

Memorandum 90-1

Subject: Study L-644 - Recognition of Trustee's Powers

We have received a suggestion for revision of the Trust Law. In brief, the proposal would seek to make the statutory grant of trustees' powers more effective by making third persons liable for costs and attorney's fees incurred in proceedings necessary to establish the existence of a statutory power. James R. Provenza, Counsel to the Senate Committee on Judiciary, recently forwarded this suggestion for revision of the Trust Law by Florence J. Luther of Fair Oaks. In a letter to Senator Lockyer, Ms. Luther's makes the following remarks:

I have been reading some of the recent probate legislation in which you were involved and find of great interest many of the constructive changes in the Probate Code.

There is one section I would like to refer you to to see if you feel an amendment or an addition to that section would be appropriate under the circumstances.

I refer to Probate Code Section 16200 and the sections that follow relating to the general powers of the Trustee and in particular the powers as set forth in Sections 16200 to and including 16249.

In drafting many of the Revocable Living Trusts which I have prepared for many years, I very often make a general statement that the Trustee shall have all of the powers now or hereafter conferred by the laws of the State of California and, in addition, powers as numerated in the Trust. On occasion some of the powers as enumerated in the Probate Code have not been specifically set forth in the Trust, in order to save expenses for the client, time and other incidental matters, since it did seem repetitious to repeat many of the powers that the law does give the Trustee in any event.

In dealing with title companies I have had recent occasion for the title company to refuse to acknowledge the specific powers of the Trustees as set forth in Section 16200 and the sections that follow and require that the power either be specifically in the Trust itself or require, at the expense of the client, amendments to the Trust.

I would like to suggest that a provision could be added to the section dealing with the powers of the Trustee similar to the section we have in dealing with a small estate, Section 13105(b), where if the holder of decedent's property refuses to pay or deliver upon the presentation of forms as set forth in the code, an action may be brought against the holder of the property or, the Court may award attorney fees to the person or persons bringing the action if the Court finds that the holder of the property acted unreasonably. I realize these are not similar sections in any manner, but I am simply pointing out that I feel that a similar appropriate section should be included in the powers of the Trust to the effect that any person refusing to acknowledge that these powers are given in the Code and refusing to accept said powers without a Court approval which, the law is trying to avoid in Section 16203, may be liable for attorney fees and expenses incurred in securing this power that was, in fact, in existence and not prohibited by the Trust, and a reading of the Code would have educated anyone in a title company or similar institution who should have a knowledge of this section of the California Probate Code.

Under prior law, the trustee had the powers specified in the trust instrument (or incorporated by reference) and additional necessary or desirable powers granted by court order. However, Section 16200 in the Trust Law (enacted on recommendation of the Commission in 1986) provides for automatic statutory powers, without the need for court authorization, except as the statutory powers may be limited in the trust instrument. The automatic powers scheme is intended to avoid the need to petition the court to repair an inadequately drafted trust. This approach is in line with modern trust law in which the focus is not on powers but on duties. As the Trust Law makes explicit, even if the trustee has the explicit power to do something, the trustee is not permitted to exercise the power if it would violate the trustee's fiduciary duties. See Section 16202. In addition, the Trust Law contains a series of sections designed to improve the ability of trustees to deal with trust property by relieving third persons of any duty to enforce the trust that might be thought to exist. Hence, Section 18100 makes clear that a third person acting in good faith and for a valuable consideration is not required to inquire whether the trustee has power to act or is properly exercising the power and is permitted to assume without inquiry that the trustee has the power and is properly exercising it.

The remarks of Ms. Luther, however, suggest that these reforms may not be enough, and that, at least in the case of some title companies, the relief from liability provided by Section 18100 is not sufficient to make the third person accept the trustee's power. Perhaps out of an abundance of caution or from habit, it would appear that certain third persons are defeating the intention of the automatic powers scheme by requiring a judicial grant of powers.

We do not know, of course, how widespread or serious this problem might be. One way to find out would be to circulate a tentative recommendation along the lines suggested by Ms. Luther. Accordingly, the staff has prepared a draft tentative recommendation for Commission consideration. The draft is attached to this memorandum. It would be useful, if the Commission approves circulation of this tentative recommendation, to include a letter of transmittal in substantially the following form:

Letter of Transmittal

In order to make the statutory list of trustees' powers more effective, this tentative recommendation would make third persons liable for costs and attorney's fees incurred by the trustee in court proceedings to confirm the existence of a statutory power where the third person unreasonably refuses to accept the existence of the power. The Commission is informed that some third persons are unwilling to rely on the automatic statutory powers and the relief from liability and any duty of inquiry provided the third person by the Trust Law. The Commission is interested in learning whether, in the experience of those commenting on this tentative recommendation, this problem is a significant one that merits a legislative solution.

It should be noted that the draft recognizes that there may be legitimate concerns on the part of the third person, such as where trust instrument is unclear or contradictory. Thus, the draft imposes liability on a third person only if the third person unreasonably refuses to accept the existence of the trustee's power. The proposed liability section is also limited to the specific list of automatic powers set forth in Probate Code Sections 16220-16249 so that the third person can have the necessary certainty to determine whether the statutory power is applicable to the situation.

If the Commission wishes to make a recommendation on this subject, the staff envisions that it could be included in a probate bill, such as the inevitable clean-up bill, in the 1991 session.

Respectfully submitted,

Stan G. Ulrich
Staff Counsel

Staff Draft

TENTATIVE RECOMMENDATION

relating to

LIABILITY FOR FAILURE TO ACCEPT TRUSTEE'S POWERS

The Trust Law provides a set of statutory powers that are automatically granted a trustee, except to the extent that the powers are limited in the trust instrument.¹ This automatic powers scheme is intended to avoid the need for the trustee to petition the court for a grant of needed powers where the trust instrument was inadequately drafted or failed to anticipate the need for a particular power.² The Trust Law focuses on the trustee's duty to exercise powers consistent with fiduciary principles, rather than on the question of whether a power has been granted by the trust, as under former law.³

The Trust Law also protects third persons who deal with the trustee in good faith and for value and without actual knowledge that the trustee is exceeding the trustee's powers or exercising them improperly.⁴ The statute makes clear that the third person does not

1. Prob. Code §§ 16200(b), 16220-16249.

2. See *Recommendation Proposing the Trust Law*, 18 Cal. Law Revision Comm'n Reports 501, 543-44 (1986).

3. See former Civil Code § 2267; former Prob. Code § 1120.2. Under former law, the trustee had only the powers conferred by the trust instrument and a few statutory powers, unless additional powers were granted by the court. See *Recommendation Proposing the Trust Law*, 18 Cal. L. Revision Comm'n Reports 501, 543 (1986).

4. Probate Code Section 18100 provides:

18100. With respect to a third person dealing with a trustee or assisting a trustee in the conduct of a transaction, if the third person acts in good faith and for a valuable consideration and without actual knowledge that the trustee is exceeding the trustee's powers or improperly exercising them:

(a) The third person is not bound to inquire whether the trustee has power to act or is properly exercising a power and may assume without inquiry the existence of a trust power and its proper exercise.

have a duty to inquire into the existence or manner of exercise of the power. Protecting persons acting in good faith in transactions with a trustee brings trust law into conformity with modern developments in the law applicable to negotiable instruments, securities, and bank accounts.⁵

These elements of the Trust Law were intended to improve the efficiency of transactions between trustees and third persons and to avoid the expense and delay that result from the need to petition for court confirmation of the existence of a power. However, the Commission is informed that this purpose is being thwarted in some cases by overly cautious third persons who are unwilling to rely on the automatic statutory powers and the relief from liability and any duty of inquiry provided by the Trust Law. Accordingly, the Commission recommends that the Trust Law be revised to provide that a third person who unreasonably refuses to accept the exercise of a statutory trustee's power is liable for costs and attorney's fees incurred in proceedings necessary to obtain court confirmation of the power.

(b) The third person is fully protected in dealing with or assisting the trustee just as if the trustee has and is properly exercising the power the trustee purports to exercise.

5. See *Recommendation Proposing the Trust Law*, 18 Cal. L. Revision Comm'n Reports 501, 593 & n.374 (1986).

PROPOSED LEGISLATION

The Commission's recommendation would be effectuated by enactment of the following measure:

An act to add Section 18105 to the Probate Code, relating to trusts.

The people of the State of California do enact as follows:

Probate Code § 18105 (added). Liability for unreasonable refusal to accept exercise of statutory trustee's power

SECTION 1. Section 18105 is added to the Probate Code, to read:

18105. If a third person dealing with a trustee unreasonably refuses to accept the exercise of a trustee's power provided in Article 2 (commencing with Section 16220) of Chapter 2 of Part 4 of Division 9, the third person is liable for costs and attorney's fees incurred in any action or proceeding necessary to confirm the existence of the statutory power.

Comment. Section 18105 is a new provision intended to make more effective the statutory grant of trustees' powers. See Sections 16200(b) (statutory powers granted, except as limited by trust instrument), 16220-16249 (statutory powers of trustees). A third person is liable under this section only where the refusal to accept the existence of the trustee's statutory power is unreasonable. Thus, a third person is not liable under this section where a question arises concerning a power granted only in the trust instrument, or where there is legitimate doubt about whether the trust instrument contains a limitation on the exercise of one of the statutory powers set forth in Sections 16220-16249.