

Question 3

Hank and Wendy married, had two children, Aaron and Beth, and subsequently had their marriage dissolved.

One year after dissolution of the marriage, Hank placed all his assets in a valid revocable trust and appointed Trustee. Under the trust, Trustee was to pay all income from the trust to Hank during Hank's life. Upon Hank's death, the trust was to terminate and Trustee was to distribute the remaining assets as follows: one-half to Hank's mother, Mom, if she was then living, and the remainder to Aaron and Beth, in equal shares.

Trustee invested all assets of the trust in commercial real estate, which yielded very high income, but suffered rapidly decreasing market value.

Hank, who had never remarried, died three years after establishing the trust. At the time of his death, the trust was valued at \$300,000. Subsequently, it was proved by DNA testing that Hank had another child, Carl, who had been conceived during Hank's marriage to Wendy, but was born following dissolution of the marriage. Wendy, Carl's mother, had never told Hank about Carl.

Wendy, Mom, Aaron, Beth, and Carl all claim that he or she is entitled to a portion of the trust assets.

1. At Hank's death, what claims, if any, do the trust beneficiaries have against Trustee? Discuss.
2. How should the trust assets be distributed? Discuss. Answer this question according to California law.

Question 3

Trusts and Wills

Hank and Wendy married, had two children, Aaron and Beth, and subsequently had their marriage dissolved. (No community property issues)

One year after dissolution of the marriage, Hank placed all his assets in a valid revocable trust (There are no formation issues) and appointed Trustee. Under the trust, Trustee was to pay all income from the trust to Hank during Hank’s life. (Hank is the income beneficiary) Upon Hank’s death, the trust was to terminate and Trustee was to distribute the remaining assets as follows: (The trustee has a duty to act impartially in investing and managing the trust property, taking into account any differing interests of the beneficiaries) one-half to Hank’s mother, Mom, if she was then living, (Mom must satisfy this condition to receive a share in the estate) and the remainder to Aaron and Beth, in equal shares. (Hank has equally provided for his known children)

Trustee invested all assets of the trust in commercial real estate, (Investing “all” assets in one investment is not reasonably prudent. Trustee breached his duty to diversity and the duty of care) which yielded very high income, (Trustee is not taking into account the needs of the remainder beneficiaries. This is a breach of the duty to act impartially) but suffered rapidly decreasing market value. (This short sentence includes many issues on the duties of a trustee)

Hank, who had never remarried, (Once again, the examiners are trying to indicate that there are no community property issues) died three years after establishing the trust. (The trust is set to terminate) At the time of his death, the trust was valued at \$300,000. Subsequently, it was proved by DNA testing that Hank had another child, Carl, who had been conceived during Hank’s marriage to Wendy, but was born following dissolution of the marriage. (Hank established the trust after Carl was born) Wendy, Carl’s mother, had never told Hank about Carl. (Hank was not aware of Carl’s birth. Hank had no intent to disinherit Carl. Thus, he is a pretermitted child)

Wendy, Mom, Aaron, Beth, and Carl all claim that he or she is entitled to a portion of the trust assets.

1. At Hank’s death, what claims, if any, do the trust beneficiaries have against Trustee? Discuss.
2. How should the trust assets be distributed? Discuss. Answer this question according to California law.

Insight Within

This essay crossed over Trusts and Wills. Interestingly enough, it tested the two “major” issues in each subject. The most heavily tested issue in Trusts are the duties of a trustee, followed by formation issues. An in-depth look at past California bar exams on Wills shall reveal the most heavily tested issue within it is pretermitted children, followed by formation issues. Hence, this essay should not have shocked anyone. It was very plain, straightforward and should have posed little confusion.

Model Answer by One-Timers ©

1. At Hank’s death, what claims, if any, do the trust beneficiaries have against Trustee?

The trust beneficiaries may claim that Trustee breached several fiduciary duties. Most importantly, the duty of care; the duty to diversify; and the duty to act impartially between beneficiaries. Each one will be discussed in turn.

Powers and Duties of Trustees

Under the Uniform Prudent Investor Act, the trustee has a duty to take reasonable steps to take and keep control of and to preserve the trust property. Also, the trustee has a duty to make the trust property productive and in furtherance of the purposes of the trust. A trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule. The trustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries. A violation by the trustee of any duty that the trustee owes the beneficiary is a breach of trust. *See California Probate Code*, §16006-7, 16400, 16046.

Here, Hank placed all his assets in a valid revocable trust and appointed Trustee. Under the trust, Trustee was to pay all income from the trust to Hank during Hank’s life and the remainder to others. Thus, it is incumbent on Trustee to make the trust productive and administer the trust in good faith taking into account the interests of Hank, the income beneficiary, and Mom, Beth and Aaron, the remainder beneficiaries.

Duty of Care – Prudent Administration

A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution. A trustee’s investment and management decisions must be evaluated not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust. *See Uniform Trust Code* §804.

On these facts, Trustee invested “all” assets of the trust in commercial real estate, which yielded very high income, but suffered rapidly decreasing market value. A reasonably prudent investor would not invest every asset of a trust in only one investment. This is a risky investment and clearly a breach of Trustee’s duty of care. Trustee is not exercising reasonable care, skill, or caution. Therefore, Trustee is in breach of trust.

Duty to Diversify

Under California Probate Code §16048, in making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust. This requires balancing the assets among investments to ensure stability in the face of volatile events.

As stated above, Trustee invested “all” the assets of the trust in one investment. Trustee has completely ignored the cardinal rule of investment strategy, *i.e.*, to diversify your portfolio. Therefore, Trustee has breached his duty to diversify the trust assets.

Duty to Act Impartially Between Beneficiaries

If a trust has two or more beneficiaries, the trustee shall act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries’ respective interests. This obligation requires careful consideration when making payments among beneficiaries and in allocating principal and income. *Uniform Trust Code* §803.

Here, by investing in commercial real estate Trustee seems to have only taken into account Hank’s respective interest. Hank is the income beneficiary and the facts state that commercial real estate yields very high “income.” However, it is rapidly decreasing in market value. Therefore, this investment is at the expense of the remainder beneficiaries. Since Trustee did not act impartially in investing and managing the trust assets, Trustee is in breach of trust.

Duty to Inform and Report

The trustee has a duty to keep the beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests. *California Probate Code* §16060.

If Trustee failed to inform all qualified beneficiaries about important issues regarding the trust, there may have been a breach. However, without more, this is a moot issue.

Remedies for Breach of Trust

Under California Probate Code §16420, if a trustee commits a breach of trust, a beneficiary may commence a proceeding: to compel the trustee to redress a breach of trust by payment of money; to remove the trustee; and/or to reduce or deny compensation of the trustee; or order any other appropriate relief.

Since Trustee committed several breaches of trust, the beneficiaries may choose from a list of many available optional remedies.

2. How should the trust assets be distributed?

In order to determine Wendy, Mom, Aaron, Beth, and Carl’s interest in the trust, it is first necessary to determine whether Carl is an omitted child. Carl’s interest has a substantial effect on every disposition under the trust.

Omitted Child

Under California Probate Code §21622, if, at the time of the execution of all of decedent’s testamentary instruments, the decedent failed to provide for a living child solely because the decedent was unaware of the birth of the child, the child shall receive a share in the estate equal in value to that which the child would have received if the decedent had died without having executed any testamentary instruments, *i.e.*, intestate.

Here, when Hank, the decedent, executed his revocable trust, Hank was unaware of Carl's birth. This fact is known because Hank created the trust one year *after* the dissolution of his marriage to Wendy. Carl had been conceived *during* Hank's marriage. Since the period of time for gestation is nine months, Carl was born prior to the creation of the trust. Moreover, Wendy never told Hank about Carl. Therefore, Hank was unaware of Carl's birth and Carl shall receive his intestate share.

Disposition of Assets

In satisfying Carl's share provided by the rule above, his share will first be taken from Hank's estate not disposed of by trust, if any. Here, the entire trust is accounted for.

Since that is not sufficient, the court may satisfy Carl's share by taking from all beneficiaries in proportion to the value they may receive. However, if the obvious intention of Hank in relation to some other provision would be defeated, that provision may be exempted from the apportionment above and a different apportionment, consistent with Hank's intention may be adopted. *See California Probate Code §21623.*

Here, it clearly seems that Hank "intends" for half of the trust to be distributed to Mom if she is living. The other half should be split equally between all of Hank's children. The court must discern the decedent's intent from all the facts and circumstances. There is no clear cut distribution.

Wendy's portion of the trust assets

Wendy's share is obvious. Wendy gets nothing. Not only would she not get a portion of the trust assets by operation of law, she clearly wasn't mentioned in Hank's trust. Wendy has no claim.

Mom's portion of the trust assets

Mom satisfied the condition relating to her ability to share in the trust assets. Furthermore, in line with Hank's intent, Mom should be awarded one-half of the \$300,000.

Aaron, Beth and Carl's portion of the trust assets

Hank clearly wanted to provide for all his children. Hank's intent would likely favor apportioning an equal division among all his children. Therefore, Aaron, Beth, and Carl should each receive one-third of the remaining \$150,000, or \$50,000 each. While a court may disagree, this seems like the most equitable result, consistent with Hank's intention.

Organization and structure: Following the order of the calls of the question and numbering according to how the examiners furnish it. Answering each call of the question specifically while addressing each parties' respective rights in the trust assets. Using IRAC and making logical, coherent arguments supported by the law and facts **6%**

1. At Hank's death, what claims, if any, do the trust beneficiaries have against Trustee? **57%**

Powers and Duties of Trustees

Duty of Care – Prudent Administration

Duty to Diversify

Duty to Act Impartially Between Beneficiaries

Duty to Inform and Report

Remedies for Breach of Trust

2. How should the trust assets be distributed? **37%**

Omitted Child

Disposition of Assets

Wendy's portion of the trust assets

Mom's portion of the trust assets

Aaron, Beth and Carl's portion of the trust assets

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