Probate Department Newsletter

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Upcoming CLE Presentations of Interest

Sept 15, 2022: 2022 Annual Meeting California Lawyers Association

Oct 24-29, 2022 - 2022 Tax & Estate Planning Forum

Nov 1, 2022 - 43rd Annual Inland Empire Estate Planning Seminar

Nov 6-10, 2022 - 59th Annual Hawaii Tax Institute Conference

Nov 9, 2022 - 48th Annual Trust and Estate Conference by USC Gould School of Law

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Settlor Incapacity and Filling the "Empty Chair" by Jeremy J. Ofseyer**

Recent amendments to Probate Code § 15800 and § 16069, adopting AB 1079 (Stats. 2021, ch. 749) effective January 1, 2022, which change the duties of trustees to disclose information to beneficiaries upon the incompetence of a trust's settlor, are some of the most significant recent changes to California trust law. The new provisions aim to limit the class of beneficiaries entitled to certain trust information under the Probate Code -- including a copy of the terms of the trust (§16060.7), information upon reasonable request (§16061), and to annual and other trust accountings (§16062) -- while imposing new duties on the trustee if no person holding the power to revoke a trust is competent.

Background: the "Empty Chair" Pre-2022 AB 1079 addressed the so-called "empty chair problem," where the settlor, who typically holds the power of revocation, is incompetent, and thus has left empty the "chair" of the person to whom the trustee's duties flow. (Assem. Com. on Judiciary, Rep. on Assem. Bill No. 1079 (2021-2022 Reg. Sess.) Apr. 3, 2021, p. 6.) Prior to 2022, the "chair" was "filled" by the person with the power to revoke the trust, only if "the person holding the power to revoke" is competent.

Prior law left the situation unclear when a trust had more than one person with the power to revoke, as in the common situation of a married couple's joint trust. Bruce A. Last, *Incapacitated Settlor? Trustee May Owe New Duties to Some Successor Beneficiaries,* DAILY NEWS (Cal. CEB October 18, 2021). For such "two-seater" trusts, was the (singular?) "person holding the power" incompetent, if one settlor was incompetent — or only if both settlors were?

But once it was given that the settlor(s) had vacated the trust "chair", it seemed to become potentially overly filled, because "[un]der [pre-2022] law, unless the trust instrument provides otherwise, most commentators conclude that the 'chair' is filled by all nonvested contingent reminder beneficiaries." (*Id*. quoting the bill's sponsor, TEXCOM.)

Proponents of AB 1079 sought to limit the implications of *Drake v. Pinkham* (2013) 217 Cal.App.4th 400, fearing it may have entitled an overly wide class of beneficiaries to receive information about an incompetent settlor's trust. Last, *supra*. Given that Probate Code § 24 defines a trust "beneficiary" as anyone with a present or future trust interest, regardless of any contingency, the class of persons entitled to information could be quite large, including those with interests so speculative -- due to a contingency other than the settlor's death -- as to be highly improbable or near impossible. *Id*.

Amended Probate Code Sections 15800 and 16069 Probate Code § 15800, subdivision (a), as amended by Statutes 2021, chapter 749, specifies that trustee duties are owed to the person holding the power to revoke, and that person, but not any other beneficiaries, holds the rights of a beneficiary under Probate Code, Division 9, provided that at least one person holding the power of revocation over the trust, in whole or in part, is competent. This new provision removes the confusion over "two-seater" trusts: if one person with the power to revoke, in whole or part, is still competent, that person holds the rights of a beneficiary, and not any "downstream" beneficiaries.

Amended Probate Code § 15800, subdivision (b), imposes the following new trustee duties when no competent person holds the power to revoke. Subsection (b)(1) requires that the trustee provide a notice to the beneficiaries and a complete copy of the trust instrument to each beneficiary who would be entitled to receive a mandatory or discretionary distribution of trust income or principal if the settlor had died. Notice must be provided within 60 days of the trustee "obtaining information establishing the incompetency of the last person" holding the power of revocation. This subsection also specifies that if the current trust instrument is a complete restatement of the trust, the trustee need not provide any superseded trust instrument or amendment.

Subsection (b)(2) requires the trustee to account to those same beneficiaries at least annually, and to respond to such a beneficiary's request for information under Probate Code § 16061.

Subsection (b)(3) does not require the trustee to provide such disclosure to beneficiaries whose interests are conditioned on a factor not yet in existence or not yet determinable, except for the condition of the settlor's death, "unless the trustee, in the trustee's discretion, believes it is likely that the condition or conditions will be satisfied at the time of the settlor's death."

Subsection (b)(4) extends the specified trustee duties to successor beneficiaries, where the interest of the predecessor beneficiary "fails because a condition to receiving that interest has not been satisfied or the trustee does not believe that the condition will be satisfied at the time of the settlor's death...."

Amended Probate Code § 15800, subdivision (c), provides that, "to establish incompetency for the purposes of subdivision (b), the trustee may rely on either" (1) the trust instrument's specified method for determining incompetency; or (2) a judicial determination of incompetency.

Stats. 2021, ch. 749, also amended Probate Code § 16069, which limits beneficiary rights to information, to conform to amended § 15800.

Trust Administration Considerations Prior to 2022, administering a trust presented various vexing practical and legal challenges when the trust had a "seemingly empty chair" because no settlor seemed to have capacity. Many jurisdictions and authorities stress a distinction between "competence" (or "legal capacity") and other

types of "capacity" (e.g., medical, mental, or physical). *See, e.g.*, Raphael J. Leo, M.D., *Competency and the Capacity to Make Treatment Decisions: A Primer for Primary Care Physicians*, 1 PRIM CARE J CLIN PSYCHIATRY 5 131-41 (Oct. 1999) ("*Competency* is a legal term referring to individuals 'having sufficient ability… possessing the requisite natural or legal qualifications' to engage in a given endeavor.... The term *capacity* is frequently mistaken for competency. Capacity is determined by a physician, often (although not exclusively) by a psychiatrist, and not the judiciary. Capacity refers to an assessment of the individual's psychological abilities to form rational decisions, specifically the individual's ability to understand, appreciate, and manipulate information and form rational decisions. The patient evaluated by a physician to lack capacity to make reasoned medical decisions is referred to as *de facto incompetent*, i.e., incompetent in fact, but not determined to be so by legal procedures.").

California law, including amended Probate Code § 15800, does not always sharply draw such distinctions. California's Due Process in Competence Determination Act (Probate Code § 810 et seq.) does make clear that the fact that a person suffers from some "mental or physical disorder" does not alone entail that person is incapable of performing certain legally significant acts or making certain decisions. Probate Code § 810(a) provides "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." Probate Code § 811(a) requires that a determination of legal incapacity "to make a decision or do a certain act ... shall be supported by evidence of a deficit" in certain "mental functions" along with "evidence of a correlation between the deficit or deficits and the decision or act in question...."

Absent a judicial determination of incompetence, the legal status of a settlor or trustee who is incapacitated, especially in borderline cases, is thus a bit mirky. Often a trust instrument provides that a settlor or trustee is deemed incapacitated for trust purposes if one or two physicians certify in writing that the person in question is incapacitated, variously defined or described. Sometimes trust instruments provide for a "capacity committee" (which may include relatives or friends but not physicians) that can jointly determine the incapacity of a settlor/trustee. But any such determination is still distinct from -- and alone does not entail -- a judicial determination of incompetence.

Amended Probate Code § 15800 addresses these issues, and in doing so raises new questions and challenges. Subdivision (b) requires a trustee to provide the specified notice and information within 60 days of the trustee "obtaining information establishing the incompetency of the last person" holding the power of revocation. Subdivision (c) provides that, "to establish incompetency for the purposes of subdivision (b), the trustee *may* rely on either" the trust's specified method or a judicial determination of incompetency.

How should practitioners reconcile the mandatory language of (b) and the precatory language of (c)? Subdivision (b) seems to require the trustee -- presumably the successor trustee when a settlor/trustee becomes incompetent -- to provide the requisite notice upon receipt of information establishing incompetency. What degree or character of such information necessitates notice? Subdivision (c) says what the trustee "may" rely on, but not what they "must" rely on. In a situation where a successor takes over the trusteeship because of the apparent incompetence of the trustor/trustee, it seems the successor needed "information establishing incompetency" as a precondition to taking over. But one can envision scenarios where the successor could nonetheless deny a duty to disclose under § 15800. First, the successor could draw a semantic or legalistic distinction -- especially where the trust instrument uses the terms "capacity" or "incapacity" as opposed to the statutory term "incompetency" -- claiming in effect they took over because their predecessor was sufficiently incapacitated per the trust instrument, but denying they had obtained "information establishing *incompetency*."

How much weight, if any, should be placed on the term "incompetency," as a legal concept, as used in the phrase "information establishing … incompetency"? Second, where the trust instrument method is a "capacity committee" and no physician determination was made, the successor could, with perhaps even more justification, question whether they really had sufficient "information establishing incompetency." Third, a successor may prefer (or even induce) the settlor/trustee elect to "voluntarily resign" in favor of the successor, thus obviating the need to use the trust's specific method for establishing incompetency, and providing plausible deniability that the § 15800 disclosure duty had arose. These tactics for avoiding § 15800 disclosure will seem more plausible insofar as the impairment of the settlor/trustee is unclear. Could a designated successor trustee decline to provide the requisite notice/information, unless presented with further evidence or determination of incapacity or incompetence, after being presented clear evidence that, say, the settlor is gravely mentally impaired? Is comatose? Is deemed incapacitated in a physician certification as specified in the trust instrument? If the answer to any of these questions is "yes", is the mandate of disclosure under (b) really also precatory, absent a legal reform clarifying the type or level of proof of incompetence the trustee *shall* or *must* rely on?

Amended Section 15800 addresses the risks of financial elder abuse and undue influence that arise when a trustee can or does take over for an impaired settlor, by providing other beneficiaries with rights to information that will empower them to enforce the rights and to protect the interests of the vulnerable settlor. But if that protection leaves the next designated trustee wide discretion to deny that the succession of trusteeship has happened or should happen, that greatly undermines the intended protection.

Alternatively, if a designated successor trustee cannot properly turn a blind eye to their predecessor's evident incapacity, then this suggests that amended Section 15800(b) may have to be legislatively modified or judicially interpreted to impose some sort of duty of reasonable inquiry on the designated successor to ascertain the settlor's capacity and to be positively required to rely on certain information establishing incapacity. This seems especially appropriate when a beneficiary or other concerned person has taken affirmative steps to clearly put the designated successor on notice about the condition of the settlor.

This is a fraught situation, however, especially where an impaired settlor lacks insight into or denies his/her impairment, resents questioning of his/her capacity, or may even retaliate by trying to amend his/her trust to remove or disinherit a designated successor. Disputes over such questions seem to be a likely topic of litigation between beneficiaries (seeking to impose such duties) and successor trustees (seeking to avoid them).

The new notice requirement in Section 15800(b) -- which resembles the current notice requirement upon a trust becoming irrevocable in whole or part on the death of a settlor under Section 16061.7 -- is thus a major expansion of the duties of successor trustees. Although a major impetus for the amendment was to narrow the class of beneficiaries entitled to receive such information, in the context of doing that, it imposed substantial new affirmative duties of notice and disclosure not dependent on express beneficiary request. In effect, partly in response to trust information being potentially owed upon request to a very a wide class of beneficiaries, the new statute requires that such information must be provided, absent beneficiary request -- albeit to a narrower class of those beneficiaries.

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Trust Drafting Considerations The changes to Section 15800 suggest some drafting considerations for estate planning attorneys. First, because the notice requirement does not apply to trust instruments superseded by a full trust restatement, settlors intent on keeping earlier trust iterations private will have further reason -- similar to that provided by similar provision of § 16061.7 (in combination with § 16061.5 (terms of the trust)) -- to opt for full restatements over partial amendments.

Second, because Section 15800(a) and (b) expressly provide that they apply "[e]xcept to the extent that the trust instrument otherwise provides," settlors will have various opportunities, with carefully drafted provisions referencing the statute, to opt out of or limit the application of the statute's notice and disclosure duties. This could be done with provisions generally waiving or limiting notice or disclosure duties. Or it could be done by modifying or limiting the class of beneficiaries entitled to certain information -- perhaps granting more or less rights to information to some beneficiaries as opposed to others.

Such considerations may even lead settlors to limit the number and type of persons or organizations they designate as beneficiaries. Recall that the duties of notice and disclosure under § 15800(b) flow to each beneficiary who would be entitled to receive a mandatory or discretionary distribution of trust income or principal if the settlor had died. This applies regardless of the amount or degree of a beneficiary's interest in income or principal. If expecting a small sum of money or small item of tangible property could open the door to a "downstream beneficiary" having the full complement of beneficiary rights to notice and information, some settlors may be so put off by the very prospect that they may deem the modest gift they intended not worth the broad rights conferred -- with associated perceived threat to the settlor's privacy.

Amended Probate Code § 15800 thus suggests further areas for client discussion in the estate planning process.

* Disclaimer: This article is for informational purposes only, and does not constitute legal advice.
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