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Giraldin Revisited: When Does a Trustee of a Revocable Trust Owe Duties to Remainder Beneficiaries?

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Introduction

California Trust Law provides that a trustee of a revocable trust owes fiduciary duties only to the person who holds the power to revoke (typically the settlor) and not to the beneficiaries, "[e]xcept to the extent that the trust instrument otherwise provides or where the joint action of the settlor and all beneficiaries is required." Prob C §§15800, 16069(a).

There are several generally assumed corollaries to this principle applicable to revocable trusts:

- Only the settlor (or settlor's conservator) may therefore assert a breach of trust.
- The trustee need always account only to the settlor.
- The trustee is exempt from liability if the settlor signed a directive in writing.
- Claims for breach of trust die with the settlor or become the property of the settlor's estate.

The very narrowly construed decision in *Evangelho v Presoto* (1998) 67 CA4th 615, reported in 20 CEB Est Plan R 87 (Dec. 1998), gave the warning shot that these corollaries may not necessarily be true in certain limited situations. *Esslinger v Cummins* (2006) 144 CA4th 517, reported in 28 CEB Est Plan R 85 (Dec. 2006), raised the bar of nervousness when it required the trustee of a revocable trust to account to a contingent remainder beneficiary. Now, the supreme court decision in *Estate of Giraldin* (2012) 55 C4th 1058, reported in 34 CEB Est Plan R 130 (Feb. 2013), has made it clear that these corollaries, as absolute rules, are *never true in any situation*.

Giraldin Revisited

The sole issue before the supreme court in *Giraldin* was "whether, after the settlor [of a revocable trust] dies, the beneficiaries have standing to sue the trustee for breach of the fiduciary duty committed while the settlor was alive and the trust was still revocable." 55 C4th at 1062. The court's answer was yes—after the settlor's death, the beneficiaries have standing to assert a breach of the fiduciary duty the trustee owed to the settlor, to the extent that breach harmed the beneficiaries. 55 C4th at 1076. The court was very clear in affirming that, while the trust is revocable, the trustee owes no fiduciary duties to the remainder beneficiaries, but solely to the settlor. 55 C4th at 1066, 1071. That the trustee owes no duty to the remainder beneficiaries while the trust remains revocable does not retroactively change after the settlor dies. 55 C4th at 1072. Therefore, a later beneficiary action for a breach while the trust was revocable could be only for a breach of the duty owed to the settlor (or

other person holding the power to revoke) and not for a breach of duty owed to the remainder beneficiaries. 55 C4th at 1071. Had the beneficiaries brought the action only for breach of duty owed to them, the supreme court stated, the action could have been dismissed on the basis that the trustee had no such duty to the beneficiaries and the court need never have reached the issue of standing. However, the court noted that a substantial thrust of the action and the trial court's order concerned an alleged breach of the trustee's fiduciary duty toward the settlor during his lifetime. The court addressed the issue of the beneficiaries' standing to bring the action in that context. 55 C4th at 1066.

The supreme court's holding in *Giraldin* was followed by the appellate decision in *Drake v Pinkham* (2013) 217 CA4th 400, which appears to be the first published decision directly stating that a nonvested contingent future remainder beneficiary alleging the settlor's mental incapacity and trustee's breach had standing to petition the court under Prob C §17200 while the settlor was alive. The appellate court went one step further and also found that the remainder beneficiary's action for breach of trust was barred by laches, because the beneficiary's delay in not bringing the action until after the settlor's death (when beneficiary's interest vested) was necessarily prejudicial, owing to the death of the main witness, the settlor.

New Questions

A plethora of questions now arise from these holdings:

- To whom does the trustee owe fiduciary duties at any given point in time?
- How should a trustee of a revocable trust record actions taken to guard against the event of remainder beneficiaries asserting (either before or after the settlor's death) that the trustee breached the trust during the settlor's lifetime?
- Can a trustee cut off such claims?
- Is there ever a time when a trustee of a revocable trust has a duty to inform or notify remainder beneficiaries?
- How does a settlor's diminished mental capacity affect beneficiary rights or trustee duties?
- To what extent does a trustee have a duty to consider diminished capacity?
- What would be the standard of capacity?

This article attempts to answer these questions.

Who Holds the Beneficiaries' Rights? To Whom Does the Trustee Owe Duties?

Any beneficial interest in a revocable trust or in an irrevocable trust subject to a general power of appointment or withdrawal power (to the extent of such powers) can be only a nonvested contingent future interest. For this reason, California Trust Law places a limitation on such beneficial interests. As explained in *Drake v Pinkham, supra*, quoting *Estate of Giraldin*, 55 C4th at 1065: "The limitation placed on the rights of a beneficiary by section 15800 is consistent with the principle that '[p]roperty transferred into a revocable inter vivos trust is considered the property of the settlor for the settlor's lifetime,'" and thus, "the beneficiaries' interest in that property is 'merely potential' and can 'evaporate in a moment at the whim of the [settlor].'" 217 CA4th at 407.

In placing this limitation, Prob C §15800 distinguishes two categories of beneficial interests:

- Rights afforded beneficiaries under California Trust Law (which include persons who give consent under Prob C §15801, persons to be noticed under Prob C §15802, persons to whom the trustee is required to report or account under the Probate Code, and persons who have standing to bring an action or petition the court) (hereinafter "Rights"); and
- Duties the trustee owes (which include the fiduciary duty of care and duty of loyalty) (hereinafter "Debt of Duty").

Uniform Trust Code §603 makes the same distinction. These Rights and Debt of Duty are held by the trust beneficiaries except for the following limitations, which instead grant both Rights and Debt of Duty to the following person(s), in order of priority, to the exclusion of all other beneficiaries:

(1) Per Trust Instrument

To such persons as set forth in the trust instrument. Prob C §15800.

(2) Both Settlors and Beneficiaries

To both the settlor and all beneficiaries when the joint action of the settlor and all beneficiaries is required (Prob C §15800), *e.g.,* modification or termination of a trust under Prob C §15405.

(3) Competent Person Holding Power to Revoke

During the time that a trust is revocable, to the person holding the power to revoke the trust, provided the person is competent. Prob C §15800. Typically, the power holder is the settlor. This limitation to the person holding the power to revoke is consistent with the rule that, during the time the trust is revocable, the trustee need not account to other beneficiaries (see *Johnson v Tate* (1989) 215 CA3d 1282, reported in 11 CEB Est Plan R 69 (Dec. 1989)), that the trustee does not violate the duty to account by not advising contingent beneficiaries of the existence or status of a revocable trust (Prob C §§15800, 16069(a)), and that the trustee's sole duties are to the settlor or other person holding the power to revoke (Prob C §15800(b); *Estate of Giraldin*, 55 C4th at 1066). When a revocable trust later becomes irrevocable (typically on the settlor's death), these Rights and Debt of Duty then shift to the remainder beneficiaries (whose interests then vest). *Estate of Giraldin*, 55 C4th at 1062.

(4) Donee of General Power of Appointment

To the donee of a presently exercisable general power of appointment who has the rights of a person holding the power to revoke the trust to the extent of the donee's power over the trust property. Prob C §15803. See also Prob C §§15800, 16069(a). This is what the Restatement (Third) of Trusts §74, Comment g (2007), calls an "ownership-equivalent power." Such powers may be found in either a revocable trust (*e.g.*, a survivor's trust) or an irrevocable trust (*e.g.*, a self-settled trust, or a trust not exempt for generation-skipping transfer (GST) tax purposes). A release of an existing power shifts the Rights and Debt of Duty from the donee to the trust beneficiaries.

(5) Donee of Withdrawal Power

To the donee of a presently exercisable power to withdraw property from the trust who has the rights of a person holding the power to revoke the trust to the extent of the donee's power over the trust property. Prob C §15803. This is another form of what the Restatement calls an "ownership-equivalent power" and more typically is found in an irrevocable trust. It may be a "five and five" power (so limited to the extent of such power) or, in the case of an irrevocable intentionally defective grantor trust (IDGT), if the settlor retains or gives to another person a power of substitution over trust assets (see Rev Rul 2008–22, 2008–16 Int Rev Bull 796, reported in 29 CEB Est Plan R 129 (June 2008)), this is arguably a withdrawal power under the Probate Code. A release of an existing withdrawal power shifts the Rights and Debt of Duty from the donee to the trust beneficiaries.

(6) Noncompetent Person Holding Power to Revoke—Power Held by Another

When the holder of the power to revoke the trust (or the donee of an ownership-equivalent power) is not competent, to another such person who then legally holds such power. This could be a conservator who, along with the court, has the power to revoke the trust under the Prob C §2580 substituted judgment statute. See *Johnson v Kotyck* (1999) 76 CA4th 83, reported in 21 CEB Est Plan R 88 (Dec. 1999) (reaffirmed in *Estate of Giraldin*, 55 C4th at 1071). However, the mere appointment of a conservator may not be sufficient to shift the Rights and Debt of Duty to the conservator, inasmuch as the conservatee may still retain testamentary capacity (see discussion of Settlor's Competency below); the power to revoke also depends on the court's willingness to grant a substitution petition. One might specifically request the court to grant the conservator the power to revoke with court approval under the substituted judgment statute and, if appropriate, make a finding as to whether the conservatee does or does not retain testamentary capacity, as this can make it clear who holds the power to revoke the trust for purposes of Prob C §15800.

This also could be the holder of a durable power of attorney, as discussed in *Parducci v Demello* (July 24, 2012, A133707) 2012 Cal App Unpub Lexis 5430. For such power to be effective, the power of attorney must be durable (see Prob C §4124) and must specifically authorize revocation of the trust (Prob §4264(a)); the trust instrument must allow an attorney-in-fact to exercise the power to revoke (Prob C §§4264(a), 15401(c)). See also Restatement (Third) of Trusts §63, Comment l (2003), and Restatement §74, Comment a(2), which anticipate exercise of a power to revoke or amend either by a conservator or holder of a durable power of attorney.

(7) Noncompetent Person Holding Power to Revoke—No Other Power Holder

When the holder of the power to revoke the trust (or, by extension, the holder of a presently exercisable general power of appointment or withdrawal power) is not competent, and if there is, or comes to be, no other such person holding the legal power to revoke the trust (or exercise the ownership-equivalent power), then the Rights and Debt of Duty shift to the trust beneficiaries. To emphasize this point again: If the person holding the power to revoke the trust is incompetent, and there is no one else with the legal ability to revoke, then the remainder beneficiaries become the persons holding the beneficiary Rights to whom the trustee owes the Debt of Duty, even though the trust remains revocable, the settlor is still alive, and the remainder beneficiaries' contingent future interests are not yet vested.

This is the holding of *Drake v Pinkham* (2013) 217 CA4th 400, which not only held that the then nonvested contingent remainder beneficiary alleging the settlor's incompetence had standing to petition the court regarding documents allegedly signed under undue influence, and for alleged breach of trust under Prob C §§17200 and 15800 while the settlor was alive, but further found that the beneficiary's action brought after the settlor's death was barred by laches because failure to bring the action until after the settlor died was necessarily prejudicial when each cause of action "centered on" the settlor's mental capacity, susceptibility to undue influence, and understanding of trust amendments and her estate, making the settlor an important witness. The decision states in reference to the beneficiary's right to petition the court: "The allegation of [the settlor's] incompetency takes this matter outside the terms of section 15800." 217 CA4th at 408. The beneficiary would have had "the usual rights of trust beneficiaries" if, as she alleged, the settlor was incompetent, and she would have had the burden of proving the settlor's incompetence to establish her standing to pursue those claims.

With no other person holding the legal power to revoke the trust, the limitations of Prob C §15800 are extinguished, which serves to shift these beneficiary Rights and Debt of Duty to the beneficiaries. The Law Revision Commission Comments to §§17200 and 15800 make

clear that those limitations apply only during the time the person holding the power to revoke is competent. "The language concerning the incompetence of the settlor would be wholly superfluous if the beneficiary could not challenge competence until after the settlor's death." *Drake v Pinkham*, 217 CA4th at 408.

The reasoning for this shift of Rights and Debt of Duty to the beneficiaries in light of the settlor's incompetence is consistent with authorities discussed in *Giraldin*, although this issue was not before that court. For example, the Comment to Prob C §15800 refers to "postponing the enjoyment of rights of beneficiaries of revocable trusts until the death *or incompetence* of the settlor or other person holding the power to revoke the trust" (emphasis added). See *Estate of Giraldin*, 55 C4th at 1067, 1072, 1074 (discussion of Comment to UTC §603(a), referring to "death or incapacity"). The above discussion is also consistent with the district court decision in *Jack v Jack* (ND Cal, Feb. 12, 2013, No. C 12–02459 DMR) 2013 US Dist Lexis 19573, citing *Estate of Giraldin* as authority that plaintiff beneficiary and trustee had no standing to bring claims of fraud, cancellation of deed, or quiet title during the time the trust was revocable when plaintiff had not produced sufficient evidence of settlor's incapacity nor had any judicial determination been made.

Finally, the reasoning follows from the Probate Code itself. It is only by the limitation of Prob C §15800 that a trustee is relieved under Prob C §16069(a) from the duty to account to beneficiaries, provide terms of the trust, or provide requested information; §15800 requires a competent holder of the power to revoke the trust. Without a competent holder of such power, §15800 does not apply and §16069(a) does not relieve the trustee from the duty to account to, provide trust terms to, and respond to requests of the beneficiaries. Notwithstanding these arguments and authorities, it has not previously been clear to many practitioners that nonvested contingent remainder beneficiaries hold the Rights and Debt of Duty, with standing to bring an action for breach of trust or a Prob C §17200 petition, when the settlor is incompetent and no one else holds the power to revoke.

If the Rights and Debt of Duty shift to the beneficiaries on the settlor's incompetence, does the trustee still owe any duties to settlor? Yes, to the extent settlor is a trust beneficiary and so shares with the other beneficiaries the Rights and Debt of Duty. But the answer seems to be no if settlor is not a beneficiary, although the general requirement that the trustee follow the settlor's intent (Prob C §21102(a)) protects the settlor's only remaining interest in the trust.

One could prevent this shift of Rights and Debt of Duty to the beneficiaries by prior draft of terms in the trust instrument (see paragraph (1), above), such as by granting to some other person the power to revoke the trust in the event of the settlor's incapacity under Prob C §15401(b) (but cautiously to neither grant a power of appointment nor allow that person to direct the disposition of the trust as provided in Prob C §15410(b)(2)–(3) because of tax consequences) or by provisions relating to competency that could possibly delay a finding of incompetency until certain formal evaluations were made (see Capacity to Revoke a Trust, below).

Another way to prevent the shift would be keeping open an existing conservatorship proceeding until the settlor's death, commencing a conservatorship proceeding and continuing it until the settlor's death, or keeping an applicable durable power of attorney in effect until the settlor's death (see paragraph (6), above).

In the absence of a person holding the legal power to revoke the trust and resulting shift of the Rights and Debt of Duty to the beneficiaries, does the trust now become irrevocable? Do the beneficiaries' contingent future interests now vest? Although these questions have been raised, common sense would answer that the trust remains revocable and the remainder beneficiaries' interests do not vest as long as the settlor is alive. It may be possible that the settlor's capacity could be restored. *Rands v Rands* (2009) 183 CA4th 907, reported in 31 CEB Est Plan R 65 (Dec. 2009), concerned a dispute over whether settlor had regained capacity at the time of his revocation of a trust. It is always possible to appoint a conservator for the settlor (see paragraph (6), above).

Potential Prospective Duties

Although the settlor or some other person (but not the remainder beneficiaries) holds all Rights and the Debt of Duty during the time the trust was revocable, as set forth in paragraphs (3), (4), (5), and (6), above, the trustee still may be required to account to the beneficiaries and respond to an action for breach of trust concerning the trustee's actions during that time.

The "beneficiaries" here include all remainder beneficiaries, even those with contingent remainders. Contingent remainder beneficiaries were the plaintiffs whose standing to bring the action for breach in *Giraldin* was affirmed by the supreme court, despite provisions in the trust instrument that waived any requirement to "render a report or account to the beneficiaries" while the initial life beneficiary was alive and gave the trustee the ability to "act arbitrarily, so long as he or she does not act in bad faith, and [provided] that no requirement of reasonableness shall apply to the exercise of his or her absolute discretion." *Estate of Giraldin*, 55 C4th at 1063.

Recall that *Esslinger v Cummins* (2006) 144 CA4th 517, went even further and ordered the trustee of (apparently) both the revocable and irrevocable shares of a family trust after the death of the first spouse, and while survivor was alive, to give full annual accountings under Prob C §16062 to a contingent remainder beneficiary. In other words, a trustee may be faced with having to account for administration of a revocable trust at any time, although the trial court also may deny a beneficiary's request. See *Ross v Alley* (Apr. 9, 2010, F056536) 2010 Cal App Unpub Lexis 2567.

What Steps Should the Trustee Take Now?

At the outset, the trustee will want to keep accurate accounting records as well as maintain records of all actions taken, investments made (or not made), directives from the settlor, consents from the settlor and beneficiaries, and documentation of all discussions with the settlor and future beneficiaries regarding trust property, actions, planning, and the like. These will be crucial if later claims are made or an accounting is ordered. How can a trustee limit future claims? There are five general ways.

Satisfaction of Gifts

First, when possible, paying out the gift such that the beneficiary no longer has any interest in the trust can dispense with future concerns or claims from such beneficiary. Obviously, in a revocable trust, this may not always be possible.

Accountings to Beneficiaries

Second, a trustee who voluntarily produces accountings to all trust beneficiaries (as a trustee might for an irrevocable trust) would limit possible future claims by the beneficiaries against the trustee (see Prob C §16460), but the settlor likely would not be very happy with such revelations.

Beneficiary Consents

Third, obtaining each beneficiary's consent to significant actions also would relieve the trustee of potential future liability to the extent of such consent (Prob C §16463), but, again, the settlor may not desire such disclosures. On the other hand, when the settlor is comfortable with including family members in the estate planning or family business succession process, when all participate in the planning and decision making and have shared knowledge of the settlor's intentions and are educated by the settlor's attorney as to why documents are drafted as they are and what they mean, the settlor's or trustee's attorney(s) can easily obtain written consents from family members (contingent remainder beneficiaries as well as possibly other influencing persons, such as children's spouses) at various stages in the planning process as decisions are made.

Court Approval

Fourth, usually the most costly but most secure option would be to obtain court approval for an action or accounting to cut off future claims. However, this does mean not only beneficiary disclosure but filed public record disclosure, as well as legal and possibly accounting expenses.

Written Direction

Finally, a different means of limiting a trustee's liability exposure that requires no disclosures to beneficiaries is found in Prob C §16001(a), which provides that "the trustee of a revocable trust shall follow any written direction acceptable to the trustee given from time to time (1) by the person then having the power to revoke the trust or the part thereof with respect to which the direction is given or (2) by the person to whom the settlor delegates the right to direct the trustee."

Restatement §74, Comment b, states:

> Even if the settlor directs the trustee to perform acts that are contrary to the terms of the trust or inconsistent with the trustee's normal fiduciary responsibilities, the trustee has a duty to comply with the direction if it is communicated to the trustee in writing and in a manner that would be effective to amend or revoke the trust.

A trustee following such written direction is protected from liability under Prob C §16462(a), which provides that "a trustee of a revocable trust is not liable to a beneficiary for any act performed or omitted pursuant to written directions from the person holding the power to revoke." Hence, for actions or omissions that possibly could be of later concern to beneficiaries, a trustee might seek written direction from the settlor before acting (or not acting).

Restatement §74, Comment g, indicates that donees of "ownership-equivalent powers" (*e.g.*, a presently exercisable general power of appointment or withdrawal power) may similarly so direct the trustee in writing in a manner that conforms to the requirements of exercising the power. Although Comment g does not specifically address relief from liability to beneficiaries, it would seem that relief should apply under Prob C §§16462(a) and 15803 inasmuch as donees hold the power to revoke the trust to the extent of such powers.

Such "ownership-equivalent powers" are distinguished from powers given by the settlor to another to direct the trustee (see Prob C §16001(a)(2)), which are not ownership-equivalent powers. Examples may be powers given to a special trustee, advisor, consultant, trust protector, or holder of a veto power. The trustee is required to act in accordance with the directive, but only to the extent the directive is not contrary to the terms of the trust or the power and does not violate a fiduciary duty that the power holder owes to the beneficiaries. The relief from liability for a trustee following written direction from a person holding the power to revoke a trust does not apply to these powers or directives (although some relief of liability may be given in the trust instrument).

The trustee's relief from liability is not absolute. Restatement §74, comment b, points out that, while a trustee is not liable to the beneficiaries for a loss that results from compliance with the settlor's direction, the trustee does remain subject to fiduciary duties and thus has potential liability with respect to those aspects of the directed conduct that are not prescribed by the terms of the settlor's direction (*e.g.*, for a directive to sell property, the trustee must still act with prudence in arranging the price and other terms of the sale).

In addition, questions of the settlor's competency may nullify this protection. The trial court in *Giraldin*

found that the settlor "was not sufficiently mentally competent ... to authorize and direct [the trustee] to make" the investment. *Estate of Giraldin*, 55 C4th at 1064. The settlor's authorization was contained in written documents, but the trial court nevertheless removed the trustee, ordered an accounting, and surcharged the trustee. A trustee, therefore, cannot ignore indicia of a settlor's diminished mental capacity in blind reliance on the protection of Prob C §16462.

Settlor's Competency

In the following discussion, the term "settlor" refers to any person who holds the power to revoke a trust and includes the donee of an "ownership-equivalent power" to the extent of such power. The issue of settlor competency arises in the context of Prob C §15800's requirement that "the person holding the power to revoke the trust is competent" in reference to the above paragraphs (6) and (7), as well as in the context of written direction by the settlor under Prob C §16001(a)(2) (with its concurrent relief from trustee liability under Prob C §16462).

Section 15800 uses the term "competent," which implies not only the power to revoke but also the mental capacity to do so. This mental capacity involves "decisional capacity" (*e.g.*, to execute a trust, enter into a contract, transfer property, sign a directive) at the time the decision is made or action taken. This is distinct from "functional capacity" (*e.g.*, to take care of personal needs, resist fraud or undue influence), which is sustained over a period of time, as would be involved in determining whether a conservatorship is required. Unlike susceptibility to undue influence, which can having varying degrees, both decisional and functional capacity are threshold concepts—either the person is or is not competent; there is no middle ground. See Streisand & Spar, *A Lawyer's Guide to Diminishing Capacity and Effective Use of Medical Experts in Contemporaneous and Retrospective Evaluations*, 33 ACTEC J 180 (Winter 2008).

California case law historically has distinguished between testamentary capacity and contractual capacity. To some extent, this distinction remains useful for discussion of trusts because both tests apply. In *Marriage of Greenway* (2013) 217 CA4th 628, 639, in a case dealing with capacity to dissolve a marriage, the court referred to "multiple and overlapping" statutes found in the Probate Code, Welfare and Institutions Code, Civil Code, and Family Code and stated: "After reviewing the relevant case law, we conclude mental capacity can be measured on a sliding scale, with marital capacity requiring the least amount of capacity, followed by testamentary capacity, and on the high end of the scale is the mental capacity required to enter contracts."

Testamentary Capacity

The classic test of testamentary capacity, as stated in *Estate of Smith* (1926) 200 C 152, 158, is whether the testator "has sufficient mental capacity to be able to understand the nature of the act he is doing, and to understand and recollect the nature and situation of his property and to remember, and understand his relations to, the persons who have claims upon his bounty and whose interests are affected by the provisions of the instrument." In *Estate of Mann* (1986) 184 CA3d 593, reported in 8 CEB Est Plan R 70 (Dec. 1986), the court elaborated (184 CA3d at 602):

> Testamentary capacity must be determined at the time of execution of the will. Incompetency on a given day may, however, be established by proof of incompetency at prior and subsequent times. Where testamentary incompetence is caused by senile dementia at one point in time, there is a strong inference, if not a legal presumption, that the incompetence continues at other times, because the mental disorder is a continuous one which becomes progressively worse. [Citations omitted.]

On the other hand, "[w]hen one has a mental disorder in which there are lucid periods, it is presumed that his will has been made during a time of lucidity." 184 CA3d at 604.

There is a "rebuttable presumption affecting the burden of proof that all persons have the capacity to make decisions and to be responsible for their acts or decisions." Prob C §810(a). The plain text of the statute applies this presumption to all decisions and actions, including testamentary as well as contractual capacity. See Prob C §811(a). In *Marriage of Greenway, supra*, the court added: "The burden of proof on mental capacity changes depending on the issue; there is a presumption in favor of the person seeking to marry or devise a will, but not so in the context of a person executing a contract." 217 CA4th at 639. However, that statement may refer to CC §39 regarding rescission of contracts by a person of unsound mind. Section 39(b) provides: "A rebuttable presumption affecting the burden of proof that a person is of unsound mind shall exist for purposes of this section if the person is substantially unable to manage his or her own financial resources or resist fraud or undue influence."

The appellate decision in *Halverson v Vallone* (Dec. 27, 2011, H035884) 2011 Cal App Unpub Lexis 9873 dealt with legal capacity in the context of a trust amendment. Appellant asserted that there was evidence the settlor could not manage her finances, and therefore under CC §39 the burden was on the beneficiaries of the trust amendment to rebut this presumption. The court noted that §39(b) was added in 1995 by the same legislation that added Prob C §810, which provides that a person under a mental disability may still be capable of executing wills and trusts. The court reviewed the legislative history of Prob C §§810 and 811, particularly the presumption that all persons have the capacity to make decisions and be responsible for their acts, and applied the testamentary capacity standard.

The statutory test of testamentary capacity in Prob C §6100.5, first enacted in 1985, codified the common law. See *Goodman v Zimmerman* (1994) 25 CA4th 1667,

1677. Section 6100.5(a) provides that a person is not mentally competent to make a will if at the time either of the following is true:

> (1) The individual does not have sufficient mental capacity *to be able to* (A) understand the nature of the testamentary act, (B) understand and recollect the nature and situation of the individual's property, or (C) remember and understand the individual's relations to living descendants, spouse, and parents, and those whose interests are affected by the will. [Emphasis added.]
>
> (2) The individual suffers from a mental disorder with symptoms including delusions or hallucinations, which delusions or hallucinations result in the individual's devising property in a way which, except for the existence of the delusions or hallucinations, the individual would not have done.

Note that the standard for impairment in one or more cognitive functions under §6100.5(a)(1) is being "able to" do such function—there is a difference between actually remembering something at one point in time and being able to remember it. Also note that (a)(1) pertains to impairment in one or more cognitive functions, while (a)(2) looks to a mental disorder (*e.g.*, schizophrenia), which may not affect cognition but still may affect capacity. However, the general capacity standards in Prob C §810 recognize that a person with a mental or physical disorder may still be capable of executing wills and trusts, and so provide that a judicial determination that a "person should be deemed to lack the legal capacity to perform a specific act, should be based on evidence of a deficit in one or more of the person's mental functions rather than on a diagnosis of a person's mental or physical disorder." §810(c). Mental functions to be examined are listed in Prob C §811. Under Prob C §812, except as otherwise provided by law:

> [A] person lacks the capacity to make a decision unless the person has the ability to communicate ... the decision, and to understand and appreciate, to the extent relevant, all of the following:
>
> (a) The rights, duties, and responsibilities created by, or affected by the decision.
>
> (b) The probable consequences for the decisionmaker and, where appropriate, the persons affected by the decision.
>
> (c) The significant risks, benefits, and reasonable alternatives involved in the decision.

Contractual Capacity

Historically, as a higher standard than testamentary capacity, contractual capacity depends on the particular subject matter: "Was the party mentally competent to deal with the subject before him with a full understanding of his rights? Did he understand the nature, purpose, and effect of the contract?" *Pomeroy v Collins* (1926) 198 C 46, 69. The test "is aimed at cognitive capacity and specifically asks the question whether the party understood the transaction which he [now] seeks to avoid. Some contracts require less competence than others, so the test of understanding varies from one contract to the next." *Smalley v Baker* (1968) 262 CA2d 824, 832.

Under current law, the general capacity standards of Prob C §§810–813 apply to contractual capacity under common law, as well as under CC §39. See *Halverson v Vallone, supra* (discussed above under the heading Testamentary Capacity).

Capacity to Revoke a Trust

For purposes of Prob C §15800's provision that the settlor must be competent or else the Rights and Debt of Duty will shift to the beneficiaries, what standard of mental capacity applies?

The decision in *Rands v Rands* (2009) 178 CA4th 907 provides authority that a trust instrument could set its own standards for competency separate from statutory requirements for competency. The dispute concerned the validity of a signed instrument revoking the trust. The trust instrument stated the trust could not be amended during settlor's incapacity, which was defined as "inability to act rationally and prudently in his or her or own best interests financially," and would be determined by certificates of two physicians. The settlor asserted that the trial court, in finding incapacity pursuant to certificates of two physicians, erred in not applying the factors set forth in Prob C §811 regarding a court finding of incompetency. The appellate court affirmed that the trial court did not make an original finding of incompetency based on those factors, but that its findings rested on the requirements of the trust instrument. (The court offered no authority for supplanting §811 requirements for a finding of incompetency with the terms of the trust instrument.)

This holding, then, inasmuch as it directly determined whether the settlor still held the power to revoke in the context of a trust instrument that allowed amendment only if there was no incapacity as defined in the trust, is authority that the competency required for purposes of Prob C §15800 would first be determined by the terms of the trust instrument. But if the trust instrument is silent on capacity to amend/revoke, then we turn to common law and statutory principles as to what capacity might be required. The answer has not been clear in the past. As stated in 13 Witkin, Summary of California Law, *Trusts* §25 (10th ed 2005): "Anyone with capacity to transfer property may create a trust." Uniform Trust Code §601 states that the capacity to create, amend, revoke, or add property to a revocable trust, or to direct the actions of the trustee of a revocable trust, are all the same capacity as required to make a will—but this has not been uniformly held in California, and it is not the law today (as discussed below).

Probate Code §15401 specifies the methods of revocation but is silent on the question of a settlor's capacity to revoke, as is California case law directly. We begin with the general capacity provisions of Prob C §§810–812, discussed above under Testamentary Capacity. A settlor

is presumed to have capacity (§810(a)), and a judicial determination that a settlor lacks capacity to revoke should be based on evidence of a deficit in one or more mental functions (§810(c)), and the evidence must show a correlation between the deficit and the act of revocation (see §811(a)). The list of mental functions in §811 would apply to revocation except to the extent that testamentary capacity applies, and then Prob C §6100.5 and the common law on testamentary capacity would apply.

Yet the Probate Code does not clearly indicate which standard applies. Every trust amendment either revokes some portion of the trust language, or adds new language, or does both. In *Rands v Rands, supra*, the court applied trust provisions regarding amendment to a revocation. Is the capacity to revoke the same as capacity to amend a trust? Or to create a trust? Under earlier common law, a power of revocation implied the power of modification and an unrestricted power to modify might also include the power to revoke. See *Heifetz v Bank of America* (1957) 147 CA2d 776, 781. Thus, it should be no surprise that historically, the California Supreme Court had spoken of testamentary capacity as sufficient to establish a trust, and such being the same capacity required to make an ordinary transfer of property (*Walton v Bank of Cal.* (1963) 218 CA2d 527) or to execute a deed (*Tuttle v Bessey* (1955) 137 CA2d 725; *Hughes v Grandy* (1947) 78 CA2d 555). Yet, as case law developed the divergent tests of testamentary capacity and contractual capacity, the courts did not specifically analyze the standards for capacity to make, amend, or revoke a trust, separate from a will. Indeed, when Prob C §6100.5 codified testamentary capacity, its language solely applied to wills.

Furthermore, the general capacity provisions in Prob C §§810–812, enacted in 1996, now clarify that unless testamentary capacity applies, these general provisions (including what was called "contractual capacity") will apply. See Prob C §811. Therefore, it is clear that the answer to the question of capacity to revoke a trust will not come from historical cases that treat capacity to make a trust, amend a trust, and create a trust all as the same, but will need to come from case law specifically analyzing applicability under the current statutory scheme.

The clarifying case is *Andersen v Hunt* (2011) 196 CA4th 722, reported in 33 CEB Est Plan R 25 (Aug. 2011), which pertained to capacity to amend a trust. The analysis and holdings are as follows:

- California courts have not applied consistent standards in evaluating capacity to make or amend a trust. 196 CA4th at 729.
- Testamentary capacity, when applicable to trusts, is the same standard set forth in Prob C §6100.5 and as developed in the case law pertaining to wills. 196 CA4th at 731.
- The general capacity standards of Prob C §§810–812 apply to making various kinds of decisions, transact business, and enter into contracts (196 CA4th at 728), but these provisions do not relate solely to contractual capacity and include testamentary capacity (196 CA4th at 730).
- Although the initial 16-page *Andersen* trust instrument was complex, the amendments at issue were very simple and only changed the percentages of the trust estate each beneficiary was to receive. The decision states: "In view of the amendments' simplicity and testamentary nature, we conclude that they are indistinguishable from a will or codicil." 196 CA4th at 731.

The decision concludes (196 CA4th at 731):

> When determining whether a trustor had capacity to execute a trust amendment that, in its content and complexity, closely resembles a will or codicil, we believe it is appropriate to look to section 6100.5 to determine when a person's mental deficits are sufficient to allow a court to conclude that the person lacks the ability "to understand and appreciate the consequences of his or her actions with regard to the type of act or decision in question." (§811, subd. (b).) In other words, while section 6100.5 is not directly applicable to determine competency to make or amend a trust, it is made applicable through section 811 to trusts or trust amendments that are analogous to wills or codicils.

The court first looked to the general capacity standards to determine capacity pertaining to trusts, and only on finding that the particular trust amendments at issue were "indistinguishable from a will or codicil" and "testamentary in nature" did the court apply the standard of testamentary capacity. *Andersen v Hunt* clearly suggests that had the trust amendment at issue been more complex and not "indistinguishable from a will or codicil," then the general capacity standards would continue to apply without reference to testamentary capacity. Indeed, the opinion indicates that the trial court had used the capacity standards of §§810–812 to evaluate the settlor's transfer of funds from the trust to joint tenancy accounts and change of beneficiary on his life insurance policy, and the appellate court affirmed the trial court's judgment as to these items based on this standard.

The supreme court denied review in *Andersen v Hunt* and so consciously let it stand. It seems reasonable, if not explicitly clear, that the *Andersen v Hunt* analysis for determining capacity applicable in its situation of making a trust amendment would be the same analysis for determining capacity to revoke a trust and create a trust. As noted above, Prob C §15402 states that, unless the trust provides otherwise, a settlor may amend a trust by the procedure for revocation, implying the same capacity standard for both.

There is also an argument that Prob C §6124, concerning the presumption of revocation of a will, implies that the same testamentary capacity is required to revoke a will as to make a will, and therefore the same testamentary capacity for making dispositive provisions of a trust applies to revoking the dispositive provisions. See Ca-

pacity and Undue Influence: Assessing, Challenging, and Defending, Step 11 (Cal CEB Action Guide).

This conclusion appears to be consistent with the Restatement, which gives no bright line test for capacity to revoke, amend, or create a trust, and appears to use both contractual and testamentary capacity, depending on the matter at hand. Restatement (Third) of Trusts §11 (2003), concerning a settlor's capacity to create a revocable inter vivos trust, suggests that the same testamentary capacity standard applies to the extent the trust is a testamentary instrument or will substitute. However, Restatement §11, Comment b, states:

> Insofar as the establishment of a revocable trust may also present issues of the settlor's ability to understand matters beyond those involved in making a testamentary disposition, the consequences of inadequate understanding of those matters [*i.e.,* contractual capacity issues] may be dealt with by reformation or other appropriate remedies that will not jeopardize the plan of disposition by making it dependent on a standard different [from] or higher than that for making a will.

The analysis is the same as in *Andersen v Hunt*: If the subject matter is only testamentary in nature, then testamentary capacity is required, but if the subject matter is more complex, then contractual capacity is required (and the comment suggests one might keep the two separate to protect the validity of the testamentary dispositions subject to the lower capacity requirement).

A similar application of both standards is seen in Restatement (Third) of Trusts §74 (2007) pertaining to the settlor's ability to revoke a trust, direct a trustee, or exercise a presently exercisable general power of appointment or withdrawal power. Restatement §74 has provisions similar to Prob C §15800 that beneficiaries' rights are subject to a competent settlor. Comment a(2) states that the settlor's or donee's required mental capacity is the capacity to do such acts "and to make and understand the business, financial, personal, and other judgments appropriate to the matters involved in an exercise of authority or control under this Section." This would imply need for contractual capacity to revoke unless the trust was solely a will substitute when "the matters involved" are solely testamentary in nature. Further, Comment e expresses the capacity needed to continue to report to settlor and not inform other beneficiaries as being as long "as the settlor has capacity to understand and evaluate information provided by the trustee regarding the administration of the trust." This appears to be testamentary capacity, although the need to "understand and evaluate" could imply contractual capacity, depending on the complexity of trust affairs. The same standard is reflected in Comment g concerning the trustee's providing accounting and information to a donee of an ownership-equivalent power. These statements are reconcilable in light of the *Andersen v Hunt* analysis that contractual capacity applies unless the instrument is solely testamentary in nature.

To date, no published decisions have moved beyond the *Andersen v Hunt* standard, but several unpublished decisions have followed it:

- *Halverson v Vallone* (Dec. 27, 2011, H035884) 2011 Cal App Unpub Lexis 9873 used testamentary capacity as the standard to execute a trust amendment that clearly was a will substitute, only changing trust beneficiaries due to the deaths of previously named beneficiaries.
- *Conservatorship of Anderson* (May 17, 2013, A132474) 2013 Cal App Unpub Lexis 3507 held that testamentary capacity applied to trust amendments; inasmuch as the trust instrument required both spouses to amend the trust as to community property, the trial court erred in finding the amendments effective when it had failed to consider issues of the wife's mental capacity, focusing solely on the husband.
- *Christie v Kimball* (June 6, 2013, B241394) 2013 Cal App Unpub Lexis 4002 concerned a settlor/trustee's execution of a deed transferring real property out of the revocable trust to the settlor individually. As to issues of capacity generally, the court followed *Andersen v Hunt*, although on the question of capacity to make a deed, the court did not consult the current general capacity statutes of Prob C §§810–812, but instead cited 1961 case law holding that rules governing capacity to make a deed were the same as those governing testamentary capacity. (Note: The decision relates to actions described in *Christie v Kimball* (2012) 202 CA4th 1407, reported in 33 CEB Est Plan R 117 (Feb. 2012).—*Eds.*)

The recent decision in *Marriage of Greenway, supra*, dealing with capacity to dissolve a marriage, discussing at length both testamentary capacity and contractual capacity in statutes and common law, curiously omits any reference to *Andersen v Hunt* and makes the blanket statement that capacity to contract includes the capacity to create a trust, as well as to convey (contrary to *Christie v Kimball, supra*) and make gifts—without citing any authority. However, that case dealt with dissolution of marriage, not amendment or revocation of trusts.

Finally, the appellate decision in *Parducci v Demello* (July 24, 2012, A133707) 2012 Cal App Unpub Lexis 5430, reported in 34 CEB Est Plan R 61 (Oct. 2012), directly addressed the issue of an incompetent settlor under Prob C §15800 when there is no other person holding the power to revoke, as discussed above in paragraph (7) under Who Holds the Beneficiaries' Rights? The court applied a standard of testamentary capacity, inasmuch as the case reflected trust provisions that were solely testamentary in nature (thus following *Andersen v Hunt, supra*), and concluded that a judicial finding of incompetence was not necessary to shift those Rights and Debt of Duty from

the settlor to the beneficiaries. The unpublished decision states (citations omitted):

> The incompetency of the settlor or other person holding the power to revoke is thus the crucial element, not a formal adjudication of incompetency that may occur later in the settlor's lifetime or not at all.... When such a successor trustee assumes responsibility for the trust upon the settlor's incompetency, the trustee's duty transfers to the beneficiaries without requiring the beneficiaries to have the settlor judicially declared incompetent.
>
> A strict standard of proof safeguards against a beneficiary's unfounded assertion that a settlor is or was incompetent and that a beneficiary has acquired rights under a revocable trust. To prove a settlor's incompetency, one must overcome the presumption that the settlor was competent in the sense of lacking testamentary capacity. A trustee administering a revocable trust for the settlor's benefit may generally rely upon this presumption of competency and need not scrutinize the soundness of the settlor's mind. A trustee cannot, however, ignore clear signs of mental deficits affecting the settlor's capacity to understand the nature of his or her acts affecting the trust.

Capacity to Direct Trustee

The fact statement in *Giraldin* indicates that the settlor created the revocable trust to facilitate his intent to make a certain investment (*Estate of Giraldin*, 55 C4th at 1064) (*i.e.*, the investment that was later determined by the trial court to be a breach by the trustee), but the facts give no indication that there had been any challenge to the settlor's capacity to create the trust. The only capacity challenge was to the settlor's authorization of the investment or the direction to the trustee to make it. The trial court found the settlor lacked the capacity to make such direction (under a contractual capacity standard), but this issue was not addressed by the supreme court decision (which focused solely on standing of beneficiaries). This indicates that all probably agreed the settlor had testamentary capacity, but whether he had contractual capacity remained in dispute, and the trial court assumed that contractual capacity was required to direct the trustee to make the investment.

From the foregoing discussion, it seems reasonable to assume that the *Andersen v Hunt* analysis applicable to trust amendments would also apply to capacity to direct the trustee. This would be consistent, in general terms, with the discussion of Restatement §74 above under the heading Capacity to Revoke a Trust pertaining to the settlor's ability to revoke a trust, direct a trustee, or exercise a presently exercisable general power of appointment or withdrawal power.

If this is indeed the case, then California's general competency standards of Prob C §§810–812 would apply (contractual capacity), unless the directive to the trustee were solely testamentary in nature, in which case testamentary capacity and Prob C §6100.5 would apply.

Conclusion

On remand, the court of appeal in *Giraldin* stated that the duty owed by the trustee to a living settlor who has not been declared incompetent "poses some questions on the very frontiers of trust administration law." *Estate of Giraldin* (Apr. 16, 2013, G041811) 2013 Cal App Unpub Lexis 2675. These questions apply equally to any trust with a settlor who may have diminished mental capacity. All of the issues in this article need to give a strong red flag to trustees of revocable trusts, and their advisors, to be aware of the trustee's possible duties to remainder beneficiaries (not only to the settlor) as well as a red flag to be aware of an attorney's ethical responsibilities in the face of a settlor client who may have diminished capacity.

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