

## Memorandum 84-24

Subject: Study L-640 - Trusts (Liability of Trust and Trustee to Third Persons)

This memorandum considers the law relating to the liability of the trust and the trustee to third persons. Included within this general topic is the question of ultimate liability as between the trust estate and the trustee and the trustee's right to indemnity. The question of creditors' rights against revocable inter vivos trusts is discussed, as well as the protection of bona fide purchasers and the rights of persons dealing with the trustee.

Attached to this memorandum as Exhibit 1 is a copy of draft sections relating to these issues. Exhibit 2 is a copy of existing statutory law bearing on these matters. Relevant Restatement provisions are in Exhibit 3. Three letters from interested persons concerning creditors' rights and revocable trusts are attached as Exhibits 4, 5, and 6. Some relevant statutes of other states are set forth in Exhibit 7.

Liability of Trust and Trustee to Third Persons

Liability of Trustee

The liability of the trustee is generally analyzed in three categories: liability for contracts made by the trustee, liability arising from property ownership, and liability for torts committed by the trustee. The general rule of the common law is that the trustee is personally liable for obligations incurred in administration of the trust to the same extent as if the trustee held the property free of the trust. Restatement (Second) of Trusts § 261 (1959) [hereinafter cited as Restatement]; see 7 B. Witkin, Summary of California Law Trusts § 100, at 5460 (8th ed. 1974) [hereinafter cited as Witkin, Trusts]. As a general rule, the trustee is entitled to be indemnified out of the trust estate for obligations properly incurred in administration of the trust. Id. comment b. (Indemnification will be discussed separately below.) The modern trend of trust law provides more protection to the trustee by treating the trustee in a representative capacity.

### Trustee's Contract Liability

As a general rule, the trustee is personally liable on contracts made in the administration of the trust. Restatement § 262. However, if the contract provides that the trustee is not personally liable, the contract provision will govern (except where the trust property is insufficient to pay the amount of the contract because of the trustee's breach of trust). See Restatement § 263(1), (3). If the trustee has made a contract that is not within the trustee's powers, the trustee is personally liable for breach of warranty. Restatement § 263(2). The question of what language is adequate to shield the trustee from personal liability has resulted in much litigation. See G. Bogert, *The Law of Trusts and Trustees* § 714, at 280-88 (rev. 2d ed. 1982) [hereinafter cited as Bogert, *Treatise*]; Tepper, Liability of the Trust Estate Arising out of Trustee's Contracts with Third Person, 2 *Hastings L.J.* 53, 56 (1950).

California law is not clear. Civil Code Section 2267 provides in part as follows: "A trustee is a general agent for the trust property. . . . His acts, within the scope of his authority, bind the trust property to the same extent as the acts of an agent bind his principal." It has been suggested that while this language is "not apt or clear, it would seem to have been intended to establish representative liability." Bogert, *Treatise* § 712, at 268. While some California cases have applied Section 2267 to hold that the trustee acting within the scope of his authority obligates the trust estate, contrary to the common law (see, e.g., *Purdy v. Bank of America*, 2 Cal.2d 298, 40 P.2d 481 (1935)), other cases have cited the common law rule with approval (see, e.g., *Hall v. Jameson*, 151 Cal. 606, 611, 91 P. 518 (1907)). Even where the trust is liable, it does not appear that this liability supplants the trustee's personal liability. See Evans, Observations on the State, Etc. of the California Laws of Uses and Trusts, 28 S. Cal. L. Rev. 111, 120-21 (1955). The Restatement cites the Field Code provision embodied in Section 2267 as authority for the proposition that a person to whom the trustee has incurred a liability should be able to resort to the trust estate if it is equitable to do so. Restatement § 271A & comment a. There is some question whether the Field Code was actually intended to make such a change. See Tepper, supra, at 59.

Several states have varied the common law rule by statute or case law. See Bogert, *Treatise* § 712, at 269-74 n. 35. A large group of states has adopted Uniform Probate Code Section 7-306, subdivision (a) of which provides rules governing the contract liability of trustees to

third persons. This provision makes the trustee liable on contracts properly entered into only where the contract provides for personal liability or where the "trustee fails to reveal his representative capacity and identify the trust estate in the contract." A draft of this provision was approved by the Commission in 1983 and is attached as draft Section 4520 in Exhibit 1.

As to this draft, the staff is concerned about the dual requirements that the trustee identify the trust and reveal his representative capacity. This would seem to leave the trustee open to technical arguments that serve no policy purpose, such as in a case where the trustee has clearly signed "as trustee" but failed to "identify the trust." One commentator, referring to technical arguments arising under the case law on the sufficiency of contract provisions to relieve the trustee from liability, wrote that "by the better view, if in any manner it appears from the contract, construed in the light of the attending circumstances, personal liability was not intended," then the trustee should not be personally liable. Tepper, supra, at 56. It is not likely to be a frequent problem, but the Commission may wish to consider adding language that saves the trustee from personal liability in any situation where the representative capacity of the trustee appears from the contract. Section 30-4-3-10(a) of the Indiana Trust Code does not even require this much: "Unless the terms of the contract or other non-negotiable obligation expressly provide otherwise, the trustee is not personally liable on a contract or other non-negotiable obligation with a third person made by him in the administration of the trust." (See full copy in Exhibit 7.)

#### Trustee Liability for Holding Property

Since the trustee was considered as the property owner under the common law, liabilities arising from mere ownership of property were the personal responsibility of the trustee. See Restatement § 265 comment a. Section 265 of the Restatement now limits this liability to the extent to which the trust estate is sufficient to indemnify the trustee. This type of liability involves taxes and other expenditures required to maintain property in a condition that satisfies safety and nuisance regulations or covenants. See Bogert, Treatise § 720, at 327. The common law liability for calls and assessments on stock in the trust estate has been largely relieved by statute. See Corp. Code § 413.

The Uniform Probate Code introduces the concept of personal fault into the liability of the trustee arising out of ownership. Section 7-306(b) of the UPC provides in relevant part: "A trustee is personally

liable for obligations arising from ownership or control of property of the trust estate . . . only if he is personally at fault." Presumably, this would have the effect of making the trustee ultimately liable for penalties for late payment of taxes due on real property or for the expense of repairs or penalties due to the trustee's neglect of a dangerous condition on real property. The principle of UPC Section 7-306 was approved by the Commission in 1983 and appears as draft Section 4521 in Exhibit 1.

#### Trustee Liability for Torts

Under the common law, the trustee was liable for torts committed in the course of administration of the trust just as if the trustee held the property free of the trust. Restatement § 264. This rule applies regardless of whether the trustee committed the tort intentionally, negligently, or without fault, whether the trustee's conduct consisted of action or failure to act, or whether the trustee was violating the duties under the trust. Id. comment a. The trust can not shield the trustee from tort liability. Id. comment d. The older cases and the Restatement restrict the liability of charitable trustees to situations where they are personally at fault. Restatement § 402; G. Bogert, Handbook of the Law of Trusts § 129, at 4679 (5th ed. 1973) [hereinafter cited as Bogert, Handbook]. However, the doctrine of charitable immunity has been abolished in a majority of the states. See Bogert, Treatise § 401.

Nearly half the states have adopted statutes modifying the common law rules to permit an action against the trust, in the form of a suit against the trustee in a representative capacity. See Bogert, Treatise § 732, at 376-79, § 735, at 389. This change has been influenced in large part by the Uniform Trusts Act (1937) and the Uniform Probate Code (1977), and statutes based on them. Under UPC Section 7-306(b): "A trustee is personally liable . . . for torts committed in the course of administration of the trust estate only if he is personally at fault." A statute based on UPC Section 7-306(b) was approved by the Commission in 1983 and is included in Exhibit 1 as draft Section 4522.

#### Indemnification of Trustees

Even though the common law made the trustee personally liable in a variety of circumstances, the right of the trustee to indemnification from the trust was also recognized. Hence, if the trustee properly incurred liability in the administration of the trust, the trustee was

entitled to have the liability satisfied out of trust property so that the trustee's own funds would not be used (exoneration), or if the trustee had used personal funds to satisfy the obligation, the trustee was entitled to repayment from trust property (reimbursement). See Restatement §§ 244 & comment b. The trustee also had a lien on trust property in the amount of the indemnification due. See id. comment c. The right to indemnification may be limited by the trust to a particular part of the trust property, such as in the case of a business where the risks of the business are expected to be borne by the business property and not other assets of the trust. Id. comment i. The trustee is not entitled to indemnification for expenses improperly incurred, except where a benefit is conferred on the trust (unless it would be inequitable to allow indemnification) or the beneficiary accepts the actions of the trustee. Id. § 245. These general principles of the Restatement are applied to liabilities arising from contract, property ownership, and tort, although the application of the general principles takes on a different flavor in the area of torts, as distinct from contract. See id. §§ 246-248 & comments. For example, a trustee who is liable for a tort of an agent, or on grounds of negligence, is entitled to indemnity; a trustee who is personally at fault is not entitled to indemnity. See id. comments b-d. The right to indemnification does not extend to the beneficiary's own funds unless the beneficiary has agreed to indemnify the trustee. Restatement § 249(1). However, if the trustee had a right to indemnity out of trust funds paid to the beneficiary, the trustee may resort to such funds unless it is inequitable to permit it. Restatement § 249(2).

The logic supporting the right of indemnification for contract liability is clear. The trustee is a representative who acts for the trust, not in his own interest but in the interest of the beneficiaries. The benefits conferred will go to the beneficiaries, and so should the burdens arising in the normal administration of the trust. The trustee is in charge of the trust estate, and in the normal situation will meet contract obligations out of trust property in the first place by self-help. Torts may arise as a matter of course in the conduct of a business or the holding of real property, so the trustee is also entitled to indemnification for torts. However, there is an element of culpability which enters into tort law that refuses the right of indemnification where the trustee is personally at fault, since it would appear inequitable to permit the trustee to avoid any penalty for intentional torts.

However, in cases where the tort benefits the trust estate, the trustee is entitled to indemnification so long as the tort is not wilfull. See generally Bogert, Handbook § 127, at 461-62, § 130, at 472-73.

California law provides for indemnification in Civil Code Section 2273: "A trustee is entitled to the repayment, out of the trust property, of all expenses actually and properly incurred by him in the performance of his trust. He is entitled to the repayment of even unlawful expenditures, if they were productive of actual benefit to the estate." This statute clearly permits reimbursement for contract liabilities, such as brokerage fees (*Rutherford v. Ott*, 37 Cal. App. 47, 173 P. 490 (1918)), insurance premiums (*Bixby v. Hotchkis*, 58 Cal. App.2d 445, 136 P.2d 597 (1943)), interest on loans (*Purdy v. Johnson*, 174 Cal. 521, 163 P. 893 (1917)), litigation expenses (*Van Orden v. Golden West Credit & Adjustment Co.*, 122 Cal. App. 132, 9 P.2d 572 (1932)), and expenses for obtaining a patent (*Jackson v. Hyde*, 91 Cal. 463, 27 P. 759 (1891)). However, as the statute makes clear, the trustee will be denied reimbursement if the expenditure was improper, as where litigation expenses were caused by the trustee's "greed and indifference." *Estate of Vokal*, 121 Cal. App.2d 352, 259-60, 263 P.2d 64 (1953). The question of reimbursement for tort liability arises much less frequently, but it appears that a trustee would be allowed reimbursement for torts of agents committed in the course of administration of the trust so long as the trustee is not personally at fault. See *Johnston v. Long*, 30 Cal.2d 54, 181 P.2d 645 (1947) (executor operating business personally liable for negligence of agents and entitled to reimbursement, citing Restatement of Trusts §§ 247, 268). A dissent in *Johnston* urged the view that the executor should be held liable only in a representative capacity. 30 Cal.2d at 81 (Schauer, J., dissenting).

Draft Section 4530 in Exhibit 1 continues existing law on indemnity, as approved by the Commission in 1983. However, the Commission should consider recommending a more detailed statute, perhaps based on the Restatement rules. A statute drafted along these lines would make clear that the trustee may be indemnified for torts. A more detailed indemnification statute would also link up with the UPC provision approved by the Commission in 1983 that provides for determination of liability between the trust and the trustee "in a proceeding for accounting, surcharge or indemnification." (See discussion of procedure infra.) Assuming that the UPC rules on trustee liability set out in draft Sections

4520-4522 are acceptable, the question remains as to the extent to which the trustee may be indemnified. It is elementary that in any case where the trust is liable, the trustee is entitled to indemnification if the trustee pays out of personal funds. There is another class of cases, however, where the trustee is personally liable, and in some of them the trustee should be indemnified. The statute should codify the rule applicable to contract liability that improperly incurred expenses can be indemnified if a benefit was conferred on the trust or the beneficiary accepts the trustee's actions. See Restatement § 245. The same rule should be codified as to tort liabilities, even where the trustee is personally at fault. The Restatement incorporates an exception to the right to indemnity where it would be inequitable. As noted above, the Restatement applies this exception to exclude indemnity where the trustee was at fault. A different approach is taken in the Uniform Trusts Act (1937) which in Section 13 permits indemnity if (1) the tort was a common incident of the kind of business activity in which the trustee was properly engaged for the trust, or (2) although the tort was not a common incident of such activity, if neither the trustee nor any officer or employee of the trustee was guilty of personal fault in incurring the liability, or (3) if a trustee commits a tort which increases the value of the trust property even though he would not otherwise be entitled to indemnity. The Commission should consider the policy issue of whether a trustee who is personally at fault should be indemnified in any circumstances. The Uniform Trusts Act, which focusses on benefit to the trust, is easier on trustees than the Restatement, which focusses on equitable principles.

#### Trustee's Lien

Where the trustee has a right to indemnity, the common law affords the trustee a lien on trust property to secure reimbursement for personal funds spent for the benefit of the trust. See Restatement § 244 comment c. Such a lien is recognized in Probate Code Section 1120.2(14) for advances made for the protection of the trust. This provision is drawn from Section 3(c)(18) of the Uniform Trustees' Powers Act (1964). This lien is good only against the beneficiary, not against third persons. See Horowitz, Uniform Trustees' Powers Act, 41 Wash. L. Rev. 1, 22 (1966). There is some question about the need for this lien, however, since the trustee ordinarily has title to and control of the property

and is in no need of a lien, even assuming that such a lien could exist in the face of title. Bogert, Treatise § 718, at 314-15. It appears that the lien provision is an unnecessary complication. It would be better to make clear, if need be, that the trustee may retain trust property against demands of the beneficiary until reimbursement is made. It might also be urged that the lien or priority of the right of indemnity be expanded to cover contest between trustees and creditors of the trust. A lien provision equivalent to existing law is included in Exhibit 1 as draft Section 4531, but the staff suggests that the Commission consider eliminating it.

#### Procedural Problems

If the contract or tort creditor is not paid, the creditor has historically been faced with the problem of determining whom to pursue and on what theory. Under traditional rules, a contract creditor could sue the trustee, in an action at law, as an individual, but the creditor could not resort to trust property unless the contract so provided. See Bogert, Treatise § 712, at 258-66. Equity came to the rescue of creditors in situations where it was impossible or extremely difficult to collect against the trustee by permitting recovery by way of a creditor's suit out of trust assets in the amount of the trustee's right of indemnity. See id. § 716, at 297-304. In many jurisdictions, the necessity of relying on an equitable action was eliminated by statutes permitting suit against the trustee in a representative capacity, or directly against the trust, resulting in collection against trust assets. See id. § 712, at 269-76 nn. 35-38. Thus the law has progressed by cutting through the law-equity dichotomy and providing relatively simple rules that aid creditors.

One of the simplest statutes accomplishing this goal is UPC Section 7-306(c) and (d), the substance of which was approved by the Commission in 1983 in the form set out in draft Sections 4523 and 4524 in Exhibit 1. (For purposes of comparison, some alternative provisions from other states' trust laws are set out in Exhibit 7 attached to this memorandum.)

A question that arises from consideration of the UPC scheme is whether beneficiaries should have notice of the action against the trustee as representative of the trust. In situations where the indemnification of the trustee is involved, beneficiaries would have notice. However, the UPC scheme does not provide for notice to beneficiaries of the action against the trustee. By way of contrast with the UPC, Sections



12(2) and 14(3) of the Uniform Trusts Act (1937) provide that a judgment can not be rendered against the trustee in a representative capacity unless the plaintiff gives notice to the beneficiaries within 30 days after commencing the action (and at least 30 days before judgment). The reasons of the UPC drafters for not following the Uniform Trusts Act in this regard is not indicated. One writer has suggested that they "balanced the unwieldiness of notifying the beneficiaries against the desirability of an efficient determination of the creditor's claim and elected efficiency." Minzner, Article VII of the New Probate Code: In Pursuit of Uniform Trust Administration, 6 N.M.L. Rev. 213, 231 (1976). The staff does not think notice to the beneficiaries is necessary in this case.

It should also be noted that there are other theories which have supported various types of actions by creditors who were not content to rely on the solvency of the trustee or the amount of indemnification available to the trustee. A discussion of these theories is generally unnecessary, however, in light of the Commission's decision to adopt a modern approach. It should be noted, however, that California law has not restricted contract creditors to derivative recovery based on the trustee's right of indemnity. The "conferred benefit" theory has been applied to permit a contract creditor to recover directly against the trust estate in the amount of the benefit conferred on the trust, notwithstanding the fact that the trustee may not be entitled to indemnity. See *Irvine v. MacGregor*, 203 Cal. 583, 585-86, 265 P. 218 (1928); *Tepper, supra*, at 64-65. Procedurally, this saves the creditor the trouble of proving the amount of indemnity the trustee is entitled to.

#### Protection of Third Persons Dealing with Trustee

Much law has developed as to the rights of third persons engaged with the trustee in transactions involving trust property. The basic concept is that bona fide purchasers take property free of the trust, even though the property was transferred in breach of trust. See Restatement §§ 283, 284. Bona fide purchasers are not liable to the beneficiary or the trustee in an action to recover the property or for its value. Of course, the third person does not take the property free of the trust if no value was given or if the third person had notice of the breach. See Restatement §§ 289, 291. The rules governing what is notice and what is value can be complicated, depending upon the circumstances of the case. See, e.g., Restatement §§ 296-297 (notice), 298-309 (value); *Witkin, Trusts* §§ 90-92, at 5449-52.

In California, the general rule is codified in Civil Code Section 2243: "Every one to whom property is transferred in violation of a trust, holds the same as an involuntary trustee under such trust, unless he purchased it in good faith, and for a valuable consideration." Rules of this sort, and more generous versions, have found favor with the courts and state legislatures largely because of commercial expediency. Professor Fratcher has described the general state of the law as follows:

One who purchases half a million dollars worth of corporate bonds from a trustee need not inquire into his powers to sell and to give a receipt for the price, but one who buys a pig or a rocking chair at a trustee's auction is bound to study the terms of the trust and determine at this peril their correct legal meaning.

Fratcher, Trustees' Powers Legislation, 37 N.Y.U. L. Rev. 627, 662 (1962).

Draft Section 4540 in Exhibit 1 is drawn from Section 7 of the Uniform Trustees' Powers Act (1964) and was approved by the Commission in 1983. This provision is highly protective of third persons. Constructive knowledge or inquiry notice of the trustee's powers is not sufficient to deprive the third person of protection; actual knowledge that the trustee is improperly exercising the trust powers is required before protection is banished. This varies the common law rule. See Restatement § 297(a) ("knows or should know of the breach") & comments; Bogert, Handbook § 165, at 608-11; Fratcher, supra, at 662. This change is consistent with changes that have been made regarding negotiable instruments, securities, and bank accounts. See, e.g., Com. Code §§ 3117(b), 3304(2), (4)(e), 8304, 8308(7), 8403; Fin. Code § 952.

By statute, California has protected purchasers for value of real property where the trust does not appear of record and where the beneficiary does not appear of record. See Civil Code §§ 869, 869a. These provisions are continued in the draft statute as Sections 4543 and 4544, but they are probably surplus if the recommended general rule of Section 4540 is retained in the draft statute. The duty of inquiry would be eliminated by draft Section 4540, but there may be some who will still find comfort in continuation of the old statutes and argue for their retention on the grounds of their specificity. There appears to be a conflict, however, between the old law and the general rule in draft Section 4540, since the old law creates a presumption in favor of the transferee and thus seems to leave room for impressing a duty of inquiry. The staff recommends eliminating Civil Code Sections 869 and 869a in favor of the general rules.

A third person who transferred property to a trustee who then misapplies it is liable only if the third person had notice of the trustee's intent. Restatement § 321. This principle is codified in Civil Code Section 2244 which protects good faith transferors. Section 4541 of the draft state continues this general rule in the language of part of Section 7 of the Uniform Trustees' Powers Act (1964).

#### Creditors' Rights as to Self-Settled Inter Vivos Trusts

Concern is developing over the problems faced by creditors of persons who create self-settled inter vivos trusts, particularly where such trusts are revocable. These trusts are primarily intended to avoid probate and may also avoid conservatorship; they are not created to avoid taxes. See generally Chillag, Creditors' Rights to Reach Nonprobate Assets, 5 Est. Plan. & Cal. Prob. Rep. 1 (1983); Dennis-Strathmeyer, Simple Probate-Avoidance Trusts: Higher Stakes and Old Problems, 4 Est. Plan. & Cal. Prob. Rep. 69 (1983); Effland, Rights of Creditors in Nonprobate Assets, 48 Mo. L. Rev. 431 (1983). Trusts of this sort can usually be amended or revoked by the trustor at any time. The trustor is the trustee until incompetence or death and is the only beneficiary having any present enjoyment of the trust.

Trusts of this sort have in the past been attacked as invalid attempts to avoid the Statute of Wills. The doctrine of merger has been used to destroy the trust by finding a merger of beneficial interests in the trustor. The 1935 Restatement of Trusts provided in Section 57 that a revocable trust in which the trustor had a life estate was testamentary and invalid under the Statute of Wills if the trustor retained power to control the trustee in the administration of the trust. The Restatement (Second) of Trusts reversed this position and provided that such trusts were not invalid. Legislation sponsored by the State Bar in 1983 added Civil Code Section 2225 to banish any doubts about the validity of such trusts in California:

A voluntary trust shall not be deemed invalid, merged, or terminated if the trustor is also the sole trustee and sole beneficiary during the trustor's lifetime, or if there are two or more trustors, one or more of whom is a trustee, and the beneficial interest in the trust is in the trustors during the lifetimes of the trustors, so long as the trust provides for one or more successor beneficiaries or remaindermen following the death of the trustor. . . .

The question about validity having been answered, a creditor of a decedent who has created a revocable inter vivos trust will have to find another method of attack where the trust has not provided for the payment of debts. Apparently, drafters of revocable inter vivos trusts as part of an estate plan commonly insert a provision in the trust authorizing but not directing the payment of debts in order to avoid the risk of problems with creditors. See Dennis-Strathmeyer, supra, at 73. However, it is also suggested that a direction to pay debts is unwise in part because it waives the contention that the trust is not liable. Id. Creditors may attack the trust as a fraudulent conveyance where provision is not made for payment of debts. See Civil Code §§ 3439-3439.12 (Uniform Fraudulent Conveyance Act); cf. Headen v. Miller, 141 Cal. App.3d 169, 170 Cal. Rptr. 198 (1983)(creditors could reach proceeds of life insurance policy fraudulently transferred by changing beneficiary from business partner to wife). Professor Effland suggests the following argument on behalf of creditors:

One response might be that if there is no completed transfer of the beneficial interest during the settlor's lifetime, the transfer takes place at death. Since it results in making involent the probate estate available for creditors, the transfer at death is a fraudulent conveyance which the personal representative can sue to set aside.

Effland, supra, at 441. Probate Code Section 579 is consistent with this argument; Section 579 authorizes the personal representative, on application of a creditor, to sue to recover property fraudulently conveyed in the decedent's lifetime if estate assets are insufficient to satisfy creditor's claims.

Another problem faced by creditors is reaching the principal of the revocable trust during the lifetime of the trustor-income beneficiary. Code of Civil Procedure Section 709.010 does not offer much help since it provides for reaching the judgment debtor's interest as a beneficiary of a trust which would seem to exclude a power to revoke held by the debtor as a trustor. The creditor may attack the creation of the trust or transfer to the trust as a fraudulent conveyance. Also relevant may be Civil Code Section 3440 which establishes a "conclusive" presumption that personal property transferred without a change of possession is in fraud of the transferor's creditors. The creditor may also attack on the theory that the trust with extensive power to revoke and amend is really a general power of appointment and so is available under Civil

Code Sections 1390.3-1390.5 (rights of creditors as to general power of appointment). See Civil Code § 1381.2 (general power of appointment defined). Apparently this argument has not been considered in California case law, although it has been successful in Massachusetts and Oregon. See Dennis-Strathmeyer, supra, at 73; Effland, supra, at 442-43. Of course, the power of appointment theory would not be available in the case of an irrevocable trust, but the creditor can reach the trustor-beneficiary's interest under the trust (notwithstanding any spendthrift clause), and may attack the trust as a fraudulent conveyance.

Professor Effland notes that the Restatement shows a "glaring inconsistency" in comparable problems in this area:

If the same settlor had no power to revoke but gave the trustee a discretionary power to pay the principal to the settlor, the settlor's creditors could reach the principal. [Citing Restatement § 156(2).] If the same settlor reserved not a power to revoke but a general power of appointment, again the creditors could reach the principal. [Citing Restatement of Property § 328 (1940).] Why should a power to revoke, which is a greater power, mean that the creditors are left with no rights?

Effland, supra, at 440.

The Commission should consider to what extent these problems should be dealt with in the trust law recommendation. The staff believes it would be useful to provide by statute that creditors may reach interests of a trustor to the extent that the trustor has retained powers over the trust property exercisable in his own favor. This would eliminate the distinction between powers and property reflected in the Restatement. See Restatement § 330 comment o. The Commission should also consider the extent to which the rights of creditors change when the trustor-beneficiary dies. This is a question not certainly answered by any existing statutes. Effland, supra, at 443. The problem is that a power to revoke passes with the decedent and so the theory that the creditor should be able to reach property subject to that power is of uncertain application after death. Professor Effland apparently argues that the death of the trustor should not affect the rights of creditors, and the staff agrees. Hence, after death, creditors should be able to reach property over which the trustor had a power exercisable in his own favor just before death. (For a letter urging Commission attention to creditors' rights in revocable trusts after death, see Exhibit 5.)

Several related questions need to be considered. The suggestion has been made that the process for presenting claims of creditors to trustees of inter vivos trusts after the death of the trustor needs to

be clarified. See letter from Estelle M. Depper in Exhibit 4 attached to this memorandum. Ms. Depper notes that the trustee is not able to distribute to beneficiaries with any assurance because the trustee can not take advantage of any procedure cutting off creditors' claims. Ms. Depper suggests enacting an optional procedure for publishing a notice of death giving the creditors a four month period within which to make claims. If the trustee chose not to take advantage of this procedure, the general statutes of limitation would apply. This seems like a good suggestion to the staff. Is the Commission interested in proposing such a scheme?

Several suggestions regarding formalities for revocable trusts are made by Robert A. Schlesinger in a letter attached as Exhibit 6. He suggests in effect that the Statute of Wills be revived against revocable trusts with the result that such will substitutes be witnessed if they are to have an affect on and after death. Mr. Schlesinger also suggests that a "notice of irrevocability" be given to beneficiaries under revocable trusts when they become irrevocable upon the death of the trustor. Memorandum 84-21 discusses the duties of the trustee, among which is the duty to inform beneficiaries. The draft statute attached to that memorandum also makes clear that the beneficiaries have the right to a copy of the terms of the trust describing or affecting the beneficiary's interest. See draft Section 4340 in Exhibit 1, to Memorandum 84-21. This should be adequate to afford the needed protection. Finally, Mr. Schlesinger suggests that a 30-day notice of intended distribution be given beneficiaries under revocable trusts that have become irrevocable, and that the beneficiary receive an accounting as part of the notice. This notice would give the beneficiary time to determine that the distribution is proper. As currently written, draft Section 4341 attached to Memorandum 84-21 requires an accounting at termination of the trust. Is the Commission interested in providing for the pre-distribution notice and accounting suggested? If so, there is some question whether this scheme should be limited to revocable trusts.

Respectfully submitted,

Stan G. Ulrich  
Staff Counsel

## EXHIBIT 1

Staff Draft

## CHAPTER 4. RELATIONS WITH THIRD PERSONS

Article 1. Liability of Trustees to Third Persons

32124

§ 4520. Personal liability of trustee to third persons on contracts

4520. Unless otherwise provided in the contract, a trustee is not personally liable on a contract properly entered into in the trustee's fiduciary capacity in the course of administration of the trust unless the trustee fails to reveal the trustee's representative capacity [and] [or] identify the trust in the contract.

Comment. Section 4520 is a new provision and is the same in substance as Uniform Probate Code Section 7-306(a). The rule provided in Section 4520 is the reverse of the case law rule in California that a trustee was personally liable on a contract unless the contract stipulated that the trustee was not liable. See *Hall v. Jameson*, 151 Cal. 606, 611, 91 P. 518 (1907); *Duncan v. Dormer*, 94 Cal. App.218, 221, 270 P. 1003 (1928); but *cf.* *Purdy v. Bank of America*, 2 Cal.2d 298, 301-02, 40 P.2d, 481 (1935) (trust estate also liable when properly bound by acts of trustee). However, to fall within the rule of Section 4520 the trustee's status and the identity of the trust must be revealed. This was not sufficient under prior case law. See *Hall v. Jameson*, *supra*. Section 4520 also supersedes former Civil Code Section 2267 to the extent it affected liability.

32175

§ 4521. Personal liability of trustee arising from ownership or control of trust estate

4521. A trustee is personally liable for obligations arising from ownership or control of trust property only if the trustee is personally at fault.

Comment. Section 4521 is a new provision and is the same in substance as part of Uniform Probate Code Section 7-306(b).

311 79

§ 4522. Personal liability of trustee for torts

4522. A trustee is personally liable for torts committed in the course of administration of the trust only if the trustee is personally at fault.

Comment. Section 4522 is a new provision and is the same in substance as part of Uniform Probate Code Section 7-306(b).

§ 4523. Assertion of claims against trust

4523. A claim based on a contract entered into by a trustee in the trustee's fiduciary capacity, on an obligation arising from ownership or control of trust property, or on a tort committed in the course of administration of the trust may be asserted against the trust by proceeding against the trustee in the trustee's fiduciary capacity, whether or not the trustee is personally liable on the claim.

Comment. Section 4523 is a new provision and is the same in substance as Uniform Probate Code Section 7-306(c). This section supersedes the first and last sentences of former Civil Code Section 2267 (acts of trustee within scope of authority bind trust property). Section 4523 alters the case law rule that the trustee could not be sued in a representative capacity where the trust estate was not liable. See *Purdy v. Bank of America*, 2 Cal.2d 298, 301, 40 P.2d 481 (1935); *Rapaport v. Forer*, 20 Cal. App.2d 271, 278, 66 P.2d 1242 (1937). See also Section 4524 (liability as between trustee and trust estate).

32184/NZ

§ 4524. Liability as between trustee and trust estate

4524. The question of liability as between the trust estate and the trustee individually may be determined in a proceeding for accounting, surcharge, or indemnification, or other appropriate proceeding.

Comment. Section 4524 is new and is the same as Uniform Probate Code Section 7-306(d). The Comment to Uniform Probate Code Section 7-306 contains the following explanation:

Ultimate liability as between the estate and the fiduciary need not necessarily be determined whenever there is doubt about this question. It should be permissible, and often it will be preferable, for judgment to be entered, for example, against the trustee individually for purposes of determining the claimant's rights without the trustee placing that matter into controversy. The question of his right of reimbursement may be settled informally with beneficiaries or in a separate proceeding in the probate court involving reimbursement. The section does not preclude the possibility, however, that beneficiaries might be permitted to intervene in litigation between the trustee and a claimant and that all questions might be resolved in that action.

For rules governing indemnification of trustees, see Section 4530. See also Section 4620 et seq. (proceedings against trustee by beneficiary).

Article 2. Indemnity of Trustees

405 779

§ 4530. Repayment of trustee for expenses

4530. A trustee is entitled to the repayment out of the trust estate of all expenses properly incurred by the trustee in the administration of the trust. The trustee is also entitled to repayment of unauthorized expenditures if they benefitted the trust estate.



Comment. Section 4530 continues the substance of former Civil code Section 2273 and supersedes part of the last sentence of Probate Code Section 1122 relating to proper expenses.

405 757

§ 4531. Trustee's lien

4531. The trustee has a lien on the trust property as against the beneficiary in the amount of advances, with any interest, made for the protection of the trust or for expenses, losses, and liabilities sustained in the administration of the trust or because of holding or ownership of any trust property.

Comment. Section 4531 continues the substance of part of subdivision (14) of former Section 1120.2 and is the same in substance as part of Section 3(c)(18) of the Uniform Trustees' Powers Act (1964).

Article 3. Rights of Third Persons Dealing with Trustees

405/192

§ 4540. Protection of third person dealing with trustee

4540. (a) With respect to a third person dealing with a trustee or assisting a trustee in the conduct of a transaction, the existence of a trust power and its proper exercise by the trustee may be assumed without inquiry. The third person is not bound to inquire whether the trustee has power to act or is properly exercising a power.

(b) A third person without actual knowledge that the trustee is exceeding the trustee's powers or improperly exercising them is fully protected in dealing with the trustee just as if the trustee possessed and properly exercised the powers the trustee purports to exercise.

Comment. Section 4540 is drawn from Section 7 of the Uniform Trustees' Powers Act (1964). Section 4540 supersedes former Civil Code Section 2243.

405 198

§ 4541. Application of property delivered to trustee by third person

4541. A third person who acts in good faith is not bound to ensure the proper application of trust property paid or delivered to the trustee.

Comment. Section 4541 supersedes former Civil Code Section 2244 and is essentially the same as the last sentence of Section 7 of the Uniform Trustees' Powers Act (1964).

§ 4542. Protection of third person dealing with former trustee

4542. A good faith transaction entered into with a former trustee by any person acting without knowledge that the trustee's office has been vacated is binding on all parties.

Comment. Section 4542 continues the substance of the second paragraph of former Civil Code Section 2281. See also Section 4573 (vacancy in office of trustee).

§ 4543. Effect on purchaser of omission of trust from grant of real property

4543. If an express trust relating to real property is not contained or declared in the grant to the trustee, or in an instrument signed by the trustee and recorded in the same office with the grant to the trustee, the grant shall be deemed absolute in favor of purchasers from the trustee without notice and for a valuable consideration.

Comment. Section 4543 continues the substance of former Civil Code Section 869.

§ 4544. Effect on real property transactions where beneficiary undisclosed

4544. (a) If an interest in or lien or encumbrance on real property is affected by an instrument in favor of a person in trust but no beneficiary is indicated in the instrument, it is presumed that the person holds the interest, lien, or encumbrance absolutely and free of the trust. This is a presumption affecting the burden of proof. In an action or proceeding involving the interest, lien, or encumbrance affected by the instrument instituted against the person, the person shall be deemed the only necessary representative of the undisclosed beneficiary and of the original grantor or trustor and anyone claiming under them. A judgment is binding upon and conclusive against these persons as to all matters finally adjudicated in the judgment.

(b) An instrument executed by the person holding the interest, lien, or encumbrance as described in subdivision (a), whether purporting to be the act of that person in his or her individual right or in the capacity of a trustee, is presumed to affect the interest, lien, or encumbrance according to the tenor of the instrument. This is a presumption affecting the burden of proof. Upon the recording of the instrument

in the county where the land affected by the instrument is situated, the presumption becomes conclusive in favor of a purchaser or encumbrancer in good faith and for valuable consideration.

Comment. Section 4544 continues the substance of the first two paragraphs of former Civil Code Section 869a. See Hansen v. G & C Trucking Co., 236 Cal. App.2d 481, 491-94, 46 Cal. Rptr. 186 (1965). The language relating to the presumptions affecting the burden of proof in both subdivisions (a) and (b) is consistent with Evidence Code Section 605.

Note. If this section is retained, the staff will attempt to make its meaning clearer.

## EXHIBIT 2

## Selected Statutes on Trustee Relations with Third Persons

CIVIL CODE

379 60

§ 869 (repealed). Effect on bona fide purchaser of omission of trust from grant of real property

Where an express trust is created in relation to real property, but is not contained or declared in the grant to the trustee, or in an instrument signed by him, and recorded in the same office with the grant to the trustee, such grant must be deemed absolute in favor of purchasers from such trustee without notice, and for a valuable consideration.

Comment. The substance of former Section 869 is continued in Probate Code Section 4543.

§ 869a (repealed). Effect of real property transactions where beneficiary undisclosed

Whenever any estate or interest in, or lien on or encumbrance on real property is conveyed, created, aliened, mortgaged, encumbered or affected by an instrument in writing to or in favor of a person or persons in trust, or (a) where such person is designated "trustee" or "as trustee," or (b) where such persons are designated "trustees" or "as trustees," and regardless of whether a joint tenancy or right of survivorship as between such persons is expressed or not, then, if no beneficiary be indicated or named in said instrument, it shall be presumed that said person or persons, as the case may be, holds or hold the title to the estate, interest, lien or encumbrance absolutely in his or their own individual right and free from any trust, and an instrument executed by such person or persons, whether purporting to be the act of such person or persons in his or their individual right, or in his or their capacity as trustee or trustees, shall prima facie affect such estate, interest, lien, or encumbrance according to the tenor of such instrument. As to such instrument last mentioned and any judgment against such person affecting the title, such presumption shall be and become conclusive as to such undisclosed beneficiary and the original grantor or trustor and anyone claiming under them in favor of a purchaser or encumbrancer in good faith and for valuable consideration upon the filing of such instrument last mentioned for record in the office of the recorder of the county wherein the land affected thereby is situated.

In any action or proceeding involving the estate, interest, lien or encumbrance affected by the instrument first mentioned instituted against such person or persons, he or they shall be deemed the only necessary representative of such undisclosed beneficiary and of the original grantor or trustor and anyone claiming under them, and any

judgment or decree shall be binding upon and conclusive against them as to all matters finally adjudicated therein.

Provided, however, that as to such instruments so filed for record prior to the taking effect of this act, such presumption shall not become conclusive except in favor of a purchaser or encumbrancer in good faith and for a valuable consideration until one year after the taking effect of this act when it shall become conclusive without any qualification whatsoever and no action to avoid or impugn any such instrument last mentioned shall be commenced after the time when such presumption becomes conclusive as hereinbefore provided; and further provided, that nothing herein contained shall be construed as depriving such original grantor or trustor or undisclosed beneficiary, or anyone claiming under them, from commencing and maintaining actions other than actions affecting the land the subject of such instruments.

Comment. The substance of the first and second paragraphs of former Section 869a is continued in Probate Code Section 4544. See the Comment to Prob. Code § 4543. See also Prob. Code § 10 (singular includes plural). The last paragraph of former Section 869a is not continued because it is no longer needed.

370 17

§ 2243 (repealed). Third persons as involuntary trustees

THIRD PERSONS, WHEN INVOLUNTARY TRUSTEES. Every one to whom property is transferred in violation of a trust, holds the same as an involuntary trustee under such trust, unless he purchased it in good faith, and for a valuable consideration. (Enacted 1872.)

Comment. Former Section 2243 is superseded by Probate Code Section 4540.

§ 2244 (repealed). Obligations of third persons

WHEN THIRD PERSON MUST SEE TO APPLICATION OF TRUST PROPERTY. One who actually and in good faith transfers any money or other property to a trustee, as such, is not bound to see to the application thereof, and his rights can in no way be prejudiced by a misapplication thereof by the trustee. Other persons must, at their peril, see to the proper application of money or other property paid or delivered by them. (Enacted 1872.)

Comment. Former Section 2244 is superseded by Probate Code Section 4541.

370 16

§ 2267 (repealed). Trustee as general agent

TRUSTEE'S POWERS AS AGENT. A trustee is a general agent for the trust property. His authority is such as is conferred upon him by the declaration of trust and by this Chapter, and none other. His acts,

within the scope of his authority, bind the trust property to the same extent as the acts of an agent bind his principal. (Enacted 1872.)

Comment. The first and third sentences of former Section 2267 are superseded by Sections 4520 and 4523. See also Prob. Code § 4523 (claims based on contract made by trustee in fiduciary capacity). The substance of the second sentence is continued in Probate Code Section 4400.

§ 2273 (repealed). Repayment of expenses paid by trustee

INDEMNIFICATION OF TRUSTEE. A trustee is entitled to the repayment, out of the trust property, of all expenses actually and properly incurred by him in the performance of his trust. He is entitled to the repayment of even unlawful expenditures, if they were productive of actual benefit to the estate. (Enacted 1872.)

Comment. The substance of former Section 2273 is continued in Probate Code Section 4530.

EXHIBIT 3

RESTATEMENT (SECOND) OF TRUSTS

Rules on Trustees' Relations with Third Persons

TOPIC 8. INDEMNITY OF THE TRUSTEE  
FOR EXPENSES

§ 244. Expenses Properly Incurred

The trustee is entitled to indemnity out of the trust estate for expenses properly incurred by him in the administration of the trust.

§ 245. Expenses Not Properly Incurred

(1) Except as stated in Subsections (2) and (3), the trustee is not entitled to indemnity out of the trust estate for expenses not properly incurred by him in the administration of the trust.

(2) Although an expense is not properly incurred in the administration of the trust, the trustee is entitled to indemnity out of the trust estate for such expense to the extent that he has thereby conferred a benefit upon the trust estate, unless under the circumstances it is inequitable to allow him such indemnity.

(3) Although an expense is not properly incurred in the administration of the trust, the trustee is entitled to indemnity out of the trust estate for the full amount of the expense, if the transaction in which the expense is incurred is of such a character that the beneficiary is in a position either to reject or accept it and he accepts it.

§ 246. Liability upon Contract

The rules stated in §§ 244 and 245 are applicable to liabilities upon contracts incurred by the trustee in the course of the administration of the trust.

§ 247. Liability for Tort

The rules stated in §§ 244 and 245 are applicable to liabilities in tort incurred by the trustee in the course of the administration of the trust.

§ 248. Liability as Title Holder

The rules stated in §§ 244 and 245 are applicable to liabilities incurred by the trustee by reason of holding title to the trust property.

**§ 249. Indemnity from the Beneficiary Personally**

(1) Although the trust estate is not sufficient to indemnify the trustee for expenses properly incurred by him in the administration of the trust, he is not entitled to indemnity from the beneficiary personally, unless there was an agreement either in specific words or otherwise between the trustee and the beneficiary that the beneficiary would indemnify the trustee.

(2) If the trustee is entitled to indemnity out of the trust estate for expenses incurred in the administration of the trust and conveys the trust estate to the beneficiary without deducting the amount to which he is entitled as indemnity, he is entitled to indemnity from the beneficiary personally to the extent of the property so conveyed, unless he manifested an intention to forego his claim to indemnity, or unless the beneficiary has so changed his position that it is inequitable to compel him to indemnify the trustee.

**TOPIC 9. LIABILITIES OF THE BENEFICIARIES**

**§ 250. Liability of the Beneficiary to the Trustee Individually**

The trustee is not entitled to a charge on a beneficiary's interest in the trust estate to secure a liability of the beneficiary to the trustee not connected with the administration of the trust, unless the beneficiary contracts to give him such a charge.

**§ 251. Liability of Beneficiary to Trust Estate**

If a beneficiary is under a liability to the trustee as such, his interest in the trust estate is subject to a charge for the amount of his liability.

**§ 255. Advance or Loan of Trust Money to One Beneficiary**

If the trustee makes an advance or loan of trust money to a beneficiary, the beneficiary's interest is subject to a charge for the repayment of the amount advanced or lent.

**TOPIC 1. LIABILITY OF TRUSTEE**

**§ 261. Liability of Trustee in General**

The trustee is subject to personal liability to third persons on obligations incurred in the administration of the trust to the same extent that he would be liable if he held the property free of trust.



**§ 262. Liability of Trustee upon Contract**

Except as stated in § 263, the trustee is subject to personal liability upon contracts made by him in the course of the administration of the trust.

**§ 263. Agreement That Trustee Shall Not Be Liable**

(1) The trustee is not subject to personal liability upon a contract made by him in the course of the administration of the trust, if by the contract it is provided that he shall not be personally liable.

(2) If the trustee represents that he has power to bind the trust estate by the contract and purports to do so, he is subject to personal liability for breach of warranty if he has no such power.

(3) If the trustee makes a contract binding the trust estate, and because of a breach of trust committed by him the trust estate is insufficient to pay the amount due under the contract, the trustee is personally liable for the deficiency.

**§ 264. Liability of Trustee for Tort**

The trustee is subject to personal liability to third persons for torts committed in the course of the administration of the trust to the same extent that he would be liable if he held the property free of trust.

**§ 265. Liability of Trustee as Title Holder**

Where a liability to third persons is imposed upon a person, not as a result of a contract made by him or a tort committed by him but because he is the holder of the title to property, a trustee as holder of the title to the trust property is subject to personal liability, but only to the extent to which the trust estate is sufficient to indemnify him.

**TOPIC 2. POWER OF CREDITOR TO REACH  
TRUST PROPERTY**

**§ 266. Reaching Trust Property in an Action at Law**

A person to whom the trustee has become liable cannot reach trust property in an action at law against the trustee, although the liability was properly incurred by the trustee in the course of the administration of the trust.

**§ 267. Reaching Trust Property by a Suit in Equity**

A person to whom the trustee has incurred a liability in the course of the administration of the trust can by a

proceeding in equity reach trust property and apply it to the satisfaction of his claim under the circumstances stated in §§ 268-271 A.

**§ 268. Reaching Trust Property Where Trustee is Entitled to Exoneration**

If a person to whom the trustee has become personally liable in the course of the administration of the trust cannot obtain satisfaction of his claim out of the trustee's individual property, he can by a proceeding in equity reach trust property and apply it to the satisfaction of his claim to the extent to which the trustee is entitled to exoneration out of the trust estate.

**§ 269. Reaching Trust Property Where Trust Estate Benefited**

A person who has conferred a benefit on the trust estate and cannot obtain satisfaction of his claim out of the trustee's individual property can by a proceeding in equity reach trust property and apply it to the satisfaction of his claim to the extent to which the trust estate has been benefited, unless under the circumstances it is inequitable to allow him such remedy.

**§ 270. Where the Terms of the Trust Provide for Liability of the Estate**

Persons to whom the trustee has incurred a liability in the administration of the trust can by a proceeding in equity reach trust property and apply it to the satisfaction of their claims, if by the terms of the trust the settlor manifested an intention to confer such a power upon them.

**§ 271. Where Contract Binds the Trust Estate**

If the trustee makes a contract with a third person and the contract provides that the trustee shall not be personally liable upon the contract but that the third person shall look only to the trust estate, the third person can by a proceeding in equity reach trust property and apply it to the satisfaction of his claim upon the contract, provided that the contract was properly made by the trustee in the administration of the trust.

**§ 271 A. Other Situations Where It is Equitable to Permit Satisfaction Out of the Trust Estate**

A person to whom the trustee has incurred a liability in the course of the administration of the trust may be permitted to obtain satisfaction of his claim out of the

trust estate if it is equitable to permit him to do so, although his claim does not fall within the rules stated in §§ 268-271.

**§ 272. Specific Enforcement of Duties to Third Persons**

(1) Where the trustee makes a contract to sell, lease, mortgage or otherwise dispose of or deal with trust property in the proper exercise of a power to make such a contract, the other party to the contract can specifically enforce the contract, provided that it is one which would be specifically enforceable against the trustee if he held the property free of trust.

(2) Where the trustee so uses or threatens to use trust property as to constitute a tort to a third person, the third person can maintain a proceeding in equity to enjoin the tort, provided that it is one which would be enjoined if the trustee held the property free of trust.

**§ 273. Protection of Interest of Third Person in Trust Property**

Where a third person has an interest in specific trust property, such interest will be protected to the same extent as if the property were not held in trust.

**TOPIC 3. LIABILITY OF BENEFICIARY**

**§ 274. Liability of Beneficiary in General**

The beneficiary as such is not personally subject to liabilities to third persons incurred in the administration of the trust.

**§ 275. Liability of Beneficiary upon Contract**

The beneficiary as such is not personally liable upon contracts made by the trustee in the course of the administration of the trust.

**§ 276. Liability of Beneficiary for Tort**

The beneficiary as such is not personally liable to third persons for torts committed by the trustee in the course of the administration of the trust.

**§ 277. Liability of Beneficiary as Title Holder**

The beneficiary of a trust of property is not as such subject to the liabilities to third persons which are imposed upon the holder of the title to such property.

**§ 278. Where the Trustee is Entitled to Exoneration from the Beneficiary Personally**

If a person to whom the trustee has become personally liable in the course of the administration of the trust cannot obtain satisfaction of his claim out of the trustee's individual property, and the trustee is entitled to exoneration from the beneficiary personally, he can by a proceeding in equity reach and apply to the satisfaction of his claim the trustee's right of exoneration against the beneficiary personally.

**§ 279. Where the Beneficiary Has Received the Trust Property**

If a creditor is entitled by a proceeding in equity to reach trust property and apply it to the satisfaction of his claim, and the trustee conveys the trust property to the beneficiary before the claim has been paid, the creditor can by a proceeding in equity hold the beneficiary personally liable for the claim to the extent of the value of the trust property so conveyed, unless the beneficiary is a bona fide purchaser or has so changed his position that it is inequitable to hold him personally liable.

**TOPIC 2. TRANSFEREES OF TRUST PROPERTY**

**TITLE A. GENERAL PRINCIPLES**

**§ 283. Where Transfer is Not in Breach of Trust**

If the trustee transfers trust property to a third person or creates a legal or equitable interest in the subject matter of the trust in a third person, and the trustee in making the transfer or in creating the interest does not commit a breach of trust, the third person holds the interest so transferred or created free of the trust, and is under no liability to the beneficiary.

**§ 284. Bona Fide Purchaser**

(1) If the trustee in breach of trust transfers trust property to, or creates a legal interest in the subject matter of the trust in, a person who takes for value and without notice of the breach of trust, and who is not knowingly taking part in an illegal transaction, the latter holds the interest so transferred or created free of the trust, and is under no liability to the beneficiary.

(2) In the Restatement of this Subject such a transferee is called a "bona fide purchaser."

**§ 285. Conveyance of Equitable Interest**

The rule stated in § 284 is applicable to a transfer of trust property to a bona fide purchaser although the trust property is an equitable interest.

**§ 286. Creation of Equitable Interest in Trust Property**

If the trustee in breach of trust purports to create in a third person an equitable interest in the trust property, the third person cannot enforce such equitable interest if to do so would compel the trustee to complete the breach of trust, except as stated in § 314.

**§ 287. Transfer by Transferee to Bona Fide Purchaser**

If the trustee in breach of trust transfers trust property to a person who is not a bona fide purchaser and the transferee transfers the property to a bona fide purchaser, the latter takes the property free of the trust.

**§ 288. Transferee with Notice**

If the trustee in breach of trust transfers trust property to a person who takes with notice of the breach of trust, the transferee does not hold the property free of the trust, although he paid value for the transfer.

**§ 289. Donee**

If the trustee in breach of trust transfers trust property and no value is given for the transfer, the transferee does not hold the property free of the trust, although he had no notice of the trust.

**§ 290. Transferee in an Illegal Transaction**

If the trustee in breach of trust and as part of an illegal transaction transfers trust property to a person who knows the circumstances which make the transaction illegal, the transferee does not hold the property free of the trust, although he had no notice of the trust.

**§ 291. Extent of Liability of Transferee with Notice**

(1) Where the trustee in breach of trust transfers trust property to a person who takes with notice of the breach of trust, the transferee can be compelled,

(a) if he has not disposed of the property, to restore it to the trust, together with the income which he has received from the property; or

(b) if he has disposed of the property, to pay the proceeds of the sale with the income received from the

property and from the proceeds, or the amount of the proceeds with interest thereon and with any income which he received from the property before he sold it, or to pay the value of the property at the time of the decree with the income received from the property; or

(c) if he received the property with knowledge of the breach of trust, to pay its value at the time when he received it with interest thereon; and if with knowledge of the breach of trust he refused to restore the property to the trust, to pay its value at the time of such refusal with interest thereon; and if with knowledge of the breach of trust he disposed of the property, to pay its value at the time he disposed of it with interest thereon.

(2) The beneficiary can enforce an equitable lien upon the property or its proceeds as security for his claim under the rules stated in Clauses (b) and (c).

(3) In each of the cases specified in Subsection (1), the transferee is entitled to a credit of the amount which he paid for the property to the extent to which the trust estate has received a benefit therefrom, and to a credit for any sums paid by him in the discharge of encumbrances upon the property; and, if he did not have knowledge of the breach of trust, he is entitled to a credit for the amount of expenditures made by him for repairs and improvements upon the property to the extent that the property is thereby enhanced or preserved in value.

## § 292. Extent of Liability of Donee

(1) If the trustee in breach of trust transfers trust property and no value is paid for the transfer, the transferee can be compelled to restore the property to the trust if he has not disposed of it and has not so changed his position that it would be inequitable to compel him to restore it.

(2) If the transferee disposes of the property before he receives notice of the breach of trust, he is liable to the extent and only to the extent that at the time when he receives such notice he is enriched at the expense of the trust estate.

(3) If the transferee disposes of the property after he receives notice of the breach of trust and before he has so changed his position that it would be inequitable to compel him to restore the property to the trust, he is liable to the same extent as though he had received the property with notice of the breach of trust.

**§ 293. Extent of Liability of Transferee in an Illegal Transaction**

If the trustee in breach of trust and as part of an illegal transaction transfers trust property to a person who knows the circumstances which make the transaction illegal but who takes the property without notice of the breach of trust, the transferee is liable to the extent and only to the extent stated in § 292.

. . . .

**TITLE B. NOTICE**

**§ 296. Notice of Existence of Trust**

If the trustee transfers trust property in breach of trust to a transferee for value, the transferee takes free of the trust although he has notice of the existence of the trust, unless he has notice that the trustee is committing a breach of trust in making the transfer.

**§ 297. What Constitutes Notice of Breach of Trust**

A person has notice of a breach of trust if

(a) he knows or should know of the breach of trust,  
or

(b) by statute or otherwise he is subjected to the same liabilities as though he knew or should have known of the breach of trust, even though in fact he did not know and had no reason to know of the breach of trust.

**TITLE C. VALUE**

**§ 298. Present Value**

If money is paid or other property is transferred or services are rendered as consideration for the transfer of trust property, the transfer is for value.

**§ 299. Payment of Value Prior to Transfer**

A transfer of trust property is a transfer for value although the value is paid prior to the transfer.

**§ 300. Payment of Value after Transfer**

A transfer of trust property is a transfer for value although the value is paid subsequent to the transfer.

**§ 301. Payment of Value After Notice**

A transferee of trust property takes subject to the trust if prior to the payment of value he has notice that the trustee is committing a breach of trust in making the transfer, although he receives the transfer before he has such notice.

**§ 302. Promise as Value**

(1) Except as stated in Subsections (2) and (3), a transfer of trust property in consideration of a promise to make payment therefor in the future is not a transfer for value.

(2) A transfer of trust property in consideration of a promise upon which the transferee would be liable even if he were compelled to surrender the property is a transfer for value.

(3) A transfer of trust property in consideration of a promise to make payment therefor in the future is a transfer for value, if there has been such a change of position by the transferee that it would be inequitable to deprive him of the property although discharged from his liability upon the promise.

**§ 303. Partial Payment**

Except as stated in § 302(2, 3), if the transferee of trust property receives notice that the transfer was in breach of trust after the transfer and after he has paid a part but before he has paid the full amount agreed to be paid therefor, he does not hold the property free of the trust, but he is entitled to a lien upon the trust property so transferred for the part of the purchase price which he paid before he had notice of the breach of trust.

**§ 304. Satisfaction of Antecedent Debt as Value**

(1) Except as stated in Subsections (2) and (3), if the trustee transfers trust property in consideration of the extinguishment of a pre-existing debt or other obligation, the transfer is not for value.

(2) If the trustee transfers trust property in consideration of the extinguishment in whole or in part of a pre-existing debt or other obligation, the transfer is for value, if

(a) the trust property transferred is a negotiable instrument or money, or

(b) the transferee held security for the debt or other obligation and surrendered the security, or



(c) there has been such a change of circumstances that it would be inequitable to deprive the transferee of the property although the debt or other obligation were revived.

(3) If the trustee transfers trust property in consideration both of the extinguishment of a pre-existing debt or other obligation and of the payment of money or transfer of other property or the rendition of services, the transfer is for value.

### **§ 305. Security for Antecedent Debt as Value**

(1) Except as stated in Subsections (2) and (3), if the trustee transfers trust property as security for a pre-existing debt or other obligation, the transfer is not for value.

(2) If the trustee transfers trust property as security for a pre-existing debt or other obligation, the transfer is for value, if

(a) the trust property transferred is a negotiable instrument or money, or

(b) the transferee held security for the debt or other obligation and surrendered the security, or

(c) there has been such a change of circumstances that it would be inequitable to deprive the transferee of the property.

(3) If the trustee transfers trust property as security for a debt or other obligation in pursuance of a promise made at the time of the creation of the debt or obligation to transfer the property as security therefor, the transfer is for value.

## EXHIBIT 4

## WELLS FARGO TRUST AND INVESTMENT GROUP

ESTELLE M. DEPPER  
Vice President  
and Managing Senior Counsel

June 28, 1983

Stan G. Ulrich, Esq.  
Staff Counsel  
California Law Revision Commission  
4000 Middlefield Road, Room D-2  
Palo Alto, CA 94306

Dear Ulrich:

Chuck Collier advises me that you are the person to contact respecting Law Revision Commission Study 83-17 on the administration of trusts. He said that you are interested in comments which may be incorporated into future recommendations of the Commission.

On that basis, I have a recommendation to make regarding living trusts. Under California Probate Code §333, creditors of decedents are generally required to file any claims they have in the probate proceedings within four months from the date of first issuance of letters to a personal representative. One of the functions of this section is to close off creditors on a timely basis so that the personal representative can safely proceed with the administration and distribution of the estate without having to worry about a later claim being made by someone who was a creditor of the decedent.

That protection and assurance is not available to the trustee of a living trust. When the grantor of a revocable living trust or a holder of a general power of appointment dies, and there are no probate proceedings attached to that death, the trustee is generally responsible for the payment of all of the decedent's debts and expenses. However, there is essentially no time limit on when claims can be presented to the trustee. At best, a four year statute of limitations would seem to apply.

I believe this leaves an area of uncertainty in fiduciary law. While many trust agreements attempt to exculpate the

trustee from personal liability, by specifying that the trustee is only to accept claims for 120 days after death of the grantor, or some comparable language, all that does is allows the trustee to distribute the property to the remainder beneficiaries without assuming personal liability. I do not believe that it precludes a creditor from seeking to attach the assets which have been distributed. While in the family trustee situation this may not be cause for concern, for third party trustees, including corporate fiduciaries, I believe it is a matter that needs to be addressed.

I would like to see a section comparable to Probate Code §333 for living trusts whereby the trustee, at his or her option, could elect to publish a "notice of death" which would require creditors to file claims within four months from a specified date, perhaps that of first publication. If the procedure were optional, the family trustee situations could simply ignore it, but it would be an available protection for the third party trustee. If the trustee chose to not take advantage of the provision, then the general statutes of limitations would continue to apply.

I would appreciate the Law Revision Commission considering this concept as they proceed with the study of 83-17 on trust administration.

Sincerely yours,

A handwritten signature in cursive script, appearing to read 'Stan G. Ulrich', written in dark ink.

EMD:bs

## EXHIBIT 5

**DREISEN, KASSOY & FREIBERG**

A PROFESSIONAL CORPORATION

## LAWYERS

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October 26, 1983

CA Law Revision Commission  
4000 Middlefield Road, #D-2  
Palo Alto, California 94306

Attn: Mr. John H. DeMouilly  
Executive Secretary

Dear Mr. DeMouilly:

We would appreciate receiving from you Memorandum 83-87, Schedule for Future Meetings. We would also like to know if new members of the Commission have been appointed by the Governor. If so, whose term has expired?

In the August 1983 issue of Estate Planning and California Probate Reporter (C.E.B. Vol. V, No. 1), there is an article by Nancy A. Chillag entitled, "Creditors Rights to Reach Non-probate Assets." This article summarizes the existing state of the law regarding creditors' rights to reach non-probate assets. There are a number of inconsistencies in the law regarding the rights of creditors and the ability of debtors to evade them. Two areas that deserve special attention are the rights of creditors against joint tenancy property and against revocable inter vivos trusts which become irrevocable in whole or in part upon the death of the debtor.

Since the change in the tax laws to create an unlimited marital deduction, joint tenancy is being used by an increasing number of married people as a means of both avoiding tax and probate. Since of the roles of probate has always been to protect creditors of the decedent, to allow a debtor to escape those creditors through use of joint tenancy property does not appear to be good public policy. There ought to be revised legislation which makes at least the decedent's undivided interest in the joint tenancy assets subject to levy by creditors.

DREISEN, KASSOY & FREIBERG  
LAWYERS

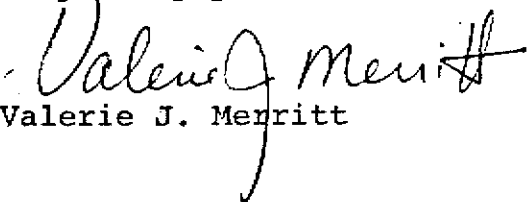
CA Law Revision Commission  
Attn: Mr. John H. DeMouly  
October 26, 1983  
Page Two

Revocable inter vivos trusts are becoming increasingly popular means of estate planning which avoid the probate process. There are many legitimate reasons for using a revocable inter vivos trust to avoid probate, such as planning for possible disability or promoting privacy. On the other hand, the law regarding creditors' rights in this area is unclear. There is no good reason why a revocable trust which becomes irrevocable upon the death of the debtor should be insulated from levy by creditors.

Since California law is currently unclear, I believe it would be good for the law to be clarified by means of legislation.

A review of all of the article might suggest other areas where the California Law Revision Commission can act to create a logical and fair system of allowing creditors of deceased debtors to enforce their legitimate claims.

Very truly yours,

  
Valerie J. Merritt

VJM/gb



ROBERT A. SCHLESINGER *Attorney at Law*  
A LAW CORPORATION

S 10001.002

In reply refer to \_\_\_\_\_

November 30, 1983

John H. DeMouly, Executive Secretary  
California Bar Review Commission  
4000 Middlefield Road  
Palo Alto, CA 94306

Re: Suggested Revocable Trust Reforms

Dear Mr. DeMouly:

As a member of the Executive Committee of the Estate Planning and Probate Trust Law Section of the State Bar, I have been made aware of the excellent work the California Law Review Commission has accomplished in this field. It has occurred to me over the years that with the explosive growth of the use of revocable trusts, safe guards are needed to protect both those who establish the trust and the beneficiaries. Among the matters which should be considered for appropriate legislation are the following:

1. Signing Requirements. Wherever revocable trusts purport to distribute property after the death of a trustor, the signing requirements for the trust should be the same as for a will. The revocable trust is a will substitute and there is no logical reason why the law governing signing should not be the same. The use of witnesses will insure the validity of the document as well as the capacity of the trustor.

2. Notice. When a revocable trust become irrevocable, notice of irrevocability should be required the same as a notice of death in probate. Under present law there is no way that a beneficiary of a private trust is made aware that the trust has become irrevocable so that it is difficult for a beneficiary to protect the interest of the beneficiary. The notice of irrevocability should contain a statement that the beneficiary is entitled to a copy of the governing document upon written request to the Trustee.

3. Distribution. 30 days notice should be required before a distribution may be made from a trust which has become irrevocable. Only with this notice can a beneficiary verify that the beneficiary is receiving what is provided for under the trust agreement. The beneficiary should also be entitled to an accounting as part of this distribution notice.

If you think that the ideas suggested have merit, I will be glad to assist in the drafting of appropriate proposed legislation.

John H. DeMouilly, Executive Secretary  
California Law Review Commission  
November 30, 1983  
Page 2 of 2

Since Dacey's publication of "Avoiding Probate" and the suggested use of a revocable trust, I have been concerned with the operation of these trusts and what happens when all or a portion of the trust become irrevocable. My own estate planning experience has included many examples of failure to carry out revocable trust provisions including disregard of the separation of trusts for tax and other purposes. There are also serious questions regarding creditor's rights in addition to the rights of beneficiaries not to mention the various taxing agencies. The minimal safe guards suggested above should solve most of the major problems.

With personal regard, I am

Sincerely yours,

ROBERT A. SCHLESINGER, A LAW CORPORATION

By: Robert A. Schlesinger

RAS:sc

ccs: K. Bruce Friedman, Esq.  
Kenneth M. Klug, Esq.  
H. Neal Wells, III, Esq.

## EXHIBIT 7

## Selected State Statutes on Trustee Relations with Third Persons

I N D I A N A**30-4-3-10 Liability to third persons****Sec. 10. (Liability to Third Persons)**

(a) Unless the terms of the contract or other non-negotiable obligation expressly provide otherwise, the trustee is not personally liable on a contract or other non-negotiable obligation with a third person made by him in the administration of the trust.

(b) When a third person is entitled to compensation for injury suffered in the course of the administration of the trust:

(1) If the injury is the result of the trustee's personal act or omission as trustee, the trustee will be personally liable and the injured party will be entitled to satisfaction of his claim from the trustee's individual property first and then, to the extent the claim is yet unsatisfied, from the trust estate.

(2) If the injury is the result of the act or omission of an agent of the trustee, and the agent was properly selected and supervised and there was no improper delegation of authority to the agent, the injured party will be entitled to satisfaction of his claim from the trust estate first and then, to the extent that the claim is yet unsatisfied, from the trustee's individual property.

(3) If the injury is the result of the act or omission of the settlor or his agent, and not that of the trustee or his agent, the injured party will be entitled to satisfaction of his claim from the trust estate and not from the trustee's individual property.

(4) The question of ultimate liability as between the trust estate and the trustee individually, if it is to be determined, shall be determined in a proceeding for accounting, surcharge or indemnification.

**30-4-3-10 Liability to third person****Trust Code Study Commission Comments**

(a) This section is contrary to Restatement (Second), Trusts §§ 261, 262, 263 and 403 (1959). The beneficiary as such is not personally liable upon contracts made by the trustee in the course of the administration of the trust. *Id.*, § 275.

(b) This subsection is intended to provide a system for assessing the respective liabilities of the trustee and the trust estate when a third person is entitled to compensation for injury suffered in the course of the administration of the trust. Whether or not the injury resulted from an act in the "course of administration of the trust" depends upon the facts of each case. Restatement (Second), Trusts §§ 264, 268 and 269 (1959) and *Hankins v. Kimball*, 57 Ind. 42 (1877); *Evans v. Hardy*, 76 Ind. 527 (1881); *Riley v. Kepler*, 94 Ind. 308 (1883); *Prine v. Whitten*, 87 Ind.App. 407, 158 N.E. 826 (1927); *Isbell v. Heiny*, 218 Ind. 579, 33 N.E.2d 106 (1941); *Ostheimer v. McNutt*, 116 Ind.App. 649, 66 N.E.2d 142 (1946).



It is contrary to both the Restatement and the present Indiana law. See Restatement (Second), Agency § 229 (1958) for principles applying to an agent's scope of employment which might be somewhat analogous to the trustee's acts in the administration of the trust.

Under subdivision (4), the allocation of the judgment, with respect to the trustee and the beneficiaries may be separated from the proceeding from which the judgment is rendered. The allocation is to be made in a proceeding for accounting, surcharge or indemnification.

### **30-4-4-1 Presumption of trustee's authority**

#### **Sec. 1. (Presumption of Trustee's Authority)**

(a) Except as provided in subsection (b) of this section, any third person dealing with the trustee or assisting him in conducting a transaction:

(1) may assume without inquiry that the trustee has the powers he purports to exercise and has exercised them properly; and

(2) shall not be responsible for the application of money or property paid or delivered to the trustee.

(b) If the third person has actual knowledge that the trustee is exceeding his powers or is improperly exercising them, that person will not be protected under subsection (a) of this section.

(c) If a trust which includes real estate is a public record in the county in which the real estate is situated, a third person dealing with the trustee with respect to that real estate shall be deemed to have actual notice of the terms of the trust.

### **30-4-4-2 Transfers by the trustee to third persons**

#### **Sec. 2. (Transfers by the Trustee to Third Persons)**

(a) If, in transferring an interest in trust property to a third party, the trustee is not committing a breach of trust, the transferee holds the interest free of the trust and incurs no liability to the beneficiary.

(b) A third person, to whom an interest in trust property is transferred by the trustee in breach of trust, takes his interest free of the trust if he:

(1) takes for value and without notice of the breach of trust; and

(2) is not taking part in what he knows to be an illegal transaction.

SUB-PART B. INDEMNITY OF THE TRUSTEE

§ 2191. Indemnity for expenses properly incurred

A trustee is entitled to indemnity from the trust estate for expenses properly incurred by him in the administration of the trust, unless the trust instrument provides otherwise.

Comments—Louisiana State Law Institute

(a) This section makes no change in the law.

(b) If a trustee properly incurs a liability in the administration of the trust, he is entitled to indemnity. Indemnity takes the form of either exoneration or reimbursement. A trustee is exonerated if trust property is used in discharging a liability. He is reimbursed if he is repaid with trust property after he has discharged a liability with his own property. The trust instrument may provide that only one form of indemnity may be used, but, unless it so provides, either form may be used. Restatement of Trusts 2d, Sec. 244 and Comments.

(c) R.S. 9:2133 was based upon the Restatement of Trusts, Sec. 244. This section is similar to Sec. 244 of the Restatement of Trusts 2d.

(d) In other states a trustee is entitled to indemnity for expenses properly incurred by him in the administration of the trust. Bogert, Trusts and Trustees, Sec. 718 (2d ed. 1960), Sec. 975 (2d ed. 1962); Scott on Trusts, Sec. 244 (2d ed. 1956).

§ 2192. Indemnity for expenses not properly incurred

If an expense is not properly incurred in the administration of a trust, a trustee is entitled to indemnity from the trust estate for such an expense to the extent that he has thereby conferred a benefit upon the trust estate, unless the trust instrument provides to the contrary, or unless the circumstances make it inequitable to allow him indemnity.

If an expense is not properly incurred in the administration of a trust, a trustee is entitled to indemnity from the trust estate for the full amount of the expense, if the transaction in which the expense is incurred is of such a character that the beneficiary is in a position either to reject or accept it and he accepts it.

Comments—Louisiana State Law Institute

(a) The Trust Estates Law was silent on this subject.

(b) This section follows the language of Restatement of Trusts 2d, Sec. 245, and resembles the laws of most states. Scott on Trusts, Secs. 245-245.2 (2d ed. 1956).

### **§ 2193. Liability of beneficiary**

If the trust estate is not sufficient to indemnify a trustee for expenses properly incurred by him in the administration of a trust, a beneficiary shall be personally liable only if the trustee can show an express or implied contract between that beneficiary and himself that would entitle the trustee to indemnity.

#### **Comments—Louisiana State Law Institute**

(a) The Trust Estates Law was silent on this subject.

(b) The Restatement of Trusts 2d, Sec. 249(1), does not permit a trustee to obtain indemnity from the beneficiary personally if the trust estate is insufficient to indemnify the trustee unless there is an agreement between the trustee and the beneficiary that the beneficiary is to indemnify the trustee.

(c) The English cases and texts generally agree that a trustee is entitled to obtain indemnity from the beneficiaries personally if the trust estate is insufficient to indemnify him. Generally in the United States, a trustee can obtain indemnity from the beneficiaries only if he can show an express or implied contract between the beneficiaries and himself that would entitle him to indemnity. Bogert, *Trusts and Trustees*, Sec. 718 (2d ed. 1960); Scott on *Trusts*, Secs. 249, 249.1 (2d ed. 1956).

### **§ 2194. Charge on beneficiary's interest**

If a beneficiary is liable to a trustee as such, his interest in the trust estate is subject to a charge for the amount of his liability; but a trustee is not entitled to a charge on a beneficiary's interest in the trust estate to secure a beneficiary's liability not connected with the administration of the trust, unless the beneficiary contracts to give him such a charge.

#### **Comments—Louisiana State Law Institute**

(a) This section makes no change in the law.

(b) R.S. 9:2134, the source of this section, was based upon the Restatement of Trusts, Secs. 250 and 251. This section is similar to Secs. 250 and 251 of the Restatement of Trusts 2d and the laws of most states. Scott on *Trusts*, Secs. 250, 251 (2d ed. 1956).

### **§ 2195. Charge on beneficiary's interest; advance or loan of trust money**

If a trustee makes an advance or loan of trust money to a beneficiary, the beneficiary's interest is subject to a charge for the repayment of the amount advanced or lent.

#### **Comments—Louisiana State Law Institute**

(a) This section makes no change in the law.

(b) R.S. 9:2135 was based upon the Restatement of Trusts, Sec. 255. This section is similar to Sec. 255 of the Restatement of Trusts 2d.

(c) In other states a charge is placed on the beneficiary's interest for the repayment of an amount advanced or lent to the beneficiary by the trustee. Scott on *Trusts*, Secs. 255, 255.1 (2d ed. 1956).

## § 2196. Indemnity for tort liability

A. A trustee who has incurred personal liability for a tort committed in the administration of the trust is entitled to indemnity from the trust estate if:

(1) The tort was a common incident of the kind of business activity in which the trustee was properly engaged for the trust, or,

(2) Although the tort was not a common incident of such activity, if neither the trustee nor an officer or employee of the trustee was guilty of personal fault in incurring the liability.

B. If a trustee has committed a tort that has increased the value of the trust property, he is entitled to indemnity from the trust estate to the extent of the increase in value, even though he would not otherwise be entitled to indemnity.

### Comments—Louisiana State Law Institute

(a) R.S. 9:2136 was based upon the Uniform Trusts Act, Secs. 13(1) and 13(2).

(b) The Restatement of Trusts 2d, Sec. 247 and Comments, permits a trustee to be indemnified for tort liability if liability was incurred in the proper administration of the trust and the trustee was not personally at fault. It also permits a trustee who committed a tort with the intention of benefiting the trust estate to be indemnified to the extent of the benefit.

(c) This section is similar to the laws of most states. Bogert, Trusts and Trustees, Sec. 734 (2d ed. 1960); Scott on Trusts, Sec. 247 (2d ed. 1956).

(d) A trustee is not entitled to receive indemnity from a beneficiary personally for torts for which he becomes liable in the course of administration unless the beneficiary has agreed to indemnify him. Cf. Sec. 2193; Bogert, Trusts and Trustees, Sec. 734 (2d ed. 1960).

## T E X A S

### Section 114.062. EXONERATION OR REIMBURSEMENT FOR TORT.

(a) Except as provided in Subsection (b) of this section, a trustee who incurs personal liability for a tort committed in the administration of the trust is entitled to exoneration from the trust property if the trustee has not paid the claim or to reimbursement from the trust property if the trustee has paid the claim, if:

(1) the trustee was properly engaged in a business activity for the trust and the tort is a common incident of that kind of activity;

(2) the trustee was properly engaged in a business activity for the trust and neither the trustee nor an officer or employee of the trustee is guilty of actionable negligence or intentional misconduct in incurring the liability; or

(3) the tort increased the value of the trust property.

(b) A trustee who is entitled to exoneration or reimbursement under Subdivision (3) of Subsection (a) is entitled to exoneration or

reimbursement only to the extent of the increase in the value of the trust property.

**Section 114.063. GENERAL RIGHT TO REIMBURSEMENT.**

(a) A trustee may discharge or reimburse himself from trust principal or income or partly from both for:

- (1) advances made for the convenience, benefit, or protection of the trust or its property; and
- (2) expenses incurred while administering or protecting the trust or because of the trustee's holding or owning any of the trust property.

(b) The trustee has a lien against trust property to secure reimbursement under Subsection (a) of this section.

[Sections 114.064 through 114.080 reserved for expansion]

**SUBCHAPTER D. THIRD PERSONS**

**Section 114.081. PAYMENT OF MONEY TO TRUSTEE.**

(a) A person who actually and in good faith pays to a trustee money that the trustee is authorized to receive is not responsible for the proper application of the money according to the trust.

(b) A right or title derived from the trustee in consideration of the monetary payment under Subsection (a) of this section may not be impeached or questioned because of the trustee's misapplication of the money.

**Section 114.082. CONVEYANCE BY TRUSTEE.**

(a) If property is conveyed or transferred to a trustee in trust but the conveyance or transfer does not identify the trust or disclose the names of the beneficiaries, the trustee may convey, transfer, or encumber the title of the property without subsequent question by a person who claims to be a beneficiary under the trust or who claims by, through, or under an undisclosed beneficiary.

(b) Although trust property is held by the trustee without identifying the trust or its beneficiaries, the trust property is not liable to satisfy the personal obligations of the trustee.

**Section 114.083. RIGHTS AND LIABILITIES FOR COMMITTING TORTS.**

(a) A personal liability of a trustee or a predecessor trustee for a tort committed in the course of the administration of the trust may be collected from the trust property if the trustee is sued in a representative capacity and the court finds that:

- (1) the trustee was properly engaged in a business activity for the trust and the tort is a common incident of that kind of activity;
- (2) the trustee was properly engaged in a business activity for the trust and neither the trustee nor an officer or employee of the trustee is guilty of actionable negligence or intentional misconduct in incurring the liability; or
- (3) the tort increased the value of the trust property.

(b) A trust that is liable for the trustee's tort under Subdivision (3) of Subsection (a) is liable only to the extent of the permanent increase in value of the trust property.

(c) A plaintiff in an action against the trustee as the representative of the trust does not have to prove that the trustee could have been reimbursed by the trust if the trustee had paid the claim.

(d) Subject to the rights of exoneration or reimbursement under Section 114.062, the trustee is personally liable for a tort committed by the trustee or by the trustee's agents or employees in the course of their employment.

**Section 114.084. CONTRACTS OF TRUSTEE.**

(a) If a trustee or a predecessor trustee makes a contract that is within his power as trustee and a cause of action arises on the contract, the plaintiff may sue the trustee in his representative capacity, and a judgment rendered in favor of the plaintiff is collectible by execution against the trust property. The plaintiff may sue the trustee individually if the trustee made the contract and the contract does not exclude the trustee's personal liability.

(b) The addition of "trustee" or "as trustee" after the signature of a trustee who is party to a contract is prima facie evidence of an intent to exclude the trustee from personal liability.

(c) In an action on a contract against a trustee in the trustee's representative capacity the plaintiff does not have to prove that the trustee could have been reimbursed by the trust if the trustee had paid the claim.

**Section 115.015. NOTICE TO BENEFICIARIES OF TORT OR CONTRACT PROCEEDING.**

(a) A court may not render judgment in favor of a plaintiff in an action on a contract executed by the trustee or in an action against the trustee as representative of the trust for a tort committed in the course of the trustee's administration unless the plaintiff proves that before the 31st day after the date the action began or within any other period fixed by the court that is more than 30 days before the date of the judgment, the plaintiff gave notice of the existence and nature of the action to:

(1) each beneficiary known to the trustee who then had a present or contingent interest; or

(2) in an action on a contract involving a charitable trust, the attorney general and any corporation that is a beneficiary or agency in the performance of the trust.

(b) The plaintiff shall give the notice required by Subsection (a) of this section by registered mail or by certified mail, return receipt requested, addressed to the party to be notified at the party's last known address. The trustee shall give the plaintiff a list of the beneficiaries or persons having an interest in the trust estate and their addresses, if known to the trustee, before the 11th day after the date the plaintiff makes a written request for the information.

(c) The plaintiff satisfies the notice requirements of this section by notifying the persons on the list provided by the trustee.

W A S H I N G T O N

**"30.99.100 Contract and tort liability.** Actions on contracts which have been transferred to a trust and on contracts made by a trustee, and actions in tort for personal liability incurred by a trustee in the course of his administration may be maintained by the party in whose favor the cause of action has accrued as follows:

"(1) The plaintiff may sue the trustee in his representative capacity and any judgment rendered in favor of the plaintiff shall be collectible by execution out of the trust property: *Provided, however,* if the action is in tort, collection shall not be had from the trust property unless the court shall determine in such action that (a) the tort was a common incident of the kind of business activity in which the trustee or his predecessor was properly engaged for the trust; or (b) that, although the tort was not a common incident of such activity, neither the trustee nor his predecessor, nor any officer or employee of the trustee or his predecessor, was guilty of personal fault in incurring the liability; or (c) that, although the tort did not fall within classes (a) or (b) above, it increased the value of the trust property. If the tort is within classes (a) or (b) above, collection may be had of the full amount of damage proved, and if the tort is within class (c) above, collection may be had only to the extent of the increase in the value of the trust property.

"(2) If the action is on a contract made by the trustee, the trustee may be held personally liable on such contract, if personal liability is not excluded. Either the addition by the trustee of the words "trustee" or "as trustee" after the signature of a trustee to a contract or the transaction of business as trustee under an assumed name in compliance with RCW 19.80.010 to 19.80.050 inclusive shall exclude the trustee from personal liability. If the action is on a contract transferred to the trust

or trustee, subject to any rights therein vested at time of such transfer, the trustee shall be personally liable only if he has in writing assumed such liability.

"(3) In any such action against the trustee in his representative capacity the plaintiff need not prove that the trustee could have secured reimbursement from the trust fund if he had paid the plaintiff's claim.

"(4) The trustee may also be held personally liable for any tort committed by him, or by his agents or employees in the course of their employments, subject to the rights of exoneration or reimbursement:

"(a) A trustee who has incurred personal liability for a tort committed in the administration of the trust is entitled to exoneration therefor from the trust property if (i) the tort was a common incident of the kind of business activity in which the trustee was properly engaged for the trust, or (ii) although the tort was not a common incident of such activity, if neither the trustee nor any officer or employee of the trustee was guilty of personal fault in incurring the liability;

"(b) A trustee who commits a tort which increases the value of the trust property shall be entitled to exoneration of reimbursement with respect thereto to the extent of such increase in value, even though he would not otherwise be entitled to exoneration or reimbursement.

"(5) No judgment shall be rendered in favor of the plaintiff in any such action unless the plaintiff shall cause a copy of the notice of the hearing on such action to be mailed not less than twenty days before the date therefor to the trustor, if living, the trustee and to each beneficiary whose name and address is known to him. Proof of the mailing of such notice shall be made by affidavit which shall be filed at or before the hearing.

All those whose names or addresses are not known or are not legally competent and any beneficiary who is not ascertained shall be represented at the hearing by a guardian ad litem appointed by the court when it sets the time of hearing.

"(6) Nothing in this section shall be construed to change the existing law with regard to the liability of the trustee of a charitable trust for the torts of the trustee."