

## Memorandum 87-70

Subject: Study L-3010 - Corporate Trustees' Fees

This memorandum considers several approaches to controlling and reviewing corporate trustees' fees and to removing and replacing corporate trustees. At the last meeting, the Commission had before it a staff draft of a procedure for replacement of corporate trustees, but this draft was not considered. (This draft was attached to Memorandum 87-54.) Instead, the Commission directed the staff to distribute a questionnaire to attorneys on our mailing list to determine whether there is a problem with corporate trustees' fees and, if so, the nature and extent of the problem. This questionnaire has been distributed to more than 700 persons. The results will be analyzed in a supplement to this memorandum. The staff was also directed to develop a set of questions to be sent to corporate trustees to determine existing and previous fee structures. Representatives of the California Bankers Association agreed to assist the staff in developing these questions and providing contact people. The information on fees provided by corporate trustees will also be analyzed in a supplement.

Pending the receipt and analysis of this data, it is useful to outline the various proposals that have been suggested and consider their advantages and disadvantages. The following approaches are set out in the same order and in the same terms as presented in the questionnaire sent to attorneys.

Analysis of Possible Approaches

(a) *Permit transfer to another corporate trustee with court approval where it is shown to be to the advantage of the trust in light of the fees charged by the existing corporate trustee.*

This approach would use a modified form of the existing mechanisms for removing a trustee and appointing a new trustee to fill the vacancy. See Prob. Code §§ 15642, 15660 (included in Exhibit 3 attached to this memorandum).

Advantages. This is an incremental change that preserves the traditional approach of using court procedures to deal with such issues. It also is presumably the most politically acceptable. By providing a standard for replacement of a trust company, the procedure avoids the potential tax problems of giving an unrestricted power to the beneficiaries.

Disadvantages. Requiring a cotrustee or beneficiary to petition the court involves the expense of attorney's fees and court costs as well as some delay and the risk of failure. The remarks of Assembly Member Harris at the Commission's March meeting support the conclusion that the problem will not be solved by employing an impedimentary procedure.

Staff conclusion. This procedure is useful and should be incorporated in a legislative proposal. However, it should not be the only remedy.

*(b) Permit transfer to another corporate trustee if the corporate trustee to be replaced and all trust beneficiaries agree.*

This approach would rely on the consent of the affected persons. It is consistent with the procedure in existing law permitting a trustee to resign with the consent of all adult beneficiaries who are receiving or are entitled to receive income under the trust or to receive a distribution of principal if the trust were terminated at the time consent is sought. See Prob. Code § 15640 (included in Exhibit 3 attached to this memorandum).

Advantages. By requiring the consent of the trust company to be replaced, this procedure avoids the adversarial nature of some other procedures. This procedure should be readily acceptable to corporate trustees.

Disadvantages. The presumed acceptability of this procedure to trust companies points up its defect. The trust company is in control of both the fees and the consensual replacement procedure.

Staff conclusion. This is not an adequate procedure standing by itself, but it is useful to make clear that the trustee and beneficiaries can agree to replace the trustee without the need to go seek court approval.

(c) Permit transfer to another corporate trustee if all trust beneficiaries agree on the transfer (consent of existing corporate trustee not required).

This is the approach, combined with the approach set out in paragraph (d) below, that was drafted for Commission consideration at the July meeting but not considered. (See Memorandum 87-54.) Replacement of a trust company by agreement of all beneficiaries takes the view that in most cases the trust company is not providing a unique service and thus may be replaced by action of the consumers involved just as in the case of a broker, financial advisor, or attorney. This scheme requires that the beneficiaries find a successor trust company who is ready to take over administration of the trust before the existing trust company is removed. This procedure is akin to the power of all beneficiaries to compel modification of a trust as provided in Probate Code Section 15403, except that no court petition is required. (Copy of Section 15403 included in Exhibit 3.)

Advantages. This approach is simple and avoids the expense and impediment of hiring an attorney and petitioning the court. Its simplicity might also have the effect of restraining fee increases. This procedure would facilitate the operation of the competitive market.

Disadvantages. As noted in Memorandum 87-54, there is a potential tax problem arising from the IRS view that the power to replace is equivalent to the power to control the trustee. Trust companies are concerned that services may suffer where fees are the sole basis for selecting or replacing a trustee. It is also argued that a potential successor trustee would not want to get involved unless the existing trust company is willing to step aside. (See letter from Kenneth M. Klug, attached as Exhibit 1.)

Staff conclusion. The tax problem will need to be dealt with in some fashion before this scheme can be proposed. If the action of the beneficiaries can only be taken if some standard is met, the revenue ruling should not apply. The problem is to draft a standard that can be fairly applied without the need in most cases to seek court review.

(d) Permit transfer to another corporate trustee upon the direction of all cotrustees other than the one to be replaced (consent of beneficiaries not required).

This scheme is primarily aimed at the situation where a trust has one or more individuals selected as trustee by the settlor, presumably because of a relationship with or confidence placed in that person. As in the approach outlined in paragraph (c) above, this scheme treats the trust company cotrustee as a provider of services that usually can be provided by some other trust company. The individual cotrustee may be in a better position than the beneficiaries to judge the fees and services of the trust company and to seek a replacement trust company.

Advantages. This procedure is even simpler than requiring the consent of all beneficiaries.

Disadvantages. As in the case of replacement by beneficiaries, there may be tax problems, particularly if the cotrustee is also a beneficiary. There may be a problem of the individual cotrustee "shopping" for a more compliant trust company. (See letter from Sandra S. Kass, attached as Exhibit 2.) It may also be improper for a cotrustee to have such a power without the consent or knowledge of the beneficiaries or the consent of a court.

Staff conclusion. The staff is persuaded that this scheme, as first proposed in the draft attached to Memorandum 87-54, is too broad. If there is interest in this approach, the cotrustee's power should be limited to individual trustees acting pursuant to some standard and with notice to the beneficiaries.

(e) Require prior court approval of any increase in the fees charged by a trustee.

Requiring prior court approval of fee increases would have the effect of returning this aspect of trust administration to the prior statutory scheme where trust administration was viewed more paternalistically.

Advantages. This would put a substantial brake on fee increases since the burden would be on the trustee to seek and obtain court approval.

Disadvantages. This scheme seems too restrictive since it might prevent justifiable fee increases to which no interested person

objects. It is also a stricter scheme than that prevailing under the former continuing court jurisdiction statute which did not explicitly require prior court approval.

Staff conclusion. There is no problem with a trust company voluntarily seeking approval of a fee increase, but to require prior court approval seems too burdensome to the staff.

*(f) Permit the trustee to increase fees if no objection is received after giving notice to all trust beneficiaries.*

This scheme is analogous to the notice of proposed action procedure under the Independent Administration of Estates Act. If there is an objection under this scheme, then the trustee would have to decide whether to petition the court for an increase in fees or seek to resign as trustee. The beneficiaries would also be able to seek the removal and replacement of the trust company. (See the letter from Kenneth M. Klug, attached as Exhibit 1.)

Advantages. This scheme uses a familiar mechanism in probate law to attempt to strain out acceptable fee increases without having to go to court. It also could impel trust companies to seek an acceptable fee level so that objections will not be encountered. The notice and power to object allows the beneficiaries to prevent the fee increase in the first instance without any need to go to court or hire an attorney.

Disadvantages. The staff has no way of knowing, but this procedure may not work as intended if beneficiaries routinely object to proposed fee increases, thus rendering this procedure essentially the same as requiring court approval of fee increases. However, even if this is the likely result, this approach seems less onerous than the approaches outlined in paragraphs (a) and (e) above.

Staff conclusion. This appears to be a desirable procedure that balances the interests of the beneficiaries and the trust company even though it is not known whether beneficiaries would routinely object.

*(g) Provide specifically by statute for court review of the reasonableness of a trustee's fees on petition by any interested person.*

This is a clarification of existing law which permits a beneficiary or trustee to petition the court concerning the internal

affairs of a trust. See Prob. Code § 17200; see also Prob. Code §§ 15680 (increase or decrease of fees specified in trust instrument), 15681 (trustee entitled to reasonable compensation where trust silent), 15682 (determination of prospective compensation), 17200(b)(9) (petition fixing or allowing payment of trustee's compensation). (Copies of these provisions are included in Exhibit 3.)

Advantages. This would merely make crystal clear what is already the law.

Disadvantages. Sometimes it is nice not to have to belabor the obvious.

Staff conclusion. This should not be necessary, but past experience supports the conclusion that lawyers and courts can find limitations and technicalities where none were intended or apparent.

*(h) Establish a statutory fee schedule for trustees based on the value of the trust estate and permit charging additional fees for extraordinary services only with court approval.*

Providing a statutory fee schedule would adopt a probate scheme in trust law. Compare Prob. Code § 901.

Advantages. This would adopt a familiar scheme and regularize fees. Statutory control of the amount of the fees would restrain future increases because of the difficulty of amending the statute.

Disadvantages. Assuming that there is competition under the current state of affairs, a statutory fee schedule would restrict or eliminate it. There is a perception that fee schedules are unfair or too high. The beneficiaries would presumably not be permitted to petition the court to reduce the fees below the scheduled amount. If the trust instrument could override the fee schedule, trust companies might be expected to routinely require inclusion of such a provision as a condition to accepting the trust. A statutory fee schedule would presumably bring with it the escape hatch of extraordinary fees.

Staff conclusion. The statutory fee schedule is the target of criticism in estate administration and does not seem to be an ideal scheme for dealing with fees in trust administration. To the extent that trust companies can avoid the statutory fee schedule by overriding provisions in the trust instrument, other solutions are still

required. The percentage fees typically charged by trust companies, which are subject to some negotiation and court review, represent a better scheme than the more rigid statutory fee schedule. In other words, nothing would seem to be gained by adopting this scheme in place of some of the other proposals.

#### Other Factors

##### Standard for Removal

Some of the approaches discussed above can be adjusted by employing a different standard for action by the beneficiaries, cotrustees, or the court. The standard suggested in connection with the scheme for permitting replacement of the trustee with court approval is where it is shown to be to the advantage of the trust in light of the fees charged by the trustee. This is a typical standard in estate administration. A more mechanical standard could be applied, such as some percentage increase in fees that would trigger the opportunity to seek replacement of a trust company. At the last meeting, representatives of the California Bankers Association suggested a more stringent standard such as that the fee increase is unconscionable.

##### Beneficiaries Needed to Consent or to be Given Notice

The above schemes that involve consent of or notice to beneficiaries, are based on the assumption that unanimous action is required. It would also be possible to provide for action by a majority of beneficiaries.

There is also an important question of which beneficiaries must give consent or receive notice. The draft statute attached to Memorandum 87-54 on the agenda for the last meeting contained the following description of beneficiaries who could agree to replacement of a trust company:

- (1) Each adult beneficiary who receives or is entitled to receive income under the trust or would be entitled to receive a distribution of principal if the trust were terminated at the time the directive is executed or, if a conservator has been appointed for the adult beneficiary, the

conservator.

(2) A parent of each minor beneficiary who receives or is entitled to receive income under the trust or would be entitled to receive a distribution of principal if the trust were terminated at the time the directive is executed or, if that minor beneficiary has a guardian of the estate, the guardian of the estate.

Replacement might also be appropriate by action of the same persons who may consent to the resignation of a trustee, described in Probate Code Section 15640(a)(3) as follows: "[A]ll adult beneficiaries who are receiving or entitled to receive income under the trust or to receive a distribution of principal if the trust were terminated at the time consent is sought."

#### Replacement Involving Individual Trustees

The suggestion has been made that a corporate trustee should be able to be removed and replaced with an individual trustee. (See letter from Kenneth M. Klug, attached as Exhibit 1.) Comments received in response to the questionnaire on attorney's fees suggest that competition would be improved and the problem with the small trust solved if an individual could be substituted for a corporate trustee.

Some bank representatives and others have suggested that the procedures for review of fees should apply to both individual and corporate trustees. The staff has no objection to applying the same rules concerning review of fees to individual trustees, but there is a problem with permitting easy removal of individuals under traditional trust doctrines. Accordingly, the question of applying any revisions proposed by the Commission to individual trustees should be deferred until the nature of the proposal is determined.

Respectfully submitted,

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Staff Counsel



## EXHIBIT 3

**§ 15403. Modification or termination of irrevocable trust by all beneficiaries**

**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, 462, 165 P.2d 15 (1946). 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 & 17208 (appointment of guardian ad litem). See also Section 15406 (no conclusive presumption of fertility). For provisions governing modification and termination of trusts where the consent of all beneficiaries cannot be obtained, see Sections 15408 (trust with uneconomically low principal) and 15409 (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).

**§ 15640. Resignation of trustee**

**Comment.** Subdivisions (a) (1), (a) (3), and (a) (4) of Section 15640 are similar to Section 106 of the Restatement (Second) of Trusts (1957), except that the class of persons whose consent is needed under subdivision (a) (3) is more restricted. For a provision governing acceptance of the trust, see Section 15600. Subdivision (a) (1) continues part of the second sentence of former Probate Code Section 1138.8 without substantive change. Subdivision (a) (2) is a new provision that recognizes that the person holding the power to revoke a revocable trust has control over the trust rather than the beneficiaries. See Section 15800. Subdivision (a) (3) supersedes former Civil Code Section 2282(d) which permitted discharge from the trust with the

consent of "the beneficiary, if the beneficiary has capacity to contract." For provisions relating to consent by beneficiaries under an incapacity, see, e.g., Civil Code §§ 2450, 2467 (statutory form of durable power of attorney); Prob. Code §§ 2580 (conservator), 17208 (guardian ad litem). Subdivision (a) (4) restates the authority of the court under former law. See former Civil Code §§ 2282(e), 2283; former Prob. Code §§ 1125.1, 1138.1(a) (9), 1138.8. Under subdivision (a) (4) the court has authority to accept a resignation regardless of whether the trust provides a manner of resignation. Former Probate Code Section 1138.8 permitted the court to act where the trust was silent.

The provision that the trustee's resignation shall be accepted by the court in subdivision (b) restates part of the last sentence of the first paragraph of former Probate Code Section 1125.1 and part of the third sentence of former Probate Code Section 1138.8. The authority for protective orders in subdivision (b) restates part of the last sentence of the first paragraph of former Probate Code Section 1125.1 and part of the third sentence of former Probate Code Section 1138.8. See also Section 17206 (general authority to make necessary orders). For the procedure applicable to proceedings under subdivision (b), see Section 17200 *et seq.* See also Section 17200(b) (11) (petition to accept resignation of trustee).

#### **§ 15642. Removal of trustee**

**Comment.** Subdivision (a) of Section 15642 is the same in substance as Section 107 of the Restatement (Second) of Trusts (1957). The authority of the court to remove trustees continues authority found in former law. See former Civil Code §§ 2233, 2283; former Prob. Code §§ 1123.5, 1138.1(a) (10). The recognition that the trustee may be removed as provided in the trust instrument is new. See Restatement (Second) of Trusts § 107 comment h (1957). The authority for removal on the court's own motion is drawn from the third sentence of former Probate Code Section 1123.5. For the procedure applicable to judicial removal proceedings, see Section 17200 *et seq.* See also Section 17200(b) (10) (petition to remove trustee).

The statement of grounds for removal of the trustee by the court is drawn from the Texas Trust Code and the Restatement. See Tex. Prop. Code Ann. § 113.082(a) (Vernon 1984); Restatement (Second) of Trusts § 107 comments b-d (1957). Paragraphs (1) and (2) of subdivision (b) supersede parts of former Civil Code Sections 2233 and 2283 and part of the first sentence of former Probate Code Section 1123.5. The general language relating to a trustee being otherwise unfit to administer the trust subsumes the reference in former Section 1126 to a trustee who is incapable of acting. Paragraph (3) of subdivision (b) continues part of the second sentence of former Probate

Code Section 1123.5 without substantive change, except that the reference to "ill feeling" is omitted as redundant with "hostility," and the word "continued" has been omitted since the test is whether the administration of the trust is impaired. Paragraph (4) of subdivision (b) continues part of the first sentence of former Probate Code Section 1126 and part of the first sentence of former Probate Code Section 1138.9 without substantive change. Paragraph (5) of subdivision (b) continues authority found in former Probate Code Sections 1126 and 1138.9.

Subdivision (c) continues former Probate Code Section 1138.2 without substantive change and restates former Probate Code Section 1123.6 without substantive change. See also Section 17206 (general authority to make necessary orders).

#### **§ 15660. Appointment of trustee to fill vacancy**

**Comment.** Section 15660 supersedes former Civil Code Sections 2287 and 2289 and former Probate Code Sections 1125, 1126, and 1138.9. For a provision governing the occurrence of vacancies in the office of trustee, see Section 15643. Subdivision (a) makes clear that the vacancy in the office of a cotrustee must be filled only if the trust so requires. If the vacancy in the office of cotrustee is not filled, the remaining cotrustees may continue to administer the trust under Section 15621, unless the trust instrument provides otherwise. The provision in subdivision (b) relating to a "practical" method of appointing a trustee continues language found in former Civil Code Section 2287 and supersedes part of former Probate Code Section 1138.9.

The authority of the court to appoint the same or a lesser number of trustees in subdivision (c) continues the second sentence of former Civil Code Section 2289 without substantive change. The provision requiring the court to give consideration to the wishes of the beneficiaries in subdivision (c) supersedes the second sentence of former Civil Code Section 2287. See Restatement (Second) of Trusts § 108 comment i (1957). Subdivision (c) gives the court discretion to fill a vacancy in a case where the trust does not name a successor who is willing to accept the trust, where the trust does not provide a practical method of appointment, or where the trust does not require the vacancy to be filled. For a limitation on the rights of certain beneficiaries of revocable trusts, see Section 15800. For the procedure applicable to judicial proceedings, see Section 17200 *et seq.* See also Section 17200(b)(10) (petition to appoint trustee).

**§ 15680. Trustee's compensation as provided in trust instrument; different compensation**

**Comment.** Subdivision (a) of Section 15680 continues the first sentence of former Civil Code Section 2274 without substantive change and restates the first sentence of former Probate Code Section 1122 without substantive change. Subdivision (b) restates the second sentence of former Civil Code Section 2274 and the second sentence of former Probate Code Section 1122 without substantive change, except that subdivision (b) makes clear that the court can reduce the trustee's compensation when appropriate. Subdivision (c) makes clear that an order changing the amount of compensation cannot be applied retroactively to actions already taken. See also Sections 15682 (court determination of prospective compensation), 17200(b) (9) (petition to fix compensation).

**§ 15681. Trustee's compensation where trust silent**

**15681.** If the trust instrument does not specify the trustee's compensation, the trustee is entitled to reasonable compensation under the circumstances.

**Comment.** Section 15681 continues the third sentence of former Civil Code Section 2274 without substantive change and restates part of the third sentence of former Probate Code Section 1122 without substantive change. The trustee has authority to fix and pay its compensation without the necessity of prior court review. See Section 16243 (power to pay compensation and other expenses). See also Sections 15682 (court determination of prospective compensation), 17200(b) (9) (petition to fix compensation).

**§ 15682. Court determination of prospective compensation**

**15682.** The court may fix an amount of periodic compensation under Sections 15680 and 15681 to continue for as long as the court determines is proper.

**Comment.** Section 15682 is a new provision that makes clear that the court may fix compensation prospectively. This section supersedes the last part of the third sentence of former Probate Code Section 1122. See also Section 17200(b) (9) (petition to fix compensation).

**§ 17200. Petitioners; grounds for petition**

**Comment.** Section 17200 restates the substance of subdivision (a) of former Probate Code Section 1138.1 and supersedes parts of former Probate Code Section 1120. The reference to determining the existence of a trust in subdivision (a) is new.

Subdivision (a) also restates without substantive change part of former Probate Code Section 1139.1 and the first sentence of former Probate Code Section 1139.2 (petition for transfer of trust to another jurisdiction) and part of former Probate Code Section 1139.12 (petition for transfer to California). The introductory clause of subdivision (a) is a new provision that has the effect of giving the right to petition concerning the internal affairs of a revocable living trust to the settlor (or other person holding the power to revoke) instead of the beneficiaries during the time that the settlor (or other person holding the power to revoke) is competent. See Section 15800 and the Comment thereto.

The list of grounds for a petition concerning the internal affairs of a trust under subdivision (b) is not exclusive and is not intended to preclude a petition for any other purpose that can be characterized as an internal affair of the trust. Paragraphs (1) and (2) of subdivision (b) are new and are drawn from Section 7-201(a) of the Uniform Probate Code (1977). Paragraph (3) is new. Paragraph (5) restates parts of subdivisions (b) and (d) of former Civil Code Section 2269 (review of exercise of discretionary powers) without substantive change. See Sections 16080-16081 (duties with regard to discretionary powers). Paragraph (9) supersedes the last sentence of former Civil Code Section 2274.

Various provisions elsewhere in this division relate to proceedings under this article. For limitations on the right of a beneficiary to compel the trustee to account or report under paragraph (7), see Sections 15800 and 16060-16064. As to granting powers to the trustee under paragraph (8), see Section 16201. As to the trustee's compensation under paragraph (9), see Sections 15680-15683. As to breaches of trust involved in paragraph (12), see Sections 16400-16462. As to modification and termination of trusts under paragraph (13), see Sections 15400-15410. As to combining or dividing trusts under paragraph (14), see Sections 15411 and 15412. As to transfers of trusts under paragraph (16), see Sections 17400-17405 and 17450-17457. As to transfers of certain testamentary trusts within California under paragraph (17), see Section 17304. As to removal of certain testamentary trusts from continuing court jurisdiction under paragraph (18), see Section 17352.

The procedure provided in this chapter is available to determine matters concerning the administration of trusts notwithstanding a purported limitation or exclusion in the trust instrument. The provision of former Probate Code Section 1138.1(b) to the effect that the trust could restrict the availability of remedies is not continued.

See also Sections 24 ("beneficiary" defined), 82 ("trust" defined), 17005 (venue).