

#L-640

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9/17/85

Second Supplement to Memorandum 85-73

Subject: Study L-640 - Probate Code (Comprehensive Trust Law)

Attached to this supplement are copies of three letters commenting on aspects of the draft trust law which is attached to Memorandum 85-73. The letters from Richard Kinyon (Exhibit 1) and from the California Bankers Association (Exhibit 2) were distributed at the September meeting. We will be considering comments in these letters that relate to matters in the trust draft that have not yet been covered.

Exhibit 3 is a letter from L. Bruce Norman providing background on the CBA's position on the duty to use special skills, which you should read. Unless the Commission otherwise desires, we do not plan to discuss this issue at the upcoming meeting since it was considered at the September meeting.

Respectfully submitted,

Stan G. Ulrich
Staff Counsel

EXHIBIT 1

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September 5, 1985

777-6035

Mr. Stan G. Ulrich
Staff Counsel
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, California 94303-4739

Re: Trust Law Proposals

Dear Stan:

Thank you for your letters of August 20 and August 23, 1985. I appreciate the opportunity to have participated in the deliberations of the working group earlier this year and to comment on the latest staff draft proposal.

I have reviewed the Staff Draft of the Trust Law, dated August 15, 1985, and am enclosing copies of those pages on which I suggest changes be made. If I had more time I could make other suggestions as well, but the enclosed changes are the only ones that occurred to me while reading through the draft.

It seems to me that the simplest and most straightforward way of dealing with revocable trusts would be to provide that when a trust is revocable or otherwise subject to a non-lapsing general power of appointment, the power holder should be treated as the sole beneficiary of the trust for certain purposes, unless otherwise provided in the trust instrument. This would eliminate the need for many other provisions specifically relating to revocable trusts, such as Sections 15800-15802, 16001 and 16462. Also, Section 15404 as well as Section 15403 would apply only to irrevocable trusts. The following definition that I presently include in my trust "boilerplate" incorporates this concept:

The terms "beneficiary" and "beneficiaries" shall refer to those persons (other than indefinite charitable and other organizations) who are, from time to time, entitled to current distributions out of income and/or

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principal of any trust established under this instrument, as a matter of right or in the Trustee's discretion, plus those persons specified in Sections 1215.1 and 1215.2 of the California Probate Code, who would be entitled to notice of a hearing; provided, however, that a person who holds a nonlapsing general power of appointment (as defined in Section 1381.2 of the California Civil Code) that is presently exercisable with respect to trust property, in whole or in part, shall be treated as the sole beneficiary of the trust or portion thereof for purposes of Article VII (Provisions Relating to the Trustee), above.

This approach is also consistent with the way the tax laws treat grantor-type trusts.

As I mentioned during the working group sessions when we discussed the trustee's duty to report information and account to beneficiaries (see Sections 16060-16064), I feel very strongly that unless otherwise provided in the trust instrument, a trustee should not only be required to account annually to those beneficiaries to whom income or principal is required or authorized in the trustee's discretion to be distributed currently, but also to presumptive remainder beneficiaries, included with the above quoted definition from my trust boilerplate provisions and in proposed Section 15803. Although a remainder beneficiary can request certain information under proposed Section 16061, he or she might not know that his or her interest is or has been affected by the trustee's action. The best way to protect all beneficiaries as well as the trustee is to provide all beneficiaries (other than remote, contingent beneficiaries) with an annual accounting. This would not unduly burden the trustee and would allow any questions regarding the administration of the trust (such as the propriety of a discretionary distribution of principal to a life beneficiary) to be dealt with in a timely manner. The remainder beneficiaries are often the ones whose interests are most likely to be adversely affected by the trustee's actions, and I cannot understand why they should not be given regular notice of those actions and a chance to protect themselves.

Another reason to require annual accountings to be given to remainder beneficiaries as well as income beneficiaries is to better protect individual trustees holding tax-sensitive powers. It is common practice in California to name the life beneficiary (such as the surviving spouse) as the sole trustee

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of a trust that allows the trustee to invade principal for his or her own benefit according to an "ascertainable standard." In order to convince the Internal Revenue Service and a court that this standard is being followed, I believe it is helpful if not necessary to show that the remainder beneficiaries (those whose interests would be adversely affected by the exercise of the power of invasion) are entitled to receive annual accountings.

Otherwise, there is no effective check on the potential abuse of this power by the trustee-beneficiary unless the remainder beneficiaries are alert enough to regularly demand accountings by the trustee.

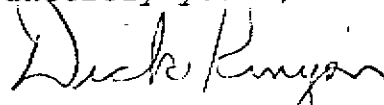
With regard to proposed Sections 16304 and 16305, it seems to me that insurance premiums and dividends on insurance policies (which are often characterized as a return of premiums) as well as insurance proceeds should be treated as items of principal rather than income. Also, annuities are wasting assets, and therefore in my opinion each annuity payment should be treated as part income and part principal, in such proportions that the present value of the right to the annuity at the time it is received by the trust will be recovered over the period during which the payments are likely to be received.

I agree with the suggestion in Chuck Collier's April 23, 1985, letter to you that the trust law specify the treatment of income of a revocable trust immediately after the death of the settlor. Proposed Sections 16305 and 16306 might be modified to cover this situation.

Finally, with respect to Chuck Collier's letter to you of August 7, 1985, it seems to me that interest on a tax deficiency should be charged against income rather than principal. If the correct tax had been paid originally so that no deficiency would have later been assessed, the income of the trust would have been correspondingly reduced. Therefore, the interest on the deficiency, which is the payment for the trust's use of the deficiency after the time it was due, would logically seem to be chargeable to income.

Please give me a call if you would like to discuss these or any other matters with me in more detail, or if you think my attendance at the Commission meeting on September 12-13 would be helpful.

Sincerely yours,



Richard S. Kinyon

RSK:mjf
cc: Charles A. Collier
Edward C. Halbach, Jr.
Arthur K. Marshall

PART 2. CREATION, VALIDITY, MODIFICATION,
AND TERMINATION OF TRUSTS

CHAPTER 1. CREATION AND VALIDITY OF TRUSTS

§ 15200. Methods of creating trust

15200. Subject to other provisions of this chapter, a trust may be created by any of the following methods:

(a) A declaration by the owner of property that the owner holds the property as trustee, ~~for the owner or another person,~~

(b) A transfer of property by the owner during the owner's lifetime to another person as trustee, ~~for the transferor or for a third person,~~

(c) A testamentary transfer of property by the owner to another person as trustee, ~~for that person or for a third person,~~

(d) An exercise of a power of appointment to another person as trustee, ~~for the donee of the power or for a third person,~~

(e) An enforceable promise to another person whose rights under the promise are to be held in trust, ~~for a third person,~~

Comment. Section 15200 is the same in substance as Section 17 of the Restatement (Second) of Trusts (1957). Section 15200 supersedes parts of former Civil Code Sections 2221 and 2222. A declaration under subdivision (a) must satisfy the requirements of Section 15206 (Statute of Frauds as applied to trust of real property) or 15207 (oral trust of personal property), if applicable.

§ 15201. Intention to create trust

15201. A trust is created only if the settlor properly manifests an intention to create a trust.

Comment. Section 15201 codifies Section 23 of the Restatement (Second) of Trusts (1957). This section continues a requirement of former Civil Code Section 2221(1). Special requirements may apply to the manifestation of the settlor's intent. See Sections 15206 (Statute of Frauds as applied to trust of real property), 15207 (oral trust of personal property).

§ 15202. Trust property

15202. A trust is created only if there is trust property.

Comment. Section 15202 is the same as Section 74 of the Restatement (Second) of Trusts (1957). Section 15202 continues a requirement of former Civil Code Sections 2221 and 2222. See also Section 62 ("property" defined). For additional comments concerning

Comment. Section 15403 is drawn from Section 337 of the Restatement (Second) of Trusts (1957). Unlike the Restatement, however, subdivision (b) gives the court some discretion in applying the material purposes doctrine except in situations where transfer of the beneficiary's interest is restrained, such as by a spendthrift provision. See Section 15300 (restraint on transfer of beneficiary's interest). Section 15403 permits termination of an irrevocable trust with the consent of all beneficiaries where the trust provides for successive beneficiaries or postpones enjoyment of a beneficiary's interest. The discretionary power provided in subdivision (b) also represents a change in the California case-law rule. See, e.g., *Moxley v. Title Ins. & Trust Co.*, 27 Cal.2d 457, 165 P.2d 15 (1945). Section 15403 is intended to provide some degree of flexibility in applying the material purposes doctrine in situations where transfer of the beneficiary's interest is not restrained. For provisions governing judicial proceedings, see Section 17200 et seq. For provisions relating to obtaining consent of persons under an incapacity, see e.g., Civil Code §§ 2450, 2467 (statutory form of durable power of attorney); Prob. Code §§ 2580 (conservator), 15405 & 17207 (appointment of guardian ad litem). See also Sections 15406 (no conclusive presumption of fertility), 15407 (effect of disposition in favor of heirs or next of kin of settlor). For provisions governing modification and termination of trusts where the consent of all beneficiaries cannot be obtained, see Sections 15409 (trust with uneconomically low principal) and 15410 (modification or termination by court order in changed circumstances). Subdivision (a) limits the application of this section to irrevocable trusts since if the trust is revocable by the settlor, the method of revocation is governed by Section 15401. Compare Section 15404 (modification or termination by settlor and all beneficiaries).

§ 15404. Modification or termination by settlor and all beneficiaries

15404. (a) If the settlor and all beneficiaries of ^{an irrevocable} trust consent, they can compel the modification or termination of the trust.

(b) If any beneficiary does not consent to the modification or termination of the trust, upon petition to the court the other beneficiaries, with the consent of the settlor, can compel a modification or a partial termination of the trust if the interests of the beneficiaries who do not consent are not substantially impaired.

Comment. Section 15404 is drawn from Section 338 of the Restatement (Second) of Trusts (1957). Subdivision (a) continues the substance of the rule formerly provided by the second sentence of the second paragraph of Civil Code Section 771 and supersedes part of former Civil Code Section 2258(a). A trust may be modified or terminated pursuant to this section without court approval, but a court order may be sought by petition under Section 17200. A revocable trust may be modified or terminated pursuant to this section, as in a case where the method of modification or revocation

living person, notice shall be given to the living person.

(3) Where an interest has been limited upon the happening of any future event to a person, or a class of persons, or both, and the interest, or a share of the interest, has been further limited upon the happening of an additional future event to another person, or a class of persons, or both, notice shall be given to the person or persons in being who would take the interest upon the happening of the first of these events.

(b) If a conflict of interest involving the subject matter of the trust proceeding exists between a person to whom notice is ^{required to be} given and another person to whom notice is ^{otherwise} not required to be given under subdivision (a), notice ^{also} shall be given to ^{such other} persons, ~~not otherwise entitled to notice under subdivision (a)~~.

(c) Nothing in this section affects any of the following:

(1) Requirements for notice to a person who has requested special notice, a person who has filed notice of appearance, or a particular person or entity required by statute to be given notice.

(2) Requirements for appointment of a guardian ad litem pursuant to Section 17207.

Comment. Subdivision (a) of Section 15803 continues the substance of former Probate Code Section 1215.1. See also Section 24 ("beneficiary" defined). For provisions where this section applies, see Sections 17203 (notice of hearing on petitions generally), 17351 (provisions for removal of certain testamentary trusts from continuing jurisdiction), 17403 (notice of petition for transfer to another jurisdiction), 17504 (notice of petition for transfer to California).

Subdivision (b) continues the substance of former Probate Code Section 1215.2. ~~¶~~ Subdivision (c) continues the substance of the first sentence of former Probate Code Section 1215.4. See Section 17204 (request for notice and copy of petition).

PART 4. TRUST ADMINISTRATION

CHAPTER 1. DUTIES OF TRUSTEES

Article 1. Trustee's Duties in General

§ 16000. Duty to administer trust

16000. On acceptance of the trust, the trustee has a duty ~~to the~~ ~~beneficiaries~~ to administer the trust according to the trust instrument and, except to the extent the trust instrument provides otherwise, according to this division.

Comment. Section 16000 is drawn in part from Sections 164 and 169 of the Restatement (Second) of Trusts (1957). Section 16000 continues the part of former Civil Code Section 2258 requiring the trustee to "fulfill the purpose of the trust" and also continues former Civil Code Section 2253 insofar as it related to control of the trustee's duties by the trust instrument. See also Sections 15600 (acceptance of trust by trustee), 15800 (duties owed primarily to person holding power to revoke trust), 16001 (duties of trustee of revocable trust), 16040 (trustee's standard of care in performing duties).

§ 16001. Duties of trustee of revocable trust

16001. (a) Except as provided in subdivision (b), the trustee of a revocable trust shall follow any written direction acceptable to the trustee given from time to time (1) by the person then having the power to revoke the trust or the part thereof with respect to which the direction is given or (2) by the person to whom the settlor delegates the right to direct the trustee.

(b) If a written direction given under subdivision (a) would have the effect of modifying the trust, the trustee has no duty to follow the direction unless it complies with the requirements for modifying the trust.

Comment. Subdivision (a) of Section 16001 continues the first sentence of former Civil Code Section 2258(b) without substantive change. The qualification that a direction be acceptable to the trustee does not mean that the trustee is required to determine the propriety of the direction. For the rule protecting the trustee from liability for following directions under this section, see Section 16462. See also Sections 15800 (duties owed to person holding power to revoke), 16000 (duties subject to control in trust instrument), 16040 (standard of care in performing duties).

Subdivision (b) is a new provision that clarifies the relationship between the duty to follow directions provided in

§ 16009. Duty to keep trust property separate and identifiable. ✓

16009. The trustee has a duty to do the following:

~~(a) To keep the trust property separate from the trustee's individual property.~~

(a) To keep the trust property separate from other property not subject to the trust.

(b) To see that the trust property is designated as property of the trust.

Comment. Section 16009 codifies the substance of Section 179 of the Restatement (Second) of Trusts (1957). Section 16009 supersedes the rule against comingling provided in former Civil Code Section 2236. For exceptions to this general duty, see, e.g., Fin. Code §§ 1563 (securities registered in name of nominee), 1564 (Uniform Common Trust Fund Act). See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee's standard of care in performing duties).

§ 16010. Duty to enforce claims

16010. The trustee has a duty to take reasonable steps to enforce claims that are part of the trust property.

Comment. Section 16010 codifies the substance of Section 177 of the Restatement (Second) of Trusts (1957). This section is in accord with case law. See Ellig v. Naglee, 9 Cal. 683 (1858). Under this section, it may not be reasonable to enforce a claim depending upon the likelihood of recovery and the cost of suit and enforcement. See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee's standard of care in performing duties).

§ 16011. Duty to defend actions

16011. The trustee has a duty to take reasonable steps to defend actions that may result in a loss to the trust.

Comment. Section 16011 codifies the substance of the first part of Section 178 of the Restatement (Second) of Trusts (1957). This section is in accord with case law. See, e.g., Estate of Duffill, 188 Cal. 536, 206 P.42 (1922). Depending on the circumstances of the case, it might be reasonable to settle an action or suffer a default rather than to defend an action. See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee's standard of care in performing duties).

§ 16012. Duty not to delegate

16012. The trustee has a duty not to delegate to others the performance of acts that the trustee can reasonably be required

of care provided by Section 16040 and authorizing any investment permitted under Chapter 2 (commencing with Section 16200).

Comment. Section 16042 continues the second sentence of subdivision (e) of former Civil Code Section 2261 without substantive change.

Article 3. Trustee's Duty to Report Information
and Account to Beneficiaries

§ 16060. Trustee's general duty to report information and account to beneficiaries

16060. The trustee has a duty to keep the beneficiaries of the trust reasonably informed of the trust and its administration.

Comment. Section 16060 is drawn from the first sentence of Uniform Probate Code Section 7-303 (1977) and is consistent with the duty stated in California case law to give beneficiaries complete and accurate information relative to the administration of a trust when requested at reasonable times. See *Strauss v. Superior Court*, 36 Cal.2d 396, 401, 224 P.2d 726 (1950). Except as otherwise required by statute, the trustee is not ordinarily under a duty to furnish information in the absence of a request. See Sections 16061 (duty to report information about trust to beneficiary on request), 16062 (duty to account to beneficiaries). However, the trustee is under a duty to communicate to the beneficiary material facts affecting the interest of the beneficiary that the trustee knows the beneficiary does not know and that the beneficiary needs to know for the beneficiary's protection in dealing with a third person. See Restatement (Second) of Trusts § 173 comment d (1957). Thus, the general duty provided in this section is ordinarily satisfied by compliance with Sections 16061 and 16062 unless there are extraordinary circumstances. See also Sections 24 ("beneficiary" defined), 15800 (duties owed primarily to person holding power to revoke revocable trust), 16000 (duties subject to control in trust instrument), 16001 (duties of trustee of revocable trust); see also Section 16460 (limitations on proceedings against trustee).

§ 16061. Duty to report information about trust on request

16061. Except as provided in Section 16064, on reasonable request by a beneficiary, the trustee shall provide the beneficiary with a report of information about ^{a) the assets, liabilities, and the receipts and disbursements} the assets of the trust, ^{and (b)} the acts of the trustee, and the particulars relating to the administration of the trust relevant to the beneficiary's interest, including the terms of the trust that describe or affect the beneficiary's interest.

Comment. Section 16061 is drawn from Uniform Probate Code Section 7-303(b). The reference to the acts of the trustee is drawn

from former Probate Code Section 1138.1(a)(5). If the trustee does not comply with the reasonable request of the beneficiary, information may be sought on petition pursuant to Section 17200(b)(7). A beneficiary who is not entitled to an annual account under Section 16062 may be entitled to information or a particular account under this section. See also Sections 24 ("beneficiary" defined), 15800 (limits on right of beneficiary of revocable trust), 16064 (exceptions to duty to report and account). In an appropriate case, more information may be required under this section than through the duty to account annually. See Section 16063 (contents of annual account).

§ 16062. Duty to account to beneficiaries

✓ 16062. (a) Except as provided in Section 16064, the trustee shall account at least annually, at the termination of the trust, and upon a change of trustees, to each beneficiary to whom income or principal is required or authorized in the trustee's discretion to be currently distributed ^{and} to whom notice must be given under Section 15803.

(b) A trustee of a living trust created by an instrument executed before [operative date], or of a trust created by a will executed before [operative date] and not incorporated by reference in a will after [operative date], is not subject to the duty to account provided in this section.

Comment. Subdivision (a) of Section 16062 supersedes parts of subdivisions (b) and (c) of former Probate Code Section 1120.1a and parts of former Probate Code Sections 1121 and 1138.1(a)(5). The requirement of an annual account is drawn from the statute formerly applicable to testamentary trusts created before July 1, 1977. See former Prob. Code § 1120.1a.

Subdivision (b) makes clear that the annual account required by subdivision (a) does not apply to pre-operative date trusts. This rule does not affect any requirement for an account that may exist under prior law, whether pursuant to statute or court order. See, e.g., former Prob. Code § 1120.1a(b).

✓ § 16063. Contents of ~~annual~~ account

16063. An account furnished pursuant to Section 16062 shall contain the following information:

(a) A statement of receipts and disbursements of principal and income that have occurred during the last complete fiscal year of the trust or since the last account.

(b) An ~~inventory of trust property~~ ^{statement of the assets and liabilities of the trust} as of the end of the last complete fiscal year of the trust or since the last account.

unnecessary in view of Section 16100(b). See also Section 10 (singular includes plural).

§ 16103. Exceptions applicable to split-interest trusts

16103. With respect to split-interest trusts:

(a) Subdivisions (b) and (c) of Section 16102 do not apply to any trust described in Section 4947(b)(3) of the Internal Revenue Code.

(b) Section 16102 does not apply with respect to any of the following:

(1) Any amounts payable under the terms of such trust to income beneficiaries, unless a deduction was allowed under Section 170(f)(2)(~~B~~), 2055(e)(2)(~~B~~), or 2522(c)(2)(~~B~~) of the Internal Revenue Code.

(2) Any amounts in trust other than amounts for which a deduction was allowed under Section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522 of the Internal Revenue Code, if such amounts are segregated, as that term is defined in Section 4947(a)(3) of the Internal Revenue Code, from amounts for which no deduction was allowable.

(3) Any amounts irrevocably transferred in trust before May 27, 1969.

Comment. Section 16103 continues the substance of subdivisions (b) and (c) of former Civil Code Section 2271.1. See also Section 16100 ("split-interest trust" defined).

§ 16104. Incorporation in trust instruments

16104. The provisions of Sections 16101, 16102, and 16103 shall be deemed to be contained in the instrument creating every trust to which this article applies. Any provision of the instrument inconsistent with or contrary to this article is without effect.

Comment. Section 16104 continues the substance of the second paragraph of former Civil Code Section 2271 and subdivision (d) of former Civil Code Section 2271.1.

§ 16105. Proceedings

16105. (a) A proceeding contemplated by Section 101(1)(3) of the Tax Reform Act of 1969 may be commenced pursuant to Section 17200 by the organization involved. All specifically named beneficiaries of

§ 16305. When right to income arises; apportionment of income

16305. (a) An income beneficiary is entitled to income from the date specified in the trust instrument or, if none is specified, from the date an asset becomes subject to the trust. In the case of an asset becoming subject to a trust by reason of a ~~will~~ ^{person's death}, it becomes subject to the trust as of the date of the death of the ~~testator~~ ^{person} even though there is an intervening period of administration of the testator's estate.

(b) Upon an asset becoming subject to a trust by reason of a ~~will~~ ^{person's death}:

(1) Receipts due but not paid at the date of death of the ~~testator~~ ^{person} are principal.

(2) Receipts in the form of periodic payments (other than corporate distributions to stockholders), including rent, interest, or annuities, not due at the date of the death of the ~~testator~~ ^{person} shall be treated as accruing from day to day. That portion of the receipt accruing before the date of death is principal and the balance is income.

(c) In all other cases, any receipt from an income-producing asset is income even though the receipt was earned or accrued in whole or in part before the date when the asset became subject to the trust.

(d) If an income beneficiary's right to income ceases by death or in any other manner, all payments actually paid to the income beneficiary or in the hands of the trustee for payment to the income beneficiary before such termination belong to the income beneficiary or to his or her personal representative. All income actually received by the trustee after such termination shall be paid to the person next entitled to income by the terms of the trust. This subdivision does not apply to income received by a trustee under subdivision (b) of Section 16306.

(e) Corporate distributions to stockholders shall be treated as due on the day fixed by the corporation for determination of stockholders of record entitled to distribution or, if no date is fixed, on the date of declaration of the distribution by the corporation.

Comment. Section 16305 continues former Civil Code Section 730.04, except that subdivision (b)(2) has been conformed to Section

Section 17200.

(f) Reforming or excusing compliance with the governing instrument of an organization pursuant to paragraph (19) of subdivision (b) of Section 17200.

Comment. Section 17206 restates the substance of former Probate Code Section 1138.10 and the parts of Probate Code Section 1240 that formerly related to trusts. Unlike former law, however, Section 17206 lists the orders that are not appealable, rather than the orders that are appealable. Under this section, orders described in Section 17200 that are new to the law are appealable. See, e.g., Section 17200(a) (determining existence of trust), (b)(1) (construction of trust instrument), (b)(2) (determining existence of any immunity, power, privilege, duty, or right). Unlike the former statute, Section 17206 permits an appeal from the grant or denial of an order for the modification or termination of a trust with uneconomically low principal. See former Civil Code § 2279.1; former Prob. Code §§ 1138.1(b)(12), 1138.10. See also Section 17202 (dismissal of petition).

§ 17207. Appointment of guardian ad litem

17207. (a) The court may, on its own motion or on request of a trustee or other person interested in the trust, appoint a guardian ad litem at any stage of a proceeding concerning the trust, If the court determines that representation of the interest otherwise would be inadequate; a guardian ad litem may be appointed to represent the interest of any of the following;

- (1) A minor.
- (2) An incapacitated person.
- (3) An unborn person.
- (4) An unascertained person.
- (5) A person whose identity or address is unknown.
- (6) A designated class of persons who are not ascertained or are not in being.

(b) If not precluded by a conflict of interest, a guardian ad litem may be appointed to represent several persons or interests.

(c) Sections 373 and 373.5 of the Code of Civil Procedure do not apply to the appointment of a guardian ad litem under this section.

Comment. Section 17207 continues without substantive change paragraph (2) of subdivision (a) and subdivision (b) of former Probate Code Section 1215.3 and the substance of subdivision (a) of former Probate Code Section 1138.7, and supersedes part of the last paragraph



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September 6, 1985

Mr. John DeMouly
Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, California 94303-4739

Re: California Bankers Association's Recommendations
Regarding Proposed Trusts Law (Staff Draft
Dated 8-15-85)

Dear John:

The California Bankers Association again thanks the Commission and its staff for the opportunity to review the staff draft of the Trust Law at the two working sessions. The Trust State Governmental Affairs Committee has reviewed the staff draft of the Trust Law dated August 15, 1985, and makes the following recommendations:

Section 15002. Common Law as Law of State.

The CBA reserves judgment on this section: We are committed to the belief that the Code should be all-encompassing to be most effective.

Section 15004. Application of Division of Charitable Trusts

Charitable Trusts should be subject to the code, not to the common law, if there is a conflict. The CBA sees no reason to distinguish between the two types of trusts.

Section 15401. Method of Revocation by Settlor.

The CBA believes that the term "Settlor" is archaic, and is misleading and that the code should talk about "Trustors."

This statute should be amended to permit revocation by the Trustor or the person designated in writing by the Trustor under the Uniform Durable Power of Attorneys Act. The CBA has recently experienced an influx of amendments and revocations of trust by holders of such durable powers. These statutes should make clear that amending and revoking a trust is a permissible activity by the holder of such a power, unless the trust document specifically provides otherwise.

This section should also be clarified to indicate how amendments to a trust are accepted by the trustee. This clarification could either occur in 15401, dealing with revocation by the Trustor, 15600, dealing with acceptance of the trust by the trustee, or in a separate section dealing solely with modification of trusts, such as 15402, for example.

Section 15403. Modification or Termination of Irrevocable Trusts by All Beneficiaries.

15403(b) should be amended to delete the word "valid" on the next to the last line. The moving party should have the responsibility to challenge whether a restraint is valid. Additionally, the restraint should be further defined by adding at the end of the sentence "as described in Section 15300 et. seq."

Section 15409. Trust With Uneconomically Low Principal.

The CBA strongly recommends the Commission's further study of termination of trusts with uneconomically low principal. There are several possible alternatives to allow termination without the requirement of the intervention of the court process, which is both costly and time consuming.

1. The first alternative is to state a monetary sum, under which there is a presumption that the trust is properly terminated without a court order. The CBA suggests a figure such as \$20,000 as such a small sum.

2. A second alternative would be to set an arbitrary dollar figure within which there could be a quasi-summary probate procedure similar to the Section 630 process. The CBA suggests that a trust with \$60,000 or less could perhaps be terminated through this procedure, through forms prepared by the Judicial Council.

This is a recurring problem with corporate trustees. The already minimal funds within a small trust must presently be expended to obtain a court order to terminate the trust. At the minimum, Judicial Council forms should be promulgated to make such termination very inexpensive.

Section 15600. Acceptance of Trust by Trustee.

The CBA strongly objects to Section 15600(b), in its entirety. The section inherently contains liability for inaction, even though the trustee does not accept the

trust. This section suggests that if there is an immediate risk, the trustee has a duty to take an action before the trustee has accepted the trust. This section should be deleted in its entirety.

The Trustee should not have duties and obligations imposed if the trustee has not yet accepted the trust.

Section 15622. Temporary Incapacity of Co-Trustee.

The CBA again recommends that the term "temporary incapacity" be defined, at least in the comment. The definition should serve as a guide to trustees as to how much incapacity will allow unilateral action.

The CBA recommends the following language be contained in the comment:

"Temporary incapacity includes a continuous period of time of more than five days, but not to exceed six months."

Section 15641. Liability of Resigning Trustee.

The CBA recommends that the section be amended to state as follows:

"Liability for acts and omissions of a resigning trustee or of the sureties on the trustee's bond, if any, is not released or affected in any manner by the trustee's resignation."

The amendment should clarify that the co-trustee does not have continued liability for another co-trustee's actions after his or her resignation.

Section 15642. Removal of Trustee.

The CBA believes that the working session agreed to strike "ill feeling" from this section, and recommends that this term be stricken. The CBA believes that the word "hostility" covers this potentiality.

Section 15660. Appointment of Trustee to Fill Vacancy.

The comment to this section indicates that the court may appoint additional trustees or a greater number than provided in the trust. This is not California Law. The CBA is opposed to this comment. The ability to appoint additional

trustees not only creates a greater cost burden on the trust, but more potential liability for the co-trustees for acts of the additional persons named by the court. Additionally, the addition of trustees will automatically slow down the administration of a trust. This comment should be deleted.

Section 15680. Trustee's Compensation Provided Under Trust Terms: Different Compensation.

The CBA is opposed to this section as now drafted. As drafted, the section allows the court to lower compensation, despite specific terms within a trust document. This is directly contrary to California Law (See Estate of Bodger). The ability to reduce fees does not take into account the continued liability of the trustee under the trust. The Trustee's liability is not lessened simply because duties may change over the term of the trust. Section 15680(b) should be amended to delete the term "or lesser."

Section 15803. Notice in Case Involving Future Interest of Beneficiary.

It appears that Section 15803(a) contains typographical errors. We believe that the Commission intends to restate the law as found in Section 1215.1 of the Probate Code, stating that notice "be given to the beneficiaries or the persons."

Section 16005. Duty Not to Take Adverse Trust.

This section should be amended to allow the Trustee to continue administering a trust with the full disclosure of a conflict, and/or consent of the beneficiaries. Section 2233 of the Civil Code provides this ability, and should be reinstated.

The CBA recommends that the following language be added to the section:

"Upon discovery of such a conflict, the Trustee is susceptible to immediate dismissal as trustee of both trusts unless the Trustee gets the permission of the beneficiaries of the trust."

This is current California Law (CC § 2233).

This statutory provision should be reinstated in the new law, as part of Section 16005, to allow beneficiaries to consent to a conflict.

Section 16013. Duty With Respect to Co-Trustees.

The CBA strongly objects to this section as written.

The Trustee should not be a guarantor in terms of breach of duty by a co-trustee. The Trustee at a minimum should have actual prior knowledge of the breach, and control over the actions of the Co-Trustee in order to impose liability on the Trustee for a Co-Trustee's breach.

This section should be coordinated with Section 16402, which again should require prior knowledge and control by the Trustee before liability is imposed for agents acts.

Section 16014. Duty to Use Special Skills.

The CBA does not agree that this represents California law. The correct statement of the duty to use skills comes out of Coberly, 231 C.A. 2d 685 (689), that says "the Trustee has a duty to apply the full extent of his skills." Other cases that state that there is a duty to use special skills only do so in dictum, with the exception of the Estate of Beach, which only applies to executors. The CBA again recommends that this section be amended to conform to California law. It should state:

"The Trustee has a duty to apply the full extent of his skills."

Section 16015. Certain Actions Not Violations of Duties.

The CBA believes there is a typographical error, in that "affiliate" on the second line should be "affiliates". The Trustee should not be limited to using the services of one affiliate, when it has more than one.

Section 16040. Trustee's Standard of Care In Administering Trusts.

This section has been revised in accordance with the working session's recommendations, which the CBA approves.

However, the comments have not been amended to reflect these changes. Please see the comments above, to Section 16014, which are directly applicable to this section, as well.

The comment to this section should not be included as currently in the staff draft. Rather, the correct interpretation of California cases, as described above (paragraph 16014) should be used.

Section 16041. Standard of Care Not Affected by Compensation.

This conflicts directly with Probate Code Section 3912(b)(1), wherein a custodian is not liable for investment decisions of a principal. The comment should clarify that this section does not apply to custodians under that section.

Section 16200. General Powers of Trustee.

The comment appears to have a typographical error in the last sentence on page 47. This should probably state "sub-division(c) is consistent . . ."

Section 16202. Exercise of Powers Subject to Trustees Duties.

This section conflicts directly with the comment. The section seems to state that "just because the trustee has the power, it shouldn't use it if it conflicts with a general fiduciary duty."

On the contrary, the comment seems to state: "The trust provision overrides a general fiduciary duty."

The CBA does not understand what this section means, taken in conjunction with the comment. This needs clarification, so that it is clear what the order of priority is between a trust provision and a general fiduciary duty.

The section could state: "If the trustee has a power, it is overridden by a duty, unless there is a specific duty or direction in the instrument to the contrary."

The comment could state: "A specific duty or direction in an instrument overrides a general fiduciary duty."

Section 16225. Deposits.

16225(b) should have the same broad scope as found in Section 16015, and should define affiliates in the same manner.

Sections (a)(1), (2) and (3) should state that the account will be insured or collateralized "by a governmental agency." This appears much more prudent, especially in light of the recent failures of institutions which were insured by private companies.

Section 16240. Insurance.

The section should state that the ability to obtain insurance will be "at the expense of the trust estate."

Section 16244. Loans to Beneficiary.

This section should be clarified so that a beneficiary who has an interest in a trust with a spendthrift clause will not be able to qualify that interest as collateral of a loan from the trust.

Section 16400. Breach of Trust.

The comment to this section should be revised to state that the trustee of a revocable trust owes duties "only" to the person holding the power to revoke.

Additionally, Section 24 should incorporate the provisions of Section 15800, defining a beneficiary of a revocable trust. An example of the problems that will be created if there is no consistency in interpretation of a beneficiary of a revocable trust is found in Section 16064, which refers back to Section 24. At a minimum, Section 24 should incorporate Section 15800 by reference.

Section 16401. Trustees Liability to Beneficiary for Acts of Agent.

The CBA strongly objects to this section.

This section should save the Trustee from liability if the Trustee has no control over the agent, and has not retained the agent. The trustee should not be liable for acts of an agent which is retained by the Trustor of a revocable living trust, or which the trust document directs the Trust to retain.

Specific problem provisions within this of section are:

1. 16401 (a)(1) holds the Trustee liable if he "per-
mits" the act of the agent. The Trustee of a revocable living trust has no control if the Trustor so directs.

2. (a)(3) holds the Trustee liable if the Trustee "retains" the agent. Again, if the Trustor so directs, or the document specifies that agent must be used, the Trustee should not be liable.

3. (a)(4) holds the Trustee liable for not exercising "proper supervision" over the agent's conduct. Again, if the Trustor has directed the use of this agent, the Trustee has no control! The Trustee should not be liable for this.

4. (a)(6) makes the Trustee liable for neglecting to take proper steps to compel the agent to redress a wrong.

In the revocable trust situation, the Trustee has no control over these agents in the normal situation. The Trustor has directly retained the agent or directed the Trustee to do so. The Trustee should not be responsible for agents over which it has no control.

One way to resolve this situation is to only hold the Trustee liable for agents retained and controlled by the Trustee. The Trustee should also have prior knowledge of the proposed action by the agent, before liability is imposed.

The section should be conformed to Civil Code Section 2258(b). This section allows the Trustor of a Revocable Living Trust, or the person with the power to revoke, to direct the Trustee with respect to actions, and under which the Trustee has no liability for such actions.

Section 16402. Trustee's Liability to Beneficiary for Acts of Co-Trustee.

This section directly contradicts Section 16403. Which section controls co-fiduciary liability? Under Section 16402, if the Trustee negligently enables the Co-trustee to commit an act, the Trustee is liable. Under Section 16403, however, a Co-trustee who does not join in exercising a power is not liable. The Commission should consider carefully the question of absolving a dissenting minority trustee of liability.

The CBA strongly recommends that these sections be clarified so that a dissenting co-trustee in a minority position, with no control over the actions of the co-trustees, will not be liable for actions of the co-trustees. At a minimum, the co-trustee should have advance knowledge of the proposed breach.

Section 16403. Liability of Dissenting Co-Trustee to Beneficiary.

This section should be further clarified. As now drafted, sub-section (c) appears to require the dissenting co-trustee to continually go to court to obtain injunctions and redress breaches. The intent of sub-section (c) should be clarified so that the minority trustee does not constantly have to go to court when he or she dissents.

Section 16404. Trustee's Liability to Beneficiary for Acts of Predecessor.

The CBA strongly recommends that sub-section (b)(3) should be deleted.

The Commission has stated that liability of a successor trustee should be limited. This section is not clear, in the context of the Commission's decision to limit liability of successor trustees.

At a minimum, beneficiaries should be able to determine if they want a breach redressed. Examples of situations where redress would not be appropriate are:

1. If the cost to redress the breach would be too expensive;

2. The situation may not be appropriate, such as when the breach was committed by the parent of the children, which parent is now incompetent. The Trustee should not be forced to sue the incompetent parent or the conservatorship estate of that parent for a breach, if the children do not approve.

Additionally, the Trustee should have knowledge of a breach before it must be redressed. The CBA strongly recommends that subsection (b)(3) be deleted. At a minimum, it should be qualified to allow the adult, competent beneficiaries to consent to not redress the breach, and to look at the economic benefits of redress versus the costs.

Section 16440. Measure of Liability for Breach of Trust.

Sub-section (a)(3) should be amended to conform to the previous sub-sections, and state:

"(3) Any profit that would have accrued to the trust estate if the loss of profit is the result of the breach of trust."

Section 16461. Exculpation of Trustee.

The amendment to section 16461(b) should occur as approved by the working session.

The section should state:

"(b) A provision in the trust instrument is not effective to relieve the trustee of liability for breach of trust committed in bad faith, intentionally, or with reckless indifference to the interest of the beneficiary."

The CBA strongly recommends that the provisions after "beneficiary" be deleted from the section. Profiting from the trust should not be an automatic breach of trust.

The Commission decided that a Trustee may offer ancillary services to a trust, either directly or through affiliates. This obviously entails the Trustee "making a profit."

Additionally, a Trustor should be able to direct a Trustee to take an act, for which it profits.

Beneficiaries of a trust should be able to consent to a profit by the Trustee.

Section 16462. Non-Liability for Following Instructions Under Revocable Trust.

The section should be amended to state that the Trustee of a revocable trust is not liable to any beneficiary.

It is not clear by stating that the Trustee is not liable to "the beneficiary" that the trustee is exculpated for following the direction of the Trustor of a revocable living trust. The Trustee should be exculpated from liability as to any beneficiaries of a revocable trust.

Section 17203. Notice.

It is unclear who the beneficiary is who will receive notice under this section. Again, Section 24 should be amended to not include the remainder beneficiaries of a Revocable Living Trust, while the Trustor still is alive.

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Section 18003. Liability of Dissenting Co-Trustee to Third Persons.

This section is in direct conflict internally, with the same problem occurring in Sections 16402 and 16403. Individual trustees will be completely confused by this section. The dissenting co-trustee should not be liable for acts taken by the majority trustees, when the dissenting co-trustee has no power to control the situation.

Section 18200. Creditors Rights Against Revocable Trust During Settlor's Lifetime.

The CBA applauds the staff's attempt to deal with this very complex area. However, the sections should go farther, to clarify several problems presently encountered.

1. What happens if there is no probate?

This should not stop a creditor from reaching a trust's assets for claims against the Trustor/decedent.

2. There is no mechanism for claims.

After the Settlor's death, the CBA suggests a provision requiring claims to be presented to the trustee within four months after notice, similar to the Probate process. Again, these sections need guidelines and mechanisms for filing claims, etc.. We hope that these can be added to the sections as now drafted.

The California Bankers Association again thanks the Commission and its staff for the opportunity to review and comment upon this draft before the September 12th and 13th meeting. We look forward to meeting with the Commission at that time, in order to review the draft, and these comments in detail.

Sincerely,

Paulette E. Leahy

cc: Members, Trust State Governmental Affairs Committee
George Cook, CBA - Sacramento
Sandra Fowler, CBA - San Francisco
George Galucci
Jerald P. Lewis
Estelle Depper

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September 12, 1985

Mr. John H. DeMouilly
Mr. Stanley G. Ulrich
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303

Dear John and Stan:

You are both to be complimented for the generally excellent results of your most recent efforts in further modifying the proposed comprehensive trust law to reflect the input of the May and June working group meetings.

I'm sure it came as no big surprise that the California Bankers Association has yet more comments on this recent draft. Paulette Leahy submitted these comments to you under separate cover (September 6, 1985).

While also referenced in the California Bankers Association official comments, I continue to be troubled by the LRC's treatment of Section 16014 and the Comment to Section 16040 as the law of California is being misstated; and new law will be made which seriously prejudices corporate fiduciaries' ability to defend their actions.

So, at the risk of appearing as some modern Don Quixote jousting with windmills in the mistaken belief they are giants, please indulge me by considering the following points.

A. Section 16014.

1. As the Comment concedes, this "duty" is taken from the last part of Uniform Probate Code Section 7-302. The Comment correctly cites no California case or statutory authority because there is no authority to cite (see paragraph A 2 below). If the proposed language of Section 16014 isn't California law, then it must be recognized as common law to justify inclusion in the listing of trustee "duties". However, the Uniform Probate Code language extends the concept beyond what is an accurate statement of the common law (see paragraph A 3 below).

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The conclusion: Either delete Section 16014 entirely or amend it to conform with the common law (see paragraph A 4 below).

2. There is no statutory authority and no case authority in California to support Section 16014 that I am aware of, only case dictum. Coberly v. Superior Court (1965) 231 C.A.2d 685, 689 ("Trustees are bound to use such talents as they possess."); but the holding of Coberly is correctly summarized in a Civil Code Section 2269 annotation (at page 350) which states that even absolute discretion conferred by a trust instrument "does not relieve trustee from performance of its duties and exercise of its judgment, or give trustee immunity from tort liability in administration of trust or permit it to escape its responsibility of justifying its actions in court...". Manchester Band of Pomo Indians, Inc. v. United States (D.C. Calif. 1973) 363 F. Supp. 1238, 1245 ("while the normal standard of care and skill required of a trustee is that of a man of ordinary prudence in dealing with his own property, if the particular trustee has a greater degree of skill than that of a man of ordinary prudence, he will be held liable for any loss resulting from the failure to use such skill as he has"); but after enumerating several additional fiduciary "principles" (the one in question being taken from a portion of the Restatement (Second) of Trusts, Section 174 comment), the court found the United States' investment performance wanting without regard to the degree of skill possessed by the defendant as trustee.

3. That portion of proposed Section 16014 dealing with representations ("...or is named as a trustee on the basis of special skills...") has no basis in California law, nor are there any cases "squarely holding that this principle is applicable to trustees" according to Professor Scott (Section 174 at page 1411). The concept is taken from the law of agency, endorsed philosophically by Scott (Section 174 at page 1411) and Bogert (Section 541 at page 171); was thereafter incorporated into the Restatement (Second) of Trusts, Section 174, and later into the Uniform Probate Code. It is, of course, well understood that the Restatement and Uniform Probate Code are to be viewed as guides to law, but not a binding statement of applicable law unless specifically adopted. The inescapable conclusion must be that representations of trustee skills are not a common law "duty".

4. I am convinced what follows more closely resembles the probable "law" on the subject (California as well as common law); and would therefore commend to the Commission's consideration this revision of proposed Section 16014:

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"Section 16014. Duty to use skills

16014. The trustee has a duty to use all the skills actually possessed by the trustee.

Comment. Section 16014 is consistent with the common law. See Coberly v. Superior Court, 231 Cal. App.2d 685, 689, 42 Cal. Rptr. 64 (1965) (dictum); and Manchester Band of Pomo Indians, Inc. v. United States, 363 F. Supp. 1238 (D.C. Calif. 1973) (dictum). See also Sections 16000 (duties subject to control by trust instrument), 16040 (trustee's standard of care in performing duties)."

B. Section 16040.

1. The proposed statute now reads well, but the Comment in part continues to muddle prevailing law in California.

2. The Comment says: "A higher standard of care is required of experts as recognized in California cases." In truth, there is no case authority for the proposition that "a higher standard of care is required of experts" when applied to trustees. The citation to Collins is admitted to be dictum; and the citation to Coberly is just plain inapplicable (see discussion of Coberly in Section 16014 above), as well as dictum. Beach is cited only for comparison purposes because the fiduciary was an executor, not a trustee; but even the oft-quoted language of Beach ("Those undertaking to render expert services in the practice of a profession or trade are required to have and apply the skill, knowledge and competence ordinarily possessed by their fellow practitioners under similar circumstances, and failure to do so subjects them to liability for negligence.") is only dictum because the standard of care by which the defendant bank was to be judged was not in issue--the bank stipulated that its liability would "be determined by more stringent standards than would the liability of a lay executor."

Even if one were to assume that the California Supreme Court would apply the logic of Beach to professional trustees were the issue brought before it today (and I am not offering any opinion in that regard), the fact remains that the Comment language in question and purported case authority are misleading and may by unfortunate repetition (see paragraph B 3 below) make new law on the subject. As an aside, the most recent dictum attributable to Beach was not annotated in your Comment. Estate of Pitzer (1984) 155 Cal. App.3d 979, 995 ("A bank engaged in the business of acting as a fiduciary for

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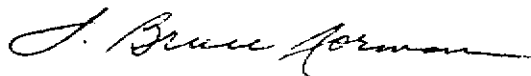
estates and trusts must exercise that skill and knowledge ordinarily possessed by such professional fiduciaries").

3. The Comment continues by citing to the (1979) comment to Section 2401 and (1984) comment to Section 3912 which refer to professionals--and trust companys and bank trust departments are singled out--as being held to a greater standard of care than lay fiduciaries based on their presumed expertise. Authority offered for this proposition is Beach, but the quote actually comes from Collins dictum interpreting broadly the above-quoted language of Beach.

4. Besides the technical inaccuracies of the Comment as described in paragraphs B 2 and B 3 above, the attempt to focus attention upon a bifurcated standard of care seems to miss what Section 16040 requires. Section 16040 and its predecessor Civil Code Section 2261 make no distinction in terms of the standard of care between individuals and corporate fiduciaries. The standard compares the conduct of the trustee in question with another, knowledgeable trustee. If the former has applied the full extent of his, her or its skills, there is no breach of duty under my proposed version of Section 16014, but there may be liability imposed for failure to meet the requisite standard of care if the latter trustee and others similarly situated possessed and would have applied appreciably greater skills. This result fosters a fiduciary obligation environment emphasizing the best rather than the least qualified. Exceptions to the standard of care should only be made by explicit language contained in the trust instrument (Section 16000). For a more scholarly treatment of the intended impact of AB 630, I would recommend reading William P. Wade's "The New California Prudent Investor Rule: A statutory Interpretive Analysis", American Bar Association Real Property and Trust Journal (Spring, 1985).

5. To avoid misleading conclusions, it is recommended that the Comment language beginning "A higher standard of care..." through "...under Uniform Transfers to Minors Act)." be omitted.

Very truly yours,



L. Bruce Norman
Vice President and
Trust Counsel

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