6/20/77

Memorandum 77-44

Subject: Powers of Appointment

BACKGROUND

The California statute relating to powers of appointment (Civil Code Sections 1380.1-1392.1) was enacted in 1969 upon recommendation of the Law Revision Commission. At the 1974 session, upon Commission recommendation, this topic was dropped from our agenda of topics since the Commission did not anticipate that any technical defects would be discovered in the new statute.

Two possible technical defects have come to the attention of the staff and are outlined below.

ABILITY OF DONEE OF POWER OF APPOINTMENT TO CONTRACT TO APPOINT

Section 1388.1 of the Civil Code provides:

> 1388.1. (a) The donee of a power of appointment that is presently exercisable, whether general or special, can contract to make an appointment to the same extent that he could make an effective appointment.
>
> (b) The donee of a power of appointment cannot contract to make an appointment while the power of appointment is not presently exercisable. If a promise to make an appointment under such a power is not performed, the promisee cannot obtain either specific performance or damages, but he is not prevented from obtaining restitution of the value given by him for the promise.

Subdivison (b) of Section 1388.1 provides that the donee of a power not presently exercisable cannot contract to make an appointment. Subdivision (b) was drawn from Section 10-5.3 of the New York Estates, Powers and Trust Law. The New York Law Revision Commission has recommended an amendment that restricts the prohibition against contracting to make a power of appointment to cases where the donor and donee are different persons.

The staff recommends that the California statute be conformed to adopt the substance of the New York recommendation. A copy of the New York recommendation is attached; the recommendation has been edited to eliminate portions discussing another defect in the New York statute that was corrected in the statute recommended and enacted in California.

Specifically, the staff proposes that Section 1388.1 be amended to add a new subdivision (c), to read:

> (c) Subdivision (b) does not apply where the donor and the donee are the same person unless the creating instrument expressly provides that the donee may not contract to make an appointment.

Since we are not authorized to study this topic, we are not in a position to prepare a recommendation and a Comment to the amendment of Section 1388.1. However, such a Comment would read:

> Comment. Subdivision (c) is added to Section 1388.1 to avoid a construction of subdivision (b) that would apply that subdivision where the donor and the donee are the same person. The purpose of subdivision (b) is to prevent the donor's intent from being defeated by the donee contracting to appoint under a power of appointment that is not presently exercisable. By giving a testamentary or postponed power to the donee, the donor expresses his desire that the donee's discretion be retained until the donee's death or such other time as is stipulated. However, where the donor and the donee are the same person, his or her intent is better protected by an exception allowing the ability to deal with the power during the donor-donee's lifetime. Subdivision (c) reflects a policy consistent with Section 1390.4 which makes an unexercised general power of appointment created by the donor in favor of himself, whether or not presently exercisable, subject to the claims of creditors of the donor or of his estate and to the expenses of the administration of his estate. A similar policy is reflected in subdivision (a) of Section 1392.1 which permits the donor to revoke the creation of a power of appointment when the power is created in connection with a trust which is revocable under Section 2280. A New York provision similar to subdivision (b) was held to apply to a case where the donor and donee are one and the same person in Matter of Brown, 33 N.Y.2d 211 (____), but the New York Law Revision Commission thereupon recommended a revision of the New York statute to restrict the prohibition against contracting away the power to cases where the donor and donee are different persons. See Memorandum of Law Revision Commission Relating to the Ability of a Donee of a Testamentary Power of Appointment to Contract to Appoint and to the Donee's Release of the Power, Under the Estates, Powers and Trusts Law (N.Y. Leg. Doc. (1977) No. 65 (C)).

The staff believes that it is important that this matter be clarified in the California statute. The California statute is the same in substance as the New York statute. The New York statute has been construed to apply where the donor and the donee are the same person, and the New York decision would be cited if this issue were presented for decision in California and, absent a California decision in point, will create

uncertainty for the lawyer advising a client as to the California law. (It is interesting to note, however, as is noted in the New York Law Revision Commission recommendation, that of all the judges who passed on the matter in New York, six applied the prohibition against contracting, while seven found the statute not intended to apply to the donor-donee situation. The highest court held 4-3 that it was compelled by the wording of the New York statute to apply the prohibition to the situation where the donor-donee were the same person.)

EXERCISE OF POWER OF APPOINTMENT BY MINOR

Section 1384.1 of the Civil Code provides:

> 1384.1. (a) A power of appointment can be exercised only by a donee having the capacity to transfer the interest in property to which the power relates.
>
> (b) Unless the creating instrument otherwise provides, a donee who is a minor may exercise a power of appointment.

Subdivision (b) as enacted upon recommendation of the Commission required the minor to be over 18 if he exercised the power by a will and, in all other cases, to be a minor who under Civil Code Section 25 was deemed to be an adult. In the conforming revisions of various sections to conform to the statute making 18 the age of majority, subdivision (b) was amended to read as set out above.

The staff recommends that subdivision (b) be amended to read:

> (b) Unless the creating instrument otherwise provides, a donee who is a minor may not exercise the power of appointment during minority.

This amendment would restore the original policy stated in subdivision (b) prior to its amendment. Moreover, it is more likely to reflect the intent of the donor that the power can be exercised only after the donee has reached the age of majority. Note that, under the amendment proposed by the staff, the power may be exercised by a minor if the creating instrument specifically so provides.

Respectfully submitted,

John H. DeMoully
Executive Secretary

RECOMMENDATION OF THE LAW REVISION COMMISSION
TO THE 1977 LEGISLATURE

Relating to the Ability of a Donee of a Testamentary Power of Appointment to Contract to Appoint

There is a strong policy in New York against allowing the donee of a power of appointment not presently exercisable to contract away that power since this would frustrate the donor's intention. (Farmer's Loan & Trust Co. v. Mortimer, 219 N.Y. 290).

Section 10-5.3, Estates, Powers and Trusts Law (EPTL) purports to promote that policy.

Cal § 1333.1

> §10-5.3 Contract to appoint; power not presently exercisable. (a) The donee of a power of appointment which is not presently exercisable, or of a postponed power which has not become exercisable, cannot contract to make an appointment. Such a contract, if made, cannot be the basis of an action for specific performance or damages, but the promisee can obtain restitution of the value given by him for the promise unless the donee has exercised the power pursuant to the contract.
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> (b) The provisions of this section shall not abridge the ability of the donee of a power of appointment which is not presently exercisable to release his power pursuant to 10-9.2[1] or to make the power, after release, an imperative power.

Cal. § 1338

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1. Section 10-9.2 states that a power as to some or all of the appointive property is releasable with or without consideration by written instrument signed by the donee and must be delivered to any person so specified in the donor's will, or any trustee of the subject property, or any person adversely affected by the exercise of the power, or an appropriate County Clerk. Other aspects of this statute are dealt with elsewhere in this memorandum.

The Commission addresses two problems respecting §10-5.3 in this Recommendation and advances amendments for their resolution. First, the prohibition of subdivision (a) has been held to bar a contract by the donee even where he is also the donor under an inter vivos trust. Because the purpose behind the prohibition is to protect a deceased donor's intent, the rule should not operate in situations where the donor and donee are the same person, and the statute should so provide.

Ability to Contract Where Donor and Donee the Same Person

Subdivision (a) of §10-5.3 protects the donor's intent by preventing the donee from contracting the power away. What if, under an inter vivos trust, the donor and donee are the same person; does the statute forbid the donee to release this power during his lifetime?

In Matter of Brown (33 N Y 2d 211) the decedent was the donee of two separate powers of appointment - one over the assets of a trust under his mother's 1925 will, the other over the assets of an inter vivos trust he had created in 1927. In order to resolve family differences, in 1944 he agreed to exercise both powers in part in favor of his son, and at the same time executed a will making appointments in accord with the agreement. In 1964, decedent

made a new will in which he utilized both powers in favor of his estate, with no benefits to the son who, as part of the 1944 agreement, had been adopted by his mother's second husband. Decedent meanwhile had also remarried and his 1964 will left everything to his second wife and daughter born of that marriage. The son brought a proceeding to enforce the 1944 agreement and the Surrogate found §10-5.3 to be a bar to his claim since it prohibited the making of such a contract in the case of both powers. (68 Misc 2d 986, Laurine, S.).

The Appellate Division reversed in part, 4-1, on the ground that since the donor and donee were the same under the inter vivos trust, that power could be released. There was no question but that the statute barred the contract insofar as the power under the mother's will was concerned since that presented exactly the situation sought to be controlled by subdivision (a). (41 AD 2d 275.)

The Court of Appeals agreed as to the power under the mother's will, but reversed, 4-3, concerning the power under the inter vivos trust. The majority was unwilling judicially to amend subdivision (a) to provide an exception to the bar where the donor and donee were one and the same person. Since decedent had not, in the inter vivos trust, reserved the right to himself to revoke he had effectively relinquished any effective rights under the trust except, of course, the right to make a testamentary appointment. Thus, he was in no different a position with respect to bargaining with that power than he was with respect to the

power under his mother's trust. Moreover, since such ownership had been relinquished, those in the contingent remainder class named in case of default in exercise of the power would have to release their interests in order to validate such a contract.

The dissent, following the Appellate Division majority, found that subdivision (a) was intended to apply only where the donor's testamentary wishes were to be protected and that when the donor and donee are the same person the purpose of the statute has no application. Quoted with approval is Justice Shapiro's statement at the Appellate Division: "Since the power of appointment was reserved by the creator of the trust to himself, can it be seriously contended that his purposeful action as donee in contracting to exercise the power in the objectant's behalf was at the same time defeating his intent as the donor of the power?" (33 NY 2d at 219.)

The dissent notes further that EPTL 10-7.4 provides that property subject to a general power of appointment is reachable by the donee's creditors where the power was created by the donee in favor of himself. "The fact the Legislature left such self-created powers vulnerable to the donee's creditors renders it inconceivable that it intended to immunize situations where the donor-donee would choose to bargain with his power." (Ibid.) As to the contingent remaindermen, the dissent stated: "...it could not have been with their interests in mind that EPTL 10-5.3 was enacted. Rather, the statute was enacted to protect the interests of the settlor-donor." (Id. at 220).

Cal. § 1340.4

Thus, it was thought that in a donor-donee case remaindermen should have no say should the donor-donee deal with the power during his lifetime.

The position of the Appellate Division majority and the Court of Appeals' minority[3] is based on the theory that the intent of subdivision (a) is derived wholly from Farmers' Loan & Trust Co. v. Mortimer (219 N.Y. 290). As stated in the Appellate Division:

> A practice commentary on this provision by Judge I. Leo Glasser (McKinney's Cons. Laws of N.Y., Book 17B, EPTL 6-1.1 to 10-10.8, pocket part, in explaining the meaning thereof, says: "If the power is testamentary, it is exercisable only by a written will of the donee (EPTL 10-3.3) and a will in its very nature is ambulatory. The exercise of the power in such a case is intended to represent the final judgment of the donee. Until the moment of his death, he has the right to appoint the property as he deems best. 'To permit him to bargain that right away would be to defeat the purpose of the donor. The testamentary power cannot be exercised by force of a contract to make a will, for such a contract, specifically performed under compulsion of the court becomes the equivalent of a grant' [sic]. (Farmers' Loan & Trust Co. v. Mortimer, supra) (emphasis supplied).
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> But in relying upon the Farmers' Loan & Trust case (supra) for his broad and all inclusive interpretation of EPTL 10-5.3, Judge Glasser was not discussing a fact pattern in which the donee ... is also the donor. In such a case there is no bargaining away of the right of appointment which the donor manifested that the donee have until the moment of his death for, since the donor and the donee are one and the same, his intention, far from being frustrated, is being observed to the very letter. (41 AD 2d 275, 278)

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3. It will be noted that of all the judges who passed on the matter, six (the Surrogate, one Appellate Division dissenter and the four in the Court of Appeals' majority) applied the subdivision (a) prohibition, while seven (four in the Appellate Division majority and three in the Court of Appeals' minority) found the statute not intended to apply to the donor-donee situation.

The Commission agrees that subdivision (a) was not and should not have been intended to cover the donor-donee case. The Court of Appeals' majority, however, was faced with language which allowed for no exception.

Therefore, the Commission recommends:

I. That section 10-5.3 of the EPTL be amended to read as follows:

§10-5.3 Contract to appoint; power not presently exercisable.

(a) The donee of a power of appointment which is not presently exercisable or of a postponed power which has not become exercisable, cannot contract to make an appointment [.]; except that this prohibition shall not apply if the donor and donee are the same person. Such a prohibited contract, if made, cannot be the basis of an action for specific performance or damages, but the promisee can obtain restitution of the value given by him for the promise unless the donee has exercised the power pursuant to the contract.