Indemnification—the Teeth of a Fiduciary Release

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What is a Release and Indemnification Agreement?

- Sometimes called a "Receipt, Release, Refund, and Indemnification Agreement," or RRRI. Sometimes called an "Agreement Settling Account."
- Document that is obtained typically at the conclusion of estate or trust administration, when a fiduciary plans to make distributions of funds to beneficiaries.
- Used as an informal, non-judicial, and less costly way to settle an account.

When should a fiduciary seek a Release and Indemnification Agreement?

- Toward the conclusion of fiduciary's administration of estate or trust, upon making of final distributions.
- Also upon making of interim distributions.
- When a beneficiary asks fiduciary to take certain actions with respect to the administration of estate or trust.
- When a fiduciary resigns before termination of estate or trust.

Key considerations for the fiduciary and reasons to ask for an indemnity

- Indemnification from potential claim by other beneficiaries.
- Indemnification from potential claim by the beneficiary.
- Indemnification from potential claim by third parties.
- Discourage “stalking horse” beneficiaries.
- Attorneys’ fees to deal with such claims.

Key considerations for the beneficiary and what to watch out for

- Narrow the events to which the indemnity applies.
- Consider carving out obligation to indemnify fiduciary for claims arising from gross negligence or willful misconduct.
- Limit the amount of the indemnity.

Further considerations for the beneficiary and what to watch out for

- Insertion of notice provision.
- Be intentional about whether indemnity will apply to third party claims only, or to first party claims as well (i.e., claims by indemnitor).
- Be clear about attorneys' fees.

An indemnification agreement is a contract. Ordinary contract principles apply

- Must be supported by adequate consideration. *See*, *e.g.*, *Murphy White v. Richert*, No. 15 CV 8185, 2021 WL 2156448 (N.D. Ill. May 27, 2021), *aff'd*, No. 21-3203, 2023 WL 2200963 (7th Cir. 2023).
  - "'A promise to do something one is already obligated to do is no consideration and creates no new obligation.'" Release and indemnity signed by beneficiary was invalid because the instrument "refers only to [fiduciary's] pre-existing legal duty to distribute [beneficiary's] share of the . . . Trust estate."

Conditioning *mandatory* distributions on an indemnity may be a breach of fiduciary duty or statute

- *Estate of Worrall by Worrall v. J.P. Morgan Bank, N.A.*, 645 S.W.3d 441 (Ken. 2022).
  - Trustee/bank sought liquidation of trust assets and required beneficiary to choose between signing a release and indemnity, or the "formal and expensive option" requiring court intervention. Lower court held in fiduciary's favor.
  - Court of Appeals denied review; Supreme Court granted review.

Estate of Worrall by Worrall v. J.P. Morgan Bank, N.A.

- Supreme court reversed, holding that trustee violated Kentucky Revised Statutes 386B.8-180(5) providing "[n]o trustee [of a] trust shall request that any beneficiary indemnify the trustee against loss in exchange for the trustee forgoing a request to the court to approve its accounts at the time the trust terminates or at the time the trustee is removed or resigns, except as agreed upon by the parties pursuant to [procedure set forth elsewhere in statute]."
- It was "simply beyond the pale for a trustee to extort such a document when the legislature has provided an adequate mechanism and remedy for the settlement and distribution of trust assets."

Conditioning *mandatory* distributions on an indemnity may be a breach of fiduciary duty or statute

- *In re Robert Stout Revocable Trust*, 2014 WL 265553 (Mich. Ct. App. Jan. 23, 2014) (unpublished).
    - Release and indemnity in return for mandatory distribution was a breach of duty even if no statute proscribed such conduct.

Fiduciaries must be careful not to overuse indemnification as a hammer

- Fiduciary holds considerable leverage to request indemnity in exchange for distribution of assets without a costly and time-consuming formal accounting.
- Use the leverage wisely.

Additional layer of scrutiny in fiduciary context

- Fiduciary must provide *full disclosure* of the circumstances of the indemnity as well as the consequences of the indemnity.
- Indemnities, in general, are *construed narrowly*, but transactions between a fiduciary and his beneficiary are always subject to an additional layer of scrutiny because they are viewed with suspicion as a form of *self-dealing*.

Full disclosure is always necessary

- *Williams v. Hardison*, 704 S.W.3d 807 (Tenn. Ct. App. 2024).
  - Substitute co-trustee disclosed that it did not provide investment management services. Beneficiaries signed an indemnity and investment agreement under which they would appoint a separate investment advisor.
  - Agreement was not void *ab initio* where substitute trustee "made it perfectly clear that if it were to serve as a co-trustee, it would not agree to be responsible for the management and investment of the Trust's assets" and "plaintiff and the qualified beneficiaries were fully informed that they would have to appoint an investment advisor who would be responsible for the management and investment of the trust assets."

Full disclosure is always necessary

- *Murphy White v. Richert*, No. 15 CV 8185, 2021 WL 2156448 (N.D. Ill. May 27, 2021).
  - Trustee (niece of beneficiary) sought indemnification from beneficiary's estate for attorney's fees and costs incurred in defending the lawsuit filed by beneficiary's estate.
  - "[T]he Court does not credit defendant's self-serving and biased testimony on the scope of the indemnification provision. . . . the Court simply cannot believe that defendant forthrightly disclosed to [beneficiary] that, in the event [beneficiary] herself brought a claim against defendant—including a claim based on defendant's forging of the trust instrument—the indemnification provision would oblige [beneficiary] to fund defendant's defense."

Full disclosure is always necessary

- Uniform Trust Code Section 1009, "Beneficiary's Consent, Release, or Ratification."
  - Beneficiary may consent to trustee conduct regarding a breach of trust and release trustee from liability if consent was informed and there is no improper conduct by trustee. *See also* Section 817.

Indemnification agreements are strictly construed

- In general, indemnities are construed narrowly, and any ambiguity will be construed against the drafter or the party to be indemnified.
- Some courts have spoken of a “growing trend” to relax the rule of strict construction.
- Nevertheless, in the fiduciary context, scrutiny likely to be strict.

Indemnification agreements are strictly construed

- *Williams v. J.P. Morgan & Co., Inc.*, 248 F. Supp. 2d 320 (S.D.N.Y. 2003).

  - Settlor's wife, the income beneficiary, agreed to indemnify corporate trustee JP Morgan for her direction to liquidate tax-generating investments in order to avoid repercussions of potential US-Brazilian tax treaty.

  - "I hereby release and discharge you from any liability to me for making such sales and causing the trust to incur a net current decrease on account of capital gain taxes. In addition, I hereby agree to indemnify you against any claims made by other beneficiaries of the trust arising out of my requested action."

Williams v. J.P. Morgan & Co., Inc.

- Trustee started third-party action for indemnification against income beneficiary when income beneficiary's son sued the trustee for breach of fiduciary duty and accounting.

- Court construed the indemnity narrowly by looking not only at the language of the indemnity, but at other factors to conclude that income beneficiary did not unmistakably intend to undertake a broad obligation to indemnify trustee for all time and for all reasons, even if the proposed treaty never took effect.

Fiduciary may engage in self-interested action with beneficiary informed consent

- *Hastings v. PNC Bank NA*, 54 A.3d 714 (Md. 2012).
  - Majority upheld indemnity provision stating beneficiaries release and indemnify PNC "in its corporate capacity and as Trustee" from "all losses . . . which may arise from its administration of the Trust" and "all decisions made and actions taken or not taken with regard to the administration of the Trust. . . ."
  - Clause was "a fairly sizeable increase in the amount of protection PNC would have received" but "[t]he differences . . . are of degree rather than kind" and "Petitioners retained the choice to accede to that request, perhaps negotiate a release agreement not as broad in its protection of PNC, or simply reject it out of hand and accept the delay in distribution."

Hastings v. PNC Bank NA

- Dissent found that indemnity was too broad, and also accused PNC of not providing beneficiaries full information explaining their rights.
- In a footnote, majority responded that the disclosure issue was not before the court, but cautioned that full disclosure was necessary.

Can or should indemnification agreements be used to alter fiduciary behavior?

- **Case study #1**
  - X, the primary beneficiary of trust, caused trustees to pay him a series of distributions from the trust—not because he needed the funds, but as part of his plan to disinherit his children, Y, and Z—who were the remainder beneficiaries of the trust. He signed a number of releases with indemnities providing that he, for himself, his heirs, and his executors, was indemnifying the trustees from any claims and legal fees arising out of their distributions.

Can or should indemnification agreements be used to alter fiduciary behavior?

- **Case study #1**
  - Clear case where the trustees advanced the interest of one beneficiary over others and were comfortable making the distributions as they knew X had adequate funds to cover them in the event Y or Z filed suit against them, which they did.
  - Despite language purporting to bind his "heirs," the release and indemnity likely would have been unenforceable as to X's children, Y and Z, who were not signatories to the agreement (nor told about the distributions).
  - The indemnity from X made the trustees impervious to any challenge by Y and Z.

Beware when the *fiduciary* is being asked to indemnify

- **Case study #2**
  - Client was one of two proposed executors named in the will and was granted sole letters of administration. The other named executor never filed a petition for appointment and instead filed an amended decree seeking to be appointed as co-executor, which was never acted upon by the court.
  - Client attempted to sell real estate assets in the estate as part of her administrative duties, but title companies refused to recognize her authority in light of the other appointee's application seeking to amend the decree, and declined to insure title without an indemnity from client.

Other considerations unique to fiduciary indemnities

- Existence of fraud, misrepresentation, or undue influence in procuring the indemnification agreement will render it unenforceable, but the absence of these things will not render it automatically enforceable.
- Timing of when the indemnification agreement was obtained may matter—in the ordinary course of settling account; are parties already in litigation?

Other considerations unique to fiduciary indemnities

- Burden of proof is on the fiduciary.
- Overall fairness of the transaction will be examined.
- Trust and estate disputes are usually resolved in courts of equity.

Other contexts: indemnification in underlying trust or will

- Also strictly construed against the fiduciary.
- As a matter of public policy, fiduciary may not be indemnified for acts of bad faith or gross negligence.

Uniform Trust Code 1008 "Exculpation of Trustee"

- Exculpatory terms are unenforceable if they relieve trustee of liability for breach of trust committed in bad faith or reckless indifference to trust purpose or beneficiaries, or if obtained by trustee abusing a fiduciary or confidential relationship with settlor. Section 1008(a).
- Section 1008(b) also provides that exculpatory terms prepared by the trustee are invalid unless trustee proves that terms are fair and were adequately communicated to the settlor. If settlor is represented by independent counsel, requirements of 1008(b) are met. *See* Uniform Trust Code 1008(b) comment.

Other contexts: Indemnification of settlor's attorney

- *Castro v. Thomason*, 20 Wash. App. 2d 1016 (2021) (unpublished opinion).
  - Lawyer Alex Thomason (37), obtained a loan from his client, Bert Stennes (88), for $400,000 so he could buy property next to Bert's land. Loan was interest-free for first 7 years.
  - Thomason and Bert (by then 93) later signed an agreement in 2016 canceling the note evidencing the loan with a reciprocal *indemnity* of "any and all claims . . . arising out of or in connection with" the termination of the note and other related transactions.
  - Bert also amended his will by providing that he was canceling and forgiving the loan to Thomason, and if any of his beneficiaries or their spouses were to sue Thomason relating to any open business transactions with him at the time of Bert's death, "I direct my Personal Representative and Trustee to *indemnify and defend* [Thomason] from any such claim" with costs of such defense to be paid from the family trust allocated to the suing beneficiary.

Castro v. Thomason

- Bert's wife's estate sued Thomason.
- Thomason filed a third-party action against Bert's estate seeking defense and indemnification.
- Lower court dismissed, but appellate court upheld the indemnity claim, finding the 2016 agreement "imposes a broad obligation of indemnification for claims asserted against [Thomason]" requiring Bert's estate to indemnify Thomason from any claim "arising out of or in connection with" the transactions.
- No duty to defend was found under the 2016 agreement and the duty to defend under the will did not apply as that duty only embraced events open at the time of Bert's death and only to claims asserted by Bert's beneficiaries or their spouses.

Attorneys' Fees/Duty to Defend

- In some states, like New York, an indemnity will not be read to require reimbursement of attorneys' fees unless the language specifically makes that obligation unmistakably clear.
- Whereas in other states, unless contrary intention appears, indemnitor is bound to pay the cost of defense with respect to matters embraced by the indemnity, either by statute or common law. *See*, *e.g*., Cal. Civ. Code 2778.
- Different treatment for third party claims v. first party claims?

Attorneys' Fees/Duty to Defend

- Fees may not be paid on an ongoing basis unless the provision expressly says so. Indemnitors in the fiduciary context are not insurers.
- *People ex rel. Harris v. Shine*, 16 Cal. App. 5th 524 (Ct. 2017).
    - Former trustee requested advance from trust to fund his defense to Attorney General petition for removal and surcharge.

People ex rel. Harris v. Shine

- Where trust is silent on award of interim fees, "The court must first assess the probability that the trustee will ultimately be entitled to reimbursement of attorney fees and then balance the relative harms to all interests involved in the litigation, including the interests of the trust beneficiaries. An assessment of the balance of harms requires at least some inquiry into the ability of the trustee or former trustee to repay fees if ultimately determined not to be entitled to the costs of defense."

Attorneys’ Fees/Duty to Defend

- If a duty to defend exists, who controls the defense? Tension between two competing interests:
  - Fiduciary would have an interest in controlling its defense and ensuring that counsel does a good job to defend its performance.
  - On the other hand, the indemnitor, i.e., beneficiary also has an interest in making sure that the fiduciary does not run up the defense costs and may want to resolve the dispute more quickly and cost-effectively.

Attorneys' Fees/Duty to Defend

- Similar tension exists in negotiating a settlement.
  - Fiduciary may want to agree to any terms of settlement to get out of the litigation.
  - Beneficiary, who is ultimately paying the settlement amount, may want to settle on its own terms without requiring extensive fiduciary input, which may hold up the settlement negotiations.

Checklist for an enforceable indemnification agreement

- √ Adequate consideration?
- √ Full disclosure?
- √ Is the transaction fair?
- √ Was the beneficiary represented by independent counsel, or advised to seek independent counsel?
- √ Is language clear on the scope of the indemnity?
- √ Is language clear on fiduciary’s recoverability of attorneys’ fees?

Questions?

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Jay is laser-focused on efficiently obtaining wins for his clients, who hire him for his seasoned and sound judgment in dispute resolution both in and out of the courtroom. A trusted counselor, he has deep expertise representing all types of stakeholders in sophisticated and complex trust and estate disputes. Jay has significant experience litigating all manner of breach of fiduciary duty actions, trustee accountings and removal proceedings, and Will contests and other contested probate matters. As part of this practice, he counsels private clients in potentially contentious business and personal matters regarding, among other areas, closely-held businesses, real estate and tax. Jay's practice also includes guardianship actions and other contested elder law matters. A carefully aggressive advocate — honed over many years of focusing solely on private client litigation — Jay's clients look to him for their thorniest matters.

Jay is well-known in his field, and often speaks and writes on fiduciary litigation topics, including undue influence, no contest clauses, accountings, and fiduciary risk mitigation. Jay is a Fellow in the peer-elected American College of Trust and Estate Counsel (ACTEC). He is the chairperson of the Litigation Committee of Trusts & Estates magazine. The chairperson of the Steering Committee for the Cambridge Forum on Private Wealth Litigation. And Jay's practice is Chambers rated.

For many years Jay was an adjunct professor at Fordham University School of Law, where he taught legal writing. And he served as a law clerk for the Honorable Diane Weiss Sigmund, judge for the US Bankruptcy Court in the Eastern District of Pennsylvania.

Jay resides in Manhattan with his wife (he's a recent empty-nester). When not with his family or in the office, he can be found training for his next race. Jay is a veteran of numerous road races and triathlons and, on happy occasion, makes the podium.

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