

Memorandum Urging Approval

NYSBA #40 - GOV

August 13, 2018

S. 6138
A. 10100

By: Senator Bonacic
By: M. or A. Dinowitz
Senate Committee: Judiciary
Assembly Committee: Judiciary
Effective Date: Immediately

AN ACT to amend the estates, powers and trusts law, in relation to limitations on powers and immunities of executors and testamentary trustees.

LAW & SECTION REFERRED TO: Section 11-1.7 of the Estates, Powers and Trusts Law.

Exoneration clauses excuse fiduciaries, most notably executors and trustees, from liability for the failure to exercise reasonable care.¹ Although exoneration clauses in testamentary instruments have been deemed void as against public policy, pursuant to Estates, Powers and Trusts Law (“EPTL”) § 11-1.17, there is no analogous statutory prohibition concerning the enforceability of similar provisions in inter vivos trusts.² The absence of such statutory guidance has left courts to reach divergent views concerning the enforceability of exoneration clauses in lifetime trust instruments. In order to create uniformity in terms of the duties that fiduciaries (whether they be executors, trustees of testamentary trusts, or trustees of lifetime trusts) owe and to remedy the omission of any reference to inter vivos trusts from EPTL § 11-1.7, the New York State Bar Association’s Trusts and Estates Law Section (the “Section”) supports the proposal to amend EPTL § 11-1.7 in accordance with A.10100 and S.6138.

History of EPTL § 11-1.7

Estate and trust fiduciaries owe a duty of undivided, absolute loyalty to the beneficiaries whose interests they protect.³ This “inflexible” duty of fidelity is akin to the highest standards of honor, not just honesty alone.⁴ It obligates fiduciaries to administer the estate or trust for the benefit of the beneficiaries, with undivided loyalty and without regard to self-interest.⁵ The legal responsibilities arising from that fiduciary status cannot generally be divested by agreement or other means.⁶

Despite the foregoing, however, testators and grantors have attempted to insulate their fiduciaries from liability for breaching their obligations. These attempts come in the form of

¹ Cf. Margaret Valentine Turano, Commentary: N.Y. E.P.T.L. § 11-1.7 (2008) (discussing exoneration clauses).

² *Matter of Knox*, 98 AD3d 300, 312-13 (4th Dep’t 2012).

³ *Boles v Lanham*, 55 AD3d 647, 647-68 (2d Dep’t 2008); 41 N.Y. Jur. 2d *Decedents’ Estates* § 1450 (2009).

⁴ *Matter of Wallens*, 9 NY3d 117, 122-23 (2007).

⁵ *See id.*

⁶ *See id.*

exoneration clauses, which purport to exculpate fiduciaries from liability for breaching the duty of undivided loyalty, among other duties.⁷ Such provisions are not universally enforceable.

More than a century ago, in *Crabb v Young*, the Court of Appeals first addressed the issue of whether exoneration clauses are enforceable.⁸ In *Crabb*, the decedent's will exempted the trustees of a testamentary trust from liability for "any loss or damage . . . except [that which occurred due to] their own willful default, misconduct or neglect."⁹ When the trust suffered investment losses, the beneficiaries sought to be reimbursed by the trustee.¹⁰ Although both the trial court and intermediate appellate court ruled that the trustee had an obligation to replace the amount lost, the Court of Appeals reversed, relying upon the exoneration clause contained in the will.¹¹ In doing so, the Court explained that the decedent "had an absolute right to select the agencies by which his bounty should be distributed and to impose the terms and conditions under which it should be done."¹² Since there was no evidence of willful default, misconduct, or negligence on the trustee's part, the Court found that the exoneration clause required that the fiduciary be excused from liability for the losses.¹³

Subject to the requirement that fiduciaries act honestly and in good faith, the rule in *Crabb* prevailed for more than five decades, until the Great Depression,¹⁴ when the Legislature enacted Decedent Estate Law ("DEL") § 125 in 1936.¹⁵ DEL § 125 proscribed the enforcement of exoneration clauses that purported to excuse estate and testamentary trust fiduciaries from liability for failing to exercise reasonable care.¹⁶ In passing DEL § 125, the Legislature restricted the freedom of testation, which generally is favored as a matter of public policy.¹⁷

DEL § 125 was necessitated by the "increasing practice of testamentary draftsmen . . . in vesting in . . . fiduciaries almost unlimited powers, with a minimum of obligations."¹⁸ As the legislative history reflects, this practice was "a serious potential menace . . . to the rights of . . . all persons interested in estates."¹⁹ Additionally, "[t]he primary duties of ordinary care, diligence and prudence and of absolute impartiality among . . . beneficiaries [were] of the very essence of a trust, and any impairment of these or similar obligations of a fiduciary [was found to be] contrary to public policy."²⁰

⁷ Robert Whitman, "Exoneration Clauses in Wills and Trust Instruments," 4 *Hofstra Prop. L. J.* 123, 124-25 (1992).

⁸ *Crabb v Young*, 92 NY 56, 65-67 (1883).

⁹ *See id.*

¹⁰ *See id.*

¹¹ *See id.*

¹² *See id.*

¹³ *See id.*

¹⁴ Cf. Henry A. Shinn, "Exoneration Clauses In Trust Instruments", 42 *Yale L. J.* 359, 365 (1933) (discussing the rapid depreciation of trust assets).

¹⁵ *Matter of Clark's Will*, 257 NY 132, 138 (1931); *Matter of Balfe's Will*, 243 AD 22, 24-25 (2d Dep't 1935); Turano, *supra* note 1.

¹⁶ *Matter of Stralem*, 181 Misc2d 715, 719-20 (Sur Ct, Nassau County 1999).

¹⁷ Turano, *supra* note 1.

¹⁸ *Stralem*, 181 Misc2d at 719-20.

¹⁹ *See id.*

²⁰ *See id.*

The same policy-based reasons governed thirty years later, when the Legislature enacted DEL § 125's successor, EPTL § 11-1.7.²¹ Under EPTL § 11-1.7, a testator is prohibited from exculpating the executor or testamentary trustee nominated in a will from liability for failing to "exercise reasonable care, diligence and prudence."²² Will provisions that purport to do so are void as against public policy.²³ Indeed, as explained in *Matter of Stralem*, "the attempted exoneration of the fiduciary [of an estate or testamentary trust] for any loss, unless occasioned by 'willful neglect or misconduct' is a nugatory provision amounting to nothing more than a waste of good white paper."²⁴

Examples of cases in which courts have reached the same conclusion that the court did in *Stralem* abound.²⁵ For example, in *Matter of Lubin*, the decedent's will provided that the executor of his estate would be relieved of liability "for any loss or injury to the property . . . except . . . as may result from fraud, misconduct or gross negligence."²⁶ Describing that provision as a "toothless tiger," the court held that it was unenforceable as against public policy.²⁷

Although EPTL § 11-1.7 unquestionably applies to testamentary instruments, the statute is silent with respect to inter vivos trust instruments.²⁸ That silence has left courts to reach their own, sometimes divergent, views on the issue and necessitates amendments to EPTL § 11-1.7.

Exoneration Clauses in Inter Vivos Trust Instruments

As EPTL § 11-1.7 does not address inter vivos trusts, the issue of the enforceability of exoneration clauses in such instruments has been left to the discretion of the courts.²⁹ In exercising their discretion, however, courts have reached conflicting conclusions as to the applicability of EPTL § 11-1.7 to inter vivos trust instruments and the enforceability of the exculpatory provisions contained in them.³⁰

Absent statutory guidance declaring exoneration clauses in inter vivos trust instruments void as against public policy, most courts have, historically speaking, enforced them, applying a "more liberal rule" to such provisions than to exculpatory clauses in testamentary instruments.³¹

²¹ *See id.*

²² EPTL § 11-1.7(a)(1).

²³ EPTL § 11-1.7(a)-(b).

²⁴ *Matter of Stralem*, 181 Misc2d 715, 719-20 (Sur Ct, Nassau County 1999).

²⁵ *Matter of Lang*, 60 Misc2d 232, 234-35 (Sur Ct, Bronx County 1969); *Matter of Egerer*, 30 Misc3d 1229(A), at *3 (Sur Ct, Suffolk County 2006).

²⁶ *Matter of Lubin*, 143 Misc2d 121, 122 (Sur Ct, Bronx County 1989).

²⁷ *See id.*

²⁸ *Matter of Shore*, 19 Misc3d 663, 665-67 (Sur Ct, New York County 2008); *Matter of Francis*, 19 Misc3d 536, 541-43 (Sur Ct, Westchester County 2008).

²⁹ *See Turano, supra* note 1.

³⁰ *Matter of Mednick*, 155 Misc2d 115, 116 (Sur Ct, New York County 1992) (noting that "the limitations on the powers and immunities of testamentary trustees under EPTL 11-1.7 do not apply to *inter vivos* trustees"); *Matter of Shore*, 19 Misc3d 663, 665 (Sur Ct, New York County 2008).

³¹ *Matter of Mankin*, File No. 330328, 2010 N.Y. Misc LEXIS 3091, at *3-4 (Sur Ct, Nassau County 2010), *aff'd*, 88 A.D.3d 717 (2d Dep't 2011).

“The rationale for this difference . . . is said to be the nature of an *inter vivos* transaction and the contracting freedom of the [grantor] and trustee to define the scope of the latter’s powers and liabilities.”³²

Notwithstanding a grantor’s freedom to contract as he or she wishes, several courts have found that EPTL § 11-1.7 governs in cases involving inter vivos trusts.³³ What is more, even the courts that have applied a more liberal standard to exoneration clauses in inter vivos trust instruments have held that there are limitations to the enforceability of such provisions.³⁴

It is beyond dispute that the “trustee of a lifetime trust who is guilty of wrongful negligence, impermissible self-dealing, bad faith or reckless indifference to the interests of beneficiaries will not be shielded from liability by an exoneration clause.”³⁵ Nor will the courts enforce exculpatory provisions that seek to render a trustee completely unaccountable;³⁶ to excuse the fiduciary of an inter vivos trust from the duty to account;³⁷ to absolve an attorney-fiduciary who drafted the lifetime trust instrument of liability for all conduct other than acts committed in bad faith;³⁸ or to require beneficiaries to resolve disputes with the fiduciary through arbitration, rather than litigation in the Surrogate’s Court.³⁹ Even under the more liberal standard discussed above, the beneficiaries of an inter vivos trust are entitled to some level of protection, as loyalty, accountability and reasonableness are hallmarks of a trustee’s fiduciary relationship.⁴⁰

Additionally, case law suggests that an exoneration clause contained in an inter vivos trust instrument is not enforceable when the fiduciary is involved, either directly or indirectly, in drafting or creating it.⁴¹ The court recognized as much in *Matter of Shore*, where it found that an

³² *See id.*

³³ *Matter of Goldblatt*, 162 Misc2d 888, 893 (Sur Ct, Nassau County 1994) (in the context of an SCPA Article 17-A guardianship proceeding, holding that an exoneration clause contained in a proposed supplemental needs trust was violative of public policy); *Shore*, 19 Misc3d at 665 (finding that “the public policy in EPTL 11-1.7 against exonerating a fiduciary from liability for the failure to exercise reasonable care, diligence and prudence applies equally to inter vivos trust where by its terms there is no one in a position to protect the beneficiaries from the actions of the trustee”).

³⁴ *Matter of Tydings*, 32 Misc3d 1204(A), at *6 (Sur Ct, Bronx County 2011) (citations omitted); *see also O’Hayer v de St. Aubin*, 30 AD2d 419, 420-28 (2d Dep’t 1968) (addressing the application of an exoneration clause in an inter vivos trust instrument); *Matter of Cowles*, 22 AD2d 365, 76-78 (1st Dep’t 1965), *aff’d*, 17 NY2d 567 (1966).

³⁵ *Tydings*, 32 Misc3d 1204(A), at *6; *see also Boles v Lanham*, 55 AD3d 647, 648 (2d Dep’t 2008) (opining that a “trustee is liable if he or she commits a breach of trust in bad faith, intentionally, or with reckless indifference to the interests of the beneficiaries”).

³⁶ *Matter of Rivas*, 30 Misc3d 1207(A), at *4 (Sur Ct, Monroe County 2011).

³⁷ *Matter of Shore*, 19 Misc3d 663, 665 (Sur Ct, New York County 2008); *Stansbury v Stansbury*, NYLJ, May 21, 2007, at 45, col. 1 (Sur Ct, Kings County).

³⁸ *Tydings*, 32 Misc3d 1204(A), at *6.

³⁹ *Matter of Mede*, 177 Misc2d 974, 982 (Sur Ct, Kings County 1998).

⁴⁰ *Shore*, 19 Misc3d at 666.

⁴¹ *Cf. Matter of Tydings*, 32 Misc3d 1204(A), at *6 (Sur. Ct., Bronx County 2011) (citations omitted) (“Nonetheless, it is clear that where, as here, a trustee was neither directly nor indirectly involved in drafting or creating the trust, and may be presumed to have relied upon the explicit provisions of an

exculpatory clause contained in an inter vivos trust drafted by the trustee was void and unenforceable.⁴²

In the absence of statutory guidance, the issue of the enforceability of exoneration clauses in inter vivos trust instruments has been left to the discretion of the courts and resulted in what appear to be decisional inconsistencies. The inconsistencies, when taken in conjunction with the public policies discussed below, warrant amendments to EPTL § 11-1.7, declaring broad exculpatory clauses in inter vivos trust instruments exonerating fiduciaries from liability for failing to honor the duties of reasonable care, diligence, and prudence void as against public policy.

Additional Policy-Based Reasons to Amend EPTL § 11-1.7

While the freedom of contract, much like the freedom of testation, generally is favored,⁴³ it is not so sacred as to render enforceable a contract provision that contravenes public policy.⁴⁴ It has been restricted on public policy grounds in several contexts, including disputes concerning attorneys' fees;⁴⁵ collective bargaining conflicts involving public employees;⁴⁶ and cases concerning contractual provisions exonerating caterers from liability for damages resulting from the caterer's negligence.⁴⁷ Moreover, as the law is anything but static, the courts have recognized that contract provisions which "were valid in one era may be wholly opposed to the public policy of another."⁴⁸

In the trusts and estates context, the freedom of testation – which, much like the freedom of contract, generally is strongly favored – already has been restricted, yielding to public policy concerns that executors and trustees under testamentary instruments not be absolved of the duty of reasonable care.⁴⁹ There exists no valid public policy-based justification for differentiating between the standards of care owed by fiduciaries acting under testamentary and inter vivos trust instruments. On the contrary, public policy requires that fiduciaries acting pursuant to testamentary and inter vivos trust instruments alike adhere to the standards of reasonable care,

exoneration clause contained in a lifetime trust instrument before agreeing to serve as fiduciary, generally the trustee will not be held liable for acts specified in the exoneration clause.”).

⁴² *Matter of Shore*, 19 Misc3d 663, 666-67 (Sur Ct, New York County 2008).

⁴³ *The Bajan Gr., Inc. v Consumers Interstate Corp.*, 28 Misc3d 1227(A), at *7 (Sup Ct, Albany County 2010) (“After all, even in commercial contracts between sophisticated business entities, a covenant against competition is subject to a rule of reason that requires courts to balance the competing public policies in favor of robust competition and freedom of contract.”).

⁴⁴ *Lustig v Congregation B’Nai Israel of Midwood*, 65 Misc2d 1052, 1054 (Sup Ct, Kings County 1971); see also *Brown v Sup. Ct. I.O.F.*, 175 NY 132, 137 (1903) (opining that despite “the general rule that the law permits great freedom of action in making contracts, there are some restrictions placed upon that right by legislation by public policy and by the nature of things”).

⁴⁵ *Samuel v Druckman & Sinel, LLP*, 50 AD3d 322, 324 (1st Dep’t 2008).

⁴⁶ *Niagara Wheatfield Admin. Ass’n v Niagara Wheatfield Cen. Sch. Dist.*, 44 NY2d 68, 72 (1978).

⁴⁷ *Lustig*, 65 Misc2d at 1057-58.

⁴⁸ See *id.* at 1054.

⁴⁹ EPTL § 11-1.7.

diligence, and prudence, as they are, unquestionably, bound by the same duty of undivided loyalty.⁵⁰

This is especially true in the case of a revocable trust. As a revocable trust is a substitute for a will,⁵¹ a fiduciary acting under a revocable trust should be bound to the same duty of reasonable care, diligence and prudence that is imposed upon an executor or testamentary trustee.

Based upon the foregoing, EPTL § 11-1.7 should be amended to reflect that trustees of inter vivos trusts are subject to its provisions. Doing so will further the public interest of ensuring that fiduciaries acting under lifetime trusts exercise reasonable care, diligence, and prudence in connection with their fiduciary duties.

Conclusion

Since executors, testamentary trustees, and inter vivos trustees are held to the same standard of absolute, undivided loyalty to the beneficiaries whom they serve, public policy necessitates that they be treated similarly, especially in the context of exoneration clauses. The Section, therefore, supports the proposal to amend EPTL § 11-1.7 to provide that it applies to the trustees of lifetime trusts, as set forth in A.10100 and S.6138.

Based on the foregoing, the New York State Bar Association respectfully urges the Governor to **APPROVE** this legislation.

⁵⁰ *Boles v Lanham*, 55 AD3d 647, 648 (2d Dep't 2008); see also *Matter of Quatela*, No. 355511, 2010 WL 4466757 (Sur Ct, Nassau County Sept. 30, 2010) (citations omitted) ("A trustee is duty-bound to act in good faith in the administration of a trust, with honesty and undivided loyalty to the beneficiaries and avoid any circumstances whereby the trustee's personal interest will come in conflict with the interest of the beneficiaries. The purpose of this rule is to ensure that the trustee's acts are above suspicion and that the trust receives the trustee's uninfluenced judgment.").

⁵¹ *Matter of Tisdale*, 171 Misc2d 716, 720 (Sur Ct, New York County 1997); see also *Matter of Goetz*, 8 Misc3d 200, 205 (Sur Ct, Westchester County 2005) (citations omitted) ("Further, revocable trusts are commonly employed as estate planning tools and are coordinated with the grantor's will, functioning in much the same manner as a will. Because the Goetz revocable trust was created as a part of the decedent's overall estate planning at the same time as his will, the trust can be deemed to 'function[] as a will since it is an ambulatory instrument that speaks at death to determine the disposition of the settlor's property.'"); *Matter of Davidson*, 177 Misc2d 928, 930 (Sur Ct, New York County 1998) (noting that "revocable trusts – used increasingly as devices to avert will contests – function essentially as testamentary instruments (*i.e.*, they are ambulatory during the settlor's lifetime, speak at death to determine the disposition of the settlor's property, may be amended or revoked without court intervention and are unilateral in nature) and therefore must be treated as the equivalents of wills in the eyes of the law").