



TRUSTS & ESTATES SECTION

THE STATE BAR OF CALIFORNIA

MODIFICATION AND TERMINATION OF TRUSTS

LEGISLATIVE PROPOSAL (T&E-2016-03)

TO: Office of Governmental Affairs

FROM: Mark S. Poochigian, Member of the Executive Committee, Trusts and Estates Section

DATE: May 4, 2015

RE: Proposal to Amend Probate Code sections 15403, 15404 and 15406 (Modification and Termination of Trusts)

SECTION ACTION AND CONTACTS:

Date of Approval by Section Executive Committee: May 3, 2015
Approval Vote: Yes: 21, No: 5, Abstain: 3

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SUMMARY OF PROPOSAL:

Introduction

The existing statutes governing modification and termination of trusts (Probate Code section 15400 *et seq.*),¹ are flawed in a number of ways, and would benefit from clarification and a modest expansion of the ability of consenting beneficiaries to modify or terminate a trust with court approval under section 15403. The Executive Committee of the Trusts and Estates Section (TEXCOM) is aware of some confusion among practitioners regarding the requirements for obtaining modification or termination of trusts that results from uncertain language in the existing statutes. Moreover, the usefulness of existing section 15403 (authorizing the modification or termination of trusts with the consent of all beneficiaries) is too limited under current law because of the numerous impediments to obtaining a modification or termination under that section.

Summary of Problems With Existing Statutes

Certain flaws in the existing statutes governing modification and termination of trusts (section 15400 *et seq.*), may be summarized as follows:

1. The use of the term “compel.” Section 15403 and 15404 both use the word “compel,” which results in a lack of clarity in those sections. While the word “compel” typically connotes someone or something being forced or required to do something, that is not what is occurring under either section 15403 or 15404.

a. In section 15403. Existing section 15403 provides that, if all beneficiaries of an irrevocable trust consent, “they may compel modification or termination of the trust upon petition to the court.” However, it is not clear who or what is being “compel[led]” in this context. What is actually occurring under section 15403 is that the beneficiaries are requesting that the court modify or terminate a trust.

b. In section 15404. Existing section 15404 provides that, if the settlor and all beneficiaries of a trust consent, “they may compel modification or termination of the trust.” Again, it is not clear who or what is being “compel[led]” in this context. What is actually occurring under section 15404 is that the settlor and beneficiaries are simply modifying or terminating a trust by their mutual agreement.

The statutes should be clarified with respect to their confusing use of the term “compel.”

¹ All further statutory references are to the California Probate Code.

2. Limited availability of procedure afforded by section 15403 because of requirement for affirmative court determination that the reason for the modification or termination outweighs the interest in accomplishing a material purpose of the trust. Under current law, a court is precluded from modifying or terminating a trust under section 15403 (where all beneficiaries of an irrevocable trust consent) unless the court affirmatively determines that the reason for the modification or termination outweighs the interest in accomplishing a material purpose of the trust. The result is inflexibility in adapting trusts as circumstances change, as courts are reluctant to weigh competing interests and make an affirmative determination that a proposed modification or termination outweighs other competing interests. The statute should be revised to provide that—unless the court finds that the proposed modification or termination would defeat a material purpose of the trust—the trust shall be modified or terminated as agreed by all beneficiaries.

3. Limited availability of procedure afforded by section 15403 because of prohibition on termination by a court of a trust that is subject to a valid restraint on transfer of the beneficiary's interest. Under current law, a court is precluded from terminating a trust under section 15403 (where all beneficiaries of an irrevocable trust consent) if the trust is subject to a valid restraint on transfer of the beneficiary's interest as provided in Chapter 2 of the Probate Code, i.e., a "spendthrift provision." In modern trust drafting, spendthrift provisions are ubiquitous and, as a result, section 15403 largely precludes their termination. Courts should not be precluded from terminating a trust containing a spendthrift provision; rather, courts should be given the discretion, after giving due consideration to the spendthrift provision, to terminate a trust containing a spendthrift provision under appropriate circumstances.

4. Lack of discretion afforded to the court to limit where appropriate the class of beneficiaries whose consent is necessary to modify or terminate a trust. Relative to trusts, the Probate Code defines "beneficiary" to mean a person to whom a donative transfer of property is made or that person's successor in interest, including a person who has any present or future interest, vested or contingent. (Prob. Code §86.) The result of this definition is that the class of persons required to consent to a modification or termination of a trust is very broad, and frequently includes beneficiaries who are unborn or unascertainable. Included within this definition of "beneficiary" are persons whose interests in the trust are extremely remote, e.g., where the likelihood of their actually taking under the instrument is very low. Current law is somewhat inconsistent regarding the ability of the court to limit the class of beneficiaries whose consent is needed to modify or terminate a trust:

a. With respect to modification or termination under section 15403 (with the consent of all beneficiaries), there is no provision allowing the court to limit the class of beneficiaries whose consent is required.

b. With respect to modification or termination under section 15404 (with the consent of the settlor and all beneficiaries), section 15404(c) authorizes

the court to limit the class of beneficiaries whose consent is required to the beneficiaries who are reasonably likely to take under the circumstances.

The rationale for this inconsistency is unclear, as the court seemingly should have the ability to limit the class of beneficiaries whose consent is required under both circumstances.

Proposed Statutory Amendments

This proposal would amend the statutes governing modification and termination of trusts to bring clarity to ambiguous provisions, and expand in relatively modest ways the ability of consenting trust beneficiaries to obtain modifications or terminations of trusts. Specifically, this proposal would:

1. Amend Probate Code sections 15403 and 15404 to remove the word “compel” from those sections, as the use of that word makes the statutes unclear and causes confusion.
2. Make the modification and/or termination of trusts more available under section 15403 by:
 - a. Providing that, where all of the beneficiaries consent to the proposed modification or termination, the requested modification or termination shall be granted by the court unless the court determines that the requested modification or termination would defeat a material purpose of the trust (in other words, absent the court’s determination that the proposed modification or termination would defeat a material purpose of the trust, the requested modification or termination shall be made); and
 - b. Eliminating the outright prohibition on termination of trusts by the court where the trust is subject to a valid spendthrift provision, instead making the spendthrift provision a factor that the court is to consider when considering a termination of a trust proposed by all beneficiaries.
3. Harmonize the current inconsistency between sections 15403 and 15404 regarding the ability of a court to limit the class of beneficiaries whose consent is necessary to modify or terminate a trust by providing the court with authority to limit the class of beneficiaries whose consent is necessary to modify or terminate a trust to those beneficiaries whose interests would be “substantially impaired” by the requested modification or termination. For example, where a trust includes beneficiaries whose interests are so remote that a proposed modification or termination would not substantially impair their interests, then the court would be given the power to dispense with the requirement of consent from those beneficiaries.

HISTORY:

TEXCOM is not aware of prior legislative proposals on this topic.

PENDING LITIGATION:

None known.

LIKELY SUPPORT & OPPOSITION:

TEXCOM supports this legislation.

There is no known opposition.

FISCAL IMPACT:

Unknown fiscal impact.

GERMANENESS:

This proposal requires the special knowledge, training, experience and technical expertise of the members of the Executive Committee of the Trusts and Estates Section because it relates to trust administration matters which are within the special purview of TEXCOM.

DISCLAIMER:

This position is only that of the Trusts and Estates Section of the State Bar of California. This position has not been adopted by either the State Bar's Board of Trustees or overall membership, and is not to be construed as representing the position of the State Bar of California.

Membership in the Trusts and Estates Section is voluntary and funding for section activities, including all legislative activities, is obtained entirely from voluntary sources.

TEXT OF PROPOSAL:

SECTION 1. Section 15403 of the Probate Code is amended to read:

(a) Except as provided in subdivision (b), if all beneficiaries of an irrevocable trust consent, ~~they may compel to a~~ modification or termination of the trust, the trust shall be modified or terminated by the court as agreed by the beneficiaries upon petition to the court.

(b) ~~If the continuance of the trust is necessary to carry out~~ The court shall grant a petition for modification or termination made pursuant to subdivision (a) unless the court determines the modification or termination would defeat a material purpose of the trust, ~~the trust cannot be modified or terminated unless the court~~ after considering, in its discretion, determines that the

~~reason for doing so under the circumstances outweighs the interest in accomplishing a material purpose of the trust. Under this section the court does not have discretion~~addition to permit termination of any other factors deemed relevant to the court, whether the trust ~~that~~ is subject to a valid restraint on the transfer of ~~the~~ a beneficiary's interest as provided in Chapter 2 (commencing with Section 15300). The court is not precluded from modifying or terminating the trust solely because of such a restraint on transfer.

SEC. 2. Section 15404 of the Probate Code is amended to read:

(a) ~~If~~A trust may be modified or terminated by the written consent of the settlor and all beneficiaries ~~of a trust consent, they may compel the~~without court approval of such modification or termination ~~of the trust.~~

(b) If any beneficiary does not consent to the modification or termination of the trust, upon petition to the court, the other beneficiaries, with the consent of the settlor, may compel a modification or a partial termination of the trust if the interests of the beneficiaries who do not consent are not substantially impaired.

(c) If the trust provides for the disposition of principal to a class of persons described only as "heirs" or "next of kin" of the settlor, or using other words that describe the class of all persons who would take under the rules of intestacy, the court may limit the class of beneficiaries whose consent is needed to compel the modification or termination of the trust to the beneficiaries who are reasonably likely to take under the circumstances.

SEC. 3. Section 15406 of the Probate Code is amended to read:

In determining the class of beneficiaries whose consent is necessary to modify or terminate a trust pursuant to Section 15403 or 15404,~~the presumption of fertility is rebuttable. :~~

(a) the presumption of fertility is rebuttable; and

(b) the court in its discretion may limit the beneficiaries whose consent is required to beneficiaries whose interests would be substantially impaired by the modification or termination. For purposes of this subdivision (b), the court may consider the likelihood of a beneficiary taking under the trust.