ESTATE CORPORATIONS

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The term "estate corporations" is not yet familiar to the vocabulary of law because the problems implicit in that phrase are still in embryonic stage. Here it will be used to include (1) any close corporation, a controlling interest in which is held by executors or testamentary trustees, and (2) any corporation organized by executors or trustees pursuant to testamentary direction for the purpose of taking over a decedent's business or his investment holdings. What gives the subject special interest is the circumstance that it lies on the borderline between the law of corporations and the law of testamentary trusts. Because of this Janus-like position, the topic has presented peculiar difficulties to the courts. The answer to every dilemma regarding estate corporations involves to some degree a preliminary selection of the avenue of approach. It will be seen, moreover, that most of the conflicts existing in the jurisprudence can be traced back to this initial difficulty of choice.

As usual, when such a bivalence is inescapable, the solution of any particular problem will ultimately depend upon considerations of expediency. The field is as yet too new to disclose a high degree of judicial self-consciousness, but it may safely be predicted that over a period of years and after considerable dogmatizing and oscillation, a body of law will generate on utilitarian principles. Most of the cases have arisen in New York, possibly because of the widespread use of estate corporations in that jurisdiction. There is, however, nothing peculiarly local in the nature of the problem, and during the last decade courts in other states have begun, Laocoön-like, to struggle with it. In this contest an incisive realism will prove the most effective weapon.

Estate corporations have proven an exceedingly popular device for the administration and distribution of large business and investment holdings. Their advantages are manifest: ease of administration, limitation of liability, simplicity in dealing with third parties, continuity of management, avoidance of partition, ease of distribution and facility of family collaboration. The primary purpose of an estate corporation is therefore to divorce the administration of a business or of investments from the inhibitions and confinements of ordinary trusteeship. Just how far that purpose can be realized is the nub of the instant problem.

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I

A testator may validly direct by his will that his executors form a corporation and transfer to it his investment holdings or his business in exchange for the capital stock.[1] The will may further direct the mode of distribution of the capital stock either by outright bequest or by retention in trust. The rule against perpetuities is not violated by such direction because the mere conversion or change in the form of decedent's property is not regarded as a suspension of alienability or postponement of vesting. The preliminary acts necessary to effectuate the testator's wishes are viewed for this purpose as though instantaneously performed.[2]

Where discretion is accorded to the executors to form one or more corporations as they may see fit, they should consider the desirability of segregating certain classes of assets. For instance, it would be the part of prudence to form a separate corporation for decedent's business, and possibly to form separate corporations for specific parcels of real estate where liability might accrue under a mortgage or otherwise. The practical value of these steps is obvious, but no final decision should be reached without giving thought to the provisions of the Revenue Act of 1937 bearing upon personal holding corporations.[3]

The major problems in this field are created when a controlling stock interest in the estate corporation is retained in the hands of testamentary trustees. What constitutes control cannot be categorically stated. Generally the courts consider a fifty per cent stock ownership sufficient for that purpose. In determining the question, it is customary to take into account any securities held by the trustee in his individual capacity which may, in combination with his holdings as trustee, constitute a practical voting majority.[4]

Wherever the trustees have a working control of the estate corporation, it seems their duty to obtain representation on the board of directors and to supervise diligently the administration of the corporate affairs. Common sense requires that this duty be reasonably delegable. Once a trustee as-

1. Palmer v. Neely, 162 Ga. 767, 135 S. E. 90 (1926) (decided under statute); Boyle v. Boyle & Co., 136 App. Div. 367, 120 N. Y. Supp. 1048 (2d Dep't, 1910), *aff'd*, 200 N. Y. 597, 94 N. E. 1092 (1911); Matter of Juilliard, 238 N. Y. 499, 144 N. E. 772 (1924); Matter of Noll, 157 Misc. 73, 283 N. Y. Supp. 721 (Surr. Ct. 1935), *aff'd, but modified on minor point*, 273 N. Y. 219, 7 N. E. (2d) 108 (1937); *In re* Pittock, 102 Ore. 159, 199 Pac. 623 (1921). See *In re* Scott's Estate, 280 Pa. 9, 13, 124 Atl. 270, 271 (1924). In the absence of such authority or of the consent of all interested parties, the executor may not take such action. Heap v. Heap, 258 Mich. 250, 242 N. W. 252 (1932); Garesche v. Levering Inv. Co., 146 Mo. 436, 48 S. W. 653 (1898); Matter of Wyckoff, N. Y. L. J., Dec. 12, 1936, p. 2161, col. 3 (Surr. Ct.); Matter of Doelger, 164 Misc. 590 (Surr. Ct. 1937).

2. Matter of Juilliard, 238 N. Y. 499, 144 N. E. 772 (1924); Matter of Noll, 157 Misc. 73, 283 N. Y. Supp. 721 (Surr. Ct. 1935), *aff'd*, 273 N. Y. 219, 7 N. E. (2d) 108 (1937).

3. Pub. L. No. 377, 75th Cong., 1st Sess. (Aug. 26, 1937) titles I, II.

4. Pyle v. Pyle, 137 App. Div. 568, 122 N. Y. Supp. 256 (1st Dep't, 1910); Matter of Auditore, 249 N. Y. 335, 164 N. E. 242 (1928), *remitted for further hearing*, 136 Misc. 664, 240 N. Y. Supp. 502 (Surr. Ct. 1930); Matter of Kirkman, 143 Misc. 342, 256 N. Y. Supp. 495 (Surr. Ct. 1932); Matter of Witkind, N. Y. L. J., April 30, 1937, p. 2161, col. 6 (Surr. Ct.).

sumes his functions as director or officer, he may become subject to a divided loyalty. The general business interests of the corporation and the desires of its outside stockholders may point to more speculative enterprises. In such case, it remains the duty of the trustee-director to adhere to that standard of conservatism and prudence which the interests of his trust demand. A distinction may be made where the trustee, by reason of his own stockholdings or otherwise, had been a director of the corporation prior to his appointment as trustee.[5]

The duties of the trustee as stockholder are not confined to the mere receipt of dividends. He must keep himself informed of the state of corporate affairs, and if for any reason the investment held by him is imperiled, he must take diligent steps to safeguard it. His remedies are the same as those of any other stockholder, e. g., stockholder's action, voting for dissolution, etc., except that he may additionally resort to the court having jurisdiction over the trust for the removal of any co-trustee whose participation in the corporate affairs has proven dishonest or wasteful.[6]

II

The foregoing principles are implemented by the accountability of the trustee. It is well established that where a trustee holds a working control of the stock in an estate corporation he is accountable in the probate court for the administration of the corporate affairs. His cestuis que trustent may require him to treat the corporate transactions as though they were his own transactions as trustee.[7] An exception has been made where disclosure of the corporate affairs will probably injure the rights of other stockholders and where the directors did not derive their office from their stockholdings as trustees.[8]

The accountability of the trustee-director is not restricted to a mere disclosure of the corporate administration. If it appears that he is guilty of a breach of trust with respect to the corporate affairs, he may be surcharged by the probate court. This is true even though a judgment has

5. This distinction has been made in other connections. Matter of Ebbets, 149 Misc. 260, 267 N. Y. Supp. 268 (Surr. Ct. 1933); *Re* Lewis, 103 L. T. R. 495 (Ch. 1910).

6. Matter of Auditore, 249 N. Y. 335, 164 N. E. 242 (1928); Matter of Kinreich, 137 Misc. 735, 244 N. Y. Supp. 357 (Surr. Ct. 1930); Matter of Doelger, 164 Misc. 590 (Surr. Ct. 1937); see General Rubber Co. v. Benedict, 215 N. Y. 18, 22, 109 N. E. 96, 97 (1915); *cf.* Matter of Fidelity Loan, Trust & Guar. Co., 23 Misc. 211, 51 N. Y. Supp. 1124 (Surr. Ct. 1898).

7. Farmers' Loan & Trust Co. v. Pierson, 130 Misc. 110, 222 N. Y. Supp. 532 (Surr. Ct. 1927); Matter of Auditore, 249 N. Y. 335, 164 N. E. 242 (1928); Matter of Greenberg, 149 Misc. 275, 267 N. Y. Supp. 384 (Surr. Ct. 1933); Matter of Markowitz, 152 Misc. 1, 272 N. Y. Supp. 462 (Surr. Ct. 1934); Matter of Steinberg, 153 Misc. 339, 274 N. Y. Supp. 914 (Surr. Ct. 1934).

8. Matter of Ebbets, 149 Misc. 260, 267 N. Y. Supp. 268 (Surr. Ct. 1933); see Matter of Witkind, N. Y. L. J., April 30, 1937, p. 2161, col. 6 (Surr. Ct.).

already been recovered against him on behalf of the corporation. The rights of action are independent and arise out of separate and distinct duties.[9]

The measure of damages in determining the surcharge is the extent of impairment in the value of the estate's stockholdings. Assuming, therefore, a completed transaction in which the loss to the corporation has been liquidated, the surcharge will be that proportion of the loss which the estate's shares bear to the entire outstanding stock.[10] It is believed, however, that in special cases the surcharge will be larger, as where indirect impairment of the estate's investment may be made to appear over and above the immediate consequences of the breach of the trust.

There is an irreconcilable conflict in the cases as to the extent to which the probate court will inject itself into the internal administration of the corporation. This conflict largely parallels the discordance on the subject in general equity jurisprudence. Broadly speaking, the probate court will not, even upon the application of the trustee-directors, instruct or sanction in advance a proposed business transaction.[11] If, however, the proposed transaction appears to the court to exceed the powers of the trustee-directors, or to involve a breach of trust, the court will intervene.[12]

This problem may arise in a variety of connections. In a recent case [13] the testator had during his lifetime formed a real estate holding corporation and, for the customary motives, had set up his capital investment on its books as an indebtedness to himself. The entire stock of this corporation constituted part of the corpus of a testamentary trust for the benefit of testator's mother and sister, to whom income was to be paid during their lives. The remainder in fee was bequeathed to testator's widow and other relatives. The trustee-directors proceeded to use the earnings of the corporation to reduce the debt owed by it to the trust corpus. The consequence of this procedure was to enlarge the capital of the estate at the expense of the income beneficiaries. The court, after holding that this procedure effected by indirection an unlawful accumulation,[14] intervened in the corporate affairs to the extent of prohibiting the same and requiring the dis-

9. Matter of Auditore, 249 N. Y. 335, 164 N. E. 242 (1928), *remitted for further hearing*, 136 Misc. 664, 240 N. Y. Supp. 502 (Surr. Ct. 1930); Matter of Boyle, 140 Misc. 523, 251 N. Y. Supp. 197 (Surr. Ct. 1931); see Note (1929) 38 YALE L. J. 965.

10. Matter of Auditore, 249 N. Y. 335, 164 N. E. 242 (1928), *remitted for further hearing*, 136 Misc. 664, 240 N. Y. Supp. 502 (Surr. Ct. 1930); Pyle v. Pyle, 137 App. Div. 568, 122 N. Y. Supp. 256 (1st Dep't, 1910) *semble*.

11. Matter of Pulitzer, 139 Misc. 575, 249 N. Y. Supp. 87 (Surr. Ct. 1931).

12. Matter of McLaughlin, 164 Misc. 539 (Surr. Ct. 1937); Matter of Adler, *id.* at 544 (Surr. Ct. 1937); Matter of Doelger, *id.* at 590 (Surr. Ct. 1937).

13. Matter of Adler, *id.* at 544 (Surr. Ct. 1937).

14. Since the "accumulation" was not the result of an express or implied direction of the will, it was probably not within the statutory prohibition. CHAPLIN, SUSPENSION OF THE POWER OF ALIENATION (3d ed. 1928) § 255 and cases cited. See the reference in Matter of McLaughlin, 164 Misc. 539 (Surr. Ct. 1937). The result, however, is correct on the other ground stated.

tribution of net earnings as income. The testamentary scheme was thereby preserved from emasculation.

A direction in the will requiring the trustees to vote the stock of an estate corporation in a specific manner, as for the election of designated directors, is binding on the trustees and will be enforced by the probate court.[15] A testamentary direction as to the manner in which the directors may exercise their power to sell corporate property will also warrant judicial intervention,[16] as will any contemplated violation of testamentary restrictions upon the field of investments which the corporation may make.[17]

In cases of this type, the corporation is regarded as a mere "instrumentality of administration", and although there is much talk as to whether or not the corporate fiction should be disregarded, the essence of the matter is that the trustees simply respond to the personal jurisdiction of the court in which they qualify. The trend is toward an enlargement of the visitatorial functions of that court.[18]

The wisdom of this trend may well be called into question. We have already pointed out that the utility of the estate corporation arises out of its strictly corporate features. Its separateness as a legal entity produces numerous valuable by-products. True, not all of these are impaired by judicial intervention and supervision. For instance, incorporation may nonetheless prove a valuable device to simplify distribution and avert partition. But in the administration of large businesses and property holdings it must be apparent that judicial interference may, by imposing an impractical and inflexible standard, work havoc. So too, it may be argued that the same considerations of modesty which have prompted chancery courts in general to leave the determination of corporate questions to those better versed in the specific business involved might well actuate probate courts to decline jurisdiction except in palpably urgent cases.[19]

III

The familiar principles governing a trustee's dealings with his cestuis or with the trust res have been extended to dealings of a trustee-director with the estate corporation. The trustee-director is accountable for any profits arising out of such dealings and may be removed if he employs his fiduciary office to his own advantage.[20]

15. Elger v. Boyle, 69 Misc. 273, 126 N. Y. Supp. 946 (Sup. Ct. 1910).
16. Farmers' Loan & Trust Co. v. Pierson, 130 Misc. 110, 222 N. Y. Supp. 532 (Sup. Ct. 1927).
17. Matter of Doelger, 164 Misc. 590 (Surr. Ct. 1937).
18. See cases cited *supra* notes 12, 16; Pound, *Visitatorial Jurisdiction Over Corporations in Equity* (1936) 49 HARV. L. REV. 369.
19. See Boyle v. Boyle & Co., 136 App. Div. 367, 120 N. Y. Supp. 1048 (2d Dep't, 1910), *aff'd*, 200 N. Y. 597, 94 N. E. 1092 (1911).
20. Elias v. Schweyer, 13 App. Div. 336, 43 N. Y. Supp. 55 (1st Dep't, 1897); Matter of Hirsch (No. 1), 116 App. Div. 367, 101 N. Y. Supp. 893 (1st Dep't, 1906), *aff'd*, 188 N. Y.

A more difficult ramification of this rule arises as to the taking of salaries. A trustee holding stock in an estate corporation may be called upon as director or officer to render extensive services which would ordinarily be compensable by the corporation. These services in many instances are of substantial value to stockholders who are not interested in the trust. The customary commissions for trusteeship, whether fixed by statute or by rule of court, will generally prove inadequate in such case.

Largely because of an excessively academic approach, the courts have found grave difficulty in disposing of this question. They have analyzed it in terms of precedents governing trustees' compensation for extraordinary services. In several instances they have subsumed the salary question to the general rule against obtaining secret profits. The consequence is a line of decisions which brand the taking of salaries (unless specifically authorized in the will) as a breach of trust.[21]

There is a justification for this point of view. One or two courts have been realistic enough to appreciate that a trustee who obtains a corporate salary will be loath to dispose of the trust's investment in the corporation when an advantageous opportunity offers itself.[22] It is submitted, however, that that very accurate surmise should not prove a bar to the payment of reasonable salaries. It should simply be taken into account in judging the prudence and fidelity with which the trustee has acted in retaining the corporate stock.

To a large degree the salary question should be determined upon the facts of the individual case. If the estate corporation was one formed by the decedent, a partial guide may be found in the decedent's own course of conduct as to payment of salaries. In some instances there is not sufficient extraneous work to justify going beyond the statutory commissions. By and large, however, a trustee qua director or officer will be called upon to render extensive services, and if the work is to be thoroughly and conscientiously done the corporation must be ready to pay a fair price therefor.[23] Otherwise the cestuis que trustent will lose in earnings much more than they may save in unpaid salaries.

584, 81 N. E. 1165 (1907); Matter of Grossman, 157 Misc. 164, 283 N. Y. Supp. 323 (Surr. Ct. 1935); Matter of Beck, N. Y. L. J., Dec. 17, 1936, p. 2253, col. 2 (Surr. Ct.). See *In re* Estate of Evans, 212 Iowa 1, 232 N. W. 72 (1931); *In re* Johnson's Estate, 187 Wash. 552, 60 P. (2d) 271 (1936).

21. Matter of Hirsch (No. 1), 116 App. Div. 367, 101 N. Y. Supp. 893 (1st Dep't, 1906), *aff'd*, 188 N. Y. 584, 81 N. E. 1165 (1907); Pyle v. Pyle, 137 App. Div. 568, 122 N. Y. Supp. 256 (1st Dep't, 1910); Matter of Kinreich, 137 Misc. 735, 244 N. Y. Supp. 357 (Surr. Ct. 1930); Matter of Kirkman, 143 Misc. 342, 256 N. Y. Supp. 495 (Surr. Ct. 1932); Matter of Grossman, 157 Misc. 164, 283 N. Y. Supp. 323 (Surr. Ct. 1935); see Matter of Stulman, 146 Misc. 861, 872, 263 N. Y. Supp. 197, 211 (Surr. Ct. 1933), 99 A. L. R. 963 (1935).

22. Elias v. Schweyer, 13 App. Div. 336, 43 N. Y. Supp. 55 (1st Dep't, 1897); Matter of Fidelity Loan Co., 23 Misc. 211, 51 N. Y. Supp. 1124 (Surr. Ct. 1898).

23. Lawrence v. Garner, 48 Hun 618, 1 N. Y. Supp. 534 (Sup. Ct. 1888); Matter of Gerbereux, 148 Misc. 461, 470, 266 N. Y. Supp. 134, 145 (Surr. Ct. 1933); Lafferty's Estate, 2 Pa. Dist. 215 (Orph. Ct. 1893); Estate of Peabody, 218 Wis. 541, 260 N. W. 444 (1935);

Distinction is often made between the trustee who prior to decedent's death had already enjoyed some connection with the corporation and the trustee who by means of his fiduciary holdings "injected" himself into the corporate management.[24] This distinction is hardly tenable, since it overlooks the duty of the diligent trustee to participate actively in the affairs of the estate corporation. If he is legally bound to participate, he should (in the absence of testamentary prohibition) assume an executive role and be fairly compensated therefor. His conduct in using his stock control to vote himself a salary should be evaluated in terms of reasonableness and the worth of the duties which he is called upon to perform. This should follow wherever the trust has a working control of the corporation, and no distinction should be made between fifty per cent and one hundred per cent stock ownership. It is not important whether third parties benefit from the trustee's services, as they will where the trust holds less than all of the stock. The true criterion is whether the trustee is called upon to safeguard the shares which he holds, and whether, in doing so, he must render services not within the contemplation of ordinary commissions.

The foregoing analysis eliminates such theoretic niceties as the propriety of disregarding the corporate fiction. The question is fundamentally one of business, and must ultimately be resolved in terms of fair commercial practice.

IV

We have been considering various facets of a single problem, to wit: whether an estate corporation is to be treated as a distinct entity or as a mere "instrumentality of administration". The same difficulties which presented themselves as to other topics have arisen with regard to the determination of what constitutes principal and income. If the estate corporation is viewed as a mere transparent form, its net earnings (to the extent of the stock held) constitute income and must be distributed as such. If, on the other hand, the corporation is held to be entirely divorced from rules of trusteeship, the beneficiary of income can look only to dividends declared and paid by it.

Three interesting ramifications of this problem are worthy of special comment. In *Boyle v. John Boyle & Co.*[25] the testator had directed his executors and trustees to transfer his business to a corporation to be formed, and to hold the stock of the corporation in trust for the benefit of his wife. The corporation at first operated successfully but later failed to pay divi-

In re Dover Coalfield Extension, [1907] 2 Ch. 76, *aff'd*, [1908] 1 Ch. 65; *Re* Lewis, 103 L. T. R. 495, 497 (Ch. 1910); RESTATEMENT, TRUSTS (1935) § 170, comment *n*. See Matter of Schlesinger, 143 Misc. 275, 256 N. Y. Supp. 381 (Surr. Ct. 1932).

24. E. g., Matter of Berri, 130 Misc. 527, 224 N. Y. Supp. 466 (Surr. Ct. 1927).

25. 136 App. Div. 367, 120 N. Y. Supp. 1048 (2d Dep't, 1910), *aff'd*, 200 N. Y. 597, 94 N. E. 1092 (1911).

dends, the directors electing to set up substantial reserves. Certain of the trustees then sued for the return of the corporate property on the ground that it was still impressed with the testamentary trust. The court dismissed the suit, holding that the property had passed to the corporation and was free of the trust; that the rights and powers of the corporate directorate were determined by the law of corporations and not by testator's will, and that the uncertainties attending the situation indicated that the court could not beneficially assume the duties of the directors in passing upon the desirability of reserves. What is most important in this case is, of course, the holding that an estate corporation may set up out of income proper reserves for contingencies, a valuable right which is denied to trustees.

In *Matter of Langdon* [26] the trustees held all of the stock of a real estate holding corporation organized by the testator during his lifetime. After his death certain profits were realized upon the sale of parcels of realty. Dividends were declared and the trustees applied to the court for instructions as to the allocation thereof between principal and income. The profits had been realized upon sales of real property held by the corporation long before decedent's death. The remaindermen contended that the corporate form should be disregarded and the allocation made as though the testator had died owning the real property. In such case, on familiar principles, the entire profit would be allocated to principal. But the court held otherwise, and directed that the dividends should be apportioned between principal and income in the same manner as any similar corporate dividend. It pointed out that the testator, in forming the corporation and in bequeathing its stock, must have had in mind the advantages of such a method in the administration of its holdings and the distribution of the estate assets. The thought underlying this decision is not that the corporate form may not be disregarded, but rather that the testamentary scheme could be more perfectly effectuated by respecting it.

In the third case, *Matter of McLaughlin,*[27] the question took a different aspect. The directors of an estate corporation were using the earnings to pay the corporation's indebtedness to decedent's estate. They were thereby building up principal while starving out the beneficiaries of income. The court insisted upon its power to supervise the corporate affairs, directed the reversal of what had been done, and further required the trustees to effect the dissolution of the corporation. Here too, the implicit gravamen of the decision was the desire to preserve and validate the testamentary scheme. Whether the court was justified in directing dissolution of the corporation is not equally clear. In the instant case the trustee raised no objection

26. 139 Misc. 379, 248 N. Y. Supp. 146 (Surr. Ct. 1931).

27. 164 Misc. 539 (Surr. Ct. 1937). As to dividends of an estate corporation whose assets are of a wasting nature, see Oliver's Estate, 136 Pa. 43, 20 Atl. 527 (1890), and cases collected in Matter of Hilliard, N. Y. L. J., Oct. 14, 1937, p. 1149, col. 6 (Surr. Ct.).

thereto. The effect of dissolution was, however, to surrender the advantages incident to the corporate device. The retention of these advantages may itself be considered an integral part of the testamentary scheme.

The directors, in passing upon the declaration of dividends, are therefore confronted with dual criteria. They must respect the testamentary scheme, but in doing so they can avail themselves of certain enlarged rights accorded by the law of corporations. Their problem is further complicated by the provisions of the Revenue Act of 1936, under which capital gains may constitute part of the corporate income for tax purposes.[28] If the corporate income, including capital gains, is fully distributed, an apportionment of the dividend will be necessary, and part of the corporate property will thus pass into the principal of the trust. If the capital gains are not distributed, the trustees may be surchargeable for wasting the amount of tax thus incurred. Of course the director of any corporation may be accused of waste if he invites an increase in taxes by unreasonable failure to declare dividends. But in the case of an estate corporation the duty is heightened by the admonitions contained in the will. The function of an estate corporation is not to build up equity but to preserve a productive asset intact. Consequently, although trustee-directors have the power to establish suitable reserves out of income, they should exercise that power with considerable caution.

This much is clear—that the income of the corporation is not income of the trust. It may become income of the trust upon the declaration of dividends. Even when that takes place, the dividends paid may be required to be apportioned between principal and income. The most that can be said on the part of those who contend for the disregard of the corporate entity is that the trustee-directors may be instructed to declare dividends where failure to do so would render the testamentary scheme nugatory. In essence this is simply a particular and somewhat intensified application of the general rule that directors may not arbitrarily refuse to declare dividends.

V

The necessity of a pragmatic approach becomes even more important when the rights of third parties vis-à-vis the estate corporation arise. It is manifest that adjustments of great delicacy must be made to preserve an equitable balance in the triad consisting of the estate corporation, the cestuis que trustent and the third parties. The function of a third party (1) as stockholder, and (2) as creditor, will be considered.

The role of a third party as stockholder in an estate corporation may prove an unhappy one. We have defined an estate corporation as one in which the control resides in the trustee, taking into account both his indi-

28. 49 STAT. 1678, 26 U. S. C. A. § 112 (Supp. 1936).

vidual and his trust holdings. The outside stockholder is therefore presumptively in a minority position. His status is further impaired by the division of loyalty of those in control of the corporation. The directorate are confined by their trust obligations and in many instances by express testamentary inhibitions. The outside stockholder who enjoys none of the benefits of the trust may thus find his own investment restricted or jeopardized by its terms. The directors may refuse to reduce the capital indebtedness or to renovate corporate realty or to establish ample reserves, all because their duties to the trust cut across the line of free action as directors.

What are the rights of the outside stockholder in such a case? It would seem that wherever he can be charged with having made his investment after knowledge of the peculiar circumstances affecting the corporation, he cannot complain. The corporation in such instance has been likened to one created by special statute, having limited privileges and powers.[29] Notice of such limitations may be contained in the corporate charter, the by-laws, or the very title of the company. Where, however, there is nothing in the charter, by-laws, or style of the corporation to indicate that it is an estate corporation, it would seem that the vendor should be under a duty to disclose this pertinent element.

The outside stockholder's predicament may, however, arise in a different manner. He may have owned his shares during the decedent's lifetime and before the corporation was converted by the will into testamentary control. In such case it does not appear that the outside stockholder could compel the trustee-directors to violate the terms of their trust. It is possible, however, that he could obtain a decree directing either the dissolution of the corporation or, where local statutes permit, assessment of the value of his shares and the retirement thereof.

It may be contended that the conversion of the corporation into an estate corporation (effected by the will of the majority stockholder) is tantamount to such amendment of the corporate by-laws or charter as any majority stockholder might bring about during his lifetime. On the other hand, amendment of the charter or by-laws usually requires a much more substantial majority interest than is effective to convert the company into an estate corporation. Moreover, the changes in the administration of corporate affairs so effected are not such changes as are ordinarily the subject of amendments to the charter or by-laws. The essence of the entity is transformed.

The courts have never been particularly sympathetic with the predicament of a minority stockholder in a close corporation. In the absence of proof of fraud or waste he is usually remediless. Where, however, he can show that the action of the directorate will inevitably subserve loyalties in

29. Matter of Doelger, 164 Misc. 590 (Surr. Ct. 1937).

which he has no interest (that is to say, loyalties to the trust), and where the testamentary inhibitions are sufficiently substantial to transmute the corporate business, equity may extend its arm to enable him to withdraw. No authority for this position has been found.

Familiar chancery principles should govern the rights of creditors in their relation to the estate and to the estate corporation. The corporate entity will not be disregarded where both it and the estate become insolvent and the rights of creditors of both entities are involved.[30] Where because of the solvency of both the estate and the corporation no practical harm can be done, there has been some judicial cutting across fields. In *Matter of Daly*[31] the surrogate allowed an attorney to recover from the estate for services rendered to the estate corporation. And in *Matter of Auditore*[32] the court required attorneys to refund a payment made by the estate where they had misrepresented the amounts theretofore received by them from the estate corporation, stating that the estate could adjust the refund with the corporation.

There is some peril in this over-simplification. True, the remedies in the probate court are invitingly simpler than those at law. But there is always the possibility of overlooking the rights of creditors and lienors who are not before the court or who have contingent or unliquidated claims. It is therefore the part of wisdom, even where both the estate and the corporation are solvent, to remit the creditors of each to their respective obligors.

VI

A very recent case, *Matter of Doelger*,[33] suggests an unexplored area in the law of estate corporations. That is the question of the scope of corporate powers and the extent to which trustee-directors may exercise them. As has been indicated, restraints and inhibitions not in conflict with the mandatory law of the state may be validly imposed by the testator upon the trustee-directors. He may admonish them how to conduct the corporate business, how to vote the corporate stock, how to compensate themselves and others, etc. These directions are effectual through the medium of chancery jurisdiction over the fiduciaries in their capacity as trustees. If the testamentary directions are embodied in the corporate charter or by-laws, it would seem that even a stockholder who was a stranger to the

30. See Matter of Richman, 142 Misc. 103, 107, 253 N. Y. Supp. 838, 843 (Surr. Ct. 1931).

31. 158 Misc. 659, 287 N. Y. Supp. 957 (Surr. Ct. 1935), *aff'd*, 246 App. Div. 759, 283 N. Y. Supp. 929 (2d Dep't, 1935); *cf.* Matter of Steeby, 143 Ore. 501, 20 P. (2d) 1080 (1933); Hake v. Dilworth, 96 S. W. (2d) 121 (Tex. Civ. App. 1936).

32. N. Y. L. J., June 9, 1937, p. 2910, col. 6 (Surr. Ct.).

33. 164 Misc. 590 (Surr. Ct. 1937).

trust could enforce compliance therewith. In any event, express or implied testamentary directions remain efficacious without any theoretic necessity of piercing the corporate veil.

The difficult question here is what restraints, if any, are implied where the will is silent. A simple example will suffice to illustrate. Testator has owned during his lifetime all the stock of a business corporation the sole asset of which is a residential property which he had bought for investment. Stock of this corporation forms part of his residuary trust. The corporate charter contains the customary extensive powers, far more extensive than the uses of the corporation during testator's lifetime. Can the trustee-directors of this estate corporation sell the real property and employ the proceeds to engage in the diamond business?

Attention should be called to another possible development. The testator, through a business corporation, had sold ladies' dresses. The stock of this corporation forms part of his residuary trust. Have trustee-directors the right to extend the business to a more expensive line of dresses? To sale of dresses on the instalment plan? To sale of millinery? In short, have the trustee-directors the right to enlarge the corporate activities, either in allied or in radically different channels?

We have assumed that the will is silent on the question. If the court finds express or implied testamentary direction as to the scope of the business, it will not permit that scope to be radically modified. Where, however, the will is silent, the court will be called upon to decide whether the corporate charter, with its extensive powers, constitutes a carte blanche to the trustee-directors.

It has been submitted throughout this article that the dominant criterion of the action of the trustee-directors is respect for the testamentary scheme. If that path of approach is correct, then we may postulate an implied intent that the corporation confine itself to the bounds of operation delimited during testator's lifetime. If, therefore, decedent has employed his or the corporate property in a specific business, he has impliedly directed that it continue in that business. The extension into contiguous fields should not be undertaken unless the maintenance of the business on a profitable basis necessitates such action. Even then, trustees would find it the part of wisdom to seek instructions of the probate court. Radical modification of the purposes of the corporation should not be sanctioned unless express or implied authority therefor can be found in the will or in surrounding circumstances.[34] An attempt to validate an unauthorized departure in the corporate activities by amending the charter or by-laws will be ineffective.[35] The trustees cannot lift themselves by their own boot-straps.

34. Matter of Rowland, 273 N. Y. 100, 6 N. E. (2d) 393 (1937).
35. Matter of Doelger, 164 Misc. 590 (Surr. Ct. 1937).

If the estate corporation holds several parcels of real propery (non-legal investments) and sells one of them, may the directors acquire another parcel in its stead? Assuming again that the will is silent as to investments and therefore, on familiar principles, restricts the *trustees* as such to the purchase of legal investments, on the reasoning just advanced the conclusion is that the directors may make new investments of the same general category as those liquidated. The silence of the will is at once a prohibition of change and a sanction of continuance.[36]

In conclusion, emphasis should once more be placed upon the peculiar advantages of the estate corporation.[37] It serves as a very necessary bridge over the deep ravine of probate administration, a bridge to which draftsmen of wills should give intensive study. And courts will do well not to undermine the supports thereof. If that bridge is viewed as an avenue of convenient transmission, the judicial function will properly be limited to keeping the trust res on the prescribed path.[38]

36. See Matter of Guglielmi, 138 Cal. App. 80, 31 P. (2d) 1078 (1934); Matter of Stulman, 146 Misc. 861, 263 N. Y. Supp. 197 (Surr. Ct. 1933); Matter of Steeby, 143 Ore. 501, 20 P. (2d) 1080 (1933). Where, however, there is no testamentary trust and the proceeds of the estate corporation shares are needed to pay general legacies, the executors must liquidate promptly and will be surcharged for losses arising out of their failure to do so. Matter of Kinreich, 137 Misc. 735, 244 N. Y. Supp. 357 (Surr. Ct. 1930).

37. See Matter of Langdon, 139 Misc. 379, 383, 248 N. Y. Supp. 146, 150 (Surr. Ct. 1931).

38. Most of the complexities as to salaries, dividends, investments, etc. can be obviated by good craftsmanship in the drawing of wills. The initiative in inquiry must be taken by the attorney; lay testators will not perceive the existence of any testamentary problem. The reader hereof will observe how many of the cases cited are of very recent date.