Accounting for a Controlling Interest in an Entity

By David A. Bamdad

Introduction

More than 70 years ago, the Court of Appeals explained 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."[1] In other words, if fiduciaries, in their individual and/or fiduciary capacities, own a controlling interest in an entity, they have a duty to account to the beneficiaries of the estate or trust for the transactions of such entity. However, at that time, the court did not directly address the manner in which the fiduciary must account, and there has been a dearth of case law on the issue since that decision. That is, until 2018, when the Nassau County Surrogate's Court addressed the issue head on in *In re Kalikow*[2] and provided a great deal of latitude to fiduciaries in accounting for such entities. This article will explore the basis for a fiduciary's obligation to account for entities owned by an estate or trust, the limited case law concerning the manner in which the fiduciary must account, and the impact of *In re Kalikow* on fiduciaries and beneficiaries.

The Duty To Account

New York case law makes clear that a fiduciary must account for an entity in which an estate or trust owns a controlling interest, or in the event the estate or trust's interest, together with the fiduciary's individual interest, amount to a controlling interest. In *In re Hubbell*, the decedent's estate owned 50% of the shares of a corporation and the decedent's husband, who also served as a co-trustee of a testamentary trust under the decedent's will that held the decedent's shares, owned the remaining 50% of the shares.[3] Accordingly, the Court of Appeals held that:

> [W]here as here the fiduciaries control a corporation by the help of the estate stock interest added to the stock interest held personally by one of them they are not disabled to make such accounts and are therefore under obligation to do so. There is nothing sacrosanct about a corporation. It is not an impenetrable screen behind which facts may be successfully hidden.[4]

Furthermore, in 1989, the New York County Surrogate's Court went a bit further than the Court of Appeals, holding that such a fiduciary has an "absolute duty to render a full account of the estate and corporate transactions."[5]

These cases, among others, laid a framework for understanding the rationale for the duty: (i) that the beneficiaries, as persons with an indirect interest, are entitled to information relating to the entity, (ii) that the fiduciary, as the party in control of the entity, is in a position to obtain the information, and (iii) that the information may reveal misconduct by the fiduciary.[6] Therefore, the courts will not allow a fiduciary to conceal potential misconduct from the beneficiaries who would be impacted by such misconduct.

However, the cases did not address whether the accounting of the entity is required to be in the same judicial format as other accounts in the Surrogate's Court or if the obligation could be fulfilled in some other manner. In *In re Hubbell*, the co-trustees accounted for the corporation by including its financial statements for the relevant period as a supplement to their account of the trust, but the beneficiaries did not object on that basis so the court did not address the issue.[7] Moreover, *In re Sturman* was a compulsory accounting proceeding in which the executors contested their duty to account for the entities in any manner as part of the estate accounting.[8] Therefore, while the court granted the petition to compel an accounting, including the accounts of five corporations controlled by the fiduciaries, it did not directly address the manner in which the accounts of the corporations were to be presented.[9]

However, nearly 30 years later, the Nassau County Surrogate's Court directly addressed the issue in *In re Kalikow*.

In re Kalikow

In re Kalikow involved the dueling accountings of co-trustees of a testamentary trust for the benefit of the decedent's surviving spouse during her lifetime.[10] The trust was initially funded by, *inter alia*, 10 income-producing apartment buildings, but approximately seven years into the administration of the trust, the co-trustees at the time transferred the properties to a limited partnership in exchange for a 98.5% interest therein.[11] Upon the death of the surviving spouse, the co-trustees filed separate accountings. One co-trustee filed an accounting that included all of the transactions related to the properties even though they took place at the partnership level, while the other co-trustee included summary statements as an addendum to his account.[12]

Nevertheless, years later, the co-trustee who had included all of the transactions in his account filed a motion

seeking to compel a complete accounting of the partnership's transactions by the other trustee.[13] Specifically, the co-trustee sought to compel a "detailed breakdown, on a building-by-building basis, of all transactions of the ten buildings for the entire period of the account" in the format promulgated by JA-4 of the Surrogate's Court Procedure Act, on the grounds that such a detailed account was required by *In re Hubbell*.[14]

The court disagreed and denied the motion in its entirety.[15] In doing so, the court explained that *In re Hubbell* "never directed the fiduciaries with respect to the manner in which they were required to account" and that, in fact, the fiduciaries in *In re Hubbell* had only filed financial statements for the corporation during the relevant period.[16] The court further explained that, to the extent the co-trustee required the detailed information sought in order to enable him to file objections to the account, he could obtain such information during SCPA 2211 examinations and discovery.[17]

The Scope of the Account

In the wake of *In re Kalikow*, fiduciaries appear to have significant latitude in terms of the manner in which they account for entities they control. As a result, there are potential advantages and disadvantages to both fiduciaries and beneficiaries depending on the circumstances. For example, in an uncontested matter, a fiduciary would not be required to prepare a detailed accounting of the underlying entities, which could cost the estate or trust a substantial amount of legal and/or accounting fees, at the expense of the beneficiaries. On the other hand, in a potentially contested matter, it enables the fiduciary to control the manner in which the information concerning the entity is initially disclosed to the court and the beneficiaries. This is a significant benefit for fiduciaries because, although the beneficiaries would still be entitled to obtain more detailed information through the discovery process, the beneficiary has to do much of the heavy lifting and undertake the expense of retaining professionals to review such discovery to uncover potential misconduct.

Notably, in *In re Kalikow*, the court reached its conclusion despite the fact that the trust initially held direct interests in the buildings and it was the trustees themselves who transferred the buildings to a limited partnership.[18] Clearly, had the buildings remained in the trust, the co-trustees would have had no choice but to account for each individual transaction. However, by transferring the buildings to an entity in exchange for an interest in such entity, the trustees were able to avoid having to account in such a manner.

Conclusion

The court's decision in *In re Kalikow* provides a great deal of deference to fiduciaries, but also is a more practical approach. To require a fiduciary to provide a full detailed accounting of entities owned by estates or trusts as a general rule would lead to a significant waste of resources in many cases, including judicial resources to review all such accountings for accuracy. By requiring the fiduciaries to disclose all pertinent information during the course of discovery instead, the beneficiaries still receive all of the information they are entitled to in order to examine the fiduciary pursuant to SCPA 2211 and to prepare their objections, without the estate/trust and court having to expend such resources in all such cases.

Endnotes

1 *In re Hubbell*, 302 N.Y. 246, 254-255 (1951).

2 No. 265583/M (Sur. Ct., Nassau County, Jan. 11, 2018).

3 *In re Hubbell*, 302 N.Y. at 251-252.

4 *Id.* at 260.

5 *In re Sturman*, N.Y.L.J., June 9, 1989, p. 21, col. 3 (Sur. Ct., N.Y. Co.).

6 *See* John C. Novogrod and Dana L. Hirsch, *Owning Up: The Accountability and Conflicts of a Fiduciary Holding a Controlling Interest in a Corporation*, N.Y.L.J., Jan. 31, 2011, http://www.newyorklawjournal.com/id=1202479581191 ("Owning Up").

7 *In re Hubbell*, 302 N.Y. at 253.

8 *Sturman*, N.Y.L.J., June 9, 1989 at 21, col 3.

9 *Id.*

10 *In re Kalikow*, No. 265583/M (Sur. Ct., Nassau County, Jan. 11, 2018).

11 *See id.*

12 *Id.*

13 *Id.*

14 *Id.*

15 *Id.*

16 *Id.*

17 *Id.*

18 *See id.*

David A. Bamdad is a partner at Meltzer, Lippe, Goldstein & Breitstone, LLP and chairs the firm's trusts and estates litigation practice group. In his practice, he regularly counsels fiduciaries and beneficiaries in contested probate, administration and accounting proceedings, discovery and turnover proceedings, and other miscellaneous proceedings.