

Memorandum 87-31

Subject: Study L-640 - AB 362 (Trusts)

Attached to this memorandum is a set of amendments implementing the Commission's decisions regarding the Trust Law at the March meeting. (See Exhibit 1.) After the April meeting, we will make any necessary revisions in these amendments to implement Commission decisions and get the bill reprinted.

Also attached is a set of comments to these amendments. (See Exhibit 2.) After making necessary revisions, the comments will be filed with the legislative committees and the Legislative Counsel, in accordance with our usual procedure for establishing official comments.

Amendments approved at an earlier meeting and which have not yet been added to AB 362 are also set out in Exhibit 1. (See Amendments 2 and 3.)

The following matters need further consideration:

§ 16222. Participation in business; change in form of business

We have added the following language to the limitation on the power of a trustee to continue operation of a business: "For the purpose of this subdivision, the lease of four or fewer residential units is not considered to be the operation of a business or other enterprise." (See Amendment 4, in Exhibit 1.) The inspiration for this exception was Code of Civil Procedure Section 580b which precludes deficiency judgments in certain cases involving "a dwelling for not more than four families." The technical question here is whether the property involved must be one building with up to four units in it or may be as many as four separate buildings with a total of four units. The staff sees no reason to distinguish among two duplexes, one four-plex, or a family home with a separate in-law unit.

§ 16441. Measure of liability for interest

At the March meeting, the Commission decided to clarify the application of the prejudgment interest rule to breaches of trust

occurring before the operative date of the Trust Law. The Commission directed the staff to clarify the language and bring it back for final consideration at this meeting. Set out below are two drafts that clarify the applicable prejudgment interest rate but reflect different policies, both of which the staff believes should be acceptable.

Alternative #1 (10% as of January 1, 1983):

SEC. . Section 16441 of the Probate Code is amended to read:

16441. If the trustee is liable for interest pursuant to Section 16440, the trustee is liable for the greater of the following amounts:

(a) The amount of interest that accrues at the legal rate on judgments in effect during the period when the interest accrued.

(b) The amount of interest actually received.

Comment. Subdivision (a) of Section 16441 is revised to clarify the interest rate applicable to a determination of liability for a breach occurring before the operative date of the Trust Law. Under this rule, the legal rate of interest on judgments in effect when the liability accrued is applied. Thus, the rate is 7% per year until January 1, 1983, when the interest rate on judgments was raised to 10% per year. See Code Civ. Proc. § 685.010(a); American Nat'l Bank v. Peacock, 165 Cal. App. 3d 1206, 1210-12, 212 Cal. Rptr. 97 (1985). Under the Trust Law, interest is not compounded as it was under former Civil Code Section 2262.

For example, if a breach of trust that occurred in 1980 is the subject of proceedings commenced or pending on the operative date of the Trust Law (July 1, 1987), and if the trustee is found liable for interest at the rate provided in subdivision (a) of this section, interest is determined at the rate of 7% from 1980 until December 31, 1982, and then at the rate of 10% from January 1, 1983, until the date of judgment. After judgment, interest accrues at the rate of 10% pursuant to Code of Civil Procedure Section 685.010.

Alternative #2 (10% as of July 1, 1987):

SEC. . Section 16441 of the Probate Code is amended to read:

16441. (a) If the trustee is liable for interest pursuant to Section 16440, the trustee is liable for the greater of the following amounts:

(a) (1) The amount of interest that accrues at the legal rate on judgments.

(b) (2) The amount of interest actually received.

(b) Where a trustee is liable for interest pursuant to

paragraph (1) of subdivision (a) as to a breach of trust occurring before July 1, 1987;

(1) Interest accruing before July 1, 1987, accrues at the rate of 7 percent per year.

(2) Interest accruing on or after July 1, 1987, accrues at the legal rate on judgments.

Comment. Section 16441 is revised to clarify the prejudgment interest rate applicable to the determination of liability for a breach of trust occurring before the operative date of the Trust Law.

Subdivision (b)(1) recognizes the general rule under former law that interest accrued at the rate of 7%, which was then the legal rate. See, e.g., *In re Estate of McLellan*, 8 Cal. 2d 49, 55, 63 P.2d 1120 (1936); *Gaver v. Early*, 191 Cal. 123, 125-26, 215 P. 394 (1923); *Lynch v. John M. Redfield Found.*, 9 Cal. App. 3d 293, 302, 88 Cal. Rptr. 86 (1970); see also Cal. Const. Art. 15, § 1. Under the Trust Law, interest is not compounded as it was under former Civil Code Section 2262.

Under subdivision (b)(2), starting on July 1, 1987, the trustee's liability for prejudgment interest pursuant to Section 16440 accrues at the rate on judgments, which is currently set at 10%. See Code Civ. Proc. § 685.010(a).

For example, if a breach of trust that occurred in 1980 is the subject of proceedings commenced or pending on the operative date of the Trust Law (July 1, 1987), and if the trustee is found liable for interest at the rate provided in subdivision (a)(1) of this section, interest is determined at the rate of 7% from 1980 until June 30, 1987, and then at the rate of 10% from July 1, 1987, until the date of judgment. After judgment, interest accrues at the rate of 10% pursuant to Code of Civil Procedure Section 685.010.

§ 17457. Administration of transferred trust

The staff has worded this provision to deal with the concern of the California Bankers Association while at the same time avoiding complicated conflict of law issues. (See Amendment 6, in Exhibit 1.) CBA was concerned that Section 17457 might require that the validity of a trust transferred to California and the construction of its beneficial provisions be determined under California law.

Respectfully submitted,

Stan G. Ulrich
Staff Counsel

Exhibit 1

Staff Draft

AMENDMENTS TO ASSEMBLY BILL 362

AMENDMENT 1

On page 7, between lines 30 and 31, insert:

SEC. . Section 15405 of the Probate Code is amended to read:

15405. For the purposes of Section 15403 and 15404, the consent of a beneficiary who ~~is legally incapacitated,~~ lacks legal capacity, including a minor, or who is an unascertained, or unborn person may be given in proceedings before the court by a guardian ad litem, if it would be appropriate to do so. In ~~this case determining whether to give consent,~~ the guardian ad litem may rely on general family benefit accruing to living members of the beneficiary's family as a basis for approving a modification or termination of the trust.

SEC. . Section 15410 of the Probate Code is amended to read:

15410. At the termination of a trust, the trust property shall be disposed of as follows:

(a) In the case of a trust that is revoked by the settlor, as directed by the settlor.

(b) In the case of a trust that is terminated by the consent of the settlor and all beneficiaries, as agreed by the settlor and all beneficiaries.

(c) In any other case, as provided in the trust instrument or in a manner directed by the court that conforms as nearly as possible to the intention of the settlor as expressed in the trust instrument.

(d) If a trust is terminated by the trustee pursuant to subdivision (b) of Section 15408, the trust property ~~shall~~ may be distributed as determined by the trustee pursuant to ~~this subdivision.~~ the standard provided in subdivision (c) without the need for a court order. Where the trust instrument does not provide a manner of distribution at termination and the settlor's intent is not adequately expressed in the trust instrument, the trustee may distribute the trust property to the living beneficiaries on an actuarial basis.

SEC. . Section 15803 of the Probate Code is amended to read:

15803. The holder of a presently exercisable general power of appointment or power to withdraw property from the trust has the rights of a ~~settlor~~ person holding the power to revoke the trust that are provided by Sections 15800 to 15802, inclusive, to the extent of the holder's power over the trust property.

SEC. . Section 15805 is added to the Probate Code, to read:

15805. Notwithstanding any other statute, the Attorney General is subject to the limitations on the rights of beneficiaries of revocable trusts provided by Sections 15800 to 15802, inclusive.

AMENDMENT 2

On page 7, line 33, strike out "provided" and insert:
otherwise provided in this section and

AMENDMENT 3

On page 7, strike out lines 39 and 40, and on page 8, strike out lines 1 to 16, inclusive, and insert:

(b) A trustee of a living trust created by an instrument executed before July 1, 1987, is not subject to the duty to account provided by subdivision (a).

(c) A trustee of a trust created by a will executed before July 1, 1987, is not subject to the duty to account provided by subdivision (a), except that if the trust is removed from continuing court jurisdiction pursuant to Article 2 (commencing with Section 17350) of Chapter 4 of Part 5, the duty to account provided by subdivision (a) applies to the trustee.

(d) Except as provided in Section 16064, the duty of a trustee to account pursuant to former Section 1120.1a of the Probate Code (as repealed by Chapter 820 of the Statutes of 1986), under a trust created by a will executed before July 1, 1977, which has been removed from continuing court jurisdiction pursuant to former Section 1120.1a, continues to apply after July 1, 1987. The duty to account under former Section 1120.1a may be satisfied by furnishing an account that satisfies the requirements of Section 16063.

AMENDMENT 4

On page 8, between lines 39 and 40, insert:

SEC. . Section 16222 of the Probate Code is amended to read:

16222. (a) Subject to subdivision (b), the trustee has the power to continue or participate in the operation of any business or other enterprise that is part of the trust property and may effect incorporation, dissolution, or other change in the form of the organization of the business or enterprise.

(b) Except as provided in subdivision (c), the trustee may continue the operation of a business or other enterprise only as authorized by the trust instrument or by the court. For the purpose of this subdivision, the lease of four or fewer residential units is not considered to be the operation of a business or other enterprise.

(c) The trustee may continue the operation of a business or other enterprise for a reasonable time pending a court hearing on the matter or pending a sale of the business or other enterprise.

(d) The limitation provided in subdivision (b) does not affect any power to continue or participate in the operation of a business or other enterprise that the trustee has under a trust created by an instrument executed before July 1, 1987.

AMENDMENT 5

On page 10, between lines 22 and 23, insert:

[See draft alternatives in the memorandum at pages 2-3.]

AMENDMENT 6

SEC. . Section 17457 of the Probate Code is amended to read:

17457. A trust transferred to this state pursuant to this chapter shall be administered in the same manner as a trust of that type created in this state. This section does not apply to the validity of a trust or the construction of the beneficial provisions of a trust transferred to this state.

Exhibit 2

Staff Draft

REVISED COMMENTS FOR COMMITTEE REPORT ON AB 362

Probate Code § 15405 (amended). Guardian ad litem

Comment. Section 15405 is amended to make clear that it applies to a minor and to replace the phrase "legally incapacitated" with "lacks legal capacity" for conformity with guardianship and conservatorship law. See, e.g., Section 2582. This is a nonsubstantive revision.

Probate Code § 15410 (amended). Disposition of property upon termination

Subdivision (d) of Section 15410 is revised to provide a default rule for disposition of trust property upon termination of a trust worth less than \$20,000.

Probate Code § 15803 (technical amendment). Rights of holder of power of appointment or withdrawal

Comment. Section 15803 is revised to substitute the broader phrase "person holding the power to revoke the trust" for "settlor." This is a technical revision to conform the language of this section to Sections 15800-15802.

Probate Code § 15805 (added). Attorney General subject to limitations on rights of beneficiary of revocable trust

Comment. Section 15805 is intended to make clear that the Attorney General is treated the same as a beneficiary of a revocable living trust for the purposes of the provisions limiting such beneficiaries' rights. This section is consistent with Section 24 which defines beneficiary to include any person entitled to enforce a charitable trust, taking into account the provision of Section 15800 that beneficiaries of revocable trusts do not have the rights normally afforded beneficiaries so long as the charitable trust is revocable and the person holding the power to revoke remains competent. This section

recognizes that the Attorney General's rights to receive notice under Section 17203(c) and to petition under Section 17210 are limited just as in the case of individual beneficiaries.

Probate Code § 16222 (amended), Participation in business; change in form of business

Comment. Subdivision (b) of Section 16222 is revised to exclude the lease of four or fewer residential units from the requirement that the trustee obtain court approval to continue operation of a business or other enterprise that is a part of trust property.

Subdivision (d) is added to limit the rule in subdivision (b) requiring court authorization for the trustee to operate a business or other enterprise that is a part of trust property. This is a special application of the rule stated in Section 16203.

Probate Code § 16441 (amended), Measure of liability for interest

Comment. *[Text depends on draft of amendment that is approved. See draft alternatives in the memorandum at pages 2-3.]*

Probate Code § 17457 (amended), Administration of transferred trust

Comment. The second sentence is added to Section 17457 to distinguish rules governing the validity of a trust and the construction of its beneficial provisions from the procedural and administrative provisions covered by the first sentence of this section. See also Section 15400 (limitation on California rule that trust is revocable unless it provides otherwise).