

Date of Hearing: April 6, 2021

ASSEMBLY COMMITTEE ON JUDICIARY
Mark Stone, Chair
AB 1079 (Gallagher) – As Introduced February 18, 2021

PROPOSED CONSENT (As Proposed to be Amended)

SUBJECT: TRUSTS: REVOCATION

KEY ISSUE: SHOULD A TRUSTEE OWE DUTIES TO REMAINDER BENEFICIARIES OF A TRUST AFTER THE SETTLOR OR OTHER PERSON WITH THE POWER TO REVOKE THE TRUST HAS BEEN DEEMED INCOMPETENT?

SYNOPSIS

This non-controversial bill seeks to address problems that arise when remainder beneficiaries, who only stand to benefit from a trust when the rights of principal beneficiaries are terminated, gain rights upon the deemed incompetence of the settlor or other person with revocation authority.

Under existing law, when the settlor of a trust or other person with revocation authority is deemed incompetent, the trustee no longer owes certain administrative duties to the trust settlor, but instead owes these duties to each beneficiary under the trust. Thus, principal and remainder beneficiaries are all required to be notified of the trust, which can result in remainder beneficiaries exercising rights to the detriment of the settlor, the trustee, and the corpus of the trust. The only exception is if the trust instrument provides otherwise.

This bill modifies existing law by creating a process whereby a trustee will instead be required to provide (i) a true and complete copy of the trust instrument and any amendments, and (ii) an annual accounting and information upon request to each beneficiary to whom income or principal would be required to be provided if the settlor had actually died. The trustee has discretion to determine whether this duty is owed to a beneficiary whose interest is conditional on some factor not yet in existence or not yet determinable. 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 trustee's duty will be owed to the beneficiary or beneficiaries who would next succeed to that interest at the relevant time or period as determined under the trust instrument. Additionally, this bill clarifies that a trustee may determine the settlor's incompetency either by (i) the method for determining incompetency specified by the trust instrument, and if there is none, a certification of incapacity by one or more physicians pursuant to an examination of the settlor's condition, or (ii) a judicial determination of incompetency.

The bill is sponsored by the Trusts and Estates Section of the California Lawyers Association. It has no opposition. This analysis incorporates and discusses amendments to the bill that will be taken in Committee..

SUMMARY: Clarifies which beneficiaries under a revocable trust are owed duties by the trustee in the event the settlor or other person holding the power to revoke the trust is deemed incompetent. Specifically, **this bill:**

- 1) Provides that, during the time that a trust is revocable and the person holding the power to revoke the trust, in whole, if the trust has more than one settlor and all settlors are then living, or in part, is competent, the following shall apply:
 - a) The person holding the power to revoke, and not the beneficiary, has the rights afforded beneficiaries under trust law.
 - b) The duties of the trustee are owed to the person holding the power to revoke.
- 2) Establishes, except if the trust instrument provides otherwise, or the joint action of the settlor and all beneficiaries is required, that if the settlor or any other person holding the power to revoke the trust, whether in whole or in part, is not competent, then:
 - a) The trustee must, within 60 days of obtaining the information establishing the incompetency, provide a true and complete copy of the trust instrument and any amendments to each beneficiary to whom the trustee would be required to distribute income or principal (or in the trustee's discretion, could so distribute) if the settlor were deemed to have died on the date the trustee received the incompetency information.
 - b) The trustee need not, under a), provide the superseding trust instrument or amendments if the trust has been completely restated. The trustee owes duties to account at least annually and to provide statutorily-required information on request to each beneficiary to whom the trustee would be required to distribute income or principal (or in the trustee's discretion, could so distribute) if the settlor were deemed to have died during the relevant period.
 - c) The trustee may use its discretion as to whether to treat a beneficiary whose interest is conditional as a beneficiary owed a duty; if the trustee does not believe the condition will be satisfied at the time of the settlor's death, the trustee will owe a duty to the beneficiary or beneficiaries who would next succeed to that interest at the relevant time or period, as determined under the trust instrument.
- 3) Clarifies that incompetency may be established either by (a) the method for determining incompetency specified by the trust instrument, as amended or restated, and if none, a certification of incapacity by one or more physicians pursuant to an examination of the settlor's condition, or (b) a judicial determination of incompetency.
- 4) Makes conforming changes to a related provision.

EXISTING LAW:

- 1) Governs the creation, validation, modification, termination, and administration of trusts, and provides for the adjudication of disputes relating to trusts. (Probate Code Section 15000 *et seq.* All further statutory references are to that code unless stated otherwise.)
- 2) Provides for the rights and responsibilities of all parties to a trust: the settlor (i.e., the creator of the trust), trustee, beneficiary, heir, and any third party, such as a creditor. (*Ibid.*)
- 3) Provides that a trustee includes an original, additional, or successor trustee, whether or not appointed or confirmed by a court. (Section 84.)

- 4) Provides that a trustee has a duty to administer the trust according to the trust instrument and, except to the extent the trust provides otherwise, trust law set forth in the Probate Code. (Section 16000.)
- 5) Provides that the trustee has a duty to keep the beneficiaries of the trust reasonably informed of the trust and its administration. (Section 16060.)
- 6) Provides that during the time that a trust is revocable and the person holding the power to revoke the trust is competent:
 - a) The person holding the power to revoke, and not the beneficiary, has the rights afforded beneficiaries.
 - b) The duties of the trustee are owed to the person holding the power to revoke. (Section 15800.)
- 7) Provides, during the time that a trust is revocable and the person holding the power to revoke the trust is competent, a notice that is to be given to a beneficiary shall be given to the person holding the power to revoke and not to the beneficiary. (Section 15802.)
- 8) Requires the trustee, when a beneficiary makes a reasonable request relating to the administration of the trust relevant to the beneficiary's interest, to report to the beneficiary by providing the requested information. (Section 16061.)
- 9) Requires the trustee, when a revocable trust becomes irrevocable, to provide a copy of the terms of the trust to any heir or beneficiary upon request. (Section 16061.5.)
- 10) Requires the trustee to account at least annually, at the termination of the trust, and upon a change of trustee, to each beneficiary to whom income or principal is required or authorized in the trustee's discretion to be currently distributed. (Section 16062.)
- 11) Requires a trustee to provide notification to beneficiaries and heirs as specified. (Section 16061.7.)
- 12) Requires a trustee to serve notification to each beneficiary of an irrevocable trust and each heir of the deceased settlor, as provided, when one of the following events occur:
 - a) When a revocable trust, or any portion thereof, becomes irrevocable because of the death of one or more settlors or because of the express terms of the trust;
 - b) Whenever there is a change of trustee of an irrevocable trust; and
 - c) Whenever a power of appointment retained by the settlor is effective or lapses, as provided. (Section 16061.7 (a), (b).)
- 13) Requires notification to be provided within 60 days of the triggering event requiring the notification or within 60 days of the trustee becoming aware of a person who is entitled to receive notification. Requires the notice to contain the following information:
 - a) The identity of the settlor or settlors and the date of execution of the trust instrument;

- b) The name, address, and telephone number of each trustee;
- c) The address of the physical location where the principal place of administration of the trust is located;
- d) Any additional information that may be expressly required by the terms of the trust instrument; and
- e) 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. (Section 16061.7 (f), (g).)

FISCAL EFFECT: As currently in print this bill is keyed non-fiscal.

COMMENTS: In the event a settlor or other person with the power to revoke the trust in whole or in part is determined to be incompetent, the question becomes, who does the trustee owe a duty to in the absence of the settlor or other person with revocation authority? When the settlor is competent, the trustee owes their duty to the settlor. When the settlor becomes incompetent, the trustee owes their duty to beneficiaries. However, some trusts are complicated and involve different types of beneficiaries. AB 1079 clarifies which beneficiaries are owed a duty from the trustee in the event the settlor or other person with revocation authority is deemed incompetent.

Background on Trusts. Trusts are commonly used to avoid probate and may provide certain tax advantages. There are two types of trust estate plans; a testamentary trust, which is written into a will and becomes effective upon death, and a living or inter vivos trust, which is created in a separate document. There are two types of living trusts, revocable and irrevocable trusts, although living revocable trusts generally become irrevocable trusts upon the death of the person creating the trust (in California, the settlor). Unlike a revocable trust, an irrevocable trust does not permit the settlor to revoke or change the trust without the consent of the beneficiaries of the trust and/or the court.

A settlor is the person who creates and funds the trust. The trustee is appointed by the settlor to administer the trust. The same person can perform both functions or different people can act as settlor and trustee but Californians who create a revocable living trust as part of their estate plan generally designate themselves as the initial trustee(s). So long as those individuals are alive and competent, California law protects the privacy of their trust, even in situations where someone other than the settlor has assumed the role of trustee.

Background on Beneficiaries: There are different types of beneficiaries. Some beneficiaries have a vested interest to receive trust property. Additionally, there are beneficiaries whose interest in the trust is not vested. For example, there are presumptive remainder beneficiaries who may become vested or qualified beneficiaries only if the current beneficiary's interest in the trust is terminated. There may also be contingent beneficiaries, whose rights are conditional on the occurrence of certain events.

Rights of Beneficiaries. Under current law, a trustee is required to notify the trust's beneficiaries, and the heirs of the deceased settlor, of the existence of the trust when certain events occur. That notification starts the clock ticking on when the beneficiaries or heirs may bring an action to contest the trust. Thus, according to current law, a trustee would be required to notify each beneficiary, meaning beneficiaries whose interest is vested in the trust **and**

beneficiaries who stand to benefit from the trust only if the current beneficiary is terminated. Under this bill, when the settlor is deemed incompetent the trustee would be required to notify the beneficiaries with a vested interest in the trust and would be authorized to use discretion to determine whether to notify beneficiaries whose interest is not vested in the trust. The only exception, in either case, is if the trust instrument specifies different procedures in the event of the settlor's incompetence.

Limit the Rights of Remainder Beneficiaries When a Settlor is Deemed Incompetent. The issue addressed in this bill is to what extent beneficiaries whose interest in the trust is not vested have rights under the trust when the settlor has been deemed incompetent and unable to express their intent for the administration and enforcement of the trust.

According to the sponsor, California Lawyers Association, Trusts and Estates Section (TEXCOM):

Where a successor trustee takes over during the settlor's lifetime because the settlor has become incompetent, the...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."

This bill creates a process for determining which beneficiaries are owed a duty by the trustee when the settlor or other person with authority to revoke the trust is deemed incompetent. Under the bill, a trustee will automatically be required to provide a true and complete copy of the trust instrument and any amendments, an annual account, and information upon request to each beneficiary to whom income or principal would be required to be provided if the settlor had died.

Next, the trustee will have discretion to determine whether the same duty listed above is owed to a beneficiary whose interest is conditional on some factor not yet in existence or not yet determinable, if the trustee believes it is likely the condition or conditions will be satisfied at the time of the settlor's 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 trustee's duty will be owed to the beneficiary or beneficiaries who would next succeed to that interest at the relevant time or period as determined under the trust instrument.

Determination of incompetency. AB 1079 addresses the trustee's duty in administering the trust following notification that the settlor or other person with the authority to revoke the trust in whole or in part has been determined to be incompetent. This means the settlor or other person with revocation power will no longer have authority to make decisions regarding the trust and the trust will be administered as if the settlor has died. Under this bill, the trustee may determine the settlor's incompetency either by (1) the method for determining incompetency specified by

the trust instrument, and if none, a certification of incapacity by one or more physicians pursuant to an examination of the settlor's condition, or (2) a judicial determination of incompetency.

Author's amendment - clarifying trustee's duty to conditional or successive beneficiaries. Two proposed amendments clarify the trustee's discretion when considering duties owed to beneficiaries whose interest is conditional or whose interest is only actual when the principal beneficiary is no longer a beneficiary of the trust:

Proposed new subdivision (b)(3):

A beneficiary whose interest is conditional on some factor not yet in existence or not yet determinable shall not be considered a beneficiary, for purposes of this section, unless the trustee, in the trustee's discretion, believes it is likely that the condition or conditions will be satisfied at the time of the settlor's death.

Proposed new subdivision (b)(4):

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 in paragraphs (1) and (2) shall be owed to the beneficiary or beneficiaries who would next succeed to that interest at the relevant time or period as determined under the trust instrument, as amended and restated.

These amendments clarify how the trustee should apply their discretion when considering beneficiaries whose interest in the trust is conditional. When using discretion, a trustee must consider whether the beneficiary is likely to satisfy the condition at the time of the settlor's death. If the main beneficiary under the trust is not likely to satisfy the condition before the settlor's death, then the trustee owes their duty to the next beneficiary in line to benefit from the trust.

An additional amendment clarifies the methods permitted for determining that the settlor or other person with the power to revoke the trust is incompetent:

Proposed new subdivision (c):

To establish the incompetency, the trustee may rely on either (1) the method for determining incompetency specified by the trust instrument, as amended or restated, and if none, a certification of incapacity by one or more physicians pursuant to an examination of the settlor's condition, or (2) a judicial determination of incompetency.

This amendment clarifies that a determination of incompetency can be established based on more than one method, and sets up a default method (physician certification) if the trust instrument does not. Language was added to require the physician providing a certificate of incompetency to have examined the settlor's condition before making the determination.

ARGUMENTS IN SUPPORT: According to the sponsor TEXCOM:

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....

TEXCOM believes delineating that a trustee has duties in such situation to clearly defined "qualified beneficiaries" only, as per the UTC, but not to more remote beneficiaries, will provide much need reasonable guidance to trustees and beneficiaries alike.

REGISTERED SUPPORT / OPPOSITION:

Support

California Lawyers Association, Trusts and Estates Section (sponsor)

Opposition

None on file

Analysis Prepared by: Victoria Anderson and Jith Meganathan / JUD. / (916) 319-2334