

Memorandum 84-93

Subject: Study L-640 - Trusts (Breach of Trust)

Attached to this memorandum is a staff draft of a statute implementing Commission decisions on the law relating to breach of trust that were made at the September meeting. Some of the material remains essentially unchanged, but much of it is new; consequently we intend to proceed through the draft section by section at the next meeting. Since the background of these provisions was fully presented in Memorandum 84-23 and the First Supplement thereto, this memorandum will add little; the sections and their comments should be largely self-explanatory.

§ 951. Liability of trustee for acts of agents

When the Commission considered the question of the extent to which a trustee should be liable for acts of agents, only the introductory general principle of the draft section was approved. This would have the effect of making the trustee liable for acts of agents as if the trustee had committed them even though the trustee has acted reasonably in hiring and directing the agent. We doubt that the Commission intends such a result. Consequently, draft Section 951 in Exhibit 1 proposes adoption of the limiting factors drawn from Restatement (Second) of Trusts Section 225(2).

§ 952. Liability of trustee for acts of cotrustee

This section implements a specific Commission decision to continue Civil Code Section 2239 without the bracketed clause: "A trustee is responsible for the wrongful acts of a co-trustee to which he consented, or which, by his negligence, he enabled the latter to commit, [but for no others]." The equivalent provision from the Restatement (Second) and its comment read as follows:

§ 224. Liability for Breach of Trust of Co-trustee

(1) Except as stated in Subsection (2), a trustee is not liable to the beneficiary for a breach of trust committed by a co-trustee.

(2) A trustee is liable to the beneficiary, if he

(a) participates in a breach of trust committed by his co-trustee; or

(b) improperly delegates the administration of the trust to his co-trustee; or

(c) approves or acquiesces in or conceals a breach of trust committed by his co-trustee; or

(d) by his failure to exercise reasonable care in the administration of the trust has enabled his co-trustee to commit a breach of trust; or

(e) neglects to take proper steps to compel his co-trustee to redress a breach of trust.

Comment:

a. Scope of the rule. Where several trustees are liable for a breach of trust committed by them jointly or for a breach of trust committed by one of them for which the others are liable under the rule stated in Subsection (2), they are jointly and severally liable to the beneficiary for the breach of trust.

Illustration to Clause (a):

1. A and B are co-trustees. By the terms of the trust they are permitted to invest only in bonds. A suggests to B that he invest part of the funds in shares of stock which B does. A as well as B is liable for the breach of trust.

Illustration to Clause (b):

2. A and B are co-trustees. A directs B to invest the trust funds without consulting with A. In breach of trust B invests in shares of stock. A is liable for breach of trust.

Illustration to Clause (c):

3. A and B are co-trustees. B makes an improper investment and tells A that he has done so. A approves of the investment. A is liable for breach of trust.

Illustration to Clause (d):

4. A and B are co-trustees. A improperly permits B to have the sole custody and management of the trust property and makes no inquiry as to his conduct. B is thereby enabled to sell the trust property and embezzle the proceeds. A is liable for breach of trust.

Illustration to Clause (e):

5. A and B are co-trustees. A knows that B has embezzled a part of the trust property but makes no effort to compel him to make restitution. A is liable for breach of trust.

b. Cross references. As to the duty of a trustee with respect to co-trustees, see § 184.

As to the duty of a trustee where a power of control is conferred upon another, see § 185.

As to the right of one trustee to contribution or indemnity from his co-trustees, see § 258.

The Restatement rule was not approved by the Commission apparently because of concern that it would be unduly burdensome to make one trustee responsible for overseeing acts of a cotrustee and liable for not taking action to remedy breaches by cotrustees. Further research indicates that in at least one case a California court has with approval cited the first Restatement for the proposition that "each trustee is under a duty to the beneficiary to use reasonable care to prevent a cotrustee from committing a breach of trust or to compel a cotrustee to redress a breach of trust." Estate of Hensel, 144 Cal. App.2d 429, 438, 301 P.2d 105 (1956).

The staff suggests that the Commission consider replacing draft Section 952 with the substance of Section 224 of the Restatement (Second) of Trusts in light of Estate of Hensel. The staff has several concerns: (1) Civil Code Section 2239 is not an accurate statement of the law; (2) a modified version of Civil Code Section 2239 which omits the limiting clause would not provide sufficient guidance; (3) Section 224 of the Restatement is not inconsistent with California law; and (4) Section 224 of the Restatement provides more guidance through its greater detail. Consequently the staff thinks the Restatement approach is preferable to the revision of Civil Code Section 2239 set out in draft Section 952.

On the other hand, it should be noted that the Restatement is written in the context of the common law approach requiring unanimous action by cotrustees, whereas the Commission has decided to adopt the majority rule approach. In this context, the Commission should consider the following provision from the Texas Trust Code:

114.006. (a) A trustee who does not join in exercising a power held by three or more cotrustees is not liable to a beneficiary of the trust or to others for the consequences of the exercise nor is a dissenting trustee liable for the consequences of an act in which the trustee joins at the direction of the majority trustees if the trustee expressed the dissent in writing to any of the cotrustees at or before the time of joinder.

(b) This section does not excuse a cotrustee from liability for failure to discharge the cotrustee's duties as a trustee.

This section is the same in substance as Section 6(a) & (c) of the Uniform Trustees Powers Act (1964) and Section 11 of the Uniform Trusts Act (1937).

Another aspect of Civil Code Section 2239 merits discussion. This section is located in a series of sections dealing with breach of trust (i.e., involving liability to beneficiaries), but Section 2239 is not by

its terms limited to breach. Consequently Section 2239 might be thought to cover liability to third persons, although we do not find any cases that have applied it in this fashion. The staff thinks it should be made clear that the rules on trustee liability for acts of cotrustees is the same as to beneficiaries and third persons.

§ 970. Accountability for profits in absence of breach of trust

Draft Section 970 codifies the rule of Restatement (Second) of Trusts Section 203 that the trustee is accountable for profit made from administration of the trust, even though there is no breach of trust. Existing California law provides that a "trustee may not use or deal with the trust property for his own profit, or for any other purpose unconnected with the trust, in any manner." Civil Code § 2229. However, the cases citing this section seem generally to be concerned with whether there was a breach of trust. Restatement Section 203 makes breach an irrelevant consideration in the context of accountability for profits. This is a two-edged sword because it protects a trustee from an unnecessary finding that it has breached the trust just because a profit has been made, but it also permits an order requiring an accounting for profits where the trustee has not committed any breach.

There is a significant difference between accountability without regard to breach and liability for breach. A trustee who is found to have breached a trust may suffer damage to its reputation, may be removed, may lose commissions, and may be liable in an amount out of proportion to the gravity of its fault. Niles, Trustee Accountability in the Absence of Breach of Trust, 60 Colum. L. Rev. 141, 142 (1960). Restatement Section 203 embodies the notion that the trustee's duty of loyalty extends beyond the ability of the beneficiary to prove a breach of trust.

As an aid to understanding the intended scope of draft Section 970, consider the comment to Restatement Section 203:

Comment:

a. Scope of the rule. If the trustee enters into a transaction in connection with the administration of the trust for the purpose of acquiring a profit for himself in violation of his duty of loyalty to the beneficiary, he commits a breach of trust under the rule stated in § 170, and is liable under the rule stated in § 206. Even if he enters into the transaction without intending to make a profit for himself and commits no breach of trust in so doing, nevertheless he is not permitted to retain the profit.

Thus, if the trustee receives a commission or bonus for acts done in connection with the administration of the trust, he is accountable therefor, even if he does not commit a breach of trust in receiving the commission or bonus.

b. Profit made through the use of trust property. If the trustee makes a profit out of the trust property, he is accountable for the profit although he commits no breach of trust in making the profit. Thus, if the trustee receives payment for the use of the trust property, he is accountable for the money received, as for example where the trustee of a farm receives payment from a third person for the privilege of hunting on the farm. If the trustee makes an authorized investment in securities which he sells at a profit, he is of course accountable for the profit.

c. Profit made through sale of trustee's individual property to the trust. If the trustee purchases for the trust property in which he has an individual interest but is not liable for breach of trust because he did not know and had no reason to know that he was purchasing property in which he had such an interest, he is nevertheless accountable for any profit which he makes. Thus, if a trust company as trustee instructs a broker to purchase certain bonds and the broker places the order with a bank which purchases the bonds from the trustee's commercial department, the trustee is accountable for any profit which it makes on the sale, although it had no knowledge or reason to know that it was purchasing the bonds from itself. The trustee in such a case, however, is not liable for interest at the legal rate or for any loss resulting from the purchase, as he would be if he had known that he was purchasing from himself. See § 206.

d. Profit made through use of trustee's individual property. Even if the profit is made by the use of the trustee's individual property and he does not commit a breach of trust in making the profit, he may be accountable for the profit. Thus, if the trustee with his own funds purchases an encumbrance upon the trust property for the purpose of protecting the trust property, he is accountable for any profit he makes thereby.

Illustration:

1. A devises Blackacre to B in trust. Blackacre is subject to a first mortgage for \$10,000 and a second mortgage for \$5000. In order to prevent a foreclosure of the second mortgage, B with his own money purchases the second mortgage for \$3000. On the foreclosure of the first mortgage Blackacre sells for \$16,000. B is entitled only to \$3000 and interest out of the proceeds of the sale. See § 170, Comment j.

e. Profit unconnected with administration of trust. If the trustee enters into a transaction not connected with the administration of the trust, he is not accountable for a profit which may result merely because the trust property is indirectly affected thereby.

Illustration:

2. A devises his family residence to B in trust to permit C, the widow of A, to reside therein during her lifetime and at her death to convey the property to D. By the terms of the trust B is not authorized to purchase land. During C's lifetime B learns that negotiations are pending for the sale of adjoining land for uses of an objectionable nature. To prevent this, B with his own funds purchases the adjoining land for \$10,000, and after holding it for five years he sells it for \$25,000. B is not accountable for the profit.

f. *Cross reference.* As to the liability of the trustee for profits made by him through a breach of trust, see § 205.

The impact of Restatement Section 203 should not be exaggerated. The staff anticipates that those speaking for institutional trustees who are frequently target defendants may at first react negatively to Section 203. As discussed in connection with the First Supplement to Memorandum 84-22 at the September meeting, the California Bankers Association is concerned about liability where a bank through its lending operations has a potential conflict of interest with its trust department. See *Estate of Pitzer*, 155 Cal. App.3d 979, 988 (1984). This situation may arise, for example, where a person intending to buy trust property offered for sale by the bank acting as trustee borrows money to finance the purchase from the bank acting in its normal lending functions. (A later statement of the CBA's concern is attached to Memorandum 84-92 as Exhibit 3.) The staff does not, however, think that Restatement Section 203 should be the focus of the CBA's concern. The Pitzer case and its companion, Burton v. Security Pacific National Bank, 155 Cal. App.3d 967 (1984), expose institutional trustees to what they find to be unacceptable liabilities as a consequence of confused jurisdictional limitations and procedural practices, mainly involving the role of the jury in assessing punitive damages. This general problem is discussed in the First Supplement to Memorandum 84-29 (on the agenda for the November 1984 meeting). The staff believes that disposition of the jurisdictional and procedural questions as proposed elsewhere should do much to remedy the "difficulties and severe problems facing fiduciaries in today's pervasive litigation-prone climate." See McLean-Utley, Surcharge Problems of Trustees and Executors, in *Estate Planning 1983* § 6.7, at 235. Adoption of Restatement Sections 203 and 204, as set forth in draft Sections 770 and 771, should aid in making the necessary distinctions between the more severe liabilities for breach (see draft Sections 760, 772, and 773) and the accountability for profits actually made.

§ 973. Trustee's liability for interest

Draft Section 973(a) makes clear that the legal rate of interest is the rate applicable to judgments, that is, 10%. See Code Civ. Proc. § 685.010. This was assumed without discussion in the memorandum on this question considered at the September 1984 meeting. However, it should be noted that Section 1 of Article 15 of the California Constitution establishes a 7% rate of interest "upon the loan or forbearance of any money, goods, or things in action, or on accounts after demand" subject to several exceptions, including by contract of the parties or by statute as to the rate on judgments. It is assumed that the constitutional article on interest rates, characterized as "usury", does not limit the rate of interest that may be applied against a fiduciary as damages for a breach of trust. Cf. *Lynch v. John M. Redfield Found.*, 9 Cal. App.3d 293, 302 n.1, 88 Cal. Rptr. 86 (1970) ("There is authority that the surcharge is at 'the usual rate of return on trust investments, and not for interest at the legal rate' [citing Scott], or 'at the legal rate or such other rate as the court in its sound discretion may determine.' [citing Restatement § 207 and C.J.S.]")

§ 980. Limitations on proceedings against trustees

This section is the same as the version considered at the last meeting. Two questions deserve further consideration. The Comment to draft Section 980 states that the one-year rule of the section does not displace the three-year rule applicable to fraud and running from the date of discovery. See Code Civ. Proc. § 338(4). The one-year period in Section 980 also may run from the date of discovery, or the date when the beneficiary should have discovered the breach, or the date of disclosure. It is not clear why the element of fraud should triple the length of the applicable limitations period. The staff suggests that the Commission consider eliminating the special fraud rule in this area, making the one-year period applicable in all cases.

The second issue relates to the word "limitation" in the introductory clause of Section 980: "Unless previously barred by adjudication, consent, or limitation . . ." It appears that the only way limitation can be relevant is where the subject of the claim for breach has not been disclosed or discovered and the beneficiary would not reasonably have discovered it. The one-year period of Section 980 has not been triggered, so the question is whether the four-year limitations period of Code of Civil Procedure Section 343 would apply. Under existing law

the four-year rule applies, but as against a fiduciary it does not begin to run until the beneficiary learns of the breach. See 2 B. Witkin, California Procedure Actions § 354, at 1191 (2d ed. 1970). Accordingly, the claim for breach would never be barred by limitations in this type of case, although laches would ultimately provide some relief. It is thus not clear how limitation would bar a claim, unless there is some special state or federal statute involving trust companies that applies a shorter period. It is also possible that a claim might be barred by application of the statute of limitation of another state. The reference to "limitation" in the introductory clause of Section 980 does not do any harm, and the staff concludes that it should be retained to cover such eventualities.

Respectfully submitted,

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EXHIBIT 1

Staff Draft

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CHAPTER 4. LIABILITY OF TRUSTEES TO BENEFICIARIES

Article 1. Liability for Breach of Trust

§ 950. Breach of trust

950. A violation by the trustee of any duty that the trustee owes the beneficiary is a breach of trust.

Comment. Section 950 is new and is drawn from Section 201 of the Restatement (Second) of Trusts (1957). Section 950 supersedes former Civil Code Section 2234.

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§ 951. Liability of trustee for acts of agents

951. The trustee is liable to the beneficiary for an agent's acts or omissions that would be a breach of the trust if committed by the trustee [under any of the following circumstances:

- (a) Where the trustee directs or permits the act of the agent.
- (b) Where the trustee delegates to the agent the authority to perform an act that the trustee is under a duty not to delegate.
- (c) Where the trustee does not use reasonable care in the selection or retention of the agent.
- (d) Where the trustee does not exercise proper supervision over the agent's conduct.
- (e) Where the trustee approves, acquiesces in, or conceals the act of the agent.
- (f) Where the trustee neglects to take proper steps to compel the agent to redress the wrong.]

Comment. Section 951 [is the same in substance as Section 225(2) of Restatement (Second) of Trusts (1957)]. Nothing in this section limits liability of an agent for acts or omissions that would be a breach of trust if committed by the trustee.

Note. The bracketed language has not been approved by the Commission.

§ 952. Liability of trustee for acts of cotrustee

952. If a trustee consents to a cotrustee's acts or omissions or negligently enables the cotrustee to commit them, the trustee is liable to the beneficiary for the cotrustee's acts that would be a breach of the trust if committed by the trustee.

Comment. Section 952 supersedes former Civil Code Section 2239.

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§ 953. Liability of successor trustee

953. (a) A successor trustee is not liable to the beneficiary for a breach of trust committed by a predecessor trustee.

(b) A successor trustee is liable to the beneficiary for breach of trust involving acts of a predecessor trustee in either of the following circumstances:

(1) Where the successor trustee knows or should know of a situation constituting a breach of trust committed by the predecessor trustee and the successor trustee improperly permits it to continue.

(2) Where the successor trustee neglects to take proper steps to compel the predecessor trustee to deliver the trust property to the successor trustee.

Comment. Section 953 is the same in substance as Section 223(1) and (2)(a)-(b) of the Restatement (Second) of Trusts (1957).

Note. This draft omits Restatement Section 223(2)(c) which reads: "neglects to take proper steps to redress a breach of trust committed by the predecessor." This language is omitted to implement the Commission direction that the liability of a successor trustee should be similar to the liability of a trustee for acts of a cotrustee.

2966

Article 2. Remedies for Breach of Trust

§ 960. Remedies for breach of trust

960. If the trustee commits a breach of trust, or threatens to commit a breach, the beneficiary may commence a proceeding for any of the following purposes that is appropriate:

(a) To compel the trustee to perform the trustee's duties.

(b) To enjoin the trustee from committing a breach of trust.

(c) To compel the trustee to redress a breach of trust by payment of damages.

(d) To appoint a receiver or temporary trustee to take possession of the trust property and administer the trust.

(e) To remove the trustee.

(f) To set aside acts of the trustee.

(g) To reduce or deny compensation of the trustee.

(h) To impose an equitable lien on, or enforce a constructive trust of, trust property remaining in the hands of the trustee.

(i) To trace trust property that has been wrongfully disposed of and recover the property or its proceeds.

Comment. Section 960 codifies in general terms the remedies available to the beneficiary where the trustee has committed a breach of trust or threatens to do so. For the applicable procedure, see Part 5 (commencing with Section 1100) (Judicial Proceedings Concerning Trusts). This section does not limit the remedies that may be available under the common law. See Section 962.

Subdivision (a) of Section 960 supersedes a part of former Civil Code Sections 863 (beneficiary may "enforce the performance of the trust") and 2251 (beneficiary may "take advantage" of trust). See also Restatement (Second) of Trusts § 199(a) (1957).

Subdivision (b) is consistent with other statutes. See Civil Code § 3422; Code Civ. Proc. § 526(7); see also *St. James Church of Christ Holiness v. Superior Court*, 135 Cal. App.2d 352, 359-62, 287 P.2d 387 (1955); Restatement (Second) of Trusts § 199(b) (1957).

Subdivision (c) continues the general liability for damages provided in former Civil Code Sections 2236-2238 and 2262. See also Restatement (Second) of Trusts § 199(c) (1957). The reference to damages in subdivision (c) is comprehensive and includes liability that might be characterized as restitution or surcharge. For the measure of damages, see Article 3 (commencing with Section 970).

Subdivision (d) makes explicit the authority to appoint a receiver. See Code Civ. Proc. § 564(1), (7); see also Restatement (Second) of Trusts § 199(d) (1957). Subdivision (d) also permits appointment of a temporary trustee where appointment of a receiver would be appropriate. For provisions governing appointment of trustees, see Sections _____.

Subdivision (e) continues in general terms the authority to remove a trustee for breach of trust provided by former Civil Code Section 2283 and former Probate Code Section 1123.5. See also Restatement (Second) of Trusts § 199(e) (1957). For provisions governing removal of trustees, see Sections _____.

Subdivision (f) is new. The authority to set aside wrongful acts of the trustee is a corollary of the power to enjoin a threatened breach as provided in subdivision (b). The wrongful acts of the trustee may not be set aside if to do so would impair the rights of bona fide purchasers. See G. Bogert, *The Law of Trusts and Trustees* § 861, at 16-17 (rev. 2d ed. 1982).

Subdivision (g) is new and is drawn from Section 243 of the Restatement (Second) of Trusts (1957). Prior California statutes provided only for the determination of reasonable compensation and for the allowance of greater compensation under appropriate circumstances. See former Civil Code § 2274; former Prob. Code § 1122, 1138.1(a)(7).

Subdivision (h) states a general rule recognized in California cases. See, e.g., *Citizens' Bank v. Rucker*, 138 Cal. 606, 609-10, 72 P. 46 (1903); see also Restatement (Second) of Trusts § 202 (1957).

Subdivision (i) is consistent with California case law. See *Noble v. Noble*, 198 Cal. 129, 135, 243 P. 439 (1926); *Keeney v. Bank of Italy*, 33 Cal. App. 515, 517, 165 P. 735 (1917); *Carlin v. Masten*, 118 Cal. App. 373, 376, 5 P.2d 65 (1931); *People v. California Safe Deposit & Trust Co.*, 175 Cal. 756, 759, 167 P. 388 (1917); *Church v. Bailey*, 90 Cal. App.2d 510, 504, 203 P.2d 547 (1949).

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§ 961. Common law applies

961. The availability and application of the remedies for breach of trust described in Section 960 are governed by the common law.

Comment. Section 961 recognizes that the catalogue of remedies for breach of trust provided in Section 960 is a general list that omits the refinements and exceptions developed over many years by the common law. As used in this section and in Section 962, the "common law" does not refer to the common law as it existed in 1850 when the predecessor of Civil Code Section 22.2 was enacted; rather, the reference is to the contemporary and evolving rules of decisions developed by the courts in exercise of their power to adapt the law to new situations and to changing conditions. See, e.g., *Fletcher v. Los Angeles Trust & Sav. Bank*, 182 Cal. 177, 187 P. 425 (1920).

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§ 962. Other remedies preserved

962. Nothing in Section 960 is intended to prevent resort to any other remedy for breach of trust available under any other statute or the common law.

Comment. Section 962 makes clear that the remedies prescribed in Section 960 are not necessarily exclusive. See, e.g., Penal Code § 506; *People v. Stanford*, 16 Cal.2d 247, 105 P.2d 969 (1940) (embezzlement). For a discussion of the "common law," see the Comment to Section 961.

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Article 3. Accountability and Measure of Damages

§ 970. Accountability for profits in absence of breach of trust

970. The trustee is accountable for any profit made by the trustee through or arising out of the administration of the trust, even if the profit does not result from a breach of trust.

Comment. Section 970 is the same as Section 203 of the Restatement (Second) of Trusts (1957).

§ 971. Nonliability for loss in absence of breach of trust

971. The trustee is not liable to the beneficiary for a loss or depreciation in value of the trust property, or for a failure to make a profit, not resulting from a breach of trust.

Comment. Section 971 is the same as Section 204 of the Restatement (Second) of Trusts (1957).

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§ 972. Measure of damages in case of breach of trust

972. (a) If the trustee commits a breach of trust, the trustee is chargeable with any of the following that is appropriate under the circumstances:

(1) Any loss or depreciation in value of the trust estate resulting from the breach of trust.

(2) Any profit made by the trustee through the breach of trust.

(3) Any profit which would have accrued to the trust estate if there had been no breach of trust.

(b) If the trustee has acted honestly and reasonably, the court, in its discretion, may excuse the trustee in whole or in part from liability under subdivision (a) if it would be fair to do so.

Comment. Subdivision (a) of Section 972 is the same in substance as Section 205 of the Restatement (Second) of Trusts (1957). Subdivision (a) supersedes former Civil Code Sections 2237 and 2238. See also Section ____ (propriety of considering investments as part of an overall investment strategy).

Subdivision (b) codifies the good faith exception to the general liability rules found in the Restatement. See Restatement (Second) of Trusts § 205 comment g (1957). This rule is consistent with Estate of Talbot, 141 Cal. App.2d 309, 296 P.2d 848 (1956) and former Civil Code Section 2238(a).

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§ 973. Trustee's liability for interest

973. (a) If the trustee commits a breach of trust and thereby incurs a liability for damages with interest thereon, the trustee is chargeable with interest at the legal rate on judgments or such other rate as the court in its discretion may determine, but in any event the trustee is chargeable with interest actually received or which should have been received.

(b) If the trustee is chargeable with interest, the trustee is chargeable with simple interest, but the trustee is chargeable with compound interest in any of the following circumstances:

- (1) Where the trustee has received compound interest.
- (2) Where the trustee has received a profit that cannot be ascertained but is presumably at least equal to compound interest.
- (3) Where it was the trustee's duty to accumulate the income.

Comment. Section 973 supersedes former Civil Code Section 2262 which provided a liability for interest upon failure to properly invest trust funds. Section 973 is the same in substance as Section 207 of the Restatement (Second) of Trusts (1957). In exercising its discretion under this section, the court should consider the following factors as delineated in the following comments to Section 207 of the Restatement:

a. Interest received. The trustee is chargeable with any interest actually received by him on trust funds, although the amount received is greater than the legal rate or the current rate of return on trust investments.

b. Interest which should have been received. If it was the duty of the trustee to invest trust funds in securities paying interest at a certain rate and in breach of trust he neglects to do so, he is chargeable with that rate of interest, even though it is higher than the legal rate or the current rate of return on trust investments.

c. Interest at legal or other rate. Except under the circumstances mentioned in Comments a and b, the beneficiary is entitled to interest at the legal rate, or at the current rate on trust investments, or at some other rate, as the court may in its sound discretion determine.

In determining the rate of interest with which the trustee is chargeable, the following circumstances may be relevant: (1) whether the breach of trust was committed in bad faith, was intentional although not committed in bad faith, was committed negligently or as a result of a mistake in the interpretation of the trust instrument; (2) whether the breach of trust consisted in action by the trustee or in his failure to act.

Ordinarily if a breach of trust consists only in the failure of the trustee to invest trust money, or in the failure to sell trust property and to invest the proceeds, the trustee is chargeable with interest at the current rate of return on trust investments and not with interest at the legal rate.

If breach of trust consists in an improper sale of trust property or an improper purchase of property for the trust, the trustee is chargeable with interest at the current rate of return on trust investments, unless the breach of trust was intentionally committed, in which case he is ordinarily chargeable with interest at the legal rate.

If the breach of trust consists in the failure to pay to the beneficiary trust funds to which he is entitled, the trustee is ordinarily chargeable with interest at the legal rate if he intentionally violated his duty to the beneficiary in withholding payment. If, however, his failure to pay was due to a reasonable doubt as to

his duty to make payment, he is not liable, during the period while the question of his duty is being litigated, for any interest except such as he has actually received or should have received during that period. In such a case the trustee should ordinarily not invest the money but should deposit it in a [financial institution] in order that he may be in a position to pay it over immediately if the court should so decree.

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Article 4. Limitations and Exculpation

§ 980. Limitations on proceedings against trustees

980. (a) Unless previously barred by adjudication, consent, or limitation:

(1) If a beneficiary has received an interim or final account in writing that fully discloses the subject of a claim, a claim against the trustee for breach of trust is barred as to that beneficiary unless a proceeding to assert the claim is commenced within one year after receipt of the account.

(2) If an interim or final account does not fully disclose the subject of a claim, a claim against the trustee for breach of trust is barred as to that beneficiary unless a proceeding to assert the claim is commenced within one year after the beneficiary discovered, or reasonably should have discovered, the subject of the claim.

(b) For the purpose of subdivision (a), a beneficiary is deemed to have received an account if, in the case of an adult, it is received by the adult personally or in the case of a minor or person under legal disability, it is received by the person's representative.

Comment. Section 980 is a new provision and is drawn in part from Uniform Probate Code Section 7-307. Under prior law, the four-year limitations period provided in Code of Civil Procedure Section 343 was applied to actions for breach of express trusts. See *Cortelyou v. Imperial Land Co.*, 166 Cal. 14, 20, 134 P. 981 (1913); *Oeth v. Mason*, 247 Cal. App.2d 805, 811-12, 56 Cal. Rptr. 69 (1967). [This provision does not displace the statute of limitations applicable to actions for relief on the ground of fraud. See Code Civ. Proc. § 338(4).] A parent of a minor may represent the interest of the minor under subdivision (b) so long as the parent does not have a conflict of interest.

§ 981. Exculpation of trustee

981. (a) Except as provided in subdivisions (b) and (c), the trustee can be relieved of liability for breach of trust by provisions in the terms of the trust.

(b) A provision in the trust instrument is not effective to relieve the trustee of liability (1) for breach of trust committed in bad faith, intentionally, or with reckless indifference to the interest of the beneficiary, or (2) for any profit that the trustee derives from a breach of trust.

(c) To the extent that a provision relieving the trustee of liability for breach of trust is inserted in the trust instrument as the result of an abuse by the trustee of a fiduciary or confidential relationship to the trustor, the provision is ineffective.

Comment. Section 981 is the same in substance as Section 222 of the Restatement (Second) of Trusts (1957). For special provisions applicable to revocable trusts, see Section 982. Although a trust may not exculpate a trustee from liability for a profit from a breach, as provided in clause (2) of subdivision (b), the trust may limit the trustee's duties with the effect that the trustee does not commit a breach in this area. However, it is against public policy to attempt to eliminate liability for profits derived from a breach of a duty that the trustee does have. See Restatement (Second) of Trusts § 222 comments b & c (1957).

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§ 982. Nonliability for following instructions under revocable trust

982. (a) Notwithstanding Section 981, a trustee of a revocable trust is not liable to the beneficiary for any act performed pursuant to written directions from the person having the power to revoke, including a person to whom the power to direct the trustee is delegated.

(b) The rule provided in subdivision (a) applies to a trust that is revocable in part with respect to the interest of the beneficiary in that part of the trust property.

Comment. Section 982 continues the substance of subdivision (b) of former Section 2258 insofar as it concerned the trustee's liability under a revocable trust. See also Section _____ (trustee's duty to follow written directions under revocable trust).

EXHIBIT 2

Tentative Outline of Trust Law Revision

Division 3 (Commencing with Section 500) of the Probate Code

Note. Acceleration of the Probate Code revision will leave Division 3 blank. This is the most appropriate location for the material on trusts. Accordingly, as the revised draft is prepared, it will be renumbered following this outline.

Division 3. Trusts

Part 1. General Provisions	\$ 500
Chapter 1. General Provisions	\$ 500
Chapter 2. Transitional Provisions	\$ 520
Article 1. Application of Division 3	\$ 520
Article 2. Removal of Trusts From Continuing Court Supervision	\$ 540
Part 2. Creation and Termination of Trusts	\$ 600
Chapter 1. General Provisions	\$ 600
Article 1. General Provisions	\$ 600
Article 2. Spendthrift Trusts	\$ 610
Chapter 2. Creation of Trusts	\$ 620
Chapter 3. Revocation, Modification, and Termination of Trusts	\$ 640
Part 3. Administration of Trusts	\$ 700
Chapter 1. Duties of Trustees	\$ 700
Article 1. Trustees' Duties in General	\$ 700
Article 2. Trustees' Standard of Care	\$ 720
Article 3. Trustees' Duty to Account to Beneficiaries	\$ 730
Article 4. Duties With Regard to Discretionary Powers	\$ 740
Article 5. Duties of Trustees of Private Foundations, Charitable Trusts, and Split-Interest Trusts	\$ 750
Chapter 2. Powers of Trustees	\$ 800
Article 1. General Provisions	\$ 800
Article 2. Specific Powers of Trustees	\$ 820
Chapter 3. Revised Uniform Principal and Income Act	\$ 900

Chapter 4. Liability of Trustees to Beneficiaries	\$ 950
Article 1. Liability for Breach of Trust	\$ 950
Article 2. Remedies for Breach of Trust	\$ 960
Article 3. Accountability and Measure of Damages	\$ 970
Article 4. Limitations and Exculpation	\$ 980
Part 4. Trustees	\$ 1000
Chapter 1. Compensation and Expenses of Trustees	\$ 1000
Chapter 2. Relation of Trustees With Third Persons	\$ 1020
Article 1. Liability to Third Persons	\$ 1020
Article 2. Indemnity of Trustees	\$ 1030
Article 3. Rights of Third Persons	\$ 1040
Chapter 3. Office of Trustee	\$ 1050
Article 1. General Provisions	\$ 1050
Article 2. Cotrustees	\$ 1060
Article 3. Resignation and Removal of Trustees	\$ 1070
Article 4. Appointment of Trustees	\$ 1080
Part 5. Judicial Proceedings Concerning Trusts	\$ 1100
Chapter 1. Court Jurisdiction Over Trusts	\$ 1100
Article 1. Jurisdiction and Venue	\$ 1100
Article 2. Notice	\$ 1110
Article 3. Proceedings Concerning Trusts	\$ 1130
Chapter 2. Transfer of Trust to Another Jurisdiction	\$ 1160
Chapter 3. Transfer of Trust From Another Jurisdiction	\$ 1180
Part 6. Uniform Management of Institutional Funds Act	\$ 1200