First Supplement to Memorandum 83-4

Subject: Study L-640 - Trusts (Trust Administration Under the Uniform Probate Code)

This memorandum considers the provisions of Article VII of the Uniform Probate Code (Trust Administration) in relation to the provisions of California law. Copies of the UPC provisions and relevant provisions of California law are attached as exhibits to Memorandum 83-4; you will need to refer to that material from time to time for the full text of a provision under discussion. Also attached to this supplement as exhibits are staff drafts of several provisions relevant to aspects of trust administration discussed in this supplement.

As indicated in Memorandum 83-4, we have chosen the Uniform Probate Code trust administration provisions as a convenient point of departure. In some instances, the staff concludes that California law is superior to the UPC, but in others, we recommend adoption of provisions based on the UPC. Specific subjects are discussed roughly in the order they appear in the UPC in the remainder of this supplement.

Trust Registration

The Uniform Probate Code requires trustees to register trusts in the court in the principal place of administration. UPC § 7-101. Unless otherwise designated in the trust instrument, the principal place of administration is "the trustee's usual place of business where the records pertaining to the trust are kept, or at the trustee's residence if he has no such place of business." Id. The trustee is also under a "continuing duty to administer the trust at a place appropriate to the purposes of the trust and to its sound, efficient management." UPC § 7-305. The court may order a change of place of administration where appropriate, and in doing so may order removal of the trustee and appointment of a trustee in another state. Id.

The concept of trust registration has been described as one of the UPC's most controversial provisions. Averill, A Comparison of the Uniform Probate Code With the Law of Texas--Trust Administration, in Comparative Probate Law Studies 801, 804 (1976). It appears, however, that a certain amount of this controversy has arisen from a misunderstanding of the registration provision. It does not require filing a copy of the trust instrument or registering the terms of the trust. Registration is accomplished, as provided in UPC Section 7-102, by filing a statement including the following: (1) the name and address of the trustee, (2) an acknowledgment of the trusteeship by the trustee, (3) a statement whether the trust has been registered elsewhere, and (4) an identification of the trust. The manner of identifying the trust depends upon the nature of the trust. If it is testamentary, the statement must include the name of the testator and "the date and place of domiciliary probate." If it is a written inter vivos trust, the statement must include the name of each settlor and the original trustee and the date of the trust instrument. If it is an oral trust, the statement must give information identifying the settlor "or other source of funds" and describe "the time and manner of the trust's creation and the terms of the trust, including the subject matter, beneficiaries and time of performance." Hence, only in the case of oral trusts must the terms of the trust be disclosed. The staff considers this to be a desirable provision. There is also a provision permitting the settlor of a revocable trust to exempt the trustee from the registration requirement as long as the power of revocation is retained. See UPC § 1-108. Otherwise, a provision in a trust is not effective to excuse the trustee from the registration requirement. See UPC § 7-104.

Registration results in submitting to the personal jurisdiction of the court in proceedings relating to administration of the trust. UPC § 7-103(a). Beneficiaries given notice pursuant to UPC Section 1-401 are subject to jurisdiction of the court of registration to the extent of their interests in the trust. UPC § 7-103(b). If a trustee fails to register the trust in a proper place, the trustee is still subject to personal jurisdiction of the court in which the trust could have been registered, in any proceeding initiated by a beneficiary. UPC § 7-104. The settlor or a beneficiary may also give a written demand to the trustee that the trust be registered; if the trustee fails to do so within 30 days after receipt of the demand, the trustee is subject to removal and denial of compensation or to surcharge. UPC § 7-104.

The trust registration scheme serves several purposes. It informs the beneficiaries of the existence of the trust. It provides evidence that the trustee has accepted the trust. It subjects the trustee and beneficiaries to the jurisdiction of an identified court so that any dispute that arise concerning administration of the trust may be litigated with relative ease. While facilitating judicial proceedings initiated by the trustee or beneficiaries, the UPC avoids compulsory, continuing judicial supervision. Uniform Probate Code Section 7-201(b) provides:

> Neither registration of a trust nor a proceeding under this section result [sic] in continuing supervisory proceedings. The management and distribution of a trust estate, submission of accounts and reports to beneficiaries, payment of trustee's fees and other obligations of a trust, acceptance and change of trusteeship, and other aspects of the administration of a trust shall proceed expeditiously consistent with the terms of the trust, free of judicial intervention and without order, approval or other action of any court, subject to the jurisdiction of the Court as invoked by interested parties or as otherwise exercised as provided by law.

The trust registration provisions have not been well received by the states that have considered the UPC. The staff has examined the statutes of 15 states--14 of them "UPC states" and Kentucky, which enacted much of the article on trust administration. Only three states--Alaska, Idaho, and North Dakota--enacted the trust registration scheme with a mandatory duty that is not subject to significant exceptions. Two states--Maine and Nebraska--have made the registration an option by substituting the word "may" where "shall" appears in UPC Section 7-101. Six states omit the registration provisions entirely--Arizona, Florida (which had initially enacted the registration scheme), Minnesota, Montana, New Mexico, and Utah. Four states have registration schemes with a mandatory duty but subject to significant exceptions. Colorado provides for registration as a general rule, but exempts trusts having no asset other than the right to receive property upon the occurrence of some future event, trusts nominally funded (assets valued at $500 or less), and revocable inter vivos trusts (while revocable). Hawaii requires registration in the principal place of administration or where land held in trust is located and does not require registration of inter vivos trusts unless required by the settlor (the exception does not apply when the settlor dies). Kentucky similarly provides that there is no duty to register an inter vivos trust unless the settlor so directs. Michigan does not require registration of testamentary trusts or any trust containing terms exempting the trustee from the registration provisions.

The State Bar has opposed the registration concept, labelling it "alien to the policy adopted by the California Legislature in respect to inter vivos trusts in that it prevents the creation of private trusts without public disclosure." State Bar of California, The Uniform Probate Code: Analysis and Critique 197 (1973). This criticism glosses over the fact that registration does not involve disclosure of the terms of written inter vivos trusts nor of the trust beneficiaries. It is hard to understand what policy concerning the creation of private trusts without public disclosure is impaired in any significant manner by the UPC registration provisions. If the State Bar was referring to some policy in favor of oral trusts, then some additional support for the statement is needed. In addition, as noted by the Joint Editorial Board of the UPC, the State Bar "does not attempt to relate the alleged 'policy' of the California Legislature to private, testamentary trusts which cannot be created in California without full public disclosure of all of the trust terms and assets--much more than would be required by UPC's registration provisions." Joint Editorial Board of the Uniform Probate Code, Response of the Joint Editorial Board 70 (1974). In any event, modifications in the registration scheme like those enacted in some other states could make registration permissive during the life of the settlor of a written inter vivos trust and so avoid the State Bar objection.

Before considering any modifications in the UPC scheme, the Commission should consider whether to continue the substance of California law relating to jurisdiction over trusts or to adopt some form of registration. California has moved away from continuing judicial supervision of testamentary trusts and at the same time provided for judicial supervision of inter vivos and testamentary trusts upon petition of a trustee, beneficiary, or remainderman. See Prob. Code §§ 1120 (testamentary trust not subject to continuing jurisdiction unless testator provides otherwise), 1138 (trust defined), 1138.1 (grounds for petition). The State Bar has commented that the "philosophical orientation of Article VII of the UPC is similar to that of the California Probate Code." State Bar, supra, at 194. It should be noted, however, that Probate Code Section 1138.13 permits a trust to exempt itself from judicial supervision either expressly or by "necessary implication." The registration provisions of the UPC may not generally be avoided. Probate Code Section 1138.3 gives jurisdiction to the superior court where the principal place of administration of the trust is located. This is the same place where, under UPC Section 7-101, the trust would be required to be registered. (The rules on determining the principal place of administration differ in the case of cotrustees.) Registration under the UPC makes clear that the trustee submits personally to the court's jurisdiction. UPC § 7-103(a). If the trustee does not register the trust, Section 7-103(a) makes clear that accepting the trusteeship results in submitting to the court's jurisdiction and the proceedings may be commenced in the principal place of administration where the trust could have been registered. UPC § 7-202.

Registration would make it easier for beneficiaries and remaindermen to know the proper court for initiating proceedings. This benefit must be weighed against the financial burden on government of establishing a registration system and the burden on trustees of routinely requiring registration. Remember, however, that under the UPC the trustee is not subject to any penalty for not registering the trust until 30 days after the trustee receives a written demand for registration. Does the Commission wish to propose enactment of a registration scheme?

If the Commission approves trust registration, the following alternatives should be considered:

1. Adopt the UPC scheme, including mandatory registration of trusts, except revocable trusts which may avoid registration while the power to revoke lasts.

2. Make registration mandatory, subject to certain exceptions where registration would be permissive, such as:

-- Trusts with no assets other than right to receive property upon occurence of future event. (Colorado)
-- Trusts nominally funded in an amount such as $500. (Colorado)
-- Inter vivos trusts during the life of the settlor. (Hawaii)
-- Inter vivos trusts at any time, unless required by the settlor. (Kentucky)

3. Make registration generally permissive. (Maine, Nebraska)

If the Commission decides to recommend some sort of registration scheme, the staff will draft a statute on the basis selected and present it at the next meeting.

Foreign Trustees

Uniform Probate Code Section 7-105 would permit foreign trustees to receive distributions from local estates, to hold, invest in, manage, or acquire property in California, and to maintain litigation without the necessity of qualifying to do business in the state. However, a foreign corporate trustee would be required to qualify if it maintains the principal place of administration of the trust within the state or otherwise acts in a way requiring qualification to do business. The Comment to Section 7-105 says that this should

> correct a widespread deficiency in present regulation of trust activity. Provisions limiting business of foreign corporate trustees constitute an unnecessary limitation on the ability of a trustee to function away from its principal place of business. These restrictions properly relate more to continuous pursuit of general trust business by foreign corporations than to isolated instances of litigation and management of the assets of a particular trust.

Section 7-105 also provides that a foreign cotrustee is not required to qualify in the local jurisdiction solely because its cotrustee maintains the principal place of administration there.

California law, with some very minor exceptions relating to bonds, precludes foreign corporations, other than national banking associations, from directly or indirectly transacting trust business in this state. Fin. Code § 1503. Apparently, alien and nonresident individuals may act as trustees. See Ellis, Trustees and Administrative Provisions, in California Will Drafting Practice § 14.3, at 643-44 (Cal. Cont. Ed. Bar 1982). It should be noted that the UPC does not displace the general rules concerning what other acts require qualification by a foreign corporation in a state. The Corporations Code reflects a more enlightened view of interstate commerce. Corporations Code Section 191(c) provides that a foreign corporation is not conducting intrastate business where it maintains an action or "conducts an isolated transaction completed within a period of 180 days and not in the course of a number of repeated transactions of like nature." See also Corp. Code §§ 2100-2116 (foreign corporations).

The State Bar found that enactment of a provision like UPC Section 7-105 "would facilitate the administration of trusts with multi-state real property assets" but also suggested that "this may create other problems that form the basis for the long-standing policy in California of prohibiting out-of-state corporate fiduciaries from transacting business in the State of California without qualifying to do so." State Bar, supra, at 198. The Joint Editorial Board of the UPC responded by noting that the nature and importance of the other problems was not revealed, but presumed that they were "problems for local banks interested in keeping out corporate competitors." The Joint Editorial Board also asked whether the California system is "effective against arrangements involving co-trustees, nominees, and individual original and successor trustee arrangements that are frequently used to circumvent the barriers against foreign corporations." Joint Editorial Board, supra, at 71.

The staff recommends adoption of a provision drawn from UPC Section 7-105. A draft is attached to this supplement as Exhibit 1. In light of the lack of any restrictions on foreign individuals acting as trustees in California under existing law, and the limited nature of the acts permitted by nonqualified foreign corporate trustees under Section 7-105, this provision seems desirable.

Court Jurisdiction Over Trusts

Consistent with its purpose of eliminating procedural distinctions between testamentary and inter vivos trusts, UPC Sections 7-201 to 7-206 provide a unified scheme for judicial involvement in trust administration. As noted above, the UPC does not contemplate continuing judicial supervision or intervention. See UPC § 7-201(b). Section 7-201 provides that the court has "exclusive jurisdiction of proceedings initiated by interested parties concerning the internal affairs of trusts." Under the UPC, court is defined as the one with jurisdiction in matters relating to the affairs of decedents. The same court is given concurrent jurisdiction with other courts of the state as to actions to determine the existence of nontestamentary trusts, actions involving creditors or debtors of trusts, and other actions involving third parties. UPC § 7-204. Section 7-202 provides for venue in the place of registration or where the trust could have been registered as to internal matters, and Section 7-204 incorporates general venue rules for other actions. Section 7-203 provides a forum non conveniens rule applicable to foreign trusts and requires the court to refuse to entertain a proceeding unless all appropriate parties could not be bound by litigation in the foreign courts or when the interests of justice otherwise would be seriously impaired.

Under UPC Section 7-201(a), the court has exclusive jurisdiction over proceedings concerning the administration and distribution of trusts, the declaration of rights, and the determination of other matters involving trustees and beneficiaries. Without limiting the scope of such proceedings, Section 7-201(a) lists the following proceedings: (1) to appoint or remove a trustee, (2) to review trustees' fees and to review and settle interim or final accounts, (3) to ascertain beneficiaries, determine any question arising in the administration or distribution of a trust including questions of construction of trust instruments,

(4) to instruct trustees, (5) to determine the existence of any immunity, power, privilege, duty, or right, and (6) to release trust registration. Section 7-205 also permits the court to review "the propriety of employment of any person by a trustee" and the reasonableness of the person's compensation and the trustee's compensation.

The substance of these UPC provisions is largely in accord with California law, although there are some important differences. The jurisdiction over inter vivos trusts and testamentary trusts not subject to court supervision is in the superior court. Prob. Code § 1138.1(a). Venue is in the principal place of administration. Prob. Code § 1138.3. If a testamentary trust remains under the jurisdiction of the court as provided in Probate Code Section 1120, the venue rules are different because the superior court where the will was probated retains jurisdiction. This rule seems to be a historical remnant.

California law does not deal neatly with the exclusivity of jurisdiction over internal matters. The UPC provisions which place exclusive jurisdiction in the superior court at the principal place of administration appeal to the staff and do not appear to be contrary to any significant policy of existing law. Probate Code Section 1138.11 provides that the remedies of Sections 1138-1138.14 are "cumulative and nonexclusive." The State Bar and the Joint Editorial Board of the UPC have disputed the meaning of this provision. See State Bar, supra, at 200-01; Joint Editorial Board, supra, at 71-72.

California provisions concerning the grounds for petitioning the court are both more detailed and repetitious. The following table compares California law regarding supervised trusts and nonsupervised trusts and the UPC.

California Law		Uniform Probate Code
Supervised Testamentary Trusts Prob. Code §§ 1120-1126	Nonsupervised Trusts Prob. Code §§ 1138.1, 1138.2	§§ 7-201, 7-205
Determine recipients of property on termination of trust. § 1120(b)	Same. § 1138.1(a)(1)	Ascertain beneficiaries. § 7-201(a)(3)
Settle accounts. § 1120(b)	Same. § 1138.1(a)(2)	Settle interim or final accounts. § 7-201(a)(2)
Pass on acts of trustee. § 1120(b)	Same. § 1138.1(a)(2)	[See general language.]
Instruct the trustee. § 1120(b)	Same. § 1138.1(a)(4)	Same. § 7-201(a)(3)

Accept additions to trusts. § 1120(b)	Same. § 1138.1(a)(3)	[See general language.]
Grant powers provided in § 1120.2. § 1120(b)	Same. § 1138.1(a)(6)	Determine existence of any power. § 7-201(a)(3)
Amend trust for charitable estate tax deduction. § 1120(b)	Same. § 1138.1(a)(13)	
Submit accounts to beneficiary and remaindermen. § 1121	Same. § 1138.1(a)(5)	[Duty in § 7-303; see general language.]
Fix compensation. § 1122	Same. § 1138.1(a)(7)	Review trustee fees. § 7-201(a)(2), 7-205
Appoint trustee. §§ 1125, 1126	Same. § 1138.1(a)(8)	Same. § 7-201(a)(1)
Accept resignation of trustee. § 1125.1	Same. § 1138.1(a)(9)	
Remove trustee. § 1123.5	Same. § 1138.1(a)(10)	Same. § 7-201(a)(1)
Modify trust with low principal. § 1120.6	Same. § 1138.1(a)(12)	
		Review employment of persons by trustee. § 7-205

The UPC also provides that proceedings may be maintained concerning the "administration and distribution of trusts, the declaration of rights and the determination of other matters involving trustees and beneficiaries." UPC § 7-201(a). This includes proceedings to "determine any question arising in the administration or distribution of any trust including questions of construction of trust instrument . . . and determine the existence or nonexistence of any immunity, power, privilege, duty or right." UPC § 7-201(a)(3).

California law does not contain such broad language; however, Probate Code Section 1138.2 does provide that the court may make "all orders and decrees and take all other action necessary or proper to dispose of the matters presented by the petition." In Copley v. Copley, 80 Cal. App.3d 97, 145 Cal. Rptr. 437 (1978), the court of appeal held that the superior court in proceedings under Probate Code Sections 1138-1138.13 was exercising limited probate jurisdiction and did not have the general equity powers of the superior court. In this case the probate court was found to lack jurisdiction to determine the beneficiaries' allegation of fraud or to rescind a sale of stock and determine damages. It appears that the authority granted the court under UPC Section 7-201 is broader than that allowed the probate court under existing California law.

The staff proposes a statute that would consolidate the procedures applicable to supervised testamentary trusts and nonsupervised trusts. We also recommend expanding the jurisdiction of the court consistent with the language in UPC Section 7-201. This entails provisions for obtaining jurisdiction over all interested parties. This expanded jurisdiction would be consistent with the trend of both the statutes and decisional law. See Copley, *supra*, at 107-08. A draft will be presented in a later memorandum.

General Duty of Trustee

Uniform Probate Code Section 7-301 provides as follows:

> Except as specifically provided, the general duty of the trustee to administer a trust expeditiously for the benefit of the beneficiaries is not altered by this Code.

The purpose of this provision appears to be to avoid any construction that traditional trust principles are replaced by the UPC. Section 7-301 has received almost no attention from commentators on this part of the UPC. The staff finds this provision unobjectionable; although it does not provide much guidance, it does anticipate the question whether the statutory statement of specific duties is exclusive. The staff recommends that a provision of this type be included in the proposed legislation. See Exhibit 2, attached hereto.

Field Code-derived provisions in the Civil Code bear on the general duties of trustees. Civil Code Section 2228 provides:

> In all matters connected with his trust, a trustee is bound to act in the highest good faith toward his beneficiary, and may not obtain any advantage therein over the latter by the slightest misrepresentation, concealment, threat, or adverse pressure of any kind.

However, most statutory provisions in California law are stated as limitations on the actions of the trustee, such as Civil Code Section 2231: "A trustee may not use the influence which his position gives him to obtain any advantage from his beneficiary." Civil Code Section 2238 also limits the liability of a trustee "who uses or disposes of the trust property in any manner not authorized by the trust, but in good faith, and with intent to serve the interests of the beneficiary." The staff assumes that courts would not be receptive to arguments based on technicalities in language used in these various formulations of the basic fiduciary duties of the trustee. Consequently, the determination of an appropriate statutory formulation is ultimately a matter of taste.

"Prudent Man" Standard in General

Uniform Probate Code Section 7-302 provides a prudent man standard that applies to all the trustee's actions:

> Except as otherwise provided by the terms of the trust, the trustee shall observe the standards in dealing with the trust assets that would be observed by a prudent man dealing with the property of another . . . .

The Comment to UPC Section 7-302 recognizes that this standard differs from that in the Restatement of Trusts, which refers to the care a "man of ordinary prudence would exercise in dealing with his own property." The Comment explains the difference in wording as reflecting the traditional standard "as it has been articulated in some decisions regarding the duty of a trustee concerning investments." The Comment also says that the new wording "more clearly conveys the idea that a trustee must comply with an external, rather than with a personal, standard of care." The UPC formulation has been well received in states which have enacted the UPC trust administration provisions.

The prudent man standard appears in several incarnations in California trust law. See Civil Code §§ 730.02(a)(3), 2261, 2290.6. The general rule is set forth in some detail in Civil Code Section 2261 as follows:

> (1) In investing, reinvesting, purchasing, acquiring, exchanging, selling and managing property for the benefit of another, a trustee shall exercise the judgment and care, under the circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of their capital. Within the limitations of the foregoing standard, and subject to any express provisions or limitations contained in any particular trust instrument, a trustee is authorized to acquire every kind of property, real, personal or mixed, and every kind of investment, specifically including, but not by way of limitation, corporate obligations of every kind, and stocks, preferred or common, which men of prudence, discretion and intelligence acquire for their own account.
>
> (2) In the absence of express provisions to the contrary in the trust instrument, a trustee may continue to hold property received into a trust at its inception or subsequently added to it

> or acquired pursuant to proper authority if and as long as the trustee, <u>in the exercise of good faith and of reasonable prudence, discretion and intelligence</u>, may consider that retention is in the best interests of the trust. Such property may include stock in the trustee, if a corporation, and stock in any corporation controlling, controlled by, or under common control with such trustee.
>
> . . .
>
> [Emphasis added.]

The prudent man standard in subdivision (1) was derived from the Model Prudent Man Statute drafted by the American Bankers Association and was enacted in 1943, replacing the legal list of permissible investments. See Comment, <u>Prudent Man Investment of Trust Funds During Inflation</u>, 39 Calif. L. Rev. 380, 381 (1951). Some remnants of the legal list provisions remain, however, such as in Civil Code Section 2261(3) providing for deposit of funds in an insured bank account.

The more specific language of California law appears to achieve the same purpose as UPC Section 7-302 of referring to an "external" rather than a "personal" standard of care, though Civil Code Section 2261 accomplishes this purpose by frowning upon speculation and requiring consideration of the safety of capital. The staff is not aware of any significant difficulties arising from the language of Civil Code Section 2261 and we conclude that no significant differences would result from the application of one standard rather than the other. The UPC language is certainly simpler, but the Civil Code language seems to provide more guidance. <u>The staff is inclined to retain the general wording of the California standard</u>, as set forth in Exhibit 2, attached hereto. What does the Commission wish to do?

<u>Expert Standard of Care</u>

Uniform Probate Code Section 7-302 imposes a higher standard of care on professional trustees by providing that "if the trustee has special skills or is named a trustee on the basis of representations of special skills or expertise, he is under a duty to use those skills." A similar rule is provided in the Restatement (Second) of Trusts § 174 (1959). This rule is not codified in California, although it is recognized in several cases. See Estate of Collins, 72 Cal. App.3d 663, 673, 139 Cal. Rptr. 644 (1977) (dictum); Coberly v. Superior Court, 231 Cal. App.2d 685, 689, 42 Cal. Rptr. 64 (1965); <u>cf.</u> Estate of Beach, 15 Cal.3d 623, 635, 542 P.2d 994, 125 Cal. Rptr. 570 (1975) (bank as executor). See also the Comment to Probate Code § 2401 (greater standard of care applies to professional guardian or conservator of estate). The staff proposes that this rule be codified in the general terms of UPC Section 7-302, as set forth in Exhibit 2, attached hereto.

Trustee's Duty to Inform and Account to Beneficiaries

Uniform Probate Code Section 7-303 provides as a general rule that the "trustee shall keep the beneficiaries of the trust reasonably informed of the trust and its administration." Upon "reasonable request" by the beneficiary, the trustee is also required to provide a copy of the terms of the trust relevant to the beneficiary's interest and information about the trust assets and the "particulars relating to the administration." UPC § 7-303(b). The beneficiary is also entitled upon "reasonable request" to a statement of the trust accounts annually, on termination of the trust, or change of the trustee. UPC § 7-303(c). These provisions are recommended as a preferable alternative to routinely required court accountings. General Comment to UPC Article VII. The trustee is encouraged to submit accounts to the beneficiary by UPC Section 7-307 which bars claims against a trustee as to any beneficiary who has received a statement fully disclosing the matter after the expiration of six months from receipt of the statement.

In California there is no duty to account to either the court or beneficiaries on a regular basis. See 7 B. Witkin, Summary of California Law Trusts § 69, at 5429 (8th ed. 1974); id., Wills and Probate § 254, at 5757. Probate Code Section 1121 provides a procedure whereby a beneficiary of a testamentary trust subject to court supervision, or the beneficiary's guardian or conservator, may petition the court for an order requiring the trustee to render an account; the application may not be denied if no account has been rendered to the court within the previous six months. Probate Code Section 1138.1(a)(5), applicable to inter vivos trusts and to testamentary trusts not subject to court supervision, permits a petition compelling the trustee to submit accounts and report acts as trustee to a beneficiary or remainderman "when it appears that the trustee has failed to submit an accounting and report within 60 days after written request of a beneficiary or remainderman and no accounting and report has been made within six months preceding such request." The California Supreme Court has stated that a "trustee has the duty to the beneficiaries to give them upon their request at reasonable times complete and accurate information relative to the administration of the trust." Strauss v. Superior Court, 36 Cal.2d 396, 401, 224 P.2d 726 (1950).

The State Bar has reacted to the UPC provision for informal accountings to the beneficiary as follows:

> Under California law, beneficiaries presumably may request a non-court accounting, but there is no requirement that the trustee provide it. California law is superior on this point. If matters between the beneficiary and the trustee cannot be handled on an informal basis, the remedy is to require the trustee to file a formal accounting with the appropriate court. Informal accountings may, of course, be submitted by the trustee to beneficiaries at any time, and there appears to be no particular need for statutes governing these informal accountings. [State Bar, supra, at 206.]

The Joint Editorial Board of the UPC found that the State Bar offered "no basic objection" to the duty to give information and accountings and argued that the UPC provision would aid beneficiaries where the trustee is in another state and not subject to the jurisdiction of California courts. See Joint Editorial Board, supra, at 74. This comment assumes enactment of the UPC provision or a provision with similar impact in the jurisdiction with power over the trustee.

The staff finds the UPC provision for accounting to beneficiaries to be useful and not in conflict with any policy of California law. See the draft attached hereto as Exhibit 3. It should be noted that UPC Section 7-303(c) provides for an accounting upon request on an annual basis whereas Probate Code Section 1138.1(a)(5) contains an implicit six-month period.

Trustee's Bond

Uniform Probate Code Section 7-304 provides that a bond is not required unless (1) required by the terms of the trust, (2) reasonably requested by a beneficiary, or (3) found by the court to be necessary to protect interests of incapacitated or unrepresented beneficiaries. The general rules governing bonds of personal representatives under UPC Sections 3-604 and 3-606 apply to trustee's bonds when required. Section 7-304 also permits the court to excuse bond or reduce its amount upon petition of the trustee or other interested person but no standard is provided.

Under California law, a trustee named in a will or inter vivos trust instrument is not required to give bond unless the instrument otherwise requires. However, bond is required of a testamentary trustee appointed by the court, except in the case of a nonprofit corporation acting within the scope of its charitable purposes. Prob. Code §§ 1127, 1127.5. It has been held that bond may be waived if all creditors and beneficiaries consent and there are no minor or unascertained beneficiaries. Estate of Shapiro, 79 Cal. App.2d 731, 181 P.2d 117 (1947). Drafting manuals suggest that bond is ordinarily an unnecessary expense, and that if it is felt that bond is needed, then perhaps a different trustee should be selected. See, e.g., Ellis, Trustees and Administrative Provisions, in California Will Drafting Practice § 14.26, at 666 (Cal. Cont. Ed. Bar 1982). It has been suggested that bond be required of a nonresident trustee. See 3 J. Goddard, Probate Court Practice § 1819 (2d ed. 1977). It has also been suggested that an attorney who drafts a will or trust instrument naming the attorney as trustee should include a provision requiring bond. Moltzen, The Lawyer and Will Drafting, in California Will Drafting § 1.38, at 21-22 (Cal. Cont. Ed. Bar 1965).

The staff does not detect any real conflict between California law and the UPC as regards trustees' bonds. The staff recommends approval of a provision containing the substance of UPC Section 7-304. See Exhibit 4, attached hereto. This section would held clarify the law by providing a general rule subject to several exceptions; California law currently provides only some limited and unrelated exceptions. Adoption of UPC Section 7-304 would result in a less restrictive requirement in situations now governed by Probate Code Section 1127 which requires bond of a testamentary trustee appointed by the court. Section 7-304 would apply the general rule that does not require bond in such cases, unless otherwise ordered by the court or required by the trust. This change would answer the query whether a bond is required if a will nominates rather than appoints a successor trustee, since it is unclear under existing Probate Code Section 1127 whether bond is required of a trustee appointed by the court consistent with the testator's nomination. See California Will Drafting Supplement § 17.21, at 259 (Cal. Cont. Ed. Bar 1981).

Liability of Trust Estate and Trustee to Third Persons

Uniform Probate Code Section 7-306 provides substantive rules governing the liability of trustees to third persons. Subdivision (a) makes the trustee personally liable on contracts property entered into in the administration of the trust only where the contract so provides or where the "trustee fails to reveal his representative capacity and identify the trust estate in the contract." A trustee is liable for obligations arising from ownership or control of trust property or for torts only if the trustee is "personally at fault." UPC § 7-306(b). Third persons are permitted to sue the trust estate on contracts entered into in the trustee's fiduciary capacity, on obligations arising from ownership or control of the trust estate, or on torts by bringing an action against the trustee in the trustee's fiduciary capacity. UPC § 7-306(c). The question of the trustee's liability to the estate may be determined in the main action or other appropriate proceeding such as for an accounting or surcharge. UPC § 7-306(d) and the Comment thereto.

The UPC provision is representative of the modern tendency to put the economic burden on the trust rather than the trustee. See Tepper, Liability of the Trust Estate Arising Out of Trustee's Contracts With Third Persons, 2 Hastings L.J. 53, 61-65 (1950). The general rule followed in California is that the trustee is personally liable for contracts and torts as if the trustee owned the property free of the trust, except where the trustee is expressly exempted by contract. See cases cited in 7 B. Witkin, Summary of California Law Trusts § 100, at 5460 (8th ed. 1974). Under the common law, the trustee was recognized only in an individual capacity so that a judgment would bind the trustee's assets but not the trust estate. The trustee could pass this liability on to the estate if no fiduciary duty had been breached. See Garvey, The Ohio Law of Trusts and the Uniform Probate Code: A Comparison, in Comparative Probate Law Studies 769, 783-84 (1976). Creditors could be subrogated to the trustee's right against the trust estate but the creditor's right was generally limited to the trustee's right of indemnification. Id. at 784.

California statutes are largely silent on the liability of trustees to third persons. Civil Code Section 2267 provides that as a general agent, a trustee may bind the trust estate by acts within the scope of the trustee's authority. One commentator has described Section 2267 as an "enigmatic declaration" which is presumably aimed at the old rule that a trustee necessarily acted as principal since the trust had no legal personality. Evans, Observations on the State, Etc. of the California Laws of Uses and Trusts, 28 S. Cal. L. Rev. 111, 120 (1955); see also Tepper, Liability of the Trust Estate Arising Out of Trustee's Contracts

With Third Persons, 2 Hastings L.J. 53, 59-61 (1950). Under Section 2267 obligees on a contract made within the scope of the trustee's authority may reach the trust property directly without being restricted to the trustee's right of exoneration. See Purdy v. Bank of America, 2 Cal.2d 298, 301-02, 40 P.2d 481 (1935).

The staff recommends adoption of the substance of UPC Section 7-306. See the draft attached hereto as Exhibit 5. This would make the law more accessible and provide clearer rules. Adoption of the substance of UPC Section 7-306 would change California law in several respects. A trustee would no longer be personally liable on contracts entered into in a fiduciary capacity, if the trustee revealed its representative capacity and identified the trust estate. This would reverse the California rule that a trustee is personally liable unless the contract provides an exemption. See Duncan v. Dormer, 94 Cal. App. 218, 221, 270 P. 1003 (1928). Tort liability of the trustee would be restricted to cases where the trustee was personally at fault. Section 7-306 also appears to smooth procedural difficulties by permitting actions against the trust estate. This appears to alter the rule stated in Rapaport v. Forer, 20 Cal. App.2d 271, 278, 66 P.2d 1242 (1937).

Limitations on Actions Against Trustee for Breach of Trust

Uniform Probate Code Section 7-307 bars actions against the trustee for breach of trust brought later than six months after a final account making full disclosure and showing termination of the trust relationship. The accounting may be a formal account made pursuant to court proceedings or an informal accounting made directly to the beneficiary under the provisions of UPC Section 7-303. If the final account does not make full disclosure, a three-year limitations period applies if the beneficiary has received a final account and been informed of the location and availability of the trustee's records. Apparently claims based on interim accounts are barred only by adjudication or consent, unless some general statute is applicable. It also appears that the six-month and three-year provisions do not apply in cases of the trustee's fraud. See UPC § 1-106 (two-year period running from time of discovery of fraud).

The State Bar has summarized California law as follows:

> In California, absent fraud, the four-year general statute of limitations applies to trusts not subject to court supervision and to court supervised trusts when no accounting is rendered. Under

> California law, an accounting settled by the court is final once the period for appeal expires unless the decree of approval is set aside within six months by reason of mistake, inadvertence or neglect. [State Bar, supra, at 206-07.]

The four-year catch-all statute of limitations provided in Code of Civil Procedure Section 343 has generally been applied to actions for breaches 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). But cf. Estate of McCabe, 80 Cal. App.2d 823, 183 P.2d 72 (1947) (termination of trust did not start statute running since Prob. Code § 1121 gives beneficiary absolute right to account if not rendered to court in preceding six months, court not deciding whether statute of limitations applied). The statute of limitations applicable to actions for relief on the ground of fraud is three years from the discovery of the facts. Code Civ. Proc. § 338(4).

The Uniform Probate Code is more protective of trustees than California law. The effect of court-approved accounts appears to be the same, but the six-month period applicable to nonapproved accounts, including informal accounts to the beneficiary, would be a significant change in California law. Under the UPC scheme, the important factor is whether full disclosure has been made in the final account. If it has, then the six-month period applies; if not, then the three-year period applies. The staff thinks that this scheme makes sense and recommends it for Commission approval. See the draft attached hereto as Exhibit 6.

The Commission may want to consider whether different time limits should be applicable. It should be noted that the six-month period is bracketed in the UPC, indicating that it is recognized that a different period may be preferred in enacting jurisdictions. An examination of the law of 13 states that have enacted a provision like UPC Section 7-307 reveals that only Hawaii altered the six-month period, raising it to two years. Only Florida rejected the three-year period, substituting a reference to general statutes of limitation. Several reported California cases have involved a dispute over whether a three-year or four-year period applies; but of course such cases wouldn't have arisen if the applicable limitation was clear. If the three-year period of the UPC is approved by the Commission, a transitional provision will be needed to preserve rights existing under the four-year statute. The staff would not at this point recommend UPC Section 1-106, the general section on actions based on fraud; this provision will be considered in the course of the probate administration study.

Sincerely,

Stan G. Ulrich
Staff Counsel

EXHIBIT 1

Staff Draft of Provisions Relating to
Foreign Trustees

Probate Code § (added). Qualification of foreign trustees

[1]. (a) A foreign corporate trustee is required to qualify as a foreign corporation doing business in this state if it maintains the principal place of administration of a trust within this state. A foreign corporate cotrustee is not required to qualify as a foreign corporation doing business in this state solely because its cotrustee maintains the principal place of administration of a trust within this state.

(b) Unless otherwise doing business in this state, a foreign trustee, corporate or individual, is not required to qualify in this state in order for the trustee to receive a distribution from a local estate, to hold, invest in, manage, or acquire property located in this state, or to maintain litigation in this state.

(c) Nothing in this section affects the determination of what other acts require qualification as a foreign corporation doing business in this state.

Comment. Section [1] is a new provision and is the same in substance as Uniform Probate Code Section 7-105. Under this section, a foreign corporate trustee may perform isolated instances of litigation and management of the assets of a particular trust without being required to qualify as a foreign corporation doing business in this state, such as is required where the foreign corporation seeks to pursue a general trust business in California. Subdivision (c) of Section [1] preserves the general rules governing when qualification is required, subject to the exceptions provided in subdivisions (a) and (b). See Corp. Code §§ 191, 2100-2116; Fin. Code §§ 1503, 1750.

Note. Financial Code Sections 1503 and 1750 will need to be amended if a provision like that set out above is approved.

Financial Code § 1503 (amended). Foreign corporations exercising trust powers

1503. No foreign corporation, other than a national banking association which is authorized to conduct a trust business in this state, shall have or exercise the powers of a trust company nor directly or indirectly transact or conduct in this state a trust business as defined in Section 106; but any foreign corporation which is authorized by its articles to exercise trust powers may act as trustee for the following purposes:

(a) To deliver bonds and receive payments therefor.

(b) To deliver permanent bonds in exchange for temporary bonds of the same issue.

(c) To deliver refunding bonds in exchange for those of a prior issue or issues.

(d) To register bonds or to exchange registered bonds for coupon bonds or coupon bonds for registered bonds.

(e) To pay interest on such bonds, and take up and cancel coupons representing such interest payment.

(f) To redeem and cancel bonds when called for redemption or to pay and cancel bonds when due.

(g) To certify registered bonds for the purpose of exchanging registered bonds for coupon bonds.

<u>(h) To perform acts related to the trust as provided in Section [_______] of the Probate Code.</u>

A foreign corporation which is authorized by its articles to exercise trust powers may be appointed and may accept appointment and act as trustee under any mortgage, deed of trust, or other instrument securing bonds or other obligations issued or to be issued by any railroad corporation which owns a railroad operating in the State of California and extending into another state.

A foreign corporation exercising in this state the powers conferred by this section shall not establish or maintain directly or indirectly any branch office or agency in this state unless it has complied with all of the applicable provisions of Chapter 13.5 (commencing with Section 1700).

<u>Financial Code § 1750 (amended). Conduct of business by foreign banks</u>

1750. (a) (1) No foreign (other state) bank shall transact business in this state.

(2) No foreign (other nation) bank shall transact business in this state except at an agency or branch office which it is licensed to maintain and at which it is permitted by this chapter to transact such business.

(b) Subdivision (a) shall not be deemed to prohibit:

(1) Any foreign (other nation) bank which maintains a federal agency or federal branch in this state from transacting at such federal agency or federal branch such business as it may be authorized to transact under applicable federal laws and regulations;

(2) Any foreign bank from carrying on the activities described in subdivision (d) of Section 191 of the Corporations Code;

(3) Any foreign bank which does not maintain an agency or branch office from making in this state loans secured by liens on real property located in this state; or

(4) Any foreign bank which does not maintain an agency or branch office from transacting trust business as permitted under Section 1503 <u>of the Financial Code or under Section [______] of the Probate Code</u>.

(c) For purposes of subdivision (a), no foreign bank shall be deemed to be transacting business in this state merely because a majority-owned subsidiary transacts business in this state.

EXHIBIT 2

Staff Draft of Provisions Relating to
Trustee's Standard of Care and Performance

Probate Code § (added). General duty of trustee

[1]. A trustee has a general duty to administer the trust expeditiously for the benefit of the trust beneficiaries.

Comment. Section [1] is a new provision and is drawn from Uniform Probate Code Section 7-301.

Probate Code § (added). Trustee's standard of care and performance

[2]. Except as otherwise provided by the terms of the trust, the trustee shall exercise the judgment and care, under the circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital.

Comment. Section [2] continues the substance of the first sentence of subdivision (1) and the first sentence of subdivision (2) of former Civil Code Section 2261.

Probate Code § (added). Expert trustee's standard of care

[3]. If a trustee has special skills or is named as a trustee on the basis of representations of special skills or expertise, the trustee is under a duty to use those skills.

Comment. Section [3] is the same as part of Uniform Probate Code Section 7-302. This section codified the rule that a higher standard of care is required of experts which was recognized in California cases. See Estate of Collins, 72 Cal. App.3d 663, 673, 139 Cal. Rptr. 644 (1977) (dictum); Coberly v. Superior Court, 231 Cal. App.2d 685, 689, 42 Cal. Rptr. 64 (1965); cf. Estate of Beach, 15 Cal.3d 623, 635, 542 P.2d 994, 125 Cal. Rptr. 570 (1975) (bank as executor). See also the Comment to Probate Code § 2401 (greater standard of care applicable to professional guardian or conservator of estate).

EXHIBIT 3

Staff Draft of Provisions Relating to
Trustee's Duty to Account to Beneficiaries

Probate Code § (added). Trustee's duty to inform and account to beneficiaries

[1]. (a) The trustee shall keep the beneficiaries of the trust reasonably informed of the trust and its administration.

(b) Upon reasonable request, the trustee shall provide the beneficiary with a copy of the terms of the trust which describe or affect the beneficiary's interest and with relevant information about the assets of the trust and the particulars relating to the administration of the trust.

(c) Upon reasonable request, the trustee shall provide the beneficiary with a statement of the accounts of the trust annually, at the termination of the trust, or upon a change of trustees.

Comment. Section [1] is a new provision and is drawn from Uniform Probate Code Section 7-303. Subdivision (a) is the same as the first sentence of Uniform Probate Code Section 7-303 and is consistent with the duty stated in California case law to give beneficiaries complete and accurate information relative to administration of a trust when requested at reasonable times. See Strauss v. Superior Court, 36 Cal.2d 396, 401, 224 P.2d 726 (1950). Subdivision (b) is the same in substance as Uniform Probate Code Section 7-303(b). Subdivision (c) is the same in substance as Uniform Probate Code Section 7-303(c). If the trustee does not comply with the reasonable request of the beneficiary, an accounting may be compelled as provided in Section [ ]. See also Section [ ] ("beneficiary" defined).

Note. California Probate Code Section 1138.1(a)(5) permits a remainderman to petition for an accounting. As used in UPC Section 7-303 "beneficiary" includes "a person who has any present or future interest, vested or contingent." The staff plans to include a similar definition in this statute.

EXHIBIT 4

Staff Draft of Provisions Relating to
Trustee's Bond

Probate Code § (added). Trustee's bond

[1]. (a) A trustee is not required to provide bond to secure performance of the trustee's duties, except in any of the following circumstances:

(1) Where bond is required by the terms of the trust.

(2) Where bond is reasonably requested by a beneficiary.

(3) Where bond is found by the court to be necessary to protect the interests of beneficiaries who are not able to protect themselves and whose interests otherwise are not adequately represented.

(b) On petition of the trustee or other interested person, the court may excuse a requirement of bond, reduce the amount of the bond, release the surety, or permit the substitution of another bond with the same or different sureties.

(c) If bond is required, it shall be filed in the court [having jurisdiction over the trust] in the amount and with surieties and liabilities as provided for bonds of personal representatives.

Comment. Section [1] is the same in substance as Uniform Probate Code Section 7-304. This section supersedes former Probate Code Sections 1127 (bond of trustee named by court) and 1127.5 (exception for substitute or successor trustee that is charitable corporation).

Note. The court described in subdivision (c) will be the court of registration, if the Commission adopts a registration scheme. Otherwise it will be the court in the principal place of administration of the trust.

EXHIBIT 5

Staff Draft of Provisions Relating to
Liability of Trustee and Trust Estate to Third Persons

Probate Code § (added). Personal liability of trustee to third persons on contracts

[1]. Unless otherwise provided in the contract, a trustee is not personally liable on a contract properly entered into in the trustee's fiduciary capacity in the course of administration of the trust unless the trustee fails to reveal the trustee's representative capacity and identify the trust estate in the contract.

Comment. Section [1] is a new provision and is the same in substance as Uniform Probate Code Section 7-306(a). The rule provided in Section [1] is the reverse of the case law rule in California that a trustee was personally liable on a contract unless the contract stipulated that the trustee was not liable. See Hall v. Jameson, 151 Cal. 606, 611, 91 P. 518 (1907); Duncan v. Dormer, 94 Cal. App.218, 221, 270 P. 1003 (1928). However, to fall within this rule the trustee's status and the identity of the trust must be revealed. This was not sufficient under prior case law. See Hall v. Jameson, supra.

Note. The staff has some concern about the technical aspects of UPC Section 7-306(a), specifically where it requires the trustee to reveal his representative capacity and identify the trust estate. Read literally, personal liability could not be avoided if the trustee merely signed the contract as trustee. We are uncertain as to the purpose of this requirement and wonder whether it should be retained. It has been suggested that "by the better view, if in any manner it appears from the contract, construed in the light of the attending circumstances, personal liability was not intended," then the trustee should not be personally liable. See Tepper, Liability of the Trust Estate Arising Out of Trustee's Contracts with Third Persons, 2 Hastings L.J. 53, 56 (1950). It seems that identification of the trustee as a trustee should be sufficient in most cases.

Probate Code § (added). Personal liability of trustee arising from ownership or control of trust estate or torts

[2]. A trustee is personally liable for obligations arising from ownership or control of property of the trust estate and for torts committed in the course of administration of the trust only if the trustee is personally at fault.

Comment. Section [2] is a new provision and is the same in substance as Uniform Probate Code Section 7-306(b).

Probate Code § (added). Assertion of claims against trust estate

[3]. A claim based on a contract entered into by a trustee in the trustee's fiduciary capacity, on an obligation arising from ownership or control of the trust estate, or on a tort committed in the course of administration of the trust may be asserted against the trust estate by proceeding against the trustee in the trustee's fiduciary capacity, whether or not the trustee is personally liable on the claim.

Comment. Section [3] is a new provision and is the same in substance as Uniform Probate Code Section 7-306(c). This section supersedes the last sentence of former Civil Code Section 2267 (acts of trustee within scope of authority bind trust property). Section [3] alters the case law rule that the trustee could not be sued in a representative capacity where the trust estate was not liable. See Purdy v. Bank of Am. Nat'l Trust & Sav. Ass'n, 2 Cal.2d 298, 301, 40 P.2d 481 (1935); Rapaport v. Forer, 20 Cal. App.2d 271, 278, 66 P.2d 1242 (1937). See also Section [4] (liability as between trustee and trust estate).

Probate Code § (added). Liability as between trustee and trust estate

[4]. The question of liability as between the trust estate and the trustee individually may be determined in a proceeding for accounting, surcharge, or indemnification, or other appropriate proceeding.

Comment. Section [4] is new and is the same as Uniform Probate Code Section 7-306(d). The Comment to Uniform Probate Code Section 7-306 contains the following:

> Ultimate liability as between the estate and the fiduciary need not necessarily be determined whenever there is doubt about this question. It should be permissible, and often it will be preferable, for judgment to be entered, for example, against the trustee individually for purposes of determining the claimant's rights without the trustee placing that matter into controversy. The question of his right of reimbursement may be settled informally with beneficiaries or in a separate proceeding in the probate court involving reimbursement. The section does not preclude the possibility, however, that beneficiaries might be permitted to intervene in litigation between the trustee and a claimant and that all questions might be resolved in that action.

EXHIBIT 6

Staff Draft of Provisions Relating to
Limitations on Actions for Breach of Trust

Probate Code § (added). Limitations on proceedings against trustees after final account

[1]. (a) Unless previously barred by adjudication, consent, or limitation:

(1) If a beneficiary has received a final account or other statement fully disclosing the subject of a claim and showing termination of the trust relationship between the trustee and the beneficiary, a claim against the trustee for breach of trust is barred as to that beneficiary unless a proceeding to assert the claim is commenced within six months after receipt of the final account or other statement.

(2) Notwithstanding a lack of full disclosure, if a beneficiary has received a final account or other statement and the trustee has informed the beneficiary of the location and availability of records for examination, a claim against the trustee for breach of trust is barred as to that beneficiary unless a proceeding to assert the claim is commenced within three years after receipt of the final account or other statement.

(b) For the purpose of subdivision (a), a beneficiary is deemed to have received a final account or other statement if, in the case of an adult, it is received by the adult personally or, in the case of a minor or disabled person, it is received by the minor's or disabled person's representative.

Comment. Section [1] is a new provision and is the same in substance as Uniform Probate Code Section 7-307. 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). This provision does not displace the statute of limitations applicable to actions for relief on the ground of fraud. See Code Civ. Proc. § 338(4).