HOWE v. LORD DARTMOUTH—A REPLY

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I

In an earlier issue of this review the rule in *Howe v. Lord Dartmouth*[1] was castigated as an anachronism extended beyond its original and only justifiable field of operation.[2] The criticism was harsh and if the learned members of the judiciary who gave the doctrine increase are to be chastised for their temerity we must first be assured that the punishment is merited.

That is not accomplished by showing that the rule 'is habitually excluded. . . . by every draftsman of a will who remembers its existence.'[3] G. L. Fricke is prepared to concede that this 'may be no more than *prima facie* evidence of the unsuitability'[4] of the rule. With respect, it is not even *prima facie* evidence. The value of the rule must be measured by its operation in those cases where it is *not* excluded. The burden of this criticism of a critic is that we should not alter established principles unless some clear advantage is thus obtained and any alteration to the existing principles is as unlikely to prove beneficial as the substitution of a blind date for a tolerable and occasionally useful companion.

It must not be forgotten that the so-called rule in *Howe v. Lord Dartmouth* has in reality two branches. The first requires that 'where residuary personal estate is settled by will for the benefit of persons in succession, all such parts of it as are of a wasting or future or reversionary nature, or consist of unauthorized securities, must be converted into property of a permanent and income-bearing character'[5]—authorized trustee securities. With its emphasis on permanent and income-bearing securities the rule underlines the principle that trust funds are not 'risk' money.[6] The law will attempt to preserve the nominal value of the capital even if it shrinks from the problem of preserving the real value.

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[1] (1802) 7 Ves. 137.

[2] Graham L. Fricke: '*Howe v. Lord Dartmouth*—An Anachronism?' (1957) 1 *M.U.L.R.* 193.

[3] *Ibid.*, 193.

[4] *Ibid.*

[5] This statement of the rule is taken from Underhill, *Law Relating to Trusts and Trustees* (10th ed., 1950) 274.

[6] Here we would suggest that it is far from clear that in a country such as Australia which requires a substantial amount of investment funds for national development conservative trustee investment has a deleterious effect upon the economy. *Cf.* G. L. Fricke, *op. cit.*, 194-195.

The operation of this rule would appear to have been modified by statute.[7] Section 13 (5) of the Trustee Act 1953 provides: 'A power to postpone sale shall be implied in the case of every trust for sale of property.'

With this modification the rule seems quite unexceptionable. The trustee will continue to be subject to an overriding duty to exercise care in relation to investment so that he is under an obligation to convert into authorized investments as opportunity or necessity dictates.

If G. L. Fricke would quarrel with this result it must be because the trustee has not a complete power over *new* investment. Yet most solicitors would agree that there should be some limitation on the investment powers of trustees. Many trustees lack the business acumen to make wise investments if their investment powers were extended *in general terms*. Indeed, any such amendment is unlikely to prove effective in operation for the simple reason that conscientious trustees are unlikely to welcome the duty to determine permissible investments if they have a power to invest in any except 'hazardous' investments.[8] Moreover, such a power would involve an obligation of constant supervision. The ordinary shares of any specified company listed on the stock exchanges may well be a permissible investment at one time but a hazardous investment a decade later. True, section 13 (6) of the Trustee Act 1953 provides: 'where there is a power to postpone sale, the trustee shall not be liable in any way for postponing the sale, in the exercise of his discretion, for any indefinite period', but this requires the trustee to exercise an active discretion[9] and he may not be protected if he does not direct his attention to developments bearing on the future prosperity of the company.

There may be scope for addition to the list of authorized investments,[10] but the limitations imposed by the strait-jacket into which trustee investments may be forced by the narrowness of the definition of authorized investments is only indirectly relevant to the rule in *Howe v. Lord Dartmouth*. Moreover, even if this definition were expanded to include forms of investment which have become signifi-

[7] It has been suggested that the sub-section may not apply to implied trusts for sale, but I can find no reason in either the wording of the sub-section or the policy behind it to draw the distinction.

[8] The concept of hazardous investment is that apparently accepted by G. L. Fricke, *op. cit.*, 194, 198, although it should be pointed out that he did not attempt an exact formulation of the principle which he would use to replace the existing one.

[9] By analogy with the interpretation given to the Trustee Act 1953, s. 19. See *Re Greenwood; Greenwood v. Firth* (1911) 105 L.T. 509 and *National Trustees Executors and Agency Co. of Australasia Ltd v. Dwyer* (1940) 63 C.L.R. 1.

[10] Trustee Act 1953, s. 4. This is the alternative (and preferable) suggestion of G. L. Fricke. However, even it is adopted there is scope for disagreement on the operation of the second branch of the rule. Should the tenant for life receive the actual income of such investment? *Infra?*

cant in recent years such as debentures and shares, the amendment should be by specific enumeration or description if chaos is to be avoided.[11]

Let us pass to the second branch of the rule which requires that pending conversion the life tenant is 'only entitled to a fair equivalent for the income which he would have received if the property had been sold and invested in trustee securities'.[12]

It must be admitted that this rule may cause grave injustice especially in times of inflation. On the other hand similar injustices have occurred in trusts where this rule was expressly excluded—and it would not be an exaggeration to say that inflation has been the burden on the life tenants' shoulders and the effect of this branch of the rule has been negligible in comparison.

Would G. L. Fricke suggest that the life tenant should obtain all the income from a string of racehorses or would he regard this as an investment which is obviously hazardous? If he would exclude them on such a principle, how would he formulate that principle? If the testator's residuary personal estate is comprised largely of investments with a low immediate return and a slow but considerable capital appreciation, is the life tenant to be sacrificed to the greater good of the remainderman?

It is suggested that his attention was directed towards one type of residuary personal property—shares in limited liability companies—and they deserve separate consideration.

II

If the criticisms made by G. L. Fricke in respect of company shares are valid then they should be taken outside the operation of the rule in *Howe v. Lord Dartmouth* by including shares (or a limited class of shares) in the definition of authorized investments. However, are his criticisms valid in respect of company shares? Let us assume for the purposes of argument that companies are under a duty to provide adequate depreciation and to pay dividends only out of profits.[13] It is submitted that an obvious pre-occupation with the importance of depreciation has led G. L. Fricke into error because the lack of an adequate accounting technique was only one of a complex of factors which combined to draw and keep company shares within the rules in *Howe v. Lord Dartmouth*.

If the company is successful, usually it will provide adequately for depreciation and by planning for future development attempt to

[11] *Infra?*

[12] This statement of the rule is taken from Underhill, *Law Relating to Trusts and Trustees* (10th ed., 1950) 280.

[13] The authorities are canvassed by G. L. Fricke, *op. cit.*, 196-205.

preserve a balance between present dividends and future prosperity which will ensure a reasonable balance between the interests of life tenant and remainderman.

However, this is not a necessary result. Suppose that the shareholder has taken up shares in a new flotation or that the company adopts a policy of consolidation so that immediate returns to shareholders are subordinated to ultimate profit objectives. If the rule in *Howe v. Lord Dartmouth* is excluded, the tenant for life is deprived of a very necessary income for no clearly apparent reason. It must be remembered that, in cases to which the second branch of the rule applies, the testator will have drafted his will in the expectation of the rule operating to preserve the rights of the life tenant or will not have adverted to this point at all. When a person invests his property the devolution of each particular investment after his death is rarely in the forefront of his mind.

Moreover, if the company is not successful (and it must be conceded that many fail), the remainderman is likely to be sacrificed because of prospective but contingent benefits which may become available to the life tenant.

Even if the company has fluctuating fortunes the possibility of injustice between life tenant and remainderman is great. The testator may have required his beneficiaries to take the risk of such fluctuations, but in the absence of any indication to this effect it is difficult to criticize a rule which attempts with a considerable measure of success to treat successive beneficiaries equitably.

Unfortunately G. L. Fricke concentrated on the concept of shares as wasting assets and therefore exaggerated the importance of depreciation provision. It seems clear that the justification for treating ordinary shares as subject to the rule in *Howe v. Lord Dartmouth* is the fact that, like any other form of business enterprise, the income and capital value of an investment can vary so greatly that they are inappropriate to preserve the respective rights of life tenant and remainderman and even where they are retained as investments it is inappropriate to measure the entitlement of a life tenant by their actual return. The injustice caused by the rule in *Howe v. Lord Dartmouth* has been due to the narrow field of 'authorized investments' open to trustees subject to this rule. The cumulative effect of the two rules has been to limit trustees to investments with a comparatively low return which has not expanded in relation to the cost-of-living. We should at least blame the right culprit. The rule in *Howe v. Lord Dartmouth* would have worked satisfactorily if the income and capital value of authorized investments had kept pace with inflation.

In fact the increasing acceptance of ordinary shares as desirable investments where they are permitted by the trust instrument is largely due to the fact that they are less susceptible to the malady of inflation than government bonds which have depreciated greatly in real value in the last decade. Inflation injures the tenant for life and remainderman alike.

Should the list of authorized investments be expanded to include shares? In 1945 the Council of the Law Institute of Victoria proposed the addition of certain deposits, debentures and 'fully paid up preference or ordinary stock or shares listed on the Melbourne Stock Exchange and carried on the Victorian register of any company or corporation incorporated or carrying on business in the State of Victoria having a paid up capital of not less than £200,000 and having during each of the five years last past before the date of investment paid a dividend at the rate of not less than five *per centum* on its ordinary stock or shares'.[14] To make allowance for inflation we might now require a paid up capital of £500,000.

Yet even within this limited class there is ample scope for both the conservative and the gambler. What is to be the test by which the liability of a trustee for an improvident investment is to be determined? Is it to remain dependent on whether he has exercised 'reasonable care'?

This vague test has proved satisfactory in the past because the very limited range of authorized investments gives comparatively little scope for carelessness. It is suggested that insurmountable difficulties would arise if this test were retained to deal with investments in ordinary shares. The solution might be to give the trustee a blanket protection unless fraud or recklessness were proved, but at this stage it is necessary to pause and consider whether the beneficiaries are being loosed from their shackles only to become whipping-boys.

This scheme would give, in fact, an invulnerable protection to dishonest trustees who were sufficiently intelligent to take a few elementary precautions. Far more important (because the majority of trustees are aware of their moral obligations), it puts the beneficiary at the mercy of the business acumen of the trustee. The prospect may appear inviting when we can survey a decade of fantastic progress and buoyant profits when wise investment created vast fortunes and foolish investment only involved lesser wealth and rarely disaster. Wise investment may become more vital as the 'boom' subsides.

[14] (1945) 19 *Law Institute Journal* 63. In England the matter has been considered by the Nathan Committee. The recommendations of that committee are discussed by W. G. Nursaw 'The Inadequacy of Statutory Investment Powers of Trustees' (1958) *Journal of Business Law* 150.

III

The rule in *Howe v. Lord Dartmouth* is logically distinct from, although affected by, any decision to include ordinary shares in the list of authorized investments. *In the circumstances in which it operates* it does achieve a balance of justice between life tenant and remainderman besides protecting the interests of all beneficiaries by requiring conversion into authorized investments. To that extent it effects the presumed intention of the testator with a moderate degree of success.

It cannot be denied that the rule in *Howe v. Lord Dartmouth* coupled with inflation has caused grave hardship in many cases, but it must surely be accepted that the lender is at a disadvantage in a time of inflation whatever expedients are adopted to protect his position. In any event no one has suggested that a trustee should have an absolute discretion in the investment of trust funds and unless this stand is taken the 'hardship' cases are properly referable to the list of 'authorized investments' rather than to the rule in *Howe v. Lord Dartmouth*. The greatest difficulty facing those who suggest an amendment of the existing rules is to suggest (as G. L. Fricke did not) an amendment which is sufficiently precise to be workable and which will yet ensure justice for the beneficiaries. True, 'the mass of litigation which the rule has led to has provided much work for lawyers over the last century and a half', but at least that mass of litigation has given us a set of detailed principles offering a solution to most problems. Past litigation is not relevant unless there is no indication of any diminution. It is suggested that any alteration to existing rules is likely to provoke more litigation than their retention. This would certainly seem the case if the liability of the trustee is to turn on some vague concept of 'hazardous investments' or 'reasonable care'.

In relation to ordinary shares there must be a realization that in exchanging a fixed income for the variations of company dividends the ultimate beneficiary must bear the lean years as well as rejoice in the years of plenty. Expansion has underlined the attractiveness of ordinary shares as a trustee investment and the accompanying inflation has crippled the beneficiaries dependent on a list of authorized investments practically limited to government bonds and mortgages. The ultimate decision on the question whether ordinary shares should be added to the list of authorized investments involves problems for the economist and the politician as well as for the lawyer. A lawyer can merely indicate the alternatives and disadvantages of each in respect to the law of trusts.