



## TRUSTS & ESTATES SECTION

THE STATE BAR OF CALIFORNIA

### *TRUSTEE NOTIFICATION*

#### **LEGISLATIVE PROPOSAL (T&E-2009-10)**

To: Saul Bercovitch, Legislative Counsel

From: Peter S. Stern, Chair, Trusts and Estates Section Executive Committee  
Richard Burger, Chair, Trusts and Estates Section Administration Subcommittee  
David B. Gaw, Advisor, Trusts and Estates Section Executive Committee  
David W. Baer, Member, Trusts and Estates Section Executive Committee

Date: July 19, 2008

Re: An act to amend §§16061.5, 16061.7, 16061.8, and 16061.9 of the Probate Code, relating to trusts.

#### **SECTION ACTION AND CONTACTS**

Date of Approval by Section Executive Committee: July 19, 2008

Approval Vote: Unanimous

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## PURPOSE

This proposal would 1) reconcile inconsistencies between related sections of the Probate Code, 2) close a loophole that may permit evasion of the required notice of trust administration, 3) clarify that late service of notice is nonetheless effective to trigger the 120 day statute of limitations to file a trust contest, and 4) clarify provisions relating to a trustee's liability for failure to comply with the required notice of trust administration and modify related provisions so that beneficiaries and heirs are treated the same way.

## ISSUES

### I. RECONCILIATION OF INCONSISTENCIES BETWEEN PROBATE CODE SECTIONS 16061.5 AND 16061.7

Section 16061.7 requires a trustee to serve a notice of trust administration on beneficiaries, heirs, and the Attorney General (if the trust is a charitable trust subject to the supervision of the Attorney General), upon the occurrence of certain specified events. The required notice must state, among other things, that the recipient is entitled to receive a copy of the terms of the trust, upon reasonable request to the trustee.

Section 16061.5 requires the trustee to provide a copy of the terms of the trust to any trust beneficiary and to any heir of a deceased settlor (creator of the trust) who requests it, upon the occurrence of certain specified events.

This proposal reconciles two inconsistencies between Section 16061.7 and Section 16061.5, neither of which appears to serve a beneficial or public purpose.

#### a). Copy of the terms of the trust upon change of trustee

Section 16061.7(a)(2) provides that the required notification must be sent when there is a change of trustee of an irrevocable trust. Section 16061.5 does not require the trustee to provide a copy of the terms of the trust to a requesting beneficiary when there is a change of trustee of an irrevocable trust. This inconsistency creates uncertainty. This proposal would correct this inconsistency by amending Section 16061.5 to add language requiring the trustee to provide a copy of the terms of the trust to any trust beneficiary who requests it whenever there is a change of trustee of an irrevocable trust.

#### b). Copy of the terms of the trust to the Attorney General

Section 16061.7(b)(3) provides that the required notification must be served on the Attorney General if the trust is a charitable trust subject to the supervision of the Attorney General. Section 16061.5 does not require the trustee to provide a copy of the terms of the trust to the Attorney General upon request, as it does with beneficiaries and heirs. This proposal would amend Section 16061.5 to add the Attorney General, thereby making the statute consistent with Section 16061.7.

II. CLOSING A LOOPHOLE THAT MAY PERMIT EVASION OF THE REQUIRED NOTICE OF TRUST ADMINISTRATION UNDER THE LITERAL TERMS OF THE CURRENT STATUTE

Probate Code Section 16061.7(a) requires that notice of trust administration be provided when a trust becomes irrevocable due to the death of the settlor. The notification must be sent to the settlor's heirs and the trust beneficiaries. However, the literal terms of the statute may not require notice upon the death of a settlor who created an ostensibly irrevocable inter vivos trust but retained a power of appointment. Even though the settlor retained the right to amend the plan of distribution until death in the same manner as in a revocable trust, the notice requirement arguably is not triggered because such a trust technically was irrevocable upon creation, not upon the death of the settlor. This loophole could be used to conceal elder abuse by preventing interested persons from receiving notice, which would give them the opportunity to challenge the trust.

This proposal would close this loophole by amending Section 16061.7 to provide that notification is required whenever a power of appointment retained by a settlor is effective or lapses upon the death of the settlor with respect to an inter vivos trust that was or purported to be irrevocable upon its creation. That same change would be incorporated into Section 16061.5 (covering a trustee's obligation to provide a copy of the terms of the trust upon request), so the two statutes would be consistent.

III. CLARIFYING THAT LATE SERVICE OF NOTICE IS NONETHELESS EFFECTIVE TO TRIGGER THE 120 DAY STATUTE OF LIMITATIONS TO FILE A TRUST CONTEST

Probate Code Section 16061.8 provides that service of notice "pursuant to this chapter" starts the running of certain deadlines to file a trust contest, which must be filed within 120 days to be valid. Section 16061.7(f) of the chapter requires that notice be served within 60 days following the occurrence of the event requiring notice (or the discovery of the person requiring notice). Consequently, notice that is served late technically may not constitute notice "pursuant to this chapter," and the 120 day statute of limitations may never begin to run where notice is served late.

For example, suppose that Settlor dies on January 1, 2008, triggering the notice requirement under Section 16061.7. The trustee serves the required notice along with a copy of the trust on July 1, 2008. The 120 day deadline to file a contest provided under Section 16061.8 may never start to run because the commencement of this period is triggered by the service of notice "pursuant to this chapter," and Section 16061.7(f) requires notice to be served within sixty days of date of death. Consequently, if notice is served later than March 1, 2008 (sixty days from Settlor's death), it is not clear when the window to file a timely trust contest would close.

This proposal would clarify this issue by amending Section 16061.8 to provide that the 120 day statute of limitations to file a contest will be triggered by service of the required notice "within or after the time period set forth in subdivision (f) of Section 16061.7." It should be

noted that the proposed amendment will not affect the liability of the trustee for damages arising pursuant to Probate Code Section 16061.9 from the failure to serve timely notice.

IV. CLARIFYING AND MODIFYING PROVISIONS RELATING TO A TRUSTEE'S LIABILITY FOR FAILURE TO COMPLY WITH THE REQUIRED NOTICE OF TRUST ADMINISTRATION.

The proposed amendments to Section 16061.9 relate to actions brought by beneficiaries or heirs alleging that a trustee has failed to comply with Section 16061.7's notification requirements. The first set of proposed amendments relates to the recovery of attorney's fees in those actions.

This proposal would amend Section 16061.9 so that beneficiaries and heirs would be treated equally with respect to the potential recovery of attorney's fees. Currently, subdivision (a) contains language providing for the recovery of attorney's fees by beneficiaries but subdivision (b), covering heirs, contains no such language. The Trusts and Estates Section Executive Committee (TEXCOM) does not believe there is a sufficient policy basis for treating heirs and beneficiaries differently in this respect.

This proposal would also clarify that attorney's fees are recoverable only if they constitute damages. Under California law, absent a statute or contract to the contrary, the prevailing party cannot recover the attorney's fees it incurs in a lawsuit. California Code of Civil Procedure Section 1021. This rule – the so-called “American Rule” – applies in proceedings under the Probate Code (see Probate Code § 1000), including actions against trustees. *Estate of Gump* (1982) 128 Cal.App.3d 111, 118. Despite this rule, where as a result of the defendant's wrongdoing the plaintiff must bring an action against a third party, the plaintiff generally can recover the attorney's fees incurred in the third party action from the defendant. Strictly speaking, this is not an exception to the “American Rule,” since the theory of recovery is that the attorney's fees incurred in the third party action are recoverable as an element of the plaintiff's *damages* caused by the defendant's wrongdoing.

As relevant to this proposal, the clearest example of this is as follows. Assume that in violation of Probate Code Section 16061.7, a trustee negligently fails to give an heir the required notification that a trust has become irrevocable. The heir, who receives nothing under the trust, later learns about it from another source and disputes its validity, by which point the trustee has already distributed the trust's assets to the trust beneficiaries. The heir therefore sues the beneficiaries to recover the trust assets distributed to them, and also files an action against the trustee for violating Probate Code Section 16061.7. The heir prevails in invalidating the trust, but by then the beneficiaries have already expended a substantial portion of the trust distributions and cannot fully compensate the heir. Under the proposal, the trustee would be liable to the heir for damages, including both the value of any wrongfully distributed trust assets that the heir cannot recover from the beneficiaries and the attorney's fees and costs that the heir incurred *in the suit against the beneficiaries*. The proposal, however, would *not* require the trustee to pay the heir's attorney's fees incurred *in the action against the trustee itself*. Those attorney's fees would *not* be considered “damages” under California law, but would instead be considered part of the expense of proceeding with the litigation against the trustee. These results are consistent

with existing law: the “American Rule” (Code Civ. Proc. § 1021) and the so-called “exception” to the “American Rule.”

It is not clear that these same results would follow under the current statutory language, which makes the trustee “responsible for damages, attorney’s fees and costs caused by the failure” to comply with Section 16061.7.<sup>1</sup> In failing to specify that the recoverable attorney’s fees are those that constitute damages (i.e., the fees incurred in a third party action), the current language suggests that the trustee may be held liable for the attorney’s fees and costs incurred in the action against the trustee itself. This proposal rectifies this, clarifying that attorney’s fees and costs are only recoverable if they constitute damages and that therefore each party must bear his or her own attorney’s fees incurred in the suit against the trustee.<sup>2</sup>

The second set of proposed amendments relates to a trustee’s liability for failure to serve the required notice of trust administration. Under Section 16061.9, a trustee who fails to serve the required notification is liable to a beneficiary or an heir “unless the trustee makes a reasonably diligent effort to comply with Section 16061.7.” A “reasonably diligent effort to comply” is not defined with respect to service on a beneficiary, but mailing the required notification to an heir’s “last mailing address actually known to the trustee” automatically constitutes a “reasonably diligent effort to comply.” This proposal rectifies this discrepancy by making the rule the same for both beneficiaries and heirs. As with the recovery of attorney’s fees discussed above, TEXCOM does not believe there is a sufficient policy basis for treating the trustee’s obligations to heirs and beneficiaries differently in this respect.

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<sup>1</sup> AB 1172 of 1997 added Probate Code Section 16061.7, which provided in part: “A trustee who fails to serve the notification by trustee as required by this Section shall be responsible for *all damages, including attorney’s fees and costs.*” (Emphasis added.) Much like this proposal, in AB 460 of 2000, Section 16061.9(a) would have provided: “A trustee who fails to serve the notification by trustee as required by Section 16061.7 shall be responsible for *all damages, including attorney’s fees and costs,* caused by the failure unless the trustee makes a good faith effort to comply with that section.” (Emphasis added.) The March 30, 2000 amendments to AB 460 deleted “including attorney’s fees and costs” entirely, so Section 16061.9(a) would have read “all damages caused by the failure.” The April 25, 2000 amendments to the bill added “attorney’s fees” back, but instead of re-inserting the phrase “damages, *including attorney’s fees and costs,*” the amendment added “damages, attorney’s fees, and costs.”

<sup>2</sup> The Probate Code currently contains other references to the recovery of attorney’s fees. Section 17211 applies if a beneficiary contests the trustee’s account. Under subdivision (a), if the “court determines that the contest was without reasonable cause and in bad faith, the court may award against the contestant the compensation and costs of the trustee and other expenses and costs of litigation, including attorney’s fees, incurred to defend the account.” Under subdivision (b), if the “court determines that the trustee’s opposition to the contest was without reasonable cause and in bad faith, the court may award the contestant the costs of the contestant and other expenses and costs of litigation, including attorney’s fees, incurred to contest the account.” Section 18100.5 deals with a certification of trust. Under subdivision (h), except as otherwise provided in the statute “a person making a demand for the trust documents in addition to a certification of trust to prove facts set forth in the certification of trust acceptable to the third party shall be liable for damages, including attorney’s fees, incurred as a result of the refusal to accept the certification of trust in lieu of the requested documents if the court determines that the person acted in bad faith in requesting the trust documents.” In all of these cases, the statute requires the court to make a determination of “bad faith” before a party may be liable for another party’s attorney’s fees (whether damages or not). Under Section 17211, even *with* a finding of bad faith the court’s award of attorney’s fees remains discretionary. Section 16061.9, in contrast, essentially applies a negligence standard, and then mandates an award of attorney’s fees. Permitting an award of attorney’s fees that are not damages under these circumstances would be a significant departure from the general rule that each party to a lawsuit must bear its own attorney’s fees.

This proposal would also eliminate the current statutory language providing that notification sent to an heir's last known mailing address automatically constitutes reasonable diligence, and would treat beneficiaries and heirs the same way. Under this proposal, the trustee's exercise of reasonable diligence in ascertaining the identity and mailing address of a beneficiary *or* heir (and otherwise complying with Section 16061.7) will constitute a complete defense to an action based on the beneficiary's or heir's failure to receive the notification required by Section 16061.7. But simply mailing notification to an heir's last *known* address would not suffice, and would not necessarily constitute the exercise of reasonable diligence. For example, after a trustee mails a Section 16061.7 notification to an heir, the notification might be returned in the mail stamped "unknown at this address." The existing standard would appear to absolve trustees from doing anything at all to find out any more about an heir's whereabouts under that circumstance. Under this proposal, to be entitled to immunity the trustee would then need to exercise "reasonable diligence" to determine the heir's correct address.

**HISTORY:** Affected statutes added and amended by AB 1172 (Kaloogian), Chapter 724, Statutes of 1997; AB 2069 (Kaloogian), Chapter 682, Statutes of 1998; AB 460 (Ackerman), Chapter 34, Statutes of 2000; AB 1628 (Kaloogian), Chapter 592, Statutes of 2000. The author is not aware of any similar bills that have been introduced to modify these statutes in the manner described.

**IMPACT ON PENDING LITIGATION:** The author is not aware of any litigation currently pending regarding the issues addressed by the proposal.

**LIKELY SUPPORT & OPPOSITION:**

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| <u>Support:</u> Most of the provisions of the proposed legislation will more than likely find support by professional and corporate trustees, as well as counsel for individual (non-professional) trustees. | <u>Reasons:</u> This proposal reconciles inconsistencies, clarifies statutes, and closes a loophole. |
| <u>Oppose:</u> The California Bankers Association may oppose portions of this proposal dealing with failure to comply with notification requirements imposed on trustees.                                    | <u>Reasons:</u> There may be objections to increased obligations or potentially increased liability. |

**FISCAL IMPACT:** No anticipated fiscal impact.

**GERMANENESS:** Drafting a proposal such as this requires an understanding of the interests of both trustees and trust beneficiaries. The members of the Trusts and Estates Executive Committee have interest and expertise in these areas.

## TEXT OF PROPOSAL

SECTION 1. Section 16061.5 of the Probate Code is amended to read:

16061.5 (a) ~~When a revocable trust or any portion of a revocable trust becomes irrevocable because of the death of one or more of the settlors of the trust, or because, by the express terms of the trust, the trust becomes irrevocable within one year of the death of a settlor because of a contingency related to the death of one or more of the settlors of the trust, the trustee shall provide a true and complete copy of the terms of the irrevocable trust, or irrevocable portion of the trust, to any beneficiary of the trust who requests it and to any heir of a deceased settlor who requests it. A trustee shall provide a true and complete copy of the terms of the irrevocable trust, or irrevocable portion of the trust, to each of the following:~~

(1) *Any beneficiary of the trust who requests it, and to any heir of a deceased settlor who requests it, when a revocable trust or any portion of a revocable trust becomes irrevocable because of the death of one or more of the settlors of the trust, when a power of appointment is effective or lapses upon the death of a settlor under the circumstances described in subdivision (3) of Section 16061.7(a), or because, by the express terms of the trust, the trust becomes irrevocable within one year of the death of a settlor because of a contingency related to the death of one or more of the settlors of the trust.*

(2) *Any beneficiary of the trust who requests it, whenever there is a change of trustee of an irrevocable trust.*

(3) *If the trust is a charitable trust subject to the supervision of the Attorney General, to the Attorney General, if requested, when a revocable trust or any portion of a revocable trust becomes irrevocable because of the death of one or more of the settlors of the trust, when a power of appointment is effective or lapses upon the death of a settlor under the circumstances described in subdivision (3) of Section 16061.7(a), or because, by the express terms of the trust, the trust becomes irrevocable within one year of the death of a settlor because of a contingency related to the death of one or more of the settlors of the trust, and whenever there is a change of trustee of an irrevocable trust.*

(b) The trustee shall, for purposes of this section, rely upon any final judicial determination of heirship. However, the trustee shall have discretion to make a good faith determination by any reasonable means of the heirs of a deceased settlor in the absence of a final judicial determination of heirship known to the trustee.

SEC. 2. Section 16061.7 of the Probate Code is amended to read:

16061.7. (a) A trustee shall serve a notification by the trustee as described in this section in the following events:

(1) When a revocable trust or any portion thereof becomes irrevocable because of the death of one or more of the settlors of the trust, or because, by the express terms of the trust, the trust becomes irrevocable within one year of the death of a settlor because of a contingency related to the death of one or more of the settlors of the trust.

(2) Whenever there is a change of trustee of an irrevocable trust. The duty to serve the notification by the trustee is the duty of the continuing or successor trustee, and any one cotrustee may serve the notification.

(3) *Whenever a power of appointment retained by a settlor is effective or lapses upon the death of the settlor with respect to an inter vivos trust which was or purported to be irrevocable upon its creation.*

The duty to serve the notification by the trustee is the duty of the continuing or successor trustee, and any one cotrustee may serve the notification.

(b) The notification by the trustee required by subdivision (a) shall be served on each of the following:

(1) Each beneficiary of the irrevocable trust or irrevocable portion of the trust, subject to the limitations of Section 15804.

(2) Each heir of the deceased settlor, if the event that requires notification is the death of a settlor or irrevocability within one year of the death of the settlor of the trust by the express terms of the trust because of a contingency related to the death of a settlor.

(3) If the trust is a charitable trust subject to the supervision of the Attorney General, to the Attorney General.

(c) A trustee shall, for purposes of this section, rely upon any final judicial determination of heirship, known to the trustee, but the trustee shall have discretion to make a good faith determination by any reasonable means of the heirs of a deceased settlor in the absence of a final judicial determination of heirship known to the trustee.

(d) The trustee need not provide a copy of the notification by trustee to any beneficiary or heir (1) known to the trustee but who cannot be located by the trustee after reasonable diligence or (2) unknown to the trustee.

(e) The notification by trustee shall be served by mail to the last known address, pursuant to Section 1215, or by personal delivery.

(f) The notification by trustee shall be served not later than 60 days following the occurrence of the event requiring service of the notification by trustee, or 60 days after the trustee became aware of the existence of a person entitled to receive notification by trustee, if that person was not known to the trustee on the occurrence of the event requiring service of the notification. If there is a vacancy in the office of the trustee on the date of the occurrence of the event requiring service of the notification by trustee, or if that event causes a vacancy, then the 60-day period for service of the notification by trustee commences on the date the new trustee commences to serve as trustee.

(g) The notification by trustee shall contain the following information:

(1) The identity of the settlor or settlors of the trust and the date of execution of the trust instrument.

(2) The name, mailing address and telephone number of each trustee of the trust.

(3) The address of the physical location where the principal place of administration of the trust is located, pursuant to Section 17002.

(4) Any additional information that may be expressly required by the terms of the trust instrument.

(5) A notification that the recipient is entitled, upon reasonable request to the trustee, to receive from the trustee a true and complete copy of the terms of the trust.

(h) If the notification by the trustee is served because a revocable trust or any portion of it has become irrevocable because of the death of one or more settlors of the trust, or because, by the express terms of the trust, the trust becomes irrevocable within one year of the death of a settlor because of a contingency related to the death of one or more of the settlors of the trust, the notification by the trustee shall also include a warning, set out in a separate paragraph in not less than 10-point boldface type, or a reasonable equivalent thereof, that states as follows:

“You may not bring an action to contest the trust more than 120 days from the date this notification by the trustee is served upon you or 60 days from the date on which a copy of the

terms of the trust is mailed or personally delivered to you during that 120-day period, whichever is later.”

(i) Any waiver by a settlor of the requirement of serving the notification by trustee required by this section is against public policy and shall be void.

(j) A trustee may serve a notification by trustee in the form required by this section on any person in addition to those on whom the notification by trustee is required to be served. A trustee is not liable to any person for serving or for not serving the notice on any person in addition to those on whom the notice is required to be served. A trustee is not required to serve a notification by trustee if the event that otherwise requires service of the notification by trustee occurs before January 1, 1998.

SEC. 3. Section 16061.8 of the Probate Code is amended to read:

16061.8. No person upon whom the notification by the trustee is served pursuant to this chapter *whether the notice is served on him or her within or after the time period set forth in subdivision (f) of Section 16061.7* may bring an action to contest the trust more than 120 days from the date the notification by the trustee is served upon him or her, or 60 days from the day on which a copy of the terms of the trust is mailed or personally delivered to him or her during that 120-day period, whichever is later.

SEC. 4. Section 16061.9 of the Probate Code is amended to read:

16061.9. (a) ~~A trustee who fails to serve the notification by trustee as required by Section 16061.7 on a beneficiary shall be responsible for all damages, attorney’s fees, and costs caused by the failure unless the trustee makes a reasonably diligent effort to comply with that section. Except as provided in subdivision (b), a trustee who fails to comply with Section 16061.7 shall be responsible for all damages caused by the failure including, but not limited to, reasonable attorney’s fees and costs incurred by or on behalf of the beneficiary or heir.~~

~~(b) A trustee who fails to serve the notification by trustee as required by Section 16061.7 on an heir who is not a beneficiary and whose identity is known to the trustee shall be responsible for all damages caused to the heir by the failure unless the trustee shows that the trustee made a reasonably diligent effort to comply with that section. For purposes of this subdivision, “reasonably diligent effort” means that the trustee has sent notice by first class mail to the heir at the heir’s last mailing address actually known to the trustee. The trustee’s exercise of reasonable diligence in ascertaining the identity and mailing address of the beneficiary or heir and otherwise complying with Section 16061.7 shall constitute a complete defense to any action based on the beneficiary’s or heir’s failure to receive the notification as required by Section 16061.7.~~

(c) A trustee, in exercising discretion with respect to the timing and nature of distributions of trust assets, may consider the fact that the period in which a beneficiary or heir could bring an action to contest the trust has not expired.