#L-640 02/07/84

Memorandum 84-19

Subject: Study L-640 - Trusts (Indefinite Beneficiaries and Purposes)

This memorandum considers whether California law should relax the rules that invalidate private (non-charitable) trusts that contain indefinite beneficiary designations or specify indefinite purposes.

## Indefinite Beneficiary Designations

Both Civil Code Sections 2221 and 2222 require a beneficiary for there to be a trust. If there is no beneficiary designated in a purported testamentary trust, the trust will fail and the property passes to the heirs in the absence of a residuary clause in the will. In re Estate of Ralston, 1 Cal.2d 724, 726, 37 P.2d 76 (1934). This inquiry may also involve the court in deciding whether the uncertainty goes to the testator's intent to create a trust or to the designation of beneficiaries; in the former case, the disposition may be saved, in the latter it may not.

The problem becomes more complicated where the trustor designates a class of persons as beneficiaries. In In re Estate of Davis, 13 Cal. App.2d 64, 68, 56 P.2d 584 (1936), the court upheld a testamentary trust to distribute the estate to the trustor's sons and grandchildren as the trustee "deems best". In this case the court considered the testator to have given the trustee a power of appointment. See also Jue v. San Tong Jue, 163 Cal. App.2d 231, 240-43, 329 P.2d 560 (1958) (trust for "family" held to exclude family members who were born in China in light of law providing for escheat of alien interests in land).

Section 120 of the Restatement (Second) of Trusts provides that the "members of a definite class of persons can be the beneficiaries of a trust." In comment b it is stated that a question of construction arises as to who are to be included as members of a family. "Family" may be limited to resident family, and it may exclude the trustor and the trustor's spouse. However, the Restatement considers "family" to be a definite class, whereas "relatives" is an indefinite class that will result in an invalid trust unless the trustee is authorized to select who is included in the class. Restatement (Second) of Trusts § 121 & comment a (1959). If "relatives" is construed to mean "family", then the definite class rule is satisfied. Probate Code Section 6151 (enacted by 1983 Cal. Stats. ch. 842, operative January 1, 1985) treats devises

to "family" and to "relatives" the same, with the result that the rules of intestate succession are applied. We suggest that consideration of the potential inconsistency between the law of wills and trusts be postponed for now; Professor Susan French will be considering the question of rules of construction applicable to all instruments.

One aspect of indefinite classes should be clarified by statute, although the staff is not aware of any California cases on point. This problem concerns the validity of a trust for an indefinite class where the trustee is given the power to determine the beneficiaries. American courts have generally applied the rule that a trust is valid only if the entire membership of the class is capable of ascertainment. Palmer, Private Trusts for Indefinite Beneficiaries, 71 Mich. L. Rev. 359, 360 (1972). The reasons suggested for this rule are that if the trustee does not make any selection, then there is no one to enforce the trustee's duty to select the beneficiaries, and that if the entire membership of the class is unknown, the court will be unable to order equal distribution to all class members. Id., at 361, 366-67. However, if the same disposition were to be judged under the rules governing powers of appointment, the result would be different since the general rule is that a power will be upheld if some persons might reasonably be said to answer the description of the class. See id. at 361.

This problem is illustrated by Professor Palmer as follows:

> If, for example, property is bequeathed to X for life, with power to appoint the remainder to such of the testator's friends as X shall select, and in default of appointment to B, the power of appointment is valid under the Restatement of Property. If the property is given to a trustee to pay the income to X for life, with power in the trustee to appoint the remainder in the same manner and with the same gift in default, the power is still valid and the trust is therefore effective as intended. But if the power given the trustee is regarded as imperative--and this is the usual construction where there is no express gift in default--the power is in trust, is governed by trust rules, and is invalid under those rules because the beneficiaries are indefinite.

Id. at 361 (footnotes omitted).

The Restatement (Second) of Trusts deals with the problem of indefinite classes in Section 122 as follows:

> Except as stated in § 121 [trust for relatives with power of selection in trustee], where the owner of property transfers it in trust for the members of an indefinite class of persons, no enforceable trust is created; but if the transferee is authorized or directed to convey the property to such members of the class as he may select, he has power so to convey, unless the selection is

> authorized or directed to be made at a time beyond the period of the rule against perpetuities, or the class is so indefinite that it cannot be ascertained whether any person falls within it.

Comment h limits this rule to testamentary trusts, the problem of indefinite beneficiary classes in inter vivos trusts being determined under a revocable agency analysis. This means that the transferee can apply the property under the terms of the instrument until the authority is revoked or the transferor dies, at which time the transferee holds the property on a resulting trust for the transferor or his estate. See Restatement (Second) of Trusts § 419. This position has been roundly criticized by Professor Palmer. See Palmer, supra, at 370 n.45; Palmer, The Effect of Indefiniteness on the Validity of Trusts and Powers of Appointment, 10 UCLA L. Rev. 241, 284-86 (1963).

As the staff sees it, Professor Palmer's main criticism of the Restatement rule is that it does not go far enough. The staff is persuaded by Palmer's arguments. Consider the following:

> To the extent that the validity of a trust depends on ascertainable beneficiaries, there has been a failure to fully accept the significance of the fact that one method of ascertainment is the exercise of a power of appointment.
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> In the new version [of the Restatement of Trusts] the requirement of an ascertainable beneficiary is retained without change. When beneficiaries are designated by some group term the trust is valid only if it is possible to ascertain the entire membership of the class. This is true even though the trustee is given a power of selection. If the group does not meet the foregoing test of "definiteness," there is no "enforceable trust" but the trustee has a valid power, unless the class is "so indefinite that it cannot be ascertained whether any person falls within it." . . . The consequence is that a power that would be valid simply as a power will not be valid when it is connected with a trust, even though the settlor meant to place the trustee under a duty to exercise the power. . . .
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> . . . [In the case of a trust for an unborn person] a trust can arise forthwith even though all the beneficiaries are to be ascertained at a later time and in fact may never come into being.
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> The same should be true where beneficiaries are to be ascertained through the exercise of a power, whether the power is held by the trustee or some other person and whether the group of objects is definite or indefinite. There is a trust from the inception of the arrangement, though there may be no beneficiary to enforce it until one is selected through the exercise of the power. . . .
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> The central fault, however, lies in the assertion that a trust must have a beneficiary. . . .
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> The verdict of the common law has been that it is desirable to allow a donor to create legally protected interests in unborn or unascertained persons, within the limits imposed by the rule against perpetuities. If, instead of creating legal interests of this sort, the donor chooses to create equitable interests, with legal

> title held by one who is subject to the duties of a trustee in the care and management of the property, this should be and has been allowed. The verdict of the common law has also been that it is desirable to permit a donor to give to another a power to dispose of the donor's property in accordance with virtually any criteria the donor chooses to prescribe. It makes no difference whether the scope of the power is defined in terms of persons, institutions or purposes. If the donor wishes to create such a power in connection with a transfer to one who is subject to the duties of a trustee, this too should be allowed. It is time to stop trying to solve these problems by turning a description of the usual trust into a definition and then deciding whether the arrangement in question comes within the definition.

Id. at 280-83 (footnotes omitted).

The staff proposes to codify Palmer's suggestion. Hence, a private express trust would be valid (1) if a definite beneficiary or beneficiary class is designated, (2) if a class is sufficiently described so that it can be reasonably determined that a person is within it, and (3) if the trust gives the trustee or another person the power to select the beneficiaries. If this harmonization of the law of trusts and powers is unacceptable to the Commission, the Commission should consider the rule of Section 122 of the Restatement set out above. If this rule is adopted, it should extend to inter vivos trusts because there is no reason to distinguish between testamentary and inter vivos trusts in this area.

## Indefinite Purposes

Civil Code Sections 2221 and 2222 require that a trust specify its purpose. Section 2253 provides, somewhat enigmatically, that the "nature, extent, and object of a trust are expressed in the declaration of trust." Generally there must be some stated and relatively definite purpose to support a private trust, although on occasion the courts may find a trust purpose where it has not been explicitly declared. See 7 B. Witkin, Summary of California Law Trusts § 25, at 5388 (8th ed. 1974). Where the trust is charitable, courts are more tolerant of indefinite purposes, as long as there is a discernible charitable intent. See id., § 48, at 5409-11.

The interplay of these rules results in the invalidation of private express trusts for indefinite purposes and trusts for "benevolent" (not quite charitable) purposes, as well as trusts where the trustees are given the power to dispose of property for purposes as they see fit. "Merely benevolent" purposes may be so upsetting to a court that if mixed with charitable purposes the entire trust will fail. See, e.g., In re Estate of Sutro, 155 Cal. 727, 734, 102 P. 920 (1909); see also

the cases cited in B. Witkin, supra, § 47, at 5407-09. Part of the problem involves the exemption of charitable trusts from the rule against perpetuities. Leaving aside the perpetuities problem for now, there does not seem to be any convincing reason for invalidating gifts in trust for benevolent purposes where the same gift by way of a power of appointment would be upheld. See Palmer, Private Trusts for Indefinite Beneficiaries, 71 Mich. L. Rev. 359, 368-69 (1972). A trust for indefinite or general purposes may also involve the indefinite beneficiary problem since the trustor may have defined the class of intended beneficiaries by reference to the general purpose of the trust. For example, consider the case of Adolph Sutro, who gave 1200 acres within the city of San Francisco ultimately to a trust "for such charities, institutions of learning and science and for premiums to be set apart for distinguished scholarships and scientific discovery and inventions as shall be directed by my executors." In re Estate of Sutro, 155 Cal. 727, 730, 102 P. 920 (1909). George Bernard Shaw attempted unsuccessfully to establish a trust to develop a new English alphabet. In re Shaw, [1957] 1 W.L.R. 729 (Ch.). Both trusts failed.

In a case where a testator has given property to another to dispose of "as he may see fit" the disposition may fail if the word "trust" is used (see In re Estate of Ralson, 1 Cal.2d. 724, 725-26, 37 P.2d. 76 (1934)), but may be upheld where "trust" does not appear (see Estate of Kuttler, 160 Cal. App.2d 332, 334, 337-39, 325 P.2d 624 (1958)). See also In re Estate of Maloney, 27 Cal. App.2d 332,333, 80 P.2d 998 (1938) ("I wish for Mrs. Sarah Collins to doe wat she know I like done if any is left" held to be invalid trust for failure to indicate purpose or beneficiaries); Estate of Feldman, 78 Cal. App.2d 778, 780, 787-90, 178 P.2d 498 (1947) (attempted trust of $12,000 "to distribute according to my personal wishes" held invalid for uncertainty as to purposes and beneficiaries). It is difficult to discover the point of these cases. There is probably some concern, as we have seen in the case of indefinite beneficiaries, that there will be no one to enforce the trustee's duties. However, there are always the remaindermen, or the potential beneficiaries of a resulting trust, should the trustee not exercise the power of selection. See Palmer, The Effect of Indefiniteness on the Validity of Trusts and Powers of Appointment, 10 UCLA L. Rev. 241, 270 (1963). It should also be remembered that a non-charitable trust is subject to the rule against perpetuities, so there is not the same opportunity to sit

on the private trust without making distributions as there is in the case of charitable trusts. Professor Palmer concludes, consistently with common sense, that "[i]n most instances the trustee would conscientiously carry out the directions [of a trust for benevolent purposes] and there would be no occasion for judicial intervention except to approve an accounting." Id. at 269-70.

The question may be posed whether the state has a compelling interest in thwarting the intentions of testators and donors by the application of the more rigid rules traditionally prevailing in trust law as compared with the law of powers. Again, Professor Palmer:

> When the beneficiaries or purposes are vaguely defined, we must suppose that the testator intended it to be that way and to give the trustee a correspondingly wider discretion--a discretion to resolve doubts about eligibility. But this has not been the course of decision; Professor Scott was fully justified in writing in 1939 that in general, the test of definiteness is whether it would be practicable to divide the property in equal shares among the members of the group.

Id. at 274 (footnotes omitted).

In a partial attempt to deal with the problems of indefinite or general purposes, Section 123 of the Restatement (Second) of Trusts states the following rule:

> Where the owner of property transfers it in trust for indefinite or general purposes, not limited to charitable purposes, no enforceable trust is created, except as stated in § 398 (2-4) [see infra]; but if the transferee is authorized or directed to apply the property for such purposes, he has power so to apply it, unless the application is authorized or directed to be made at a time beyond the period of the rule against perpetuities, or the purpose is so indefinite that it cannot be ascertained whether any application falls within it.

Section 398 of the Restatement, referred to in Section 123, reads as follows:

> (1) Where by the terms of the trust the trustee is directed to apply the trust property to purposes which are not limited to charitable purposes but include non-charitable purposes for which a trust or power cannot validly be created, the intended trust fails altogether, except as stated in Subsections (2), (3) and (4).
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> (2) If the settlor manifested an intention that the whole of the trust property should be applied to charitable objects unless the trustee should choose to apply a part of it to non-charitable objects for which a trust or power cannot validly be created, and

his primary purpose was to apply it to the charitable objects, the power to apply the property to the other objects is invalid, and there is a valid charitable trust of the whole of the property.

(3) If it was not the primary purpose of the settlor to apply the property to charitable objects, but the maximum amount which would be required for the accomplishment of the non-charitable objects can be ascertained, the trust fails only as to the amount so required, and the charitable trust of the balance is valid.

(4) Where the trustee is directed to apply the trust property to several enumerated objects in such shares as he shall determine, and some of these objects are charitable but the others are non-charitable objects for which a trust or power cannot validly be created, the court will direct a division of the property into as many equal shares as there are objects enumerated, and the trusts of the share for the charitable objects are valid, but the trusts of the shares for the other objects fail, unless

(a) the primary purpose of the settlor was to apply the property to the non-charitable objects, in which case the whole trust fails (Subsection (1)), or

(b) the primary purpose of the settlor was to apply the property to the charitable objects, in which case there is a valid charitable trust of the whole of the property (Subsection (2)), or

(c) the maximum amount which would be required for the accomplishment of the non-charitable objects can be ascertained, in which case the charitable trust of the balance is valid (Subsection (3)), or

(d) an equal division would not be in accordance with what the settlor would probably have intended.

The staff proposes to codify the substance of these rules, with the intention of validating trusts for indefinite or general purposes. Such rules should apply to both testamentary and inter vivos trusts. The Commission may want to eliminate any restriction on the indefiniteness or generality of purposes. This would make trust law more symmetrical with the law of powers since the trustor would have the power to delegate the discretion to determine purposes as well as beneficiaries.

Respectfully submitted,

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