CHAPTER 1: ISSUES TESTED

Editorial Note 1: The Professor refers to specific page numbers throughout this lecture. The content does not always match these references due to formatting changes.

A. Summary of the Issues Tested

1. Parties to Trust
   - Settlor, Trustee, Beneficiary

2. Express Trusts
   - Intent
   - Trust property
   - Valid trust purpose
   - Ascertainable beneficiaries

3. Challenging the Validity of the Trust
   - Undue Influence
   - Fraud

4. Charitable Trusts
   - Charitable purpose
   - Cy Pres Doctrine

5. Rights of Beneficiaries and Creditors to Distribution
   - Income/Remainder
   - Lapse & Anti-Lapse
   - Discretionary/Mandatory
   - Alienability
   - Support Trust & Spendthrift Trust

6. Trust Termination

7. Trustee’s Duties
   - Duty of Care
   - Duty of Loyalty
   - Other Duties
B. Parties to Trust

- **Grantor/Settlor:** The creator of trust
- **Trustee:** Holds legal interest or title to trust property
- **Beneficiaries:** Receive the benefit of the trust

C. Express Trusts

**Exam Tip 1:** If the facts state that there is a valid trust, you do not have to analyze the elements of a trust.

1. **Inter vivos trust**

   An inter vivos trust is a trust created while the trustor is living that transfers some or all of the trustor’s property into a trust. The trustor can designate himself as the trustee or a third party.

2. **Testamentary trust**

   A testamentary trust is created in writing in a will or in a document incorporated by reference into a will. The will containing the trust must meet the attested or holographic will requirements.

3. **Intent**

   The settlor may manifest intent to make a gift orally, in writing, or by conduct; manifestation of intent must occur prior to or simultaneously with transfer of property.

4. **Trustee**

   A court will appoint a trustee if settlor fails to designate one.

5. **Trust property**

   Trust must be funded with identifiable trust property (res); described with reasonable certainty

6. **Valid trust purpose**

   A trust can be created for any purpose as long as it is not illegal or contrary to public policy; if one of trust terms violates public policy, alternative terms will be honored, or, if none, term will be stricken.

7. **Ascertnable beneficiaries**

   - The beneficiaries must be identifiable so that the equitable interest can be transferred automatically by operation of law and directly benefit the person.
   - The settlor may refer to outside writings or acts to identify beneficiaries.
   - Exceptions to Identifiable Beneficiaries:
     - *Class Gifts:* Trusts for a reasonably definite class (such as “my brothers”, or “my grandchildren”) will be upheld.
Charitable trusts (trusts that exist for the good of the public at large) do not need individual ascertainable beneficiaries.

8. Omitted Children (Frequently tested issue)
   - A child who is omitted from the trust can force an intestate share (see Wills outline, Intestacy) if certain requirements are met:
     - The child is born or adopted after the trust is created, or the settlor mistakenly believed the child was dead, or did not know the child existed; and
     - The child is unintentionally omitted from the trust.
   - Limitations: A share will not be forced if the child has been provided for outside of the trust, or if the settlor had other children at the time the trust was executed and left substantially all of his estate to the omitted child’s parent.

D. Challenging the Validity of a Trust
   1. Undue influence
      - General Rule: Undue influence occurs when mental or physical coercion is exerted by a third party on a testator with the intent to influence the testator such that he loses control of his own judgment. If undue influence is shown, the trust may be invalidated in whole, or in part.

          Exam Tip 2: You should discuss both approaches to undue influence below in your answer.

      a. Undue Influence – Traditional Approach
         - A contestant must show four elements:
           - Susceptibility: the testator was susceptible to being influenced.
           - Motive: the influencer has reason to benefit.
           - Opportunity: the influencer had opportunity to influence.
           - Causation: the influencer caused an unnatural result.

      b. Undue Influence – Confidential Relationship
         - A presumption of undue influence arises when:
           - The principal beneficiary of the will has a confidential relationship with the testator (example: parent/child, attorney/client),
           - The principal beneficiary participated in executing the will, and
           - The gift to the beneficiary is unnatural.

           If a presumption arises, the beneficiary must show through clear and convincing evidence that he did not exercise undue influence. If the beneficiary exerted undue influence, he will only receive what he would be entitled to under an intestate approach (if the beneficiary is a friend of the testator he would receive nothing because friends do not take under intestacy; a family member would take an intestate share).
2. Fraud

A trust can be invalidated due to fraud. Fraud requires a misrepresentation made by a beneficiary with both the intent to deceive the settlor and the purpose of influencing the testamentary disposition.

a. Fraud in the Inducement:

A misrepresentation that causes the trustor to make a different trust that he otherwise would have made. It must be shown that the trustor would not have made the gift if he had known the truth.

b. Fraud in the Execution:

A misrepresentation as to the trust itself or its contents (trustor does not know he is creating a trust or is not told the true content of the trust).

CHAPTER 2: SUBSTANTIVE LAW CONTINUED

A. Charitable trusts (Frequently tested issue in Trusts.)

- Purpose—Relief of poverty, advancement of education/religion, good health, governmental purposes, and other purposes benefiting the community at large
- Indefinite beneficiaries—the beneficiaries must be the community at large (directly or indirectly)
- Failure to follow trust terms: If the charity fails to follow the trust terms, the trustee can sue for return of the funds provided to the trust.
- Cy Pres Doctrine—A court may modify a charitable trust to seek an alternative charitable purpose if the original one becomes illegal, impracticable, or impossible to perform.

  Exam Tip 3: Look for facts indicating that a trust was created for the benefit of a charity that no longer exists (such as a retirement home, college or university, or zoo). There will usually be a similar charity that is in existence and it will ask the court to modify the trust and substitute it as the beneficiary of the trust.

  o Specific or General Intent: To determine whether it should modify the trust, a court will analyze whether the trust has a specific intent to help one charity or a general intent to help charity.

    ▪ If there is specific intent, the court may not modify the trust and the trust will be terminated and become a resulting trust (an implied trust that is held for the settlor or his/her heirs).
    ▪ If there is general intent, the court will substitute a similar charity.
Exam Tip 4: To earn full credit on the exam, you must carefully analyze whether the trustor intended for the trust to only benefit one specific charity (such as one specific retirement home), or if the trustor intended to generally benefit charity (all retirement homes).

B. Beneficiary/Creditor Rights to Distribution

1. Income Beneficiaries:
   Receive income from the trust (example, profits from a business held by the trust).

2. Remainder Beneficiary:
   Entitled to the trust principal upon termination of trust.

3. Lapse and Anti-Lapse
   - Under the Common Law, if a beneficiary dies before the settlor (creator) of the trust dies, the gift to the beneficiary lapses (fails).
   - Under modern Anti-Lapse statutes (applicable in CA), if the beneficiary was blood-related to the settlor, the beneficiary’s surviving issue (child) will take in his/her place.
   - Limitation: If the trust beneficiaries are a class, such as “my brothers”, only the members of the class who are alive at the time of the execution of the trust will receive the benefit of the trust.

   Example 1: T creates a trust giving his property to “my brothers” upon his death. His brother C died before he created the trust. Neither C nor his issue would be entitled to a share of the property upon T’s death. Only T’s other brothers, A and B, who were alive at the time of the trust creation would take the property. Note: Anti-lapse would apply to A and B and give their issue a share of the property if one of them died before T.

4. Discretionary Trust
   Trustee is given complete discretion regarding whether or not to apply payments of income/principal to the beneficiary; creditors have the same rights as a beneficiary if trustee exercises discretion to pay.

5. Mandatory Trust:
   Trustee has no discretion; the trust governs when trust property is to be distributed.

6. Alienation
   A beneficiary’s equitable interest in trust property is freely alienable (it can be sold or used as collateral for a loan) unless a statute or trust instrument limits this right.

7. Support Trust
   Directs trustee to pay income or principal as necessary to support trust beneficiary; creditors cannot reach these assets unless providing a necessity to beneficiary.
8. **Spendthrift Trust**
   - Expressly restricts beneficiary’s power to voluntarily or involuntarily transfer his equitable interest (this is called a spendthrift clause).
   - Creditors usually cannot reach the trust interest, unless money is owed for child/spousal support, basic necessities providers, or tax lien holders.
   - Surplus: If a beneficiary is receiving more money that necessary to maintain his current lifestyle, any extra money (surplus) that he is receiving can be reached by creditors.

C. **Trust Termination**
   - Revocable/Irrevocable Trust
     - Revocable: Settlor must expressly reserve the right to modify or terminate a trust in order to be granted such powers, otherwise it will be irrevocable.
     - Irrevocable: Modification/termination while settlor is alive can occur only with the consent of all beneficiaries and if the proposed change will not interfere with a primary purpose of the trust.
   - A trust terminates automatically only when trust purpose has been accomplished.
   - A trust may also terminate:
     - By consent if settlor is deceased/has no remaining interest, and all the beneficiaries consent.
       - Unfulfilled Material Purpose—A trustee can block a premature trust termination by the beneficiaries if the trust is shown to have an unfulfilled material purpose.
     - By the court if purpose becomes illegal, impracticable, or impossible.
   - Trustee’s Power to Terminate—none unless the trust contains express termination provisions.
   - Removal of Trustee: A court can remove a trustee if purpose of the trust would be frustrated by the trustee’s continuance in office or if the trustee violated a duty.

**CHAPTER 3: SUBSTANTIVE LAW CONTINUED**

A. **Trustee’s Powers, Duties, Remedies for Breach of Duties**

1. **Trustee Powers**
   - The trustee has powers granted expressly in the trust, and powers necessary to act as a reasonably prudent person in managing the trust, including the implied power to contract, sell, lease, or transfer the trust property.

2. **Duty of Care**
   - **Exam Tip 5:** A trustee’s Duty of Care includes numerous sub-duties. You should discuss each of the sub-duties in separate paragraphs on the exam. A trustee’s actions can trigger multiple related sub-duties.
Example 2: If a trustee invests all of the trust money into high risk stock, she has violated the prudent investor rule (did not invest reasonably) and failed to diversify the trust investments.

- General duty to act as a reasonably prudent person and treat the trust property as if it was his/her own.
- Duty to follow the trust directions and carry them out in accordance with the trust.
- Investments
  - Prudent Investor Rule: Requires trustee to act as a prudent investor would act when investing his own property (putting less emphasis on risk level); trustee must exercise reasonable care, caution, and skill when investing and managing trust assets.
  - Duty to Diversify: Trustee must adequately diversify the trust investments in order to spread the risk of loss under a total performance portfolio approach, but not if administrative costs would outweigh the benefits.
- Duty to Make Property Productive: Pursue all possible claims, derive the maximum amount of income from investments, sell assets when appropriate, secure insurance, pay expenses, and act within a reasonable period of time in all matters.

Example 3: If the trust contains rental property, the trustee has a duty to try and rent the property; a failure to try and rent the property would be a breach of duty.

- Duty to be Impartial: Balance interests of the present beneficiaries (must not favor one of the present beneficiaries over the others, unless trust provides for it).

Example 4: Settlor’s trust states that Trustee is to equally distribute the rent from an apartment to S’s three children, A, B, and C. A suffers from a health condition and is unable to work. Trustee distributes 2/3 of the rent from the apartment to A and only 1/3 to B and C. Trustee has breached his duty of impartiality.

- Additional Duty to be Impartial: The Trustee must balance the interests of the present and future beneficiaries by investing property so that it produces a reasonable income for the income beneficiaries while preserving the principal for the remainder beneficiaries.

Example 5: Settlor’s trust states that A and B are to receive the income from the trust for life (A and B are therefore present income beneficiaries) and upon their death all of the trust assets are to go to C (C is a remainder beneficiary). Trustee invests the trust money into a high risk stock that pays frequent and substantial dividends (trust income), but the stock decreases in value by 50%. The present income beneficiaries, A and B, are receiving high income, but the remainder beneficiaries will receive a reduced principal; this would be a breach of duty of impartiality.
3. **Duty of Loyalty**

Duty to administer trust in good faith (subjective standard) and to act reasonably (objective standard) when investing property and otherwise managing the trust solely in the best interests of the beneficiaries.

a. **Self-Dealing**

- When the trustee personally engages in a transaction involving trust property, a conflict of interest arises between the trustee’s duties to the beneficiaries and her own personal interest.
- Prohibited transactions—buying/selling trust assets, selling property between trusts that trustee manages, borrowing from or making loans to trust, using trust assets to secure personal loan, engaging in prohibited transactions with friends/relatives, or otherwise acting for personal gain through trustee position.
- There is an irrebuttable presumption that trustee breached duty of loyalty when self-dealing is an issue; no further inquiry into trustee’s reasonableness or good faith is required because self-dealing is a per se breach.
- Exceptions: Even when self-dealing is authorized (by settlor, court order, or all beneficiaries), transaction must still be reasonable and fair to avoid liability for breach.

4. **Other Duties**

- **Duty to Disclose:** Disclose complete and accurate information about nature and extent of the trust property, including allowing access to trust records and accounts.
- **Duty to Account:** Periodically account for actions taken on behalf of the trust so that trustee’s performance can be assessed against the terms of the trust

5. **Remedies for Violation of Trustee’s Duties**

Lost profits, interests, and other losses resulting from a breach of trust are trustee’s responsibility; beneficiaries may sue the trustee and seek damages or removal of the trustee for breach of duties.
CHAPTER 4: PRACTICE QUESTION; FEBRUARY 2012, QUESTION 1

Sam, a widower, set up a valid, revocable *inter vivos* trust, naming himself as trustee, and providing that upon his death or incapacity his cousin, Tara, should be successor trustee. He did not name any additional trustee. He directed the trustee to distribute the income from the trust annually, in equal shares, to each of his three children, Ann, Beth, and Carol. He specified that, at the death of the last of the three named children, the trust was to terminate, and the remaining assets were to be distributed to his then living descendants, by representation.

When he established the trust, he also executed a valid will pouring over all his additional assets into the trust.

Two years later, Sam died. He was survived by Ann, Beth, and Carol. Within two months, Dave, age 25, began litigation to prove that he was also a child of Sam’s, although Sam had never known of his existence.

For three years after Sam’s death, Tara administered the trust as trustee. Because Ann had very serious medical problems and could not work, and because Beth and Carol had sufficient assets of their own, Tara distributed nearly all of the trust income to Ann and little to Beth and Carol.

After the court determined that Dave was in fact Sam’s child, Dave claimed a share of the trust. Beth and Carol have filed suit against Tara, claiming breach of fiduciary duties. Tara has submitted her resignation, and Beth and Carol have sought termination of the trust so that all assets may now be distributed outright to the beneficiaries now living.

1) What interests, if any, does Dave have in the trust assets? Discuss. Answer according to California law.

2) Are Beth and Carol likely to be successful in terminating the trust? Discuss.

3) Are Beth and Carol likely to be successful in suing Tara? Discuss.

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Sample Answer

Inter Vivos Trust

Here, Sam (S) created a valid inter vivos trust, with himself as Trustee and Tara (T) as the successor Trustee for the benefit of his three children Ann (A), Beth (B), and Carol (C). S also provided that at his death all of his other assets should be poured over into the trust for the benefit of A, B, and C.

1) Dave's (D) right as an omitted child

In general, a child may be disinherited if the child is left out of a will or other testamentary document created by a parent. However, where a child is unknown to the parent at the time the testamentary document is created, and the parent had no reason to know of the child, that unknown child will not be disinherited, and will be able to recover his intestate share of the parent's estate.

Here Sam (S) set up the trust only 2 years ago. D was 25 years old at the time of S's death. Because D was born before the execution of the trust and pourover will, he would generally be treated as disinherited and unable to recover. Here, however, S was unaware that D was alive or that D was his child at the time the testamentary documents were created. D would be considered an omitted child and have a right to his intestate share.

Because A, B, and C were all alive, D would be entitled to 1/4 of S's estate. Because the trust contained all of the assets of S due to the pourover will, this will be where the assets are taken from.

Notwithstanding the clause in the trust that requires the assets to be distributed to living descendants, by representation after A, B, and C die, D will not be required to wait for A, B, and C to die before recovering. Therefore, D will be entitled as an omitted child to 1/4 of the Trust assets.

2) Termination by B and C

There are several manners in which a trust can be terminated.

A trust will be terminated when a specific condition in the writing calls for the termination of the trust and is satisfied. In this case, the trust stated that it would terminate at the death of the last of the three named children. Here, all three of the named children are still alive, and therefore the trust will not terminate.

Further, a trust can be terminated when the stated purpose of the trust has been satisfied and all beneficiaries and trustees agree to end the trust. In this case, this option does not appear to be available. Although there was no stated purpose to the trust, it provided for equal payments to each of Sam's children. Therefore, the purpose of the trust appears to be to provide for Sam's children as long as they are living. This purpose is not satisfied as all three children are still living, and can still be provided for. Also, it is not clear that all the beneficiaries would agree to terminate the trust. Only Beth and Carol are suing to terminate the trust, and there is no indication that Ann or Dave would agree to the termination.

In addition, a trust may also be terminated when all beneficiaries agree to terminate the trust. As stated above, it is not clear that all beneficiaries would agree to terminate the trust because there is no
indication that Ann or Dave would agree. Also, the trust has further beneficiaries besides the three
to the three named children. The trust provides that after the death of the last of the three named children, the
remaining assets of the trust were to be distributed to Sam's then living descendants, who would also
be considered beneficiaries of the trust. If the trust is to be terminated due to consent of all the
beneficiaries of the trust, they must also consent. There is nothing to indicate that they would consent
to the termination of the trust, and therefore Beth and Carol will not be successful in terminating the
trust.

Beth and Carol may additionally claim that the trust should be terminated because Tara, the sole
trustee, resigned from her position, and because the trust itself does not name any additional
trustees. However, this argument will be unsuccessful. Courts will not allow a private express trust to
fail for lack of trustee. Instead, a court will merely appoint a new trustee.

3) Fiduciary duties of trustee breached by T.

A trustee has a number of duties to the beneficiaries of the trust. Among those duties are a) a duty
of care, b) a duty to distribute benefits in accordance with the trust, c) a duty to treat beneficiaries
equally, d) and a duty to follow the settlor's instructions.

Here, S was the original trustee of the trust and named T as the successor trustee. Therefore, T owed
the duties discussed below to A, B, and C, and any breach of such could result in personal liability and/or
expulsion from the trustee position.

a) Duty of care

A trustee has the duty to act as a reasonably prudent person in her dealings as trustee. This includes
investing reasonably, making reasonable distribution, and all other activities that a trustee conducts in
her role as trustee.

Here, T was distributing nearly all of the trust income to A and very little to B and C. A, however, had a
very serious medical problem and could not work, while B and C had sufficient assets of their own. The
trust however expressly stated that distribution of the income from the trust annually should be in
equal shares to each of A, B, and C.

Notwithstanding the express direction given to T as to distribution it is possible that T may have
reasoned that S was not aware nor could he foresee the circumstances of A, B, and C and his real
purpose was to ensure that the children were taken care of during their lives.

Therefore, T may have been reasonable in her actions as trustee, but it may be a close call because of
the express direction given in the trust.

b) Duty to distribute in accordance with the trust

A trustee has a duty to distribute in accordance with directions given in the trust instrument. This duty
is breached when the trustee acts in a way inconsistent with the specific instruction set forth by the
settlor.
Here the trust expressly stated to distribute the trust in equal shares annually to A, B, and C. T, however, decided unilaterally to distribute the majority of the trust income to A and very little to B and C. This was clearly inconsistent with the directions given by S in the trust instrument.

Therefore, T breached her duty to act in accordance with the trust, and will be liable to B and C for the difference between what they were distributed and what they were entitled to under the trust.

c) Duty to treat beneficiaries equal

A trustee should give the same care and deference to each beneficiary of the trust, in accordance with the trust purpose.

Here, T gave sympathy to A because of her medical condition, and was less concerned with B and C because they had "sufficient assets of their own." It is not a fair and equal treatment to penalize a beneficiary because they have assets available to them outside of the trust. To hold that such action by a trustee is allowed, would be to disgorge the settlor of the trust of his ability to leave trust assets to whomever he might choose. A trust is not only set up for individuals who are in need (as discussed above this is not a support trust), but rather for the benefit of whomever the settlor feels he would like to distribute benefit to.

Therefore, T has not treated B and C the same as A and will be liable for a breach of duty, again with the remedies as described above.

d) Duty to follow settlor's instructions

A trustee has a duty to follow the instructions given to him be the settlor. Here, the instruction was to distribute the shares equally to A, B, and C. T did not, as discussed above, do so.

Therefore, T breached his duty to follow instructions of the settlor.

Remedies

Having violated her fiduciary duties, Tara may be personally liable to the beneficiaries. Beth and Carol could sue Tara for damages of the amount of income that they should have been receiving under the trust. In the alternative, Beth and Carol could sue to have a constructive trust created from the excess income that Ann received over what she was entitled to receive from the trust. In such a scenario, Ann would hold the excess income as a constructive trustee, and would be required to return it to Beth and Carol.