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EXCULPATORY CLAUSES IN CORPORATE MORTGAGES AND OTHER INSTRUMENTS

PHILIP M. PAYNE†

The modern corporate trust deed is in many respects *sui generis.*¹ Mortgages of corporations are usually in the form of trust deeds, with a power of sale, in which a trustee (generally a trust company) is named to take and hold the title of the mortgaged property for the benefit of the bondholders. The bonds are made negotiable so that they may be conveniently disposed of in the market, and the mortgage is, in effect, a contract between the corporation making it and the trustee, as representing all persons who may become holders of the bonds secured by it.² The modern corporate trust deed retains characteristics of a trust, but it is distinguished from a real or true trust, by the fact that the corpus—the incumbered property—frequently remains in the possession and under the control of the borrower.³ There is a marked distinction between a mortgage trustee and an ordinary trustee.⁴ And there is a vital difference between the relation of mortgagor and mortgagee and that

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of trustee and *cestui que trust*. The trustee in a corporate mortgage is a trustee of an express trust as to the security but not as to the bonds or notes, for they are not payable to the trustee. It is elemental that the trustee, named in a trust deed securing a bond issue, represents all the bondholders in matters affecting the enforcement of the security and the administration of the trust property. Likewise there is a fiduciary relation between co-bondholders; they are *co-cestui que trust* under the trust deed.

The foregoing distinctions are fundamental. While the relationship between the trustee and the bondholders may not be entirely analogous to that existing between an ordinary trustee and his *cestui que trust*, a majority of the courts seem to imply certain

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b. Property, an equitable estate. Scott, *The Nature of the Rights of the Cestui Que Trust*, (1917) 17 Col. L. R. 269; See also, the dissenting opinion of Mr.
powers and duties from the relation of the parties to the trust fund, irrespective of the terms and provisions of the trust indenture. Other courts have taken the position that the trustee has no duties outside of those specified in the indenture and that the liability of the trustee of a corporate mortgage is determined by the terms and provisions of the mortgage itself. Under this view the courts do not impose additional duties and obligations upon the trustee and provisions of the mortgage itself. Consequently it cannot be regarded as a settled point that the liability of such


a trustee depends upon contract.\textsuperscript{12} The best opinion would seem to be that it does not, and cannot depend upon contract.\textsuperscript{13} Nevertheless, the trust deed may be regarded as the basis of the trustee's liability in equity, and in that respect the liability is closely analogous to a contract liability regarded from the viewpoint of equity jurisprudence.\textsuperscript{14}

We have seen that the modern corporate trust deed is somewhat different from the private trust.\textsuperscript{15} Certainly the trustee in a corporate mortgage securing bonds, like any trustee, owes to all parties concerned the duty of acting in good faith and of exercising all discretion vested in it by the mortgage in a proper and open manner.\textsuperscript{16}

under a Corporation Mortgage, (1898) 15 Bank L. J. 79; Herrick, Trust Departments in Banks and Trust Companies, (1925) 264; Fowler, Legal Responsibility of Trustees under Corporate Bonds and Mortgages, or Deeds of Trust, (1890) 24 Am. L.Rev. 703, 718.


Treating the trustee's duties as contractual, the trustee's obligation is a common-law obligation and enforceable in an action at law. On the other hand, if a trust relationship exists, the trustee's duties are measured not only by what is expressly provided by the trust deed, but also by the duties which the law imposes. See the authorities cited supra note 4. Thus, if the trust relation exists, the trustee is governed by the general rules that govern trustees in the ordinary performance of the duties of a trust. Moyer v. Norristown-Penn Trust Co., 296 Pa. 26, 30, 145 Atl. 682 (1929). Although equity deals with special cases, it applies general principles. Carpenter v. Danford, 52 Barb. (N. Y.) 581, 586 (1868).

\textsuperscript{13} Maitland thinks "we shall go on treating the law of trusts as something distinct from the law of contracts". Equity (1929 ed.) 54. However, the historical distinction is increasingly less important. Bogert, Trusts (1921) 40-42.

\textsuperscript{14} Fowler, Legal Responsibility of Trustees under Corporate Bonds and Mortgages, or Deeds of Trust, supra note 11. In Fidelity Insurance, Trust & Safe Deposit Co. v. Shenandoah Valley R. R. Co., 32 W. Va. 244, 264, 9 S. E. 180, 187 (1889) the Court said that the terms of a corporate mortgage are "a positive contract between the grantor, the trustee and the bondholders".

If the trustee acquires the whole estate in law and in equity and the bondholder has no estate or interest in the corpus and the interest of the bondholder is regarded as merely a personal claim against the trustee—a chose in action—to enforce the performance of the trust in equity (supra, note 9), the trustee's obligations are more analogous to those assumed by contract than those implied by law by virtue of a trust relationship between the trustee and the bondholder.

\textsuperscript{15} The nature of the corporate mortgage in the light of its origin and development and its purpose and function has been considered elsewhere. (Note) Immunity Clauses in Corporate Trust Indentures, (1933) 33 Col. L. Rev. 97; Draper, A Historical Introduction to the Corporate Mortgage, (1930) 2 Rocky Mt. L. Rev. 71; Shinn, Exoneration Clauses in Trust Indentures, (1932) 42 Yale L. J., 359, 372.

\textsuperscript{16} Speers Sand & Clay Works v. American Trust Co., 20 F. (2d) 333, 335 (C. C.}
May the trustee under a corporate trust deed exempt itself from the obligations of using care in the performance of its duties as trustee or limit its liability by an exculpatory clause? While a breach of trust is considered as a simple contract debt, the general law as to limiting one's liability by contract is not settled. Exculpatory clauses are not new. An exculpatory clause is one of discharge and indemnity; it is designed to avoid the responsibility which the trustee would be under, were it not for the clause. Such clauses in corporate mortgages are not against public policy, unless they seek to protect the trustee from liability for acts of gross negligence, willful default or for acts done in bad faith. In *Industrial & General Trust, Ltd. v. Tod,* Judge Vann said:

"No covenant of immunity can be drawn that will protect a person who acts in bad faith, because such a stipulation is against public policy, and the courts will not enforce it. The law requires the exercise of good faith, and no matter how strong the provision to shield from liability may be, there is no protection unless good faith is observed."

The cases seem to indicate that a trustee has the right by contract to limit somewhat the duties which it is to perform under the corporate indenture; and, in some instances, the trustee can be held liable for nonfeasance of such duties only as the trustee agreed to perform. However, there is a dictum to the effect that the excul-


2180 N. Y. 216, 225, 73 N. E. 7, 12 (1905).

22Green v. Title Guarantee & Trust Co., N. Y. L. J. of Nov. 24, 1923, opinion by Lehman, J., infra note 47.

patory clause cannot avail the trustee so as to excuse it from doing something which was absolutely necessary to the preservation of the lien of the mortgage. The scope and effect of the exculpatory or immunity clause is illustrated by the following cases:

A. CORPORATE TRUST DEEDS

The recent case of Harvey v. Guaranty Trust Co. was an action by a bondholder against the trustee of a corporate deed of trust for damages as a result of wrongfully satisfying the mortgage. The indenture exempted the trustee for responsibility "except for its own fraud or willful misconduct". It also provided that the certificate of the mortgagor would be conclusive evidence of facts relied upon by the trustee in acting as trustee. Nowhere in the indenture was there any express provision for the authentication by the trustee of duplicate bonds or for the delivery of a satisfaction of the mortgage upon payment of the bonds or otherwise. The mortgagor elected to redeem the outstanding bonds exclusive of those held by the plaintiff, the whereabouts of which were unknown and were said to have been lost. The mortgagor requested the trustee to issue duplicate bonds and furnished the trustee with certificates for such purpose, together with an indemnity bond. The trustee authenticated duplicate bonds which were in the mortgagor's treasury. Thereupon the mortgagor redeemed all the bonds, except those held by the plaintiff for which duplicate ones had been issued to the mortgagor company. The trustee executed and delivered a satisfaction of the trust indenture. The plaintiff maintained that the trustee's conduct constituted a breach of trust because the trustee had been placed on notice that the alleged lost bonds might be outstanding in the hands of bona fide holders, since the affidavit of the treasurer that no coupons on any of the bonds alleged to have been lost had been paid for ten years was incorrect as shown by the records of the trustee. Moreover, the records of the mortgagor showed that plaintiff held the bonds. Under such circumstances the exculpatory provisions of the indenture were held unavailable to the trustee. Frankenthaler, J. said at p. 425:

"Fairly construed, the exemption of the trustee from liability 'for anything whatever in respect to the premises or the trust hereby created, except its own fraud or willful misconduct' appears to apply only to those matters specifically referred to in the instrument itself. The indenture under consideration

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242 e. g. file and refile as a chattel mortgage.
CESTUIS' AGREEMENTS EXCULPATING TRUSTEE 177

contained no provision requiring or permitting the trustee to satisfy it. On the contrary, it expressly dispensed with the necessity of a formal satisfaction. Nor was there any authority granted to authenticate duplicate bonds or coupons. Assuming, however, that the exemption clause is regarded as applicable to the situation here presented, I am of the opinion that it cannot properly be given effect. The tendency of our courts appears to be in the direction of refusing to permit such an exculpatory provision to prevail where the misconduct of the trustee is so repugnant to the trust as to defeat its very purpose. ***

"Even if the view be taken that the exculpatory provision is not only applicable here but also effective, it seems to me that it is not going too far to characterize the trustee's action as 'willful misconduct' within the meaning of the indenture. It was certainly 'willful misconduct' in the sense of an unauthorized and wrongful act, deliberately and intentionally done with knowledge that not all the original bonds and coupons had been surrendered and with an appreciation of the possibility that they might be in the hands of innocent holders for value."

Moreover, in addition to the "willful misconduct" of the trustee,26 the Court also held that the reasons which rendered the exculpatory clause inapplicable and ineffective in connection with the satisfaction of the indenture govern with equal force respecting the authentication and delivery of the duplicate bonds. The affidavit of the treasurer of the mortgagor accompanying the certificate was inadequate, being mere hearsay information. The Court, in referring to the provision of the indenture respecting the conclusive nature of certificates delivered to the trustee, said at p. 428:

"Moreover, it is difficult to believe that the provision under discussion could have been intended to permit the trustee to satisfy the indenture solely on the basis of the mortgagor's statement that all outstanding bonds had been paid. An interpretation to that effect would practically nullify the indenture by destroying the only real reason for its existence. The court should not be astute to extend and enlarge the natural meaning of the language used by adopting a construction so opposed to the very sense of the trust instrument, so fraught with danger to the bondholders. Indeed, one cannot but entertain grave doubt that even an express permission to satisfy on the mortgagor's statement would be given effect, for reasons similar to those advanced in connection with the 'willful misconduct' clause."

In Deposit Bank & Trust Co. v. Saint Paul Trust Co.27 the trust deed provided that the trustee of a corporate mortgage should not

26The meaning of the term "willful misconduct" will be discussed infra. See note 113.
27185 Minn. 25, 239 N. W. 766 (1931).
be "liable for the performance of any duty or responsibility, nor shall it *** in any event be subjected to any liability not herein expressly stated and hereby imposed upon said trustee." The trustee received money from a sale of a part of the mortgaged property. In an action by the successor trustee against its predecessor for an accounting, the trustee asserted that it had delivered the money to the mortgagor. From the report of the case it does not appear that the trustee could, under the terms of the instrument, release any part of the security to the mortgagor. The record did not show that the mortgagor had received the money and the trustee was held liable for the money it actually received. The exculpatory provisions did not release the trustee from such liability.

In *Doyle v. Chatham & Phenix National Bank* the plaintiff, a bondholder, recovered damages in an action against the trustee for losses sustained on the ground that the trustee's certificates of authentication were issued negligently and without authority, and that thereby the plaintiff was induced to acquire worthless bonds. The indenture authorized the trustee to authenticate bonds when specified collateral had been pledged with it. Securities of a different nature were deposited with the trustee and were accepted by the trustee without obtaining, although the indenture permitted, certificates from the appropriate officers of the mortgagor corporation as to the pertinent data regarding such collateral. The trustee was deemed negligent and held to have certified the bonds without authority and in so doing it was guilty of a misrepresentation of fact which was the proximate cause of the plaintiff's loss. The exculpatory clause was held inapplicable.

*Richardson v. Union Mortgage Co.* was a suit in equity against the trustee of a mortgage. The trust deed did not authorize substitutions of pledged securities. The trust deed contained an exculpatory clause freeing the trustee from liability for errors in judgment. The trustee permitted replacements of securities; and, in so doing was held to have transcended its powers. Consequently, its judgment had no basis upon which to operate, and the exculpatory clause relied upon by the trustee was held to have no application.

In *Leeds City Brewery, Ltd. v. Plotts* an action was brought

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29210 Iowa 346, 228 N. W. 103 (1930).

against the trustees of a debenture trust deed to recover damages for an alleged breach of trust. The deed provided (p. 544) that the "trustee shall not be responsible for the consequences of any mistake or oversight or error of judgment or forgetfulness or want of prudence on the part of the trustees or trustee or of any attorney receiver or other person appointed by them or him hereunder". The clause was held (p. 544) not to protect the trustees against willful breach of trust.31

Conover v. Guarantee Trust Co.32 is a leading case,33 in which the trust agreement provided that the mortgagor would assign to the trustee bonds and mortgages guaranteed by another corporation, whereupon the trustee might certify bonds under the trust deed. The trustee accepted bonds secured by mortgages upon lands of the mortgagor, rather than bonds and mortgages owned by the mortgagor and assigned to the trustee. The trustee was held to be without authority to execute the certificates and was liable to the bondholders irrespective of the exculpatory clause. Vice-Chancellor Leaming said:

"It accordingly seems impossible to construe an immunity clause as intended to exempt a trustee from liability for transcending his powers as clearly defined by the trust agreement; his engagement is to exercise the powers, and only the powers conferred upon him, and the appropriate office and purpose of an immunity clause forming a part of a trust agreement which specifically and clearly defines the trustee's powers appears to be to limit his responsibility in matters of judgment and discretion committed to him in the execution of those defined powers." (p. 461).

Thus, the court predicated the right of the bondholders to recover damages from the trustee, on account of its unauthorized certification, upon a breach of the duty owed by the trustee to the bondholders as cestui que trustor.34

In Hunsberger v. Guaranty Trust Co.,35 the trustee, having certain securities in its possession for the protection of the bondholders, under the terms of the mortgage, agreed to the substitution in place thereof of new securities which upon their face did not comply

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31"Willful misconduct" will be discussed infra. See note 113.
3288 N. J. Eq. 450, 102 Atl. 844, aff'd 89 N. J. Eq. 584, 106 Atl. 890 (1917).
34To like effect, see Tuttle v. Gilmore, 36 N. J. Eq. 617 (1883), infra note 40.
with the terms of the agreement. The deed of trust contained an
exculpatory clause. The Appellate Division held that a question
of fact was presented for the determination by the jury as to whether
the trustee was guilty of gross negligence in accepting the substituted
security and ordered a new trial. On a stipulation, the Court of
Appeals entered judgment absolute against the trustee.

The trustee in Colonial Trust Co.'s Appeal\(^\text{5}\) had certain funds
representing the proceeds of securities in its possession for the pro
rata benefit of the bondholders. The funds were delivered to the
mortgagor company by the trustee for the payment of treasury
bonds. Holding this constituted gross neglect or willful default,
the court surcharged the trustee, saying that “the lawful claims of
the bondholders are not to be refused on account of a mistake of this
nature by the trustee.”

The exculpatory clause in Patterson v. Guardian Trust Co.\(^\text{37}\) was
identical with that in Browning v. Fidelity Trust Co.,\(^\text{38}\) as appears
from an examination of the record on appeal. The trustee failed to
see that the proceeds of the sale of the bonds were applied to the
extinguishment of prior mortgages. This amounted to a breach of
duty which the court held was implied from the trust relationship.
And in Mullen v. Eastern Trust and Banking Co.\(^\text{39}\) the exculpatory
clause was held “not to refer in any way to the act of the trustee in
authenticating” spurious bonds.

While Tuttle v. Gilmore\(^\text{40}\) did not involve a corporate mortgage,
reference is made to it at this point since it is a leading case.\(^\text{41}\) The
trustee’s failure to make proper examination and inquiry respecting
certain investments was held such neglect as amounted to a “willful
and intentional breach of trust” within the meaning of the excul-
patatory clause in the deed of trust. The trustee accepted second
mortgages and this constituted an affirmative act in disregard of
certain obvious facts which showed that such action might result
in loss to the *cestui que trust*. The Court was of the opinion that
such a clause of limitation should be strictly construed.\(^\text{42}\)

\(^{38}\)241 Pa. 554, 88 Atl. 798 (1913).
\(^{36}\)250 Fed. 321 (C. C. A. 3d, 1918), certiorari denied 248 U. S. 564, 39 Sup. Ct. 9
(1918).
\(^{30}\)108 Me. 498, 81 Atl. 948 (1911).
\(^{42}\)3 N. J. Eq. 617 (1883).
\(^{40}\)If, Browning v. Fidelity Trust Co., *supra* note 38; Conover v. Guarantee
Trust Co., *supra* note 32; Woodruff v. Freehold Trust Co., 112 N. J. Eq. 405,
164 Atl. 411 (1933), *infra* note 69.
\(^{40}\)36 N. J. Eq. 617, 622 (1883). To like effect, see Rehden v. Wesley, 29
Turning now to a consideration of the cases in which the exculpatory clause effectually shielded the trustee from liability, we find Benton v. Safe Deposit Bank\(^4\) which presented the question of the liability of a trustee under a corporate mortgage to the bondholders for failure to record the mortgage. The indenture stated that the trustee was under no duty to record the same and further provided that the “trustee, save for its gross negligence or willful default, shall not be personally liable for any loss or damages.” The lower court\(^4\) was of the opinion that the provisions relieving the trustee from the duty of recording the instrument and from negligence were against the public policy of the State of New York. The Court of Appeals, however, held that the law of Pennsylvania was applicable and by that law\(^4\) no liability attached by reason of the alleged negligence; the contract specifying the trustee’s duties and obligations as well as its liability being legal.

In Security Building Corp. v. Title and Trust Co.,\(^4\) certain rentals were pledged as additional security for the payment of the bonds. The mortgage provided that the trustee should be under no obligation to take any action likely to involve expense until it was indemnified; and further provided that the trustee should not be liable for mistakes or errors of judgment or otherwise in connection with the trust, except for gross negligence or willful and intentional default. In an action against the trustee to recover damages on account of its alleged negligence in failing to collect certain rentals, the trustee was held not liable, except for improper application of rentals actually received.

Green v. Title Guarantee & Trust Co.\(^4\) was vigorously contested. Plaintiff, the owner of a large number of bonds, brought an action for damages against the trustee named in the mortgage for various derelictions on its part, including gross negligence as a trustee in failing to refile the mortgage each year in order to keep it alive as a chattel mortgage. The mortgage provided that “the trustee is under no obligation to record or file this indenture in any office whatsoever or to procure any additional instrument or further assurance or to do any act for the continuance or conservation of the lien hereof or for giving notice of the existence of such lien.”


\(^4\)131 Ore. 624, 284 Pac. 175 (1930).
Complaint was dismissed since the allegation of gross negligence was insufficient. Mr. Justice Lehman said:

"Obviously, the defendant can be held liable for damages to the plaintiff only if these damages occur as a result of the failure of the defendant to perform some duty which it owed to the plaintiff as a bondholder. The defendant's duties as trustee arise out of and are governed by the mortgage or deed of trust. The defendant was bound to exercise due care in carrying out both the duties expressly assumed by it in the deed of trust and the duties impliedly assumed by it from the mere fact of its becoming a trustee. It may be liable for damages caused by any failure to perform such duties properly,* * * There may be question as to how far a trustee may exempt himself from the obligations of using care in the performance of his duty as trustee, but in my opinion there can be no serious doubt that a trustee has the right by contract to limit the duties which he is to perform and can be held liable for nonfeasance of such duties only as the trustee agreed to perform. In the present complaint the only allegation of negligence is for nonfeasance of duties which the defendant had not agreed to perform."

Subsequently the complaint was amended and the defendant's motion for judgment on the pleadings was denied. The Appellate Division affirmed without opinion. Thereafter there was a trial which resulted in a verdict for the plaintiff. Upon appeal, the Appellate Division reversed the judgment and dismissed the complaint, holding the exculpatory clause valid. Finally, the Court of Appeals affirmed without opinion. And a motion for reargument was denied.

In **Bell v. Title Trust & Guarantee Co.** the mortgage declared that the trustee should be under no obligation to see to the recording of the indenture. It was not recorded and it was held "that no willful breach of trust, false statement or gross negligence on the part of the trustee has been shown by the evidence in the case." (p. 237) While the decision has been criticized as contrary to the tendency of the cases, it has been followed by the New York Court of Appeals.

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51248 N. Y. 627, 162 N. E. 552 (1928).
52249 N. Y. 600, 164 N. E. 599 (1928).
54Posner, Liability of the Trustee under the Corporate Indenture, (1928) 42 Harv. L. Rev. 198, 209.
And in *Newhall v. Norristown Trust Co.* the mortgage absolved the trustee from any duty with respect to the disposition of the proceeds of the sale of the bonds, and contained the customary form of exculpatory clause. The trustee was held not liable to the bondholders for losses occasioned by the mortgagor company wrongfully delivering bonds to contractors who failed to perform their contract for extensions.

In *Bell v. Scranton Trust Co.* the mortgage provided that the trustee should not incur any liability by reason of any loss arising from the failure of the company to keep the mortgaged premises insured. The property was destroyed by fire and an action was brought by a committee of bondholders against the trustee for its failure to enforce an alleged covenant in the mortgage as to fire insurance. Judgment went in favor of the defendant for the reason that the covenant declared upon was not in the mortgage. The exculpatory clause was held to be a further ground to support the judgment.

*Browning v. Fidelity Trust Co.* is a leading case. It was an action for damages against the trustee for alleged breach of trust duty. A separate department of the trust company knew that the mortgagor was in default. Yet the trustee released certain property from the mortgage. The usual form of exculpatory clause was held, under the circumstances of the case, to relieve the trustee. Although the trustee was technically negligent, the release was not gross negligence.

The question in *Stothers v. Toronto General Trusts Corp.* was whether the trustee was justified in paying to the mortgagor, upon progress certificates of an engineer, the proceeds of the sale of the bonds without ascertaining if other securities had been disposed of by the mortgagor. The trustee was protected from liability by the exculpatory clause in the deed.

*Whicher v. National Trust Co.* is an instructive case. It was an action by a bondholder against the trustee for alleged breach of duty

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6444 Ont. L. Rep. 432 (1918). Hodgins, J. dissented (p. 469). His dissent was based (p. 480) upon the conclusions of the majority of the Court of Appeal in *Whicher v. National Trust Co.*, 22 Ont. L. Rep. 460 (1910). However, the Privy Council had reversed that decision, L. R. [1912] A. C. 377, and apparently the Court was not aware of such reversal, see *infra* note 65.
in not purchasing at the lowest price a number of bonds to be retired by operation of the sinking fund. The trustee rejected plaintiff's lower tender of a small number of bonds and accepted a tender of a large number at a higher price. As a result the trustee retired a greater number of bonds with the available funds. The trust deed contained an exculpatory clause.\(^2\) At the trial Riddell, J. found that the trustee had acted honestly and reasonably and was protected from liability by the Trustee Act and the exculpatory clause.\(^3\) This decision was reversed by a majority of three to two in the Court of Appeal for Ontario.\(^4\) Subsequently the Privy Council restored the judgment of the trial court for the reason that the trustee did not commit any breach, finding it unnecessary to consider whether the trustee's duty rested on contract or a trust relation.\(^5\)

In *Hollister v. Stewart* the mortgage contained a provision that neither of the trustees "shall be answerable except for his own willful default or misconduct." The mortgagor company was in default. Upon the advice of a majority of the bondholders, the trustees released the company from its obligations to the bondholders, deferred payment on the bonds, and consented to a new mortgage. There was an express finding that the trustees, though acting erroneously, proceeded in good faith. The General Term modified the judgment below; and, in so doing, directed that judgment should go against the trustees as such and not personally.\(^6\) This was approved by the Court of Appeals.\(^7\) In delivering the opinion\(^8\) of the General Term, Daniels, J., after referring to the exculpatory clause, said:

"This language contemplated their [trustees] exoneration from liability for mere error of judgment in the management of their trust. There was no willful default or misconduct in the payments made upon the preferred bonds, but they were made under an error of judgment as to their legal rights and duties, and it was the object of this clause in the mortgage to relieve them from liability for the results of such misjudgment."

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\(^2\)The terms of the clause do not appear in the reports. However, through the courtesy of the trustee, the original deed was consulted by the writer and it contains the following provision: "The trustee shall not be answerable for any act, default, neglect or misconduct of any of its agents or employees by it appointed or employed in connection with the execution of any of the said trusts, nor in any other manner answerable or accountable under any circumstances whatsoever except for bad faith."

\(^3\)19 Ont. L. Rep. 605, 612 (1909).


\(^6\)37 Hun (N. Y.) 645 (1885).

\(^7\)111 N. Y. 644, 19 N. E. 782 (1889).

\(^8\)Unreported. The extract quoted was taken from a copy of the Papers on Appeal, pp. 214, 221.
That is the fair import and effect of the language employed, and it should be so construed as to secure that end.

Finally, in Woodruff v. Freehold Trust Co. the trustee received a sum sufficient to redeem all the outstanding bonds. The trust indenture was silent as to the duty imposed upon the trustee with respect to the fund so received. The trustee deposited the money with a bank then in good credit. Thereafter the bank failed and complainant, the owner of several bonds called for redemption, filed a bill for a decree for payment by the defendant trustee of the sum due upon the redemption of her bonds. The bill was dismissed; the immunity clause being construed as limiting the trustee’s “responsibility in matters of judgment and discretion committed to it in the execution of the trust imposed, so far as caring for the fund in question when received was concerned.”

Thus, an exculpatory clause will not be construed as intended to exempt a trustee from liability if it transcends its powers as defined by the trust indenture. The purpose of an exculpatory clause in the indenture in which the duties of the trustee are defined is to limit the responsibility of the trustee in matters of judgment and discretion in the exercise of the defined powers.

B. Deposit Agreements

While the rules of law applicable to ordinary trusteeship are not entirely applicable, the members of a committee of bondholders are, in a broad sense, trustees for the benefit of the bondholders and are bound to protect their interests in every reasonable way. The nature and extent of the powers of a bondholders’ committee are to be found in the instrument under which they undertake to act on behalf of the bondholders and not in any statute or rule of the common law. The agreement with the bondholders is both a defini-
tion and limitation of the powers of the committee. Bonds in the hands of the committee are impressed with a trust by virtue of the deposit agreement and a fiduciary relation exists between the depositors and the members of the committee. Such a committee is held to strict accountability, and in construing the terms of the deposit agreement and the powers entrusted to the committee, in case of doubt, a construction most favorable to the bondholders will be followed.

The liability of a committee of bondholders has been considered in a few cases, and the deposit agreement usually contains an exculpatory clause for the purpose of limiting the liability of the committee. In Industrial & General Trust, Ltd. v. Tod the committee had the right to construe the agreement and their construction was made final by force of the provisions of the deposit agreement. The court held that the provision was no protection to the committee since its action was not taken in good faith. The court said:

"The power to construe and the engagement that the construction shall be final mean that it shall be final if the members of the committee act in good faith, but not otherwise. They were, doubtless, protected from the outcome of errors of judgment and honest mistakes, but good faith is the standard, erected by the law, by which all their acts and omissions are to be judged."

In Thompson v. Hays a deposit agreement provided that the members of the bondholders' protective committee should not be liable for error of judgment or mistake of law or fact, but only for willful default. The committee fully advised the bondholders

7Industrial & General Trust, Ltd. v. Tod, 180 N. Y. 215, 225, 73 N. E. 7 (1905).
7Supra, note 75.
711 F. (2d) 244 (C. C. A. 8th, 1926).
of the situation at stated and proper times. There was no charge of fraud. The handling of the property by the committee was not satisfactory to the court, but the conduct of the committee evidenced a mistake of judgment or policy. However, the committee was not guilty of willful default, as defined by the court.

And in *Dreyfus v. Old Colony Trust Co.* the committee, in good faith and upon the advice of counsel, gave instructions to the depository respecting transfers of securities. The exculpatory clause was held a protection to the committee under the circumstances.

Again in *Van Siclen v. Bartol* the members of the bondholders' committee made mistakes. The agreement expressly relieved them from liability, except willful malfeasance or gross negligence. The committee attempted to arrange a plan of reorganization but was unsuccessful. The court dismissed the charge of gross negligence and found that "of willful malfeasance—a conscious, deliberate breach of trust—there was certainly none."

Finally, in *Riker v. Also* the agreement provided that none of the committee of bondholders should be responsible for the act or omission of any of his associates, or for any act not willfully or grossly negligent. The court stated that this "merely expresses what a court of equity would hold in the absence of such a provision."

**C. Deeds and Wills**

The protection afforded the trustee by an exculpatory clause in deeds and wills, where the relation is one of ordinary trust, has been considered in many cases in the American and English courts. In *Digney v. Blanchard* the trustee of an unincorporated association existing under a declaration of trust—a so-called Massachusetts trust—was to be liable only "for the result of his own gross negligence or bad faith." The trustee, without authority in the declara-

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79218 Mass. 546, 106 N. E. 154 (1914).
8095 Fed. 793 (C. C. Pa., 1899).
8127 Fed. 251, 259 (C. C. N. Y., 1886).
82The cases cited by Circuit Judge Wallace involved co-trustees and the question in each was the liability, if any, of a trustee for acts of his co-trustee. See Bogert, *The Liability of an Inactive Co-trustee*, (1920) 34 HARV. L. REV. 483, 498.
tion of trust, erected buildings on lands in which the trust had no interest. The trustee was held not to be exonerated from liability. The court said:

"Whatever may be the extent of the liability of a trustee justifying under this clause, we do not construe it as affording him protection from a willful and intentional breach of trust, committed by acting plainly beyond his powers." (p. 337).

And in *Holmes v. McDonald* the trustees of an association were held liable in spite of a broad exculpatory clause. They were held liable for failure to bring their business sagacity to bear upon their duties and withdraw a deposit in advance of the failure of the depository, which they would have known was unreliable, if they had actively attended to their duties. There was no evidence that the trustees were guilty of willful, corrupt misconduct. But the terms of the agreement were violated in lending the money on deposit instead of investing it.

In *Drosier v. Brereton* the trustees were the grantors and voluntarily created a trust for the benefit of a bankrupt neighbor and his wife. The trust deed contained an exculpatory clause which provided that the trustees should not be responsible for "the insufficiency or deficiency in the title or value of any security nor for any other misfortune, loss or damage which might happen except through their own willful default." The trustees lent trust funds on a second mortgage and the principal was lost. Upon the suit of the widow, the trustees were held liable, since it was a breach of trust to lend the money on a second mortgage. Sir John Romilly, the Master of the Rolls, characterized the case as a "very painful" one.

And in *Knox v. Mackinnon* the trust deed empowered the trustees to lend out trust funds on such security as they might think proper,

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8826 Ill. 169, 80 N. E. 714 (1907).
8915 Beav. 221, 51 Eng. Rep. 521 (1851). See also, Brumridge v. Brumridge, 27 Beav. 5, 54 Eng. Rep. 2 (1858) where the Master of the Rolls, Sir John Romilly, in holding the exculpatory clause in a deed did not exonerate a trustee from the consequences of a misapplication of funds, although admittedly free from personal guilt or benefit, said at page 7: "This clause is constantly brought forward to sanction the misapplication of trust moneys; but until it is provided, by the instrument creating the trust, that the trustee shall be liable for no breach of trust, provided he does not obtain a personal advantage, I shall not consider the clause as giving a trustee the right or liberty of conniving at a breach of trust. Even if an instrument containing such an inconsistent clause were brought before me, I express no opinion on the result; but until it is, I cannot allow a trustee to say that it is not his business to act properly in the performance of his duty as trustee".
90L. R. 13 A. C. 753 (1888).
and declared that the trustees were not to be responsible for "omissions, errors, or neglect of management." In spite of the exculpatory clause, the trustees were held liable because they had not brought to the management "the same care and diligence which a man of ordinary prudence would have exercised in his own concerns." In delivering his opinion, Lord Watson said:

"I see no reason to doubt that a clause conceived in these or similar terms, will afford a considerable measure of protection to trustees who have bona fide abstained from closely superintending the administration of the trust, or who have committed mere errors of judgment whilst acting with a single eye to the benefit of the trust, and of the persons whom it concerns. But it is settled * * * that such a clause is ineffectual to protect a trustee against the consequences of * * * gross negligence on his part, or of any conduct which is inconsistent with bona fides. I think it is equally clear that the clause will afford no protection to trustees, who from motives, however laudable in themselves, act in plain violation of the duty which they owe to the individuals beneficially interested in the funds which they administer. I agree with the opinion expressed by Lords Ivory, Gillies, and Murray in Seton v. Dawson, 4 Ct. Sess. Cas. 2d Series, at p. 318, to the effect that 'clauses of this kind do not protect against positive breach of duty.'" (p. 765).

Finally, in Rae v. Meek21 the trustees made an investment on the security of unfinished houses in course of erection relying upon the valuation of an architect. The trust deed contained the common form of exculpatory clause found in many trust deeds. The trustees were held liable for a breach of duty and were not protected by the exculpatory clause.

As early as 1811, Lord Eldon, in discussing the effect of exculpatory clauses in wills, said22 that "in effect this Court infuses such a clause in every will, though not directed: it comes therefore to little more than what a Court of Equity would have done without any direction." In Moyle v. Moyle23 the will provided that the trustees should not be answerable for "any loss or damage which might happen without their willful default, or by the misfeasance, failure or insolvency of any banker with whom the trust-monies might be lodged for safe custody or investment or otherwise in the execution of the trusts." Nevertheless the trustees were held liable for breach of trust, because they left certain funds on deposit for nearly a year with bankers who failed. And in Pride v. Fooks24

21L. R. 14 A. C. 558 (1889).
the will provided that the testamentary trustee "should only be accountable for losses happening through his willful neglect and misconduct." Yet the trustee was held liable, though he was not guilty of any furtive motive or personal gain, for having invested funds in a mortgage when the will directed him to invest in government bonds. The exculpatory clause was not a protection against a breach of trust.

However, in *Stretton v. Ashmall* it was held that the exculpatory clause limited the broad discretionary power of the testamentary trustee in selecting securities. The Vice-Chancellor said:

"The meaning of that [exculpatory] clause is that, if the trustees exercised an honest and fair discretion, and invested upon securities of sufficient value, then any loss arose from subsequent diminution of value, the trustees should not be affected." (pp. 11-12).

*Wilkins v. Hogg* was a case arising on trusts created by a will which contained an unusual exculpatory clause since it authorized the trustees to pay over to their co-trustees without being responsible for misapplication, each trustee being answerable only for losses occasioned by his own default. The exculpatory clause was held a sufficient shield to protect the trustees. Vice-Chancellor Stuart said:

"The argument has proceeded on the assumption that the usual indemnity clause amounts to nothing; that it never receives a literal interpretation; but that this Court will look generally at the conduct of the trustees, and, for any carelessness, or any act that a prudent man ought not to have committed, will visit the trustee who has been guilty of such acts, whatever may be the language of the will. That is not the law of this Court." (p. 118).

On appeal, Lord Westbury, the Lord Chancellor, said that he "should have been glad to find a case warranting the conclusion, that a duty having been undertaken, any words qualifying that duty should be nugatory; but such could not be held to be the law. It was perfectly competent to a testator to define what should be the incidents to the duty of a trustee, as long as he kept within the bounds of the law. This clause excluded the possibility of any liability, except for actual misappropriation."

It would seem that the *ratio decidendi* of the case is that the exculpatory clause in express terms shielded the trustees from any liability for the very act of which complaint was made.98

95 Jur. (N. S.) 25 (1861).
There are two classes of cases in which exculpatory clauses have been considered:

(a) Where the trustee has been charged with an act which is per se a breach of trust; that is, where he has committed an act involving the trust estate in loss which is not authorized by the terms of the instrument defining his powers. In such cases the courts have held that, as a matter of law, he is guilty of willful misconduct and that an exculpatory clause will not protect the trustee from the consequences of his act. As soon as the trustee goes beyond the terms of his authority he is guilty of willful misconduct in contemplation of law.

(b) The second class of cases is that involving claims based on acts which are not in and of themselves a breach of trust, but the assertion of a breach is predicated on the manner or time of the exercise of a discretionary power granted to the trustee. In this class the courts have uniformly held the exculpatory clause is a protection.

*Matter of Olmstead* brings out clearly the distinction between the two classes of cases. By the will the trustee was directed to invest the trust funds in bonds and mortgages on unincumbered improved real estate; and the will provided that the trustee should not be liable for any loss to the estate, unless such loss be caused by his personal gross neglect or willful misfeasance. The trustee made a proper investment. When the mortgage became due, the trustee extended payment without any one becoming personally liable on the bond. Thereafter a fire seriously damaged the mortgaged building. The trustee collected the insurance money and turned it over to the owner of the property upon an oral understanding that the latter should repair the building. The repairs were never made and the trustee was unable to recover the insurance money from the owner. The mortgage was foreclosed, leaving a deficiency. The trustee was not charged with the deficiency caused by the extension of the time of payment of the mortgage without requiring a responsible party to assume the payment of the bond. The court said: "The utmost that can be said is that it was an error of judgment to grant such an extension, which could not be called gross neglect within the meaning of this provision of the will."

As respects the act of the trustee in turning over the insurance money to the owner in possession of the property, upon a mere verbal

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understanding that it should be used in the repair of the building, the Court charged the trustee with the amount thus lost, saying:

"Here the will contained specific directions as to the securities in which the trust estate should be invested, and certainly a willful disregard of those directions would be gross neglect, within the meaning of this term as used in the will. ** ** Whatever meaning may be given to this term 'gross neglect', as used in the will, a payment of a portion of the trust fund to a person not liable to pay a mortgage on real property, upon the understanding that he will use that money to repair a building upon the trust estate, without taking any security for the performance of the agreement, is a violation of the authority conferred upon the trustee."

In Matter of Mallon\textsuperscript{100} two breaches by the trustees were involved. The Surrogate relieved one trustee from liability for a large part of the deficit\textsuperscript{101} but held him liable for another loss. Jenks, J., writing for the Appellate Division, said:

"I think that the indemnity clause protected the trustee from losses which might be ascribed justly to his fall below the standard prescribed by law for trustees, to his improvidence, or carelessness or bad judgment and the like, but not from such purblind folly as Howard showed after he learned of his fellow-trustee's maladministration, which must have convinced any man who took second thought either that Ferry was grossly incompetent or utterly dishonest, for it must be remembered that Ferry would not or could not explain this disappearance of $30,000."

In the second class of cases it has been sought to charge the trustee for what might be termed an abuse of the discretion vested in the trustee. As previously stated, the exculpatory clause is generally a protection to the trustee.\textsuperscript{102} However, in wills or ordinary trust instruments, an exculpatory clause has never exempted a trustee from liability for an act involving (a) negligence consciously committed; (b) gross negligence; or (c) conduct unauthorized by law or the trust instrument. The cases arising under the last group may be further sub-divided into cases of: (i) Inaction or failure to secure

\textsuperscript{101} 104 Misc. 569, 570, 89 N. Y. Supp. 554 (1904).
the trust fund; (ii) Action outside the provisions of the trust instrument; (iii) Action outside of the rules imposed by the court of equity upon trustees; or (iv) Postponement of performance of a duty beyond a reasonable time.\textsuperscript{103}

As a general rule, when the powers of the trustee are discretionary, equity will not intervene unless the trustee acts in bad faith, or in abuse of his powers. Any abuse of discretion upon the part of a trustee is clearly a matter for correction in a court of equity. No matter how broad the discretion which may be bestowed upon the trustee, he is not relieved from “obedience to the great principles of equity which are the life of every trust.”\textsuperscript{104}

D. Miscellaneous Bilateral Agreements

The general law as to limiting tort liability by contract is not settled. The employer may not validly provide in the contract of employment against liability for negligently injuring his employee.\textsuperscript{105} While an ordinary bailee may limit his liability for negligence,\textsuperscript{106} the peculiar duties which a common carrier owes to the public prevent it from validly contracting to limit its liability for negligence.\textsuperscript{107} Likewise, individuals and corporations engaged in a


\textsuperscript{104}Cardozo, J. in Carrier v. Carrier, 226 N. Y. 114, 125, 123 N. E. 135 (1919). See also, Struthers Coal & Coke Co. v. Union Trust Co., 227 Pa. 29, 75 Atl. 986 (1910); Colton v. Colton, 127 U. S. 300, 321, 8 Sup. Ct. 1164 (1888); Electric Management & Engineering Corp. v. United Power & Light Corp., 19 F. (2d) 311, 316 (C. C. A. 8th, 1927); In re Smith, L. R. 1 Ch. Div. 71 (1896); Holcomb v. Holcomb, 11 N. J. Eq. 281, 290 (1857); Read v. Patterson, 44 N. J. Eq. 211, 222, 14 Atl. 490 (1888); Larkin v. Wikoff, 75 N. J. Eq. 462, 72 Atl. 98 aff'd 77 N. J. Eq. 589, 78 Atl. 1134 (1910); Angell v. Angell, 28 R. I. 592, 598, 68 Atl. 538 (1908); Markle's Estate, 182 Pa. 378, 38 Atl. 612 (1897); Keeler v. Lauer, 73 Kan. 388, 393, 85 Pac. 541 (1905); Matter of Van de Car, 49 Misc. 393, 98 N. Y. Supp. 309 (1909); (Note) Control of Trustee's Discretion, (1929) 18 Ky. L. J. 399.

\textsuperscript{105}Johnston v. Fargo, 184 N. Y. 379, 77 N. E. 388 (1906) 7 L. R. A. (N. S.) 537 (1907).

\textsuperscript{106}Graves v. Davis, 235 N. Y. 315, 139 N. E. 280 (1923).

quasi public business cannot protect themselves by contract against liability for willful misconduct or gross negligence.\(^a\) However, a public service company may, in respect to a subordinate part of its business, exempt itself from liability for damages by contractual limitations that are reasonable. Thus, a telephone company may contract against liability arising from errors or omissions in its directory of subscribers to its service.\(^b\) An exculpatory clause in a lease which provided that the landlord was to be exempt from liability either for his own negligence or the negligence of his agents does not contravene public policy.\(^c\) And a bank may protect itself against inadvertency or oversight in paying checks against which a stop-payment order has been issued.\(^d\) Finally, a commercial agency may limit its liability for loss caused by neglect in communicating information, except for gross mistakes and negligence.\(^e\)

In addition to the cases already discussed defining willful default and gross negligence, there are several additional cases defining the terms.\(^f\)

While some courts have stated that a clause in an assignment for the benefit of creditors that the trustee shall be exonerated except for gross neglect and willful misfeasance renders the deed void as against creditors,\(^g\) other courts have held that since such language merely expresses the legal liability of the assignee, it does not invalidate the deed.\(^h\) Nevertheless the creditors coming in under such

\(^c\)Kirshenbaum v. General Outdoor Advertising Co., 258 N. Y. 489, 180 N. E. 245 (1932), noted (1932) 42 YALE L. J. 139.
\(^d\)Gaita v. Windsor Bank, 251 N. Y. 152, 167 N. E. 203 (1929).
\(^g\)In re Birk & Johnson, 295 Fed. 510 (C. C. A. 7th, 1924), certiorari denied 265 U. S. 590 (1924); McIntire v. Benson, 20 Ill. 500 (1858); Hutchinson v. Lord, 1 Wis. 286, 310 (1853); True v. Congdon, 44 N. H. 48, 56 (1862).
\(^h\)Scott v. Jones, 9 N. D. 551, 84 N. W. 479 (1900); Whipple v. Pope, 33 Ill. 334, 338 (1864); Gordon v. Gordon, 59 Va. 387 (1868); Hennessy v. The Western Bank, 6 W. &S. (Pa.) 300 (1843); See also, O'Fallon v. Tucker, 13 Mo. 262 (1850); Ashursts v. Martin, 9 Porter (Ala.) 566, 575 (1839); Baldwin v. Peet, 22 Tex. 708, 720 (1859).
an assignment and claiming the benefit of its provisions are bound by the stipulation upon which the trustee accepted the trust.\textsuperscript{116}

Somewhat to the same effect is \textit{Babbitt v. Read}.\textsuperscript{117} There the corporate mortgage contained a provision that no recourse under any obligation of the mortgage or of any bond or coupon should be had against any stockholder of the mortgagor corporation. The clause is one quite familiar in corporate mortgages, and, unless used as a part of a scheme to defraud, is valid and not against public policy. It is a fair and proper protection to the stockholders and is binding upon the bondholders if they are properly apprised in advance, since the purchaser of bonds usually looks to the security of the mortgage, rather than the personal responsibility of the individual stockholders.\textsuperscript{118}

\section*{Conclusion}

There are certain cases that are effectually provided for by an exculpatory clause. Nevertheless, there may exist others to which that immunity, however extensive, will not apply. Running through all the reported cases is a broad and inherent distinction, necessarily existing in all cases, between, on the one hand, errors of judgment, or casual negligence in small matters by employees, selected with due care, in the administration and management of the trust—that is, in acts performed by the trustee which are within the scope of its powers; and, on the other hand, acts inconsistent with the trust, or which amount to gross negligence or willful disregard of the direct duties of the trustee. It is essential to ascertain and determine whether the act complained of was an act within the powers of the trustee, as distinguished from acts without or beyond the scope of such powers.

There is some divergence of opinion respecting the various obligations of a trustee to the bondholders as to the affirmative duty to preserve the security. There is little doubt that a trustee is under the negative duty of refraining from impairing or destroying the security, the retention of which constitutes the primary and fundamental object of the trust indenture for the benefit of the bondholders.

\textsuperscript{116}Olmstead v. Herrick, 1 E. D. Smith (N. Y.) 310 (1852); Litchfield v. White, 7 N. Y. 438, 444 (1852).


It would seem that the courts eschew direct application of the exculpatory clause,\textsuperscript{119} whenever possible, by holding either (a) that there was no breach of duty or negligence,\textsuperscript{120} or (b) that the trustee was guilty of gross negligence or willful default and not protected by the provision. However, the courts are careful not to deny that some weight may be attributed to the exculpatory clause. It is a mistake to assume that the exculpatory clause is discretionary and is little more than what a court of equity would have done without any such direction.

\textsuperscript{120}National Trust Co. v. Whicher, L. R. [1912] A. C. 377, 383; Matter of Clark, supra, note 102.