Study L-3057 September 13, 1995

Memorandum 95-51

Statute of Limitations in Trust Matters: Probate Code § 16460 (Comments on Tentative Recommendation)

This memorandum considers comments we have received on the tentative recommendation on *Statutes of Limitations in Trust Matters: Probate Code Section 16460,* which was distributed in July. The tentative recommendation deals with problems created by the decision in DiGrazia v. Anderlini, 22 Cal. App. 4th 1337, 28 Cal. Rptr. 2d 37 (1994). The tentative recommendation would revise the governing statute to clarify the law in light of the court's decision and restore the Commission's original intent in recommending Probate Code Section 16460. (Another copy of the tentative recommendation is attached for Commissioners.)

We received comments from four persons, whose letters are reproduced in the Exhibit:

Overview of Comments

The study leading to this recommendation was commenced in response to a letter from Edmond R. Davis, Brobeck, Phleger & Harrison, Los Angeles, who urged the Commission to review the *DiGrazia* decision as being inconsistent with the intent of the statute. (See Memorandum 95-16, Exhibit pp. 1-3.)

Support of the original draft was expressed by Valerie J. Merritt in a letter on behalf of the State Bar Estate Planning, Trust and Probate Law Section, when the Commission approved it for introduction in the 1995 legislative session at the March meeting. (The proposal was approved for inclusion in a pending bill, but no appropriate bill was found.) Ms. Merritt wrote as follows (see Minutes of March 1995 Meeting, Exhibit pp. 10-11):

> While Memorandum 95-16 was received too late for a discussion of the full Executive Committee, four members of the Executive Committee (including its Chair) have read and studied the Memorandum. We personally support the position of the staff

> and believe the full Executive Committee would also at its next meeting …. While we agree that trustees should be held to very high standards, we believe the court in the *DiGrazia* case imposed an overly mechanistic test. The proposal in this memorandum balances the interests of trustees with the legitimate interests of beneficiaries in a manner which we believe is a necessary change to deal with the *DiGrazia* case.

Alan D. Bonapart is "particularly enthusiastic" about the recommendation. (See Exhibit p. 17.) It should also be noted that Mr. Bonapart's communication comes in the form of e-mail and is the first such response the Commission has had since making materials available on the Internet. He also expresses support of the effort to offer materials in an electronic format.

Cara M. Vonk reports that the Legislative Issues Subcommittee of the Judicial Council Civil and Small Claims Standing Advisory Committee "took no position on the substance" of the recommendation, but she notes that the committee does "support changes that are designed to clarify application of the law, which appears to be the goal of this proposal." (See Exhibit p. 13.)

Russell G. Allen appears to support the thrust of the tentative recommendation but proposes an alternative draft statute for dealing with the degree of knowledge of facts sufficient to put a duty of inquiry on the beneficiary. (See Exhibit pp. 13-15.) Mr. Allen's ideas are considered below.

Luther J. Avery opposes the proposed legislation. (See Exhibit pp. 1-2.) He is concerned that it is "an attempt to overrule" *DiGrazia v. Anderlini.* The staff does not think there should be anything objectionable in the Legislature correcting a judicial misinterpretation of a statute. Mr. Avery also has several substantive points that are discussed below.

Proper Accounting Procedures

Luther Avery argues that the addition of the rule in proposed Section 16460(c) would encourage "sloppy probate and trust accounting practices" and would be "overruling the Probate Court Rules of every Probate Court in California." (See Exhibit p. 1-2.) He suggests improving the rules in Sections 16061 (duty to report information on request of beneficiary concerning assets, liabilities, receipts, and disbursements) and 16063 (contents of account) to meet the standards of the Uniform Fiduciary Accounting Principles and Model Accounts Format. (Excerpt included in Exhibit pp. 3-12.)

Proposed Section 16460(c) provides: "A written account or report under this section may, but need not, satisfy the standards provided in Section 16061 or 16063 or any other provision." Its purpose is to overrule the contrary holding in *DiGrazia*, as stated in the Comment. The standard that must be met to start the limitations period running is whether there has been an adequate disclosure of the existence of the claim. Except for the *DiGrazia* misreading, this has been the law at least since the Trust Law was enacted in 1986.

This rule has nothing to do with local probate rules. It does not overrule them or affect them in any way. The recommended provision restores the intent of the law as enacted in 1986.

The duty to account and the contents of an account remain unchanged. If the accounting rules in Sections 16060-16064 are inadequate, then the Commission may be interested in reviewing them for a possible future recommendation. However, the approach of the Trust Law was not to impose a set of highly technical accounting requirements. Nothing in the existing statute prevents more detailed accountings.

Is there interest in reviewing statutory fiduciary accounting rules, not just in the Trust Law, but in probate administration, guardianship and conservatorship, and elsewhere, as a new study taking into account the standards proposed by Mr. Avery?

Effect of Fraudulent Account

Luther Avery asks what would be the effect of a fraudulent or deliberately misleading written account or report. (See Exhibit p. 1.) He goes on to suggest that the law regarding fraudulent accountings is eliminated, since "anything in writing starts the running of the three-year statute of limitations."

The tentative recommendation does not change the law in this regard. Nor did *DiGrazia* bear on this issue. Mr. Avery's remarks are really best directed to the Trust Law as enacted in 1986. The law of fraud stands outside the Trust Law. If fraud is alleged, the applicable limitations period is the three-year period provided in Code of Civil Procedure Section 338(d), running from the time of "discovery, by the aggrieved party, of the facts constituting the fraud." According to Witkin:

> Literally interpreted, this language would give the plaintiff an unlimited period to sue if he could establish ignorance of the facts. But the courts have read into the statute a duty to exercise diligence to discover the facts. The rule is that the plaintiff must *plead and*

> *prove the facts* showing: (a) Lack of knowledge. (b) Lack of means of obtaining knowledge (in the exercise of reasonable diligence the facts could not have been discovered at an earlier date). (c) How and when he did actually discover the fraud or mistake. Under this rule constructive and presumed notice or knowledge are equivalent to knowledge. So, when the plaintiff has notice or information of circumstances to put a reasonable person on inquiry, or has the opportunity to obtain knowledge from sources open to his investigation (such as public records or corporation books), the statute commences to run.

3 B. Witkin, California Procedure *Actions,* §454, at 485 (3d ed. 1985) [emphasis in original].

The conclusion must be that the law governing the limitations period in the case of fraud is fairly close to the limitations period under the Trust Law. Both apply a three-year limitations period, and both rely on principles of actual and constructive knowledge. But we need not come to a final conclusion on the matter, since the law relating to fraud is independent of the Trust Law and is unaffected by the tentative recommendation.

Terms of Statute

Russell Allen proposes a redraft to focus on the issue of what knowledge is sufficient to bind the beneficiary, in place of the existing references to receiving a written account. (See Exhibit pp. 14-16.) The end result of Mr. Allen's draft is the same as the tentative recommendation, but Mr. Allen's draft has more theoretical elegance and simplicity, perhaps, while the tentative recommendation is more directed to practical concerns. Mr. Allen's draft is theoretically consistent, but as a consequence might be more likely to raise the issue of whether the beneficiary had requisite *knowledge* in each case. The inquiry under the existing statute focuses in the first instance on whether a written account was *received*. Of course, a written account must be a sufficient disclosure to impart the requisite knowledge, but if an account is complete and in standard form, then all that is in issue is whether it was received. While the difference in theory may be minor from a drafting standpoint, from the perspective of institutional trustees it may be important. The tentative recommendation is based on the assumption that most accounts will be adequate and that the rest of the section will have infrequent application. As a minor note, it should also be remembered that Section 16460 bears some resemblance to the approach in Section 7-307 of the Uniform Probate Code.

If the Commission is inclined to adopt Mr. Allen's approach, consider whether another tentative recommendation should be circulated.

Location of Statute

Luther Avery suggests that if a three-year statute is to apply "regardless of circumstances" then it should be rewritten and located in Code of Civil Procedure Section 343. (See Exhibit p. 2.) In fact, a three-year statute will apply in all cases of breach of trust. And in this respect, Section 16460 is an exception to the catch-all rule in Section 343, just as are all other special statutory periods, whether or not they are located near Section 343. The staff does not see that anything would be gained by moving the statute to the Code of Civil Procedure.

Encouraging Litigation

Luther Avery argues that the rule of the Trust Law will encourage litigation over what is a written account or report. (See Exhibit p. 2.) The staff doubts that it will "encourage" such litigation any more than the *DiGrazia* rule. In fact, under the Trust Law, particularly as clarified in the tentative recommendation, the *incentive* to litigate is less than under the *DiGrazia* rule. The Trust Law provides one three-year period. Its time of commencement depends on two determinations: whether there was an adequate report (which will always be an issue) and, if not, when the beneficiary discovered or should have discovered the facts. Under DiGrazia, if the beneficiary can show that the report is not adequate, a longer limitations period is available, thus increasing the incentive to litigate.

Respectfully submitted,

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Assistant Executive Secretary

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August 2, 1995

Our File No. 9911.81-35

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, California 94303-4739

Re: Statute of Limitations in Trust Matters:
Probate Code Section 16460

Gentlemen:

I write to oppose the proposed legislation referred to above. The proposal is not only an attempt to overrule DiGrazia v. Anderlini but proposes a change in the law that is unfair and unsound.

By proposing to add Probate Code §16760(c), the CLRC is not only encouraging sloppy probate and trust accounting practices but overruling the Probate Court Rules of every Probate Court in California. It is routine practice for our Probate Courts to prescribe the form and content of a fiduciary accounting. The proposed amendment specifying that a written account or report need not satisfy the standards of Sections 16061 or 16063 seems an attempt to repeal those sections and to establish no standard at all.

Countless circumstances can be imagined where a fiduciary can render "a written account or report" which is totally inadequate. The fact of a letter saying: I'm not going to send you an accounting this year; I'm too busy" seems to be a written account under the proposed amendment should that start the running of the three-year statute of limitations as contrasted with the four-year statute which is mandated by CCP §343 and DiGrazia v. Anderlini?

Another interesting question is: what is the effect of a fraudulent or deliberately misleading "written account or report"? Under this proposed amendment it would appear that the law regarding fraudulent accountings is eliminated. See Scott, The Law of Trusts (4th ed.) §220. Under the proposed amendment, it would appear that anything in writing starts the running of the three-year statute of limitations. That is bad law.

The area where improvement is needed is in the language of Probate Code §16061 and 16603 so as to make clear what is the event triggering the three-year statute of limitations.

If Probate Code §16061 and 16063 where improved to meet the standards set forth in the "Uniform Fiduciary Accounting Principles and Model Accounts Format," a project of the National Fiduciary Accounting Standards Project in 1979, the statutes would be improved. For your assistance, I enclose a copy of the Project Report. Note the Principles I, II, III and IV, pp. 3-7.

If the objective is to provide a three-year statute of limitations regardless of circumstances, then the statute could be rewritten to say that and the change should probably be in CCP §343 rather than PC §16460.

The proposed amendment is very detrimental to beneficiaries; protects those who should not be protected; and will encourage litigation over the meaning of "a written account or report." I strongly urge the Commission not adopt the Tentative Recommendation March 1995 [rev. July 20, 1995]. I suggest attention be turned to improve Probate Code §§16061 and 16063.

Yours sincerely,

Luther J. Avery

LJA cet
Enclosure

bc: SJS (w/cy encl)

Uniform Fiduciary Accounting Principles and Model Account Formats

September, 1979

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Report of Fiduciary Accounting Standards Committee

Scope of the Project

"Fiduciary Accounting" does not have one commonly understood meaning. In a broad sense, it can mean the entire process whereby a fiduciary — normally a personal representative, trustee or guardian — communicates information on an on-going basis regarding his administration of a fund and periodically justifies his administration to the parties in interest and, perhaps, to a court. In another sense, it may be the process whereby a fiduciary — here more often a trustee — periodically keeps parties in interest currently informed of transactions and investment policies being followed.

In a narrower sense, to which this report is directed, a fiduciary accounting may refer to the statement prepared by a fiduciary at the close of his administration of a fund (or at some appropriate intermediate stage) to reflect transactions that have occurred and to be presented to the parties in interest as part of a process whereby the fiduciary seeks discharge from liability for the events disclosed.

There is undoubtedly much that can be accomplished to improve the general administration of estates and trusts. A broad study of our basic fiduciary accounting models could lead to dramatic change in the future. But such a study as well as general questions regarding what constitutes fair and adequate procedures in a large variety of circumstances remain beyond the scope of this project.

Advantages to be Gained from Uniformity

The manner in which a fiduciary records receipts and disbursements and gains and losses from investment during the course of administration is commonly dictated by local practice, court rule or statute. In many jurisdictions there is a lack of clarity or consistency regarding the form and content of such an accounting. A uniform form of account and the creation of guiding principles of accounting would be a most helpful development.

Through the development of a uniform form of account the forms that are now in use can be improved. It would not be expected that immediate change to a model account format would be required of corporate fiduciaries with substantial investments in computer programs but ultimately, standardization of forms will permit more effective utilization of machine record keeping techniques and significant cost savings. Standards for acceptable accounting practices will provide needed guidelines.

Since proposed standards can be illustrated by example, we have focused on form and content of a statement of transactions, recognizing that a proper form of account is important whether the account is to be presented in court or employed as part of an informal settlement process between a fiduciary and beneficiaries.

Performance Accounting Distinguished

No effort has been made to standardize that kind of fiduciary accounting which is directed toward an analysis of the investment performance of a fund. Accounts of this type are often distributed to beneficiaries by corporate fiduciaries at regular intervals, generally one year or less, and contain statements of receipts, disbursements and assets on hand at the close of the period. The statement of assets customarily discloses additional information such as cost or tax basis, current market value, current yield expressed sometimes both in dollars and as a percentage of cost or market, and may show the distribution of investments among various categories such as bonds and stocks with subdivision of stocks by industry. These statements can be immensely valuable, both as an aid to the fiduciary in analyzing the structure of the portfolio, and for the information of beneficiaries. Indeed, because this form of report reflects and analyzes current investment policy, it may be described as more positive and forward looking than an unrationalized account of past transactions which is commonly used as a basis for discharge from responsibility for past acts. However, accountings of this type are fundamentally different in purpose from the traditional concept of discharge accounting by a fiduciary. There are inherent limitations that tend to restrict their use to professional institutionalized fiduciaries, and the need for establishment of standards appears to be less pressing than in the conventional area of discharge accounting.

Basic Objectives and General Standards of Fiduciary Accounting

The fundamental objective of an account should be to provide essential and useful information in a meaningful form to the parties interested in the accounting process. It is also important that the account should be sufficiently simple to enable its preparation without unreasonable expense to the fund, or undue distraction from the on-going administration of the estate. Finally, although the parties should understand the nature of the accounting process and the need to protect their interests, the relationship of trust and confidence existing between the fiduciary and the beneficiaries is itself important and the account should not be presented in an adversary format that will unnecessarily impair this relationship.

Competing Goals

Maximum clarity, full disclosure and complete description and explanation of all events to be disclosed appear to be standards that all would accept. But, in combination, they may present many difficulties. For example, clarity may be obscured by the detail that is required for a disclosure that omits nothing. Full explanation of all investment decisions might produce a massive document that few beneficiaries would read. On balance, a set of flexible principles keyed to the standard of good faith supports the utmost protection of the parties and permits accounting standards to change and mature as circumstances require.

Fiduciary accounts rarely will be identical. In addition to the predictable variables of the size and composition of the assets, the period covered and the position of those interested, the significance of particular issues in a controversy may be illuminated by special accounting treatment of some portion of a fund. This suggests that a fiduciary should have enough flexibility to state an account in the manner best adapted to the particular circumstances and discourages any effort to prescribe a totally rigid format. Accordingly, the following principles are suggested as general standards for fiduciary accounting.

Model Accounts

Sample Executor's and Trustee's accounts are attached to illustrate the application of the suggested standards for fiduciary accounting.

Fiduciary Accounting Principles

I. ACCOUNTS SHOULD BE STATED IN A MANNER THAT IS UNDERSTANDABLE BY PERSONS WHO ARE NOT FAMILIAR WITH PRACTICES AND TERMINOLOGY PECULIAR TO THE ADMINISTRATION OF ESTATES AND TRUSTS.

Commentary: In order for an account to fulfill its basic function of communication, it is essential that it be stated in a manner that recognizes that the interested parties are not usually familiar with fiduciary accounts. It is neither practical nor desirable to require that accounts be tailored to meet individual disabilities of particular parties but any account should be capable of being understood by a person of average intelligence, literate in English, and familiar with basic financial terms who has read it with care and attention.

Problems arising from terminology or style are usually a reflection of the fact that people who become versed in a particular form of practice tend to forget that terms which are familiar and useful to them may convey nothing to someone else or may even be affirmatively misleading. For example, the terms "debit" and "credit" are generally incomprehensible to people with no knowledge of bookkeeping and many people who are familiar with them in other contexts would assume that in the context of fiduciary accounting, the receipt of an item is a "credit" to the fund rather than a "debit" to the fiduciary.

While the need for concise presentation makes a certain amount of abbreviation both acceptable and necessary, uncommon abbreviation of matters essential to an understanding of the account should be avoided or explained.

No position is taken for or against the use of direct print-outs from machine accounting systems. The quality of the accounts produced by these systems varies widely in the extent to which they can be understood by persons who are not familiar with them. To endorse or object to a direct print-out because it is produced by machine from previously stored data would miss the essential point by focusing attention upon the manner of preparation rather than the product.

II. A FIDUCIARY ACCOUNT SHALL BEGIN WITH A CONCISE SUMMARY OF ITS PURPOSE AND CONTENT.

Commentary: Very few people can be expected to pay much attention to a document unless they have some understanding of its general purpose and its significance to them. Even with such an understanding, impressions derived from the first page or two will often determine whether the rest is read. The use that is made of these pages is therefore of particular significance.

The cover page should disclose the nature and function of the account. While a complete explanation of the significance of the account and the effect of its presentation upon the rights of the parties is obviously impractical for inclusion at this point, there should be at least a brief statement identifying the fiduciary and the subject matter, noting the importance of examining the account and giving an address where more information can be obtained.

It is assumed that the parties would also have enough information from other sources to understand the nature of their relationship to the fund (e.g., residuary legatee, life tenant, remainderman), the function of the account, and the obligation of the fiduciary to supply further relevant information upon request. It is also assumed that *notice* will be given of any significant procedural considerations such as limitation on the time within which objections must be presented. This would normally be provided by prior or contemporaneous memoranda, correspondence or discussions.

A summary of the account shall also be presented at the outset. This summary, organized as a table of contents, shall indicate the order of the details presented in the account and shall show separate totals for the aggregate of the assets on hand at the beginning of the accounting period; transactions during the period; and the assets remaining on hand at the end of the period. Each entry in the summary shall be supported by a schedule in the account that provides the details on which the summary is based.

III. A FIDUCIARY ACCOUNT SHALL CONTAIN SUFFICIENT INFORMATION TO PUT THE INTERESTED PARTIES ON NOTICE AS TO ALL SIGNIFICANT TRANSACTIONS AFFECTING ADMINISTRATION DURING THE ACCOUNTING PERIOD.

Commentary: The presentation of the information in an account shall allow an interested party to follow the progress of the fiduciary's administration of assets during the accounting period without reference to an inventory or earlier accounting that is not included in the current account.

An account is not complete if it does not itemize assets on hand at the beginning of the accounting period.

Illustrations:

3.1 The first account for a decedent's estate or a trust should detail the items received by the fiduciary and for which he is responsible. It should not simply refer to the total amount of an inventory filed elsewhere or assets described in a schedule attached to a deed of trust.

3.2 In later accounts for an estate or trust, the opening balance should not simply refer to the total value of principal on hand as shown in detail in the prior account, but should list each item separately.

Instead of retyping the complete list of assets in the opening balance, the accountant may prefer to attach as an exhibit a copy of the inventory, closing balance from last account, etc., as appropriate.

Transactions shall be described in sufficient detail to give interested parties notice of their purpose and effect. It should be recognized that too much detail may be counterproductive to making the account understandable. In accounts covering long periods or dealing with extensive assets, it is usually desirable to consolidate information. For instance, where income from a number of securities is being accounted for over a long period of time, a statement of the total dividends received on each security with appropriate indication of changes in the number of shares held will be more readily understandable and easier to check for completeness than a chronological listing of all dividends received.

Although detail should generally be avoided for routine transactions, it will often be necessary to a proper understanding of an event that is somewhat out of the ordinary.

Illustrations:

3.3 Extraordinary appraisal costs should be shown separately and explained.

3.4 Interest and penalties in connection with late filing of tax returns should be shown separately and explained.

3.5 An extraordinary allocation between principal and income such as apportionment of proceeds of property acquired on foreclosure should be separately stated and explained.

3.6 Computation of a formula marital deduction gift involving non-probate assets should be explained.

IV. A FIDUCIARY ACCOUNT SHALL INCLUDE BOTH CARRYING VALUES — REPRESENTING THE VALUE OF ASSETS AT ACQUISITION BY THE FIDUCIARY — AND CURRENT VALUES AT THE BEGINNING AND END OF THE ACCOUNTING PERIOD.

Commentary: In order for transactions to be reported on a consistent basis, an appropriate carrying value for assets must be chosen and employed consistently.

The carrying value of an asset should reflect its value at the time it is acquired by the fiduciary (or a predecessor fiduciary). When such a value is not precisely determinable, the figure used should reflect a thoughtful decision by the fiduciary. For assets owned by a decedent, inventory values or estate tax values — generally reflective of date of death values — would be appropriate. Assets received in kind by a trustee from a settlor of an inter-vivos trust should be carried at their value at the time of receipt. For assets purchased during the administration of the fund, cost would normally be used. Use of Federal income tax bases for carrying value is acceptable when basis is reasonably representative of real values at the time of acquisition. However, the carry-over basis rules introduced by the Tax Reform Act of 1976 will tend to produce a tax basis that is materially different from the real value of assets owned by a decedent. Use of tax basis as a carrying value under those circumstances could be affirmately misleading to beneficiaries and therefore is not appropriate.

In the Model Account, carrying value is referred to as "fiduciary acquisition value." The Model Account establishes the initial carrying value of assets as their value at date of death for inventoried assets, date of receipt for subsequent receipts and cost for investments. No adjustment is made for subsequent receipts such as sale of rights.

Carrying value would not normally be adjusted for depreciation.

Except for adjustments that occur normally under the accounting system in use, carrying values should generally be continued unchanged through successive accounts and assets should not be arbitrarily "written up" or "written down." In some circumstances, however, with proper disclosure and explanation, carrying value may be adjusted.

Illustrations:

4.1 Carrying values based on date of death may be adjusted to reflect changes on audit of estate or inheritance tax returns.

4.2 Where appropriate under applicable local law, a successor fiduciary may adjust the carrying value of assets to reflect values at the start of his administration.

4.3 Assets received in kind in satisfaction of a pecuniary legacy should be carried at the value used for purposes of distribution.

Though essential for accounting purposes, carrying values are commonly misunderstood by laymen as being a representation of actual values. To avoid this, the account should include both current values and carrying values.

The value of assets at the beginning and ending of each accounting period is necessary information for the evaluation of investment performance. Therefore, the account should show current values at the start of the period for all assets whose carrying values were established in a prior accounting period.

Illustrations:

4.4 The opening balance of the first account of a testamentary trustee will usually contain assets received in kind from the executor. Unless the carrying value was written up at the time of distribution (e.g., 4.2 or 4.3 supra) these assets will be carried at a value established during the executor's administration. The current value at the beginning of the accounting period should also be shown.

4.5 An executor's first account will normally carry assets at inventory (date of death) values or cost. No separate listing of current values at the beginning of the accounting period is necessary.

Current values should also be shown for all assets on hand at the close of the accounting period. The date on which current values are determined shall be stated and shall be the last day of the accounting period, or a date as close thereto as reasonably possible.

Current values should be shown in a column parallel to the column of carrying values. Both columns should be totalled.

In determining current values for assets for which there is no readily ascertainable current value, the source of the value stated in the account shall be explained. The fiduciary shall make a good faith effort to determine realistic values but should not be expected to incur expenses for appraisals or similar costs when there is no reason to expect that the resulting information will be of practical consequence to the administration of the estate or the protection of the interests of the parties.

Illustrations:

4.6 When an asset is held under circumstances that make it clear that it will not be sold (e.g., a residence held for use of a beneficiary) the fiduciary's estimate of value would be acceptable in lieu of an appraisal.

4.7 Considerations such as a pending tax audit or offer of the property for sale may indicate the advisability of not publishing the fiduciary's best estimate of value. In such circumstances, a statement that value was fixed by some method such as "per company books", "formula under buy-sell agreement", "300% of assessed value" would be acceptable, but the fiduciary would be expected to provide further information to interested parties upon request.

V. GAINS AND LOSSES INCURRED DURING THE ACCOUNTING PERIOD SHALL BE SHOWN SEPARATELY IN THE SAME SCHEDULE.

Commentary: Each transaction involving the sale or other disposition of securities during the accounting period shall be shown as a separate item in one combined schedule of the account indicating the transaction, date, explanation, and any gain or loss.

Although gains and losses from the sale of securities can be shown separately in accounts, the preferred method of presentation is to present this information in a single schedule. Such a presentation provides the most meaningful description of investment performance and will tend to clarify relationships between gains and losses that are deliberately realized at the same time.

VI: THE ACCOUNT SHALL SHOW SIGNIFICANT TRANSACTIONS THAT DO NOT AFFECT THE AMOUNT FOR WHICH THE FIDUCIARY IS ACCOUNTABLE.

Commentary: Transactions such as the purchase of an investment, receipt of a stock split or change of a corporate name do not alter the total fund for which a fiduciary is accountable but must be shown in order to permit analysis and an understanding of the administration of the fund. These can be best shown in information schedules.

One schedule should list all investments made during the accounting period. It should include those subsequently sold as well as those still on hand. Frequently the same money will be used for a series of investments. Therefore, the schedule should not be totalled in order to avoid giving an exaggerated idea of the size of the fund.

A second schedule (entitled "Changes in Investment Holdings" in the Model Account) should show all transactions affecting a particular security holding such as purchase of additional shares, partial sales, stock splits, change of corporate name, divestment distributions, etc. This schedule, similar to a ledger account for each holding, will reconcile opening and closing entries for particular holdings, explain changes in carrying value and avoid extensive searches through the account for information scattered among other schedules.

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August 4, 1995

California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Re: Comment on Statute of Limitations in Trust Matters: Probate Code § 16460

Dear Commission:

Thank you for giving us the opportunity to comment on the above-referenced tentative Commission recommendation.

This matter was referred to the Judicial Council Civil and Small Claims Standing Advisory Committee and was reviewed by its Legislative Issues Subcommittee on August 3, 1995.

The subcommittee took no position on the substance of the recommendation to amend Probate Code section 16460. The committee does, however, support changes that are designed to clarify application of the law, which appears to be the goal of this proposal.

Very truly yours,

Cara Vonk

Cara M. Vonk
Counsel to the Civil and Small Claims
Standing Advisory Committee

cc: Hon. Janet Kintner, Chair
Mr. Michael Bergeisen, General Counsel

O'MELVENY & MYERS

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Attention: Stan Ulrich
Assistant Executive Secretary

Re: Tentative Recommendations Concerning Statutes of Limitations in Trust Matters

Dear Ladies and Gentlemen:

Enclosed is an alternative proposal with respect to Section 16460. As you will see, I would be inclined to adopt language that focuses more directly on a beneficiary's knowledge of facts sufficient to put the beneficiary on inquiry into the existence of the claim. This focus is consistent with traditional California law dealing with statutes of limitations, which is concerned with knowledge of facts, not legal theories or remedies. See, e.g., Gutierrez v. Mofid, 39 Cal.3d 892, 897-98, 218 Cal. Rptr. 313, 316 (1985); Miller v. Bedtel Corp., 33 Cal.3d 868, 875, 191 Cal. Rptr. 619, 623 (1983); Lazzarone v. Bank of America, 181 Cal. App. 3d 581, 597, 226 Cal. Rptr. 855, 865 (1986); Bedolla v. Logan & Frazier, 53 Cal. App. 3d 118, 129, 125 Cal. Rptr. 59, 67 (1975).

As you have noted, a written account or report (whether satisfying the standards provided in Sections 16061 or 16063 or otherwise) may or may not provide an appropriate level of knowledge to provide a duty of inquiry (and timely filing). Therefore, I would eliminate (as unnecessary) a statutory reference to the accounting and reporting duties of the trustee so long as the comment indicates an intent to alter the reasoning of DiGrazia.

At least as I read your proposed additions to subsection (a)(2) addressing the absence of a report and account, I believe your draft and my alternative likely would reach the same result if the statute is read against the backdrop of traditional law; I suggest that my alternative language would direct the focus more specifically to that body of case law.

I must confess that I have some question about the Constitutional sufficiency of notice to a parent who does not have a conflict of interest. Nevertheless, it seems to me that the notion generally is laudable, so my alternative perpetuates the approach taken in the current statute.

Very truly yours,

Russell G. Allen
~~of~~ O'MELVENY & MYERS

RGA/br
Enclosure

ALTERNATIVE TEXT OF PROPOSED LEGISLATION

RE PROBATE CODE § 16460

16460.(a) Unless a claim is previously barred by adjudication, consent, limitation, laches or otherwise, a claim for breach of trust is barred as to a beneficiary unless a proceeding to assert the claim is commenced within three years after the beneficiary has sufficient knowledge of facts essential to the claim so that the beneficiary knows of the claim or reasonably should have inquired into the existence of the claim.

(b) For the purpose of subdivision (a), a beneficiary is deemed to know of facts essential to the claim or be charged with the responsibility for having inquired into the existence of the claim if information is received:

(1) personally, in the case of an adult beneficiary who is reasonably capable of understanding it;

(2) by a guardian ad litem, conservator of the estate or other person appointed by a court for this purpose, in the case of an adult beneficiary who is not reasonably capable of understanding the information; or

(3) by a guardian ad litem, guardian of the estate, or other person appointed by a court for this purpose, or, if no such person has been appointed, by a parent who does not have a conflict of interest, in the case of a beneficiary who is not an adult.

From: ABonapart@aol.com
Date: Sun, 13 Aug 1995 22:58:29 -0400
To: TRComments@clrc.ca.gov
Subject: CLRC Homepage on the Internet

TO: Office of the California Law Revision Commission

Congratulations and thank you for the new arrangement by which Tentative Recommendations are make available on the Internet. I was delighted to receive a news release (7-21-95) announcing two tentative recommendations and telling that the materials were available on the Internet.

I hope that you will continue the use of the Internet for releasing materials and for receiving comments.

I want also to take this opportunity to comment favorably on two Tentative Recommendations: (1) one relating to the State of Limitations in Trust Matters: Probate Code Section 16460 and (2) one relating to Inheritance From or Through Child Born Out of Wedlock. I have read both tentative recommendations. I am an experienced estate and trust lawyer. Both recommendations are well reasoned. I am particularly enthusiastic about the first of the two recommendations.

Thanks.

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STATE OF CALIFORNIA

CALIFORNIA LAW REVISION COMMISSION

TENTATIVE RECOMMENDATION

Statute of Limitations in Trust Matters: Probate Code Section 16460

March 1995

This tentative recommendation is being distributed so that interested persons will be advised of the Commission's tentative conclusions and can make their views known to the Commission. Any comments sent to the Commission will be a part of the public record and will be considered at a public meeting when the Commission determines the provisions it will include in legislation the Commission plans to recommend to the Legislature. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you believe revisions should be made in the tentative recommendation.

COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE RECEIVED BY THE COMMISSION NOT LATER THAN **September 8, 1995.**

The Commission often substantially revises tentative recommendations as a result of the comments it receives. Hence, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

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STATUTE OF LIMITATIONS IN TRUST MATTERS: PROBATE CODE SECTION 16460

In *DiGrazia v. Anderlini,*[1] the court held that the general four-year statute of limitations in Code of Civil Procedure Section 343 applies to claims for breach of trust where a "written account or report" was not given the beneficiary, despite the three-year limitations period provided by Probate Code Section 16460. *DiGrazia* also holds that an "account or other report" sufficient to trigger the statute of limitations must meet the standards provided in sections governing the trustee's duty to account to beneficiaries. While the equities in *DiGrazia* may support the court's disposition of the case, the court's statutory interpretations will create problems and are inconsistent with the intent of the Trust Law. The governing statute needs to be amended to clarify the law and restore the original intent of Probate Code Section 16460.

Applicable Statute of Limitations

The Trust Law, which was enacted on recommendation of the Law Revision Commission,[2] sets out a complete scheme governing claims by beneficiaries against trustees for breach of trust. Section 16460 provides a three-year statute of limitations, running from the time an account or report adequately discloses existence of a claim or from when the beneficiary discovered or reasonably should have discovered the subject of the claim.[3]

The *DiGrazia* court concluded that the three-year limitations period provided in Section 16460(a) applies *only* where an "interim or final account in writing, or other written report" is given. If such a report meeting standards determined by the court is not given, then the three-year statute does not apply. This led the court to the conclusion that the general, default four-year statute of limitations in Code of Civil Procedure Section 343 applies.[4]

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1. 22 Cal. App. 4th 1337, 28 Cal. Rptr. 37 (1994).

2. See 1986 Cal. Stat. ch. 820; *Selected 1986 Trust and Probate Legislation,* 18 Cal. L. Revision Comm'n Reports 1201, 1207 (1986).

3. For the language of this section, see the "Proposed Legislation" *infra.*

4. *DiGrazia,* 22 Cal. App. 4th at 1346, 28 Cal. Rptr. 2d at 43. The court cites the Commission's Comment to Section 16460 as enacted in support of its conclusion, but the Comment has been edited in such a manner as to change its meaning:

> The Law Revision Commission's comments indicate it was well aware that its proposal would create a significant exception to the then-existing statute of limitations applicable to actions for breach of express trust. In the Comment which accompanied section 16460 as originally enacted, the Commission referred specifically to the rule of "prior law" announced in Cortelyou v. Imperial Land Co., supra, 166 Cal. at page 20, 134 P. 981, and Oeth v. Mason, supra, 247 Cal.App.2d at pages 811-812, 56 Cal.Rptr. 69, and stated that "[s]ection 16460 is a new provision .... [which] is an exception to" that prior law.

(22 Cal. App. 4th at 1347, 28 Cal. Rptr. 2d at 43.)

Section 16460 is intended as an exception to the general rule of Section 343. In 1986, the Trust Law changed the former rule under which the default four-years statute of limitations in Section 343 was applied, since there was formerly no special rule applicable to trusts. The statute was meant to provide a complete statutory rule, to avoid the need to look outside the statute, and to provide one measure of the period of limitation.

In applying this rule, there will still be a question of fact as to whether a sufficient disclosure has taken place that triggers the statute under subdivision (a)(1) of Section 16460 ("If a beneficiary has received an interim or final account in writing, or other written report, that adequately discloses the existence of a claim...."). And factual issues are also inherent in the second prong of the rule ("If an interim or final account or other report does not adequately disclose the existence of a claim...."), since the court will have to decide when a beneficiary knew or should have known of the basis of the claim. But the statute was intended to at least eliminate the incentive of arguing the facts to apply a different limitations period — a prospect that is now encouraged under the *DiGrazia* rule.

Nature of Account or Report Required To Trigger Statute of Limitations

Essential to the *DiGrazia* court's conclusion is the implicit finding that the trustee's letter and other communications to the beneficiary were not written accounts or reports within the terms of the statute. The court specifically holds that "to trigger the operation of section 16460, a trustee's report or account must

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The Comment actually states: "Section 16460 is an exception to the four-year rule provided in Code of Civil Procedure Section 343." This is an independent statement, making unambiguous reference to the default statute of limitations in Section 343 — it does not refer to the case law, as the opinion states by using the phrase "that prior law." In this fashion, the legislative history of Section 16460 was turned on its head.

Compare the court's presentation with the full text of the relevant part of the Comment to Section 16460 as enacted:

> **Section 16460 is a new provision** drawn in part from Section 7-307 of the Uniform Probate Code (1987). As to the construction of provisions drawn from uniform acts, see Section 2. Section 16460 supersedes the provisions of former Civil Code Section 2282 relating to discharge of trustees. For a provision governing consent, release, and affirmance by beneficiaries to relieve the trustee of liability, see Sections 16463-16465. The reference in the introductory clause to claims "otherwise" barred also includes principles such as estoppel and laches that apply under the common law. See Section 15002 (common law as law of state). See also Sections 16461 (exculpation of trustee by provision in trust instrument), 16462 (nonliability for following instructions under revocable trust). During the time that a trust is revocable, the person holding the power to revoke is the one who must receive the account or report in order to commence the running of the limitations period provided in this section. See Sections 15800 (limits on rights of beneficiary of revocable trust), 16064(b) (exception to duty to account). **Under prior law, the four-year limitations period provided in Code of Civil Procedure Section 343 was applied to actions for breach of express trusts.** See Cortelyou v. Imperial Land Co., 166 Cal. 14, 20, 134 P. 981 (1913); Oeth v. Mason, 247 Cal. App. 2d 805, 811-12, 56 Cal. Rptr. 69 (1967). **Section 16460 is an exception to the four-year rule provided in Code of Civil Procedure Section 343.**

(See *Recommendation Proposing the Trust Law*, 18 Cal. L. Revision Comm'n Reports 501, 714-15 (1986); emphasis added.)

The ellipsis in the last line of the language quoted in the *DiGrazia* opinion represents more than 200 words, in all or part of 13 sentences.

conform to the minimum standards set out by sections 16061 or 16063 respectively."[5] This holding is not consistent with the legislative intent, although the policy advanced by the court is worth considering.

An examination of these sections does not support the court's holding on the required contents of an account or report under Section 16460. The standard that needs to be met under Section 16460(a) is whether the account or report "adequately discloses the existence of a claim." On first blush, it may appear useful to clothe the reference in Section 16460 with more detail by imposing standards drawn from Sections 16061 and 16063. However, the gain is illusory, since an accounting under Section 16061 or 16063 may or may not satisfy the adequate disclosure standard — the substantive analysis under Section 16460 still has to be made. Nothing is gained by refusing to trigger the statute when a less formal report (or letter) "adequately discloses the existence of a claim."

Recommendations

The Commission recommends amendment of Section 16460 to make clear, consistent with the original intent of the statute, that a three-year limitations period on claims for breach of trust applies whether or not an account or report is given to the beneficiary. If an adequate report is given, then the three-year period runs from the date the report is given; otherwise the three-year period runs from the time the beneficiary discovered or reasonably should have discovered the basis of the claim.

The statute should also be amended to state explicitly that an account or report need not satisfy the standards of Sections 16061 and 16063. An account or report starts the running of the statute simply if it adequately discloses the basis of the claim.

5. *DiGrazia*, 22 Cal. App. 4th at 1349, 28 Cal. Rptr. 2d at 44-45.

PROPOSED LEGISLATION

Prob. Code § 16460. Limitations on proceedings against trustee

SECTION 1. Section 16460 of the Probate Code is amended to read:

16460. (a) Unless a claim is previously barred by adjudication, consent, limitation, or otherwise:

(1) If a beneficiary has received an interim or final account in writing, or other written report, that adequately discloses the existence of a claim against the trustee for breach of trust, the claim is barred as to that beneficiary unless a proceeding to assert the claim is commenced within three years after receipt of the account or report. An account or report adequately discloses existence of a claim if it provides sufficient information so that the beneficiary knows of the claim or reasonably should have inquired into the existence of the claim.

(2) If an interim or final account in writing or other written report does not adequately disclose the existence of a claim against the trustee for breach of trust or if a beneficiary does not receive any written account or report, the claim is barred as to that beneficiary unless a proceeding to assert the claim is commenced within three years after the beneficiary discovered, or reasonably should have discovered, the subject of the claim.

(b) For the purpose of subdivision (a), a beneficiary is deemed to have received an account or report, as follows:

(1) In the case of an adult who is reasonably capable of understanding the account or report, if it is received by the adult personally.

(2) In the case of an adult who is not reasonably capable of understanding the account or report, if it is received by the person's legal representative, including a guardian ad litem or other person appointed for this purpose.

(3) In the case of a minor, if it is received by the minor's guardian or, if the minor does not have a guardian, if it is received by the minor's parent so long as the parent does not have a conflict of interest.

(c) A written account or report under this section may, but need not, satisfy the standards provided in Section 16061 or 16063 or any other provision.

Comment. Subdivision (a)(2) of Section 16460 is amended to make clear that it applies both where an insufficient account or report is given the beneficiary as well as where the beneficiary has not received any written account or report. This revision is consistent with the original intent of this section, and rejects the contrary conclusion reached by the court in DiGrazia v. Anderlini, 22 Cal. App. 4th 1337, 1346-48, 28 Cal. Rptr. 2d 37, 42-44 (1994). The three-year statute of limitations under subdivision (a) is applicable to all claims for breach of trust and the four-year statute of Code of Civil Procedure Section 343 is inapplicable. See Comment to Section 16460 as enacted by 1986 Cal. Stat. ch. 820, *Selected 1986 Trust and Probate Legislation,* 18 Cal. L. Revision Comm'n Reports 1201, 1424-25 (1986), and as re-enacted by 1990 Cal. Stat. ch. 79, *Recommendation Proposing New Probate Code,* 20 Cal. L. Revision Comm'n Reports 1001, 1940-41 (1990).

Subdivision (c) is added to make clear that the requirements for a written account or report under this section are independent of other statutes. The governing rule determining whether

paragraph (1) or paragraph (2) of subdivision (a) applies is whether the account or report "adequately discloses the existence of a claim." Subdivision (c) rejects the holding in DiGrazia v. Anderlini, 22 Cal. App. 4th 1337, 1348-49, 28 Cal. Rptr. 2d 37, 44-45 (1994), that an account or report under this section must satisfy the minimum standards set out in Section 16061 or 16063.
