

TRUST ADMINISTRATION ALERT:
NEW TRUSTEE NOTICE OF PROPOSED ACTION PROCEDURE
(PROBATE CODE § 16500 ET SEQ.)

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As of January 1, 2005, California trustees now have expanded powers. Trustees may utilize a proposed action notification procedure which has long been used by executors and administrators of probate estates. The increasingly litigious trust environment has resulted in the need for more, not fewer, court petitions and proceedings to protect trustees' actions. Unfortunately, such court review often adds significant cost to the administration of a trust. Under a new notice of proposed action statute (commencing with Probate Code § 16500), a trustee may opt into a notice procedure in order to reduce the risk associated with the exercise of a discretionary power and eliminate the need for court review. This alert outlines the new statute and provides practical suggestions for the use of the new notice procedure (which is reprinted in full at the end of this alert).

The new trustee notice of proposed action statute is a direct result of your Trusts and Estates Section Executive Committee's work. Much of what consumes the Executive Committee's time is an effort to improve the Probate Code, often as a result of suggestions made by Section members. This new procedure is the result of just such a contribution.¹

With a limited exception found in the Principal and Income Act, court review was formerly the only option available to a trustee who desired pre-approval for the exercise of a discretionary power.² Executors and administrators operating under the Independent Administration of Estates Act have long had the ability to take actions without court review, so long as a specified notice procedure was followed. This often-used procedure is found in Probate Code §10580 et seq. Once beneficiaries are put on notice of the proposed action, and unless objections are made, the personal representative is free to take the action, largely free of potential liability. Perhaps the most common use of this procedure is the personal representative's sale of the decedent's residence or personal property. Trustees must address many of the same administrative tasks that personal representatives encounter in probate estates. Trustees' counsel have by necessity adopted the use of informal, written correspondence to notify beneficiaries of an intended act or exercise of a discretionary power. Unfortunately, the trustee has not been secure from later attack, notwithstanding the advance written notice to the beneficiary.

Nervous trustees (and counsel) have required the additional step of court review and approval before undertaking proposed actions. This will change with the adoption of the new notice procedure outlined below.

A. Notice Requirements: Income and Principal Beneficiaries are Entitled to Notice.

A beneficiary who is entitled to either mandatory or discretionary distributions is required to receive notice (Probate Code § 16501). A beneficiary meets this definition if he, she or it is currently entitled to a distribution of either income or principal, or would be so entitled if the trust were terminated at the time the notice is given. Minors or incompetent adults must have notice sent to their respective guardian or conservator in order for the notice to be effective (§ 16503(b)). Absent the appointment of a guardian or conservator, the trustee remains vulnerable to the same risk associated with the proposed action with regard to the minor or incompetent adult as if the trustee had not used the notice procedure. Consideration must be given as to whether the risk/benefit analysis justifies seeking court appointment of a representative for a minor or incompetent adult beneficiary.

B. Prohibited Acts Under § 16501 (Self-Dealing Acts)

Trustees are precluded from using the notice procedure when the proposed action involves self-interest (Probate Code § 16501(d)). Examples are compensation of the trustee (or its counsel), any transaction in which the trustee (or its counsel) is a party and approval of the trustee's accounts and distributions. These types of transactions have in common the potential of self-dealing. The notice procedure cannot be used to avoid potential liability from such acts, leaving court review and approval as the only protective remedy available to the trustee.

C. Notice Form Requirements

Unlike the notice of proposed action in probate proceedings, there is no Judicial Council form currently available for use in this context. Careful review and compliance with the technical requirements is necessary for the notice to be effective. These provisions are set forth in Probate Code § 16502. Perhaps in the future a Judicial Council form will provide an adequate *pro forma* to serve for all applications. For now, the trustee must employ similar technical diligence to that used when providing notice under Probate Code § 16061.7.

The new statute prescribes a longer notification period than the fifteen days required for probate estates. The trustee must mail notice to the beneficiaries at

least forty-five days before taking any action (Probate Code § 16502). This could be a limiting factor in the use of the notice procedure, since many proposed transactions may not afford the delay of forty-five days from the notice date. This extended notice term was the subject of some legislative debate and could be the subject of further amendment, depending on the effective utility of the notice procedure overall.

D. When to Use Notice Procedure

Perhaps the first time to consider using the new procedure is in a situation that one would otherwise be the subject of a Probate Code § 17200 petition (except as to the prohibited self-dealing acts mentioned above). A few examples are: sales of real property, changing investment accounts, tax elections that affect treatment or timing of income or principal, etc. In this author's view, simple is best. A proposed transaction which can stand on its own is the best candidate for using the new notice procedure. Another way to state this is that if the proposed transaction is an element of an integrated or overall plan, the better approach might be to petition for court review and approval of the transaction as an integral part of the larger plan. Latent liability hangs in the balance. For example, a proposed transaction that itself appears appropriate and garners no objections from beneficiaries may nonetheless give rise to liability if the transaction, when viewed in the context of the overall estate, is inappropriate. This view is more likely to be revealed in the context of the trustee's annual report or account.

Use of the notice procedure may yield lesser benefits if the trustee provides annual reports or accounts. Consider that a proposed transaction will be necessarily included in the trustee's annual report or account, which carry the protections against liability under Probate Code § 16060 et seq. The added protections afforded under Probate Code § 16503(b) may not warrant use of the notice procedures if annual reports and accounts are required.

E. Relief From Trustee Liability

Use of the notice procedure protects the trustee from liability to noticed beneficiaries (Probate Code § 16503(b)). This benefit is of course limited to the proposed transaction. As mentioned above, the use of this notice procedure does not eliminate liability under any other theory of breach of duty or standard of care. However, at least with respect to the proposed transaction, the trustee is better able to conduct the affairs of the trust with less, not more, liability. Furthermore, the use of the notice procedure does not create any additional liability for the trustee (absent intentional or fraudulent acts).

F. Some Unanswered Questions

Mentioned above is the use of this notice procedure when reports or accounts are provided by the trustee. The question arises whether a beneficiary who fails to object to a specific transaction may nonetheless have a "second chance" by later raising objections to the trustee's account. An ostensible answer is that the late-objecting beneficiary can only raise claims against the trustee if the specific transaction violates a duty or standard of care in the overall context of the estate. Specific, transactional objections should be barred. This warrants careful consideration of the information that the trustee includes in the notice of the proposed transaction, so that all material information is provided to the beneficiary. When determining the materiality of the terms and conditions of any proposed transaction, use this simple rule: if a particular term or condition is questionably material, disclose it.

It is a better world for trustees commencing in 2005. Proper use of the new notice of proposed action procedure should reduce the need for court oversight and lessen administrative expense. More work may be necessary to fine-tune this notice provision, however. Your input and comments are welcomed by the Executive Committee.

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CHAPTER 5. NOTICE OF PROPOSED ACTION BY TRUSTEE

16500. Subject to subdivision (d) of Section 16501, a trustee may give a notice of proposed action regarding a matter governed by Chapter 2 (commencing with Section 16200) or Chapter 3 (commencing with Section 16320) as provided in this chapter. For the purpose of this chapter, a proposed action includes a course of action or a decision not to take action. This chapter does not preclude an application or assertion of any other rights or remedies available to an interested party as otherwise provided in this part regarding an action to be taken or not to be taken by the trustee.

16501. (a) The trustee who elects to provide notice pursuant to this chapter shall mail notice of the proposed action to each of the following:

(1) A beneficiary who is receiving, or is entitled to receive, income under the trust, including a beneficiary who is entitled to receive income at the discretion of the trustee.

(2) A beneficiary who would receive a distribution of principal if the trust were terminated at the time the notice is given.

(b) Notice of proposed action is not required to be given to a person who consents in writing to the proposed action. The consent may be executed at any time before or after the proposed action is taken.

(c) A trustee is not required to provide a copy of the notice of proposed action to a beneficiary who is known to the trustee but who cannot be located by the trustee after reasonable diligence or who is unknown to the trustee.

(d) Notwithstanding any other provision of this chapter, the trustee may not use a notice of proposed action in any of the following actions:

(1) Allowance of the trustee's compensation.

(2) Allowance of compensation of the attorney for the trustee.

(3) Settlement of accounts.

(4) Preliminary and final distributions and discharge.

(5) Sale of property of the trust to the trustee or to the attorney for the trustee.

(6) Exchange of property of the trust for property of the trustee or for property of the attorney for the trustee.

(7) Grant of an option to purchase property of the trust to the trustee or to the attorney for the trustee.

(8) Allowance, payment, or compromise of a claim of the trustee, or the attorney for the trustee, against the trust.

(9) Compromise or settlement of a claim, action, or proceeding by the trust against the trustee or against the attorney for the trust.

(10) Extension, renewal, or modification of the terms of a debt or other obligation of the trustee, or the attorney for the trustee, owing to or in favor of the trust.

16502. The notice of proposed action shall state that it is given pursuant to this section and shall include all of the following:

(a) The name and mailing address of the trustee.

(b) The name and telephone number of a person who may be contacted for additional information.

(c) A description of the action proposed to be taken and an explanation of the reasons for the action.

(d) The time within which objections to the proposed action can be made, which shall be at least 45 days from the mailing of the notice of proposed action.

(e) The date on or after which the proposed action may be taken or is effective.

16503. (a) A beneficiary may object to the proposed action by mailing a written objection to the trustee at the address stated in the notice of proposed action within the time period specified in the notice of proposed action.

(b) A trustee is not liable to a beneficiary for an action regarding a matter governed by this part if the trustee does not receive a written objection to the proposed action from a beneficiary within the applicable period and the other requirements of this section are satisfied. If no beneficiary entitled to notice objects under this section, the trustee is not liable to any current or future beneficiary with respect to the proposed action. This subdivision does not apply to a person who is a minor or an incompetent adult at the time of receiving the notice of proposed action unless the notice is served on a guardian or conservator of the estate of the person.

(c) If the trustee receives a written objection within the applicable period, either the trustee or a beneficiary may petition the court to have the proposed action taken as proposed, taken with modifications, or denied. In the proceeding, a beneficiary objecting to the proposed action has the burden of proving that the trustee's proposed action should not be taken. A beneficiary who has not objected is not estopped from opposing the proposed action in the proceeding.

(d) If the trustee decides not to implement the proposed action, the trustee shall notify the beneficiaries of the decision not to take the action and the reasons for the decision, and the trustee's decision not to implement the proposed action does not itself give rise to liability to any current or future beneficiary. A beneficiary may petition the court to have the action taken, and has the burden of proving that it should be taken.

16504. This chapter does not require a trustee to use these procedures prior to taking any action.

¹ Every Section member is encouraged (invited) to communicate ideas and suggestions to the Executive Committee that improve our profession. It's your Executive Committee – take advantage.

² Before the enactment of Probate Code § 16500 et seq., a trustee could use a notice of proposed action procedure only under Probate Code § 16337, which is limited to issues arising under the Uniform Principal and Income Act.