LIFE INSURANCE TRUSTS: A RECAPITULATION FOR THE DRAFTSMAN

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PART TWO

VI

THE BUSINESS LIFE INSURANCE TRUST

General Consideration

The second group of life insurance trust agreements includes the various agreements adapted to business organizations. In this group are found the Stock Purchase, the Partnership Liquidation, and Sole Proprietorship Insurance Trust Agreements which are used for the purpose of liquidating the interest of a deceased member of a closed business group. These agreements are to be distinguished from the methods generally used where the insurance is held for the purpose of compensating the survivors of the group for the loss sustained through the death of a member of the group, nor where the proceeds are to be used to strengthen the general credit position of the business, as in such cases the purpose may be accomplished without the necessity of agreement or services of a trustee. These agreements are directly concerned with the business interests of the individual; they affect his domestic interests only indirectly by creating a definite cash market for his interest following his death.

The business agreements are of more recent origin than the individual agreements and have, perhaps, not reached the same state of development. They have advanced, however, to the point where a discussion may be profitable. Every owner of an interest in a closed business group is sooner or later presented with the problem of what disposition shall be made of his interest in the event of his death. If liquidation is forced, the restricted marketability of the interest may cause serious loss, while on the other hand, if the interest is not sold, the executor or administrator of the deceased and ultimately his beneficiaries may become involuntarily engaged in a business to which they may not be adapted by experience or temperament.

Moreover, in most groups of this type close personal relationship is necessary and the introduction of strange parties into this relationship following the death of the deceased member of the group may be most unpleasant and impractical. The fundamental problem therefore in all cases of this type is to secure a ready market for an interest of a deceased member of the group in a manner which will afford protection not only to his estate and his beneficiaries but also protection for the surviving members of the group to the end that all values may be conserved. The Business Insurance Trust Agreements are the answer to these problems. The Stock Purchase Agree-
ments, the Partnership Liquidation Agreements and the Sole Proprietorship Agreements will be considered in the order given, which, while not entirely logical, has an advantage of clarity much to be desired in discussing these agreements which are complicated at best.

VII

THE STOCK PURCHASE LIFE INSURANCE TRUST AGREEMENT

Where a person owns stock in a close corporation, such stock may have good security behind it and may have a fine record as to earnings but usually it will have a very restricted market. Moreover, upon the death of the person owning a large block of stock, voting and management power may pass into weak or irresponsible hands with the result that the value of the stock may be greatly reduced. If the surviving stockholders are permitted to purchase the stock of the deceased stockholder in accordance with a definite plan of payment, financing and appraisal of value, the difficulties above discussed are eliminated in one operation. The Stock Purchase Agreement accomplishes this result.

The first question which must be answered in drafting an agreement of this type has to do with the parties to the agreement. Obviously the interested stockholders will be parties and whenever possible all of the stockholders will be included. But shall the corporation be a party thereto? It is frequently argued that a more simple plan of operation may be used if the corporation is a party. Where the interested parties desire the adoption of this plan, it is their expectation that the corporation will pay the premiums on the insurance policies and that upon the death of the party first to die, the corporation will purchase the stock of the deceased. Whether or not it may be possible for the corporation to be a party under these conditions will depend upon the law of the particular jurisdiction with respect to the insurable interest involved, and (2) the power of a corporation to purchase its own stock. A violation of the law on either of these points may well result in the claim that such action was ultra vires.

Insurable interest may be defined as that interest which exists where there is a reasonable ground, founded upon the close personal or business relationship of the parties, to expect some gain if the insured continues to live. Courts almost without exception hold that corporations have an insurable interest in the lives of their officers and employees because the continuance of their lives is of substantial value to the corporation and their death may result in real loss to it. If, however, the amount of insurance carried is greatly in excess of the true value to the corporation of the life insured, the payment of premiums by the corporation might well be held to be an ultra vires act; but even though a corporation may properly insure the life of an officer or an employee, there is still the question whether it may insure
the life of a stockholder who is not an officer or employee. It would seem that the same rule should also apply to certain stockholders who have a real connection with the success or failure of the corporation.

The second question to be considered in deciding whether the corporation shall be a party is whether under the laws of the particular jurisdiction the corporation may purchase its own stock, and, if such purchase may be made, whether it must be made only from surplus. As a general rule it appears that a corporation may purchase its own stock, but there are jurisdictions having statutory and case law to the contrary. Obviously, in a jurisdiction where a corporation is restricted to purchases from surplus, the value of the agreement will be greatly impaired. It is clear, therefore, that the inclusion of the corporation as a party may be troublesome because of the question of insurable interest, or because of the question as to the purchase of its own stock.

Assuming that legal difficulties may be overcome with respect to the corporation being a party to the agreement, there is still the question of whether this is the proper procedure from a practical point of view. It has been argued that, if the corporation is a party and pays the premiums, there will be an advantage with respect to income and estate taxes, as compared with cases where the corporation is not a party and the individuals pay the premiums. The basis of this argument with regard to income is that in most cases, if the individuals pay the premiums, it will be necessary to increase their salaries or to increase dividends on the stock in order to supply them with funds for that purpose, and that it will then be necessary to include such increases in the individual's income tax returns thereby increasing each individual's tax. But suppose the corporation pays the premium. Under the Revenue Act of 1932 a corporation must pay a tax of 13\(\frac{1}{4}\) per cent. on the amount of net income in excess of credits allowed, and since the corporation cannot deduct the insurance premiums as a business expense, the amount paid over for premiums is subject to tax at the aforesaid rate. On the other hand, there are not many stockholders, particularly those holding stock of the smaller corporations, whose personal income is taxable at a rate of 13\(\frac{1}{4}\) per cent. Moreover, if the stockholders are officers or employees, the corporation might properly increase their salaries by an amount sufficient to allow the officer or employee to pay the required premiums themselves. If this latter procedure was adopted, the corporation for tax purposes might deduct the entire salary from corporate income as a business expense. The officers or employees will include the increases in their personal

1 For full discussion on this point see Fletcher, Encyc. of Corporations §§ 1134-1146, 3758-3763; and authorities cited.
tax return but it will be taxable only at the rate at which their personal net income is taxable, which will in most cases be considerably less than \( 13\frac{3}{4} \) per cent. In such case, viewing the situation as a whole, there will be an appreciable saving.

With respect to federal estate taxes, if we review the situations where the corporation is the owner of the policies with the situations where each stockholder is the owner of the policy on his own life, there appears to be a slight advantage in favor of corporate ownership, as in this case proceeds will not be considered as part of the deceased's estate, although only a part of the value of the proceeds will be so included by virtue of the increase in the value of the assets of the corporation, the stock of which is held by the estate; whereas, in other cases, the entire proceeds will be included as part of the deceased's estate. But if we compare the corporate ownership situation with the situation where the stockholders separately or jointly own the insurance on the life of each individual, the advantage rests in favor of stockholder ownership of the policies, as in this case the insurance proceeds are not corporate assets and form no part of the deceased's estate. Since, for other reasons hereinafter set forth, this last method appears to be much the better in cases of individual ownership, it is submitted that from the point of view of estate taxes as well as income taxes individual ownership is to be desired.

Further, from the practical point of view, there is, in addition to the tax question, a question with respect to the rights of creditors which becomes particularly difficult where a corporation is a party. Questions with respect to rights of creditors may be avoided for the most part where the corporation is not a party to the agreement. It would seem that this point also indicates that the corporation should not be a party to the agreement.

Assuming, therefore, that the stockholders are to own the insurance policies and pay the premiums, the next question to be answered has to do with the plan of ownership and method of payment of insurance premiums. There are various methods available.

(1) Each stockholder may carry the insurance on his own life. The disadvantage in this method is that in this event the stockholder is in reality underwriting the obligations of others. So far as protection for his estate is concerned, he might just as well have no agreement of sale and carry the insurance to offset a possible loss in stock value. He would of course have protection in the event of death of another stockholder.

(2) All of the stockholders but one may carry insurance on the life of that one in successive groups, or all the stockholders may carry insurance on the lives of all as one group, to buy the stock of the one first dying. The great difficulty with this method is that while it may be possible to work out adequate protection and a balanced plan, the complicated adjustments
between the parties during life are very likely to cause trouble which may cause them to discard the whole arrangement.

(3) Each stockholder may carry insurance on the life of every other stockholder to an extent which will underwrite the obligation of such stockholder to purchase the stock of each of the other stockholders. Under this plan the party who is under obligation underwrites that obligation there will be no dispute as to premiums and the entire plan will function smoothly and in proper ratio of cost to benefit.

On full consideration of each of the above methods, it will be found that, in the usual case, the third method is the most desirable. In some cases one of the other methods may be suggested because it is easy to visualize and does not require much computation. However, the third method is so much the best one that whatever inconvenience may be encountered in arranging the schedule of the amount of insurance to be carried by various individuals, is amply paid for by the savings obtained from efficient operation after the agreement becomes effective. But it is submitted that the difficulty of computing the amount of insurance which each party must carry on the life of each of the other parties is unduly exaggerated. Let us assume that A, B and C are sole stockholders in a corporation having an authorized capital stock of 1000 shares which is issued and outstanding; A owning 500, B 300 and C 200 shares. Let us further assume that the stock is worth $100 per share at the time the agreement is executed. The number of shares which A agrees to purchase in the event of C's death is that proportion of the shares held by C which the number of shares held by A bears to the total number of shares held by A and B. Thus if we let $X$ equal the unknown, the proportion is as follows: $500:800::X:200$. $X$ therefore equals 125 which is the number of shares which A will be required to purchase from C's estate. On the basis of $100 per share, the amount of cash necessary is $12,500, which is the amount of insurance A should carry on the life of C. The amount which each party should carry on the life of each of the other parties may be computed in like manner. In the case of the above example, the schedule would be as follows:

<table>
<thead>
<tr>
<th>Owners of Policies</th>
<th>The Parties Insured; and amount of Insurance on each life.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A $21,428.57</td>
</tr>
<tr>
<td>A</td>
<td>$30,000.</td>
</tr>
<tr>
<td>B</td>
<td>20,000.</td>
</tr>
<tr>
<td>C</td>
<td>$50,000.</td>
</tr>
<tr>
<td></td>
<td>Total $100,000.00</td>
</tr>
</tbody>
</table>

The same method is followed regardless of the number of parties involved.
It is possible that in some cases the cost of insurance premiums may be greater than the parties may be able to carry even though dividends or salaries may be increased. Various methods may be used to meet this difficulty. The parties may carry part coverage in ordinary life policies and accumulate funds to make up the difference; they may carry a minimum amount at first and add to it as it becomes possible to do so, buying the balance of the stock, if necessary, with collateral notes; they may use term insurance in as large a sum as can be carried and pay the balance in collateral notes; or they may use joint insurance on all parties with only one principal sum payable and the balance payable in collateral notes. These are all make-shift arrangements. Full coverage should be obtained whenever possible.

From the discussion so far it is obvious that there may be many variations in this type of agreement. The scope of this article will not permit a full discussion of all of them. However, it will be of value to analyze the type of agreement which may be drafted to meet the requirements of the usual case. As has been indicated above, the corporation will not be a party to this agreement, each party will deposit his stock with the trustee and will underwrite his own obligation to purchase a proportionate part of the stock of the party first to die, depositing the insurance policies with the trustee.

The Stock Purchase Agreement in a form commonly used is divided roughly into three parts. The first part deals with the deposit of the stock and insurance policies with the trustee, and with covenants as to purchase and sale of the stock. The second part includes covenants relating to price of the stock and a provision with regard to the collection of insurance proceeds upon the death of the party first to die; and the third deals with the exchange and disposition of stock, insurance proceeds and insurance policies following the death of said party.

With respect to the deposit of stock with the trustee, after recitals as to capital structure of the corporation and as to stock outstanding it is usually provided that each party shall endorse in blank the certificates representing stock owned by him and that such stock shall be deposited with the trustee with the further provision that each party will deposit any additional certificates which he may own during the continuation of the agreement. The trustee will be wise if it requires a provision to be inserted at this point to the effect that the trustee shall not be obligated to enforce or attempt to enforce said covenants although the other parties may enforce them. Further, it will be provided that the trustee shall retain all certificates deposited with it during the continuance of the agreement, except as may be later provided in the agreement with respect to withdrawal upon consent of
all parties. Without further provision it might be presumed that title to the stock had passed to the trustee but usually this is not desired, the owners wishing to retain full rights of ownership excepting the power of sale. It is usually further provided, therefore, that title shall not pass to the trustee, by specifically stating that the trustee shall have no rights in the stock of the corporation, except as depositary under the agreement, and that the owner of the stock shall have the right to vote, to collect dividends and to exercise all other rights of an owner, except such as are specifically renounced in the agreement. This method of handling the stock, aside from the great practical advantage of permitting the true owner to enjoy all the incidents thereof except free right of sale has the added advantage of avoiding any question with respect to the suspension of the right to vote on the stock. For example, in New York, the right to vote should not be suspended for a period longer than that during which voting trusts are allowed to operate, which is ten years. The use of the above method of handling the stock completely avoids this question. If, however, because of unusual circumstances the above method should not be advisable, the law of the jurisdiction which is to govern should be carefully examined with respect to this point and a suitable alternative method devised.

With respect to insurance policies, in the usual case the owner of the policies will desire to retain control over them insofar as this may be in accord with the purposes of the agreement. Hence, in this case, as in the case of the Personal Agreements and for the same reasons, assignment of policies is avoided and it is provided that all policies shall be made payable to the trustee as beneficiary and that they shall be filed with the trustee, but that the person to whom such policy is issued or reissued shall be the owner of such policy and of the insurance represented thereby, at least for the purposes of the agreement. There is specifically reserved to such owner the right to receive all dividends, surrender values and any other payments of any kind arising from any policy owned by him (excepting disability payments, which should be payable to the insured), the right to cause the beneficiary thereof to be changed, the right to obtain loans thereon, the right to exercise any and all options contained in said policy, and the right to withdraw said policy from the possession of the trustee upon the written consent of the other individual parties thereto. This provision will avoid difficulties involving the exercise of rights under the policy but prevents the owner from dealing with the policy without the knowledge of the other parties.

It would seem advisable to provide further that nothing shall be payable to the trustee until the death of that one of the parties who is the first to die and that the trustee shall not be obligated to pay any premium on any such

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3 New York Stock Corp. Law (1923) § 50.
4 See Part I of this article (1932) 81 U. of Pa. L. Rev. at 286, 287.
policy. If the parties so desire, it may be provided that, if by reason of failure to pay premiums or other cause, the amount of insurance on the life of any party shall fall below a certain amount (usually the face amount of the insurance policies as shown in a schedule in the agreement), then any one of the other parties may terminate the agreement by filing with the trustee a written election indicating that intention. In such case provisions should also be included directing that in the event of termination, all stock and insurance policies shall be returned to the owners.\(^6\)

If, on the other hand, because of unusual circumstances in a particular case, it was felt that an assignment of the policies would be the better method and the draftsman has satisfied himself that the difficulties with respect to insurable interest and testamentary disposition (including transfer made in contemplation of death or intended to take effect in possession or enjoyment at or after death) may be overcome, there is one further point which it might be well to consider before arriving at a final decision in the matter. The Revenue Act of 1932 after defining gross income provides in part as follows:

"(b) Exclusions from Gross Income—The following items shall not be included in gross income and shall be exempt from taxation under this title:

(1) Life Insurance—Amounts received under a life insurance contract paid by reason of the death of the insured, whether in a single sum or in installments (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income);

(2) Annuities, etc. In the case of a transfer for a valuable consideration, by assignment, or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or this paragraph."

\(^6\) There is set forth below an example of a provision of the type above discussed:

"To the owners of the insurance policies as shown in the schedule included herein is reserved the right to receive during the life of the insured, all dividends from any policy upon the life of the insured, the right to obtain surrender values and any all other payments of any kind arising from any policy owned by him, (excepting disability payments which shall be paid over to the person whose life is insured by the policy under which such payment is made), the right to obtain loans upon said policies, the right to cause the beneficiary on any such policy to be changed, and the right to withdraw any policy owned by him upon the written consent of all of the individual parties. It is agreed that nothing shall be payable to the Trustee hereunder pursuant to the terms of any such policy until the death of that party who is the first to die and if any payment to which the owner is entitled is made to the Trustee or to the insured it shall be made over to the owner. The Trustee shall not be obligated to pay any premium or to take any action whatsoever in relation to any such policy except as specifically herein provided. It is agreed that if by reason of failure to pay premiums or other cause the amount of insurance upon the life of any party here to payable to and held by the Trustee shall fall below Thousand Dollars, then the insured at his election may terminate this agreement by filing with the Trustee a written election so to terminate it. In that case all stocks shall be made over by the Trustee to the owners."

The contention is not made here that an assignment of the policies will operate to bring the proceeds of the policies so assigned under the above provisions and as a result subject the proceeds thereof, at least in part, to taxation by the federal government as income. But the use of the assignment method may make the proceeds appear to be taxable, at least to such an extent that the tax authorities might feel called upon to make a thorough investigation, which would undoubtedly interfere with the execution of the provisions of the agreement following death. In view of the fact that rapidity of action following death is one of the great advantages of the stock purchase agreement, it would seem that the circumstances must of necessity be most exceptional to justify the use of the assignment method.

The covenants to purchase and sell briefly provide that upon the death of that one of the parties who is the first to die, the survivors shall have the right and are obligated and agree to purchase the stock which said party owned at the time of his death. The careful trustee will ask for the insertion of a relieving clause to the effect that the covenants to purchase and sell may be enforced by the individual parties but shall not be enforced by the trustee. It can be stated that the price to be paid shall be the value per share as thereafter set forth. An agreement drafted in the manner above suggested will be an agreement to buy and an agreement to sell upon the death of the party first to die. A sale does not take place at the time the agreement is executed but does take place after the death of the party first to die upon fulfillment of the conditions set forth in the agreement.

There is one further point which it is usually advisable to cover in the first part of the agreement. This relates to the sale of stock during the continuance of the agreement. In some cases it may be provided that each stockholder may sell any or all of his stock to any person. In other cases it may be provided that such sale may be made only after an offer to the other parties to the agreement has been made. In both cases, whichever provision is adopted, it should be provided that upon such sale being made the agreement shall terminate forthwith, to be followed by the usual provision for disposition of policies and stock of the parties.

The second portion of the agreement may be described as the portion which becomes operative immediately upon the death of the party first to die and may be divided into two parts: Covenants relative to the valuation of a share of stock, and covenants covering the collection of the proceeds. With respect to the method for arriving at the value to be placed upon a share of stock at the time of the death of the party first to die, there is no set plan. Each situation must be considered as it arises and frequently the parties will have definite ideas in this respect. It may be of assistance, however, to describe a few of the various methods which may be used:

(i) Arbitrary Agreements—Under this method an arbitrary price is fixed at the time the agreement is executed. The use of this method is not
recommended as it will undoubtedly cause trouble in practically every case where the actual value of the stock at the time of death does not closely approximate the price agreed upon.

(2) Periodic Adjustment—Under this method the parties periodically agree among themselves as to the proper valuation and following such agreement file a certificate of valuation with the trustee. This certificate is controlling until the next certificate is filed. This method will prove satisfactory.

(3) Book Value—Under this method the book value of the stock as last determined before the death of the party first to die is used as the basis of valuation. If book values are determined at reasonably frequent intervals, this method may also be satisfactory.

(4) Accountants or Appraisers Reckoning at the Time of Death—Under this method a valuation is set by an accountant or an appraiser after a thorough audit has been made as soon as possible following the death of the party first to die. This method also is satisfactory but may be more expensive in operation than methods (2) and (3) above.

(5) Arbitration—In this case the value is settled by arbitration between the surviving parties and the decedent’s legal representative. This method may be useful in certain situations but its disadvantages are obvious. It is a better method than (1) but not as good usually as (2), (3) or (4).

(6) Any one of the foregoing methods (2), (3), (4) or (5), but under a stated maximum not to be exceeded; the disadvantage inherent in (1) may arise if this method is used.

(7) A stated minimum value plus one of the foregoing methods (2), (3), (4) or (5). This particular method is frequently used and has been found to be satisfactory in operation. The minimum value selected is usually the face amount of the insurance policies.

(8) Any one of the above methods plus or minus an arbitrary sum or sums under varying conditions.

With respect to the obligation of the trustee to collect proceeds of insurance policies, a provision similar to the provision included in all the Personal Insurance Agreements previously discussed should be included.\(^7\)

The third portion of the agreement covers the disposition of the proceeds of insurance policies and the disposition of stock and insurance policies in the trustee’s possession. With respect to the insurance proceeds it should be provided that the trustee shall pay over said proceeds to the legal representative of the party first dying, if the full amount is required. In many agreements the full amount is directed to be paid even though it exceeds the purchase price of the stock. This is the “stated minimum” method above described. In certain cases the parties to the agreement will state that they would prefer to have such proceeds held in trust by the trustee for the benefit

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\(^7\) See Part I, supra note 4, at 296.
of certain beneficiaries rather than have such proceeds paid over to their legal representative as part of their estate. This method of disposing of the insurance proceeds is not entirely feasible. In the first place, it unduly complicates the agreement and the same result may be achieved by the parties by proper provision in their respective wills; but the second and more important objection is that, since the proceeds must be considered as part of the deceased's estate, the creditors of the deceased would undoubtedly be able to attack any disposition which might be made if such proceeds were not delivered to the deceased's legal representative unless a waiver had been obtained by the trustee from the legal representative prior to disposition of the proceeds.

The payment made to the deceased's legal representative as above described will be a payment in full or on account as the case may be. If the payment is in full, then all stock of the deceased is directed to be immediately transferred and delivered by the trustee to the survivors in the proper proportions according to their interest. If, however, the amount so paid is less than the purchase price, it is usually provided that the survivors may pay the balance in cash or execute their individual notes in the proper proportions to total the unpaid balance. It is then provided that all or part of the stock may be held by the deceased's legal representative as collateral for said notes, which are to be payable to the deceased's legal representative, in which case the representative will hold the notes and the trustee will turn over stock to the representative to be held as collateral. If notes are given, all stock deposited may be held as collateral; but usually only the stock of the deceased is so held, and not infrequently only that portion of the stock is held which was not purchased outright. In cases where only the stock of the deceased is held as collateral, it would seem advisable to include a provision directing the trustee to return the other stock deposited to the owners at once.

There will remain the insurance policies which each survivor owns on the lives of the other parties. A provision should be included which directs the trustee to return the policies to their owners who in turn agree to deliver such policies to the person whose life is insured upon receipt of the policies on his own life after a proper adjustment of surrender value has been made. It will be necessary to provide further with respect to the policies owned by the deceased on the lives of the survivors that the legal representative of the deceased shall assign and deliver such policies to the surviving parties whose lives are insured upon receipt from such parties of an amount equivalent to the cash surrender value thereof.

It will be noted that the above plan contemplates that the agreement will terminate as soon as possible after the death of the party who is the first to die. It is possible to draft the agreement so that it will not terminate but continue until only one party remains. There are two difficulties, however, which must be considered if the agreement is so continued. The first
difficulty is the rule against perpetuities which may be violated and the second is a very practical one, to the effect that conditions are frequently so changed by the death of one party that a new agreement is a practical necessity. Further, the plan gains much in simplicity if the agreement terminates after the death of one party. If the agreement is continued for more than one life it certainly should be revocable. It need hardly be stated that such provision should be so worded as to permit revocation by all parties jointly until death of a party and by the survivors after the purchase of the stock of the deceased has been completed following the death of a party to the agreement. Even in cases where the trust continues for but one life, it is usually most advisable to include a specific joint power of revocation together with a joint right to withdraw all or any part of the stock deposited. The power of revocation will provide the parties with an unquestionable method of adjusting the agreement to changed business conditions and will enable them to avoid trouble with insurance companies which might otherwise be met if the agreement did not contain such a provision.

If the agreement is drafted as above suggested, it appears that no trust is created at the time the agreement is executed. As in the case of the Personal Unfunded Agreement, title to the policies does not vest in the trustee, although the policies may be deposited with it and the trustee may be named as beneficiary thereunder. The trustee does hold stock but under the terms of the agreement does not have legal title thereto. Hence in this case, as in the case of the Personal Unfunded Agreement where policies are not assigned, there appears to be no trust created at the time the agreement is executed and the designation of the situation as a "Trust" does not appear to be accurate. The agreement is rather a combination of a contract to buy and sell, an escrow agreement and a contract for a trust to arise in the future.

Following the death of the party first to die, the trustee will hold insurance policies, stock and cash collected on policies insuring the life of the deceased. It is still clear at this point that the trustee has no title to the insurance policies remaining on deposit with it. It is also fairly clear that no title to any of the stock passes to or through the trustee, as on death a sale takes place between the parties and the deceased’s estate, title passing directly from the seller to the buyer. But with respect to the cash which the trustee holds, while it may be argued to the contrary, it seems fairly clear that the trustee takes legal title thereto for a certain purpose, namely, delivery to the deceased’s legal representative in payment for stock; that there is a distinct beneficial interest created, and that, therefore, a trust does arise following the death of the party first to die. If it be argued that no trust is created with respect to the cash received, then it would seem that the agreement continues as an escrow agreement. In cases where the agreement is to terminate as soon as possible after the death of the party first to die, as a
practical matter, the distinction appears to be of little importance. Where, however, for special reasons the agreement is to continue after the death of the party first to die, it may have some importance in connection with the consideration of the possible effect of the rule against perpetuities, and the rule against restraints on alienation.

VIII

The Partnership Liquidation Life Insurance Trust Agreement

At common law, the death of a partner automatically terminates a partnership and this rule has been carried over into the Uniform Partnership Act. As a result, liquidation of the partnership business necessarily follows the death of one of the partners. The survivors may continue the business but they will do so as a new firm, having purchased the interest of the deceased partner from his executor or administrator. Whether the business is continued or not, the executor or administrator of the deceased partner must press for immediate liquidation of such deceased partner's interest. In the case of the Stock Purchase Agreement discussed in the preceding section, we indicated the various disadvantages to all parties concerned if a method for immediate sale of the interest of the deceased party was not provided. But in that case, a sale while most convenient and advisable was not a matter of absolute necessity. In cases where a partnership interest is involved, however, there is no choice; the interest of the deceased partner must be liquidated by the executor or administrator. We have in this case not only the elements of restricted market, inconvenience and danger of loss if other parties enter the business, but also the fact that in a forced sale any element of good will in most cases will be worthless. It is, therefore, of the utmost importance to the members of a partnership that a definite arrangement be made for purchase of a deceased partner's interest. The Partnership Liquidation Life Insurance Trust Agreement provides a method by which such purchase may be made under a definite plan for appraisal of partnership assets, payment and financing. The partnership may be general or limited in nature and in either case the arrangement will be of equal value to all parties concerned. As in the case of the Stock Purchase Agreements, the Partnership Liquidation Agreement may take many different forms. Indeed, we might say that there are almost as many forms for agreements of this type as there are situations dictating the need for some such arrangement. However, it may be useful to take an agreement drafted to meet the demands of a normal problem and consider it in detail. Such an agreement will in its general outline follow very closely the Stock Purchase Agreement previously discussed. There will, of course, be differences in detail arising out of the difference in nature of a corporation and a partnership.

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As in the case of the Stock Purchase Agreement, it must first be determined who shall be a party to the agreement. This question, as in the former case, is closely related to questions with respect to ownership of the policies and payment of the premiums thereon. These questions have been discussed at length in connection with the Stock Purchase Agreements. It is not necessary to repeat the discussion here as the conclusion reached is the same and for the same reasons. In the average case, it will be found that the best method is for each partner to own and carry insurance on the life of every other partner to an extent which will underwrite his own obligation to purchase a proportionate part of the interest of the partner who may be the first to die. The individuals therefore become parties to the agreement in their individual capacity and not as partners.

The Partnership Liquidation Agreement also may be divided roughly into three parts, the first part including covenants to buy and sell, and covenants with respect to the deposit of insurance policies with the trustee, the second part dealing with the determination of the price to be paid for a partnership interest and with respect to the collection of insurance proceeds, and the third part covering the exchange and disposition of partnership interests, insurance proceeds, and insurance policies following the death of the partner first to die.

With respect to the first part of the agreement, after short recitals relative to the existence of the partnership, its registered name (if such is required), its address, and a description of the respective interests of the partners, it is usual to set forth a covenant to the effect that upon the death prior to the termination of the agreement of that one of the partners who is the first to die, the survivors will purchase the interest in the partnership owned by the party so dying. It is also customary to include a further covenant to the effect that the partners purchasing the interest of the deceased partner shall pay all debts of the partnership thereby relieving the estate of the deceased of any burden in this respect.

There should also be included in the first part of an agreement of this type a provision relative to the deposit of insurance policies. Here, as in the case of the Stock Purchase Agreements, each owner of the policies may desire to retain control over them insofar as this may be in accord with the purposes of the agreement. Even though the owner may be indifferent with respect to this matter when the agreement is executed, the time may come when he may desire to make use of the policies for individual or partnership purposes. In the usual case, policies should not be assigned to the trustee and where policies are not assigned, it should be provided that all policies shall be made payable to the trustee as beneficiary. It should of course be further provided that such policies shall be deposited with the

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*See supra page 409 et seq.*
trustee. Hence, it may be specifically stated in the agreement that the person to whom the policy is issued or reissued will be the owner of such policy and of the insurance represented thereby. As has been repeatedly pointed out herein, in such a situation it is most advisable to include a specific reservation of all rights under the policies to the owner thereof. However, in order to afford proper protection to the various parties, it should also be provided that the owner shall exercise such rights only after obtaining the consent of the person whose life is insured or of all other parties if it is so desired. Thus the owner, with the consent of the person insured, or with the consent of all of the parties to the agreement, has the right to receive all dividends, surrender values and any other payment of any kind arising from any policy owned by him (excepting, of course, disability benefits which should be paid to the insured), the right to cause the beneficiary on the policies to be changed, the right to obtain loans thereon, and the right to exercise any and all options contained in said policy, or it may be provided that the owner may withdraw policies only upon the consent of the other party and that only after a policy is so withdrawn may the owner exercise such rights. Under provisions of this type, there is full protection to all parties concerned, as the owner is free to deal with the policy as he may wish only after the consent of the other interested parties has been given, but once said consent is given, the owner may deal with the policies without restriction. Hence, in case of emergency, when the parties are agreed that one or more of the owners should withdraw a policy or policies, such withdrawal may be accomplished without undue delay. This arrangement is safe; it is also very flexible.

It should be noted with respect to the covenant covering the deposit of insurance policies by the parties that a careful trustee will require the inclusion of a relieving clause to the effect that the trustee shall not be required to enforce said covenant. Further with respect to this provision, it would also seem advisable to provide that nothing shall be payable to the trustee until the death of the party who is the first to die and that the trustee shall not be obligated to pay any premium on any such policy. Here, also, if it is so desired, it may be provided that, if by reason of failure to pay premiums or other cause the amount of insurance on the life of any party shall fall below a certain amount, then any one of the other parties may terminate the agreement by filing with the trustee a written election indicating that intention. In such case provision should be made for the return of insurance policies to the respective owners and it may be further provided that each owner shall thereupon assign and deliver each policy owned by him to the partner whose life is insured by each policy, such owner to receive in exchange the policies on his own life, provision being made for an adjustment of the surrender value of the policies so exchanged.\textsuperscript{10}

\textsuperscript{10} See \textit{supra} note 5 for an example of a provision of this type.
Assignment of policies to the trustee may be required in unusual cases but it is to be avoided because of the inflexibility which is inherent in such an arrangement, particularly as the assignment method appears to be no safer than the method first suggested.

The second portion of the agreement should include a covenant setting forth in detail the manner in which the price which is to be paid for a partnership interest shall be set, and also a provision relative to the collection of insurance proceeds. With respect to the price which is to be paid for a partnership interest, here, as in the case of the Stock Purchase Agreement, no fixed plan is used for determining the value of a partner's interest. Various methods are used as previously outlined, depending upon the particular situation involved. The covenant to be included with respect to collection of insurance proceeds may be in the form of such covenant included in the agreements previously discussed.

The third part of the agreement covers the disposition of insurance proceeds, the transfer of the interest of the deceased and the disposition of the remaining insurance policies. With respect to the insurance proceeds, it should be specifically provided that the trustee shall pay over said proceeds to the legal representative of the party first to die, if the full amount is required. If the full amount is not required, the excess may be turned over to the respective owners according to their interests, but in many cases the face amount of the insurance is considered as a minimum price and it is directed that although the actual value of the interest may be less than the face amount of insurance, nevertheless the full amount shall be paid over. If, however, the aggregate amount of the proceeds from insurance policies is less than the purchase price, the surviving partners should covenant either to pay the balance in cash or to deliver to the legal representative of the deceased notes in lieu thereof. It is usually provided in the agreement that notes so delivered shall be installment notes of short maturity and that they shall contain an acceleration provision. It may then be provided further that if such notes are given in payment of the balance of the purchase price, the surviving partners shall execute and deliver a chattel mortgage on all the tangible personal property of the co-partnership or on such part thereof as may be considered to be adequate security. In jurisdictions where it is impossible or inadvisable to use a chattel mortgage, it would seem that a conditional sale of such interest might be made. As a practical matter, the result would be the same.

After the provision relative to the security for the notes, it should then be provided that upon such payment having been arranged, the executor or administrator shall execute and deliver to the survivor a receipt for cash or a receipt for the cash and notes, as the case may be, waiving all right to

11 See supra pages 16 to 17.
an accounting and stating that all right, title and interest in the co-partnership and in the property belonging thereto owned by the deceased has been sold to the surviving partners. Following this provision, a covenant on the part of the surviving partners should be included whereby they agree upon receiving such receipt to pay all debts and discharge all other obligations whether contractual or otherwise of said co-partnership and to indemnify and save the estate of the deceased harmless from any loss suffered by reason of any such debt, and also release the estate from the obligation of contribution in the event the assets of the co-partnership are insufficient to pay debts. A careful trustee will require the insertion of a relieving clause at the end of the article covering the above provisions providing that the trustee shall be under no duty to take any action to enforce the making and delivery of such notes, mortgage, receipt and release.

With respect to the remaining insurance policies which each survivor holds on the lives of the other partners, a provision should be included directing the trustee to return the policies to their owners who should in turn agree to deliver such policies to the person whose life is insured upon receipt of the policies on his own life and upon a proper adjustment of surrender value being made. It will, of course, be necessary to provide further with respect to the policies owned by the deceased on the lives of the survivors that the legal representative shall assign and deliver such policies to the surviving parties whose lives are insured upon receipt from such parties of an amount equivalent to the cash surrender value thereof.

It will be noted that the plan outlined above, as in the case of the Stock Purchase Agreement, contemplates that the agreement will terminate as soon as possible after the death of the party who is the first to die. Here too, it is possible to draft the agreement so that it will not so terminate but continue until only one partner remains, but for the same legal and practical reasons such procedure is usually inadvisable. To repeat, although the difficulties presented by the rules against perpetuities and restraints on alienation may be avoided, the practical consideration that conditions may be and usually are radically changed by the death of one party, or by other causes over a period of time, presents a difficulty not easily avoided. If, however, the agreement is continued for more than one life, a specific power of revocation should be included. Care should be exercised in drafting the provision in order to permit revocation not only by all parties jointly but also by the survivors after the death of one or more parties. The survivors should not be permitted to revoke in such manner as to nullify their obligation to complete the purchase of the interest of any deceased partner. But even in cases where the trust continues for but one life it will usually be most advisable to include a joint power of revocation. As has been stated in connection with the discussion on the Stock Purchase Agreement, such power of revoca-
tion will provide the parties with an unquestionable method of adjustment to changed business conditions and will enable them to avoid trouble with insurance companies which might otherwise be encountered if the agreement did not contain such a provision.

Under this form of agreement also, it is clear that no trust is created at the time the agreement is executed. As in the case of the Stock Purchase Agreement, title to the insurance policies does not vest in the trustee although the policies are deposited with it and although the trustee is named as beneficiary thereunder. The trustee, of course, has no title to any of the partnership interests. Hence in this case, as in the case of the Personal Unfunded Agreement and the Stock Purchase Agreement where policies are not assigned, there appears to be no trust created at the time the agreement is executed. The agreement is a combination of a contract to buy and sell, an escrow agreement and a contract for a trust to arise in the future.

Following the death of the party first to die, the trustee will hold insurance policies and cash collected on policies insuring the life of the deceased. The trustee still has no title to insurance policies remaining on deposit with it. Title of the deceased to partnership property passes directly from the deceased's estate to the survivors and not through the trustee. It seems fairly clear that in this case also the trustee takes legal title to the cash received as beneficiary under the policies but in trust, nevertheless, to make certain disposition thereof, namely, delivery on certain conditions to the deceased's legal representative. Of course, if it may be argued that no trust is created with respect to the cash received, then it would seem that the arrangement continues as an escrow. As a practical matter, where the agreement is to terminate as soon as possible after the death of the party first to die, the distinction appears to be of little importance. Where, however, for various reasons, the agreement is to continue for more than one life, such distinction may have some importance in connection with the consideration of the possible effect of the rules against perpetuities and restraints on alienation.

IX

The Sole Proprietorship Insurance Trust Agreements

We have discussed two types of Business Insurance Trust Agreements in the order of their importance under present business conditions. There is, however, a third type of business agreement, the Sole Proprietorship Insurance Trust Agreement, which should be considered. With the growth in business enterprise which has taken place during the opening decades of the twentieth century accompanied by an equivalent increase in the complexity of business organization in the form of large corporations and partnerships, there has been a steady reduction in the ranks of those individuals who are in business for themselves. Nevertheless, there are still a large
number of individuals who are conducting their own business with their own capital.

Upon the death of a sole proprietor, the business will suffer materially or entirely fail unless the management of the sole proprietor is succeeded immediately by a new owner or owners who will be personally interested in the business. Of course, if the sole proprietor is not particularly concerned with the conservation of the business after his death, he may make an outright bequest of the business to a specific individual or group of individuals named in his will, or he may allow the business to be treated as part of his general estate, permitting his executor or administrator to liquidate the business as soon as possible after his death. In the first case, due to specific gift, the estate of the sole proprietor will receive nothing from the business; in the second case, due to forced sale, the estate will receive something but in most cases it will be an amount considerably less than the value of the business as a going concern.

It is clear, therefore, that if the sole proprietor desires to conserve the value of the business for the benefit of his estate, he must make some arrangement for the continuation or purchase of it. Since most employees in a small business will have little or no assets with which to purchase the business, it would appear that the only practical answer to the problem of conservation of value is insurance upon the life of the sole proprietor.

In accordance with sound business practice, a sole proprietor should, and in most cases it will be found that he does, operate his personal or private investments separately from the particular business of which he may be the owner. The business man of this type may carry insurance for two purposes. First, as a protection for the value of his life to the family group and, secondly, as a protection for the capital which he has invested in his business. The two purposes, of course, are closely related but the distinction remains and should be kept constantly in mind. We are not here concerned with the first type of insurance which has been covered at length in connection with the various forms of Personal Insurance Trust Agreements previously discussed herein. We are concerned, however, with the insurance which is carried as a protection to the capital which the sole proprietor has invested in his business.

It is possible for the sole proprietor who wishes to conserve his business to make the life insurance which he has obtained for business purposes payable to his estate. He may then direct his executor to continue the business and use the insurance proceeds as additional capital therein. The disadvantage of such procedure is obvious. The sole proprietor in most cases will desire to have the business continue in order that his family may have a means of support, and yet, the business of a sole proprietor will almost invariably be speculative in nature and one which under no consideration would be con-
sidered as a proper investment for trust funds upon which certain individuals
who are not actively engaged in the business will depend, at least in part,
for a livelihood. Moreover, the executor will of necessity conduct the busi-
ness on a more conservative basis than the owner, and will not feel that he
can undertake certain business risks which may be necessary for the proper
operation and future development of the business. It is clear, therefore,
that this method of meeting the situation should be avoided whenever pos-
sible.

There remains, then, the possibility of a sale of the business upon the
death of the sole proprietor. The problem is not easy. The field of prospec-
tive purchasers is not large and may be divided into three groups, each of
which is quite small. First, there are the interested employees who may be
in a position to buy the business at a reasonable figure. This, of course,
is the group which, in the great majority of cases, is most interested in the
disposal of the business, and hence this is the group most frequently involved
in a purchase agreement. Secondly, there is that group which is made up
of friendly competitors or associates in the industry who may know the value
of the business and who may be willing to buy it at a reasonable price upon
the death of the sole proprietor. The third group, and the least important
one, is made up of those customers who would be willing to purchase the
business either individually or as a group as an independent venture or for
the purpose of assuring the protection of necessary supplies to avoid inter-
ruption of their own business.

Since the agreement between the sole proprietor and an interested group
of employees is the one most commonly used, we will consider first an agree-
ment of this type. In most cases, when it has been decided that a proper
arrangement should be made for the protection and disposition of the busi-
ness by means of an agreement for sale to the employees, the business will
be incorporated with substantially all shares of stock being owned by the
proprietor. In form the agreement will then be a Stock Purchase Agreement
but it will vary to such an extent and in so many particulars from the usual
form that it may properly be considered as a separate type and as one exam-
ple of a Sole Proprietorship Insurance Trust Agreement.

The first problem and the most important one relates to the payment
of insurance premiums on policies insuring the life of the proprietor. Em-
ployees may not be able to pay insurance premiums. This, however, need not
be considered an insuperable obstacle. The policies may be taken out by the
several employees, each as owner of particular policies, the premiums on
which will be paid by the proprietor. The proprietor should be willing to do
this as he is compensated in that he avoids leaving a non-liquid asset in his
estate. Moreover, it may be provided in the agreement that if and as the
business makes a profit following the death of the proprietor, the employees
will repay to the proprietor's estate a sum equivalent to the premiums paid by
the proprietor. However, in most cases of this type some method can be
devised which will enable the employees to pay the premiums. Since the
agreements may vary according to the situation involved, they may be of
endless variety and the best that can be done is to take a particular situation
and discuss the agreement which would be applicable to it. As the case
where incorporation is thought to be advisable and where the employees
will pay the premiums appears to be the more usual one, we will choose this
type of agreement for discussion.

Under this type of agreement it will be provided that the proprietor will
deliver his stock to the trustee endorsed in blank to be held in accordance
with the terms of the agreement. It will be specifically provided with respect
to the stock that, during the life of the owner, the trustee shall have no rights
with respect to such stock except as depositary under the agreement and that
the proprietor shall have the right to vote, to collect dividends and to exercise
all other rights of an owner except the right to sell, mortgage or otherwise
incumber such stock. The employees in turn agree to assign their respective
insurance policies insuring the life of the proprietor to the trustee to be held
in accordance with the terms of the agreement.

Covenants should be included in the agreement under which the pro-
prietor agrees to sell and each employee agrees to purchase, upon the death
of the proprietor, a certain number of shares as set forth in the agreement,
with the proviso that if the proprietor shall sell any of the stock to his
employees prior to his death, then upon his death the number of shares which
the proprietor obligates his executor or administrator to sell and which the
employees are obligated to buy shall be reduced by an equivalent amount.
As in the case of the other business agreements, provision must be made rela-
tive to the price which will be paid for the stock. There is this difference,
however. In the ordinary Stock Purchase or Partnership Liquidation Agree-
ment the element of liquidation is uppermost in the minds of the parties
and it is not possible in most cases, therefore, to fix a set price upon the inter-
est to be purchased. In the present case, however, the sale element is upper-
most and it is possible, therefore, in most cases, to set forth a specific price
which shall be paid for the business.

Provision should be made in some detail with respect to the procedure
which shall be followed upon the death of the proprietor. It should be
provided, of course, that the trustee shall pay over all cash collected under
the policies up to the agreed purchase price to the executor or administrator
of the proprietor as soon as may be practicable. If, after payment of such
price, there is a cash balance remaining, such cash should be paid over to the
employees in proportion to the amount of stock purchased. Upon full pay-
ment for the stock having been made, the stock will be delivered to each
employee according to the proportion which each employee agreed to pur-
chase. If the net proceeds of the insurance policies are not sufficient to pay
the agreed price, it may be directed that employees may give collateral notes
for the unpaid balance using the stock that has been paid for as collateral, or
it may be directed that only the amount of stock which is paid for shall be
sold and that the remainder shall be delivered to the executor or administra-
tor of the proprietor's estate to be held as part of the deceased's general estate.

With respect to the insurance policies held by the trustee prior to the
death of the proprietor, specific provision should be made with respect to pay-
ment of premiums, it being agreed that the employees shall pay the premiums
and that the trustee shall be under no obligation to make such payment
except as outlined below. It may then be provided that the trustee, upon
receiving notice from the insurance company issuing a particular policy to
the effect that the premium has not been paid, shall borrow on such policy,
or upon any other policy held by it under the agreement, an amount sufficient
to pay the necessary premium. However, the trustee should be under no duty
to borrow as above outlined except upon written direction of the owner of
the policy, nor should he be under a duty to borrow unless the surrender value
of such policy, less such sum plus interest as may be a lien on such policy,
shall be sufficient to enable the trustee to borrow the required amount on the
policy. It would seem advisable, further, to provide that the trustee shall
be under no duty to borrow for payment of premiums if the proprietor or
employees advance a sufficient sum to it for that purpose before such loan is
effected by the trustee. It will usually be provided that the trustee, upon
receiving notice that the premium on a policy remains unpaid after the due
date, shall give notice to all parties of such default, usually within twenty
days after notice of such default. It may then be provided that the remaining
employees shall pay such premiums or shall make available to the trustee
funds sufficient to enable it to repay the loan, together with interest thereon.
In some cases it may be useful to provide that the parties may direct the
trustee to borrow on all policies as much as each company will lend and that
the trustee shall thereupon pay over to the proprietor the amount of such
sums borrowed by it and shall transfer to each of the employees a propor-
tionate amount of the stock which he has agreed to purchase. It may also
be useful to provide that when a policy held by the trustee shall cease to have
any value because the amount borrowed thereon plus interest equals the sur-
render value of such policy, such policy may be cancelled and surrendered
by the trustee upon the direction in writing of the owner of the policy. It
is possible, of course, that an employee, because of financial difficulties or
death, may default in the payment of a premium on a policy which he has
agreed to maintain. Specific provision should be made covering this contin-
gency. It may be provided that all rights of the employee who defaults in
the payment of premiums under the agreement shall cease, except that the employee, or his executor or administrator, if he is dead, shall have the right to be reimbursed for the amount to date of default of the cash surrender value of the policy or policies maintained by him.

Upon the death or other default of an employee, the surviving employees should name a successor to the deceased or defaulting employee. Under the provision previously discussed, the trustee is obligated to give the employees notice of default. It may be provided then, that the surviving employees, upon receiving notice of default or upon the death of an employee, shall determine (usually by majority vote), the name of the person whom they desire as a successor to the defaulting or deceased employee. After the successor has been selected, the proprietor should be notified of the selection and he should be given an opportunity to object. Hence, it may be provided that after notice has been given to the proprietor, his consent will be taken for granted unless he files with the trustee within a stated period (usually ten days), a statement to the effect that he refuses to accept such successor as a purchaser, naming a person whom he desires in place of the one originally designated. The remaining employees may then be given a stated period within which to accept the person selected by the proprietor, or some other party acceptable to him, and if no such person is selected within the stated period, the proprietor should have the right to designate a person who shall be the successor of the deceased or defaulting employee. If the proprietor fails to make such designation within a certain time following the expiration of the stated period above mentioned, it may be provided that the remaining employees shall be obligated to purchase the stock which the deceased or defaulting employee was obligated to purchase in proper proportions according to the amount of stock which each remaining employee is obligated to purchase. It should then be provided that in such event ownership of the insurance policy or policies maintained by the deceased or defaulting employee should be divided among the remaining employees in the same proportions as govern the division of the obligation to buy, and that new policies shall be issued in proper amounts according to such proportion, each employee to maintain the new policy issued to him. The new policies will, of course, be held by the trustee in the same form and manner as the other policies.

Some provision should be made, of course, relative to the means by which the succeeding employee shall signify his acceptance. It may be provided that the successor shall become a party by filing with the trustee a statement in writing duly signed and acknowledged by him stating that he agrees to become a party to the agreement in place of the defaulting or deceased employee and that as successor he shall thereafter maintain the policy or policies involved. After such a provision, it should be provided that the
successor employee or employees shall pay to the defaulting employee, or to his executor or administrator if he is dead, the amount of the surrender value at the time of such default or of his death, of the policy or policies insuring the life of the proprietor maintained by the defaulting or deceased employee at the time of such default or death less certain payments mentioned later in this paragraph. If a premium is in default on which there may have been an advance payment by the other employees, the successor should reimburse the other employees. If there was no advance made by the employees but the trustee borrowed on the policy to pay the premium, the successor employee should pay to the trustee the amount borrowed by it plus interest. In either case, these amounts should be deducted from the surrender value when paid over to the defaulting employee, or to his executor or administrator if he be dead, and provision should be made to this effect.

At the beginning of the discussion with respect to a sole proprietorship agreement, it was stated that the insurance policies would be assigned to the trustee. It is to be inferred from this that all rights under the policies pass to the trustee. Nevertheless, it seems advisable to include a specific provision covering this point. Such a provision should state that all of the property and contractual rights of each of the employees in the insurance policies including the right to borrow on the policies, to receive dividends, disability allowances, cash surrender values, or any other payments accruing under such policies, the right to exercise any and all options permitted under the terms of the policies, shall be vested in the trustee subject to the provisions of the agreement, and, further, that none of the employees shall have any right to exercise any such rights under the policies maintained by them unless such right is expressly reserved under the terms of the agreement except insofar as the exercise of such rights should be necessary to complete or give effect to the interest of the trustee in the policies. It would seem advisable, also, to provide that in administering the trust, proceeds of insurance policies accruing periodically, including dividends, shall be deemed income, and the proceeds of the policies accruing at maturity and of cash surrender values which may be payable to the trustee shall be principal. Provision should be made for the disposition of such income and principal. Usually it will be provided that the trustee shall apply income, including dividends on the policy, to the payment of premiums on the policies producing such income. With respect to principal sums, it may be provided that such sums shall be paid over to the proprietor, and as many shares of the stock which the employee, upon whose policy such payment of principal has been collected, has agreed to purchase as the amount of such payment will purchase shall be transferred to such employee. It is possible that at some time the trustee may have in its possession considerable sums of money which it may not presently distribute in accordance with the provisions of the agreement. It would seem advisable
to provide that in such event the trustee in its discretion may invest such funds in short term securities which are legal investments for the trustee, or it may hold the funds, paying thereon the then bank rate of interest on time deposits.

Each employee should covenant to maintain the insurance policies assigned by him to the trustee. However, there is usually no reason why the trustee should be required to enforce this covenant and it is usually stated that the trustee shall not be so obligated.

As in the case of all agreements previously discussed, it is advisable to include a specific provision defining the obligation of the trustee with respect to collection of the proceeds of the policies. It may be provided that the trustee shall endeavor to collect any sum payable to it on any policy insuring the life of the proprietor held by it as trustee under the agreement, either because of the maturity of the policy or due to declaration of a dividend or request for cash surrender value, or by reason of the exercise of any option permitted by the policy, or which may be collectible in case of lapse or forfeiture or because of any other event. It may also be provided that the trustee may sue for such sums or compromise any claim for or against the interests it represents if suit or compromise is necessary and, in the opinion of counsel for the trustee, advisable. The careful trustee will require the addition of a proviso to the effect that no such suit need be brought unless the trustee's estimated costs, counsel fees and expenses shall have been advanced or guaranteed in an amount and in a manner satisfactory to it.

In connection with the death of an employee, some question might possibly arise with respect to proof of death. It is well to guard against this possibility by providing that such proof shall be made to the trustee in a manner satisfactory to it and that the trustee's judgment as to the sufficiency of the proof and as to any payment made by the trustee or any other action taken by the trustee upon receiving such satisfactory proof shall be binding upon all persons claiming under the agreement. In passing, the possibility that all employees might predecease the proprietor should be noted. It may be provided that if such a situation should arise, the stock and any money which would otherwise have been transferrable to an employee shall be transferred to his executor or administrator.

Finally, a specific provision relative to termination, power of revocation and management should be reserved under the agreement. This affords equal protection to all parties concerned and permits changes to be made in accordance with changed conditions. It may be provided that if, after default shall have occurred in payment of premiums, funds shall not be made available to the trustee by the remaining employees, or if such default has been allowed to continue for a certain number of months after such default has occurred, the proprietor shall have the right to terminate the agreement
by mailing written notice of his election to the employees. It should also be provided that the agreement may be altered, amended or revoked at any time by mutual consent of all parties. Reservation of these last mentioned powers is of particular importance in this type of agreement since it appears that a trust is created with respect to the insurance policies assigned to the trustee and the absence of such reservation might cause considerable difficulty.

It is possible that situations may arise where incorporation of the business of the sole proprietor may be inadvisable. In such case, it will be necessary to work out a solution of the problem by means of a contract between the employees and the sole proprietor. Fundamentally, the contract will not differ from the agreement discussed above although its various provisions will vary considerably in detail.

X

Conclusion

It was observed at the beginning of this article that there are few judicial decisions on the subject of life insurance trusts and that as a result any discussion of the subject must be undertaken with a full realization of the dangers involved in carrying on a discussion when there is little specific authority on which to rely. In the course of our discussion, we have attempted to place before the draftsman the material necessary for a proper understanding of the present theories with respect to various insurance trust agreements with certain suggestions for the application of these theories to concrete situations. A great many of the suggestions which have been made do not rest upon the authority of judicial decision but upon practical experience in devising a means for accomplishing the various ends in view in the light of existing law in the field of trusts, insurance, and related subjects. Subsequent judicial decisions may from time to time require a revision of some of the statements which have been made. The draftsman must bear this fact constantly in mind.