

SENATE JUDICIARY COMMITTEE
Senator Thomas Umberg, Chair
2021-2022 Regular Session

AB 1079 (Gallagher)
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Fiscal: No
Urgency: No
JT

SUBJECT

Trusts: revocation

DIGEST

This bill, for instances in which a settlor of a revocable trust becomes incompetent, delineates the duties of the trustee and the class of beneficiaries owed those duties.

EXECUTIVE SUMMARY

Under existing law, beneficiaries of a revocable trust generally are not entitled to information and accounting relating to the trust during the settlor's lifetime, as long as the settlor is competent. But if the settlor becomes incompetent, existing law is silent as to the trustee's duties. This silence has been interpreted to mean that the trustee must provide that information and accounting to all beneficiaries, no matter how remote or contingent their interest.

This bill is sponsored by the Trusts and Estates Section of the California Lawyers Association, who argue that "most settlors do not intend for disclosure of the terms of their trust, asset information, investment decisions, expenditures for their care, etc. to be shared during their lifetime, should they become incompetent, with every beneficiary named in their trust, regardless of the interest granted to those beneficiaries." Following the model set forth in the Uniform Trust Code, the bill defines the class of beneficiaries owed duties by the trustee when the settlor is incapacitated. Compared to existing law, the bill would enable trustees to more narrowly focus on those beneficiaries whose interest in the trust are vested or likely to become vested. The bill is supported by the California Judges Association and has no known opposition.

PROPOSED CHANGES TO THE LAW

Existing law:

- 1) Defines “beneficiary” under the Probate Code as a person to whom a donative transfer of property is made or that person’s successor in interest and, as it relates to a trust, specifies that this includes a person who has any present or future interest, vested or contingent. (Prob. Code § 24.)¹
- 2) Provides that except to the extent a trust instrument otherwise provides or where the joint action of the settlor and all beneficiaries is required, during the time that a trust is revocable and the person holding the power to revoke is competent, the person holding the power to revoke, not the beneficiary, has rights afforded to beneficiaries and the duties of the trustee are owed to the person holding the power to revoke. (§ 15800.)
- 3) Provides that a trustee has a duty to keep beneficiaries of the trust reasonably informed of the trust and its administration. (§ 16060.) Generally requires trustees to: provide the terms of the trust to beneficiaries (§ 16060.7), report to beneficiaries, upon reasonable request, by providing information to the beneficiary relating to the administration of the trust relevant to the beneficiary’s interest (§16061), and provide annual accounting to a beneficiary at the termination of the trust and upon change of trustee (§ 16062). However, a trustee is not required to account to the beneficiary, provide the terms of the trust to the beneficiary, or provide requested information to the beneficiary during the period when the trust may be revoked. (§ 16069.)
- 4) Authorizes a beneficiary to petition a court concerning the internal affairs of a trust or to determine its existence, except as provided in section 15800, described above. (§ 17200(b).)

This bill:

- 1) Provides that, except to the extent the trust instrument otherwise provides or where the joint action of the settlor and all beneficiaries is required, if, during the time that a trust is revocable, at least one person holding the power to revoke the trust is not competent, the following apply:
 - a) Within 60 days of the obtaining of information establishing the incompetency, the trustee must provide notice and a copy of the trust to each beneficiary to whom the trustee would be required or authorized to distribute income or principal if the settlor had died as of the date of receipt of the information.

¹ All further section references are to the Probate Code unless otherwise indicated.

- b) The trustee's duties of accounting and providing information are owed to each beneficiary described in (a).
 - c) A beneficiary whose interest is conditional on some factor not yet in existence or not yet determinable is not a beneficiary for purposes of (a), unless the trustee believes it is likely that the condition will be satisfied at the time of the settlor's death.
 - d) If the interest of a beneficiary fails because a condition to receiving that interest has not been satisfied or the trustee does not believe that the condition will be satisfied at the time of the settlor's death, the duties described above are instead owed to the successor to the beneficiary's conditional interest.
- 2) Provides that in establishing incompetency, a trustee may rely on a method specified in the trust instrument or a judicial determination.
 - 3) Makes a conforming change.
 - 4) Clarifies that the bill neither diminishes the right of beneficiaries to bring certain actions against a trustee nor affects any legal standard for establishing capacity.

COMMENTS

1. Narrows the class of beneficiaries owed certain duties when the settlor is incompetent

A trust is a means for property to be managed on behalf of, and distributed to, specified beneficiaries in accordance with the wishes of the trust's creator, or "settlor" without going through probate. The settlor typically transfers property into the trust, designates beneficiaries, and establishes guidelines for the management and distribution of the trust assets by a trustee, who has a legal obligation to implement the settlor's intent and make reasonable decisions with regard to the trust property. A revocable trust may be revoked or changed without the consent of the beneficiaries or a court. Revocable trusts become irrevocable when the settlor dies, or when the trust instrument itself states when it is to become irrevocable.

Existing law provides that a trustee has a duty to keep beneficiaries of the trust reasonably informed of the trust and its administration. (§ 16060.) In general, trustees must: provide the terms of the trust to beneficiaries (§ 16060.7), report to beneficiaries, upon reasonable request, by providing information to the beneficiary relating to the administration of the trust relevant to the beneficiary's interest (§16061), and provide annual accounting to a beneficiary at the termination of the trust and upon change of trustee (§ 16062). Additionally, a trustee must serve beneficiaries and heirs with notice and a copy of the trust within 60 days of specified events: (1) the trust becoming irrevocable because of the death of the settlor, (2) a change of trustee of an irrevocable

trust, and (3) whenever a power of appointment retained by a settlor over an otherwise irrevocable trust becomes effective or lapses – which in turn triggers a 120-day limitations period for bringing an action to contest the trust. (§§ 16061.7, 16061.8.)

However, during the period when a trust may be revoked, a trustee is not required to account to the beneficiary, provide the terms of the trust to the beneficiary, or provide requested information. (§ 16069.) Furthermore, section 15800 provides that except to the extent a trust instrument otherwise provides or where the joint action of the settlor and all beneficiaries is required, during the time that a trust is revocable and the person holding the power to revoke is competent, the person holding the power to revoke, not the beneficiary, has rights afforded to beneficiaries and the duties of the trustee are owed to the person holding the power to revoke.

The limitation placed on the rights of a beneficiary by section 15800 is consistent with the principle that “[p]roperty transferred into a revocable inter vivos trust is considered the property of the settlor for the settlor’s lifetime,” and thus, “the beneficiaries’ interest in that property is “merely potential” and can “evaporate in a moment at the whim of the [settlor].”” (*Estate of Giralдин* (2012) 55 Cal.4th 1058, 1065–1066.)² Section 15800 “has the effect of postponing the enjoyment of rights of beneficiaries of revocable trusts until the death or incompetence of the settlor or other person holding the power to revoke the trust.” (*Drake v. Pinkham* (2013) 217 Cal.App.4th 400, 408 quoting Law Revision comment; italics in quoted version.) After the settlor’s death, remainder beneficiaries are entitled to pursue their rights. (See *Evangelho v. Presoto* (1998) 67 Cal.App.4th 615.)

Existing law is silent as to a trustee’s duties when the settlor becomes incompetent and there is no other person who has the power to revoke the trust.³ The Fourth District Court of Appeal stated that if “the settlor lacks this required capacity, the other beneficiaries are ordinarily entitled to exercise, on their own behalf, the usual rights of trust beneficiaries, and the trustee is ordinarily under a duty to provide them with accountings and other information concerning the trust and its administration” [Citation.] (*Drake v. Pinkham, supra*, 217 Cal.App.4th at 408-409, quoting the Restatement Third of Trusts.) Section 24 defines a “beneficiary” as a person to whom a donative transfer of property is made or that person’s successor in interest and, as it relates to a trust, specifies that this includes a person who has any present or future interest, vested or contingent. Thus, case law suggests that when a settlor becomes incompetent, all beneficiaries are, among other things, entitled to information, reports, and accountings.⁴

² That case held that, following the death of a settlor, a beneficiary may have standing to sue the trustee for a breach of fiduciary duty to the settlor during the settlor’s lifetime.

³ If the settlor is under a conservatorship who has control of the estate, beneficiaries cannot compel an accounting. (See *Johnson v. Kotyck* (1996) 76 Cal.App.4th 83, 90.)

⁴ While the court indicated that the beneficiary could have brought the underlying action challenging the validity of trust amendments adopted during the settlor’s incapacity, the court held that the action was barred by the doctrine of laches. (*Id.* at 402, 408-409.)

This can be contrasted with the Uniform Trust Code (UTC),⁵ which establishes a similar set of rules with respect to duties owed to beneficiaries while the settlor of a revocable trust is competent.⁶ Recognizing “the difficulty to identifying beneficiaries whose interests are remote and contingent”⁷ and the fact that “such beneficiaries are not likely to have much interest in the day-to-day affairs of the trust,” the UTC provides that when the settlor is incapacitated, the trustee is required to provide accounting and reports to “qualified beneficiaries,” a term defined under section 103(13) to refer to a beneficiary who can receive trust income or principal in specified circumstances.

A recent article argued that California law, as construed by *Drake*, “has perhaps left the door open too wide” and instead argues that California should adopt an approach similar to the UTC by delineating the class of beneficiaries (and excluding those beneficiaries whose interests are too remote) who become entitled to information relating to the trust when the settlor becomes incapacitated.⁸

This bill seeks to accomplish that goal. Specifically, it would amend section 15800 to provide that within 60 days of obtaining information establishing the incompetency of

⁵ *Uniform Trust Code* (Last Revised or Amended in 2010) National Conference of Commissions on Uniform State Laws, <https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=3d7d5428-dfc6-ac33-0a32-d5b65463c6e3&forceDialog=0> (May 20, 2021).

⁶ Under section 813 of the UTC, like California law, establishes a general duty for trustees to keep qualified beneficiaries of a trust reasonably informed about the administration of the trust and of the material facts necessary for the beneficiaries to protect their interests. However, Section 603(b) of the UTC, like California law, provides that if a trust is revocable and the settlor has the capacity to revoke it, the rights of the beneficiaries are subject to the control of, and the duties of the trustee are owed exclusively to, the settlor. The comment to this provision states:

If the settlor loses capacity, subsection (b) no longer applies, with the consequence that the rights of the beneficiaries are no longer subject to the settlor’s control. The beneficiaries are then entitled to request information concerning the trust and the trustee must provide the beneficiaries with annual trustee reports and whatever other information may be required under Section 813. However, because this section may be freely overridden in the terms of the trust, a settlor is free to deny the beneficiaries these rights, even to the point of directing the trustee not to inform them of the existence of the trust. Also, should an incapacitated settlor later regain capacity, the beneficiaries’ rights will again be subject to the settlor’s control.

(*Id.* at 101.)

⁷ As with California law, the term “beneficiary” under the UTC is broadly defined and may include living or ascertained individuals, as well as unborn or unascertained individuals. “The term ‘beneficiary’ includes not only beneficiaries who received their interests under the terms of the trust but also beneficiaries who received their interests by other means, including by assignment, exercise of a power of appointment, resulting trust upon the failure of an interest, gap in a disposition, operation of an antilapse statute upon the predecease of a named beneficiary, or upon termination of the trust.” (*Id.* at 12, comment to section 103.)

⁸ Patrick Kohlman *The ‘Empty Chair’: How to Account for the Rights of Contingent Remainder Beneficiaries in the Event of Incapacity* (2018) 24 Cal. Trusts & Estates Q. no 4, 19, 22.

the last person holding the power to revoke the trust, the trustee must provide notice and a copy of the trust instrument to each beneficiary who could receive distributions from the trust if the settlor had died. The bill expressly provides that the trustee's duties of accounting and providing information are only owed to those beneficiaries.

Contingent beneficiaries would not be owed these duties unless the trustee believes it is likely that the contingency will likely be satisfied at the time of death. Finally, if the interest of a beneficiary fails because a condition to receiving that interest has not been satisfied or the trustee does not believe that the condition will be satisfied at the time of the settlor's death, the duties described above are instead owed to the successor to the beneficiary's conditional interest. The bill also makes conforming and clarifying changes.

The author writes: "AB 1079 would amend the Probate Code to limit the scope of the remainder beneficiaries who have 'Drake' rights. Delineating that a trustee has duties in such a situation to clearly defined 'qualified beneficiaries' only, as under the Uniform Trust Code, but not to more remote beneficiaries, will provide more reasonable guidance to trustees."

2. Support

The bill's sponsor, the Executive Committee of the Trusts and Estates Section of the California Lawyers Association, writes:

[...] Where a successor trustee takes over during the settlor's lifetime because the settlor has become incompetent, the above provisions curtailing the rights of a remainder beneficiary are lifted. Specifically, where a settlor is no longer competent, and no other competent party holds the power to revoke the trust, there is what is referred to as an "empty chair;" the trustee does not have a competent party to whom it owes duties, and thus the "chair" that had been occupied by the competent holder of the power of revocation is now "empty." Under existing law, unless the trust instrument provides otherwise, most commentators conclude that the "chair" is filled by all nonvested contingent remainder beneficiaries. This means all such beneficiaries, which is broadly defined under the Probate Code to include even remote and contingent beneficiaries, are now occupying the "chair." Such beneficiaries are thus able to enforce the duties of the trustee, receive accountings, etc.

Although it is possible to draft language addressing this issue in the trust instrument, it is very complicated and adds to the cost of preparing the trust instrument. Members of the Executive Committee of the Trusts and Estates Section of the California Lawyers Association (TEXCOM) rarely see the issue addressed in a trust instrument, possibly because many

practitioners are not aware of the implications of current law or the intricacies involved in drafting around current law. We believe that most settlors, by virtue of creating a trust for estate planning purposes, do not intend for a trustee to have such broad duties to all nonvested contingent remainder beneficiaries if they should become incompetent. Stated otherwise, by virtue of doing basic estate planning, TEXCOM believes most settlors do not intend for disclosure of the terms of their trust, asset information, investment decisions, expenditures for their care, etc. to be shared during their lifetime, should they become incompetent, with every beneficiary named in their trust, regardless of the interest granted to those beneficiaries.

For example, Mom creates a revocable trust naming Son as successor trustee. The Trust provides on Mom's death that the trust estate passes to her children, Son and Daughter, if living and if not, to their respective children (grandchildren), and if none, to Nephew. Mom becomes incompetent. But prior to such an event, Mom moved into a very nice senior community that serves nice wine with dinner, for an extra fee. Following Mom's incompetency, Nephew, a non-vested contingent beneficiary, now is entitled to accountings from trustee and could challenge Son, as trustee, continued payment of Mom's wine allowance. Would Mom have wanted Nephew to be entitled to such information? To have standing to object? Under current California law, unless the trust instrument expressly provides otherwise, Nephew is afforded all rights granted a beneficiary to such information and the right to challenge actions taken by the trustee.

[...]

TEXCOM believes that current law has left the door too wide open. A statutory clarification delineating that a trustee has duties only to clearly defined "qualified beneficiaries", and further clarifying that those duties are implicated in a joint trust only when neither settlor (or a holder of their revocation power) is competent, will provide more reasonable guidance to trustees and comport with settlor's expectations. Clarification of when (i.e., the timing issue) the "chair" is now occupied by others will also provide trustees with needed guidance to allow them to fulfill their fiduciary obligations properly. This delineation is particularly needed in light of the growing elderly population and trends pertaining to dementia which will lead to more successor trustees taking over a settlor's trust because of incapacity during the settlor's lifetime.

SUPPORT

Trusts and Estates Section of the California Lawyers Association (sponsor)
California Judges Association

OPPOSITION

None known

RELATED LEGISLATION

Pending Legislation: AB 1062 (Mathis, 2021) provides that if a guardian or conservator of the estate becomes a successor trustee while the ward or conservatee is alive, the ward or conservatee's estate is subject to the continuing jurisdiction of the court and, unless the court finds it is not in the ward's or conservatee's best interest, to be under court supervision with the appropriate accounting required by the court. This bill is currently in the Senate Judiciary Committee.

Prior Legislation: AB 2573 (Oberholte, 2020) would have provided that a 120-day limitations period to challenge a trust applies only when the settlor dies and the trust becomes irrevocable. The bill was not heard in this Committee due to time constraints resulting from the COVID-19 pandemic.

PRIOR VOTES:

Assembly Floor (Ayes 75, Noes 0)
Assembly Judiciary Committee (Ayes 11, Noes 0)
