

9/14/84

Memorandum 84-80

Subject: Comments of California Bankers Association on Various Memoranda

Attached as Exhibit 1 is a letter from the California Bankers Association containing comments on various memoranda prepared for the September meeting.

The Agenda for the September meeting lists this memorandum under the various agenda items to which portions of this memorandum are relevant.

Respectfully submitted,

John H. DeMouilly  
Executive Secretary



ESTABLISHED 1869

LEGAL DEPARTMENT 530 BROADWAY | SUITE 1208 | SAN DIEGO, CA 92101 | (619) 238-2119

September 7, 1984

Mr. John DeMouilly  
Executive Secretary  
California Law Revision  
4000 Middlefield Road, Room D02  
Palo Alto, California 94303-4739

Re: Recommendations With Respect to Memorandum

Dear Mr. DeMouilly:

Thank you for forwarding copies of the supplements to memoranda which will be considered in the September, 1984 meeting of the California Law Revision Commission. The California Bankers Association has met to discuss the memoranda and supplements thereto, and offers the following additional comments:

1. Memorandum 84-66: Recommends amendment of the provisions of Probate Code Section 630, allowing greater amounts of property to be dispersed without the necessity of probate administration. The CBA concurs that this is a necessary amendment.

Probate Code Section 631 provides protection to the holder of assets upon receipt of an affidavit requesting distribution. The language in Probate Code Section 631 should be amended to delete the requirement that an "affiant" must present the affidavit prior to such protection being afforded. The definition of "affiant" relates back to closely related family members of the decedent. However, it is conceivable that a person who is not a member of that limited class would present an affidavit for distribution under Probate Code Section 630. The holder of assets should not be placed under the burden of proving that the affiant is a surviving spouse or child of the decedent. Instead, Probate Code Section 631 should indicate that receipt of the affidavit and compliance therewith affords the holder of assets the protection of the code.

2. Memorandum 84-22: Trustee's powers: The California Bankers Association recommends the codification of the court's holding that "as a matter of law, the outright loan by the commercial department of a Bank or lending institution to a third party, for the purchase of trust property, where the lender also acts as (testamentary) trustee representing the sale of that trust property does not constitute an impermissible act of self dealing or conflict of interest absent sufficient evidence of same."

The addition of this proposed section would be consistent with Financial Code Section 3377.1 which allows a Bank trustee to make a loan to a trust it administers. Lending of funds to a third party in order to purchase trust property is certainly less controversial than the trustee lending money directly to the trust.

3. Memorandum 84-23: Breach of trust: The proposed provision granting attorney's fees to beneficiaries would further exacerbate litigation against trustees. The trust beneficiary would be filing objections in a "no lose" situation: if he prevails, the trustee would be forced to pay his attorney's fees; if he does not prevail, the trust would pay the attorney's fees; reimbursing the trust for its fees, as well. This is especially undersirable if the objector is a remainderman. That person's interest in the trust is arguably not affected by such a charge as the fees could be paid from income, only affecting the current income beneficiary.

The real beneficiaries of such a provision are the attorneys representing the objectors, not the beneficiary him or herself. Further, the staff proposal does not limit attorney's fees to beneficiaries who prevail, rather attorney's fees are available in any action for a breach of trust. The California Bankers Association is opposed to codifying the provision granting attorney's fees to trust beneficiaries in breach of trust actions or proceedings.

Punitive damages and fraud: The California Bankers Association recommends the codification of a list of actionable conduct which would result in punitive damages. The Association also recommends that a formula be established limiting the amount of punitive damages.

Interest at Legal or other rate: With respect to the recommendation that an interest rate "floor" be established, the California Bankers Association is opposed to a floor. The trustee has no control over the economy, which directly affects the current interest rates. This would in effect penalize the trustee, and would be unfair as interest rates should move with market conditions. This proposal is analogous to putting a floor on a cost of living increase, however, the trustee would not be in the bargaining position which a lessee enjoys.

Limitations: The California Bankers Association recommends codification of a statute of limitations.

The staff draft should be amended slightly to specify who may receive an accounting in order to bind a minor beneficiary. Sub-division (b) could be amended to state that the minor's legally appointed guardian or his or her parent may receive accountings which will bind the beneficiary.

Exculpation: It appears that the Commission staff is attempting to override the provisions of Civil Code Section 2258. The rationale for maintaining sub-division (b) of 2258 is that the trustor of a revocable living trust may revoke the trust or amend the trust document at will. The ability of the trustor to "amend the document" should not be limited to execution of a formal trust document amendment. This would be very costly, and defeat the purpose of a trustor establishing a revocable living trust. Instead, written instructions should suffice for a trustor to direct a trustee. The trustee of such a trust needs the exculpation from liability in order to be able to follow the trustor's instructions.

4. Memordandum 84-24: Liability of trust and trustee to third person: The staff indicates that "personally at fault" is a clearly defined term. The California Bankers Association disagrees. The Association therefore recommends clarification so that a trustee is liable only if the trustee has committed "willful misconduct," causing loss to the trust. "Willful misconduct" is defined throughout the code and is an easily identifiable standard against which to judge acts of a trustee. "Personally at fault" leads to many different interpretations by counsel. Litigation will result due to this vague standard, if codified.

The staff suggests removing the lien provisions from the code. Instead, the trustee is to have a direct right against trust assets for reimbursement. The concept of indemnification of the trustee is good. The staff should also address the problems of a trustee's future liability, once a trust is closed. Under the present system, the lien against trust property follows said property. Actions which may be brought against the trustee for trust activities which occurred prior to the trust closing must be defended, as the trustee has personal liability for all acts. The trustee should not be left with a mere indemnification agreement by trust beneficiaries.

An alternative is giving authority to the trustee to follow assets of the trust. The beneficiary would hold these assets as "constructive trustee" for any liability of the trustee.

Another alternative is to change the statutory scheme so that the trust is liable, not the trustee personally for contracts, actions, etc. In that manner, trust assets will be sought in litigation, and prior trustees would not be involved. This could prove very beneficial to trust beneficiaries as it would be much less expensive to defend litigation. Only parties currently involved as trustees would be involved in defending a trust.

Duty to Beneficiary not a Duty to Third Persons: The staff recommends placing a statement in the comment to this section on trustee's duties, describing who may petition. This does not appear adequate, as editions of probate codes are available without comments. Creditors would not be placed on adequate notice that they were not proper parties to bring a petition. Proper parties who may petition should be designated in the code section.

The California Bankers Association endorses the staff proposal to provide a direct right to retain property and withhold payments as against the beneficiary. However, the problem of attaching assets which have previously been distributed to the beneficiary still must be resolved. The trustee's lien appears to be the best method for guaranteeing protection of the trustee under present law. Again, an alternative which the staff should consider is the revision of liability sections, so that only trust assets are liable for trust contracts and actions. The trustee, if it were no longer personally liable, would not be faced with litigation after the trust has already closed, which is a recurring problem. If the contracts which a trustee enters into did not present personal liability of the trustee, but rather only binds the trust itself, the lien provisions would no longer be necessary with respect to third party claims. Only trustee's compensation or indemnification of the trustee for acts of the trustor or a successor trustee would arguably be necessary.

Creditor's Rights: The California Bankers Association strongly supports establishment of a four months creditor's claims period for trust estates.

5. Memorandum 84-26: Office of Trustee. The California Bankers Association has re-reviewed the proposal of staff that majority action of trustees should replace the requirement of unanimity of trustee action. The Association has determined that "majority rule" may be appropriate. The CBA recommends, however, that

with a majority rule provision, the minority trustee should not be responsible for acts taken by the majority. Additionally, the minority trustee should be given the right to a fast court determination of whether acts taken by the majority are appropriate. The California Bankers Association suggests some type of hearing in the nature of an ex-parte TRO hearing, which could occur upon four hours notice to the majority trustees, and in which the judge could decide whether the proposed action should be prevented. The CBA suggests the establishment of a procedure in which the judge is given appropriate standards with which to review proposed actions by the majority of trustees. Exculpation of the minority trustee is necessary should the majority's proposed actions be upheld. It does not appear that the beneficiaries of a trust must be noticed, rather all trustees become parties to this hearing. This would resolve the concerns which the California Bankers Association has with respect to a three trustee situation where two individual trustees could force the third trustee to take an action against his or her will.

6. Memorandum 84-32: Revised Uniform Principal and Income Act. The staff has requested concrete information on the issue of whether the Revised Uniform Principal and Income Act governs the calculation of income for income tax purposes. The Internal Revenue Code supersedes the Revised Uniform Principal and Income Act for tax purposes. To the extent that the two conflict, the tax effects of a distribution or sale of assets upon the trust or the beneficiaries are determined under the Internal Revenue Code.

An example is distribution of principal to a beneficiary, where the trust has "distributable net income" for tax purposes. The trust account holds no income for Principal and Income Act purposes. The beneficiary receives a "principal" distribution for accounting purposes. The beneficiary will be taxed upon the funds received due to Federal Income Tax Regulations.

Another example is the computation of capital gains in an account. The growth of an asset will be determined to be principal for Principal and Income Act purposes. This growth is considered income for tax purposes and tax upon the capital gain will be imposed. The appreciation (i.e., capital gain) of the asset will not normally be distributed to the income beneficiaries. It will be reinvested in the account for the benefit of remainder beneficiaries. Of course, the trustor may direct that the provisions of the Uniform Principal and Income Act do not apply to his or her trust. Capital gains may be treated as income under the trust document. Irrespective of whether the Uniform Act is adhered to by the trust, the Internal Revenue Code will impose tax on the capital gain.

7. Memorandum 84-27: Conduct of trust business and qualification by foreign trustee. The California Bankers Association is opposed to a statute allowing foreign corporations to act as trustees in California. Unless the foreign corporation places itself within the jurisdiction of California, beneficiaries of trusts would find it much more difficult to redress wrongs committed by that trustee. Information from the trustee would also be very slow to reach the beneficiary. Any foreign corporation choosing to act in California would not be familiar with California's statutory scheme governing trusts and trustees. Mistakes would occur constituting breaches of fiduciary duties through lack of knowledge. The California Bankers Association agrees in substance with the comments made by the State Bar Committee.

Once the California Bankers Association receives a copy of Memorandum 84-27, the Association will be better able to comment upon the proposed statutory changes.

8. Memorandum 84-65: Optional representation systems. The California Bankers Association agrees with the staff's recommendation that the terms "per stirpes" and "by right of representation" should be defined as meaning the same thing.

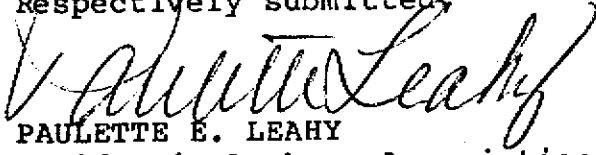


John DeMouilly  
September 7, 1984  
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9. Memorandum 84-70: Probate law and procedure.  
Inheritance of property attributable to  
decedent's pre-deceased spouse.

The California Bankers Association agrees with  
the recommendations of Bob Murphy with respect  
to abolishing the ancestral property  
doctrine. Administration of a probate estate  
would be greatly simplified in this manner.

Respectively submitted,



PAULETTE E. LEAHY  
California Bankers Association

cc: Trust State Governmental Affairs Committee Members