Wyoming Law Journal

Volume 19 | Number 3 Article 7

December 2019

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Recommended Citation

Steve Gehring, *Trusts - Royalties as a Trust Res - Rule against Perpetuities - Rule against Suspension of Alienation - McGinnis v. McGinnis*, 19 Wyo. L.J. 248 (1965)

Available at: https://scholarship.law.uwyo.edu/wlj/vol19/iss3/7

TRUSTS—ROYALTIES AS A TRUST RES—RULE AGAINST PERPETUITIES—RULE AGAINST SUSPENSION OF ALIENATION—*McGinnis v. McGinnis, 391 P.2d 927 (1964).*

The action was to require an owner of certain lands (appellant-defendant) to account for and pay to the bank-trustee, all sums received by said owner as royalty payments pursuant to an alleged assignment in trust.[1] Plaintiffs in this action are the named cestuis or beneficiaries of the alleged trust.

The trust assignment arose out of a dissolved corporation comprised of eight members of a family, plaintiffs and defendant being members of that family. Upon dissolution of the corporation, certain real property owned by it was conveyed to five family members, defendant being one of the five. It was the design of the family that the said five members would execute an assignment in trust of all oil and gas royalties derived from the land, and that the beneficiaries of the trust would be all eight members, each sharing in the proceeds, in proportion to his respective stock ownership in the defunct corporation.[2] The defendant refused to comply with the assignment and had not paid any royalties to the bank, alleging that the assignment was void because it was violative of the rule against perpetuities and violative of the rule against suspension of the power of alienation.[3]

The court, affirming the decision of the lower court for the plaintiffs, *held* that the trust was perfectly valid and that the defendant shall be required to pay all aforementioned royalties to the trustee for distribution.

According to the court, the significant portions of the trust, and the ones which will be significant later in this note, are as follows:

> WHEREAS, it is the desire of the parties named herein that each shall share in any and all royalties derived or produced from said hereinafter described lands, regardless of the ownership thereof from which such royalties are produced, in the proportion based upon the ownership of each of the capital stock of McGINNIS LAND AND CATTLE COMPANY, now dissolved hereinafter particularly set forth;
> NOW, THEREFORE KNOW ALL MEN BY THESE PRESENTS, that in consideration of the mutual promises and agreements of said parties and of the sum of ONE DOLLAR each to the other in hand paid, and of the fees and commissions to be paid to the trustee hereinafter named, the parties to this agreement hereby assign, transfer, and set over unto the FIRST NATIONAL BANK OF KEMMERER, WYOMING, any and all oil and gas royalties due or to become due us, or either of us, under and by virtue of any and all oil and gas leases heretofore executed by the parties hereto, or any of them, from and by virtue of any oil and gas leases that may hereafter, or at any time executed by us, whether jointly or severally, pertaining to the lands

1. 391 P.2d 927 (Wyo. 1964).
2. *Id.* at 928.
3. *Ibid.* The defendant also alleged that the trust provided no time for termination and that it was executed without consideration, but the court quickly dismissed these defenses as applicable to contracts, and held that the assignment was not a contract. *Id.* at 933.

> hereinafter mentioned, to any person, firm, or corporation to whom we or any of us shall or may convey by lease or otherwise for the purpose of prospecting for oil and/or gas, together with any and all the oil and gas royalties that may be produced from said lands or any part thereof through the production of oil and/or gas in any other way or manner whatsoever.[4]

The first problem that the court had to determine was the status of oil and gas royalties, *i.e.*, are they real or personal property?[5] Defendant asserted that they were personal property and must be determined in light of that assertion.[6] The court passes over the point rather lightly, although its statement is definitive and conclusive, since Wyoming courts have come but to one decision in past years and that is that oil and gas royalties are real, rather than personal property. Reliance is placed on several decisions written by Justice Blume.[7]

The royalty question was first decided by Justice Blume in 1923 in the case of *State ex rel School District No. 1 in Weston County v. Snyder,* where he ably commented, "rents and royalties from oil leases are not the ordinary rents . . . but arise from and represent the corpus of the land. . . ."[8] Although this did not represent a direct statement that royalties were real property, Justice Blume's reiteration and further analysis in the *Denver Joint Stock Land Bank v. Dixon* case was seemingly conclusive. "The right, extending as it does to oil which is come from particular land, extends to and is necessarily connected with the corpus of the land, and is, accordingly, a right which exists in the oil which still is in place, inchoate though it may be, follows it as it comes from the ground and is still attached after it has become personal property."[9] A further reiteration of these principles was made by Justice Blume in 1951.[10] In 1959, with Justice Blume still a member of the court, Justice Parker cited the *Denver Joint Stock* case but neither elucidated nor expounded further upon the Blume opinion.[11]

Although Justice Blume first made this conclusion in 1923,[12] the *McGinnis* case was the first one to make that holding regarding royalties as a trust res. Since the beneficiaries merely got the proceeds, *i.e.*, cash from the trust, it is conceivable that for purposes of a trust res, royalties could be considered personal property or a right to personal property. The foregoing is stated to make this point clear: that in the *McGinnis* case, a *new* court was deciding on royalties, and although it was undoubtedly bound to some extent by stare decisis, the consideration of royalties as a trust res was one of first impression in Wyoming, and substantial leeway was thereby given to the court to change, modify or expand the older holdings.

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4. *Id.* at 928-29.
5. *Id.* at 929.
6. *Ibid.*
7. State *ex rel.* School Dist. No. 1 in Weston County v. Snyder, 29 Wyo. 163, 212 Pac. 758 (1923); Denver Joint Stock Land Bank v. Dixon, 27 Wyo. 523, 122 P.2d 842 (1942).
8. *State ex rel. School Dist., supra* note 7, at 758.
9. *Denver Joint Stock, supra* note 7, at 849.
10. Hageman & Pond, Inc. v. Clark, 69 Wyo. 154, 238 P.2d 919 (1951).
11. Dame v. Mileski, 80 Wyo. 156, 340 P.2d 205 (1959). (Quoting *Denver Joint Stock* case, *supra* note 7).
12. *State ex rel. School Dist., supra* note 7, at 758.

The *McGinnis* decision should provide attorneys with a solid foundation upon which to design royalty trusts and a considered basis upon which to speculate as to the legal ramifications which may flow from such trusts.

After the royalty determination, the court pivoted its decision on two issues; first, was the assignment violative of the rule against perpetuities; and second, did the assignment constitute an unreasonable restraint on the power of alienation?[13] The perpetuities problem, however, is not of great significance since the court found that, upon assignment, both the equitable and legal title vested immediately in the respective owners, and therefore the rule was not violated.[14] The reasoning behind this is that the rule is only concerned with the time in which *contingent* interests will vest.[15]

The second issue, on restraint of alienation, is the most significant point of the case, since it had not been heretofore adjudicated in Wyoming and its origin and application have been noticeably clouded. It was defendant's contention that the trust was to continue indefinitely with the trustee having no right to alienate the corpus.[16] The plaintiff contended that there is no common law rule against restraints on alienation and therefore if Wyoming has any such law it must be statutory.[17] After due discussion on the point, the court concludes that since no statutory law exists in Wyoming on the subject, "there is no effective rule in Wyoming on restraints against alienation unless it be that which was derived from the common law."[18]

The history of suspension of alienation at common law is long and complex. Modern commentators vary according to their interpretation of the meaning of the common law. Gray[19] observes that it is axiomatic that a common law rule exists prohibiting such restraints.[20] Bogert concludes that American courts have established a common law rule that private, indestructible trusts must be limited in duration[21] (although Bogert does not label this the rule against suspension of alienation[22]). The Wyoming Supreme Court indicates that the rule in Wyoming is one prohibiting the "clogging of alienability."[23] In application of the rules, thus established, to the interest held by the bank in the *McGinnis* case, the court holds the trust valid since the trustee (bank) has only bare legal title and only ministerial duties to transfer the proceeds to the

13. *McGinnis, supra* note 1, at 930.
14. *Id.* at 931.
15. *Ibid.* The court held:
No intent to pass a less estate expressly appeared in the instrument or could necessarily be implied in its terms and thus under the provisions of §34-41, W.S. 1957, there was a conveyance of fee simple interest in the landowner royalty to the trustee with the equitable interest vesting immediately in the beneficiaries. The rule against perpetuities was therefore not violated. *Ibid.*
For Wyoming's rule against perpetuities see WYO. STAT. §34-40 (1957).
16. *McGinnis, supra* note 1, at 931.
17. *Ibid.*
18. *Ibid.*
19. GRAY, RULE AGAINST PERPETUITIES (4th ed. 1942).
20. *Id.* at §119.4.
21. BOGERT, TRUSTS §74 (2d ed. 1942).
22. See BOGERT, TRUSTS §52 (4th ed. 1963).
23. *McGinnis, supra* note 1, at 933.

beneficiaries. As a consequence, no possible restriction could be imposed by the trustee upon the trust res.

As to the interest held by the beneficiary, Scott[24] explains it sufficiently by pointing out that a beneficiary's interest is as alienable as any other property interest providing the beneficiary is under no disability either as to his legal capacity or as to trust provisions, such as discretionary or support trusts; and as long as local law does not prohibit alienation.[25] The trust in point in this case provides no such restrictions, and it can be assumed that all beneficiaries were capable of transferring or assigning the interest that they hold, since the court emphatically said "it is clear beyond question that the equitable title to the beneficiaries is alienable."[26]

The problem in the area is that the law is referred to by several names: the rule against suspension of the power of alienation and the rule as to duration of private trusts. The two are often confused and combined. The confustion arises, however, in the matter of terminology, and seldom in the practical application. Powell, defining the rule strictly, states that, "A suspension of the power of alienation exists when there are no persons in existence who, by joining together, can transfer complete ownership of the subject matter."[27] Obviously this is not what the parties or the court in the *McGinnis* case contemplated, since all eight beneficiaries, the trustee and the settlors were in being at the time the trust was created. Bogert, on the "Rule Against Undue Suspension of the Power of Alienation,"[28] speaks strictly of a statutory rule regarding trusts.[29] Bogert asserts that the laws were enacted to eradicate three undesirable problems: one, the trust instrument prohibiting the trustee from selling the corpus for a given period; two, the settlor forbidding the beneficiary to transfer his interest (e.g., a spendthrift trust); and three, local law making the beneficiary's interest inalienable by him. The typical statutes prohibit such aforementioned restrictions for more than a life in being plus twenty-one[30] years, twenty-five[31] years, or thirty[32] years, depending upon the particular public policy in the states. As becomes obvious, the policies and ensuing statutes were just an outgrowth and modification of the rule against perpetuities.

In distinction to this, Bogert next discusses what he calls a "Rule as to Duration of Private Trusts."[33] Bogert states that if there is such a common law rule, it has *nothing* to do with the rule regarding restraints on alienation, but, is rather founded on the idea that it is contrary to public policy to allow a settlor to control the method of enjoyment of a beneficiary's property for too

24. *Ibid.*
25. 2 SCOTT, TRUSTS §132 (2d ed. 1956).
26. *McGinnis, supra* note 1, at 933.
27. 5 POWELL, REAL PROPERTY 584 (1962).
28. BOGERT, TRUSTS §51 (4th ed. 1963).
29. *Ibid.* (citing Ariz., Colo., D.C., Idaho, Iowa, Ky., Mich., Minn., N. Dak., Okla., S. Dak., Wis.).
30. ARIZ. REV. STAT. ANN. §33-261 (1956).
31. IDAHO CODE ANN. §55-111 (1947).
32. WIS. STAT. §230.15 (1963).
33. BOGERT, *supra* note 29, at §52.

long a period. In other words, enjoyment indirectly, through a trust rather than direct, full ownership. The whole problem here is that courts have come to different conclusions as to what the law is or should be. Bogert states that the earlier cases merely applied the time limit permitted by the perpetuities rule and have either voided the trusts *ab initio*, or have terminated them at the end of the permissable time period. Other more modern courts hold that the time period is not of consequence as long as all interests germane to the trust are vested. As Bogert seems to imply, the courts with the best policy rely upon the destructibility or indestructibility of the trust, as determinative of whether or not a durational time limit will be imposed. This seems inherently logical since a destructible trust implies one in which the trust parties, on their own or upon court order, can gain the termination of the trust when desired. On the other hand, indestructible trusts are those not terminable at will due to various restrictions: the beneficiaries may not be *sui juris*; the trust purpose has not been obviated or completed; or the state has a crippling statute of one form or another. It is to this latter type of trust that a limiting period of duration is applied. The conclusion that Bogert makes, in light of the confusion here, is that the intelligent and wary draftsman still will revert and limit the trust to the perpetuities rule time limit, *i.e.*, a life in being plus 21 years.

Probably the best discussion is that by Simes and Smith.[34] They begin by developing the historical background on the prohibition of direct restraints which stems from the Statute of Quia Emptores.[35] Direct restraints, *e.g.*, A conveys a fee simple to B as long as B does not sell it, were void as an attempt to limit absolute ownership. Common law has carried forward to prevent this type of restraint almost universally. Indirect restraints such as A to B for life, then to B's children for life, then to B's grandchildren for life, *ad infinitum* were prohibited following the advent of the Statute of Uses[36] by the development of such rules as the rule against perpetuities. Restraints of this type tended to tie up property for unreasonable periods and were also a product of dead hand control, both being deemed unjustifiable by public policy. With the advent of trusts as popular devices for transferring property, American courts designed rules similar to the perpetuities rule to curb and limit trusts. Courts have promulgated such restrictions to balance interests of past, present and future generations. These rules, for the most part, refer to both legal restraints and practical restraints. A trustee may have a legal title which could be transferred but for undue restraints placed upon him by the settlor; while on the other hand a beneficiary has only an equitable title and cannot convey full ownership because a trustee has the legal title. This is not to say that trusts are not accepted, but only that restraints for an unduly long time period are to be avoided. Also, Simes and Smith aptly point out that a trust with definite beneficiaries is not necessarily void because its duration exceeds a life in being and 21 years.[37] The

34. 3 SIMES & SMITH, FUTURE INTERESTS §1112 (2d ed. 1956).
35. STAT. EDW. 1, C.1 (1290).
36. 27 Hen. VIII, C.10 (1536).
37. SIMES & SMITH, *supra* note 32 at §1391.

problem, discussed earlier by Bogert, and concurred in by Simes and Smith, remains one of the destructibility or indestructibility of the trust.[38]

The indestructible trusts, which invoke application of a durational restriction are known as "Claflin" trusts. The name is derived from a leading case in 1889, *Claflin v. Claflin*,[39] which held that an *active* trust cannot be terminated either by agreement of the beneficiaries or by court order, if the legal, material purpose of the settlor is still to be carried out or is still being carried out. Most American courts follow the *Claflin* case, and, although it has been diminished and modified to some extent, Simes and Smith contend that a "Claflin" trust extending longer than a life in being plus 21 years may be terminated, and probably at its inception.[40]

As has become evident, much confusion has arisen in terminology of the restraint areas. However, several observations and conclusions are also evident. There exists in American courts today, a public policy prohibiting dead hand control and the undue restrictions upon the transfer of property. Regarding set or consistent rules, it seems safe to say, that in absence of statutory law, few courts will allow such restrictions for longer than the life in being plus 21 years. Although it is not clear from the *McGinnis* case whether Wyoming now has a rule against suspension of the power of alienation or a rule limiting the duration of private trusts, it is clear that the court is upholding long-standing public policy that indestructible private trusts whose duration exceeds a life in being plus 21 years are to be avoided and terminated at inception, or by agreement of the beneficiaries, or at the end of the time limit. Further problems will undoubtedly arise[41] but the basic rules to be applied have finally been established.

Finally, another problem existed in the *McGinnis* case, and although it was not alleged by the litigants, consideration by the court, sua sponte, could have eliminated some obvious problems. The problem is one of the passiveness of the private trust, an area of the law never before adjudicated by Wyoming courts. Upon scrutiny of the *McGinnis* trust,[42] the only purpose of the trust was more or less of an agency situation.[43] The bank-trustee was seemingly, merely an agent of the five settlors, who did nothing more than receive royalty payment checks or receipts from said settlors and forthwith distribute the receipts to the eight beneficiaries in proportion to their corporate holdings. The bank had no established power to retain, manage, invest, conserve, or do anything but distribute the proceeds. In essence, this seems to be a passive trust which the court could have terminated and obviated the problems which must arise at the death of one or more of the beneficiaries; *i.e.*, whether the interest held is a life estate or a fee simple and whether there is a devisible interest. It is, however, conceded that in so holding the trust to be passive, the outcome of

38. *Ibid.*
39. 149 Mass. 19, 20 N.E. 454 (1889).
40. SIMES & SMITH, *supra* note 32, at §1391.
41. See, Gertman v. Burdick, 123 F.2d 924 (D.C. Cir. 1941), regarding rules against unlimited accumulation of trust income.
42. *McGinnis, supra* note 1, at 928, 929.
43. Basically, the relationship that the bank holds is as a distributing agent for the settlors-principals. See SEAVEY, AGENCY §10(c) (1964).

the case would not have been affected, but that possible future litigation over the matter could be deterred.

It is also conceded that the apparent passiveness of the trust is not clear cut. The authorities and courts are in dispute as to the conditions necessary to declare a trust dry or passive. Bogert's definition is as follows: "If title is vested in one as trustee for another, but the settlor prescribes no duties as to management and distribution of benefits to the beneficiaries, the trust is called passive because of the lack of any stated affirmative duties of administration."[44] The *McGinnis* trust seems to conform to this definition since no active duties of administration were prescribed for the trustee. The trustee did have to collect the proceeds and pay them out, but collection seemed to be a matter of merely receiving checks from the settlors and distribution would be a necessary function of a trust either active or passive, or even in an agency relationship. Nothing contained in the *McGinnis* trust would seem to lend itself to the phrase "affirmative duties of administration."

The rules regarding active and passive trusts developed out of the Statute of Uses,[45] and if passive trusts or use estates were conveyed, the statute would execute the use and transfer the legal estate from the *feoffee to uses* (trustee) to the *cestui que use* (beneficiary). The trust or use was terminated automatically and the legal and equitable interest merged. According to Bogert, when a trust is established where the settlor's only intent and purpose is to benefit the beneficiary, and no active or real duties are imposed upon the trustee, then there is no reason or purpose for a trust to exist and it may be terminated at will.[46]

Several cases are in point, and while they do not represent unanimity by any means, they are persuasive. The Supreme Judicial Court of Maine declared a trust to be passive, dry and simple when decedent conveyed property to his brother, in trust, the income to go to his children in equal proportions.[47] Here there was no direction for corpus distribution, management, investment, payment of charges, nor as to when the income should be paid; hence, the court found no reason to keep legal title in the trustee, calling him a simple depository of title, and executed the use.[48] A New York case was directly in point holding that where a trustee was merely an intermediary to collect income and transfer it to the beneficiaries, the trust was passive and was terminated.[49]

Since Wyoming has no case on the point, it may be presumed that the courts would adopt the common law rule as stated earlier under authority of

44. BOGERT, *supra* note 29, at §45.
45. SIMES & SMITH, *supra* note 32, at §1391.
46. 1A BOGERT, TRUSTS AND TRUSTEES §206 (1955).
47. Dixon v. Dixon, 123 Me. 470, 124 A. 198 (1924). Note, however, that Scott, in his treatise on Trusts, states that under similar situations the trust would be active. 1 SCOTT, TRUSTS §69 (2d ed. 1956).
48. *Dixon, supra* note 48, at 200.
49. Petition of Bankers Trust Co., 108 N.Y.S.2d 213 (Sup. Ct. 1951). See N. Y. REAL PROP. LAW §93 (McKinney 1960).

the Wyoming statutes.[50] In doing so, the *McGinnis* court could have held that that the use held by the bank would be executed, vesting legal and beneficial title in the beneficiaries, thus terminating the trust.

Although an infinite number of problems in the area of trusts still lack substantive law by which to determine them, *McGinnis v. McGinnis* is certainly a landmark case in Wyoming and should provide a very helpful basis upon which attorneys can predict common law answers to trust questions.

Steve Gehring

50. WYO. STAT., §8-17 (1957). *Adoption of Common Law.—The common law of England* as modified by judicial decision, so far as the same is of a general nature and not inapplicable, and all declaratory or remedial acts or statutes made in aid of, or to supply the defects of the common law prior to the fourth year of James the First . . . and which are of a general nature and not local to England, shall be the rule of decision in this state when not inconsistent with the laws thereof, and shall be considered as of full force, until repealed by legislative authority.