Creditors Attacking the Trust

20 Years after *Lagae v. Lackner*

BY JAMES R. WALKER

Colorado statutes regarding real estate titles held by trusts and trustees have evolved since the original curative statute was enacted in 1921. This article discusses this evolution with a focus on the impact of Lagae v. Lackner.

Twenty years ago, in the spring of 2000, the Colorado Supreme Court released its decision in *Lagae v. Lackner*.[1] The decision rejected a creditor's attack on a valuable Colorado ranch.

Lagae resolved the immediate creditor challenge, but it has also served as a catalyst for legislative reforms both in Colorado and on the national stage. This article reviews the historic *Lagae* decision and the subsequent legislative responses.

J.Y. Lagae's Legacy

At the time of his death, J.Y. Lagae's principal asset was a large Douglas County cattle ranch located between Interstate 25 and Castle Pines. The Lagae ranch was held in J.Y. Lagae's individual name.

J.Y.'s estate documents consisted of a revocable trust and a pour-over will.[2] He had established the revocable trust in 1987, and his wife Ina May Lagae was its sole beneficiary during her lifetime. The pour-over provision directed the residuary of his estate to be transferred to the revocable trust. Ina May was named as personal representative of J.Y.s estate. J.Y.'s sons-in-law were named as co-trustees of his revocable trust.

In fulfillment of J.Y.'s residuary bequest, Ina May prepared and recorded a personal representative's deed transferring the ranch to the trust. But rather than transferring title into the name of the trust, Ina May's December 31, 1993 deed named the trustees as grantees.[3] Her deed did not list any of the trust's beneficiaries. Lacking the beneficiary designations, Ina May's deed was "non-compliant" with the applicable 1921 Colorado statute. Seizing on this technical fault, one of the trustee's personal creditors asserted that the deed's noncompliance vested full title (both legal and equitable) in the trustees and, thus, the trustee's creditors could seize the ranch.

In a 1998 ruling, the Colorado Court of Appeals upheld the creditor's theory.[4] An appeal to the Colorado Supreme Court followed.

The Context for *Lagae*

Lagae involved an innovative statutory reform. Back in the 1920s, several states, including Colorado, enacted real estate reform laws so that abstractors could determine the condition of title from an examination of the records alone.[5] Almost all of these state law reforms included

a fix of the serious problems associated with "as trustee" deeds.[6]

"As Trustee" Descriptions

During the 1800s and the early 1900s, it was not uncommon for a grantee to take title "as trustee" for another. Adding the words "as trustee" was easy, and many old cases noted the practice.

Perhaps the leading "as trustee" case was decided in Massachusetts, where the Court held that "the insertion of *the word 'trustee' . . . does indicate and give notice of a trust*" and thus, "[n]o one is at liberty to disregard such notice and to abstain from inquiry for the reason that a trust is frequently simulated or pretended when it really does not exist."[7]

Before *Lagae*, Colorado Supreme Court cases also recognized and described the practice: "[T]he word 'trustee,' . . . indicates the intention of the parties that the grantee was to take the title, not in his individual capacity, but in trust for another, though the name of his cestui que trust is not disclosed by the deed."[8]

Although effective, "as trustee" descriptions were problematic. Under common law, a trustee had no power *virtue officii*,[9] and as Professor Fratcher noted, "his only powers are those of the instrument creating the trustee."[10] Thus, without the support of a trust agreement expressly listing sale power (or a judicial confirmation that such power existed), an "as trustee" property was not marketable.[11]

Purchasers and Notice

Under common law, the concept of notice was critical. A purchaser who bought "as trustee" property was charged with notice of the existence of a trust, and a trust beneficiary could recover the property if the trustee had no power to sell it. Professor Scott and other commentators believed that buying from an "as trustee" grantee without verifying the grantee's sale powers was prima facie wrongful, because the purchaser should have made inquiry and was chargeable with notice of everything that a reasonable inquiry "would appear."[12]

At common law, if the purchaser did not have notice of a breach of trust and paid value for the trust property, the buyer qualified as a bona fide purchaser for value and could acquire both legal and equitable title. A court's equitable powers would protect a purchaser against beneficiary claims.[13] A third-party purchaser who had "actual or imputed notice" that the party was dealing with a trustee was obligated to make diligent inquiry into the trustee's powers. Such a buyer was charged with whatever knowledge the buyer could have gained by such inquiry.[14]

With this deemed notice, a buyer could not be certain whether "full" title had been acquired. Understandably, purchasers and lenders often refused to deal with "as trustee" property. Thus, many states enacted reform statutes so that

> where the word "trustee" is added to the name of the grantee in a deed of conveyance of land in which no beneficiaries are named, and the purposes of the trust are not set forth in the deed and no other instrument showing a declaration of trust is recorded, a purchaser of land takes it free of any trust.[15]

Colorado's 1921 Curative Statute

Colorado's "as trustee" deed reform statute was enacted in 1921. The provision changed little from 1921 until 2001. Up until 2001, CRS § 38-30-108 provided that

> [a]ll instruments conveying real estate, or interests therein, in which the grantee is described as trustee, agent, conservator, executor, administrator, or attorney-in-fact, or in any other representative capacity, *said instruments shall also name the beneficiary so represented and define the trust or other agreement under which the grantee is acting, or refer, by proper description to book, page, document number, or file* to an instrument, order, decree, or other writing which is of public record in the county in which the land so conveyed is located in which such matters appear; *otherwise the description of a grantee* in any such representative capacity in such instruments of conveyance shall be considered and held a description of the person only and *shall not be notice of a trust or other representative capacity of such grantee.* (Emphasis added.)

This statutory provision (with its full title vesting concept) was the basis for the Colorado Court of Appeals' conclusion that the Lagae ranch was owned by a trustee individually for creditor rights purposes.[16]

The 2000 *Lagae* Decision

The Colorado Supreme Court took up the *Lagae* appeal in 2000. Following its analysis of the 1921 curative statute and its underlying legislative purpose, the Court rejected the concept of full title "vesting." The Court held that the 1921 statutory remedy, when triggered, (1) protects subsequent takers by eliminating their duty of inquiry to ascertain the nature and effect of a trust relationship, and (2) prevents the undisclosed beneficiaries from contesting the interest of subsequent takers who obtained the property from the trustee or through the trustee's chain of title.[17] Thus, the statute did not vest equitable title in a trustee.

In overturning the Court of Appeals, the Colorado Supreme Court invoked the doctrine of "avoiding absurd results." Under this doctrine, a court will read—or even rewrite—statutes to avoid absurd results. As might be expected, this doctrine is rarely used. The US Supreme Court has applied it in only a handful of cases where "the result of applying the plain language would be, in a genuine sense, absurd, *i.e.*, where it is quite impossible that Congress could have intended the result, . . . and where the alleged absurdity is so clear as to be obvious to most anyone."[18]

What is the absurdity in *Lagae*? What was the statutory result that the General Assembly could not have possibly intended? The Court's opinion makes clear that it is absurd to follow § 38-30-108's remedial mandate that a nonconforming deed vests full title in a trustee individually for creditor rights purposes. The General Assembly could not have intended such a remedy that collapses or negates a trust merely because the grantor used an "as trustee" deed. *Lagae* squarely rejected a theory that these words, if operative, mean that full title (legal and equitable) is vested in the trustee individually. It was under this theory that the Colorado Court of Appeals had granted a trustee's personal creditor access to trust property.[19] It was an absurd theory.[20]

The Reliance Issue

With the historical focus on real estate records and notice, the Colorado Supreme Court opinion

addressed creditor "reliance." The Court noted that the trustee's individual creditor did not rely on the nonconforming deed when it loaned funds to the trustee.[21]

The Court's reliance focus derived from an earlier Minnesota Supreme Court case. In *Department of Public Welfare v. Thibert*,[22] the Minnesota Supreme Court found that the Minnesota notice statute

> protects subsequent purchasers against prior conveyances where the instrument recorded contains inadequate notice of trustee powers. . . . *There is no evidence in the record that the [creditor] attempted to examine title to the [husband and wife's] property at any time before it filed its late claim, nor does the [creditor] indicate that it was otherwise prejudiced or misled about title* . . . .[23] (Emphasis added.)

In *Thibert*, the creditor had a direct business relationship with the trust settlor, who was also a trust beneficiary during her lifetime. Ina May Lagae's situation was even more compelling; in her case, the creditor had no relationship whatsoever with or claims against Ina May, J.Y., or his trust. The trustee's personal judgments in no way related to the Lagae ranch or the trust. Thus, there was no reliance.

The Colorado Legislative Response

The Colorado Bar greeted the *Lagae* decision with enthusiastic relief. It quickly moved to improve Colorado statutes regarding real estate titles held by trusts and trustees.

As a result of the 2001 changes, the recording requirements of CRS § 38-30-108 were revised to restrict a *Lagae*-type challenge. The revised statute requires a description of the representative grantee's capacity by one of several means[24] and thus clarifies and solidifies the beneficiary's ownership interest. The revised statute further states that when an instrument of conveyance to a trustee fails to comply with any of these methods, the description of the grantee will be presumed to be a description of the person only and "shall not be notice of the representative capacity of such grantee." Regardless of whether a noncompliant instrument was recorded before or after passage of the 2001 statute, the revisions explicitly allow the required information to be recorded subsequently in an affidavit cross-referencing the noncompliant deed. Therefore, all prior and subsequent interested persons thereafter will have notice of the trustee's representative capacity.

In addition to revising the grantee curative provision, the 2001 revision also relocated the statutory rule for placing title directly into the name of the trust. The relocated statute was moved to CRS § 38-30-108.5 with an explicit cross-reference to the "statement of authority" that was added in 1997 as a means to evidence the trust's existence and identify anyone authorized to act on the trust's behalf.[25]

With these 2001 changes, Colorado statutory law provides several methods to document and clean up record title when an instrument conveys an interest in real property to a trustee. These methods include:

1. naming the beneficiary of the trust;
2. identifying the trust agreement, court order, or other document establishing the trust; or
3. properly cross-referencing another document of record that contains the required information.

The sidebar illustrates the evolution of the statutory changes through 2001.

EVOLUTION OF THE 1921 CURATIVE STATUTE

1921 A "curative" statute was adopted for "as trustee" deeds located at CRS § 38-30-108.

1977 An innovative statute was adopted allowing real estate to be held in the name of a trust or joint venture, CRS § 38-30-166.

1998 The statement of authority was codified at CRS § 38-30-172.

2001 In reaction to *Lagae*, the 1921 curative statute was revised and a new separate statute was adopted for conveyances into a trust, CRS § 38-30-108.5.

Uniform Trust Code—Section 507

In 1994, the National Conference of Commissioners on Uniform State Laws (NCCUSL) formed a drafting committee to codify the common law of trusts.[26] This herculean effort produced the Uniform Trust Code (UTC).

During the UTC's development, NCCUSL's drafting committee was made aware of the *Lagae* decision and the lack of any black letter law addressing a trustee's personal creditors. Recognizing this shortfall, the UTC drafting committee added a new provision, § 507, which provides that "trust property is not subject to personal obligations of the trustee, even if the trustee becomes insolvent or bankrupt."

The UTC comments explain that "[b]ecause the beneficiaries of the trust hold the beneficial interest in the trust property and the trustee holds only legal title without the benefits of ownership, the creditors of the trustee have only a personal claim against the trustee." The comments also state that a personal creditor of the trustee who attaches trust property to satisfy the debt does not acquire title as a bona fide purchaser, even if the creditor is unaware of the trust.

In 2018, Colorado enacted the Colorado Uniform Trust Code (CUTC), which adopted (and in some cases modified) almost all of the UTC provisions.[27] However, the 2018 CUTC enactment, although comprehensive, omitted the statutory provisions in UTC Article 5, including § 507.

The Colorado Bar Association's Trust and Estate Section has formed a subcommittee to study and recommend adoption of UTC Article 5. The subcommittee's efforts may soon lead to Colorado's adoption of UTC § 507.

Conclusion

Twenty years have now passed since the Colorado Supreme Court released its decision in *Lagae v. Lackner*. This historic case clarified the correct application of a 1921 real property law "cure" regarding "as trustee" deeds. Just one year after *Lagae*, the Colorado General Assembly consolidated the statutory provisions for holding real property in trust and added a legislative statement rejecting the "full title" concept. But *Lagae*'s impact did not stop at

the Colorado border; the decision prompted a new black letter rule that became part of the UTC. And *Lagae*'s influence continues in the CUTC's ongoing evolution. CL

James R. Walker is a partner with Lewis Roca Rothberger Christie LLP in Denver. He is the firm's senior tax partner and senior trust and estate partner and is chair of the Taxation Practice Group and Trust and Estate Practice Group. Walker is a Fellow of the American College of Trust and Estate Counsel and serves as the Colorado State Chair—jwalker@lrrc.com.

Coordinating Editors: David W. Kirch, dkirch@dwkpc.net; Emily Bowman, ebowman@dwkpc.net

NOTES

1. *Lagae v. Lackner*, 996 P.2d 1281 (Colo. 2000).

2. Unif. Prob. Code § 2-511; Osgood, "The Pour-Over Will," 104 *Trusts and Estates* 768 (1965).

3. This practice finds support under common law where the trust is not recognized as a legal entity. *See* Sitkoff and Dukeminier, *Wills, Trusts, and Estates* at 393, 394 (Wolters Kluwer Law & Business 9th ed. 2013) ("Strictly speaking, a trust is not a jurisdictional entity but rather a fiduciary relationship. A trust cannot sue, be sued, hold property, or transact in its own name. Instead, the trustee sues, is sued, holds property, and transacts with respect to trust property in the trustee's fiduciary capacity as such.").

In 1977, the Colorado legislature changed this common law with a statute providing that a trustee may acquire, convey, encumber, lease, or otherwise deal with any interest in property in the name of the trust. CRS § 38-30-166, adopted June 1, 1977.

4. *Lackner v. King*, 972 P.2d 690 (Colo.App. 1998).

5. State law reforms gained momentum at the turn of the century with the country's preeminent jurist declaring, "It is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV. It is still more revolting if the grounds upon which it was laid down have vanished long since, and the rule simply persists from blind imitation of the past." Holmes Jr., "The Path of the Law," 10 *Harv. L. Rev.* 457, 469 (1897).

6. White, "Title Man's Idea of Real Property Law Reform," 10 *Cornell L. Rev.* 181, 196 (1925) (Recommendation 13 suggested that when a conveyance is made to a trustee and the powers of the trustee and the nature of the trust are not disclosed in the record, the trustee's deed shall pass the full title).

7. *Shaw v. Spencer*, 100 Mass. 382, 393–94 (1868) (emphasis added).

8. *Johnson v. Calnan*, 34 P. 905, 908 (Colo. 1893).

9. *Virtue officii* is a Latin term for "virtue of her office."

10. Fratcher, "Trustees' Powers Legislation," 37 *N.Y.U. L. Rev.* 627, 632 (1962).

11. Most all states have addressed this and similar issues through statutory revisions. In Colorado, the General Assembly enacted the Colorado Fiduciary Powers Act, CRS §§ 151801 et seq., adding a list of general powers that a trustee can exercise to properly administer the trust.

12. Scott, "Participation in a Breach of Trust," 34 *Harv. L. Rev.* 454, 456–457 (1921).

13. Costigan Jr., "The Theory of Chancery in Protecting against the Cestui Que Trust One Who Purchases from a Trustee for Value and Without Notice," 12 *Cal. L. Rev.* 388 (1924).

14. Fratcher, *supra* note 10 at 645.

15. Scott and Fratcher, *The Law of Trusts*, 297.3 at 118–19 (Little Brown and Co. 4th ed. 1989).

16. Personal trustee ownership, of course, would mean J.Y.'s trust had no trust res. The late Justice Scalia had a colorful quote regarding such a proposition: "A trust without a *res* can no more be created by legislative decree than can a pink rock-candy mountain." *Begier v. Internal Revenue Service*, 496 U.S. 53, 70 (1990) (Scalia, J., concurring).

17. *Lagae*, 996 P.2d 1281.

18. *Public Citizen v. United States Dep't of Justice*, 491 U.S. 440, 470–71 (1989) (Justice Kennedy concurring).

19. *Lackner*, 972 P.2d 690 (Colo.App. 1998).

20. *Lagae*, 996 P.2d at 1287.

21. *Id.* at 1287–88.

22. *Dep't of Public Welfare v. Thibert*, 279 N.W.2d 53 (Minn. 1979).

23. *Id.* at 58.

24. CRS § 38-30-108(1). *See also* Ambler, "Title to Colorado Real Property Held in Trust," 31 *Colo. Law.* 85 (May 2002).

25. *See* Steiner, "The New Statement of Authority for Colorado Real Estate," 27 *Colo. Law.* 99 (July 1998).

26. Langbein, "The Uniform Trust Code: Codification of the Law of Trusts in the United States," 15 *Trust Law Int'l* 69 (2001).

27. *See* Eyster and Stevens, "The Colorado Uniform Trust Code," 48 *Colo. Law.* 36 (Mar. 2019).