Study L-622 November 29, 2010

Memorandum 2010-54

Donative Transfer Restrictions: Possible Follow-Up Legislation

Senate Bill 105 (Harman) was introduced in 2009 to implement the Commission's recommendation on *Donative Transfer Restrictions*, 38 Cal. L. Revision Comm'n Reports 107 (2008). The bill was approved by the Legislature and signed by the Governor in 2010. See 2010 Cal. Stat. ch. 620.

In the course of enacting the bill, the Legislature made a number of changes to the language recommended by the Commission. Some of those changes were made quite late in the legislative process.

After the bill was signed, the staff received an email from Jeffrey Dennis-Strathmeyer, an editor of the *Estate Planning & California Probate Reporter*, published by Continuing Education of the Bar. Mr. Dennis-Strathmeyer shared a draft of an article that will be published in that periodical soon, in which he expresses concern about some of the late amendments made to SB 105. He believes that some of those changes are problematic and need to be adjusted quickly. He wonders whether the Commission might be in the best position to consider his concerns.

The draft of his article is not attached, as it has not yet been published. However, this memorandum will summarize his chief concerns. The Commission should then have a sufficient basis to determine whether it wants to take any action in response.

This memorandum begins with a brief summary of the former law and the changes to that law made by SB 105. It then discusses the three main issues raised by Mr. Dennis-Strathmeyer. It concludes with a brief discussion of possible Commission actions.

BACKGROUND

Old Law and New Law

As enacted, SB 105 preserves the existing donative transfer restriction statute (hereafter, the "Old Law"). See Prob. Code § 21350 *et seq*. However, the Old Law only applies to gifts that become irrevocable before January 1, 2011. See Prob. Code § 21355.

In addition, SB 105 adds a new donative transfer restriction statute (hereafter, the "New Law"). See Prob. Code § 21360 *et seq*. The New Law only applies to gifts that become irrevocable on or after January 1, 2011. See Prob. Code § 21392(a).

Summary of the Old Law

The Old Law established a statutory presumption of menace, duress, fraud, or undue influence when a donative transfer is made to a person who stands in a specified relationship to the transferor. The presumption covers the following types of "disqualified persons":

(1) The drafter of the donative instrument. In addition, certain associates of the drafter are also disqualified persons, including a spouse, domestic partner, cohabitant, or relative within the specified degree of kinship of the drafter, as well as a partner, shareholder, or employee of a law partnership or corporation in which the drafter has an ownership interest. Prob. Code § 21350(a)(1)-(3).

(2) A fiduciary of the transferor who transcribed the donative instrument or caused it to be transcribed. Again, some associates of the disqualified person are also subject to the presumption, including the spouse, domestic partner, cohabitant, or relative within the specified degree of kinship of the transcriber. An "employee" of the transcriber is also a disqualified person. Prob. Code § 21350(a)(4)-(5).

(3) The "care custodian" of a transferor who is a "dependent adult." As before, the spouse, domestic partner, cohabitant, or specified relative of the care custodian is also a disqualified person. Prob. Code § 21350(a)(6)-(7). Note that "care custodian" and "dependent adult" are defined terms.

There are some important exceptions to the application of the statutory presumption. It does not apply to a spouse, domestic partner, cohabitant, or specified family member of the transferor, or to an instrument drafted by such a person. Prob. Code § 21351(a). There is also an exception that applies if the

transferor is counseled by an "independent attorney" who then certifies that the proposed transfer is not the product of menace, duress, fraud, or undue influence. Prob. Code § 21351(b).

As a general rule, the presumption may be rebutted. However, to do so the proponent of the gift must produce "clear and convincing" rebuttal evidence. Prob. Code § 21351(d). The evidence must include at least some evidence other than the testimony of the beneficiary. *Id.* However, in the case of a gift to the *drafter* of the donative instrument, the presumption is conclusive. Prob. Code § 21351(e)(1).

A beneficiary who tries unsuccessfully to rebut the presumption bears the cost of the proceeding, including reasonable attorney's fees. Prob. Code § 21351(d).

If a gift is invalidated pursuant to the statutory presumption, the donative transfer operates "as if the disqualified person predeceased the transferor without spouse or issue…." Prob. Code § 21353. In other words, the invalidation of one gift in a will or trust would not affect the remaining provisions of the instrument. Presumably the property that would have been transferred under the invalidated provision would fall into the residue of the estate.

Finally, it is worth noting that the statutory presumption of menace, duress, fraud, or undue influence *supplements* the common law. It does not displace it. See Bernard v. Foley, 39 Cal. 4th 794, 800, 139 P.3d 1196, 47 Cal. Rptr. 3d 248 (2006); Rice v. Clark, 28 Cal. 4th 89, 96-97, 47 P.3d 300, 120 Cal. Rptr. 2d 522, (2002). Thus, even if a gift could not be challenged under the statutory presumption, it could still be challenged under the common law.

Summary of the New Law

The New Law mostly continues the Old Law, with the following substantive changes:

- The definition of "care custodian" was significantly recast. It no longer includes the laundry list of persons who must report elder abuse pursuant to Welfare and Institutions Code Section 15610.17. It also includes a new exception for a caregiver who has a specified preexisting personal relationship with the dependent adult. Prob. Code § 21362.
- The definition of "dependent adult," was significantly recast. It no longer encompasses every adult with a disability. Instead it is based on a functional test, which was derived in part from the standard for appointment of a conservator. Prob. Code § 21366.

- The care custodian presumption was limited to donative instruments executed during the period of care-giving, or 90 days before or after that period. Prob. Code § 21380(a)(3).
- Exemptions for family members of the donor were narrowed from the fifth degree of kinship to the fourth. Prob. Code § 21382.
- The statutory presumption of menace and duress was not continued. Prob. Code § 21380.
- A requirement that rebuttal evidence include evidence other than the testimony of a beneficiary was not continued. Prob. Code § 21380(b).
- The conclusive presumption of invalidity that governs a gift to the drafter of the donative instrument was broadened to also apply to a gift to specified family and associates of the drafter. Prob. Code § 21380(c).
- New substantive standards were added to govern the counseling that an attorney must provide before signing a certificate of independent review. Prob. Code § 21384.
- A definition of "independent attorney" was added, to provide guidance on who may sign a certificate of independent review. Prob. Code § 21370.
- A provision was added to state expressly that the statute does not preclude any other available remedy, including the common law on undue influence. Prob. Code § 21392(b).
- The special statute of limitations for actions under the statute was eliminated. A contest under the New Law will be subject to the general limitations periods governing different types of instruments.

The New Law also includes a number of minor technical changes to eliminate confusing or inconsistent language.

NEW ISSUES

Before turning to Mr. Dennis-Strathmeyer's concerns, it is worth recalling that the stakeholder consensus for enactment of SB 105 was somewhat fragile and difficult to achieve. The 2010 amendments to SB 105 were the product of significant compromise on all sides.

The staff cautions against disturbing the final version of the bill, unless there is a plain operational defect in the law.

Certificate of Independent Review

Mr. Dennis-Strathmeyer is concerned that the New Law could render previously executed certificates of independent review invalid.

There appear to be three changes in the law that might be a basis for that concern: (1) changes to the substantive standards governing the counseling that must be provided before signing a certificate of independent review, (2) changes to the definition of "independent attorney," and (3) changes to the statutory form used to prepare a certificate of independent review.

Those changes are discussed below.

Substantive Changes to Counseling Requirements

SB 105 was amended to address issues raised in *Estate of Winans*, 183 Cal. App. 4th 102, 107 Cal. Rptr. 3d 167 (2010). That case evaluated the adequacy of the counseling provided by an attorney who prepared a certificate of independent review. The *Winans* court held:

- Counseling must occur "under circumstances that would insulate the transferor from any improper influences giving rise to the donative transfer and encourage the transferor to speak frankly with the certifying attorney about those influences, if any. At a minimum, therefore, the disqualified person and any person associated with the disqualified person must be absent. Further, the counseling session must occur in the absence of any person whose presence might discourage the testator from speaking frankly with the attorney about the subject bequest." *Winans*, 183 Cal. App. 4th at 119.
- Counseling about the "consequences" of an intended transfer must include discussion of those who will receive property as well as discussion of the donor's heirs who will *not* receive property. *Winans*, 183 Cal. App. 4th at 116-17.

Consistent with those holdings, language was added to new Prob. Code § 21384(a), as indicated below:

> 21384. (a) A gift is not subject to Section 21380 if the instrument is reviewed by an independent attorney who counsels the transferor, *out of the presence of any heir or proposed beneficiary,* about the nature and consequences of the intended transfer, *including the effect of the intended transfer on the transferor's heirs and on any beneficiary of a prior donative instrument,* attempts to determine if the intended transfer is the result of fraud or undue influence, and signs and delivers to the transferor an original certificate in substantially the following form:
>
> …

(Emphasis added.)

It is possible that a certificate of independent review that would have satisfied the letter of the Old Law could be challenged for a failure to meet the new statutory standards set out above. However, such a certificate would likely also fail to meet the similar standard adopted in *Winans*.

Consequently, the staff does not believe that the New Law would significantly broaden the scope for invalidation of a certificate of independent review on this basis. *Winans* already established the grounds for such a challenge. If anything, the New Law should reduce the risk of invalidation, by providing greater certainty about the minimum standards for counseling.

Definition of "Independent Attorney"

In *Winans*, the court also discussed the meaning of "independent attorney" in the provision authorizing an independent attorney to sign a certificate of independent review. It adopted a fairly open-ended standard:

> Accordingly, an attorney is "independent" for purposes of section 21351 if the attorney's personal circumstances do not prevent him or her from forming a disinterested judgment about the validity of the bequest.

Winans, 183 Cal. App. 4th at 121.

SB 105 was amended to provide a more specific definition of the term "independent attorney":

> "Independent attorney" means an attorney who has no legal, business, financial, professional, or personal relationship with the beneficiary of a donative transfer at issue under this part, and who would not be appointed as a fiduciary or receive any pecuniary benefit as a result of the operation of the instrument containing the donative transfer at issue under this part.

Prob. Code § 21370.

It is possible that an attorney who prepared a certificate of independent review under the Old Law might not be able to meet that standard. If so, then the certificate might be successfully attacked on that basis.

However, it seems very likely that an attorney who does not meet the new statutory definition of "independent attorney" would also fail to meet the more general standard adopted in *Winans*.

Again, the staff does not believe that the New Law would significantly broaden the scope for invalidation of a certificate of independent review on this basis. *Winans* already established the grounds for such a challenge. If anything,

the New Law should reduce the risk of invalidation, by providing greater certainty about the meaning of "independent attorney."

Changes to Statutory Form

The New Law makes some minor changes to the old statutory form. Those changes are shown below, with strikeout and underscore to indicate how the new form (in Section 21384) differs from the old form (in Section 21351):

"CERTIFICATE OF INDEPENDENT REVIEW

I,_____, have reviewed
(attorney's name)

_____ and have counseled ~~my client~~ the transferor,
(name of instrument)

_____
(name of client)

on the nature and consequences of ~~the transfer, or~~ any transfers~~,~~ of property to:

_____contained in the instrument.
(name of ~~potentially disqualified~~ person described in Section 21380 of the Probate Code)

I am ~~so disassociated from the interest of the transferee as to be~~ an 'independent attorney' as defined in Section 21370 of the Probate Code and am in a position to advise ~~my client~~ the transferor independently, impartially, and confidentially as to the consequences of the transfer. On the basis of this counsel, I conclude that the ~~transfer, or~~ transfers~~, in the instrument that otherwise might be invalid under Section 21350 of the Probate Code~~ to

_____ that would be made by the instrument
(name of person described in Section 21380 of the Probate Code)

~~are valid because the transfer, or transfers,~~ are not the product of fraud~~, menace, duress,~~ or undue influence.

_____"
(Name of Attorney) (Date)

As can be seen, the changes to the form are largely technical and should not affect the substantive content of the form. This point is reinforced by the Commission's Comment to Section 21384, which indicates that the new section "restates the substance" of the old section (with exceptions not relevant here). Recall that Commission Comments are accepted as evidence of legislative intent. See, e.g., People v. Williams, 16 Cal. 3d 663, 667-68, 547 P.2d 1000, 128 Cal. Rptr. 888 (1976) ("The official comments of the California Law Revision Commission on the various sections of the Evidence Code are declarative of the intent not

only of the draft[ers] of the code but also of the legislators who subsequently enacted it.").

The technical nature of the changes made in the form is important, because *the law does not require perfect adherence to the statutory form.* A certificate of independent review need only be "substantially" in the specified form. Prob. Code § 21384. In other words, nonsubstantial deviations from the form language are excusable. Given that express grant of flexibility, the staff doubts that the minor technical changes in the new form would present much of a risk that certificates prepared using the old form would be invalidated on the basis of noncomformity.

The only change that might be problematic in this regard is the new requirement that the attorney attest to being an "independent attorney." That could perhaps be seen as a new substantive requirement. However, the old form also requires that the attorney attest to independence. It just uses different language to do so. It seems unlikely that a court would invalidate a certificate on that basis, if the attorney actually is an "independent attorney" under the law. While such a result would seem perverse, it is not impossible. There might be some small risk of invalidation on this basis.

That risk could be foreclosed entirely by the enactment of follow-up legislation. For example, a new subdivision could be added to Section 21384 along the following lines:

> (e) A certificate of independent review that was prepared before January 1, 2011, in substantially the form specified in subdivision (b) of Section 21351, shall be deemed to be in substantially the form specified in this section.

Scope of Kinship Exemptions

The Old Law provides that the statutory presumption of invalidity does not apply to a gift to a person within the *fifth* degree of kinship to the transferor or to an instrument drafted by a person within the *fifth* degree of kinship to the transferor. Prob. Code § 21351(a).

The New Law continues those exemptions, but narrows them to the *fourth* degree of kinship. Prob. Code § 21382(a)-(b).

Mr. Dennis-Strathmeyer believes that this narrowing is misguided as a matter of policy. The degree of affinity that family members feel at different degrees of kinship is variable. It is very possible that the relationship between a transferor

and a fifth degree relative would be intimate enough to justify the exemptions provided in the Old Law.

In considering this concern, it is important to understand that *the Commission does not lobby the Legislature*. It makes written recommendations, which the Legislature is free to adopt or not adopt as it sees fit. If the Legislature chooses, as it did here, to adopt a policy that is different from the policy recommended by the Commission, that decision should be respected. It would be inappropriate for the Commission to continue to push for its recommended policy, in the face of a direct legislative decision to the contrary.

Scope of Conclusive Presumption

The Old Law does not permit rebuttal of the statutory presumption of menace, duress, fraud, or undue influence when a gift is made to the drafter of the donative instrument. See Prob. Code § 21351(e)(1).

The Commission recommended that this "absolute bar" on rebuttal by the drafter be eliminated. The Legislature chose to retain it. In fact, it was broadened to also apply to specified relatives and business associates of the drafter. See Prob. Code § 21380(c).

Mr. Dennis-Strathmeyer argues against that broadening of the conclusive presumption, which he sees as unfair in many circumstances. Suppose that a law firm has a policy of drafting estate plans for its employees. An employee indicates that she would like to make a gift from her estate to a long time co-worker and friend. The drafting attorney prepares the instrument, not realizing that the co-worker is subject to the same statutory presumption as the drafter (because he is an employee of the drafter).

Under the Old Law, the employee-beneficiary would have an opportunity to rebut the presumption. Under the New Law, the presumption would be conclusive. To be clear, the employee-beneficiary would be a presumptively disqualified person under *both* the Old Law and the New Law. *The only difference is whether the presumption can be rebutted.*

There is a policy argument in favor of extending the scope of the conclusive presumption as was done in SB 105. The law already "vicariously" presumes the invalidity of a gift to the drafter's family and business associates. This clearly reflects concern that an unscrupulous drafter might otherwise evade the statutory presumption by directing a gift to a spouse or other confidant. Given

that the statute already treats these relatives and associates as a sort of "alter ego" of the drafter, it makes some sense to treat them all in the same way.

As noted above, the Commission recommended *eliminating the conclusive presumption entirely*. The Legislature made a different policy choice. The Commission should respect that decision.

Retroactivity

Aside from Mr. Dennis-Strathmeyer's policy objections to the changes in the two preceding sections of the memorandum, he also believes that it is unfair to apply those changes retroactively, to instruments that were drafted under the Old Law. Doing so could invalidate gifts that would have been valid under the Old Law (e.g., a gift to a family member in the fifth degree of kinship).

As noted above, the New Law does not apply to instruments that become irrevocable before January 1, 2011. This limitation on retroactive application of the New Law provides an opportunity to revise instruments drafted under the Old Law, to make any adjustments that might be necessary to preserve the transferor's intentions under the New Law. That should reduce the scope of the unfairness that Mr. Dennis-Strathmeyer is concerned about. However, it may not entirely eliminate it. There will probably be some transferors who drafted instruments under the Old Law, in reliance on that law, and who are unaware of the substantive changes made in the New Law. Such persons would not realize that they should revise their instruments.

One possible remedy for that problem would be to preclude retroactive application of the New Law to any instrument that was *drafted* before January 1, 2011.

While that would avoid the problem discussed here, it would create a different problem. Known substantive defects in the Old Law (e.g., the discriminatory treatment of any adult with a disability as a "dependent adult") would continue to apply to a broad class of instruments (those drafted before January 1, 2011).

There is a good argument that the application rules in SB 105 represent a reasonable policy compromise. The bill applies the substantive improvements of the New Law as broadly as possible, without imposing any substantive change on instruments that cannot be revised to avoid those changes. (Note also that the Probate Code generally favors the retroactive application of new law. See Prob. Code § 3(c).)

POSSIBLE COMMISSION ACTIONS

There are a range of actions that the Commission might take in response to the issues discussed above:

(1) **Do nothing.** With one exception, none of the problems described above result from changes recommended by the Commission. Instead, they reflect legislative policy choices and stakeholder compromise.

(2) **Pass the information along to policy makers in the Legislature.** The staff could forward this memorandum to staff in Senator Harman's office and in the Assembly and Senate Committees on the Judiciary, without any recommendation from the Commission. This would permit the Legislature to evaluate for itself whether any adjustments need to be made.

(3) **Work toward corrective legislation.** The Commission could perform an expedited study of any of the issues discussed above, with an eye toward introduction of corrective legislation as soon as practical.

The staff recommends the second option, with one possible exception. If the Commission is concerned that the changes made to the statutory form for the certificate of independent review are substantial enough to pose a meaningful risk of invalidating a certificate prepared using the old form, it might be appropriate to add language to avoid that result. If that problem exists, it would be a consequence of language recommended by the Commission. What's more, the problem would be unintended and technical, rather than an intentional substantive policy choice. In light of those factors, it would not be improper for the Commission to suggest a minor follow-up change to the statute.

That said, the staff is not entirely convinced that the problem is serious enough to justify follow-up legislation, especially given that (1) perfect adherence to the statutory form is not required, and (2) the Commission Comment makes clear that the changes in the form were not intended to be substantive. It also seems likely that the Legislature will be reluctant to make further changes to the New Law, until there has been some opportunity to evaluate its operation in practice.

Respectfully submitted,

Brian Hebert
Executive Secretary