Title

The enforceability of a trust accounting clause's failure-to-object provision (the non-judicial settlement of trustees' accounts)

Summary

It is common for the accounting clause of an inter vivos trust instrument to contain a provision along the lines of the following: "The written approval of such an account by the person or persons thus entitled to such account (OR THE FAILURE TO OBJECT TO SUCH AN ACCOUNT WITH (60) DAYS AFTER IT IS RENDERED) shall as to all matters and transactions stated therein be final and binding upon all persons (whether in being or not) who are then or may thereafter become entitled to share in either the principal or the income of the trust or share for which the account is rendered, except to the extent that such accounting involves the enlargement or shifting of the beneficial interest of any beneficiary of the trust."

Putting aside the inconvenient issue of whether a current beneficiary may bind in equity a future beneficiary when equitable property rights are at stake, I was brought up to take the failure-to-object feature with a grain/pinch of salt. From the trustee's perspective it cannot hurt to have the failure-to-object arrow among the other arrows in defense counsel's quiver, but shooting it off is unlikely to do much damage, absent very special facts. The newly-minted Restatement (Third) of Trusts suggests that such caution may be well-founded. It provides that, as a general rule, a beneficiary's informed consent must be manifested by some affirmative act. "Consent or ratification ordinarily requires more than mere failure of the beneficiary to object to conduct that the beneficiary was aware would or did constitute a breach of trust (but cf. …[laches doctrine]…); the consent or ratification is normally expressly communicated to the trustee, orally or by delivery of a writing, although the consent or ratification may be implied by the beneficiary's conduct in some circumstances." *See* Restatement (Third) of Trusts § 97 cmt. b. One lawyer in a national law firm with a robust trust department of its own absolutely refuses to include a failure-to-object provision in his/her accounting clauses, at least when banks are the designated trustees. One wonders whether the trust instruments under which the lawyer and the lawyer's partners are currently serving as trustee contain accounting clauses that also lack the failure-to-object feature. *See generally* §6.1.3.3. of *Loring and Rounds: A Trustee's Handbook* (appointment of scrivener as trustee) [page 468-472 of the 2014 Edition].

The doctrine of laches is taken up generally in §7.1.2 of *Loring and Rounds: A Trustee's Handbook* [pages 669-674 of the 2014 Edition]. In §5.5 of the Handbook [page 406 of the 2014 Edition], we remind the reader that a trust beneficiary, *qua* beneficiary, generally owes the trustee no duties, fiduciary or otherwise. *See also* §5.5's introductory quotation. The topic of the non-judicial settlement of trust accounts is discussed generally in §6.1.5.2 of the Handbook [pages 538-540 of the 2014 Edition]. The text of the discussion is reproduced in its entirety below.

Text

The following is an edited excerpt from §6.1.5.2 of Charles E. Rounds, Jr. & Charles E. Rounds, III, *Loring and Rounds: A Trustee's Handbook* [pages 538-540 of the 2014 Edition]

The nonjudicial settlement of trustees' accounts. The trustee of a testamentary trust will likely be unable to obtain a final and binding settlement (approval) of his accounts without court involvement. The general procedural requirements for getting the court involved will likely be found in a state statute.[869] The specifics are usually laid out in a body of court rules. Inter vivos trust instruments, on the other hand, often expressly provide for periodic accountings in a nonjudicial setting.[870]

When the beneficiary withholds approval in a non-judicial setting. The typical inter vivos accounting provision provides that the trustee shall be discharged of further liability upon assent of certain adult beneficiaries.[871] Sometimes there is a clause expressly providing for release upon the beneficiary's failure to object within a certain period, usually within sixty days of receipt.[872] Under the default common law, as well as general principles of equity, the failure of a beneficiary to object within such a short period of time would unlikely result in a foreclosing of the trustee's liability for a breach of trust, even for a breach that was unambiguously disclosed in the accounting. As a general rule, the beneficiary's informed consent to a breach of trust must be manifested by some affirmative act. "Consent or ratification ordinarily requires more than mere failure of the beneficiary to object to conduct that the beneficiary was aware would or did constitute a breach of trust (but cf. …[laches doctrine]…); the consent or ratification is normally expressly communicated to the trustee, orally or by delivery of a writing, although the consent or ratification may be implied by the beneficiary's conduct in some circumstances."[1] The doctrine of laches is taken up in §7.1.2 of this handbook. In §5.5 of this handbook we remind the reader that a trust beneficiary, *qua* beneficiary, generally owes the trustee no duties, fiduciary or otherwise.[2]

In jurisdictions that have enacted Section 7-307 of the Uniform Probate Code, it is default statute-law that "any claim against a trustee for breach of trust is barred as to any beneficiary who has received a final account or other statement fully disclosing the matter and showing termination of the trust relationship between the trustee and the beneficiary unless a proceeding to assert the claim is commenced within [6 months] after receipt of the final account or statement."[873]

Whether the assent of a beneficiary can bind the non-assenting co-beneficiaries. It is settled law that

[869]*See* 3 Scott & Ascher §17.4 n.13 for citations to a number of such state statutes.

[870]*See generally* Westfall, *Nonjudicial Settlement of Trustees' Accounts,* 71 Harv. L. Rev. 40 (1957); 3 Scott & Ascher §17.4; 2A Scott on Trusts §172.

[871]*See generally* Westfall, *Nonjudicial Settlement of Trustees' Accounts,* 71 Harv. L. Rev. 40, 60–63 (1957); 3 Scott & Ascher §17.4; 2A Scott on Trusts §172.

[872]*See generally* Westfall, *Nonjudicial Settlement of Trustees' Accounts,* 71 Harv. L. Rev. 40 (1957); 3 Scott & Ascher §17.4; 2A Scott on Trusts §172. *Cf.* Uniform Trust Code §1009 cmt. (available on the Internet at <http://www.law.upenn.edu/library/archives>) (suggesting that as a matter of default law, a beneficiary's failure to object is not sufficient to relieve a trustee of liability for breach of trust); 4 Scott & Ascher §24.21 (Consent of Beneficiary) ("The fact that a beneficiary knows the trustee is committing a breach of trust and fails to object is insufficient to preclude the beneficiary from holding the trustee accountable for the breach of trust").

[1] Restatement (Third) of Trusts § 97 cmt. b.

[2] See also the introductory quotation to §5.5 of this handbook.

[873]*See*, Mass. Gen. Laws ch. 190B, §7-307.

the assent of the holder of a right of revocation who is of full age and legal capacity may bind all contingent equitable interests.[874] It is unsettled, however, whether, in a nonjudicial setting, the assent of present beneficiaries of an irrevocable trust can bind future beneficiaries, remaindermen, and others including minors, the unborn, and the unascertained.[875] In this regard, the law is particularly uncertain when it comes to the nonjudicial settlement of an account that reflects a shifting of beneficial interests.[876] This is because such a shifting may implicate the following principle:

> If the trustee commits a breach of trust…with the consent of one of the beneficiaries, and the breach results in a benefit to the consenting beneficiary and a loss to the trust estate or one or more other beneficiaries, the trustee is entitled to impound the share of the consenting beneficiary, to make good the loss suffered by the trust estate or the other beneficiaries, at least to the extent of the benefit received by the consenting beneficiary.[877]

Thus the Restatement (Third) of Trusts provides that a "designated person's approval…is subject to court review for abuse, with particular attention to neglect or to the possible effects of a conflict of interests between that person and a beneficiary" and that "this review is available to a beneficiary regardless of a trust provision to the contrary, such as one purporting to make the trustee's discharge final or conclusive upon the designated person's approval."[878]

In a landmark case out of New York, the court held that the assent to an account of the trustee of an inter vivos trust by the income beneficiary could not bind the remaindermen:

> If the settlor intended by paragraph Twelfth to deprive the vested remaindermen of their right to question the acts of the trustees, then the validity of that paragraph—as regards the remaindermen—is, to say the least, doubtful. The effect of such deprivation would prevent the vested remaindermen from protecting their interests for the duration of the life estate. Even if the trust were not being performed, they would be without redress. Denial of "the equitable right to enforce the trust" is "inconsistent with its necessary and essential qualities as such." This puts the creator of the trust "in the attitude of deliberately nullifying his own evident purpose." That he meant to create an effective trust is beyond all question; and a construction which makes him destroy in the very effort to create, should not prevail if there be any other rational interpretation.[879]

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[874] *See generally* §8.11 of this handbook (what are the duties of the trustee of a revocable inter vivos trust?); 3 Scott & Ascher §17.4. *See, e.g.,* Trust of Malasky, 290 A.D.2d 631, 632, 736 N.Y.S.2d 151, 153 (2002) (deeming remaindermen to have "no pecuniary interest" in trust during period when settlor possessed right of revocation).

[875] *See, e.g.*, Jacob. V. Davis, 128 Md. App. 433, 738 A.2d 904 (1999) (suggesting that such an assent should be nonbinding). *See generally* 3 Scott & Ascher §17.4.

[876] *See, e.g.,* Trust of Malasky, 290 A.D.2d 631, 736 N.Y.S.2d 151 (2002) (holding that when a cotrustee or trustee is the sole income beneficiary, a trust provision that limits the trustees' accounting responsibilities to the income beneficiaries is violative of public policy). *See generally* 4 Scott & Ascher §20.1 (Impartiality Between Successive Beneficiaries).

[877] 4 Scott & Ascher §25.2.6.1 (When Consenting Beneficiary Profits from Breach of Trust).

[878] Restatement (Third) of Trusts §83 cmt. d (providing also that even a settlor-accountee may employ the accounting in derogation of the rights of the beneficiaries). *See also* In re Cassover, 124 Misc. 2d 630, 46 N.Y.S.2d 763 (Surr. Ct. 1984) (the court disregarding on public policy grounds a provision in an irrevocable trust that the settlor-trustee shall be accountable only to himself).

[879] In re Crane, 34 N.Y.S.2d 9 (1942) (citing Van Cott v. Prentice et al., 104 N.Y. 45, 52, 10 N.E. 257, 260). *See also* 3 Scott & Ascher §17.4 (discussing *In re Crane*).

In any case, a provision purporting to relieve the trustee of the obligation to account to future beneficiaries is unlikely to deprive a future beneficiary of standing to bring an accounting action against the trustee.[880] It is likely that standing would be granted even if the future beneficiary's equitable interest were contingent.[881] The Restatement (Third) of Trusts is generally in accord.[882] Given this uncertainty, the trustee needs to understand in advance of taking a particular action whether binding approval of that action can be obtained nonjudicially through the accounting process. Accordingly, the trustee would be well advised to have in his files a written legal opinion that addresses the types of actions that may not be covered by the settlement provisions of the particular trust's accounting clause, *e.g.*, deducting an income expense from principal, invading principal for the benefit of a current beneficiary, or pursuing an income-at-the-expense-of-growth investment strategy.[883]

Having taken an action that is appropriate but which falls outside the nonjudicial settlement provisions of the accounting clause, the trustee will need to make a cost-benefit analysis. The trustee could have the accounting that covers the period in which the action was taken approved by the court.[884] From the perspective of the beneficiary, however, the privacy and efficiencies attendant with a nonjudicial settlement are preferable to the publicity, time, and expense attendant with a judicial proceeding.[885] Moreover, a frivolous trip to the probate court itself could constitute a breach of the duty of loyalty.

The Uniform Trust Code offers a partial compromise. It would have the trustee periodically account to so-called qualified beneficiaries.[886] For purposes of the Act, a qualified beneficiary is a beneficiary who, on the date the beneficiary's qualification is determined: (A) is a distributee or permissible distributee of trust income or principal; (B) *would be* a distributee or permissible distributee of trust income or principal if the interests of the distributees in…(A)…[above] …terminated on that date; or (C) *would be* a distributee or permissible distributee of trust income or principal if the trust were to terminate on that date.[887] In other words, the trustee would have to render routine periodic written accountings to the presumptive remaindermen as well as to the current beneficiaries. A word of caution is in order here: There is less to the UTC's qualified-beneficiary concept than meets the eye. As we note in §6.1.5.1 of this handbook, "[u]nder the Uniform Trust Code, in a critical matter such as when equitable property rights, whether vested or contingent, are at stake, notice to the qualified beneficiaries would not relieve the trustee of the duty to give adequate notice to the nonqualified beneficiaries, either by giving actual notice to them or by giving notice to a duly-appointed guardian ad litem charged with representing their interests."

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[880]*See, e.g.,* Trust of Malasky, 290 A.D.2d 631, 736 N.Y.S.2d 151 (2002) (holding that when a cotrustee or trustee is the sole income beneficiary, a trust provision that limits the trustees' accounting responsibilities to the income beneficiaries is violative of public policy); Briggs v. Crowley, 224 N.E.2d 417, 421 (1967).

[881]*See, e.g.,* Siefert v. Leonhardt, 975 S.W.2d 489 (Mo. Ct. App. 1998).

[882]Restatement (Third) of Trusts §83 cmt. d.

[883]*See generally* 4 Scott & Ascher §20.1 (Impartiality Between Successive Beneficiaries).

[884]*See generally* 4 Scott & Ascher §24.31 (Liability for Incorrect Distributions).

[885]*See generally* Bogert, Trusts and Trustees §973 (Settlor's Control Over Duty to Account).

[886]Uniform Trust Code §813(c) (available on the Internet at <http://www.law.upenn.edu/library/archives>).

[887]Uniform Trust Code §103(12) (available on the Internet at <http://www.law.upenn.edu/library/archives>).