Memorandum 91-29

Subject: Study L-3010 - Legislative Program -- SB 896 (Urgency Bill) (California Bankers Association Proposal Concerning Trustees' Fees)

Attached to this memorandum is a letter from David Lauer on behalf of the California Bankers Association requesting inclusion of several amendments in the Commission's urgency probate clean-up bill to deal with problems CBA sees in the trustees' fees legislation that becomes operative on July 1, 1991, as part of the new Probate Code.

The specific amendments proposed by CBA would make the following changes in Probate Code Section 15686:

> Prob. Code § 15686. Notice of increased trustee's fee
>
> 15686. (a) As used in this section, "trustee's fee" ~~includes, but is not limited to,~~ means the trustee's periodic base fee, rate of percentage compensation, minimum fee, hourly rate, and transaction charge, but does not include fees for extraordinary services.
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> (b) A trustee may not charge an increased trustee's fee for administration of a particular trust unless the trustee first gives at least 60 days' written notice of that increased fee to each beneficiary ~~of the trust whose interest may be affected by the increased fee~~ who is entitled to statements of accounts pursuant to Section 16062. If a beneficiary has a conservator, or has designated to the trustee an attorney in fact to receive such notice, such notice shall be sent to the conservator or attorney in fact.
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> (c) If a beneficiary files a petition under Section 17200 for review of the increased trustee's fee or for removal of the trustee and serves a copy of the petition on the trustee before the expiration of the 60-day period, the increased trustee's fee does not take effect as to that trust until otherwise ordered by the court or the petition is dismissed.

The threshold problem is that the urgency clean-up bill cannot contain controversial matters. Those who worked on the trustees' fees project will remember that it was not devoid of controversy. The subject was considered from time to time beginning in March 1987, through the introduction of legislation in 1989, and beyond. Major issues included the definition of trustee's fee, who should get notice

of a proposed fee increase, and the mechanism for objecting to an increase. These are among the issues presented in the CBA letter. A quick review of comments from bar associations in our files also suggests that the changes proposed by CBA are not noncontroversial.

Definition of Trustee's Fee

CBA is concerned that the open-ended nature of the definition in Section 15686(a) puts a trustee "in the position of being second guessed later, when an increased expense not controlled by the Trustee arguably could be covered by the notice provision." (Exhibit 1, p. 1.) It is not clear to the staff exactly what sort of expense CBA is concerned about. The statute does not attempt to distinguish between fees that are increased to pass on some expense of doing business or governmental regulation or for any other cause. This would be impracticable.

Several early drafts did use "means" rather than "includes." The language was worded in its present form following a meeting on February 28, 1989, between the staff and nine bank representatives. At that meeting, the attempt to define "transaction charges" was abandoned and the exclusion of fees for extraordinary services was included in the proposed statute. The Commission approved this language at its April 1989 meeting and it was enacted in that form.

At this stage, the staff does not feel too strongly about the CBA proposal to change the verb in the definition to "means." The language of the definition is broad and covers the general categories of fees that we were aware of when the statute was drafted. It is difficult to imagine something not included in substance, although language could change. For example, a bank might assess a "service charge." Is that covered if the statute is revised as CBA suggests? We believe it would be, and that a bank would be foolhardy to attempt to avoid the statute by renaming a class of fees to fall outside the specific statutory language. In other words, the staff could live with this revision. This follows because we see the change as innocuous -- we do not see it as an urgency matter. However, if interested persons can agree on this point, the amendment to subdivision (a) of Section 15686 could be included in the urgency measure.

Which Beneficiaries Are Entitled to Notice?

CBA suggests restricting the class of beneficiaries entitled to notice of an increased fee to persons entitled to accounts under Section 16062. (Exhibit 1, p. 2.) CBA argues that it is inconsistent to require notice of an increased fee to go to beneficiaries who are not entitled to accountings. CBA makes the point that the management of the trust as reflected in the accounting is potentially a much more important matter than a minimal change in a transaction charge. This is a strong argument. The only problem we have is that not all fee increases are minimal -- consider, for example, the magnitude of a ad valorum fee increase from 1% to 1.25%. Past efforts to distinguish between de minimis and significant fee increases were abandoned in favor of the current statutory structure, we think with the agreement of most, if not all, interested parties.

The intention of the rule requiring notice to any beneficiary whose interest would be affected by the increased fee is self-evident. Those whose interests are liable for the fee should have notice of a proposed increase. Early drafts provided for broader notice, requiring notice to all beneficiaries. The "affected interest" standard was included to limit the necessary notice in cases where, for example, all fees were paid from income. (Minutes, January 1989.) In such a case, it is not necessary to give notice to principal beneficiaries.

Section 16062(a) provides for accounts "to each beneficiary to whom income or principal is required or authorized in the trustee's discretion to be currently distributed." In practical terms, the staff does not see anything wrong with the CBA proposal to give notice only to this class of beneficiaries, since a trust where the fees are all paid out of the principal account seems unlikely (though possible). We assume as a general rule that notice to present income beneficiaries is most likely to be effective. But it should be noted that concern was expressed by bar representatives at past meetings about the rights of remainder beneficiaries. This touches on the threshold issue of the controversial nature of the CBA proposal.

Further study might lead to the conclusion that a more appropriate class for notice of an increased fee is the class of persons whose consent is required for a trustee's resignation under Section 15640(c)

-- all adult beneficiaries who are receiving or are entitled to receive income under the trust or to receive a distribution of principal if the trust were terminated at the time notice is given. This protects the interests of both income and principal beneficiaries and also eliminates minors. Other alternatives might be developed. Any change in the statute should consider all the reasonable alternatives and be made only after interested persons have had a chance to react.

Notice to Minors

The CBA letter expresses concern about sending notice to minors who are children of persons who are already receiving statements. (Exhibit 1, p. 2.) CBA is concerned about the expense of such notice and the need to "monitor the existence of newly born contingent beneficiaries who may never receive any interest in the trust at all." Some clarification is appropriate here. Multitudes of contingent minor beneficiaries should not be given notice unnecessarily. But the policy of the statute has been to attempt to ensure that both income and remainder interests are notified if these interests are liable for the fees. The problem is how to accommodate these competing interests.

Section 15804 (virtual representation) provides a useful rule and should apply to this type of situation. Under Section 15804, a minor child or any other issue of an income beneficiary who is receiving notice of the increased fee would not need to be given notice, barring a conflict of interest between them. Section 15804 also provides that notice is required to be given only to the contingent beneficiaries in a class who would take if the contingency occurred immediately before "the commencement of the proceedings." This language is not fully descriptive of the notice of increased fee, however, since the notice is not really a "proceeding." This could be clarified.

This discussion points up the fact that a number of different approaches to the problem are possible, and more may be developed. The staff is hesitant to endorse any of the several possible approaches on a rush basis.

Notice to Conservators, Guardians, or Attorneys in Fact

CBA suggests that it be "clearly stated that notices to conservators, guardians or attorneys in fact, if appointed, are legally

sufficient." (Exhibit 1, p. 2.) The letter suggests that this be stated in Section 15686 or broadened to cover the provisions for accounting to beneficiaries generally.

Probate Code Section 1210 provides for notice to the guardian or conservator of the estate of an interested person. "Interested person" is defined in Section 48(a) to include trust beneficiaries. The general notice provisions in Sections 1200 *et seq.* apply to the Trust Law, as provided in Section 17100. Thus, we believe the law as to guardians and conservators to be essentially what CBA advocates.

The issue as to attorneys in fact would seem to be a general problem, not local to notices of increased fees or to the Trust Law. We note that Code of Civil Procedure Section 416.90 permits service of process on an agent appointed for that purpose. Whether this provision is of any use in the case of notices under Probate Code Section 15686 is not clear. The general rules of civil procedure are applicable to the Probate Code where the Probate Code does not provide its own rule. Prob. Code § 1000. If service on attorneys in fact is a genuine problem, it would seem to call for a solution like the general rule in Section 1210 for guardians and conservators. The staff is reluctant to attempt to solve a general problem in only one section or in one part of the code. If the law concerning the legal effect of notices sent to attorneys in fact is unclear, perhaps it should be addressed throughout the Probate Code. In any event, we do not see this as an urgency matter.

Respectfully submitted,

Stan Ulrich
Staff Counsel

California Bankers Association

Memo 91-29 EXHIBIT 1 Study L-3010

April 3, 1991

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California Law Revision Commission
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Re: Probate Code Section 15686 - Notice of Trustee Fee Increase
California Bankers Association
Proposed Amendment

Dear Stan:

This letter will serve as a written follow-up to the meeting of March 19, 1991 at which you, Paulette Leahy and I were in attendance.

As we discussed at our meeting, the California Bankers Association, (the "CBA") believes that certain provisions of new Probate Code Section 15686 require important clarification which the CBA requests be made in the Commission's "clean-up" amendment to the Trust Law. The CBA is hereby requesting that the Law Revision Commission add these amendments to the urgency bill which the Commission is currently proposing for enactment effective July 1, 1991. In the interest of clarity, I am attaching a copy of the changes which the CBA strongly recommends. The specific changes are underlined on the attachment.

The changes, and the reasons for which the CBA believes these changes to be necessary, are summarized as follows:

1. Changing the provision "trustee fees include, but are not limited to" to "trustee fee means": Since the current version of the statute includes a complete list of trustee fees, it is unnecessary to leave open to interpretation whether there are any additional "charges" to be included. Trustees need certainty as to what the statute requires, and should not be put in the position of being second guessed later, when an increased expense not controlled by the Trustee arguably could be covered by the notice provision.

2. Notice change requirement to include only persons receiving statements pursuant to Probate Code Section 16062. This change brings consistency to the Trust Law and conforms the fee increase notice to Section 16062 which states the requirement of who is to receive trust statements. It does not appear to be logical to require notices of fee increases to those persons whom the Law Revision Commission felt did not need to receive statements of a Trust's transactions as provided under Section 16062. Sales and purchases of assets and disbursements to beneficiaries are arguably more important information than a minimal change in the trustee transaction charge which may not even directly affect a beneficiary receiving the notice.

   In addition, the contingent beneficiaries who may be required to receive notice under the current version of Section 15686 will often be minors who are the issue of persons already receiving statements due to their own beneficial status. The added expense of providing this type of notice under Section 15686 does not appear warranted in the overall scheme of trust administration. In addition to providing this notice, trustees would be forced to monitor the existence of newly born contingent beneficiaries who may never receive any interest in the trust at all, thereby substantially increasing a trustee's costs and expenses. In summary, this provision is not administratively meaningful or reasonable from a cost and expense perspective.

3. Notices to conservators, guardians, or attorneys in fact.
   It should be clearly stated that notices to conservators, guardians or attorneys in fact, if appointed, are legally sufficient. This clarification could appear in Section 15686, or could be added to the provisions governing statements of account (Section 16060 et. seq.) to make the same notice clearly applicable to all account and notice provisions throughout the Trust Law.

Thank you for your consideration of these proposed changes which the CBA is requesting. Of course, Paulette and I are available to discuss these proposed changes

should you or the Commission require additional information or clarification. The CBA is extremely interested in enacting these important clarifications to the Trustee fee notice legislation prior to July 1, 1991, the effective date of Section 15686.

Very truly yours,

David W Lauer

DWL:bam

cc: CBA Board Trust Executive Committee
CBA Trust State Government Affairs Committee

CBA Trust State Governmental Affairs
Suggested Revision to Trustee Fee
Statute Effective 7/1/91

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(b) A trustee may not charge an increased trustee's fee for administration of a particular trust unless the trustee first gives at lease 60 days written notice of that increased fee to each beneficiary who is entitled to statements of accounts pursuant to Section 16062. If a beneficiary has a conservator, or has designated to the trustee an attorney in fact to receive such notice, such notice shall be sent to the conservator or attorney in fact.