**Buffalo Law Review**

Volume 14 | Number 2 Article 13

12-1-1964

# Decedents Estates and Trusts—The Income Beneficiary of One Trust Which Shares Ownership in a Corporation with Another Trust Found to Be an Incidental Beneficiary of the Latter Trust with No Standing to Enforce Its Provisions

John T. O'Mara

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Recommended Citation

John T. O'Mara, *Decedents Estates and Trusts—The Income Beneficiary of One Trust Which Shares Ownership in a Corporation with Another Trust Found to Be an Incidental Beneficiary of the Latter Trust with No Standing to Enforce Its Provisions*, 14 Buff. L. Rev. 307 (1964).

Available at: https://digitalcommons.law.buffalo.edu/buffalolawreview/vol14/iss2/13

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interpretation of New York's Constitution. Nor did they answer the inability of the legislature to take away one's jury rights by authorizing an equity court to take jurisdiction of an action previously triable at law. Other proceedings[41] in Surrogate's Court directing payment of a sum of money without jury trial as of right are distinguishable in that they arose after the estate was placed in the hands of this court. The instant holding does not mean that the new revision is invalid as Judge Burke feared. Although there is no express provision for trial by jury, the discretion given the Surrogate to determine claims does not necessarily exclude juries. A trial by jury can still be obtained as of right under Surrogate's Court Act section 68. Perhaps the only way to achieve speedy, uniform settlement of claims against estates without trial by jury is by constitutional reform.

THOMAS M. WARD

THE INCOME BENEFICIARY OF ONE TRUST WHICH SHARES OWNERSHIP IN A CORPORATION WITH ANOTHER TRUST FOUND TO BE AN INCIDENTAL BENEFICIARY OF THE LATTER TRUST WITH NO STANDING TO ENFORCE ITS PROVISIONS

Vincent and Walter McGuire incorporated a wiping materials company, later known as McGuire Bros. Incorporated, in 1916. Each owned one-half of the stock. Later they incorporated Walvin, a real estate holding company. Again, they owned the stock equally between them. Until the death of Vincent in 1936 they operated the two corporations successfully and harmoniously. By his will, Vincent bequeathed his 50 per cent ownership in each of the two corporations in the following manner: he placed 49 per cent of his ownership in each into a trust, naming his wife as income beneficiary; the remaining one per cent he willed to his brother Walter in order to secure in him controlling interest in the two corporations. Walter died in 1951 and by his will placed his controlling interest in each corporation in another trust. Thus the deaths of Vincent and Walter resulted in the creation of two trusts. The Vincent trust owning 49 per cent of each corporation and the Walter trust owning 51 per cent. Plaintiff, as testamentary trustee of the minority Vincent trust, brought an action on behalf of his income beneficiary. He sought to compel the defendant, testamentary trustee of the majority Walter trust,[1] to distribute a larger portion of the earnings of each corporation. The plaintiff argued that as a trustee of the majority trust, defendant had duties to both the income beneficiary and the remaindermen of that trust. These duties were said to require equal treatment of each of the two types of beneficiaries and to favor neither. Plaintiff contended that by defendant's failure to declare and distribute larger dividends

41. See note 32 *supra*.

1. The defendant was not sued by virtue of his position as a director of each of the corporations, but rather as a testamentary trustee who controlled the distribution of income to his majority trust's beneficiaries because of his corporate directorship.

he was depriving his majority trust's income beneficiary of monies due her while unlawfully enhancing the interests of his remaindermen. Thus, if plaintiff's contentions were upheld, the result would be increased revenue to the income beneficiary of the majority trust. Such an increase would necessitate the declaration of larger dividends causing more income to inure to the minority trust's income beneficiary. Defendant's motion to dismiss for failure to state a cause of action was denied by New York Supreme Court Special Term; the Appellate Division reversed.[2] On appeal, the Court of Appeals affirmed, Chief Judge Desmond dissenting. The Court held that where a corporation is owned by two trusts, the income beneficiary of one trust has no standing to sue the trustee of the other trust to compel him to distribute income to his trust's income beneficiary. *Cashman v. Petrie,* 14 N.Y.2d 426, 201 N.E.2d 24, 252 N.Y.S.2d 447 (1964).

The fiduciary duties of a testamentary trustee require him to be scrupulously fair to his beneficiaries.[3] The trustee is under a duty to administer the trust for the sole benefit and interest of the beneficiaries,[4] and must not be guided by the interests of any third person.[5] The reason for such a rule is that it is difficult for an individual to act fairly on behalf of two interests in the same transaction.[6] The law fears that consciously or unconsciously a trustee so situated will tend to favor one party or interest over the other, even perhaps by straining to avoid such favoritism.[7] However, as between two "beneficiaries"[8] of the same trust, the trustee must treat them with impartiality, favoring neither the income beneficiary nor the remainderman.[9]

A person is a beneficiary of a trust if the settlor manifests an explicit intention to give him a beneficial interest in the trust.[10] Absent such articulated manifestation, any benefit derived from the performance of the trust is considered incidental and any person claiming such benefit is an incidental beneficiary with no right to enforce the trust.[11] The incidental beneficiaries

2. 19 A.D.2d 520, 240 N.Y.S.2d 46 (1st Dep't 1963).
3. Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).
4. See Matter of Ebbets, 139 Misc. 250, 248 N.Y. Supp. 179 (Surr. Ct. 1931); see also Restatement (Second), Trusts § 170 (1959); 2 Scott, Trusts § 170 (2d ed. 1956).
5. Restatement (Second), Trusts § 170, comment (e) (1959).
6. Bogert, Trusts & Trustees § 543 (2d ed. 1960).
7. *Ibid.*
8. In discussing standing to sue, authorities group both income beneficiary and remaindermen into the broad classification of "beneficiaries."
9. See *In re* Hubbell's Will, 302 N.Y. 246, 197 N.E.2d 888 (1951); 2 Scott, Trusts § 183 (2d ed. 1956).
10. Matter of Rockefeller, 12 N.Y.2d 124, 187 N.E.2d 764, 237 N.Y.S.2d 300 (1962); Restatement (Second), Trusts § 127 (1959).
11. Matter of Niven, 274 App. Div. 843, 80 N.Y.S.2d 660 (4th Dep't 1948), *aff'd,* 299 N.Y. 551, 85 N.E.2d 428 (1949); City Bank Farmers Trust Co. v. MacFadden, 299 N.Y. 711, 87 N.E.2d 124, 70 N.Y.S.2d 559 (1949); Matter of Grube, 162 Misc. 228, 294 N.Y. Supp. 306 (Surr. Ct. 1937), *aff'd,* 251 App. Div. 894, 298 N.Y. Supp. 638 (2d Dep't 1937); Matter of Sill, 41 Misc. 270, 84 N.Y. Supp. 213 (Surr. Ct. 1903). *Cf.* Female Ass'n v. Beekman, 21 Barb. 565 (N.Y. Sup. Ct. 1854) which held a charitable institution not a beneficiary of a trust allowing donations to charity. See also Restatement (Second), Trusts § 126 (1959).

of a trust will not be heard to say that such a trust is being mismanaged. In the eyes of the law such incidental beneficiaries are strangers to the trust.[12] In a leading New York case the trust settlor's wife, unmentioned in trust indentures set up for their children's benefit, was denied standing to enforce a trust provision allowing the trustees to pay the costs of maintaining the family house. It was held that the provision was for the benefit of the children alone and when they ceased to reside in her house, plaintiff had no redress.[13] No case challenging this position has been found.

In the instant case the Court applied the general rule of denying all but the clearly intended beneficiaries standing to enforce a trust. In finding no status as beneficiary of the majority trust the Court stated: "The only legal relationship that exists between plaintiff and these individual defendants is plaintiff's status as a minority stockholder in corporations which the defendants direct."[14] Plaintiff admittedly did not bring this action as a minority stockholder and so was found to have "no standing to enforce the fiduciary obligations to others arising from another trust."[15] The Court stated that if the defendant trustee is violating his fiduciary duty to distribute income to his trust's income beneficiary, it is solely the latter's right to object.[16] The courts have been reluctant to allow the testamentary wishes of the settlor to be enforced or enjoined by a stranger, unless he is acting as legal representative of the beneficiary.[17] The majority reasoned that since the trust was established for the beneficiaries, they alone should have the right to be heard regarding any possible violation of its provisions. However, since plaintiff had carefully alleged mismanagement, the court expressly reserved to plaintiff the chance to bring a minority stockholder's action to compel increased dividends. Chief Judge Desmond, in his dissent, argued that under section 3013 of the CPLR the complaint requires no more than that "statements in a pleading shall be sufficiently particular to give . . . notice of the transactions, occurrences, or series ot transactions or occurrences, intended to be proved and the material elements of each cause of action . . ." Desmond stated that since the complaint ". . . contains all the allegations necessary for a suit [in corporate law] to compel payment of dividends . . . ,"[18] he argued that such allegations, if proven, would make

12. Hall v. Gardiner, 126 F.2d 227 (1942); Steed v. Carmichael, 223 Ala. 193, 134 So. 885 (1931); City Bank Farmers Trust Co. v. MacFadden, 299 N.Y. 711, 87 N.E.2d 124, 70 N.Y.S.2d 559 (1949); Loftin v. Kenan, 250 App. Div. 546, 294 N.Y. Supp. 883 (1st Dep't 1937), *aff'd*, 276 N.Y. 615, 12 N.E.2d 604 (1938); Restatement (Second), Trusts § 200 (1959); 2 Scott, Trusts § 200 (2d ed. 1956).

13. City Bank Farmers Trust Co. v. MacFadden, 299 N.Y. 711, 87 N.E.2d 124, 70 N.Y.S.2d 559 (1949).

14. Instant case at 430, 201 N.E.2d at 26, 252 N.Y.S.2d at 450.

15. *Ibid.*

16. Instant case at 429, 201 N.E.2d at 26, 252 N.Y.S.2d at 449.

17. Female Ass'n v. Beekman, 21 Barb. 565 (N.Y. Sup. Ct. 1854); Town of Sharon v. Simons, 30 Vt. 458 (1857). See Shaw v. Lawless, 7 Eng. Rep. 353, 356 (1837). It is interesting to note that these latter two cases are the sole authority examined at the original drafting of the Restatement, Trusts § 206, now § 200.

18. Instant case at 431, 201 N.E.2d at 26, 252 N.Y.S.2d 450-51.

out a strong case for holding that the piling up of reserves was in bad faith or was an abuse of director's discretion.

The estate corporation, which has been defined as "any close corporation, a controlling interest in which is held by executors or testamentary trustees,"[19] presents unique problems. The subject is of special interest because it involves the policy considerations behind the law of trusts and the law of corporations in a peculiar setting. As was predicted in 1937, "the role of a third party as stockholder in an estate corporation may prove an unhappy one."[20] Trustees of estate corporations have been advised to acquire a directorate in the organization and to supervise diligently the administration of corporate affairs.[21] Thus such a directorate will be bound by its fiduciary trust obligations and at the same time be required to comply with corporate standards of fiduciary duty.[22] The payment of dividends may very satisfactorily fulfill his trust obligations, but nevertheless damage the financial structure of the corporation. The stockholder who finds himself considered a stranger to the trust, is thus likely to have his financial interests controlled by a testamentary provision which he cannot attack. If the stockholder made his investment with knowledge of these peculiar circumstances, the denial of his right to complain does not seem as harsh.[23] When, as in the instant case, the stockholder finds himself thrust into this unenviable position by virtue of a subsequent formation of a trust, with certain of his rights diminished, perhaps equity should afford him relief.[24] Aside from corporate law, he is usually remediless.[25] There are good reasons why, as in the instant case, a plaintiff seeking increased dividends is reluctant to sue under the theory of corporation law. To succeed in compelling increased dividends in corporate law, the plaintiff must prove fraud, dishonesty or bad faith on the part of the directors in establishing the dividend policy.[26] To succeed in establishing a breach of a trustee's obligations much less is required. Poor judgment, carelessness, or even slight personal involvement may be sufficient to enable the plaintiff to succeed in his action.[27] The courts appear

19. Cahn, *Estate Corporations*, 86 U. Pa. L. Rev. 136 (1937).
20. *Id.* at 144. See also O'Neal, Close Corporations, § 8.08 (1958). See generally Note, 64 Harv. L. Rev. 299 (1950).
21. Babcock v. Chicago Ry. Co., 325 Ill. 16, 155 N.E. 773 (1927); Union Trust Co. of Springfield v. Nelen, 283 Mass. 144, 186 N.E. 66 (1933); Shelley v. Creighton, 140 N.J. Eq. 603, 55 A.2d 646 (1947); Commonwealth v. Dalzell, 152 Pa. 217, 25 Atl. 535 (1893).
22. *In re* Hubbell's Will, 302 N.Y. 246, 97 N.E.2d 888 (1951).
23. See Gause v. Commonwealth Trust Co. of New York, 196 N.Y. 134, 154, 89 N.E. 476, 482 (1909).
24. No cases have been found supporting this position. It may be considered that while he may sell his stock, a prospective buyer could well demand a price far below its prior worth in view of its hampered status.
25. Cahn, *Estate Corporations*, 86 U. Pa. L. Rev. 136, 145 (1937).
26. City Bank Farmers Co. v. Hewitt Realty Co., 257 N.Y. 62, 177 N.E. 309 (1931); Liebman v. Auto Strop Co., 241 N.Y. 427, 150 N.E. 505 (1926); Kavanaugh v. Kavanaugh Knitting Co., 226 N.Y. 185, 123 N.E. 148 (1919); Nechis v. Gramatan Gardens, Inc., 35 Misc. 2d 949, 231 N.Y.S.2d 383 (Sup. Ct. 1962); 11 Fletcher, Corporations § 5325 (Rev. ed. 1958). See generally Note, 64 Harv. L. Rev. 299 (1950).
27. See generally Loring, *A Trustee's Handbook* §§ 18-28 (6th ed. 1962) and 2 Scott, Trusts § 170 (2d ed. 1956). *Compare* N.Y. Personal Property Law § 21.

hesitant to substitute their judgment for the judgment of a board of directors, to whom has been delegated dividend policy determination.[28] This places a heavy burden of proof upon the complaining shareholder.[29] Of the many cases brought seeking such relief, it has been granted in relatively few instances.[30] When the directors are protected as trustees interested in their own beneficiaries, and the beneficiaries themselves do not choose to sue to achieve an equitable proportion between the income beneficiaries' dividends and the remaindermen's interests, the third party is at a decided disadvantage. In corporations other than estate, a minority stockholder dissatisfied with dividend policy may seek proxy votes or join with other disgruntled stockholders. When the majority is held as one, as in a trust, such relief becomes very difficult if not impossible to obtain. There is a second objection: the trustee owes a fiduciary duty to both his income beneficiary and his remainderman—a duty to treat each equitably and to favor neither over the other.[31] But only intended beneficiaries may seek to redress such a breach. In the instant case there are two trustees. The majority trustee has control of the corporation and thus establishes the amount of the dividend. Fifty-one per cent of the dividends declared inure to the majority trust's income beneficiary—forty-nine per cent to the minority. If the majority trustee is allowed to violate his duty to distribute to his own income beneficiary in accordance with the instrument, then, too, the minority trust's income beneficiary may also be treated unfairly—and yet be without the ability to complain. The remaindermen are not likely to bring suit since their trust corpus is being increased. Thus, if the income beneficiary of the majority trust cannot be compelled to institute an action on her own behalf, the income beneficiary of the minority is nearly remediless because of the increased burdens of proof required by a stockholder's suit to compel increased dividends. This situation allows the remaindermen of both trusts to be implicitly favored. The minority trustee is thus unable to meet his duty to maintain a proper balance between his income beneficiary and his remainderman. A lesson may be learned from the instant case. The problems encountered might be avoided by the stock donor transferring only a life interest in the controlling share of stock. This would still allow the surviving partner-donee to have control of the corporation, and insure its continued success. However, upon the donee's death, the stock would revert back to the donor's beneficiaries—creating for them a more favorable bargaining position. Another method of avoiding the standing-to-sue problem may be to provide in the corporate bylaws that the placing of the majority of stock in a trust will require the naming of the minority stockholder as a beneficiary to insure the required standing. Such a provision could also be placed in the trust indenture.

28. Henn, Corporations § 328, at 508 (1961).
29. *Id.* at 508-09.
30. *Id.* at 509. See generally Note, 64 Harv. L. Rev. 299 (1950).
31. Redfield v. Critchley, 252 App. Div. 568, 300 N.Y. Supp. 305 (1st Dep't 1937), *aff'd*, 277 N.Y. 336, 14 N.E.2d 377, *reargument denied*, 278 N.Y. 483, 15 N.E.2d 73 (1938).

Although the instant case deals solely with the standing-to-sue issue, Chief Judge Desmond's dissent forecasts an interesting dilemma. If the case would now go back to the trial court, and plaintiff is able to prove his allegations against the majority trustee, may the defense of an overriding fiduciary obligation to a trust be raised? For example, let us suppose the trier of fact finds that the majority trustee, as director of the corporation, is not acting in the best interests of the corporation. Could defendant argue that he is, however, acting in the best interests of his trust, as is his fiduciary duty, and adherence to that duty takes precedence over his fiduciary duty as a director? "Where the trustee holds sufficient shares to control actually or substantially the conduct of the corporation, he is under a duty to exercise that control for the benefit of the trust."[32] There is no public policy which precludes the owner of a majority of shares of a corporation from creating a trust, thereby giving the trustee the power to control the election of directors and the ultimate control over the affairs of the corporation.[33] It has been held that such power is an incident merely of the ownership of the stock "and unless abused"[34] will not be denied. The courts have allowed such a trustee wide areas of discretion,[35] and they have been reluctant to interfere unless he is guilty of an abuse of his discretionary powers.[36] Where the trustee exceeds the limitations of reasonable judgment in the exercise of control over the corporation, the court will intervene, either by directing him in the exercise of the power or holding him liable for its improper exercise.[37] Thus, in the instant case, to succeed plaintiff will be required below to prove that the defendant trustee has abused the discretion allotted him by the trust indenture. If defendant can show that his actions are in the best interests of the majority, the majority stockholder, he will be deemed to be acting within the realm of proper discretion.

JOHN T. O'MARA

## FAMILY LAW

### ANTI-HEART BALM ACT—LEGAL SUFFICIENCY OF ACTION FOR MONEY DAMAGES BASED ON BOGUS WEDDING CEREMONY

After being led to believe that the defendant intended to marry her, plaintiff participated in what she believed to be a genuine wedding ceremony. In fact,

32. 2 Scott, Trusts § 193.2 at 1462 (2d ed. 1956). *Accord*, Mudd v. Lanier, 247 Ala. 363, 24 So. 2d 550 (1945); Tapper v. Boston Chamber of Commerce, 235 Mass. 209, 126 N.E. 464 (1920). See Krasnowiecki, *Existing Rules of Trust Administration: A Stranglehold on the Trustee-Controlled Business Enterprise*, 110 U. Pa. L. Rev. 816 (1962).

33. Union Trust Co. of Springfield v. Nelen, 283 Mass. 144, 148, 189 N.E. 66, 69 (1933).

34. *Ibid.*

35. 2 Scott, Trusts § 187 (2d ed. 1956).

36. Anderson v. Bean, 272 Mass. 432, 172 N.E. 647 (1930). *Cf.* Matter of Ebbets, 139 Misc. 250, 248 N.Y. Supp. 179 (Surr. Ct. 1931).

37. *In re* Adler's Estate, 164 Misc. 544, 299 N.Y. Supp. 542 (Surr. Ct. 1937); *In re* McLaughlin's Estate, 164 Misc. 539, 299 N.Y. Supp. 559 (Surr. Ct. 1937).