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TRANSACTIONS

Be wary when you're transacting with trusts in California

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California lenders routinely make large business loans and consumer loans to both revocable and irrevocable trusts. Because a trust is a separate legal entity with special rules governing its ability to incur debt and encumber assets, lenders and their lawyers must be wary of how to structure and document these loans properly. Adequate documentation of loans to trusts require the application of California trust law as an overlay to the principles of commercial law that govern every loan.

Why are trusts so prevalent in California? Assets held in a trust do not have to be probated. Probate proceedings are needed to get a court order transferring title to a decedent's assets from the decedent to the beneficiaries. An uncontested California probate proceeding often takes 12 to 18 months, and statutory fees are payable to both the estate's executor and attorney under Probate Code Sections 10800 and 10810. Title to assets in a trust, however, are held in the name of the trustee. When the trustor (or any beneficiary) of a trust dies, a probate proceeding is not required to change title to the assets. The primary purpose of a probate — the re-titling of assets — is unnecessary, and the delays and costs of probate are avoided. Because billions of dollars of California assets are held in trusts, lenders encounter trust issues routinely.

When making a loan to a trust, the threshold question is whether the trust has authority to borrow money or pledge assets. The answer turns on the terms of the trust and the powers given the trustee in the trust instrument or under applicable law. Typically a trust will provide that the trustee may borrow money in the name of the trust, guarantee the debts of trust beneficiaries, and pledge and encumber assets of the trust estate. In addition to the powers granted in the trust instrument, a trustee automatically has all of the powers described in Probate Code Sections 16200 through 16249

unless the trust instrument provides otherwise. These include the power to borrow money for trust purposes, pledge assets, and guaranty loans to a beneficiary.

The next question is whether the trustee has the power to bind the trust. Unless a lender knows the trustee has exceeded its powers, the lender may assume, without inquiry, that the trustee is properly exercising its powers. Probate Code Section 18100 provides that if a third person acts in good faith and for valuable consideration, and without actual knowledge that the trustee is exceeding its authority, then the lender is not required to inquire as to the trustee's authority and is fully protected in dealing with the trustee.

In addition to this protection, California lenders often obtain a document known as a certification of trust to evidence a trustee's powers. Use of a certification of trust protects the confidentiality of the trust, since there is then no need to disclose to the lender the specific provisions of the trust document. Absent a lender's actual knowledge that the trustee is acting outside the scope of the trustee's powers, the lender may rely upon the certification of trust to confirm the trustee's authority to act.

Who must sign the loan documents for the trust? Generally if the trust has more than one trustee, all trustees must act to bind the trust unless the trust instrument authorizes fewer than all trustees to do so. However, if there is a vacancy in the trusteeship or if a trustee is not available (e.g., a trustee dies, resigns, or is disqualified), the remaining co-trustees may act for the trust as if they are the only trustee. If a trustee is absent, ill, or temporarily incapacitated, the remaining co-trustees may act to bind the trust if necessary to accomplish the purposes of the trust or to avoid irreparable injury to the trust property.

A related question is whether a beneficiary must sign loan documents. If a trust is revocable, consent of the beneficiaries is not required to take actions authorized by statute or the trust instrument. Even if the trust in-

strument recites that it requires a beneficiary's consent, Probate Code Section 15801 overrides this requirement and grants the person holding the power to revoke the trust, not the beneficiary, the rights owed to a beneficiary.

Many revocable trusts hold real estate that was the community property of spouses. If a loan to a revocable trust is secured by real estate that formerly was held as community property, must both spouses sign? Under Civil Code Section 1091, an interest in real property generally can be transferred only with an instrument signed by all of the parties who own those interests, including community property interests. However, if the husband and wife transferred their community property interests in real property to a revocable trust, Probate Code Section 16248 provides that the trustee may convey or encumber the real property without the signatures or consent of one or both spouses if the trustee may sign on behalf of the trust.

Once the trust powers and proper signers are determined, a key structuring issue is identifying all of the persons or entities who should be made directly liable to repay the loan. A lender should not make the trustees of a revocable trust the sole obligors regarding an unsecured obligation. A revocable trust can be revoked, and its assets entirely withdrawn, leaving no trust corpus from which a debt may be collected. In that situation, Probate Code Section 18000(a) provides that a lender also will have no recourse (other than a possible claim for fraudulent conveyance) against the personal assets of a trustee who signs a loan document as trustee. Thus, if a loan is made to a revocable trust, the lender should require each trustee to sign a continuing personal guaranty or be named as a co-borrower. If the trustee is named as a co-borrower on the loan rather than a guarantor, however, the lender should still include a waiver of suretyship defenses in the loan documents, since that obligor might be treated as an accommodation party (a guarantor) entitled to assert suretyship defenses.

The structuring of loans to trusts is further complicated if the loan is secured by real property. A limitation on remedies arises from California's so-called One Form of Action and Anti-Deficiency Rules if the loan is secured by real property. Because the trustors of a revocable trust are personally liable for the trust's creditor claims, they are likewise generally protected from deficiency claims by California's Anti-Deficiency Rules if they sign guaranties. *Torrey Pines Bank v. Hoffman*, 231 Cal. App. 3d 308, 318 (1991); compare *Talbott v. Hustwit*, 164 Cal. App. 4th 148, 151 (2008). In response to these anti-deficiency protections, lenders might take additional collateral as a cushion to satisfy a deficiency following a real estate foreclosure. The additional collateral should generally be pledged to secure the primary loan obligation, not the guaranty, to address the Anti-Deficiency Rules.

Trusts must be treated as unique entities requiring an analysis of which entities and assets will be liable for payment of loan obligations. The process of encumbering and foreclosing on collateral owned by, or pledged to support loans to, a trust requires awareness of trust considerations. Proper structuring and documentation, however, are achievable if the overlay of California trust principles is addressed early in the documentation process by the lender and its attorney.

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