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Surcharging Executors for Depreciation of Securities in Margin Account - Goldsborough, et al. v. De Witt, et al.

SURCHARGING EXECUTORS FOR DEPRECIATION OF SECURITIES IN MARGIN ACCOUNT—*GOLDSBOROUGH, ET AL. V. DE WITT, ET AL.*[1]

The testator died July 23, 1930 leaving a will which named as executors his friends and legal advisers, the two defendants-appellees. The will stated that no bond was to be required and gave wide discretionary powers to the executors. The executors were members of a New York law firm doing a great deal of trust and administration work. They qualified on August 5 in the Orphans' Court of Talbot County. Inventory and appraisements were returned on September 3 and showed the chief asset of the estate to be securities, valued as of the date of the testator's death at $552,000 (in round figures). The major portion of these securities was in a margin account in a New York brokerage house, where the account was $426,000 against which there were pledged securities, leaving the estate an equity of $234,000. The testator had also owned unpledged securities worth $89,000 which were later sold and the proceeds applied to the reduction of the broker's debt. (There was also in the estate considerable other personal property and valuable realty, the administration of which was involved in the case. This comment will be confined, however, to a discussion of the securities.) The estate was comfortably solvent. Upon application of the executors, the Orphans' Court granted numerous extensions of time for selling the securities.

The executor's petitions alleged the need for doing this "because of the business depression now existing throughout the country . . .", and expressed the hope "that with the betterment of business conditions, which your petitioners are hopeful will occur in the next few months . . .", that there would be a rise in the value of the securities. Aside from these petitions and orders of court thereon, no accounting was filed until June 21, 1934. The final accounting was made in May, 1935, and revealed a depreciation of value in the securities of $295,000. The margin account had been carried all this time with frequent calls for more margin and at one point had been saved by large guaranty accounts opened by the executors individually.

After losing in the Court of Appeals[2] on the question of whether issues could be sent to a jury, the widow (who had

[1] 189 A. 226 (Md. 1937).
[2] Goldsborough, et al. v. De Witt, et al., 169 Md. 463, 182 A. 324 (1936).

renounced the will) and the beneficiaries filed exceptions to the Administration Account and attempted *inter alia* to surcharge the executors for the depreciation of the securities. The Orphans' Court overruled the exceptions and this appeal was taken. *Held,* Affirmed. Where records of the Orphans' Court disclosed granting of extensions, but the testamentary beneficiaries took no action until May, 1935, lapse of time and laches precluded them from now questioning the authority of the court to grant such extensions, even though granted as ex parte orders, but not procured by fraud, deceit, or mistake. Measure of executors' duty in determining when and what securities to sell was to act in good faith and due diligence with same degree of care as a reasonably and ordinarily prudent man would exercise in handling his own similar affairs. The executors could carry on the margin account for the purpose of realization of the value of the securities.

The problem presented by this case arises frequently after an economic crisis.[3] The decedent leaves investments —when should the executors (or administrators) sell? It is submitted that the courts are torn between two underlying policies: first, the executor's primary duty to preserve the asssets of the estate, entailing a high degree of fiduciary responsibility;[4] second, the apparent injustice of holding liable one who has acted as an ordinarily prudent man according to the customs and beliefs of the time.

Since the courts recognize that decisions in this type of case depend largely on the particular facts and circumstances involved,[5] it is difficult to formulate any general principles. The duty of an executor to sell goods of a per-

[3] Calling in Confederate securities in southern states, Tompkins v. Tompkins, 18 S. C. 1 (1882); Involving railroad stock that depreciated in panic in 1873, Matter of Weston, 91 N. Y. 502 (1883); Depreciation following the World War, In re Varet's Estate, 181 App. Div. 446, 168 N. Y. S. 896 (1918); "Presents the frequently recurring situation arising out of the present financial depression", In re Chaves' Estate, 143 Misc. 868, 257 N. Y. S. 641, 642 (1932).

[4] "The purposes of administration are to collect the assets of the decedent, pay his debts and funeral expenses, etc. and make distribution to the persons entitled thereto. But administration includes more than this; it involves all that may be done rightfully in the preservation of the assets, and all which may be done legally by the administrator in his dealings with creditors, distributees, legatees, or which may be done by them in securing their right . . .", 23 C. J. 997. "In making investments of the funds of the estate the representative acts as trustee rather than as executor or administrator and his duties and liabilities in respect to such investments are governed by the same rules as apply to other trustees.", 24 C. J. 72.

[5] "The special and distinctive facts in each proceeding must determine the liability or exoneration of the particular fiduciary", In re Sprong's Estate, 144 Misc. 293, 259 N. Y. S. 77, 80 (1932).

ishable nature is clear.[6] However, whether securities or more especially stocks owned on margin, come within the meaning of perishable goods is a debatable point.[7] It has been stated that "an administrator or an executor in the absence of express authority therefor, is not permitted to use any part of the estate in trade, or manufacturing, or stock speculation, or other business venture, whereby the trust fund is put at hazard; and the doing by him of any of these things has generally been regarded as a breach of trust and a *devastavit*"[8] and yet the courts as a general rule have declined to surcharge executors for losses occasioned by failure to close out non-margin accounts, when they were acting with due care, good faith, and with a view to the best interests of the estate,[9] even though in some cases the losses have been stupendous. It has been held that good faith, due diligence, etc., may be evidenced by seeking the advice

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[6] Schouler, Wills, Executors and Administrators, Vol. 2, Sec. 1325a and ff.; Md. Code, Art. 93, Secs. 291, 292.

[7] Statute covering sale of perishable goods *held* not to include margin account, Off v. Russell, et al., 60 P. (2d) 331 (Calif. 1936); nor to include "all property subject to market fluctuation", In re Fisher's Estate, 128 Iowa 626, 104 N. W. 1023, 1024 (1905); no difference between those held outright and those held as collateral, In re McKee's Estate, 147 Misc. 889, 265 N. Y. S. 47 (1933); trustees could invest in mortgage "participations" under New York Banking Law, In re Flint's Will, 240 App. Div. 217, 269 N. Y. S. 470 (1934); investments in Montgomery Ward, Radio, Union Carbide, National City Bank, etc., considered not speculative, but "seasoned" and "good Moody ratings", In re Winburn's Will, 140 Misc. Rep. 18, 249 N. Y. S. 758 (1931).

On the other hand: See especially: In re Busby's Estate, 6 N. E. (2d) 451 (Ill. App. 1937), decided by the Appellate Court of Illinois, and which may, therefore, be appealed to the Supreme Court of Illinois. This case emphasizes more strongly than any other recent one the dangerous nature of a margin account, and apparently places a higher degree of responsibility on the executor than the principal case, since it rejects the doctrine of what a reasonable man would do handling his own affairs in favor of the doctrine of what a reasonable man would do in handling the property of another. See also: "Common prudence required that such a speculative account be closed out at earliest practicable moment", In re Hirsch's Estate, 101 N. Y. S. 893; an estate consisting mostly of common stocks termed "exclusively speculative", In re Stumpp's Estate, 153 Misc. 92, 274 N. Y. S. 466 (1934); Margin account considered as speculative, Appeal of Matthew's, 76 Conn. 654, 57 A. 694 (1904); duty to withdraw from marginal trading account, In re Disbrow's Estate, 145 Misc. 584, 261 N. Y. S. 635 (1932).

[8] 11 R. C. L. p. 136.

[9] See: Matter of Weston, 91 N. Y. 502 (1883); In re Clark's Will, 257 N. Y. 132, 177 N. E. 397 (1931); In re Winburn's Will, 140 Misc. Rep. 18, 249 N. Y. S. 758 (1931); In re Chaves' Estate, 143 Misc. 868, 257 N. Y. S. 641 (1932); In re Kent's Estate, 146 Misc. 155, 261 N. Y. S. 698 (1932); In re Andrew's Estate, 239 App. Div. 32, 265 N. Y. S. 386 (1933); U. S. Fidelity & Guaranty Co. v. Greer, 29 Ariz. 203, 240 P. 343 (1925); In re Curran's Estate, 312 Pa. 416, 167 A. 597 (1933); In re Megaree's Estate, 117 N. J. E. 347, 175 A. 808 (1934); In re Cross' Estate, 176 A. 101, 117 N. J. E. 429 (1935).

of recognized men of affairs or business leaders,[10] by settlement of the estate within a reasonable time[11] or by acting as would an ordinarily industrious and prudent man in the conduct of his own affairs.[12] On the other hand, evidence of undue regard for one class of beneficiaries,[13] or dominance of a personal interest of the executor's,[14] or gross delinquency in settling the estate[15] may lead the court to find such negligence as to warrant surcharging the executor. Another factor involved is the weight to be given to the fact that the decedent bought the stocks.[16] It is clear that there is a difference between speculative buying and mere retention of securities[17] (which may even be "non-legals" according to the statutory law for trustees in the particular jurisdiction). The court may consider the executor's retention of investments, which ordinarily an executor could not make, as the "result of exercise of their sound judgment",[18] while other authorities will declare that the situation was such as to make it "the duty of an executor or administrator to make changes in the investments in order to render them more secure . . . and thereby withdraw the securities from such perilous business".[19] Marketability is another question which may influence the court; it is recognized that unlisted stocks or those in a closed corporation may require more time to liquidate than the more familiar shares which are traded daily.[20] It has been contended that trust companies and others who hold

[10] People's National Bank & Trust Co. v. Bichler, 115 N. J. E. 617, 172 A. 207 (1934); In re Clark's Will, supra note 9; In re Booth's Estate, 264 N. Y. S. 773 (1933) (but surcharged Trust Company acting as executor for failure to sell after its own trust committee had advised sale of the particular stocks).

[11] One year, In re Andrew's Estate and In re Winburn's Estate, supra note 9.

[12] In re Kent's Estate; U. S. Fidelity & Guaranty Co. v. Greer, and In re Cross Estate, supra note 9; In re McCafferty's Will, 147 Misc. 179, 264 N. Y. S. 38 (1933).

[13] In re Andrew's Estate, 239 App. Div. 32, 265 N. Y. S. 386 (1933).

[14] In re Stumpp's Estate, 153 Misc. 92, 274 N. Y. S. 466 (1934).

[15] In re Junkersfeld's Estate, 244 App. Div. 260, 279 N. Y. S. 481 (1935).

[16] Emphasis is sometimes put on the decedent's apparent faith in the particular stocks. See In re McKee's Estate, 147 Misc. 889, 265 N. Y. S. 47 (1933) where decedent had been a "specialist" in the stock involved.

[17] In re Clark's Will, 257 N. Y. 132, 177 N. E. 397 (1931); In re Kent's Estate, 146 Misc. 155, 261 N. Y. S. 698 (1932).

[18] In re Curran's Estate, 312 Pa. 416, 167, A. 597, 600 (1933). See also In re Bernheimer's Estate, 106 Misc. Rep. 719, 175 N. Y. S. 594 (1919); In re Chaves' Estates, 143 Misc. 868, 257 N. Y. S. 641 (1932).

[19] 11 R. C. L. 143-144. See also Appeal of Matthews, 76 Conn. 654, 57 A. 694 (1904); In re Disbrow's Estate, 145 Misc. 584, 261 N. Y. S. 635 (1932); In re Busby's Estate, 6 N. E. (2d) 451 (Ill. App. 1937).

[20] In re Yund's Estate, 152 Misc. 785, 274 N. Y. S. 831 (1934).

themselves out as experts in administration of estates and have available superior facilities should be held accountable for a higher degree of care and diligence than individual executors and trustees;[21] but another case[22] declared that the creation of such a distinction was a legislative function. Naturally, the terms of the will have a bearing on the latitude of discretionary power which is to be allowed the executor without incurring liability.[23] Another factor which frequently plays an important part is whether or not the beneficiaries have become estopped to question the action of the executors. Of course, a direct and unsolicited approval of the executor's plans should, and will prevent the beneficiaries from later objecting, when later developments prove the judgment to have been disastrously mistaken.[24] Consultation with the beneficiaries has been held to negative liability on the part of the executors,[25] as also has the continued acquiescence of the beneficiaries.[26] But in one case[27] the court used the following language: "Such inquiries (as to the course of administration) expose the beneficiaries to no liability whatever. They do not involve the beneficiary in the estate administration, and this is so even if there be an expression of viewpoint by the beneficiary. It is only where there is an absolute assumption by the beneficiary of the fiduciary's function, under conditions which on general legal principles impose responsibility for the result, that a fiduciary should be permitted to defend the failures of his administration by charging them to the beneficiary. Any other administrative policy would be sure to result in grave harm. A lowering of the bars of this

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[21] (1931) 5 University of Cincinnati Law Review, 1, 26, 51; "Holding itself out as a specialist in trust affairs it should be held to a high degree of care", In re Cross' Estate, 115 N. J. E. 611, 172 A. 212, 214 (1934) (Reversed but no criticism of this statement in 117 N. J. E. 429, 176 A. 101 (1935).

[22] In re Flint's Will, 240 App. Div. 217, 269 N. Y. S. 470 (1934).

[23] See: Matter of Weston, 91 N. Y. 502 (1883) where the will provided that certain stocks were "to be held firmly"; and In re Cross' Estate, 117 N. J. E. 429, 176 A. 101 (1935), where a provision allowing executor to borrow up to a certain amount to keep from selling at an unfavorable time was considered to warrant holding on to the stock.

[24] Where he has acted in good faith and "his course of conduct has been requested, authorized, or assented to by the heirs or distributees, with knowledge of all the material facts, this may excuse him from any liability to them for resulting losses, even though he has deviated from the line of his duties", 24 C. J. 127-128.

[25] In re Curran's Estate, 312 Pa. 416, 167 A. 597 (1933).

[26] In re Clark's Will, 257 N. Y. 132, 177 N. E. 397 (1931); People's National Bank and Trust Co. v. Bichler, 115 N. J. E. 617, 172 A. 207 (1934).

[27] In re Pinney's Estate, 156 Misc. 844, 282 N. Y. S. 680, 690 (1935).

type of defense would undoubtedly result in escape from liability by unfaithful fiduciaries.''[28]

In the principal case the court worked out estoppel from various conferences, letters of approval (although for the most part solicited by the executors after the stocks had been retained for some time), and from the fact that the records of the Orphans' Court with the petition and orders thereon were always open to the beneficiaries.[28a] Since the beneficiaries had not objected to the course of conduct until the filing of the administration account in May, 1935, it was held that their silence and failure to object worked an estoppel. It is submitted that the amount of control which in practice executors have over the entire estate, the informality of ex parte proceedings before the Orphans' Courts, and the great reliance of both court and beneficiary upon the executors, when considered from a practical viewpoint and not from legalistic reasoning, make this principle one which should be carefully limited. Perhaps, as in the instant case, it should be used as an additional factor in exonerating executors otherwise free from fault, but it should certainly never be used as the sole ground for denying surcharge where the executors have dealt negligently or in bad faith with the funds. It is also submitted that more responsibility should attach in the case of margin accounts than in the case of stocks owned outright, for the danger of total loss is more imminent—in only three cases[29] where the executors were not surcharged for alleged delay in liquidating securities were margin accounts involved.

On the whole, it seems that the Maryland Court of Appeals has followed the general tendency to relieve from liability executors who have acted in good faith, with due diligence, and with the best interest of the estate in mind. It must be remembered that ordinarily executors would have nothing to gain personally by an extended adminis-

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[28] See also In re Stumpp's Estate, 153 Misc. 92, 274 N. Y. S. 466 (1934) (silence does not estop beneficiaries); In re Frame's Estate, 245 App. Div. 675, 284 N. Y. S. 153 (1935) (inquiries not an estoppel, nor does mere silence show acquiescence as beneficiaries have a right to assume that executors are acting legally).

[28a] In view of the impossibility of appealing from the (non-final) orders of the Orphans' Court which authorized the continuance of the margin account it would seem improper to predicate an estoppel against the beneficiaries. On the other hand, the Court's interpretation can be justified on the basis that the beneficiaries did not object to the executors' course of conduct in the Orphans' Court itself.

[29] In re McKee's Estate, 147 Misc. 889, 265 N. Y. S. 47 (1933); In re Lazar's Estate, 139 Misc. Rep. 261, 247 N. Y. S. 230 (1930); Peck v. Searle, 117 Conn. 573, 169 A. 602 (1934).

tration period. And also it should be remembered that it is all too easy to criticize after the results have occurred. And yet, the fiduciary capacity of an executor should lead the courts to restrict the tendency. Since the executor is dealing, not as an adult with his own money, but as a trustee on behalf of beneficiaries, who only too frequently are entirely dependent on the preservation of the estate for their futures, too much weight should not be given to the fact that the deceased made the original investments. The defense of estoppel should be carefully scrutinized to see if the executors actually relied on the consent or advice of the beneficiaries. It should appear convincingly that the executors recognized the danger of total loss involved in margin accounts and that they were actually trying to realize the assets and not trying to speculate. Executors should be made to realize that the burden of responsibility can easily be shifted by seeking consent of court and beneficiaries upon a full disclosure of the situation.