#L-640 9/11/84

Third Supplement to Memorandum 84-25

Subject: Study L-640 - Trusts (Comments on Oral Trusts)

Attached to this supplement is a letter from Professor Jesse Dukeminier amplifying his opposition to the proposal to abolish oral trusts and responding to staff comments made in the Second Supplement to Memorandum 84-25. (Professor Dukeminier's first letter is attached to the Second Supplement.) The staff has nothing new to say, except in response to Professor Dukeminier's argument that there is no evidence of "substantial fraud arising from oral trusts of personal property." (See Exhibit 1, p. 4.) By its nature, fraud of this sort would be hard to detect, so it would be difficult to furnish evidence of substantial fraud. A case in Indiana apparently convinced that state's Trust Code Study Commission to recommend abolishing oral trusts. See Ard, A Proposed Trust Code for Indiana--An Effort at Reform, 45 Notre Dame Law. 427, 442-44 (1970). In Hinds v. McNair, 235 Ind. 34, 129 N.E.2d 553 (1955), McNair resisted a judgment creditor's levy on his stock with the contention that the stock was held on an oral trust for his children. There was no evidence of the trust other than McNair's testimony. After a setback in the intermediate appellate court, McNair's oral trust was upheld by the Indiana Supreme Court since McNair's testimony was uncontradicted. The court suggested that legislative action might be the remedy:

> The Legislature, where it feels that usual opportunities for fraud exist has enacted statutes requiring a writing. Personal property trusts have never been included in such legislation in this state, however desirable we may think it would be to have such transactions in writing.

129 N.E.2d at 564. The minority opinion was more anxious about potential abuses:

> By holding that an oral trust may be established by the sole unsupported testimony of the settlor, given more than 21 years after the date on which the trust was allegedly formed, the majority opinion has opened wide the door to the unscrupulous for the perpetration of unlimited frauds.

129 N.E.2d at 565. Section 30-4-2-1 of the Indiana Trust Code now requires written evidence of the terms of a trust bearing the signature of the settlor or his authorized agent.

Respectfully submitted,

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September 6, 1984

Mr. John DeMoully
Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, CA 94306

Dear John:

Re: Second Supplement to Memorandum 84-25 (Oral Trusts)

Here is a reply to Stan Ulrich's staff memo replying to my letter suggesting oral trusts of personal property should not be abolished.

1. Oral trusts used to circumvent delivery. My letter suggested that oral trusts should not be abolished because, for one reason, they were useful in circumventing the requirement of delivery.

a. Using resulting and constructive trust doctrines. The staff reply suggests that imperfect delivery problems can be handled by resulting and constructive trust doctrines. I do not believe these doctrines can work in this context satisfactorily. (1) A resulting trust arises only in favor of the donor or his estate, not in favor of the donee. If the donor is dead when the issue is litigated, the donor will not have a second chance to satisfy the delivery requirement; the property will not go to the donee. (2) A constructive trust may arise from theft, fraud, breach of fiduciary duty, or confidential relationship, or from the claimant's detrimental reliance. Ordinarily none of these are involved in imperfect gift cases. In Cochrane v. Moore the gift cannot be given effect under either doctrine, I think. A resulting trust in favor of the donor, Benzon, would give the quarter interest to Benzon, not to Moore. A constructive trust seems not to work because there was no fraud or confidential relationship.

If constructive trust doctrine is to apply, some new variation on it will have to be developed by the courts. Is it wise to abolish a satisfactory, limited, workable device on the theory that the court can develop a new rule if it doesn't find the abolition satisfactory?

b. Questions re Cochrane v. Moore. The staff draft raises questions about this case worthy of a law professor discussing it in class. As to

"What was the situation between Benzon and Moore before Benzon sold the horse to Cochrane?", the court in the case refused to say. Lord Justice Fry said, "On these points we do not think it needful to express any decided opinion, because in our judgment what took place between Benzon and Cochrane [Cochrane's saying Moore's interest was "all right"], constituted the latter a trustee for Moore of one-fourth of the horse." So the trust arose when Moore said it was "all right."

As for the question of Cochrane's duties and liabilities, I suppose he has the usual ones. But it should be borne in mind that a court can avoid imposing any duties on Cochrane (for negligent destruction of the horse, for instance) by finding no trust was created. In any case, I regard these questions as peripheral. We all know what the beneficiary wants in these imperfect gift cases is the property given or the proceeds of sale. And, indeed, Moore was suing Cochrane for one-fourth of the proceeds of sale of this valuable race horse. The questions about duties of the trustee just never arise.

2. Other uses of oral trusts of personal property. Although in my earlier letter I suggested the impact of abolition of oral trusts would be felt in the undesirable tightening of the delivery requirement, abolition would also curtail several other uses of the oral trust. In the final paragraph of the staff reply, it is suggested that inter vivos trusts "are generally used as probate avoidance devices." Although I agree that written inter vivos trusts are often used as probate avoidance devices, as well as to achieve income tax benefits or to relieve the settlor of the burdens of property management, oral inter vivos trusts are not, in my experience, used generally, or even with some frequency, as will substitutes. I'd say they were used infrequently and are not quantitatively important.

Nonetheless, let's talk about oral trusts of personal property as will substitutes. There are three situations to be distinguished: (a) O declares O holds 100 shares of stock in trust for O for life, then to B; (b) O delivers 100 shares of stock to A, with A orally promising to deliver the stock to B upon the death of O; and (c) O executes a will bequeathing 100 shares of stock to A; A has made a promise to O to give the stock to B when A receives it. All of these oral trusts are will substitutes, though only the first two avoid probate.

With respect to situation (a), B has got to prove the trust by showing an expression of intention by O to become a trustee. It is my impression that the standard of proof required is high, and that B will likely lose unless O by some objective act shows an intent to hold on trust. The cases are few, indicating this will substitute is rarely used or alleged.

Situation (b) can create either an escrow or an oral trust, depending upon whether A is characterized as agent or as trustee. If A is an agent, the

escrow is generally valid unless A is the agent solely of O, in which case the agency expires at death, or unless O can revoke the escrow. These are purely technical difficulties, applicable to written as well as oral escrows, and not based on any policy of requiring sound evidence. They can be avoided by characterizing A as a trustee. If the oral trust is abolished, then all these technical problems about the validity of escrows take on new importance. And then--if you abolish the oral trust--why don't you abolish the oral escrow? The oral escrow has been given legal effect on the assumption that the testimony of the disinterested agent is believable and the condition ordinarily testified to (transfer stock on O's death) accords with our experience of what probably occurred. We deem the room for fraud minimum. Exactly the same thing can be said of the oral trust used in this situation. In fact, the oral escrow is more objectionable than the oral trust because if the agent testifies the escrow is revocable, the escrow fails; hence the validity of the escrow lies entirely in A's testimony. A trustee cannot defeat an oral trust by testifying that O could revoke it.

Situation (c) is the secret trust, valid in almost all jurisdictions. To prevent the unjust enrichment of A, evidence is admissible to show A's promise to hold in trust, and a constructive trust is, according to Restatement of Trusts, Second, § 55, Comment h, imposed for the benefit of B.

Is there any reason why these uses of the oral trust should be curtailed? The staff says you cannot have an oral will, and therefore it is consistent to ban an oral trust used as a will substitute. I have three responses. First, consistency is a virtue, but it has its costs in defeated intent and maybe higher costs in administering the Statute of Frauds. Second, consistency has to be defined in terms of evidentiary and ritual policies underlying the Statute of Wills and not in terms of specific acts. Wills require two witnesses signing at the same time, but many will substitutes are valid with one witness or none (life insurance or pension plan beneficiary designation, for example). It has been assumed that an oral inter vivos declaration of trust satisfied these policies because of the requirement that the trustee say the unusual words, "I hold in trust," or their equivalent, thus limiting its use as a will substitute to cases where the proof was very convincing. Is the staff attacking this assumption? If so, then the question is whether the oral trust of personal property opens opportunities for fraud, which I discuss below.

Finally, even if the oral trust is abolished, an "oral will" can still be made in California through the device of a "pour over," and "consistency" will not be achieved. Take this case. O executes a trust deed naming X as trustee, and naming B beneficiary. The trust deed provides that the trust can be revoked or amended at any time by a written or oral communication to X from O. O subsequently makes a will pouring over all his property into this trust. Then O invites X to come by his house for a

drink one afternoon. O tells X that at his death he wants X to give a painting to B, $10,000 to C, the family silver to D, and so forth. Under Cal. Prob. Code § 6300 (Uniform Testamentary Additions to Trusts Act), O's property is distributed in accordance with "any amendments" made to the trust. There is no requirement that the amendments be in writing, only a requirement that the trust instrument be in writing. Under the law of trusts, a trust can be revoked or amended in any manner specified in the trust instrument. Thus the oral amendments are valid, and this is in effect an oral will. If you are going to abolish the oral trust, are you going to recommend abolishing oral amendments to written trust instruments? If so, you are opening a whole new can of worms because oral amendments--in the form of waiving some provision of the trust instrument--are not infrequent.

3. Why abolish oral trusts? The staff's reply gives three reasons for abolishing oral trusts: (a) to simplify statutory trust law, (b) to avoid opportunities for fraud, and (c) "to improve the law of trusts so that the intention of the trustor can be determined from the instrument." I am not entirely sure, but I believe what the staff has in mind by (c) is that a requirement of a writing will "channel behavior" and tend to more efficient administration of the law.

I do not think something useful should be abolished just because it complicates matters a little (particularly where its abolition will introduce the complications of the Statute of Frauds). You have to rest your case for abolition, I think, on reason (b) or (c). If there is evidence of substantial fraud arising from oral trusts of personal property, you can make a good case for abolishing them. I have seen no such evidence, and doubt that it exists.

At bottom, I think you have to stand or fall on your argument (c), which you say is "by no means insignificant." I agree. The channeling function of requiring a writing should not be ignored. The question, however, is whether the efficiency resulting from channeling outweighs the resulting costs. Two types of costs will result from requiring a writing. First, there are the costs of introducing the complexities of the Statute of Frauds into trusts of personal property. Anyone who has read the cases, and the conflicting rules and hair-splitting distinctions, on whether a constructive trust will be imposed on A where O conveys real property to A upon an oral trust for B, will tread warily here. The litigation is extensive on when the Statute of Frauds will be circumvented and in what way. Scott § 45 has dozens of cases on the matter and Bogert has more. Second, there are the costs of not carrying out the transferor's intent when the evidence of that intent is clear and convincing.

The abolition of oral trusts of personal property goes contrary to the trend to open wider holes in the Statute of Frauds. The erosion of the Statute of Frauds promises to continue. Many critics believe that the

Statute promotes fraud rather than prevents it, and is inefficient because of its complexities. In any event, we should be cautious in applying the Statute where it has never been applied before, particularly where the consequences may not be seen for several years.

It is this cautious approach that leads me to conclude that oral trusts should not be abolished. The costs and the consequences are not wholly known or predictable. The present evil, if any, seems minuscule.

Sincerely,

Jesse Dukeminier
Professor of Law

JD:mrs