



# Should You Trust a Trustee?

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When one of my transactions involves a trustee, mental alarm bells start to ring, and red flags start to wave: this is not a garden-variety transaction. It's time to be careful. The cautious answer to whether to trust a trustee is: "It all depends."

## A Separate Legal Estate

The Virginia Supreme Court's decision in *Austin, Trustee v. City of Alexandria*<sup>1</sup> reminds us that a deed to a trustee creates a separate legal estate, even if the creator of the trust, the trustee, and the beneficiary are the same person. James W. Duncan, III owned a commercial property in Alexandria, VA. In 1993, Duncan recorded a deed transferring the property to himself as trustee, probably for estate planning purposes. Duncan was the only beneficiary of the trust, and he reserved the right to revoke the trust at any time. In short, Duncan still controlled the property, though he held it in trust. However, as will be seen, he could no longer deal with the property as if he owned it outright.

Six years later, in 1999, Duncan decided to put the property into a new charitable remainder trust. One purpose of the new trust was to leave the property to the City of Alexandria upon Duncan's death. To accomplish this, Duncan signed a new trust agreement naming the City of Alexandria as a beneficiary. At the same time, Duncan signed a new deed transferring the property to himself as trustee under the 1999 trust. The deed bore the ominous legend: "Prepared Without Benefit of Title Examination". If someone had ex-

amined the title, Duncan might have avoided a serious mistake.

After Duncan died, his successor, as trustee under the 1993 trust (the "1993 Trustee"), sued the successor trustee under the 1999 trust. The 1993 Trustee claimed that the 1999 deed was ineffective because Duncan had signed the 1999 deed individually, not as trustee under the 1993 trust. The Virginia Supreme Court agreed. The court reasoned that the 1993 deed had changed the ownership of the property. After the 1993 deed was recorded, Duncan no longer owned the property as an individual. He could transfer the property only by a deed signed in his capacity as trustee under the 1993 trust. The deed would have been valid if Duncan's signature had taken the following form:

/s/ \_\_\_\_\_  
James W. Duncan, III, as Trustee under  
[name and date of 1993 trust agreement  
or deed in trust]

Because Duncan did not sign as trustee, the City of Alexandria's title failed. The property continued to be owned by the 1993 Trustee.

## What is a Trust?

Trusts themselves cannot own property. There is no such thing as a deed to or from a trust. Unlike a corporation or a partnership, a trust is *not* a separate legal entity. Instead, a trust is "a legal relation between two or more persons by virtue of which one, a trustee, is bound to hold legal title of property for the use or benefit of beneficiaries, who have an equitable title or interest in the property."<sup>2</sup> Therefore, the trust itself is incapable of holding title. Only the trustee of the trust, acting

as trustee, has the legal capacity to accept or transfer title to trust property.

## The Trustee's Authority

Getting the trustee's signature right is easy, if you know what form to use and if the trustee is willing to sign. Determining whether the trustee has authority to sign a deed or other instrument sometimes presents a greater challenge.

A trustee holds title to the property for the beneficiary or beneficiaries of the trust, and the trustee's authority is strictly limited to the terms of his trust. Therefore, a trustee usually is not at liberty to dispose of trust property as he pleases. Instead, "a trustee can only do with the trust property what the deed to the trustee, either in express terms or by necessary implication, authorizes him to do."<sup>3</sup> When a purchaser knows that property is held in trust, he is under a duty to inquire into the trustee's authority to transfer the property.<sup>4</sup> If the trust is evidenced by a writing, a purchaser is chargeable with notice of the trust instrument's legal effect.<sup>5</sup> If a trust is unwritten, a purchaser must inquire of the trustee as to the extent of the trustee's authority, and in addition, must make such further inquiry as a reasonable person would make in the circumstances.<sup>6</sup>

However, there exists an important exception to the general rule that a person dealing with a trustee must inquire into the trustee's authority. A deed to the trustee may contain language that empowers the trustee to sell the property and relieves the purchaser of any duty of inquiry. A Virginia statute provides that a deed to a trustee need not name the beneficiaries of the trust and that the deed may grant the trustee the power "to sell, lease,

encumber, or otherwise dispose of [the] property.”<sup>7</sup> If the deed grants these powers to the trustee, then “no person dealing with such a trustee shall be required to make further inquiry as to the right of such trustee to act, nor shall he be required to inquire as to the disposition of any proceeds.”<sup>8</sup>

If the deed to a trustee does not expressly authorize the trustee to sell, lease, or encumber trust property, then anyone who buys land from a trustee must inquire into the trustee’s authority to deal with the property. Frequently, the person who actually makes the inquiry will be a title insurance agent. The agent’s due diligence should include:

- ☑ obtaining a copy of the trust agreement;
- ☑ reading and understanding the trust agreement; and
- ☑ making sure that the trust agreement authorizes the trustee to sell, mortgage, or otherwise dispose of the property under the terms proposed.

Further investigation may be warranted, depending on the circumstances. Of course, self-dealing by a trustee (using trust property for the trustee’s own benefit) would be an obvious warning sign that the trustee is exceeding his authority.

## Deeds to a Trustee

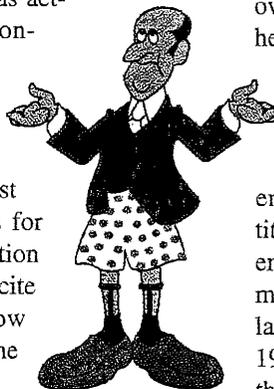
Because a trust itself cannot hold title, the grantee under a deed of property to be held in trust must be the trustee. A deed to “the XYZ Trust” would fail for lack of an existing grantee. Parties interested in the property mentioned in such a deed probably will need to invoke the aid of a court of equity to sort matters out.

Naming the trustee as the grantee of a deed is only the first step. The deed should also do one of two things: ❶ grant the trustee the power to sell, lease, encumber, or other-

wise dispose of the property; or ❷ identify the trust under which the trustee holds title. If the deed takes the first approach, a future purchaser or mortgage lender can rely on the deed itself to establish the trustee’s authority to enter into a transaction. If the deed takes the second approach, a future purchaser or lender will need to examine the trust agreement to verify that a proposed transaction comes within the trustee’s authority.

## Deeds from a Trustee

As illustrated by *Austin*, a deed conveying property held in trust should be signed by the trustee, acting in his capacity as trustee. The trustee’s deed should also contain recitals to show that the trustee acted within his authority when he executed the deed. If the trustee acquired the property under a deed granting him the power to dispose of the property, the deed from the trustee should recite that the trustee was acting pursuant to that power. If the trustee was acting under authority contained in an unrecorded trust agreement, the trustee’s deed should identify the trust agreement, state the trust agreement’s conditions for a sale or other disposition of the property, and recite facts sufficient to show that the conditions of the trust were satisfied.



## Deeds to a Trustee Can Impair Title Insurance Coverage

Estate planning lawyers sometimes advise their clients to transfer homes or other properties into a living trust. This may be an excellent idea from an estate planning standpoint. However, it could cost the client important rights under his/her title insurance policy, depending on the form of the client’s owner’s policy.

The 1992 ALTA owner’s policy does not insure a subsequent owner who acquires the property by deed from the originally insured. Therefore, if an owner transfers property to a trustee for estate planning purposes, the trustee probably has no rights under the owner’s title insurance policy. Although there appears to be no court decision on point regarding a trustee, a similar situation arose in *Gebhardt Family Trust, L.L.C. v. Nation’s Title Ins. Co. of New York*.<sup>9</sup> There, Mr. and Mrs. Gebhardt deeded property to a wholly owned limited liability company for estate planning purposes.<sup>9</sup> Prior to executing the deed, the Gebhardts had filed a claim under their title insurance policy. When the title insurance company learned that the Gebhardts no longer owned the property, the insurer denied coverage. The Maryland Court of Appeals held that the title insurer’s position was correct, and that the company had no further liability for the claim.

The practical lesson of *Gebhardt Family Trust* is that an owner insured under a 1992 owner’s policy form should not transfer his/her property to a trustee for estate planning purposes, unless the owner first obtains the title insurer’s agreement that the policy will cover the trustee. Such an agreement usually takes the form of an endorsement to the owner’s policy. Most title insurers are willing to provide such an endorsement upon request, if the request is made prior to the deed to the trustee. A similar problem would not arise under ALTA’s 1998 form of homeowner’s policy, because the 1998 homeowner’s policy form covers a trustee to whom the homeowner transfers the title.

Points to remember:

- A trust is not a legal entity. It is a legal relationship by which a trustee holds title to property for a beneficiary or beneficiaries.
- A deed that names a trust as grantee is invalid. If property is to be held in trust, the grantee must be a trustee.

- There is no such thing as a deed from a trust. If property is held in trust, it may be transferred only by the trustee, acting as trustee.
- A purchaser from a trustee must inquire into the trustee's authority to transfer the property, unless the deed to the trustee contains the powers of sale and disposition set forth in Virginia Code §55-17.1.
- A 1992 owner's policy does *not* protect a trustee to whom the insured owner transfers title for estate planning or other purposes.
- A 1998 ALTA homeowner's policy protects a trustee to whom the insured owner transfers title for estate planning or other purposes.

<sup>1</sup> 265 Va. 89 (2003).  
<sup>2</sup> *Hancock v. Anderson*, 160 Va. 225, 168 S.E. 458 (1933).  
<sup>3</sup> *William v. Jones*, 165 Va. 398, 182 S.E. 280 (1935).  
<sup>4</sup> 4 Scott on Trusts §297.4 (Aspen 4<sup>th</sup> ed. 2001).  
<sup>5</sup> *Id.* See *Wills, Special Receiver v. Chesapeake Western Ry. Co.*, 178 Va. 314, 320 (1941). (Purchaser from trustee under deed of trust was on constructive notice of limitations that the deed of trust placed on the trustee's authority.)  
<sup>6</sup> 4 Scott on Trusts §297.4 (Aspen 4<sup>th</sup> ed. 2001).  
<sup>7</sup> Virginia Code §55-17.1.  
<sup>8</sup> *Id.*  
<sup>9</sup> 752 A.2d 1222, 1226-27 (Md. App. 2000). ✓



“Oh, and don't worry about that mortgage to Consolidated Trust. Here's a signed release on the back of this cocktail napkin.”

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