

## PURCHASING PROPERTY FROM TRUSTS: CAUTION FOR THIRD PARTIES DEALING WITH TRUSTEES

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Purchasing real estate is a complex transaction, with buyers required to navigate a maze of issues and costs ranging from verifying marketable title to obtaining adequate financing. As if these hurdles are not enough, another set of questions may arise when a buyer purchases property out of trust. This is because fundamental questions about the party selling the property come into play. Is the seller of the property the trustee and does the trustee have the authority under the trust documents to sell the property? If not, what are the consequences to the buyer and is the transaction at risk of being voided?

The New Hampshire Supreme Court weighed in on these questions with the decision in *Smith v. Lillian V. Donahue Trust*, 157 N.H. 502 (2008). In *Smith*, Lillian Donahue established a trust in 1990 that held, among other assets, approximately 200 acres of property in Wakefield, New Hampshire. Lillian modified the trust in 1993 to name both her attorney and her son as co-trustees. Lillian remained the principal beneficiary of the trust, with her son and granddaughter as contingent beneficiaries. In conjunction with the trust modification, the attorney and son filed a notice with the county registry of deeds announcing their status as co-trustees of the trust and their authority to convey any interest in real estate held by the trust.

In 1996, Lillian's son entered into an agreement to sell a house located on five acres of the Wakefield property held in trust in exchange for \$50,000. Smith agreed to pay the purchase price over time and the property would only be transferred to Smith after he made the final installment payment. The agreement was signed only by Smith and the son and the agreement did not identify the property as being held in trust nor the son as co-trustee. In 2000, Lillian's attorney resigned as co-trustee of the trust. Months later, the son entered into another agreement with Smith whereby an additional three acres of the Wakefield property was to be sold for

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\$50,000. This second agreement was signed by Smith and twice by the son, once “personally” and once as “Trustee.”

In 2002, Smith brought an action against the trust to specifically enforce the purchase and sale agreements he entered into with the son. Smith alleged that he had already paid \$70,000 toward the purchase price for the Wakefield properties, but that the son had not conveyed any of the property. Instead, the son had placed the entire 200 acres of property for sale for \$700,000.

The trust defended the action and argued that the purchase and sale agreements were void because, among other reasons, Smith had constructive knowledge by virtue of the notice recorded in the county registry of deeds that Lillian’s attorney was a co-trustee and that his approval of the transaction had also been required. The Superior Court specifically enforced the purchase and sale agreements and the New Hampshire Supreme Court affirmed. On the question of constructive notice, the New Hampshire Supreme Court acknowledged the common law rule that a conveyance of trust property was void if a person took trust property with notice that the trustee transferred the property in breach of the trust. What is more, the common law required a party who knew or should have known to be dealing with a trustee to inquire into whether the trustee had the power to engage in the transaction in question and was charged with knowledge of the property construction of the trust terms. New Hampshire changed the common law in 1969, however, with the enactment of the Uniform Trustee’s Powers Act (UTPA). In contrast to the common law, the UTPA protected a third party dealing with a trustee unless the third party possessed “actual knowledge” that the trustee was exceeding or improperly exercising the trustee’s powers. The third person was also relieved of the duty to investigate the scope of the trustee’s powers. This aspect of the UTPA was memorialized in RSA 564-A:7, I, which was in effect at the times Smith and the son entered into the purchase and sale agreements. On the basis of this statute, the New Hampshire Supreme Court held that Smith could not be charged with constructive knowledge that the son exceeded his authority because Smith owed no duty to investigate the trustee’s powers. As such, the agreements would only be void if Smith had “actual knowledge” that the son exceeded the scope of his authority.

The *Smith* decision is important because it highlights a more recent change in the law concerning the “knowledge” a third party may have of a trustee’s authority. The *Smith* decision hinged on RSA 564-A:7, I, which required a third party to have “actual knowledge” that a trustee was exceeding his or her authority for the transaction to be voided. This provision of RSA 564-A:7 was repealed in 2004. In its place stands RSA 564-B:10-1012 of the Uniform Trust Code, which is very similar in the protections it affords third parties dealing with trustees, but with one important change: it expands the circumstances under which a third party has “knowledge” of the trustee’s scope of authority. Thus, a transaction

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may be voided not only where the third party has “actual knowledge” that the trustee exceeded his or her authority, but also where the third party received notice or had “reason to know” that the trustee exceeded his or her authority. See RSA 564-B:1-104.

This change raises the prospect that, unlike in *Smith*, a third party may well be charged with the knowledge he or she could have learned by reviewing a certification on trust on file with a registry of deeds. Moving forward, therefore, third parties dealing with trustees will want to insist on viewing the certification of trust, which will set forth the scope of the trustee’s authority under the trust. While reviewing such certifications has always been good practice, it is especially so with New Hampshire’s recent change in the law. Failing to do so only increases the risk that the transaction could be voided if it turns out that the trustee exceeded his or her authority.

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