

Title

Even when statute law permits inclusion in inter vivos trust instruments of *in terrorem* (no-contest) clauses, equity will have the last word when it comes to enforceability.

Text

Introduction. An *in terrorem* (no-contest) clause in an inter-vivos trust instrument provides for forfeiture of the attendant equitable property rights of any beneficiary who “contests the trust.” A contest might take the form of a challenge in the courts to the validity of trust itself, to validity of a material trust term, or to how trust is being administered. In each category of contest, however, enforceability of an *in terrorem* clause, even a clause expressly authorized by statute/case law, is subject to an equity veto, circumstances warranting.

Contesting the trust’s validity. Even when there is an *in terrorem* clause a beneficiary has standing to contest judicially the trust’s validity, provided the allegation is that the trust itself has been the product of incapacity, fraud, duress, undue influence, mistake, or breach of fiduciary duty such that someone has been unjustly enriched as a consequence. If the beneficiary prevails, the trust itself is voided; also, perforce, are its terms, of which the *in terrorem* clause is one. *See, e.g., Slosberg v. Giller*, 876 S.E.2d 228 (Ga. 2022). If contest is unsuccessful, then the *in terrorem* clause stands, with the beneficiary not only being denied unjust-enrichment-based restitution but also losing his/her equitable property rights under the trust. *Id.* *In terrorem* clauses, together with any statutory authority relating thereto, should not be parsed in isolation. Equitable context is critical. Why might a beneficiary seek the trust’s total voidance? Perhaps he/she would be entitled to entire trust estate free of trust should voidance trigger a resulting trust. Or contesting a trust “as amended” might be advantageous economically, the beneficiary being entitled to a greater economic interest under its unamended version.

Contesting a trust term. Assume current beneficiary of an inter vivos trust is deceased settlor’s girlfriend (GF). The taker of the remainder-in-corpore is to be settlor’s son (S). There is an *in terrorem* clause. Provisions for benefit of GF are alleged to be the product of the GF’s fraud, duress, or undue influence. If culpability is found, equity ought not permit the *in terrorem* clause to be triggered in GF’s favor, her hands being unclean. Now if the malfeasance had been perpetrated by someone other than GF, she, though innocent, still has been unjustly enriched. S, assuming he is one victimized by the unjust enrichment, may bring an equitable action for restitution without triggering the *in terrorem* clause. It is the unjust enrichment that is being contested, not the trust’s terms. Equity cannot allow the *in-terrorem* clause to tie equity’s hands when it comes to unjust-enrichment remediation. Had the scrivener been the GF, then the *in terrorem* clause also could be a product of a breach of fiduciary duty incident to the attorney-client agency relationship, the settlor-client being the principal, GF-lawyer the agent. Thus, even absent fraud, duress, or undue influence, if settlor had not given his informed consent to insertion of an *in terrorem* clause that would advantage GF, then equity should void the clause. Equity’s wariness when it comes to exculpatory clauses advantageous to scrivener-trustees should apply as well to *in terrorem* clauses advantageous to scrivener-beneficiaries. The exculpatory clause is taken up in §7.2.6 of *Loring and Rounds: A Trustee’s Handbook* (2023), which section is reproduced in appendix below. Again, equitable context is critical. The Handbook is available for purchase at: <https://law-store.wolterskluwer.com/s/product/loring-roundstrustees-hanbook-2023e/01t4R00000Ojr97QAB>.

Contesting how trust is being administered. Equity should not enforce an *in terrorem* clause when it comes to actions to remedy intentional breaches of trust, particularly breaches of trustee’s duty of

undivided loyalty. Otherwise trustee would personally hold subject property free of fiduciary constraints. A truly unaccountable “trustee” is indistinguishable from the donee of a completed gift. Equity should not enforce an *in terrorem* clause if to do so would effectively void the very trust the clause was intended to protect. Vexatious breach-of-trust actions brought by a beneficiary in bad faith and without reasonable cause, however, should trigger the *in terrorem clause*, particularly if the purpose of the litigation is to constructively void the trust. *See, e.g.*, *Barry v. Barry*, 851 S.E.2d 119 (Ga. 2020). So also vexatious declaratory-judgment actions. “Equity looks to the intent (substance) rather than to the form.” While actions for negligent breaches of trust may be deterred via an *in terrorem* clause, they also may be deterred via the exculpatory clause. Less confrontational. In any case, *in terrorem* clauses are too doctrinally unstable to warrant boilerplate status. The *in terrorem* clause is covered exhaustively in §5.5. of the Handbook.

Appendix

§7.2.6 Exculpatory (also Exemption or Indemnity) Provisions Covering Breaches of Trust; Trustee Exoneration Provisions [from *Loring and Rounds: A Trustee’s Handbook* (2023), available for purchase at: <https://law-store.wolterskluwer.com/s/product/loring-roundstrustees-hanbook-2023e/01t4R00000Ojr97QAB.>]

Introduction. For a black-letter synopsis of general limited-liability doctrine in the trust context, see §8.15.20 of this handbook.

The trustee’s acts of ordinary negligence. Many trust instruments contain exculpatory provisions that purport to limit the trustee’s liabilities to the beneficiary. Sometimes they are enforceable; sometimes they are not.⁶⁰⁰ In Massachusetts and North Carolina they generally are.⁶⁰¹ In New York such provisions are void as against public policy.⁶⁰² Not in the case of New York inter vivos trusts, however. In fact, the term of an inter vivos trust purporting to relieve the trustee of liability for breaches of trust occasioned by the good faith reliance on the advice of counsel has been found not to violate New York public policy.⁶⁰³ Under the federal Trust Indenture Act of 1939, a provision purporting to exculpate an indenture trustee from liability for ordinary negligence is unenforceable as against the bondholders.⁶⁰⁴ The Restatement (Third) of Trusts is more tolerant of fiduciary exculpation, although its tolerance is not unlimited: “A provision in the terms of a trust that relieves a trustee of liability for breach of trust, and that was not included in the instrument

⁶⁰⁰In Bogert §1295, there is the following example of an exculpatory provision: No Trustee, acting hereunder, shall be held responsible for the defaults of any cotrustee or for any loss sustained by the trust estate through any error of judgment made in good faith, but he shall be liable only for his own willful misconduct or breach of good faith.

⁶⁰¹*See* *J.P. Morgan Chase, N.A. v. Loutit*, 2013 N.Y. slip op. 30242(U), 2013 WL 497329 (N.Y. Sup. Ct. Jan. 22, 2013).

⁶⁰²N.Y. Est. Powers & Trusts Law §11-1.7 (providing that any attempted exoneration of a trustee from liability for failure to exercise reasonable care, diligence, and prudence is against public policy and void, exempting only from its coverage trustees of inter vivos trusts whose instruments are dated before August 24, 2018). *See, e.g., In re Wilkinson*, 179 A.D.3d 817, 117 N.Y.S.3d 683 (App. Div. 2020). *See generally* Bogert §542; 4 Scott & Ascher §24.27.3; 3 Scott on Trusts §222; Restatement (Second) of Trusts §222; 7 Scott & Ascher §45.6.6 (conflict of laws and fiduciary exculpation).

⁶⁰³*See In re HSBC Bank USA, N.A.*, 947 N.Y.S.2d 292 (App. Div. 2012). *See generally* §8.32 of this handbook (the trustee’s good faith reliance on advice of counsel as a defense to a breach of trust claim).

⁶⁰⁴15 U.S.C. §770oo. *See generally* §9.31 of this handbook (corporate trusts; trusts to secure creditors; the Trust Indenture Act of 1939; protecting bondholders).

as a result of the trustee's abuse of a fiduciary or confidential relationship, is enforceable except to the extent that it purports to relieve the trustee (a) of liability for a breach of trust committed in bad faith or with indifference to the fiduciary duties of the trustee, the terms or purposes of the trust, or the interests of the beneficiaries, or (b) of accountability for profits derived from a breach of trust."⁶⁰⁵ For a discussion of what might constitute good faith conduct on the part of a trustee, see generally §8.15.81 of this handbook.

The UTC would hold an exculpatory clause unenforceable only to the extent it purports to shield the trustee from liability arising from bad faith or reckless indifference.⁶⁰⁶ "As a result, the UTC allows such a clause to shield a trustee from liability not only for its negligence, but also for its gross negligence."⁶⁰⁷

In those jurisdictions where trust exculpatory clauses are enforceable, including England,⁶⁰⁸ courts will go only so far in giving them force and effect.⁶⁰⁹ As a general rule, anything beyond exculpation for ordinary negligence is of doubtful validity.⁶¹⁰ "No matter how broad the provision, the trustee is liable for committing a breach of trust in bad faith or with reckless indifference to the interests of the beneficiaries."⁶¹¹ Moreover, a valid exculpatory clause will not necessarily deter a court in a given situation from denying the trustee compensation.⁶¹² By federal statute, a mutual fund trustee may not be relieved of liability for acts that are occasioned by "willful misfeasance, bad faith, gross negligence or reckless disregard of the duties of his office."⁶¹³ ERISA essentially does away with fiduciary exculpation altogether.⁶¹⁴ In Texas, however, an exculpatory clause may relieve a trustee of liability for acts of self-dealing.⁶¹⁵ The exceptions are a corporate trustee loaning trust money to itself, buying trust property from itself, or selling trust property to itself.

An exculpatory clause that purports to limit a trustee's liability for a particular type of breach of trust ought not to be confused with a clause that grants the trustee a discretionary power to engage in an act that might otherwise be a breach of trust.⁶¹⁶ This is easier said than done, however, when an exculpatory clause is narrowly drawn, such as a clause that purports to exculpate the trustee from liability for retaining the family business. Whether the trustee is entitled to compensation may well hinge on whether it is actually a discretionary power.⁶¹⁷

Exculpatory clauses tend to be strictly construed by the courts.⁶¹⁸ In one case, a provision exculpating

⁶⁰⁵Restatement (Third) of Trusts §96(1). The "good faith" standard of conduct in the trust context is discussed in §8.15.81 of this handbook.

⁶⁰⁶UTC §1008.

⁶⁰⁷Alan Newman, *Trust Law in the Twenty-First Century: Challenges to Fiduciary Accountability*, 29 *Quinnipiac Prob. L.J.* 261, 264 (2016).

⁶⁰⁸Lewin ¶39-82 (England).

⁶⁰⁹Lewin ¶39-82 (England).

⁶¹⁰Lewin ¶39-82 (England). *See generally* 4 Scott & Ascher §§24.27 (U.S.), 24.27.3 (Extent to Which Exculpatory Provisions Are Against Public Policy).

⁶¹¹4 Scott & Ascher §24.27.3 (Extent to Which Exculpatory Provisions Are Against Public Policy).

⁶¹²*See generally* 4 Scott & Ascher §24.27.1. *See also* §7.2.3.7 of this handbook (reduction or denial of compensation).

⁶¹³15 U.S.C. §80a-17(h) (Investment Company Act of 1940).

⁶¹⁴*See* 4 Scott & Ascher §24.27.3 (referring to ERISA §410(a), 29 U.S.C. §1110(a)).

⁶¹⁵Tex. Commerce Bank v. Grizzle, 96 S.W.3d 240 (Tex. 2002).

⁶¹⁶*See generally* 4 Scott & Ascher §24.27.1 (Distinction Between Exculpatory Provisions and Provisions That Enlarge Trustee's Powers); 7 Scott & Ascher §45.6.6 (fiduciary exculpation versus enlarging the trustee's powers/conflict of laws); §3.5.3.2 of this handbook (the trustee's express authority to engage in acts that might ordinarily be considered breaches of trust).

⁶¹⁷*See generally* 4 Scott & Ascher §24.27.1 (Distinction Between Exculpatory Provisions and Provisions That Enlarge Trustee's Powers).

⁶¹⁸Lewin ¶39-90 (England); 4 Scott & Ascher §24.27.2 (U.S.). *But see* Tex. Commerce Bank v. Grizzle, 96 S.W.3d 240 (Tex. 2002) (liberally construing an exculpatory clause in a trust and holding that

a trustee for ordinary negligence was held not to cover a breach of the duty to keep the beneficiaries informed and a breach of the duty to treat them impartially. “The duties to furnish information and to act impartially are not subspecies of the duty of care, but separate duties.”⁶¹⁹ In another case, the court would not allow a trustee who had committed a breach of trust to compensate himself from the trust estate, even though the trustee, because of an exculpatory clause, had been relieved of liability for losses that had been occasioned by the breach.⁶²⁰

A trustee may not hide behind an exculpatory provision that has been improperly inserted.⁶²¹ An issue of the improper insertion of an exculpatory provision is likely to come up when the drafting attorney, or his law partner,⁶²² is also the named trustee.⁶²³ When the attorney-trustee drafts into the instrument a provision limiting liability, there is at best an appearance of impropriety and conflict of interest.⁶²⁴ After all, he has a duty to represent the interests of the settlor, his client—not his own interests.⁶²⁵ In situations where the drafting attorney is the named trustee, the best practice is for the attorney to insist that the settlor seek competent, independent legal advice on the matter of trustee exculpation.⁶²⁶ The benefit to the settlor is self-evident; the benefit to the trustee is that the exculpation is less vulnerable to attack than it would be otherwise. The next best practice is for the attorney to fully disclose to the settlor the existence and import of such a provision.⁶²⁷ In no event should the drafting attorney casually dismiss as mere boilerplate an exculpatory provision—neither in practice nor in response to client inquiries.⁶²⁸ That practice is unacceptable.⁶²⁹

By the time the trust instrument is executed, the relationship between a prospective corporate trustee and a prospective settlor may well have developed into a confidential one.⁶³⁰ “When a corporate officer drafts the trust instrument, even in a state in which this is permissible, there is such a relationship between

the clause relieved the trustee of liability for losses to the trust caused by a liquidation of trust assets incident to a merger of the bank with another bank).

⁶¹⁹McNeil v. McNeil, 798 A.2d 503, 509 (Del. 2002).

⁶²⁰Warren v. Pazolt, 89 N.E. 381 (Mass. 1909). *See also In re Chamberlain*, 156 A. 42 (N.J. Prerog. Ct. 1931); Restatement (Second) of Trusts §243 cmt. g.

⁶²¹*See generally* 4 Scott & Ascher §24.27; Young, *Exculpatory Clauses*, 13 Prob. L.J. 63 (1995).

⁶²²*See, e.g., In re Est. of Kramer*, No. 92-2347, 2003 WL 22889500, 23 Fiduc. Rep. 2d 245 (Pa. Ct. C.P. May 15, 2003) (ruling that law partner stands in the shoes of the scrivener).

⁶²³*See generally* 4 Scott & Ascher §24.27.4; Restatement (Second) of Trusts §222 cmt. d.

⁶²⁴*See generally* 4 Scott & Ascher §24.27.4 (Exculpatory Provision Improperly Inserted).

⁶²⁵*See generally* 4 Scott & Ascher §24.27.4 (Exculpatory Provision Improperly Inserted).

⁶²⁶Restatement (Second) of Trusts §222 cmt. d. *See also* UTC §1008 cmt. (suggesting that if the settlor was represented by independent counsel, the settlor’s attorney is considered the drafter of the instrument even if the attorney used the trustee’s form).

⁶²⁷*See Marsman v. Nasca*, 30 Mass. App. 789, 573 N.E.2d 1025 (1991), *review denied*, 411 Mass. 1102, 579 N.E.2d 1361 (1991) (exculpatory clause upheld in face of unrefuted testimony that the settlor asked the attorney-trustee to insert the clause). *But see* UTC §1008(b) (disapproving of the *Marsman* case and providing that an exculpatory provision drafted by or on behalf of the trustee is presumed to have been inserted as a result of an abuse of a fiduciary or confidential relationship). *See generally* 4 Scott & Ascher §24.27.4 (Exculpatory Provision Improperly Inserted).

⁶²⁸*See Jothann v. Irving Tr. Co.*, 151 Misc. 107, 270 N.Y.S. 721 (Sup. Ct. 1934), *aff’d*, 243 A.D. 691, 277 N.Y.S. 955 (App. Div. 1935) (striking exculpatory provision, which had been drafted by attorney acting as agent for the trustee). *See generally* *Rutanen v. Ballard*, 424 Mass. 723, 678 N.E.2d 133 (1997) (excerpting §7.2.6 of this handbook (exculpatory (also exemption or indemnity) provisions covering breaches of fiduciary duty to the beneficiary).

⁶²⁹*See generally* 4 Scott & Ascher §24.27.4 (Exculpatory Provision Improperly Inserted).

⁶³⁰*See generally* 4 Scott & Ascher §24.27.4 (Exculpatory Provision Improperly Inserted). *See also* Chapter 1 of this handbook (in part defining a confidential relationship).

the parties, even prior to the creation of the trust, that inclusion of a provision relieving the trustee of liability for breach of trust is ineffective unless the settlor fully understood the nature of the provision and freely agreed to it.”⁶³¹

In England, clauses that exonerate or indemnify trustees for negligent breaches of trust are recognized.⁶³² “The Trust Law Committee, a privately-funded body working for reform of trust law, ... [however]... has started a consultation exercise on reforming this area of the law to bar such clauses from general use by professional trustees.”⁶³³

While there are important similarities between the charitable trust and the charitable corporation,⁶³⁴ fiduciary exculpation is one area where there is a fundamental difference. *Settlers* of charitable trusts generally control the insertion of exculpatory provisions into trust instruments, not the trustees. When it comes to charitable corporations, however, it is the *directors*—the fiduciaries themselves—who generally have authority, by statute,⁶³⁵ to determine whether there is fiduciary exculpation.

As to boilerplate exculpatory-type provisions that would relieve an innocent third-party purchaser of trust property of the now nonexistent duty to see to it that the trustee properly applies the purchase price, see §8.15.69 of this handbook.

The trustee who relies on the terms of the trust. The Uniform Prudent Investor Act provides as follows: “The prudent investor rule, a default rule, may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust. A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the provisions of the trust.”⁶³⁶ The UTC is in accord.⁶³⁷ A warning: The reliance must be reasonable. Take, for example, the entrusted insurance contract. The typical trust instrument will contain exonerating boilerplate similar to the following: “The Trustee shall be under no obligation to pay the premiums which may become due and payable under the provisions of such policy of insurance, or to make certain that such premiums are paid by the Settlor or others, or to notify any persons of the \$payment of such premiums, and the Trustee shall be under no responsibility or liability of any kind in the event such premiums are not paid as required.” One thing is for sure: No matter how expansive and detailed the purported exoneration, if the trustee is on actual or constructive notice that an entrusted policy is about to lapse due to unintentional premium nonpayment, he is duty-bound to take reasonable steps to prevent the lapse, short of reaching into his own pocket. “Perhaps the most fundamental aspect of acting for the benefit of the beneficiaries is protecting the trust property ... [Such exonerating language]... cannot be relied upon to abrogate ... [the Trustee’s]... duty to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.”⁶³⁸ If the risk to the trust estate is attributable to the trustee’s own negligence, say, the trustee had undertaken to furnish the insurance company with an address to which notifications should be sent and the address had been wrong, then he could well be financially on the hook for any consequential economic harm to the trust estate.⁶³⁹

A boilerplate clause purporting to exonerate the trustee for breaches of trust occasioned by the good-

⁶³¹4 Scott & Ascher §24.27.4 (Exculpatory Provision Improperly Inserted).

⁶³²Armitage v. Nurse [1997] 2 All E.R. 705 (Eng.).

⁶³³Martyn Frost, *Overview of Trusts in England and Wales*, in *Trusts in Prime Jurisdictions* 13, 22 (Alon Kaplan ed., 2000).

⁶³⁴See §9.8.1 of this handbook (the charitable corporation).

⁶³⁵See Revised Model Nonprofit Corporation Act Subchapter E cmt. 1 (1987). See also Moody, *State Statutes Governing Directors of Charitable Corporations*, 18 U.S.F. L. Rev. 749, 782–783 (1984) (tabulating state indemnification provisions applicable to nonprofit corporations).

⁶³⁶Unif. Prudent Investor Act §1(b).

⁶³⁷See generally §3.5.2.5 of this handbook.

⁶³⁸Rafert v. Meyer, 859 N.W.2d 332 (Neb. 2015).

⁶³⁹See, e.g., Rafert v. Meyer, 859 N.W.2d 332 (Neb. 2015).

faith reliance on the opinions of counsel can be a two-edged sword. This is because the trustee who pursues an advice-of-counsel defense risks partially waiving the attorney-client privilege. Such partial waivers are taken up in §8.8 of this handbook.

The Uniform Trust Decanting Act. The Uniform Trust Decanting Act (the “Act”), specifically §17(a), provides that the terms of the second trust (the recipient trust) may not relieve an authorized fiduciary from liability for breach of trust to a greater extent than do the terms of the first (the decanted) trust. As a corollary, §17(b) provides that any enforceable express right of indemnification in the trustee of the first trust may effectively survive the decanting and remain in the trustee of the first trust should the terms of the second trust so provide. Here is the language of §17(b) verbatim: “A second-trust instrument may provide for indemnification of an authorized fiduciary of the first trust or another person acting in a fiduciary capacity under the first trust for any liability or claim *that would have been payable from the first trust if the decanting power had not been exercised.*”[italics supplied by authors]. The provision is literally nonsensical because the italicized phrase is grammatically misplaced. One may contextually infer that the phrase is intended to modify “indemnification,” not “liability or claim.” Decanting is discussed generally in §3.5.3.2(a) of this handbook.