

Memorandum 87-54

Subject: Study L-3010 - Replacement of Corporate Trustees (Draft of Tentative Recommendation)

Attached to this memorandum is a staff draft of a recommendation relating to replacement of corporate trustees. The problem of how to deal with increasing fees of trust companies was first raised before the Commission at the March 1987 meeting. At that time, Assembly Member Harris (who is also a member of the Commission) discussed his concern that the removal of testamentary trusts from court supervision has resulted in an unreasonable increase of fees by some trust companies. At the April meeting, the Commission decided to review this problem with the intention of preparing legislation for the 1988 session. We had also hoped to receive reports from the State Bar and local bar associations and from the banks, but as yet we have not received any responses.

We plan to review the draft statute section by section. Some issues are raised in notes following the relevant section in the draft. If the Commission intends to recommend legislation on this subject for the next legislative session, we need to distribute a tentative recommendation this summer.

Respectfully submitted,

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Staff Draft

TENTATIVE RECOMMENDATION

relating to

REPLACEMENT OF CORPORATE TRUSTEES

The necessity of continuing court jurisdiction over testamentary trusts was eliminated beginning in 1983.¹ The Commission is informed that in the wake of this reform some trust companies have raised their fees in an inordinate amount, presumably because they are no longer subject to routine judicial review of their accounts.² The traditional remedy of removing a trustee³ is not adequate in this situation because it does not specifically address the issue of an increase in fees and because the expense and uncertainty of petitioning the court for an order to remove a trustee and appoint a successor can be a significant deterrent to seeking relief.

The Commission recommends legislation to provide a simple means for the substitution of one trust company for another when it is considered to be appropriate to do so by the united action of the other cotrustees or the beneficiaries.⁴ This procedure would apply only

1. See former Prob. Code § 1120.1a (added by 1982 Cal. Stat. ch. 1199, § 2; repealed by 1986 Cal. Stat. ch. 820, § 31). See now Prob. Code §§ 17350-17354.

2. See remarks of Assembly Member Elihu M. Harris, Minutes of Meeting of California Law Revision Commission, March 12-13, 1987, at 4; see also Minutes of Meeting of California Law Revision Commission, April 9-10, 1987, at 5-7.

3. See Prob. Code §§ 15642 (removal of trustee), 15660 (appointment of trustee to fill vacancy). For background, see generally E. Depper & A. Bernstein, California Trust Administration §§ 13.11-13.24, 13.33-13.37 (Cal. Cont. Ed. Bar 1986).

4. If a trust company is replaced by agreement of the beneficiaries, the following persons must consent, as to each beneficiary who receives or is entitled to receive income under the trust or to receive a distribution of principal if the trust were terminated at the time the directive is executed: (1) each adult beneficiary who has legal capacity, (2) the conservator of any adult beneficiary for whom a conservator has been appointed, and (3) the parent or guardian of the estate of each minor beneficiary.

to the substitution of one trust company for another,⁵ and not to the removal or appointment of a trustee who is an individual. The replacement under this proposal is initiated by the execution of a directive stating the relevant facts and signed and acknowledged by all the cotrustees or by or on behalf of all the beneficiaries. The directive is then delivered to the intended successor trust company which indicates its acceptance of the trust in writing.

Once the successor trust company has accepted the trust, it requests the delivery of the trust property by the outgoing trust company. The replaced trust company is protected from liability for good faith reliance on the directive. The replaced trust company's compliance is enforceable on petition to the court. The replaced trust company is liable for costs and attorney's fees, and the court has discretion to award the trust punitive damages up to \$10,000 for refusing to turn over trust property without good cause.

The trust is protected in this procedure by the condition that the persons seeking the replacement find a trust company that is willing to accept the administration of the trust. The right of the cotrustees or beneficiaries to seek an appropriate trust company to administer the trust at an acceptable fee is protected by a provision that the procedure is available notwithstanding a contrary provision in the trust instrument. Otherwise, a trust company could require the

5. Probate Code Section 53 defines "trust company" as "an entity that is authorized to engage in and conduct a trust business in this state." The Comment to Section 53 amplifies this definition as follows:

Entities that are authorized to conduct a trust business in this state include state chartered commercial banks (see Fin. Code §§ 107, 1500.1) and national banking associations (see Fin. Code §§ 1502, 1503), corporations authorized to conduct a trust business (see Fin. Code § 107), trust departments of title insurance companies (see Fin. Code §§ 107, 1501; Ins. Code §§ 12392, 12395), and state and federal savings and loan associations (see Fin. Code §§ 5102, 6515). See also Fin. Code § 106 ("trust business" defined). In order to fall within the definition of "trust company" in Section 83, a corporation, association, or other entity must satisfy the requirements of state or federal law that apply to the particular type of entity.

inclusion of a provision in the trust instrument making this procedure unavailable and thwart the purpose of the proposed legislation.

The proposed legislation also permits a beneficiary to petition the court for the replacement of one trust company with another even though all the other beneficiaries who would be required to execute a directive do not consent. The court may grant the order to substitute trust companies unless it is shown that replacement of the trust company would not be to the benefit of the trust and the beneficiaries.

SEC. . Article 6 (commencing with Section 15690) is added to Chapter 1 of Part 3 of Division 9 of the Probate Code, to read:

Article 6. Replacement of Trust Company as Trustee

§ 15690. Right to replace trust company as trustee

15690. Notwithstanding any provision in the trust instrument, a trust company may be removed as trustee and replaced by another trust company as provided in this article.

Comment. This article permits the administration of a trust to be transferred from one trust company to another. The procedure provided in this article may be used notwithstanding any provision to the contrary in the trust instrument. This procedure may also be used as an alternative to a procedure for removal or replacement of a trust company that is provided in the trust instrument, such as by a majority of beneficiaries or by a single beneficiary, cotrustee, or other person. The replacement procedure under this article may be used only where an existing trustee is a trust company and the successor trustee is another trust company; it may not be used to remove or replace an individual trustee. The procedure may be used where the trust company is the sole trustee or where the trust company is a cotrustee. See Section 83 ("trust company" defined).

§ 15691. Trust company replacement directive

15691. (a) To initiate the replacement of a trustee under this article, a directive entitled "Trust Company Replacement Directive Pursuant to Section 15691 of the California Probate Code" shall be signed and acknowledged and delivered to the trust company named as the successor trustee.

(b) The trust company replacement directive shall include all of the following:

- (1) A reasonably sufficient description of the trust.
- (2) The name and address of the trust company to be replaced as trustee.
- (3) The name and address of the trust company to be the successor trustee.
- (4) A statement that the trust company currently acting as trustee is removed and replaced by another trust company as successor trustee pursuant to Section 15691 of the California Probate Code.

(5) A statement that the directive is signed and acknowledged by all of the persons required by Section 15691 of the California Probate Code to sign and acknowledge the directive.

(6) A statement that each person executing the directive certifies or declares under penalty of perjury under the laws of the State of California that the statements in the directive are true and correct.

(c) The directive shall be signed and acknowledged either by the cotrustees as provided in subdivision (d) or by or on behalf of the beneficiaries as provided in subdivision (e).

(d) If the trust has more than one trustee, the directive may be signed and acknowledged by all of the cotrustees, other than the trust company being replaced.

(e) Whether or not the trust has more than one trustee, the directive may be signed and acknowledged by all of the following:

(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.

(f) Each person signing the directive shall acknowledge it before a notary public. If the person signing the directive is a resident of this state, the directive shall be acknowledged before a notary public in this state. If the person signing the directive is not a resident of this state, the directive shall be acknowledged either before a notary public in this state or before a comparable official in the jurisdiction where the person is a resident.

Comment. Section 15691 specifies the contents of the trust company replacement directive and the persons who must sign and acknowledge the directive. Execution of the directive by the beneficiaries is not necessary if all of the cotrustees (other than the trust company being replaced as a trustee) execute the directive. However, even where the trust has cotrustees, execution of the directive by the cotrustees is not required if the directive is executed by or on behalf of all of the beneficiaries as provided in subdivision (e). A directive may not be executed under this article if there is an adult beneficiary with an

interest of the type described in subdivision (e) who lacks the legal capacity to execute the directive and for whom a conservator has not been appointed. In such a case, it will be necessary petition the court pursuant to Section 15695 or to obtain appointment of a guardian ad litem.

Note. The Commission should be aware that there is a possibility that this procedure may cause tax problems. The IRS has ruled that the corpus of an irrevocable living trust is includible in the decedent grantor's estate where the grantor retained a life power to replace the corporate trustee at will with another corporate trustee. Rev. Rul. 79-353, 1979-2 C.B. 325. The trust also provided that the settlor could not appoint himself as trustee. In this case, the trustee had the unlimited power to distribute to the decedent's adult children, and after their deaths, to the grandchildren. This ruling is based on the premise that the grantor's power to remove the trustee is equivalent to the grantor having the power to control the beneficial enjoyment of the trust by threatening removal. This ruling applied to the grantor trust situation, but some commentators are concerned that

the IRS will extend this rationale to the more common, although distinguishable, situation where the beneficiaries, rather than the grantor, have the right to remove the trustee. Therefore, the beneficiaries should seek the advice of counsel before exercising an unrestricted power to remove the trustee when coupled with a power to appoint a successor.

E. Depper & A. Bernstein, *California Trust Administration* §13.11, at 555 (Cal. Cont. Ed. Bar 1986). Apparently the fear is that the principal and accumulated income may be includible in the estate of a beneficiary who dies having the power to replace a corporate trustee. The staff is in no position to predict what ruling the IRS may make in this area. A reading of the ruling supports the conclusion, however, that it should apply only to a power retained by a grantor. It should not be extended to a statutory power granted cotrustees and beneficiaries. The ruling has also been criticized because it assumes that the trustee will violate fiduciary duties in the face of the power to remove.

§ 15692. Acceptance of trust by successor trustee and request for delivery of trust property

15692. The trust company named as the successor trustee in the trust company replacement directive may accept the trust if the trust company reasonably believes that the directive satisfies the requirements of Section 15691. The trust company may accept the trust by signing the directive or by signing a separate written acceptance.

(b) Upon acceptance of the trust pursuant to subdivision (a), the trust company named as successor trustee shall deliver the directive to the trust company being replaced and request that the trust property be delivered to the successor trustee.

(c) Within a reasonable time after receipt of the request for delivery of trust property, the trust company being replaced shall do either of the following:

(1) Deliver the trust property it holds to the trust company named as successor trustee.

(2) Advise the trust company named as successor trustee that the trust property will not be delivered because the trustee holding the property has reasonable cause to believe that the directive does not satisfy the requirements of Section 15691, specifying precisely in what respect the directive fails to satisfy those requirements.

(d) A trust company that delivers the trust property to the trust company named as successor trustee is subject to all the provisions of law that govern the duties and liabilities of a trustee who has been removed.

Comment. Section 15692 provides a simple method of transferring the trust property from the trust company that is being replaced to a successor trust company named in the trust company replacement directive. If the current trust company refuses to deliver the trust property, a court order may be sought under Section 15693. The restricted manner of acceptance of the trust provided in subdivision (a) is an exception to the manner of acceptance generally applicable pursuant to Section 15600.

§ 15693. Court enforcement; attorney fees; punitive damages

15693. (a) If a request for delivery of the trust property is made pursuant to Section 15692 and the trust company holding the trust property does not deliver the trust property to the trust company named as successor trustee in the trust company replacement directive, a petition for an order under this section may be filed by the trust company named as successor trustee, by a cotrustee, or by a beneficiary. If a petition is filed under this section and the court determines that the directive satisfies the requirements of Section 15691, the court shall order transfer of the trust property held by the trust company removed as trustee to the trust company named as successor trustee.

(b) If the court determines that the trust company removed under this article has, without reasonable cause, failed or refused to deliver the trust property to the trust company named as successor trustee within a reasonable time after receipt of the request made

pursuant to Section 15692, the court shall award the petitioner the reasonable costs of the proceeding under this section, including reasonable attorney fees. In its discretion, the court may also award to the trust punitive damages not exceeding ten thousand dollars (\$10,000).

Comment. Section 15693 provides for a court proceeding to enforce the transfer of the trust under this article.

Note. *The Commission should consider whether damages should be limited as provided in subdivision (b) or set at a different amount.*

§ 15694. Immunities where trust property delivered

15694. A trust company that delivers trust property to the trust company named as the successor trustee in a trust company replacement directive in good faith reliance upon the directive is not subject to any liability for making the delivery.

Comment. Section 15694 protects a trust company that delivers trust property in good faith reliance upon a trust company replacement directive. The section is necessary to encourage a trust company to deliver the trust property without the need for a court order.

§ 15695. Beneficiary's petition for replacement of trust company

15695. Notwithstanding Sections 15642 and 15660 or any provision in the trust instrument, where a trust has a trust company as a trustee, on petition of a beneficiary, the court may order removal of the trust company as trustee and the appointment of another trust company as successor trustee, unless it is shown that the order would not be to the benefit the trust or the beneficiaries.

Comment. Section 15695 permits a beneficiary to petition for replacement of a trust company. A petition under this section may be used if it is impossible to satisfy the requirements of Section 15691 where, for example, one beneficiary refuses to join in the execution of a trust company replacement directive or where an adult beneficiary does not have legal capacity. The introductory clause makes clear that the authority to petition for removal and replacement of a trust company under this section is a cumulative remedy. It is not subject to the limitations provided in Section 15642 (removal of trustee), in Section 15660 (appointment of trustee to fill vacancy), or in the trust instrument.