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Conveyance By Trustee

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CONVEYANCE BY TRUSTEE

IN 1925 the Legislature of Texas enacted a law¹ "for the protection of those dealing with trustees"² where the trust is secret or the beneficiaries undisclosed. Briefly, this statute provides that where a conveyance to a trustee does not disclose the fact of the trust or where it does not name the beneficiaries, a later conveyance by the trustee to third parties cannot be questioned by the beneficiaries. The present discussion is intended to point out any significant modification of common law rules. It is also intended to bring to light the method employed by the courts of this state in limiting the application of said statute, which, literally construed, could have led to unconscionable results.

THE COMMON LAW DOCTRINE

Where a trustee sells trust property to a third person and the sale is not in breach of trust, the purchaser holds the property free of the trust.³ Since the trustee has acted properly in the exercise of powers conferred upon him, neither he nor the beneficiary can set aside the sale. This rule also applies to a mortgage, or pledge, or lease of trust property properly made by the trustee in the exercise of his powers.⁴ In these cases the status of the transferee as a bona fide purchaser for value does not come into question. It

¹ TEX. REV. CIV. STAT. (Vernon 1925), Art. 7425a, was re-enacted verbatim in the Texas Trust Act of 1943, article 7425b-8. The article reads as follows: "Where a trust is created but is not contained or declared in the conveyance to the trustee or when a conveyance or transfer is made to a trustee without disclosing the names of the beneficiary the trustee shall be held to have the power to convey or transfer or encumber the title and whenever he shall execute and deliver a conveyance or transfer or encumbrance of such property, as trustee, such conveyance or transfer or encumbrance shall not thereafter be questioned by anyone claiming as a beneficiary under such trust or by anyone claiming by, through, or under an undisclosed beneficiary, provided that none of the trust property in the hands of said trustee shall be liable for personal obligations of said trustee."

² This is the purpose as set forth in the caption of House Bill No. 143 which became article 7425a.

³ 2 SCOTT, TRUSTS § 283 (1939).

⁴ RESTATEMENT, TRUSTS § 283 (1935).

is only when the trustee commits a breach of trust in making a transfer that it becomes important to consider whether the transferee is a bona fide purchaser. An innocent purchaser is generally preferred as against the owner of a merely equitable interest.⁵ The presumption is that the purchaser takes the property unencumbered by any equitable interest,⁶ which is rebutted by a showing that he did not pay value,⁷ or that he had actual or constructive notice⁸ that the property was impressed with a trust.

Early in the common law it was said:

"If my trustee conveys the land to a third person who well knows that the trustee holds for my use, I shall have a remedy in Chancery against both of them as well as the buyer as against the trustee for in conscience he buys my land."⁹

Subsequently, it was settled that a purchaser with notice takes subject to the trust. Not only must the vendee have been ignorant that the property was subject to a trust in order to take clear title, but he also must have been ignorant of any circumstances which would have put an ordinary prudent person upon inquiry which would have led to discovery of the trust.¹⁰ Of course, if the conveyance contained recitals which indicated that the grantee was but a trustee, the purchaser from him was put upon notice of that fact; and neither such purchaser nor any subsequent purchaser who proffered the trust instrument as a link in his chain of title could be regarded as an innocent purchaser.¹¹ For example, if A

⁵ *Id.*, §§ 284-294; BOCERT, TRUSTS § 153 (1942); *Armstrong v. Hix*, 107 Tex. 194, 175 S. W. 430 (1915); *Duckworth v. Collie*, 235 S. W. 926 (Tex. Civ. App. 1921).

⁶ *Higsaw v. Head*, 228 S. W. 561 (Tex. Com. App. 1921).

⁷ *Smalley v. Octagon Oil Co.*, 82 S. W. (2d) 1049 (Tex. Civ. App. 1935) *writ of error dismissed*.

⁸ For a discussion of what constitutes notice, see 2 SCOTT, TRUSTS §§ 296 and 297 (1939); RESTATEMENT, TRUSTS §§ 296 and 297 (1935); 4 BOCERT, TRUSTS AND TRUSTEES § 893 (1935).

⁹ Anonymous, Y. B. 11 Edw. IV, f.8, pl.13 (1471), translated MAITLAND, SELECTED ESSAYS 166 (1936).

¹⁰ Where, at time legal title to land was acquired, claimant of an undivided half interest in land was living on the land, the holder of legal title was not an innocent purchaser, *Cluck v. Sheets*, 141 Tex. 219, 171 S. W. (2d) 860 (1943).

¹¹ One purchasing land is charged with notice of the terms of the recorded deed

transferred to T, "trustee," and T conveyed to B, then B was under a duty to make inquiry whether the transferor was in fact a trustee, and, if so, the extent of his authority. If reasonable diligence in the inquiry would have resulted in discovery that T breached his trust responsibilities B would not take free from the trust. Many other circumstances¹² existed to put the vendee upon notice, such knowledge that the *cestui* was in possession of the land,¹³ that the vendor procured the property by means of a "sham sale";¹⁴ that the purchase was made *pendente lite*;¹⁵ and that deed itself was in such form as to carry notice.¹⁶ It is to be noted, too, that a purchaser who accepts a quitclaim deed cannot claim the benefit of the innocent purchaser doctrine.¹⁷ Thus, it seems that if the purchaser had any substantial suspicion, or if he should have had reason to believe a trust existed, he was charged with the burden of using diligence in inquiring as to the existence of the trust, and as to its terms. The mere fact that beneficiaries were not named did not relieve the prospective purchaser from the common law burden of thorough investigation if there was even slight evidence that a trust existed. It is apparent that, prior to 1925, the purchaser from a trustee was on shaky ground. Of course, this strict rule caused much inconvenience, and many business transactions failed to materialize into profitable undertakings due to an understandable caution on the part of the prospective grantee.

to his grantor and with all prior recorded deeds in the chain of title. *William Carlisle and Co. v. King*, 103 Tex. 620, 133 S. W. 241 (1910); *Leonard v. Benford Lumber Co.* 110 Tex. 83, 216 S. W. 382 (1919); but a purchaser does not have constructive notice of instruments outside his chain of title. *Davis v. Morley* 169 S. W. (2d) 561 (Tex. Civ. App. 1943).

¹² For a collection of circumstances which would put a purchaser upon inquiry see 4 BOGERT, TRUSTS AND TRUSTEES, § 895 (1935).

¹³ *Long Bell Lumber Co. v. Lowry*, 31 S. W. (2d) 345 (Tex. Civ. App. 1930); *Turner v. Dinwiddie* 276 S. W. 444 (Tex. Civ. App. 1925); *Hawley v. Geer* 17 S. W. 914 (1891).

¹⁴ *Cuney v. Dupree, Adm'r.*, 21 Tex. 211 (1858); *McClenny v. Floyd's Adm'r.*, 10 Tex. 159 (1853).

¹⁵ *Silliman v. Gano*, 90 Tex. 637, 39 S. W. 559, 40 S. W. 391 (1897).

¹⁶ *Belcher Land Mortgage Co. v. Clark*, 238 S. W. 685 (Tex. Civ. App. 1922) *writ of error refused*; *Stone v. Kahle*, 54 S. W. 375 (Tex. Civ. App. 1899).

¹⁷ *Biggs v. Polling*, 134 S. W. (2d) 801 (Tex. Civ. App. 1939) *writ of error dismissed*.

There were only a few defenses that a purchaser could rely upon for protection from attack by the beneficiary. Mainly, they were (1) a bona fide lack of notice of existence of the trust; (2) where inquiry would not lead to discovery of the breach of the trust even though circumstances placed the purchaser on inquiry;¹⁸ or (3) where the beneficiary may be estopped by his acts from attacking the transfer.¹⁹ In many states the burden of proof in an action by the beneficiary against the purchaser rests upon the purchaser.²⁰ But the rule is well settled in Texas, not affected by Article 7524a, that the *cestui que trust*, or claimant of an equitable title as against a subsequent purchaser of legal title, assumes the burden of proving that the latter was not an innocent purchaser for value.²¹

THE EFFECT OF THE STATUTE UPON THE COMMON LAW

Statutes in several states seem merely to state that the record of a conveyance to a trustee is constructive notice of the existence and terms of the trust, but that if the fact of the trust does not appear on the record of the real property conveyances, it is cut off by a conveyance to a bona fide purchaser. In other states statutes expressly provide that where a trust in relation to real property is mentioned in the instrument creating the estate, every transfer or other act of the trustees, in contravention of the trust, is void.²²

In Texas, however, the tendency is opposed to the above mentioned statutes. Again, the Texas enactment provides in substance that, if a deed runs to "T, trustee" or "T, as trustee," without more, a subsequent buyer of the property from T, or a successor

¹⁸ Possession of realty is not notice to a purchaser of a claim of the possessor, if inquiry of the possessor would not have disclosed his claim. *Downing v. Jeffrey*, 195 S. W. (2d) 696 (Tex. Civ. App. 1946) writ of error refused.

¹⁹ *Dunn v. Second Nat. Bank*, 131 Tex. 198, 113 S. W. (2d) 165 (1938).

²⁰ BOCERT, TRUSTS § 153 (1942).

²¹ *Harvey v. Humphreys* 178 S. W. (2d) 733 (Tex. Civ. App. 1944) writ of error refused; *Old National Life Ins. Co. v. Guest* 163 S. W. (2d) 241 (Tex. Civ. App. 1942) writ of error refused.

²² Statutes in other states are discussed in 4 BOCERT, TRUSTS AND TRUSTEES § 893 (1935).

of T, is entitled to assume either that the words "trustee" or "as trustee" were surplusage and did not indicate a real trust, so that T took an absolute title for his own benefit, or that T had power to sell and properly executed that power in any deed he gave.²³

Therefore, Article 7425a did not merely codify the common law rule. A very definite modification resulted from its enactment, which was intended to expedite heretofore slow and tedious land conveyances. As demonstrated by *Gulf Production Company v. Continental Oil Company*²⁴ this change has become firmly embedded in Texas law. In that case Turner and wife executed an oil and gas lease to Joiner, as trustee, without disclosing for whose benefit Joiner held. The notary who took the acknowledgment of the conveyance was a beneficiary of the trust who had previously acquired a beneficial interest in all leases thereafter to be acquired by Joiner. Plaintiffs claimed under this lease. After setting forth Article 7425a the court said:

"Prior to 1925 the rule prevailed in this state that subsequent purchasers of property which had been conveyed to a trustee were legally bound to ascertain who were the beneficiaries in the trust conveyance. This placed quite a burden upon those who acquired property from a trustee. Under the plain provisions of the above statute, where the conveyance was from Turner and wife to Joiner, as trustee, without disclosing for whose benefit Joiner held as trustee, the defendants in error could purchase from Joiner, as trustee, without being charged with constructive notice of Birdwell's interest, if any, in the property."²⁵

More operative facts seem to be required now to put a purchaser upon legal notice than merely his awareness or suspicion that a trust exists. The statute expressly states that where the conveyance to the trustee contains the trust or that the beneficiaries be named, the purchaser can be subjected to the claim that he had

²³ Article 7425a is not applicable if rights of parties were fixed by contracts long before enactment of the statute. *McWhorter v. Oliver* 2 S. W. (2d) 281 (Tex. Civ. App. 1927) writ of error dismissed.

²⁴ 139 Tex. 183, 164 S. W. (2d) 488 (1942). *Accord*, *Thlocco v. Magnolia Petroleum Co.* 141 F. (2d) 934 (1944), *certiorari denied*, 323 U. S. 785, (1944).

²⁵ 139 Tex. 183, 196, 164 S. W. (2d) 488, 494, (1942).

notice of the infirmity and thus did not acquire clear title. Does that imply that no other fact or circumstance could operate to prevent the purchaser from taking good title? An examination of Texas court decisions indicates a negative answer.

THE EFFECT OF COURT DECISIONS UPON THE STATUTE

Texas courts discovered that a literal application of the statute would lead to worse results than those which the Legislature sought to change. Some limitation was obviously necessary. So, in *Grand Court of the Order of Calanthe of Texas v. Ebeling*²⁶ the court held that since the beneficiary was in possession and the amount of consideration between grantor and grantee tended to show that the grantor held title in trust, the grantee was thereby put on notice and took subject to the trust. A similar decision was rendered in *Cage v. F. P. Eastburn and Company*²⁷ where it was held that the purchaser did not acquire title as against minor beneficiaries under Article 7425a even though the trust was not contained nor were the names of beneficiaries disclosed in the conveyance to the trustee because such purchaser had both actual and constructive notice of the breach of trust. The rationale of such decisions is very well summed up in *Woodall v. Adams*,²⁸ where the court stated:

"It could hardly be thought that the Legislature, in passing the Act, intended it as a protection to one who might accept a conveyance from one whom he knows holds legal title thereto as trustee for another without joinder of the cestui que trust."

The rule has also been announced that if a beneficiary resides on the premises for a substantial period and in obvious possession at the time the trustee attempts to convey, the purchaser takes with notice and subject to the trust.²⁹ The statute modified the common

²⁶ 129 S. W. (2d) 715 (Tex. Civ. App. 1939).

²⁷ 23 S. W. (2d) 865 (Tex. Civ. App. 1929) *writ of error dismissed*.

²⁸ 7 S. W. (2d) 922, 925 (Tex. Civ. App. 1928).

²⁹ Beneficiary resided on premises since 1933 and was in obvious possession at time trustee attempted to convey in 1940. *Held*: Purchaser took with notice. *Rodriguez v. Vallejo*, 157 S. W. (2d) 172 (Tex. Civ. App. 1941).

law rule, and now it seems that the courts have modified the statute. However, these decisions do not defeat the purpose for which the statute was enacted; that is, "to protect those dealing with trustees" because in each case the purchaser actually knew that the grantor was a trustee and either knew or should have known that trust responsibilities were being violated.

It is fair enough to charge the immediate buyer of realty from a trustee under a known trust with the duty of inquiry as to powers of the trustee and the execution thereof; while, at the same time, permitting good faith purchasers to acquire clear title under the statute without placing the common law burden upon them of ascertaining hidden details.³⁰ Article 7425a has had the effect of forcing real estate trusts into the open. On the other hand, courts have found it necessary to limit its application to situations involving good faith purchasers because otherwise it could be used as a tool in perpetrating fraud upon the beneficiary of a trust and thus defeat the purpose of its enactment.

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³⁰ TEX. REV. CIV. STAT. (Vernon, 1925) art. 7425b, enacted at the same time as Article 7425a and reenacted verbatim in Texas Trust Act of 1943, Article 7425b-9, absolves anyone who in good faith pays money to a trustee from the necessity of seeing that the money is properly applied and is not misappropriated by the trustee. Prior to enactment of this article the decisions were to the same effect. *Cooper v. Manek* 166 S. W. 58 (Tex. Civ. App. 1914) *writ of error refused*; *Rogers v. Jones*, 35 S. W. 812 (Tex. Civ. App. 1896).