Release and Indemnification of Corporate Trustee Survives Scrutiny (Barely)
Trustees ask their beneficiaries to sign release and indemnification agreements every day. These agreements are thought to avoid the time and expense of a formal accounting proceeding while providing the trustee with liability protection. But how much protection? A recent decision from Maryland’s highest court reminds us that in the fiduciary context, releases can be tricky. The case is Hastings v. PNC Bank, NA, 54 A.3d 714 (Md. 2012), reconsideration denied (Nov. 15, 2012).

**Background.** PNC served as the trustee of a testamentary trust. It was ready to terminate and fully distribute the trust to four individual beneficiaries. PNC paid the inheritance tax due, set aside its trustee’s fee, and sent the beneficiaries an accounting along with a “Waiver, Receipt, Release and Indemnification Agreement.” The accompanying letter informed the beneficiaries that they should sign the agreement if they approved of the accounting, and that PNC would be in a position to distribute the remaining proceeds once all beneficiaries had signed.

The agreement called for the beneficiaries to acknowledge that they had consulted with counsel (or had chosen not to do so), reviewed the trustee’s accounting, and approved of PNC’s administration of the trust. It also included a provision releasing and indemnifying PNC, both as trustee and in its corporate capacity, against “all losses, claims, demands, surcharges, causes of action, costs and expenses (including legal fees), which may arise from its administration of the Trust.”

Three of the beneficiaries sued, alleging that the agreement was overly broad and that PNC had acted improperly by demanding that they sign it before making distributions. They asserted that PNC was not allowed to demand a release and indemnification against all losses and expenses, and no court could enter an order as broad as what PNC tendered. Two other counts accused PNC of miscalculating taxes and trustee’s fees under the relevant Maryland statute. The trial court held for PNC on all counts. Both the intermediate appellate court and the Court of Appeals affirmed.

**Court of Appeals Decision.** The high court’s majority opinion described the question presented with respect to the release as “[w]hether a Maryland trustee can lawfully demand or request an indemnity from its beneficiaries that is broader than the protection that the trustee could have obtained through a court order or a release like that permitted for a personal representative.” The court’s answer began with a review of Maryland common law.
The duty of loyalty generally prohibits a trustee from using its fiduciary position to benefit the trustee itself or a third party. A trustee may proceed with a self-interested action (such as obtaining a release or indemnification) if the beneficiaries authorize it by their consent, but consent has its limits. First, it must be informed consent: the beneficiary must understand what he or she is approving. And even then, the consent will not be effective if the trustee is deemed to have taken undue advantage of the beneficiary. In other words, unlike most releases and other contracts, releases in the fiduciary context are subject to substantive review for fairness.

According to the majority, sufficiency of disclosure was not an issue in Hastings because the parties did not brief or argue it on appeal. The court nonetheless cautioned that “trustees seeking similar indemnification agreements in the future should adhere to the principle of ‘full information’ in order to allow beneficiaries to make informed decisions.”

As to fairness, the court focused on how the release compared with the relief the trustee could obtain in a court proceeding to settle its accounts. The majority opinion concluded that “the terms of PNC’s release and indemnity clause are not a radical departure from the common law protection and statutory right to which PNC already was entitled” — namely, indemnity for “expenses incurred reasonably and properly in the course of administering a trust.”

The release covered PNC in its corporate capacity, not just as trustee, and indemnified PNC against all costs arising from the administration, not just reasonable costs. Although the majority found these differences to be “material” and “a fairly sizeable increase in the amount of protection PNC would have received, as trustee, from liability and cost,” the differences “are of degree rather than kind” and “do not represent a reorientation of the interests that PNC and [the beneficiaries] respectively possess, but represent, at bottom, PNC[‘s] arm’s length request to exchange increased protection and indemnity for a quicker and less costly distribution of trust funds.” In other words, they were “not so broad and one-sided as to place impermissibly PNC’s interests before those of [the beneficiaries].”

Notably, the majority observed that although a trustee could properly seek a release for the activities of its trust department, “it could not seek a release of liability of its securities brokerage for brokerage services provided to the trust, if the trustee happened to employ the institution’s own brokerage division to execute trades on behalf of the trust. [If it could],
the financial institution would effectively use its position as trustee to obtain a release for its securities division, which would appear at odds with the duty of loyalty.”

**Dissent.** The three dissenting judges would have held that PNC breached its duties by tendering the release because it sought indemnification (1) for PNC in its corporate capacity as well as in its role as trustee, (2) for all costs (regardless of whether they were reasonably and properly incurred), and (3) from any and all liabilities (including to third parties). None of these protections would have been available in a proceeding to seek approval of the trustee’s accounts. The dissent also concluded that PNC was required to explain to the beneficiaries how the agreement expanded PNC’s liability protection beyond the protection it would have received upon a court’s approval of a final accounting. Finally, the dissent commented that “[w]e should not condone the practice of a bank’s asking beneficiaries to provide the bank insurance against the bank’s own blunders.”

**Analysis.** On the one hand, *Hastings* endorses the common practice of seeking releases before making final distributions, holding that it is not a breach of duty for the trustee to make such a request, even if the scope of the release is somewhat broader than the relief available in a court proceeding.

On the other hand, *Hastings* highlights how closely a beneficiary’s release of a trustee can be scrutinized. A fiduciary that tenders (or enters into) an agreement with a beneficiary containing release or indemnification language should be aware of the risk that a court may deem the agreement unenforceable because it was not fair and reasonable to the beneficiary. And what will be considered “fair” in a later court proceeding is not easy to predict.

Maryland is by no means alone in subjecting releases of trustees to heightened scrutiny. For example, in *Janowiak v. Tiesi*, 402 Ill. App. 3d 997 (1st Dist. 2010), the Illinois Appellate Court invalidated such a release, ruling that transactions between a trustee and a beneficiary carry a “presumption of fraud” (meaning the fiduciary has to prove by clear and convincing evidence that the transaction was fair and reasonable).

The *Hastings* court’s emphasis on disclosure is part of a broader trend as well. A comparison of the Second and Third Restatements of Trusts reveals a significant shift in favor of requiring greater disclosure — and not just when the trustee and the beneficiary are parties
to a transaction. (Second Restatement of Trusts § 173; Third Restatement of Trusts § 82). The Uniform Trust Code, which has been adopted in 25 states, includes substantial disclosure requirements as well. (Uniform Trust Code § 813)

Of course, the adequacy of disclosure is in the eye of the beholder, and that “eye” may be viewing the situation with the benefit of hindsight many years later. Fiduciaries would do well to think carefully about what facts need to be disclosed in order to avoid a claim that they have overreached or that the beneficiary is not bound because he or she did not receive a sufficient explanation.

**Bottom Line.** An agreement in which a beneficiary releases or indemnifies a fiduciary is arguably a self-dealing transaction because the fiduciary is looking after its own interests, not those of the beneficiary. While such agreements are clearly permitted, courts will give them a hard look. They should be drafted as narrowly as possible, with an eye toward the relief the trustee could obtain if the issue were litigated to conclusion, and they should be grounded in full disclosure of the relevant facts.

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