

First Supplement to Memorandum 84-26

Subject: Study L-640 - Trusts (Comments on Office of Trustee)

The Commission began consideration of Memorandum 84-26 at the April 1984 meeting; the first 5-1/2 pages and associated provisions in the draft statute were covered at that time. However, some comments on this material were received after the April meeting and are discussed in this supplement. We have received comments on this subject from the Executive Committee of the Probate and Trust Law Section of the Los Angeles County Bar Association (LABA Committee) and the California Bankers Association (CBA); these comments are included in letters attached to Memorandum 84-58. Additional analysis by Bruce J. Steele for the CBA is included in the letter attached to this supplement as Exhibit 1. The comments of the Executive Committee of the Estate Planning, Trust and Probate Law Section of the State Bar to an earlier memorandum on this subject were taken into account in the preparation of the draft statute attached to Memorandum 84-26.

Draft § 4500. Trustee's compensation provided under trust terms; greater compensation

Mr. Bruce J. Steele, on behalf of the CBA, suggests that a subdivision be added to this section to permit the court to determine "periodic compensation for the trustee to continue as long as the court may deem proper." (See Exhibit 1, p. 1, attached hereto.) He says that this concept is "required to avoid the necessity of multiple court proceedings." The staff thinks that this concept is inherent in the general authority to fix, direct, or allow compensation on petition under draft Section 4630(b)(9) which is referred to in the comment to draft Section 4500. As noted on page 7 of Memorandum 84-26, the staff draft is intended to broaden the existing authority of the court to fix periodic compensation by applying it to all trusts, whereas under existing law it applies only to supervised testamentary trusts subject to Probate Code Section 1122. Perhaps this intent is too subtly indicated. If so, the comments to draft Sections 4500 and 4630(b)(9) could be revised to make clear that the court can fix prospective compensation as well as approve past and

current compensation. If the Commission wants, however, we could add language to the statute specifically authorizing the court to fix periodic compensation for as long as the court deems proper.

Mr. Steele also suggests that a subdivision be added to authorize the beneficiaries with vested interests that would be affected to approve a greater compensation. (See Exhibit 1, pp. 1-2, attached hereto.) In support of this suggestion, Mr. Steele states that greater compensation could be allowed where circumstances have changed without the need for court proceedings. The staff agrees in substance with this proposal, although as a matter of drafting, it may be preferable to locate such a provision with other matters relating to modification and termination of trusts by beneficiaries. This subject is not dealt with in the staff memorandum thus far because we are awaiting completion of a consultant's study.

Draft § 4502. Compensation of cotrustees

Mr. Steele suggests that the existing rule calling for compensation among cotrustees according to the services each renders be revised to incorporate a rule of some other states

which allows up to three full trustee's fees. The proposed revision is based on the fact that a trustee is not only compensated for the actual services performed on behalf of the trust, but also for the fiduciary responsibilities assumed by the trustee and the exposure to liability for breaching such duties. Since each co-trustee shares equally in these duties, unless specifically provided otherwise by the declaration of trust, each fiduciary should receive an equal fee.

The staff is aware of the general outlines of the New York statute which allows up to three commissions for estates over \$100,000. New York law also depends upon apportionment based on services rendered where there are more than three trustees. Is the Commission interested in altering California law in this regard? It seems to the staff that the broad authority granted the court by draft Section 4500(b) to allow a greater compensation should generally be adequate. A statutorily mandated multiple fee seems excessive and unrelated to the cotrustees' duties and liabilities, especially in a situation where the fee is set by the trust instrument.

Draft § 4550. Certificate of trustee

The staff recommends that the provision for issuance of a certificate of incumbency be eliminated. (See Memorandum 84-26, pp. 11-12.) The LABA Committee agrees with this suggestion:

We are concerned about the provision for a certificate of trustee under § 4550 as it applies to trusts not subject to court supervision. If there is a court file and if that court file shows the incumbency of the trustee, in situations where it is not necessary to go to the court in order to change trustees, the ability of a clerk to issue a certificate based upon the court file may be an invitation to fraud or, at the very least, inaccuracy. The Certificate procedure seems only to be appropriate in situations where there is continuing court supervision of the trust and so it is likely that the court file will be accurate. If the certificate is limited to situations where it may not be abused, it will be limited to an increasingly small minority of supervised testamentary trusts. Under those circumstances, we should consider removing the section altogether.

(See Memorandum 84-58, Exhibit 3, p. 8.)

Draft § 4551. Trustee's bond

In the memorandum on page 10, it is suggested that the draft statute make clear either that a corporate trustee is never required to give bond or that the court has discretion to require bond from a corporate trustee. The CBA argues that corporate trustee reserve requirements provide sufficient protection so that bond should never be required. (See Memorandum 84-58, Exhibit 4, p. 9.) Mr. Steele, on behalf of the CBA, states this position in more detail. (See Exhibit 1, p. 2, attached hereto.) The staff has no objection to exempting corporate trustees authorized to conduct business in California, although we are not so confident that in the abstract the deposit requirements provide the full protection that a discretionary bond statute would. As we read the relevant statutes, a corporate trustee never needs to deposit more than \$500,000.

Draft § 4560. Actions by cotrustees

At the June 1983 meeting, the Commission decided to replace the rule requiring cotrustees to act unanimously with the modern rule permitting cotrustees to act by majority rule. As is noted in the memorandum on page 11, this conforms the rule applicable to cotrustees to the rule applicable to coexecutors under Probate Code Section 570. This change

was supported by the State Bar Committee in 1983 and is supported by the LABA Committee. (See Memorandum 84-58, Exhibit 3, p. 8.) The CBA argues for a return to the unanimous decision rule. (See Memorandum 84-58, Exhibit 4, p. 9; Exhibit 1, p. 3, attached hereto.) The concern of the CBA seems to center on the possibility that the corporate trustee might be outvoted by two individual trustees who will then act contrary to the trust provisions, raid the assets of the trust, or take actions with adverse tax consequences. One wonders if this is a problem in the large number of states that have enacted the action by majority rule. It is also possible for a minority trustee to block advantageous actions or actions required by the trust instrument under the unanimous action rule. It is apparent that there is not unanimity on this change already approved by the Commission, so the policy question remains.

Draft § 4561. Inability of cotrustee to act

This provision states the general rule that the remaining cotrustees may act where a named cotrustee is incapable of acting. The CBA suggests that the word "becomes" in draft Section 4561 be replaced by "is" to take account of the possibility that a named cotrustee is incapable of acting at the inception of the trust. (See Memorandum 84-58, Exhibit 4, p. 9; Exhibit 1, p. 3, attached hereto.) The staff thinks this is a good change.

The CBA also would enable the remaining cotrustees to act when one cotrustee is incapable of acting for any reason, omitting the reference to "legally" incapable. This change would "facilitate the on-going administration of a trust even during the temporary absence of a cotrustee." (See Memorandum 84-58, Exhibit 4, p. 9.) The context of this issue should be remembered. If the unanimous action rule is reinstated, as urged by the CBA, then it is more important to provide this escape hatch from the harshness of that rule. If trustees can act by a majority, then this exception is not so important. The staff has no strong objection to revising this section as suggested by the CBA, but an argument could be made that the opportunity presented could be subject to abuse if mere temporary absence is sufficient to deprive a cotrustee of his or her power under a unanimous action rule.

Draft § 4570. Resignation of trustee

The CBA suggests that a majority of beneficiaries, rather than all beneficiaries, should be empowered to accept the resignation of a trustee. (See Memorandum 84-58, Exhibit 4, p. 10.) No reason for this suggestion is given. Does the Commission wish to alter the existing rule, which is retained in draft Section 4570(a)(2)?

The CBA also expresses concern that draft Section 4570(b) permits involuntary servitude on the part of trustees. (See Exhibit 1, p. 3, attached hereto.) The subdivision in question does not provide authority for the court to require the trustee to do anything; it does permit the court to refuse to accept the trustee's resignation, in accordance with the Restatement (Second) of Trusts rule noted in the comment. The effect is that the trustee remains subject to the duties and liabilities of a trustee until the conditions laid down by the court are satisfied. It is also incorrect to assume as a general proposition that a court can not require a trustee to "do something it does not wish to do." Courts clearly have the authority to compel trustees to act or not act in a variety of situations. See, e.g., the discussions in Memorandum 84-23 (Breach of Trust) and Memorandum 84-29 (Judicial Administration).

Draft § 4571. Liability of resigning trustee

Mr. Steele, on behalf of the CBA, suggests that the trustee should not be "released from its fiduciary responsibilities with respect to the assets until such assets are delivered over to a successor trustee or person appointed by the court." (See Exhibit 1, p. 4, attached hereto.) The LABA Committee makes a similar point. (See Memorandum 84-58, Exhibit 3, p. 9.) When this provision was considered at the April 1984 meeting, the Commission came to the same conclusion.

Draft § 4572. Removal of trustee

The CBA notes that draft Section 4572 seems to permit a petition for removal of a trustee to be made by a creditor under the umbrella of "interested person." (See Memorandum 84-58, Exhibit 4, p. 10; Exhibit 1, p. 4, attached hereto.) The staff agrees that this is too broad and we would limit the right to petition for removal to other trustees and beneficiaries. The "interested person" language is drawn from existing law, however. See Prob. Code § 1123.5. Whatever existing law may mean, it does not seem wise to permit creditors to interfere in the internal affairs of a trust.

Draft § 4573. Occurrence of vacancy in office of trustee

The CBA suggests that a provision be added

creating the express authority for the trustee who has resigned to continue to exercise its trust powers during the interim between resignation and appointment of a new trustee and transfer of trust assets and to continue to receive compensation during such period. Otherwise there is a time interim in which the trust assets may not be appropriately subject to trustee control, and harm may occur to the trust assets in such interim.

(See Memorandum 84-58, Exhibit 4, p. 10; Exhibit 1, p. 4, attached hereto.) This raises the question discussed in the memorandum about what is the purpose of all the technical rules concerning vacancy of the trustee's office. It appears to the staff that the main function is merely to determine when it is appropriate to appoint a successor. The focus of existing law, to the extent a focus can be found, seems to involve the question of who can wear the hat of trustee, without considering all the related questions of who has power and who is subject to duties of administering the trust. The draft statute is an attempt to put existing law on a more rational footing without totally revising it. When the draft is revised after the Commission completes its consideration of this memorandum, the matters relating to technicalities of trustee vacancies and the duties with regard to disposing of trust property by a resigning trustee should be better organized and more rational. Thus far the Commission has decided that the statute should provide that a trustee who resigns remains responsible for administration of the trust property until it is delivered to the successor trustee or other person entitled to receive it.

Draft § 4580. Appointment of new trustee

The CBA suggests that subdivision (a)(1) be revised to make clear that a successor trustee may be indicated in the trust or may be selected by a manner provided in the trust. (See Memorandum 84-58, Exhibit 4, p. 10-11; Exhibit 1, p. 5, attached hereto.) The staff agrees with this suggestion.

The Commission decided at the April 1984 meeting to revise subdivision (b) to permit the court to appoint a greater number of trustees unless the trust instrument provides otherwise. This change is supported by the LABA Committee and the CBA. (See memorandum 84-58, Exhibit 3, p. 9;

Exhibit 1, p. 5, attached hereto.) In addition, the CBA notes that subdivision (b) would permit a petition by a creditor under color of "interested person." (See Memorandum 84-58, Exhibit 4, p. 11.) The staff agrees that the right to petition should be limited to cotrustees and beneficiaries. The CBA also suggests that the last sentence be revised to read: "In selecting a trustee, the court shall give consideration to ~~the~~ any expressed wishes of the beneficiaries." The staff agrees with this change.

Respectfully submitted,

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June 14, 1984

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Re: Law Revision Commission
Memorandum 84-26
Trusts (Office of Trustee)

Dear Paulette:

Here are my comments and suggested drafting revisions covering the California Law Revision Commission's Staff Draft of Provisions Relating to Office of Trustee, Memorandum 84-26, #L-640.

Section 4500 - Trustee's Compensation Provided Under Trust Terms; Greater Compensation.

A subdivision (c) should be added to this provision to provide substantially as follows:

"In exercising its discretion in subdivision (b), the court, in its discretion, may fix or allow a periodic compensation for the trustee to continue as long as the court may deem proper."

This concept is taken from the third sentence of existing Probate Code Section 1122 and is required to avoid the necessity of multiple court proceedings.

A subdivision (d) should be added to Section 4500 to provide substantially as follows:

"Notwithstanding subdivision (a), the trustee may receive greater compensation than could be allowed under the terms of the trust with the consent of all persons having vested interests in the trust which would be affected by the trustee's receipt of such greater compensation."



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This would permit the trustee to enter into agreements with the beneficiaries of a trust for payment of greater compensation where circumstances have changed since the trust's inception, without the necessity of Court proceedings.

Section 4502 - Compensation Of Co-Trustees.

Although Section 4502 is a continuation of present California law, I suggest that Section 4502 be amended to incorporate the ~~New York Rule~~ ^{which} allows up to three full trustee's fees. The proposed revision is based on the fact that a trustee is not only compensated for the actual services performed on behalf of the trust, but also for the fiduciary responsibilities assumed by the trustee and the exposure to liability for breaching such duties. Since each co-trustee shares equally in these duties, unless specifically provided otherwise by the declaration of trust, each fiduciary should receive an equal fee.

Section 4551 - Trustee's Bond.

The staff's comments on trustee bonding (see Page 10 of the above-referenced Memorandum) indicate that under Section 4551, the court would have discretion on whether or not to require a bond of a corporate trustee. In its discussion of California Law relating to bond requirements for corporate trustees, the staff has failed to consider Probate Code Sections 480 and 481 which, together, provide that a corporation or association authorized to conduct the business of a trust company in California may be appointed to act as an executor, administrator, guardian or conservator of an estate, or trustee, and shall not be required to give any bond or security. In view of the existing deposit requirements for trust companies discussed by the staff, as well as existing law, it is suggested that a new Section 4553 be added to provide substantially as follows:

"(a) A corporation or association authorized to conduct the business of a trust company in this State may be appointed to act as an executor, administrator, guardian or conservator of an estate, or trustee, in like manner as an individual; but it shall not be appointed guardian or conservator of the person of a ward or conservatee.

(b) A corporation or association receiving an appointment described under subdivision (a) shall not be required to give any bond or security, but the provisions of Article III (commencing with Section 1540) of Chapter 12, Division 1 of, and Section 1587 of, the Financial Code shall govern with respect to its liability in the making of oaths and affidavits."

Section 4560 - Actions By Co-Trustees.

Present law, requiring unanimous action by co-trustees unless the trust provides otherwise, is necessary to avoid putting minority trustees in a position where they are required to bring a legal proceeding against the majority co-trustees. Furthermore, a more important reason for maintaining the present system is to avoid giving the majority trustees the power to transfer trust assets before the minority trustees can take any action to prevent such transfer. For example, in the case of two individual co-trustees and one corporate co-trustee, the individual co-trustees could make a transfer of trust property to a bona fide purchaser without the corporate co-trustee's knowledge or consent, which transfer could have adverse tax consequences or be contrary to the provisions of the trust. Furthermore, subdivision (a) may create a tax problem involving powers of appointment where two of the three co-trustees are non-adverse parties and are able to act in opposition to the one co-trustee who is an adverse party.

Section 4561 - Inability Of Co-Trustee To Act.

The word "becomes" in the second line of this section should be changed to "is." This technical change is designed to reflect the fact that a co-trustee may be legally incapable of acting at the inception of the trust, rather than developing such incapacity.

Section 4570 - Resignation Of Trustee.

Present Section 1138.8 is the preferred method for the resignation of a trustee. If a trustee wishes to resign, the trustee should have the ability to do so. The court should not have the ability to force a trustee to do something it does not wish to do.

Section 4571 - Liability Of Resigning Trustee.

This section should be changed to read substantially as follows:

"The liability of a resigning trustee or the sureties on the trustee's bond, if any, is not released or affected in any manner by the trustee's resignation, but shall continue until said trustee has delivered up the remaining balance of the trust estate to the successor trustee or a person appointed by the court to receive the trust estate."

This provision is designed to insure that even though the trustee has resigned, the trustee is not released from its fiduciary responsibilities with respect to the assets until such assets are delivered over to a successor trustee or person appointed by the court. The words "the remaining balance of the trust estate" are designed to permit the trustee to pay its fees and expenses prior to delivery of the trust estate.

Section 4572 - Removal Of Trustee.

Subdivision (a) should be changed to delete the words "an interested person" and add the words "a Trustee, beneficiary or remainderman." Subdivision (c) should be changed to delete the words "or other interested person" in the fourth line of this subdivision and replace them with "co-trustee or remainderman." These changes are to avoid the trustee having to defend itself in removal proceedings brought by persons who do not have the right to enforce the terms of the trust under common law. The suggested language is currently in use at Probate Code Section 1138.1(a).

There appears to be a technical problem with this section which arises when a trustee resigns and a period of time elapses before the trustee transfers trust property to a successor trustee or other person appointed by the court. Since Section 4573 treats the office of trustee as vacated upon the resignation of the trustee, there is a question whether the trustee who has resigned may continue to exercise its trust powers during the period between resignation and transfer of trust assets. It is suggested that either a subdivision be added to this Section 4573 or a new section be created to expressly authorize the trustee who has resigned to continue to exercise its trust powers during this interim period and to continue to receive compensation during such period.

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Section 4580 - Appointment Of New Trustee.

Subdivision (a)(1) should be amended to read:

"In accordance with the terms of the trust, if the trust provides for the appointment of, or a practical method of appointing a trustee."

This technical change is designed to reflect the fact that when a trust instrument names a person or corporation as successor trustee, this does not create a "practical method" of appointing a Trustee, but is an actual "appointment" of a trustee.

Subdivision (b) should be changed to read substantially as follows:

"The court may, in its discretion and on petition of an interested person, appoint one or more trustees to fill the vacancy. In selecting a trustee, the court shall give consideration to any expressed wishes of the beneficiaries."

There does not appear to be any good reason to limit the court's ability to appoint the number of trustees that the court determines to be appropriate under the circumstances.

I look forward to discussing these suggestions at our meeting on June 15, 1984.

Sincerely,



Bruce J. Steele, Esq.
Office of Trust Counsel

BJS:lh