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Wills and Trusts

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During the period under review the South Carolina Supreme Court considered several cases in which the questions for decision arose from dispositions made by will. The problems were principally constructional, and as a matter of classification, although stemming from wills, they are treated elsewhere in this Survey—in Property[1] or Taxation.[2] Aside from the specific meanings and operation of the language employed in the respective cases, some familiar principles are restated in them which are customarily dealt with in the Survey subject of Wills. Thus, in *Montague v. South Carolina Tax Commission,*[3] it is stated that the primary inquiry in construing the provisions of a will is the intention of the testator at the time of the making of the will; that the intention should be effectuated unless it contravenes some well-settled rule of law or public policy;[4] that the will must be read as a whole; and that " 'where an estate or interest is once given by words of clear and ascertained legal significance, it will neither be enlarged nor cut down by superadded words in the same or subsequent clauses, unless they raise an irresistible inference that such was the intention of the testator.' " In *Taylor v. Jennings,*[5] the Court reaffirmed the rule that on the death of a testator his real estate vests immediately and directly on his devisees, and where such estate is given for life with remainder, title vests at once in the life tenant and remaindermen. In *Purvis v. McElveen,*[6] the Court adverted to and followed the rule that a possibility of reverter is not devisable or inheritable.

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1. Purvis v. McElveen, 234 S. C. 94, 106 S. E. 2d 913 (1959); Thomason v. Hellams, 233 S. C. 11, 103 S. E. 2d 324 (1958); Taylor v. Jennings, 233 S. C. 600, 106 S. E. 2d 391 (1958); Dean v. Lancaster, 233 S. C. 530, 105 S. E. 2d 675 (1958); Woodle v. Tilghman, 234 S. C. 123, 107 S. E. 2d 4 (1959).
2. Montague v. S. C. Tax Comm., 233 S. C. 110, 103 S. E. 2d 769 (1958).
3. Note 2, *supra.*
4. The same rule was stated in Dean v. Lancaster, note 1, *supra.*
5. Note 1, *supra.*
6. Note 1, *supra.*

The case of *Rushton v. Smith,*[7] which involves an action under Lord Campbell's Act and is therefore treated under Torts and Procedure, is mentioned here because of the presence of a suing administrator and the contrast as to devolution of rights between that act and the Statute of Descent and Distribution. In the case noted it was held that where a wife was wrongfully killed and the husband died thereafter before institution of the action, the cause of action did not pass beneficially to his representatives but to the next remoter class of the wife's beneficiaries mentioned in the Act.[7a] In so holding the Court declined to overrule or modify two earlier cases on the subject with similar facts.[8] If the Act and the Statute of Descent and Distribution were to be equated in terms of the latter, the opposite result would of course have followed.

The case of *Want v. Alfred M. Best Co., Inc.*[9] which involved the administration of an insolvent decedent's estate, raises a number of problems in estate administration and trusts. So far as the administration questions are concerned, no salient principles of law appear, the issues being resolved principally on their merits. There are, in addition, tax features and procedural questions relative to tax claims of the United States, which are treated elsewhere in the Survey. The propriety of asserting the tax claims in the Court of Common Pleas was upheld, the Supreme Court pointing out that the Common Pleas proceeding was *in rem,* having for its subject matter the assets of the estate and concerned with its liquidation and dispostion; and "Having taken that subject matter into its control, the Court of Common Pleas may retain such control, exclusively, until its duty has been fully performed."

The major, and perhaps most important, aspect of the case concerned the claims of certain claimants asserting preferences as alleged *cestuis que trust* under trusts *ex maleficio.* Basically their contentions were founded upon two sets of facts: the decedent had collected funds for them which he had not remitted; and he had received from them for investment funds which he had misappropriated or dissipated. The

7. 233 S. C. 292, 104 S. E. 2d 374 (1958).
7a. CODE OF LAWS OF SOUTH CAROLINA, 1952 § 10-1952.
8. Morris v. Spartanburg Ry. Gas & Elec. Co., 70 S. C. 279, 49 S. E. 854 (1904), and Elkin v. Southern Ry., 156 S. C. 390, 153 S. E. 337 (1930).
9. 233 S. C. 460, 105 S. E. 2d 678 (1958).

funds could not be traced or identified. (There were other claimants whose moneys were traced into other products, to which they were held entitled on a constructive trust.) The lower court, under the seeming authority of the well-known case of *Ex Parte Bank of Aynor*,[10] held favorably to the claimants, the Supreme Court viewing the holding of the lower court as deciding that all property of the decedent at the time of his death insolvent "became, by the very fact of his defalcations, a trust fund of which his executrix is trustee, for the benefit of those persons whose money had been lost through such breaches of trust, to the exclusion of all other creditors."

The Supreme Court reversed the lower court, stating that "while some statements in the Bank of Aynor opinion went beyond the requirements of the issues in that case, we do not think that the decision, when viewed in the light of the factual situation before the court in that case, requires the conclusion reached by the lower court in the case at bar." The Court then gives a lengthy recital of the facts in the *Bank of Aynor* case and a detailed analysis of the holding there, with the oft-quoted excerpt from the opinion of Justice Cothran in the case drawing distinction between "an ordinary constructive trust and a constructive trust *ex maleficio*." in Justice Cothran's words, "The beneficiary of a simple constructive trust is no more than an ordinary contract creditor, except where he can point to a fund in the hands of a receiver upon which his asserted trust is to operate. * * * But the case is quite different from a constructive trust *ex maleficio*. * * * The beneficiary occupies a much more favorable position than that of the general creditors or the beneficiaries of a simple constructive trust. * * * If it can be shown therefore that the mis-appropriated fund went into the coffers of the corporation prior to receivership, was disbursed by the corporation in the payment of debts or in the acquisition of property, there can be no reason or justice in allowing the general creditors to receive the benefit of stolen property simply for the reason that a corresponding amount of money was not turned over to the receiver."

The Supreme Court's dissection of the *Aynor* case led it to conclude that so far as the statement just quoted—and

10. 144 S. C. 147, 142 S. E. 239 (1927).

others—suggested that all the assets in the receiver's hands constituted a trust res for the benefit of the defrauded beneficiary, those statements were erroneous; but that actually "the conclusion to which the main opinion led was this: that because the proceeds of the notes that had been left with American Bank and Trust Company in trust had been misappropriated and used to reduce its liabilities immediately prior to its failure, the Bank of Aynor, whose money had thus indirectly swollen the assets that came into the receiver's hands, was entitled, in the distribution of the insolvent bank's assets, to priority over depositors and general creditors. Stated more simply, the opinion in reality recognized the Bank of Aynor not as a *cestui* entitled to a trust res, but as a preferred creditor."

From the last sentence in the quoted statement, one might receive the impression that until the present court's approval the *Bank of Aynor* case stands for the proposition that a beneficiary who has been injured by a fraudulent breach of trust, while not entitled to claim as a *cestui* because of the absence of tracing, may nevertheless be some sort of preferred creditor. But as Justice Legge, writer of the opinion in the instant case, himself points out, the Court in the *Bank of Aynor* case, while deciding unanimously that the securities set aside by American Bank & Trust Company to take the place of the Bank of Aynor's misconverted notes were impressed with a lien,[11] deferred the question whether the Bank of Aynor should otherwise be treated as a preferred creditor—in this respect not immediately accepting the views of Justice Cothran who urged the preferment upon the ground of a so-called constructive trust *ex maleficio*. But while there may have been a reservation as to conceding a preferred status on the ground

11. The following comment on this aspect of the case appears in an annotation in 82 A. L. R. 46, 198: "The report is not altogether clear as to whether the decision is based upon the theory that the securities which were set aside by the bank were a substitute for the trust fund and the trust fund was traced into such securities, or on the theory that the owner of the notes merely had a lien on such securities as a result of the pledge thereof to secure the payment of the proceeds of the notes; but the latter principle seems to have been uppermost in the court's mind."

There is no doubt that in Justice Cothran's mind the substituted securities were impressed with a trust; and for the purposes of the case it would make no difference whether the Bank of Aynor had a preference by way of lien or by way of trust.

of a constructive trust *ex maleficio,* the views of Justice Cothran that preference should be given such claimants as beneficiaries of such a trust prevailed unquestionably—and in fact became fixed as law—in later cases.[12] These later cases favored the claimants under fraudulent breaches of trust and other frauds as preferred creditors *because* they were *cestuis* of such trusts, and not because of some other right or equity, and in so doing it was made plain that there was no requirement of tracing or identification. These cases were not based on any misapprehension of the *Bank of Aynor* case but on a deliberate acceptance of the views stated by Justice Cothran in that case. In the absence of a lien growing out of the facts which are an alternative to a constructive trust and absent any statutory preference, it is difficult to perceive any basis for preference over general creditors unless some trust theory is invoked. If the lower court in the instant case relied on erroneous and unnecessary statements in the *Bank of Aynor* case, it was at the same time justifiably relying for precedent

12. In *Ex Parte* Hernlen, 156 S. C. 181, 153 S. E. 133 (1930), Justice Cothran, writing the opinion in which the rest of the Court concurred, declared: "It is an established principle, under the case of *Ex Parte* Bank of Aynor * * * that the beneficiary of such a trust as this is entitled to be preferred in the distribution of the assets of a failed bank, over the general creditors." In Peurifoy v. Boswell, 162 S. C. 107, 160 S. E. 156 (1931), the effect of the *Bank of Aynor* case was stated to be: "In the case referred to [Bank of Aynor] the doctrine was declared that there was a difference between the beneficiary of a trust *ex maleficio* and the beneficiary of a simple constructive trust. In the one the beneficiary is entitled to a preference in the distribution of the assets, but in the other he only shares in the assets as a general creditor of the bank." The principle advanced by Justice Cothran was reaffirmed and followed in Hampton County v. Lightsey, 164 S. C. 63, 161 S. E. 879 (1931); Bradley v. Guess, 165 S. C. 161, 163 S. E. 466 (1931); Spartanburg County v. Arthur, 169 S. C. 456, 169 S. E. 235 (1932); Fant v. Easley Loan & Trust Co., 170 S. C. 61, 169 S. E. 59 (1932), in which the Court, being asked for and allowing review of the *Bank of Aynor* case and the cases dependent on it, adhered to its opinion in the *Bank of Aynor* case and the cases following it. In Spartan Mills v. Law, 186 S. C. 61, 67, 194 S. E. 653 (1937), the rule of the *Bank of Aynor* case was followed: "The claimant, in order to establish his preferred status, must show the creation of a trust prior to the receivership and also prove a trust *res* which actually augmented the assets of the closed bank, which trust *res* can be traced into the hands of the Receiver upon insolvency. * * * Of course a different rule applies to a trust *ex maleficio* * * *." There were other cases in which the rule of the *Bank of Aynor* case, as accepted by later cases, was urged by claimants of preferences, and in them, where the result was unfavorable, the Court decided not on the basis that the rule was wrong but that the facts did not fit the rule. In fact, the only dissatisfaction expressed with the rule — dissatisfaction which did not result in its overthrow — was in the statement of Acting Associate Justice Cothran in S. C. State Bank v. Citizens Bank, 173 S. C. 496, 176 S. E. 346 (1934), in which he speaks of "that much disputed and doubtful doctrine."

on the later cases which accepted those "erroneous" statements as the law. If it is, or is to be, the law that beneficiaries of a wrongdoing fiduciary, or the victims of theft or fraud (in whose favor constructive trusts may also arise—since in order to establish such a trust a fiduciary relationship need not exist at the outset)[13] are to be treated on the insolvency of the wrongdoer, into whose assets the misappropriated or misacquired property cannot be traced, as preferred creditors and not as *cestuis*, general creditors can draw small comfort from the attaching of one label rather than another.[14]

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13. Bank of Williston v. Alderman, 106 S. C. 386, 91 S. E. 296 (1916).

14. *Cf.* RESTATEMENT, TRUSTS § 202 (2d ed. 1959): "Following Property unto its Product. (1) Where the trustee by the wrongful disposition of trust property acquires other property, the beneficiary at his option is entitled either to enforce a constructive trust of the property so acquired or to enforce an equitable lien upon it to secure his claim against the trustee for damages for breach of trust, as long as the product of the trust property is held by the trustee and can be traced. (2) Except as stated in Subsection (1) the claim of the beneficiary against the trustee for breach of trust is that of a general creditor." See comment *o* to this Section, and the statement in the cross-reference that "The general rule as to the following into its product of property wrongfully disposed of is not limited to trust property. As to the application of the rule to other wrongdoers, as well as to trustees, see RESTATEMENT, RESTITUTION §§ 202-215 (1937)." In the Section 215 mentioned, the rule is stated that "where a person wrongfully disposes of the property of another but the property cannot be traced into any product, the other has merely a personal claim against the wrongdoer and cannot enforce a constructive trust or lien upon any part of the wrongdoer's property." It is further stated that the claim "is only that of a general creditor of the wrongdoer."

In the instant case the Supreme Court, having decided that the claimants were not *cestuis* but creditors, postponed their claims to the tax claims of the United States and subordinated them to funeral and administrative expenses and to dower and homestead. It added that "whether or not their claims are entitled to priority over the general creditors is a matter not involved in this appeal." It is submitted that the quoted statement would be more reflective of the law and of the conclusion reached in the case if the word "other" were inserted before "general creditors."

The priority accorded the United States over creditors was based on Federal law — 31 U. S. C. A. §§ 191-192 (1954). Aside from these statutes, which were controlling enough, it is probable that preference would have been given under state law, by virtue of the statute prescribing the order of payment of a *decedent's* debts: Subsection (2) of § 19-476 of the S. C. Code, 1952, calling for payment of "debts due to the public", next in order after payment of funeral expenses, expenses of last illness and administrative costs directed in Subsection (1), and prior in order to payment of "Bonds, debts by specialty, and debts by simple contract" under Subsection (5).

Except where there is a lien existing at the time of death, Purdy v. Strother, 184 S. C. 210, 192 S. E. 159 (1937), or a trust attaching to specific property, the order of payment prescribed by § 19-476 controls. Precisely where beneficiaries whose claims for breach of trust cannot be satisfied out of specific property as a trust res, and who therefore are creditors, fit into this statute is not clear. The statute itself does not give them any preferred status over even "simple contract creditors".

Despite the seeming reluctance of the Court to repudiate the *Bank of Aynor* case, and the effort to rationalize its result, it would seem from the summary of principles which the Court sets out as a guide that the net effect of the decision in the instant case is at least to overthrow the announced rule—whether followed or not in the *Bank of Aynor* case and certainly followed in subsequent cases—that gives the defrauded beneficiary a trust interest in all the assets of an insolvent even though there is no tracing of the misused funds. The Court gives the following valuable summary which should clarify and crystalize the law on the subject:

> 1. If a trustee, having commingled a trust fund with his personal funds in a single bank account or other fund, becomes insolvent, the trust fund does not, by the mere commingling, lose its identity. If the *cestui* can substantially identify it, by tracing it into the commingled fund in the hands of the insolvent's receiver, he may reclaim it. In those circumstances there is a trust *ex maleficio*, because there is a trust res, *vis.*: so much of the commingled fund as has been thus identified.
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> 2. Substantial identification, e.g., by tracing trust funds, or property, or the proceeds of sale of such property, into the commingled fund in the hands of the receiver, is essential if the claimant is to establish his position, as that of *cestui* rather than creditor; for there can be no *cestui* except there be a trust *res*.
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> 3. Where the claimant cannot trace his money into, and thus identify it as part of, a particular fund or property in the hands of the receiver, his status is that of a creditor in the receivership even though he may be able to show that his money augmented the general assets of the insolvent existing at the time of the receivership and thus coming into the receiver's hands. He is a creditor, not the *cestui* of a trust, for the simple reason that there is no identifiable trust *res*.

While these summarized principles once and for all dispel the notion that a trust can be established in assets into which there has been no tracing (and logic is all on that side), and clarity and certainty are thus introduced, it does not add to resolution of the problem if the inference is to be drawn that even though a trust cannot be established a preference will

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nonetheless be given. The time will surely come when claimants like those in the instant case will compete with general creditors of an insolvent, and in a case where the matter will not become academic because of the entry into the fray of a formidable opponent like the United States, armed with a statutory preferment which sweeps away all the assets. Without tracing, they will not be *cestuis;* but will they be preferred on some other theory? And the time will also come when the case is not one of a defrauding fiduciary but another kind of perpetrator of fraud. John owes Paul and Ezra. John robs Peter to pay Paul. John becomes insolvent. Peter is not *cestui* because the funds cannot be traced into John's assets. But will Peter come ahead of Ezra in the application of John's assets? If he does, why?

Legislation

Two statutes affecting trusts were enacted by the 1959 General Assembly. Act No. 225[15] provides for nominee registration of securities held by banks, trust companies and other corporate fiduciaries and prescribes the regulations and terms of such registration. Act No. 226[16] amends the general investment statute[17] in several important respects, clarifying the language of the original statute, enlarging the scope of permissible investments and further defining and prescribing the terms and limits of investments. The obscurity in the original statute regarding debentures is removed, under Subsection (1) which permits investment in debentures, notes, bonds or other obligations, whether secured by real estate mortgage or not, if the issuing corporation has an unbroken record of cash dividends payments during the period of ten years preceding the date of purchase. Subsection (2) clarifies, and enlarges the range of, investment in first mortgages on real estate. Under the earlier version of the investment statute investment in corporate mortgages apparently could not be made except by purchase from the mortgagee or his assignees, since the secured obligation must have been outstanding for at least five years and no default in payment of interest should have occurred; under the amendment mortgages, individual and corporate, may be taken by the fiduciary directly from the

15. 51 STAT. 376.
16. 51 STAT. 378.
17. CODE OF LAWS OF SOUTH CAROLINA 1952, § 67-58.

mortgagor. There is no requirement for prior life of the obligation and the amendment speaks of the mortgage "given by the mortgagor to the fiduciary." If the mortgage is acquired by purchase, the requirement remains that there shall have been no default in the payment of interest; and in any event whether the mortgage is obtained by direct acquisition from the mortgagor or by purchase, the old requirement of sixty per cent of value is retained.