

Memorandum 85-40

Subject: Study L-640 - Trusts (Transitional Provisions)

Attached to this memorandum as Exhibit 1 is a complete draft of the transitional provisions proposed for the comprehensive trust statute. Sections 520 to 522 repeat material set out in the draft attached to Memorandum 85-32. Section 521 makes the new law applicable to all trusts regardless of their date of creation, except as otherwise provided by statute. The proposed sections in Exhibit 1 preserve the old law for existing trusts in circumstances where it would be unfair to apply a new rule. Typically, this involves a new rule that the trustor could have avoided by drafting had he or she known of it, such as the rule providing for administration by a majority of cotrustees. Some cases involve reliance of persons on an existing rule where it would be unfair to retroactively apply a new rule, such as, for example, where third persons contract with the trustee. However, some changes involve matters of public policy, such as the elimination of the conclusive presumption of fertility in relation to modification and termination.

The following discussion considers areas where the staff has tentatively concluded that there is no need for a transitional provision, but where there may be differing views. References are to the comprehensive draft statute attached to Memorandum 85-32, except as noted.

§§ 604-605. Indefinite purposes and beneficiaries

The rules in these sections would make valid some trusts that are probably not valid under existing law. For example, under Section 605(b)(2) a trust for the trustor's friends could be valid. These changes in the law are proposed as a matter of policy and should apply to all trusts.

§ 607. Oral trusts of personal property

Subdivision (b) has not been approved by the Commission, but if it is, it should apply to all trusts. This provision would require some corroborative evidence of creation of an oral trust, in addition to the oral declaration of the trustor, where the property is not actually transferred. A person who is found to have created an oral trust does not have a reliance interest in the law governing creation of oral

trusts that would require the looser requirements of existing law to be preserved.

§ 641. Manner of termination of revocable trust

This section would change the law by requiring a specific provision in the trust to exclude the statutory manner of revocation. Under existing law, the provision of a manner of revocation in the trust excludes the statutory method without more. The old rule should be preserved for trusts created before the operative date. This means that revocable inter vivos trusts created before July 1, 1987, would be subject to the old rule. See draft Section 523 in Exhibit 1.

§ 643. Termination by all beneficiaries

This section provides a degree of discretion to the court in determining whether the trust should be terminated notwithstanding a material purpose that has not been accomplished. This discretion is not available in the case of a spendthrift trust. This rule should apply to all trusts since it is a matter of public policy and is not directly subject to trustor avoidance.

§ 645. Guardian ad litem

This section expands the grounds upon which a guardian ad litem may consent on behalf of incapacitated, unascertained, or unborn beneficiaries. This is a matter of public policy, and should apply to all trusts. It is not known whether California courts might or might not create such rules in appropriate circumstances if the case were presented, so this section may anticipate change, rather than make it.

§ 646. No conclusive presumption of fertility

This section makes the presumption of fertility rebuttable as a matter of public policy and should apply to all trusts.

§ 647. Effect of disposition in favor of "heirs" or "next of kin" of trustor

This section in effect presumes that a disposition in favor of the trustor's heirs or next of kin means those persons in being at the time the consent of beneficiaries to a modification or termination is sought. It would be best to make this apply to all trusts so as to avoid complications from having two rules. However, it might be argued that a trustor may have intended to include unborns and would have drafted the trust differently if he or she had known of the rule in Section 647. Against

this it might be said that a trustor who uses "heirs" or "next of kin" is not likely to have known of this rule anyway. The staff would make this section apply to all trusts.

§ 651. Modification or termination owing to change of circumstances

This section expands the power of the court to approve a modification of administrative or dispositive provisions or the termination of the trust. The staff views this as a matter of public policy, and would make this section applicable to all trusts. This section is drawn in recognition of the fact that modification or termination is on its face contrary to the trustor's intent. However, the section looks to the trustor's underlying purposes in determining whether to modify or terminate, and in that light, does not defeat any reliance interest of parties to the trust.

§§ 700-713. Trustee's duties in general

Although the language differs from that of existing law, the general law relating to trustees' duties is not significantly altered by the draft statute. Accordingly, there is no identifiable aspect of these statements of duties that should be restricted to post-operative date trusts.

§ 720. Trustee's standard of care in administering trust

This section continues existing law, as revised effective January 1, 1985. These changes, as well as earlier revisions of Civil Code Section 2261, have applied to all trusts. The draft statute continues this policy by operation of draft Section 521.

§ 731. Duty to account annually to income beneficiary

The annual accounting requirement is new and is subject to control by the trustor. Accordingly, it should apply only to post-operative date trusts. See draft Section 524 in Exhibit 1.

§§ 800, 820. Automatic powers

The draft statute provides a set of automatic powers and also the general powers of a prudent person without the need to provide them in the trust. In a general sense, this reverses the approach of existing law. It should be remembered that the implied powers doctrine gives trustees powers not specified in the trust where necessary to accomplish the purposes of the trust. In addition, the trustee could petition the court for relief from a restriction on the exercise of powers. However,

since the powers of a trustee are subject to some degree of control in the trust instrument, it appears best to make the automatic powers doctrine applicable only to post-operative date trusts. See draft Section 525 in Exhibit 1.

§ 804. Incorporation of powers

This section is a transitional provision that should be moved to draft Section 525.

§ 902. Revised Uniform Principal and Income Act

The RUPIA rules are subject to control in the trust instrument. Accordingly, any changes made in the RUPIA should apply only to post-operative date trusts. This means that the rules on apportionment of rent, interest, and annuities (Section 905), carrying forward losses (Section 909), and limiting the allowance for depletion of certain natural resources (Section 910) should apply only to post-operative date trusts. See draft Section 526 in Exhibit 1.

§ 915. Application of chapter

This section should be deleted because it is unnecessary. Section 521 makes clear that the entire statute applies to all trusts, regardless of when created, except as otherwise provided. As just discussed, certain new rules will apply only to post-operative date trusts, but the old RUPIA would continue to apply to all pre-operative date trusts. Hence, this old transitional provision which made the RUPIA applicable to receipts and expenditures under pre-existing trusts is not needed.

§ 951. Liability of trustee for acts of agents

The substance of this provision is still under consideration. However, in questions of liability, it might be best to limit the application of the rules to acts or omissions occurring after the operative date. It is doubtful that there will be such a significant change in these rules that the reliance interest of a trustee would be violated. On the other hand, there is no crucial policy change being made in this section that would argue for retroactive application. On balance, the staff thinks it is best to apply this section only prospectively. See draft Section 527 in Exhibit 1.

§ 952. Liability of trustee for acts of cotrustee

The analysis of this section parallels that for draft Section 951. See draft Section 527 in Exhibit 1.

§ 960. Remedies for breach of trust

The list of remedies for breach is a catalogue of existing remedies and remedies available under general law. A breaching trustee has no vested right in suffering a particular remedy, so this section should apply to all trusts and to breaches occurring before or after the operative date. Note that draft Section 521(b) applies the new law to pending proceedings, but not where the court finds that application of a particular provision would substantially interfere with the rights of the parties.

§§ 970-973. Accountability and measure of liability

The rules on accountability and liability in the draft statute are different in form, but not greatly different in substance, from those of existing law. It should be noted, however, that this view is not shared by all who have studied these materials. On balance, the staff believes that the draft statute limits the liability of trustees, more than it expands it. The staff would apply these rules to all trusts and to actions occurring before or after the operative date.

§ 980. Limitations on proceedings against trustees

This section shortens the statute of limitations from a general four-year statute (in the absence of approval of an account by the court) to one year running from full disclosure or when the beneficiary discovered or should have discovered the subject of the claim. Application of this rule to breaches occurring before the operative date might deprive beneficiaries of their rights. Accordingly, this section should apply only to claims arising after the operative date. See draft Section 528 in Exhibit 1. An alternative would be to provide a grace period of one or two years for filing petitions on pre-operative date claims, but this might be more confusing than helpful.

§ 1010. Actions by cotrustees

An existing trust that is silent on the matter requires cotrustees to act unanimously. This rule should be preserved for pre-operative date trusts. Trusts created after the operative date will encounter a reverse rule so that silence on the matter results in administration by majority. See draft Section 529 in Exhibit 1.

§ 1103. Jurisdiction over trustees and beneficiaries

This section embodies a consent feature whereby acceptance of the trusteeship by the trustee or of benefits by the beneficiary results in personal jurisdiction. In theory, there might be thought to be some violation of the rights of the trustee or beneficiary who accepts the trust or an interest in the trust before the operative date, but the staff does not think this is of practical significance. Accordingly, we would not limit application of this provision to post-operative date trusts.

§ 1130. Petitioners; grounds for petition

The procedure provided in this section and its companions should be available to all trusts regardless of when created (except as otherwise provided in the special rules on testamentary trusts subject to continuing court jurisdiction). This is consistent with the Commission's decision that the trust instrument should not have the option of making these proceedings unavailable, as is permitted by existing Probate Code Section 1138.1(b). This rule is necessary under the draft statute since the proceedings under draft Section 1130 et seq. are exclusive, whereas a beneficiary may proceed by a formal action under existing law.

§ 1200. Personal liability of trustee to third persons on contracts

This section alters the existing rule that the trustee is personally liable on a contract unless the contract provides otherwise. Accordingly, there is a possibility of a reliance interest of persons dealing with trustees and the new rule should apply only to contracts entered into after the operative date. See draft Section 530 in Exhibit 1. The other liabilities governed by this chapter of the draft statute are not subject to control by the parties, nor is there an identifiable reliance interest, so no special transitional provision is called for.

§§ 1120-1221. Rights of creditors of trustor

These sections apply new rules. However, they should apply to all trusts as a matter of public policy. This area of the law is unsettled in California, so there is no identifiable reliance interest on the part of trustors or their beneficiaries who might desire to defeat the claims

of creditors. It is also conceivable that the California courts, if called upon to do so, would follow the courts of Massachusetts and Oregon in declaring rules equivalent to those in the draft statute.

Respectfully submitted,

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EXHIBIT 1

100/958

CHAPTER 2. TRANSITIONAL PROVISIONS

Article 1. Application of Division 3 and Transitional Provisions

§ 520. Definitions

520. As used in this article:

(a) "Operative date" means July 1, 1987.

(b) "Prior law" means the applicable law in effect on June 30, 1987.

Comment. Section 520 is drafted on the assumption that Division 3 (commencing with Section 500) will become operative on July 1, 1987.

15918

§ 521. General rule concerning application of division

521. Except as otherwise provided by statute:

(a) This division on and after its operative date applies to all trusts regardless of whether they were created before, on, or after the operative date.

(b) This division on and after its operative date applies to all proceedings concerning trusts commenced before the operative date unless in the opinion of the court application of a particular provision of this division would substantially interfere with the effective conduct of the proceedings or the rights of the parties and other interested persons, in which case the particular provision of this division does not apply and prior law applies.

Comment. Section 521 provides the general rule governing the application of this division to existing trusts and pending proceedings. Subdivision (a) continues the substance of the first sentence of subdivision (e) of former Civil Code Section 2261 and the first sentence of former Probate Code Section 1138.13. Subdivision (a) is also comparable to Section 8 of the Uniform Trustees' Powers Act (1964). Subdivision (b) is drawn from Code of Civil Procedure Section 694.020 (application of Enforcement of Judgments Law). For provisions governing trusts subject to continuing jurisdiction of the court, see Article 2 (commencing with Section 540). See also Section 82 ("trust" defined).

§ 522. Interpretation of trust terms concerning legal investments

522. If a trust created before or after the operative date refers to investments permissible or authorized by law for investments of trust funds or to legal or authorized investments, or uses other words of similar meaning in defining the powers of the trustee relative to investments, such language, in the absence of other controlling or modifying provisions of the trust instrument, shall be construed as authorizing any investment permitted under Chapter 2 (commencing with Section 800) of Part 3.

Comment. Section 522 continues the substance of the second sentence of subdivision (e) of former Civil Code Section 2261.

Note. Sections 520-522 have already been considered by the Commission. These sections are also set out in the draft statute attached to Memorandum 85-32, but are duplicated here for convenience of reference. The following provisions have not been considered by the Commission and reflect staff recommendations as discussed in Memorandum 85-40:

4644

§ 523. Application of rules governing manner of revocation

523. The manner of revocation of a trust revocable by the trustor that was created by an instrument executed before the operative date is governed by prior law and not by Section 641.

Comment. Section 523 preserves the prior law governing the manner of revocation. Hence if the trust provides the manner of revocation, the statutory method is not available. See the Comment to Section 641. See also Section 520(a) ("operative date" defined), 520(b) ("prior law" defined).

4628

§ 524. Application of duty to account annually to income beneficiary

524. A trustee of a living trust created by an instrument executed before the operative date, or of a trust created by a will executed before the operative date and not republished thereafter, is not subject to the duty to account annually provided by Section 731.

Comment. Section 524 makes clear that the annual accounting required by Section 731 does not apply to pre-operative date trusts. This does not affect any requirement for an accounting that may exist under prior law, whether pursuant to statute or court order. See, e.g., former Section 1120.1a(b). See also Section 520(a) ("operative date" defined).

4468

§ 525. Application of rules governing trustee's powers

525. (a) The powers of a trustee of a living trust created by an instrument executed before the operative date, or of a trust created by a will executed before the operative date and not republished thereafter, are governed by prior law and not by Section 820.

(b) An instrument that incorporates the powers provided in former Section 1120.2 shall be deemed to refer to the powers provided in Article 2 (commencing with Section 820) to the extent that these powers were provided by former Section 1120.2.

Comment. Subdivision (a) of Section 525 makes clear that the automatic powers afforded trustees by Section 820 are not available to trustees under pre-operative date trusts. See Section 520(a) ("operative date" defined), 520(b) ("prior law" defined). A trustee may be relieved from the restrictions of former law, however, pursuant to Section 801.

Subdivision (b) clarifies the effect of references in instruments to the former provisions listing trustees' powers.

Note. Subdivision (b) is the same as Section 804 in the draft statute attached to Memorandum 85-32. This provision is better located here.

4447

§ 526. Application of Revised Uniform Principal and Income Act

526. With respect to the allocation of receipts and expenditures to income or principal, the administration of a living trust created by an instrument executed before the operative date, or of a trust created by a will executed before the operative date and not republished thereafter, is governed by prior law and not by Chapter 3 (commencing with Section 900) of Part 3.

Comment. Section 526 makes clear that pre-operative date trusts are not subject to the changes that have been made in the Revised Uniform Principal and Income Act. See, e.g., Sections 905 (apportionment of income), 909 (business and farming operations), 910 (natural resources), and the Comments thereto. See also Section 520(a) ("operative date" defined), 520(b) ("prior law" defined).

§ 527. Application of rules governing liability of trustee for acts of agents and cotrustees

527. The liability of a trustee for acts or omissions of agents and cotrustees that occurred before the operative date is governed by prior law and not by Section 951 or 952.

Comment. Section 527 preserves the prior law governing the trustee's liability for acts or omissions of agents occurring before the operative date. See Sections 951 (trustee's liability for acts of agents), 952 (trustee's liability for acts of cotrustees). See also Section 520(a) ("operative date" defined), 520(b) ("prior law" defined).

§ 528. Application of limitations period in proceedings by beneficiaries against trustees

528. The limitations period applicable to actions by a beneficiary against a trustee on a claim that arose before the operative date is governed by prior law and not by Section 980.

Comment. Section 528 makes clear that the one-year statute of limitations provided by Section 980 does not apply to claims arising prior to the operative date. See Section 520(a) ("operative date" defined), 520(b) ("prior law" defined).

§ 529. Application of rule governing actions by cotrustees

529. Exercise of a power vested in three or more trustees of a living trust created by an instrument executed before the operative date, or of a trust created by a will executed before the operative date and not republished thereafter, is governed by prior law and not by Section 1010.

Comment. Section 529 preserves the unanimous action rule of former Civil Code Section 2268 for pre-operative date trusts, subject to a contrary provision in the trust instrument. See Section 520(a) ("operative date" defined), 520(b) ("prior law" defined).

§ 530. Application of rule governing personal liability of trustee to third persons on contracts

530. The personal liability of a trustee on a contract entered into prior to the operative date is governed by prior law and not by Section 1200.

Comment. Section 530 preserves the case law rule governing a trustee's personal liability on contracts for pre-operative date contracts. See the Comment to Section 1200. See also Section 520(a) ("operative date" defined), 520(b) ("prior law" defined).