understood as ensuing from following to a logical conclusion the crystalized technical conceptions of the law, but not one in consonance with the spirit of equity, with its hesitancy at inflicting undue hardship and its principle against unjust enrichment. Further, if one would argue the point from a technical standpoint, it has often been pointed out that a trustee is ordinarily not the agent of the cestui que trust. Moreover, the rules for ratification of an unauthorized act have been strictly construed, requiring the presence of certain elements in the situation. Among these elements, in the trust situation, the following are lacking: the principal must have present ability to do the act himself or to authorize it to be done; the act ratified must have been done by the assumed agent as agent, not as a principal; and he must, according to the weight of authority, have professed to act for a principal.

Some cases have intimated that, although there could be no ratification, there could be an "adoption" of the transaction. "The chief difficulty," says Mechem, "in the way of acceptance of this doctrine of adoption, rather than ratification of the

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9 Supra, sec. 204.
11 Mechem, supra, secs. 376 et seq.
13 Merritt v. Kevanee, 175 Ill. 537, 548, 51 N. E. 867 (1898).
15 Supra, sec. 382; see also: McArthur v. Times Printing Co., 48 Minn. 319, 51 N. W. 216 (1892); In re Empress Eng. Co., 16 Ch. Div. 125 (1880); Falke v. Ins. Co., 34 Ch. Div. 234, 249 (1886)—"There is nothing more vague than the way in which the word 'adoption' is used in arguments at law and sometimes ambiguous language used about adoption is imported into arguments about ratification. There is no such thing as adopting or ratifying anything except where there is the sanction of an act professedly done on your behalf in such a case as to make you liable for it. A man can ratify that which purports to be done for him, but he cannot ratify a thing which purports to be

K. L. J.—10
contract, lies in the fact that there seems not to be any such doctrine known to our law.' There could, of course, be an acceptance of a continuing offer, a new contract, or a novation where there is no ratification possible, but such cannot be found in the facts of the cases of trustees discussed. It is conceded that in many cases, if the cestui que trust is *sui juris,* he can consent and take the benefit of a trustee’s unauthorized act. This consent, however, should not be taken as a power that the cestui que trust can exercise over the trustee to profit at the latter’s expense, but rather to exculpate the trustee and permit him to hold the securities without liability. It is in the nature of an estoppel, estopping the cestui que trust from denying the trustee’s authority. An estoppel cannot be used affirmatively by the person estopped; it is restrictive, not enabling.

So far, an attempt has been made to show the basis or rationale on which the rule against setting off gains against losses was formulated and followed. Its history, and the incongruity of this penalty to other current law governing trustees who have acted bona fide but in breach of trust, offer further arguments against it. The rule was accepted and followed in England in 1783, although the court at that date recognized it as incurring hardship. The court said, ‘The executor has behaved very honourably; and I do not doubt that when the infants come of age, they will think themselves bound in honour to make up this loss to him.’ Subsequent cases have only reluctantly applied the rule. By statute in England, if it appears to the court that a trustee is or may be personally liable for a breach of trust, but has acted honestly and reasonably and ought fairly to be excused for the breach of trust, the court may relieve him wholly or partly from liability for the same. Under this statute, trustees who have incurred losses in investments outside the terms of their trusts, have been excused from liability therefor. Note that the rule against set-off often loads on a trustee a liability where there has been no actual loss to the estate, or a

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done for someone else. Ratification takes effect in law from its being equivalent to previous authority, and a previous authority is an incident which only arises in the relation of principal and agent.”

16 *Adye v. Feuilleteau,* supra, note 3.

17 *Robinson v. Robinson,* 11 Beav. 371 (1848); *In Re Deare,* 11 T. L. R. 183 (1895).

18 Judicial Trustees Act, 1896, 59 & 60 Vict., cap. 35, Sec. 3.

19 *Perrins v. Bellamy* (1899), 1 Ch. 797; *In Re Grindley* (1898), 2 Ch. 593.
liability greater than the loss to the estate, a more stringent rule than that contemplated and abated by the English statute.

The tendency of the English Courts as well as the legislature has been one of increasing leniency toward trustees in such situations. Story remarked on the rigorous treatment accorded trustees. Later a more understanding and charitable attitude was noted by the late Augustine Birrell, who attributed the change in the courts' attitude to the change in equity procedure. When questions were decided on affidavits in the absence of the suitors, chancellors dispassionately applied the strict rules to the facts. When presentation of evidence became oral, and the trustee appeared with his obvious good intent, innocence, and shortcomings, the court grew more sympathetic. In an opinion under the Judicial Trustees Act, relieving a trustee of liability, for loss of income from improperly handling trust property, Rigby, L. J., gives another explanation:

"I remember well in my early days cases in which, there having been inadvertent breaches of trust involving no moral blame, the consequences were visited on trustees. It was said, 'The Court of Chancery was open to you, and if you chose to incur the risk of going on without asking the direction of the Court, you must take the consequences.' That was the only excuse that I can remember for the extremely hard orders against trustees, and it shocked one's conscience. Now all that has been altered. A trustee is not now entitled, as of course, to get the direction of the Court. He cannot get rid of his responsibility. He cannot, except at the risk of having to pay the costs of the proceedings, approach the Court at all. That is such a change that no possible excuse has been left for those old decisions which operated so hardly in many cases upon trustees."

Thus a relinquishment of the peremptory treatment of trustees has evolved from the time when the rule against set-off was formulated. It would be consistent with the evolution to reconsider the harsh rule which survives.

How does the rule against set-off compare with rules in similar situations and fit in the general policy of the law of trustees' liability? If one dismisses the bases for the rule suggested above, one may still feel that the rule is justifiable to secure strict observance of the terms of the trust by the trustee. Still considering the situation presented in the principal hypo-

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21 The Duties and Liabilities of Trustees, London, 120, p. 13 et seq.
22 Perrins v. Bellamy (1899), 1 Ch. 797, 801; to the same effect, Re Roberts, 76 L. T. R. (N. S.) 479, 484 (1897).
Theoretical case, the one real danger against which the law should provide, is the risk of loss to the estate through improper investment and the inability to recover from the trustee because of his lack of assets. A New Jersey case precisely outlines the problem—the risk incurred only when the trustee is insolvent. It held the trustee subject to a surcharge for losses to the trust from his breach of trust, but refused to withhold his commission, saying:

"It is, of course, true that a general rule of law applies alike to those possessed of small means as well as those possessed of large, but it is equally true that where a trustee is possessed of very large resources, as this trustee is, and therefore nothing that it has done could possibly jeopardize the interests of the cestui que trust, and the latter would, in every event, receive all that the court found due to them, a different situation exists than if a trustee of meagre resources should make unauthorized investments and thereby jeopardize the interests of the cestui que trust, and make it possible that they would lose what ought to come to them."

This risk should be forestalled by the law. In the case where funds are invested simultaneously in different securities innocently, the question resolves itself into how great a penalty should be exacted. As already stated, the trustee cannot personally profit from unauthorized investments. He will be liable for the loss on unauthorized investments. To a trustee aware of these terms there is no inducement to misinvest. If the trustee is ignorant of the limits of the trust or of the law, a stricter law will be no deterrent. Perhaps harsher law will bring wider knowledge, and in turn more compliance. The penalty of forbidding set-off might seem justified as an additional penalty for this purpose. But the law has not seen fit to penalize a trustee who with equal or greater guilt and risk to the estate has otherwise improperly invested. There are numerous cases in which a trustee has misused funds—used them for his own benefit in his business; speculated on margin; loaned without security; improperly delegated his duties to another; deposited money in his own bank account—all manners of improper investments which afforded every degree of danger to

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24 Matter of Myers, 131 N. Y. 409, 30 N. E. 155 (1892); Faulkner v. Hendy, 103 Cal. 15, 36 Pac. 1021 (1894).
26 Roache's Estate, 50 Ore. 179, 92 Pac. 118 (1907).
27 Meck v. Behrens, 141 Wash. 676, 252 Pac. 91 (1927).
the trust estate, yet the courts have not felt constrained to apply any penalty beyond holding the trustee liable for principal and interest.

The inconsistency of the rule against set-off, based as it is on the question of whether or not there were separate and distinct transactions, is brought out clearly in English v. McIntyre, where the trustee improperly speculated on margin with trust property. The court held that the purchases and sales were not separate and distinct investments, and so profits could be used to offset losses. Here the trustee multiplied several times the risk over outright purchase, without penalty, while the penalty attaches to outright purchase. The result gives comparative immunity to this trustee and encourages this more repugnant sort of misuse of trust funds. Favoring such flagrant jeopardizing of trust funds finds little support in public policy.

Perhaps the court realized that imposition of the penalty in such a case might prove too onerous. A burden of similar proportions could be accumulated if the trustee actively bought and sold outright. Could he build up a liability greater in amount than the misinvested fund, a liability greater than a thief's?—there being no apparent limit to the rule's application.

In the cases of other improper investments, not only is there no penalty, but no punitive rate of interest is charged, generally four to six per cent, with occasionally a higher rate where it is felt that it had been earned by use of the trust money. Further, commissions which are manifestly paid for the due execution of the terms of the trust have not been denied, even in cases in which no set-off was allowed. In the midst of such universally tolerant treatment of the well-meaning trustee, the penalty of the hypothetical case is anomalous.

Perhaps the insolvency of the trustee is not the only contingency to be guarded against. For example, the helplessness of the courts in the face of modern management and accounting practice, or the problems of proof, may warrant a stricter ac-

\* Supra, note 25.
\* Accord: Restatement of Trusts, sec. 204, comment I.
\* Babbitt v. Fidelity Trust Co., supra, note 23.
countability to enable the courts to keep their grasp on an institution the integrity of which they seek to guard absolutely. If so, apply a penalty, but one which aims at all acts endangering the trust, not one which reaches only the small and ill-defined class of cases where improper investments are made in "distinct transactions".

So far, the argument has attempted to discredit a holding that contemporaneous purchases made by a trustee in good faith and with reasonable care should be subject to the rule against setting off gains against losses. The question then arises—in what cases, if any, should the rule apply? Certain distinctions must be observed:

Transactions may be separate and distinct because:

1. They are made with properties belonging to different trusts; or from the same trust, but under such circumstances that transactions made at one time should not affect the status of the trust at a former time, because, for example, there has been in the meantime an accounting on which the beneficiary has a right to rely, or the rights of third parties have intervened.
2. They involve the purchase of different securities, or the same security bought from different parties.
3. They are made at different times.

The transactions may have been made by the trustee:

1. To benefit the estate, unknowingly in violation of some duty imposed in making investments.
2. With the intention of committing a breach of trust, but without violating the duty of loyalty, solely in the interest of the beneficiary.
3. To benefit the trustee, or to misappropriate trust property.

It is perfectly clear that when a trustee makes improper investments with funds derived from two wholly unrelated trusts, the outcome of the individual investments should have no effect on each other. And in the course of the same trust, an accounting by the trustee may give the beneficiary such right to rely on the assets of the trust, including the profits from improper investments, that the trustee should not be permitted to reduce his liability for loss from subsequent improper investments by
deducting profits made prior to the accounting. The decision as to the remoteness of relation between trust funds is generally not difficult to make, and of course where separate, no set-off should be allowed.

When transactions arise in the investment of money out of a single trust, but separate because several kinds of investments are made, as in the principal hypothetical case, it is submitted on the argument above, that set-off should be permitted, regardless of the intention of the trustee. He is liable to account for what should have been; for the total net gain if any; or for a surcharge for any net loss. That is the extent of his liability if he had bought only one kind of equally bad stock, or if with any amount of bad faith he had risked the trust fund in numerous other ways. There seems to be no case holding a thief for more.

Where, however, improper investments are made with intervals of time, the motive and observance of the required duties are to be considered in deciding on the application of the rule. Keeping in view of the purpose of the law, to protect the trust estate, we must apply the penalty where deterrence will protect the estate from risk. If at different times, with funds of the same trust, the trustee improperly invests, acting reasonably and honestly, he should be allowed to set off the gains and losses. In ignorance of any wrongdoing, the stricter rule will do little to forestall the risk to the trust. The acts are not more blameworthy than a commensurate single wrongful investment. And this is not going as far as the English Statute of 1896 by which the court could relieve the trustee of all liability—it leaves him liable for the capital improperly invested, and interest.

An analogy for drawing the line at this point can be found in the cases allowing or denying commissions to a trustee who has acted in breach of trust. The line contended for does not appear too liberal in comparison, for the penalty of withholding commissions when the trustee has failed to perform the work for which the commission is compensation would seem rather more than less readily applied than the penalty of denial of set-off. A recent New York case thus sums up the law on that question:

34 Matter of Taft, 145 Misc. 435 (Surrogate's Court, King's County, N. Y. 1932).
"In an effort to ascertain the correct dividing line between conduct which will warrant a denial of commissions and that which does not justify such a course, an analysis of pertinent decisions has been made by the court. This indicates that in all cases in which a denial of commissions has been refused, the good faith of the fiduciary has been demonstrated, and there has been an absence of conduct savoring of extreme carelessness or neglect of duty. In other words, although the conduct of the fiduciary may have been such as to entail loss to the estate, for which he was surcharged, his error was one which did not involve either intentional dereliction or wanton disregard of the rights of persons primarily interested in the assets in his charge. The specific instances of such conduct not deemed sufficient to justify a denial involved an error in judgment in failing to institute action on a note, failure to collect rents, and omission to pay a questioned debt due the estate from himself. So, also, erroneous payments of estate assets in good faith have been considered insufficient ground for denial as have investments in legally unauthorized securities (Morgan v. Morgan, 4 Dem. 353, 356; Gillespie v. Brooks, 2 Redf. 349, 368) and the omission to change non-legal into authorized investments (Matter of Mount, 2 Redf. 405). Other instances where the conduct of the fiduciary has not been deemed such as to call for a deprivation of the statutory recompense are the failure to apply for a will construction and resulting continued retention of assets under a dry trust in the honest belief that it was an active one; improper makeup of accounts where no misconduct or dereliction was demonstrated; the act of an ignorant woman in permitting her counsel to manage the estate where no loss was shown; and suffering a dishonest co-fiduciary whose embezzlements were made good to conduct the affairs of the estate.

"Turning now to the cases in which commissions have been denied, there is evident a tendency to deny the recompense even though the financial damage to the estate has been repaired by the medium of a surcharge where either positive mala fides has been demonstrated or there has been long continued and striking disregard of fiduciary duties ..."

There is also express authority for the position advocated. Where, up to a certain date, unauthorized dealings in real estate had produced large profits, but similar dealings after that date caused the loss of all the profits and some of the principal of the fund, the court held that the cestui que trust had his election to take the fund with legal interest, or the fund with all the profits. But if he should elect to take the profits, he must take them over the entire period, subject to all the losses.35 Similarly,

35 Baker v. Disbrow, 18 Hun. 29, affd. 79 N. Y. 631 (1879): "In such a case the rule seems to be that the cestui que trust has his election to take the fund and legal interest thereon, or the fund and all the profits that has been made upon the fund. If the cestui que trust elects to take the profits he must take them during the whole period, subject to all the losses of the business; he cannot take profits for one period and interest for another. Hill on Trustees, 2nd Am. ed. 534; Perry, secs. 470-472; Heathcote v. Hulme. The trustee cannot be charged with a greater amount of profits than he has actually received. Jones v. Poxall, 15 Beav. 388, 395; Utica Ins. Co. v. Lynch, 11 Pai. 523 et seq. The principle is that, in the management of a trust, the trustee may lose but cannot gain. If by any improper use of the fund, profits
where speculative securities had been retained, and a later commitment in bonds was made to protect some of them, the trustee was held accountable only for the net profit, the court refusing to "mulet him in a large sum of money because of a technical violation of the law, although the persons seeking thus to penalize him have been by just such violation largely benefited."

"... In pursuing a settled and consistent policy, with reference to the speculative securities of different kinds which came into his possession, he acted with rare good judgment. Had he looked only to his own protection from risk and a speedy settlement of the estate and consequent shifting of responsibility from his shoulders, the infants in whose behalf complaint is now being made would have been deprived of the enormous advantages which have accrued from his management. To permit a distributee to select an investment out of others more fortunate, though the executor's conduct with reference to all have been actuated from the same motives and in the exercise of the same discretion, would be a gross injustice. It is a familiar maxim that he who seeks equity must do equity, and infants are not more relieved from this rule than adults. Upon a survey of the entire administration of this accountant, I think that his judgment is to be commended; that his good faith is beyond question; and still it is seriously urged that I must, nevertheless, mulet him in a large sum of money because of a technical violation of the law, although the persons seeking thus to penalize him have been by such violation largely benefited. Such a claim does not commend itself to my notions of equity, and I refuse to give the support of my opinion to such construction of the law." Lacey v. Davis, 5 Redf. Surr. (N. Y.) 301 (1882).

And where a business is improperly carried on by a trustee with success for some years, but subsequently unprofitably, it is generally held that the beneficiaries are not entitled to take the profits earned during one period and hold the trustee liable for the losses in another.

have been realized, they must be accounted for, and if no profits have been made he is to be charged with the fund and interest thereon. The profits which may have accrued at any particular time are a mere accretion to the fund, and the trustee can be charged with them only upon the ground that he has appropriated them to his own use. If upon an accounting, in respect to the fund during the entire period of the trust, it appears that no profit has been made, the trustee is chargeable with interest only. The improper investment is considered as against the trustee himself, as equivalent to no investment. But in favor of the cestui que trust it gives an option to claim either the investment made, or the replacement of the original fund, with interest, according as the one or the other may be most for his benefit."

"Estate of Porter, 5 N. Y. Misc. 274, 25 N. Y. S. 822 (1893):

"Heathcote v. Hulme, 1 J. & W. 122 (1819); Small's Estate, 144 Pa. 293, 22 Atl. 809 (1891); Seguin's Appeal, 103 Pa. 139 (1883):

"The principles upon which profits made by the use of trust moneys are ascertained and awarded, may be stated thus: Where a trustee makes a profit off the trust fund, the cestui que trust may at his election claim the profits so made, or interest at the legal rate upon the amount so invested. When he elects to take the profits he can only claim the net result of the investment; he cannot claim profits when profits are made and interest for the remainder of
Where the trustee willfully misappropriates trust property or risks it for his own benefit, as in the case of an attempt to escape a liability from a loss previously incurred through a breach of trust, by a subsequent gamble, the law cannot tolerate a benefit to the trustee. To deter the act, the law must prevent any profit from it. The solution is to isolate the transaction, divert any profit therefrom to the trust, and hold the trustee liable for any loss. So, also, where the trustee has made a profit by an unauthorized investment, and willfully risks it, knowingly violating his duty of care, he should be liable for any loss on the second transaction.

More doubtful may be the solution when a trustee acts knowingly beyond the terms of the trust, but entirely in good faith to benefit the beneficiary. However, the policy of the foregoing paragraph would seem to apply equally to this class of cases. It is not unfair to put the risk on the trustee who is aware of going beyond his power. He assumes the risk, and the risk should increase with each extension of wrongful commitment of trust property.

An allied problem arises when a trustee has made a profit on an authorized investment, a loss on an unauthorized one. So long as one holds to the established rule that a trustee is liable the time. The reason for this is that he is only entitled to profits on the footing that he sanctions, approves of, and adopts the investment of the trustee as his own. He has his option to say all investments of the trust fund are in contemplation of law made for my benefit, and belong to me with their legitimate fruits, in which case he must take them just as they are; or he may say, you had no right to invest the funds in that way, and I refuse to accept the investment or to ratify what you have done. If he adopts the latter course, the trustee, not having invested according to the law, must account for the principal and also for the interest which he ought to have made by a proper investment, and which the law therefore presumes he has made, and charges him with, namely, six per cent, and no more. If the cestui que trust adopts the investment, he is bound by its terms. He ratifies and adopts the acts of his trustee. He simply steps into his shoes, and is entitled to nothing but what the trustee has received or would receive if the funds had been his own. Having ratified and adopted the acts of the trustee, all questions as to the legality or propriety of such acts are laid at rest. The trustee will then be allowed his commissions as though the investment had been a strictly legal one. Rapalje v. Hall, 1 Sanford's Ch. R. N. Y. 399. When a trustee makes an illegal investment nothing can be imposed on him by way of punishment, for, inasmuch as he would be liable for the principal and interest if he dishonestly appropriated the money to his personal use, it would be inequitable to inflict an additional penalty where he merely made an irregular, but it may be, a well-meant or even a judicious investment.
for losses from unauthorized investments, it does not seem feasible to let him escape liability by decreasing that loss: by pointing to a profit made on an authorized investment. This improper investment is viewed as a thing apart, and even though the purpose of the law is only to secure to the trust the principal fund, the strong tendency to hold the trustee for losses from improper investments prompts the feeling that even a fortuitous profit belonging to the estate should not be detracted from because of the trustee’s default. If we should depart from the rule of strict liability for loss from improper investments, as by the English Statute, if the trustee acted honestly and reasonably, there would be no need of set-off as he might be relieved of liability, profit or no profit on the proper investment. But apart from such slackening of the rules, his liability would be unabated.

It may then be argued, that, the worse a trustee is, the better off; for if the former investment, X, had been improper and was profitable, he could set off that gain against the loss on the subsequent improper one, Y, but not if X had been proper. True in that case, he would be better off. But of course, if X had shown a loss he would have suffered a greater liability. While in the ultimate result of a single case, as where X appreciates, Y depreciates, the liability of the more righteous trustee is greater; the picture should be viewed from the time the two investments are made. At that time, on the average the liability of loss to the more transgressing trustee is higher.

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See: Murphy-Bolans Land and Loan Co. v. McKibben, 236 S. W. 78 (Tex. Com. App. 1922); Contra: Fletcher v. Green, 33 Beav. 426 (1864).

To illustrate: A makes two investments of $100 each, in X and Y. We will assume that each fluctuates equally in a range from $75 to $125; that X is an improper investment; and will calculate A’s liabilities in nine contingent relationships that fluctuations may cause, when Y is a proper investment, and when an improper one:

<table>
<thead>
<tr>
<th>X, improper</th>
<th>Y</th>
<th>LIABILITY OF TRUSTEE</th>
</tr>
</thead>
<tbody>
<tr>
<td>125</td>
<td>125</td>
<td>If Y proper: 0</td>
</tr>
<tr>
<td>125</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>125</td>
<td>75</td>
<td>0</td>
</tr>
<tr>
<td>100</td>
<td>125</td>
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<td>75</td>
<td>75</td>
<td>25</td>
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</tbody>
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TOTAL: 75 100