

Memorandum 90-120

Subject: Study L-644 - Recognition of Trustees' Powers (Draft of Recommendation)

At the July meeting, the Commission reviewed comments received on the *Tentative Recommendation Relating to Recognition of Trustees' Powers* (March 1990) and decided to revise the recommendation to provide an affidavit procedure for achieving recognition of trustees' powers. A revised recommendation to accomplish this purpose is attached to this memorandum. The revised recommendation combines the affidavit approach under durable powers of attorney with the liability for unreasonable refusal to recognize the trustee's powers. In this form, the draft statute would apply both to statutory powers and to powers expressed in the instrument.

If the Commission approves this draft, the recommendation will be printed and submitted to the 1991 legislative session.

Respectfully submitted,

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08/21/90

RECOMMENDATION

Under the Trust Law, a trustee has three classes of powers without the need to obtain court authorization: powers conferred by the trust instrument and, except as limited in the trust instrument, powers provided by statute and powers needed to perform duties under the statutory standard of care.<sup>1</sup> The broad set of statutory powers that are automatically granted a trustee, except to the extent that the powers are limited in the trust instrument,<sup>2</sup> avoid the need to repeat the statutory powers in the trust instrument and are intended to give general guidance to third persons dealing with trustees without the need to examine lengthy trust instruments.

The Trust Law protects third persons who deal with the trustee in good faith, for value, and without actual knowledge that the trustee is exceeding the trustee's powers or exercising them improperly.<sup>3</sup> The Trust Law focuses on the trustee's duty to exercise powers consistently with fiduciary principles, rather than on the question of whether a

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1. Prob. Code § 16200.
  2. Prob. Code §§ 16200(b), 16220-16249.
  3. Probate Code Section 18100 provides:

18100. With respect to a third person dealing with a trustee or assisting a trustee in the conduct of a transaction, if the third person acts in good faith and for a valuable consideration and without actual knowledge that the trustee is exceeding the trustee's powers or improperly exercising them:

(a) The third person is not bound to inquire whether the trustee has power to act or is properly exercising a power and may assume without inquiry the existence of a trust power and its proper exercise.

(b) The third person is fully protected in dealing with or assisting the trustee just as if the trustee has and is properly exercising the power the trustee purports to exercise.

power has been granted by the trust, as under former law.<sup>4</sup> The statute makes clear that the third person does not have a duty to inquire into the existence or manner of exercise of the power.<sup>5</sup>

These elements of the Trust Law seek to improve the efficiency of transactions between trustees and third persons and to avoid the expense and delay that result from the need to petition for court confirmation of the existence of a power. However, the Commission is informed that this purpose is being thwarted in some cases by overly cautious third persons who are unwilling to rely on the statutory protections. This problem may occur both with regard to the automatic statutory powers and powers expressly provided in the trust instrument. In the case of a lengthy or complicated instrument, the third person may not want to take the time and incur the expense necessary to be sure that the power claimed actually exists. Some third persons are probably unfamiliar with the automatic statutory powers, but others may simply be unwilling to rely on the existence of the automatic statutory power because it may be subject to a limitation in the trust instrument which they are unwilling to review. No doubt there are situations where the existence of the power may not be sufficiently certain to the third person even after a careful and time-consuming review of the trust instrument. In this case, the third person may still be unwilling to act because of doubts about whether, having made an inquiry in to the matter, the third person will be found to have acted in good faith should the transaction be questioned by disgruntled beneficiaries in court.

In order to make the automatic powers scheme more effective and to avoid unnecessary judicial proceedings, as well as to protect the

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4. See former Civ. Code § 2267; former Prob. Code § 1120.2. Under former law, the trustee had only the powers conferred by the trust instrument and a few statutory powers, unless additional powers were granted by the court. See *Recommendation Proposing the Trust Law*, 18 Cal. L. Revision Comm'n Reports 501, 543 (1986).

5. Protecting persons acting in good faith in transactions with a trustee brings trust law into conformity with modern developments in the law applicable to negotiable instruments, securities, and bank accounts. See *Recommendation Proposing the Trust Law*, 18 Cal. L. Revision Comm'n Reports 501, 593 & n.374 (1986).

legitimate reliance interest of third persons, the Commission recommends that the Trust Law be revised to provide for a trustee's affidavit that the trustee has the power sought to be exercised and is properly exercising it.<sup>6</sup> The affidavit could be given voluntarily by the trustee or on demand of the third person as a precondition to dealing with the trustee. The third person relying on the affidavit would be protected from liability and would not have any duty of inquiry so long as the third person did not have actual knowledge that the trustee did not have the power or was improperly exercising it.<sup>7</sup> A third person who refuses to rely on the trustee's affidavit would be liable for costs and attorney's fees incurred in proceedings necessary to obtain court confirmation of the power, unless the court finds that the third person believed in good faith that the trustee did not have the power claimed or was attempting to exercise it improperly. The affidavit procedure would be supplementary to the existing protection provided by Probate Code Section 18100 and no implication of a lack of good faith would arise from the failure of a third person to demand an affidavit from a trustee.

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6. This type of affidavit is familiar under the Durable Power of Attorney. Civ. Code § 2404. More extensive and detailed enforcement of powers and protection of reliance is given under some newer power of attorney statutes in other states. See, e.g., Ill. Ann. Stat. ch. 110½ ¶ 802-8 (Smith-Hurd Supp. 1990); Minn. Stat. Ann. §§ 523.16-523.20 (West Supp. 1990); Mo. Ann. Stat. § 404.719 (Vernon 1990).

7. This actual knowledge standard differs from the general standard under Probate Code Section 18100 which also requires the third person to act in good faith and for a valuable consideration.

PROPOSED LEGISLATION

Probate Code § 18100.5 (added). Reliance on trustee's affidavit; liability for costs and attorney's fees

18100.5. (a) The trustee may execute an affidavit stating that the trustee is qualified and has power to act and is properly exercising the powers under the trust. An affidavit under this subdivision may be executed by the trustee voluntarily or on the demand of a third person.

(b) With respect to a third person dealing with the trustee or assisting the trustee in the conduct of a transaction, if the third person relies on the trustee's affidavit without actual knowledge that the trustee is exceeding the trustee's powers or improperly exercising them:

(1) The third person is not bound to inquire whether the trustee has power to act or is properly exercising a power and may assume without inquiry the existence of a trust power and its proper exercise.

(2) The third person is fully protected in dealing with or assisting the trustee just as if the trustee has and is properly exercising the power the trustee purports to exercise.

(c) If the trustee furnishes an affidavit pursuant to subdivision (a), whether voluntarily or on demand, a third person dealing with the trustee who refuses to accept the exercise of a trustee's power covered by the affidavit is liable for costs and attorney's fees incurred in an action or proceeding necessary to confirm the trustee's qualifications or powers, unless the court determines that the third person believed in good faith that the trustee was not qualified or was attempting to exceed or improperly exercise the trustee's powers.

(d) A third person's failure to demand an affidavit under subdivision (a) does not affect the protection provided the third person by Section 18100, and no inference as to whether a third person has acted in good faith may be drawn from the failure to demand an affidavit from the trustee.

Comment. Section 18100.5 is new. This section supplements the protection of third persons provided by Section 18100. See subdivision (d).

Subdivision (a) provides for execution of an affidavit concerning the existence of the trustee's powers either voluntarily or on the

demand of a third person with whom the trustee seeks to do business. This provision is drawn in part from the affidavit provision applicable to powers of attorney. See Civ. Code § 2404. The powers covered by the affidavit may be powers granted in the trust instrument, statutory powers, or necessary powers. See Sections 16200(a) (powers expressed in trust), 16200(b) (statutory powers except as limited), 16220-16249 (statutory powers), 16200(c) (powers needed to perform duty under standard of care).

Subdivision (b) protects a third person who relies on the trustee's affidavit, so long as the third person does not have actual knowledge that the trustee is not qualified, does not have the powers claimed, or is improperly exercising the powers. The protection provided by subdivision (b) is the same as the general protection of third persons provided in Section 18100(b) where there is no affidavit. However, there is a crucial difference between these two immunity provisions. To be protected under Section 18100(b), the third person must act in good faith, for valuable consideration, and without actual knowledge of a defect in the trustee's authority. Under Section 18100.5(b), the third person relying on a trustee's affidavit is protected from liability as long as the third person does not have actual knowledge of a defect in the trustee's authority. Both sections provide explicitly that the third person has no duty of inquiry.

Unless the court determines that the third person refused in good faith to rely on the trustee's affidavit, subdivision (c) imposes liability on the third person for costs and attorney's fees in a proceeding needed to confirm exercise of a power. This provision is intended to make trustees' powers more effective and avoid the need to seek judicial confirmation of the existence of a power. The liability under subdivision (c) applies only where the trustee gives an affidavit, whether voluntarily or on demand. If the trustee has not executed an affidavit, a third person may refuse to recognize the trustee's power even though the third person would be fully protected under Section 18100.

Subdivision (d) makes clear that the failure to require the trustee to execute an affidavit does not affect the protection provided by Section 18100, and no inference as to whether a third person has acted in good faith should be drawn from the failure to request an affidavit from the trustee. Consequently, a third person who satisfies the requirements of Section 18100 is fully protected. The availability of the affidavit procedure in this section is not intended in any way to detract from the general protection provided in Section 18100.