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The "Credit Crisis" in Commercial Lending and the Effect on Your Real Estate Practice

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The recent "credit crisis" affecting commercial lending might have a profound effect on real estate in the near future. The fallout from the subprime debacle and the sudden collapse of the Commercial Mortgage-Backed Securities (CMBS) market has dramatically changed the lending landscape. Long-term practitioners will recall that most real estate commercial loans were historically made by local and regional banks and life insurance companies: "relationship" lending was the only effective way for borrowers to find the debt capital necessary to buy or build commercial real estate. During the mid-90s, this practice changed. Banks and life insurance companies began to package commercial loans in large mortgage pools, and the interests in these pools were sold as bonds to foreign and domestic investors. This CMBS market, as it became known, maximized the liquidity available to finance commercial real estate. The available liquidity, in turn, led to an efficient or perhaps overly heated market for acquisition and disposition of real estate assets. Prices for commercial property increased significantly, in part as a result of available credit. Borrowers and lenders relied far less on relationship lending. Real estate loans became an easily available commodity. Lenders aggressively competed for borrowers. Real estate development and construction activity escalated as construction lenders loaned funds in markets with sharply decreasing capitalization rates and a near certainty of "take-out" offered by the CMBS market. For those borrowers who were selling housing lots or condominiums, the "take-out" took the form of appreciating housing markets and ready buyers.

Sudden and recent changes in the housing and CMBS markets, however, have radically altered the core assumptions of the recent past. To provide some perspective, approximately $200 billion of commercial real estate loans were processed through the CMBS market in 2007. In 2008, less than 10% of that figure will occur. The cutback in available liquidity is forcing developers and buyers to scramble as they search for secondary and tertiary lending sources. Portfolio lenders such as banks and life insurance companies do not have the available capital necessary to replace the liquidity shortfall. Such lenders are instead tightening lending standards, extracting higher interest rates, shortening loan terms, and demanding full recourse liability.

It might appear that the subprime and CMBS market problems are irrelevant to the real estate practitioner's day-to-day practice in Washington state. Fortunately, our part of the country has been insulated from some of the economic contortions affecting other areas of the country. It might be a mistake, however, to assume that new market forces will not impact many of our clients, including the family who owns a highly appreciated piece of property, the homebuilder, the small company looking for construction financing to build a new plant or office, or the classic big-time developer of commercial and multi-family projects. This article will discuss the origins of the CMBS market, describe what is happening to CMBS and the overall real estate lending market, and attempt to offer some practical suggestions to the practitioner who wants to assist real estate borrowers, sellers, and buyers during these tumultuous times.

The History of the CMBS Market

The CMBS market that developed in the mid-1990s reflected

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Notes from the Chair

by Tim Osborn –
Microsoft Corporation, Redmond

Al Falk, now "Past Chair", handed the RPPT gavel over to me (there really is a RPPT gavel) at our annual business meeting June 7, 2008. Al left very big shoes to fill, and we'll be consulting with him for sage advice in his new capacity.

The Mid Year in Vancouver, Washington, was quite successful. There were 204 attendees, and Heidi Orr and Joe McCarthy did a terrific job putting together an outstanding program. I perused the feedback, which of course, coming from lawyers, was not without constructive suggestions (most common: some conference rooms were too cold – but I bet no one dozed off). However, my favorite enthusiastic (anonymous) comment about one speaker was "[t]oo bad this guy is married!" We'll just leave it at that.

The Sections are WSBA member's primary contact with the Bar Association. In case you didn't know, the RPPT is by far the largest Section, with over 2200 members. We've been at about the same level for a few years, which means we haven't grown at the same pace as the WSBA in general. So if you feel you get good value for your $17 *per year* from this Newsletter, the Mid Year, our CLEs, review of proposed legislation by the Executive Committee (which, although you may not realize it, has saved all of us from some horrendous problems), web page and list serve, please suggest that others who practice in the real estate or estate planning areas join.

Jean McCoy and Elizabeth Stephan have been running the web page and list serve, which is used by quite a few members. They will be stepping down soon, so anyone with at least moderate computer skills interested in contributing to the Section can contact Jean, Elizabeth or me.

The Executive Committee's annual retreat was September 19 – 21, our time for long range planning and considering initiatives. We want to be more intentional and systematic about spending our $5,000 annual public outreach budget, so if you have any suggestions let us know.

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an innovative and sophisticated process to create a national lending market and securitize interests in commercial real estate loans as a liquid investment. Prior to the emergence of the CMBS market, commercial real estate loans were "portfolio" loans originated by a lender (typically a bank or insurance company) and held on the lender's balance sheet until the loan was paid. The CMBS allowed for securitization of commercial real estate loans. In a CMBS transaction, individual commercial mortgage loans, with different loan amounts secured by different types of property in different locations, are pooled and contributed to a trust. The trust, in turn, issues bonds that typically vary by duration, yield amount and priority of payment. Bond purchasers choose bonds based on a credit risk rating with differing expectations for yield and bond term duration. Investors rely on national rating agencies to allocate credit ratings to the separate bond classes issued by the trust. Typically, the trust is created as a real estate mortgage investment conduit (REMIC) that allows pass-through tax treatment. The price for bonds issued in the REMIC generally reflects the understanding that a pool of loans is worth more than the aggregate value of all the loans contributed to the REMIC.

The REMIC structure attracted a wide number of corporate and foreign investors which led to favorable pricing for borrowers. Many practitioners witnessed the evolution of commercial lending in the past 10 years as loans made for properties in Spokane, Vancouver, Puyallup, and Wenatchee were no longer held by local and regional banks but were immediately transferred to national "loan servicers" located far from Washington state.

Standard underwriting practices, pooling of performing and non-performing loans across the country, and the securitization of commercial real estate loans to corporate and foreign investors, all characterized the CMBS market. The growth in CMBS was dramatic because of the inherent efficiencies of the loan pooling approach in contrast to historic portfolio lending. In 1995, total commercial real estate loans outstanding were approximately $1.014 trillion. CMBS represented approximately 5.4%. By 2005, total commercial real estate loans outstanding were approximately $2.618 trillion. CMBS represented 19.9% of this total and represented 37% of all commercial real estate loans issued in 2005 alone. In fact, from 2004 to 2006, CMBS originations outpaced commercial bank portfolio origination during 12 of 14 quarters. In 2007, there were approximately $200 billion of newly issued CMBS loans, despite a dramatic drop-off in the last half of the year.

The CMBS market emerged in part as a result of the 1980s savings and loan meltdown and the ensuing formation of the Resolution Trust Corporation (RTC). The RTC acquired a significant number of loans and assets from defaulting savings and loan institutions. Wall Street recognized the need for a large amount of capital to liquidate billions of dollars in real estate assets and loans held by the RTC. However, without standard underwriting practices or an official rating system, it was not possible to attract the necessary capital from corporate and foreign investors. As a result, major bond-rating agencies and uniform underwriting standards were formulated in the early to mid-1990s, which allowed for the subsequent pooling of mortgage loans and the securitization of the mortgage pools.

As mentioned earlier, most commercial real estate lending in the past was done on a portfolio basis by banks and insurance companies. Most banks, however, faced lending limits tied to the amount of deposits they held and loan allocation requirements imposed by regulators, which restricted the amount of commercial real estate loans a bank could have on its balance sheet. Regulators did not want to repeat the savings and loan fiasco and thus regulated the commercial real estate loan activity of banks. Moreover, since bank loan limits are tied to the amount of deposits held, which

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deposits are inherently short-term in nature, banks were further limited in the size and term of loans they could hold on their balance sheets. Accordingly, most banks were able to provide short-term construction financing for real estate borrowers, but were limited in their ability to issue longer-term “permanent” loans. Life insurance companies often played the role of the long-term lender. A life insurance company is not bound by depositary restrictions and is generally in a better position to manage its long-term cash position to issue longer-term loans to borrowers. However, most life insurance companies limit their exposure for real estate loans to approximately 5% to 30% of total assets. Additional restrictions often include a limit on any individual loan (e.g., not to exceed 1% of aggregate assets).

The inherent restrictions facing banks and life insurance companies effectively limited the total amount of debt capital available to commercial real estate borrowers. Given the limited number of banks and life insurance companies, borrowers were forced to compete by promoting only the higher quality real estate assets, offering personal guaranties and personal balance sheets, and fostering longer-term working relationships with certain banks and life insurance companies. CMBS fundamentally changed the behavior of borrowers and lenders.

Securitized lending, available through the CMBS process, introduced a massive amount of new liquidity available for commercial real estate lending. Banks were in a new position to originate loans and then sell those loans without the restrictions of lending limits based on deposits or regulatory restrictions applicable to portfolio loans. The formation of REMICs essentially allowed non-traditional lenders (such as corporations and foreign investors) to become commercial real estate lenders by purchasing bonds in the new mortgage pools. Loan terms changed dramatically. Banks could make non-recourse loans. Banks could offer long-term loans (e.g., 10-year loans rather than shorter-term loans) since the REMICs were structured as longer term investments. Banks became sales agents for the CMBS market. Since CMBS fostered a much more efficient process to raise debt capital, borrowers had greater access to available credit. Banks were forced to compete for customers on the basis of slight variations in interest rate spreads and commercial real estate loans became akin to commodities. Life insurance companies created CMBS departments to be competitive with banks selling loans to the CMBS market.

The freely available credit also had a direct impact on the overall real estate market. Buyers with easy access to credit competed with each other to acquire properties on a much more rapid basis. Cap rates plummeted in many parts of the country as the CMBS market matured into a highly efficient source of capital for real estate. Of course, CMBS was not the sole reason for property appreciation, but it was a significant contributor to the increase in value. The timing of real estate transactions changed dramatically as well. Long-term practitioners remember well that many property acquisitions were structured with much longer due diligence and financing periods. Recently, many acquisitions were structured with 30-day due diligence and 30-day closing periods. Financing of late was not much of an issue because the available credit from the CMBS market eliminated many of the inherent delays that were a necessary part of a real estate acquisition. Construction lenders also were more willing to make construction loans because of the confidence lenders had in the “take-out” chances offered by CMBS. Moreover, the heated real estate market, created in part because of available credit, gave lenders confidence in project valuations as general property values across the country continued to escalate.

What a Change a Year Can Make

The CMBS market took 10 years to develop and was becoming a predominant source of capital for real estate transactions. In late 2007, the bottom fell out. There are a number of possible explanations for the collapse of the CMBS market, including overly aggressive

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underwriting, loss of investor faith in the CMBS market's assessment of project valuation and risk, and fears of repeating the "subprime" mess, but one effect of the collapse is clear: The projected CMBS issuances for 2008 will be less than 10% of what occurred in 2007.

During the past few years, the CMBS market began to offer aggressive loan products to feed its accelerated growth. For example, of the aggregate $723 billion CMBS loans outstanding in 2007, at least 53% were interest-only loans; 25.6% of these loans had a partial interest-only term and 27.4% were interest-only for the full term of the loan. In addition, loan-to-value (LTV) ratios changed during the past few years, with loans often exceeding 80% LTV ratios for commercial real estate. Many loans were issued on a ten-year, non-recourse basis. The loosening underwriting standards occurred as CMBS investors continued to have faith in the increasing property valuations across the country, and banks and life insurance companies competed with the CMBS market for deals. Investors and lenders assumed that property appreciation would resolve any underwriting concerns with project cash-flow, and would offer the most compelling exit strategy for borrowers and lenders. Given years of rapid escalation in property values, this investor and lender optimism was well founded. However, the house of cards could be shaken if commercial banks and CMBS investors lost faith in the core assumption that property valuation escalations were sustainable or even accurate in the first place.

The recent "subprime" mess and the precipitous drop in single-family home values across the country provided the first shock to the CMBS market. The subprime situation is beyond the scope of this article, but few practitioners are unaware of the daily news reports describing dramatic changes in homeowner lending, loss of home values, failing investment houses, etc. Many of the nation's largest commercial banks were also heavily involved in the residential home-loan business and have already suffered enormous losses because of home loan write-downs. Nearly 18 of the top 20 largest lenders currently have significant balance-sheet problems because of home-loan losses. The sharp downturn in the value of residential housing led in part to increased risk concerns for commercial banks in their underwriting of commercial loans. In fact, commercial bank portfolio lending dropped from $37 billion in the second quarter of 2007 to $9 billion in the third quarter of 2007. In addition, regulatory concerns escalated because of bank exposure to residential and commercial real estate.

The sudden loss of residential home values also led to another factor that affected the CMBS market. There is a perception that rating agency assessment of property valuations and risk was inaccurate. The credit-rating agencies assessed risk for issuances of home loans packaged in similar pools known as mortgage-backed securities or MBS. Part of the "subprime" mess is an overall recalculation of risk assessment for home loans and a general downgrading of MBS issuances. The downgrading that occurred created a general concern that the credit-rating agencies were off track in assessing the risk of commercial real estate loans. The perception is that the risk of commercial property loan defaults will occur at a much greater rate than forecasted in the rating agency assessments. Since CMBS investors rely heavily on the credit-rating agencies, it is not difficult to imagine a sudden loss of investor interest in CMBS issuances if the investors lose faith in the credit rating agencies and their ability to accurately assess risk

The combination of bad news offered by the home-loan crisis, a tightening of underwriting standards by commercial banks, and an overall unease in the perceived valuations of commercial real estate provided the ingredients for the CMBS collapse. The investors who purchased REMIC bonds issued from the CMBS market suddenly stopped buying.

The full extent of the CMBS and subprime loan problems is not known at this time. What is known is that there is not as much liquidity in the overall market for commercial real estate loans. Loans are harder to find and are far more expensive. For the near term, it is likely that several trends will affect commercial real estate loans. Interest rates have increased in the form of higher spreads charged by lenders. That is why loans are more expensive even though the U.S. Treasury rates have dropped in recent months. For example, it was common in 2007 to find loans with interest rates equal to 90-150 basis points above 10-year Treasury rates. Today, spreads have jumped to 200-300 basis points and spreads can vary wildly in a day. The higher rates are required to attract investors back to the CMBS market. Banks, however, are unwilling to issue loans based on spread assumptions in an unstable market because they will suffer great losses if they issue a loan with a loan spread that is actually less than required by the CMBS market. Many borrowers will not accept the current spreads because the higher interest rates derail their acquisition pro formas. There is even a wide perception that the demand for CMBS will not occur again for some time. The CMBS collapse is based in large measure on investor loss of confidence in the market's ability to accurately assess credit risk even though the actual foreclosure and loan loss rates for commercial properties have not increased significantly. The actual loan-watch list for loans issued between 2005-2007 (when many "interest-only" loans occurred) has increased recently, and there is fear that foreclosures and loan losses are just around the corner. If there is an increase in foreclosures beyond forecasts, the absence of CMBS investors could be long-term.

In addition to the loss of CMBS dollars, real estate borrowers also face loan limits affecting the portfolio lenders. As mentioned earlier, many of the large commercial banks have adverse balance-sheet issues that curtail their ability to make additional loans. Commercial banks are also negatively impacted by regulatory requirements. Many commercial banks must increase their capital reserves for anticipated loan losses, in part because of regulator

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evaluation of portfolio risk, which is changing quickly in light of the commonly accepted wisdom that property values are decreasing in many markets. A recent change to the Financial Accounting Standards Board (FASB) standards might limit commercial bank lending capacity. The new rule (157) requires that the property securing many commercial real estate loans be valued on a current market basis rather than original appraised value. The more stringent rule could impact capital reserve requirements, which further limits the ability of commercial banks to make loans

The liquidity shortfall due to the CMBS collapse combined with fewer loan dollars available from commercial banks will mean tougher underwriting standards for any new commercial real estate loans. Interest rates are higher. Loan terms are shorter. Loan to value requirements have increased for many lenders. Full recourse lending is becoming common again as non-recourse financing options are prohibitively expensive for most borrowers. Property values are flat or declining in many markets, partly because debt financing is far less available and much more expensive.

What Effect Does This Have on My Practice and What Can I Do About It?

The recommendations described below are my own and based solely on my experiences to date. It may be difficult to see how the macro-economic forces affecting lending and commercial real estate can affect the day to day lives of practitioners and their clients in Washington state. We seem to be insulated from the severe problems occurring in other parts of the country. I believe, however, that our local market is more linked to the national credit and lending market than in prior years and that many of our clients will be caught off guard by the sudden change in the overall lending environment. We can be helpful by being proactive.

1. **Dust off the loan documents**. The practitioner should pull out copies of the loan documents affecting his or her clients and confirm the maturity dates for each loan. Borrowers do not have the luxury of assuming that debt financing is easily available to refinance loans that mature in the next few years. In fact, borrowers should assume that it may take 8-12 months to refinance a commercial loan. The practitioner can be helpful in advising the client well in advance of the impending maturity date and the market changes that may have a dramatic impact on available loan terms. Advising the client well in advance that he or she should expect tougher loan-to-value ratios and shorter loan terms will help the client prepare to raise the additional equity necessary to comply with new lending requirements. Perhaps the client needs to discuss the additional equity requirements with his or her partners. Perhaps the client needs to position the property for sale because the property cannot be refinanced and the client cannot raise additional equity. Perhaps the client needs to work on project performance to increase cash flow to support higher values for property to satisfy tougher LTV ratio requirements. All of this requires time and the practitioner can really help a client by advising it to work on these approaches far in advance of an impending loan maturity date.

2. **Approach existing lenders early.** Sometimes, lenders are willing to extend loans if a borrower gives them enough notice to process the request in a reasonable manner through their credit committees. This approach does not work for borrowers who already have CMBS loans in an existing mortgage pool, but can work for portfolio lenders and construction lenders. Many borrowers today are not able to easily refinance loans and have to seek extensions of their existing loans. Some lenders are using the last-minute extension request to demand onerous conditions including increases in interest rates, loan remargining (pay down of a portion of the loan to improve the lender's LTV ratio), and personal recourse. Some lenders are simply refusing last-minute requests because of outside pressures described above that have nothing to do with the underlying property performance. Generally, however, it is wise to resurrect the "relationship" lending approach of several years ago and approach the existing lender early. Discuss the loan maturity date and the refinancing obstacles with the lender. Try to negotiate loan extensions. Many banks are willing to consider loan extensions for a fee or an increase in interest rate. For some clients, the cost is well worth it if they extend the loan to avoid a premature sale of the project or refinancing on terms that will not work well. Many people believe that the crisis affecting the overall lending environment will be worked out over time and that liquidity flow will increase. Many borrowers, however, will be hurt badly by premature sales or adverse refinancing of projects. In fact, if you are helping a client with a new construction loan, encourage the client to add as many loan extensions or "mini-perm" options as possible because the client cannot assume that "take-out" financing will be available in the near future. In the recent past, borrowers based construction loan timing on their forecasts of project completion and income stabilization necessary to obtain a permanent loan. Today, borrowers have to also factor credit market uncertainty in that mix and give themselves more time.

3. **Broaden the net.** As commercial real estate lending became more widely available, borrowers had the luxury of viewing loan originators as commodity brokers. Today, borrowers have a much smaller pool of available and willing lenders. The practitioner can help clients by encouraging them to approach many lenders and qualified loan brokers to address their loan requirements. I cannot emphasize enough the level of change in the lending environment. Major lenders that were firmly affixed in the commercial real estate lending business only last year have completely shut down their real estate lending operations. There are some estimates that at least 500 banks across the country will go under in the next year or two. Borrowers cannot rely on the lending sources they used in the past. Lenders that are still active in making construction and permanent loans are inundated with

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Flow-Through Entities Owned by Trusts and Estates

Allocation of Income Tax

by Marcia K. Fujimoto – Graham & Dunn PC, Seattle and David Keene – Bancroft Buckley Johnston & Serres LLP, Seattle

I. Introduction

An owner of a flow-through tax entity, such as a partnership, limited liability company or S corporation, is taxed on the owner's share of the entity's taxable income, whether or not the owner receives distributions from the entity. The owner often encounters the situation where the owner's share of the taxable income of the entity (which we will refer to as the owner's "K-1 income") is not the same as the distributions from the entity. Only by coincidence are those two amounts the same in any given year. If the distributions from the entity are less than the owner's income tax liability for the K-1 income or are made at times that do not coincide with the April 15 and quarterly estimated income tax due dates, the owner may encounter inconvenient cash shortfalls.

If an owner of a flow-through entity is an estate or trust, the fiduciary of the estate or trust must be concerned not only about the source of cash to pay the income tax, but also about how to allocate the income tax between the income and principal of the estate or trust. How the fiduciary allocates the tax can produce significantly different results.

II. Issue

Assume that a trust's K-1 income from a flow-through entity is $1,000,000 for a year in which the entity distributes $100,000 to the trust. Assume further that the trust is required to distribute all income. Under one approach to allocating the tax, the income beneficiary gets none of the $100,000 because the trustee is

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loan requests and can be very choosy. The practitioner can again really help the client by facilitating new lender contacts and encouraging the client to sit down with a number of lenders on a face-to-face basis to discuss its lending needs. This can include introductions to new mezzanine debt sources. The aggressive LTV ratio lending offered by commercial banks and CMBS lenders in the past is gone. Borrowers can still find loans for quality projects with LTV ratios in the 50-60%; however, many clients do not have the equity necessary to satisfy the LTV requirements. A practitioner can help by introducing the borrower to new mezzanine debt sources which are developing to help borrowers with the extra equity necessary to obtain debt financing. Of course, mezzanine debt sources can be very expensive, but it might be the only available option to borrowers to avoid foreclosure of a project.

4. **Recourse is here to stay**. Practitioners should advise clients that they should not assume that non-recourse financing is easily available. Practitioners should advise clients to properly analyze the effects of recourse liability. For example, many recent permanent loans were non-recourse and borrowers did not face personal liability for loan loss unless caused by "bad act" reasons such as fraud, misappropriation of insurance or condemnation proceeds, etc. Today, borrowers should consider ways to negotiate recourse liability with lenders. The practitioner can help clients by offering ideas such as partial recourse based on overall net worth or liquid net worth tests, lender requirements to foreclose on the property prior to seeking remedies against a guarantor, and recourse-sharing arrangements among co-owners or partners in the borrowing entity. Long-term practitioners dealt with these issues prior to the emergence of the CMBS market, and we must resurrect that analysis for recourse loans today.

5. **Advising property owners and sellers.** The credit crisis affecting commercial real estate will negatively affect property values. Cap rate reductions in the past few years reflected, in part, easily available credit. The higher cost and unavailability of debt make it much more difficult for buyers to purchase properties based on recent cap rates. Accordingly, cap rates will probably rise. It is unclear if property values will stay flat or decrease in value for an extended period. A practitioner can offer valuable advice to clients owning commercial real estate by recommending strategies to "ride out" the volatility in the credit markets. For example, property owners that have to sell property in the near future will likely not get the price they could if they sold at a time when the credit markets stabilize. Some property owners have to sell because their loans become due. Some property owners have to sell because a family is closing an estate or the partners do not want to pay for a capital improvement. The practitioner can suggest "bridge loan" strategies for these clients to allow them to retain the property for a short time, ride out the credit market volatility and then position the property for sale. There are nearly 700 investment funds for "distressed properties" that have been created recently precisely in anticipation that property owners will have to sell at inopportune times. The practitioner can provide enormous value to a client by assisting it with strategies that avoid sale at an inopportune time.

I am interested in creating a sub-committee for the Washington State Bar Association Real Property, Probate and Trust Section, to assist bar members with timely market information and information-sharing about the commercial lending crisis. If you have any interest in joining a sub-committee, please let me know.

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Flow-Through Entities Owned by Trusts and Estates

required to use it to pay the trust's tax. Under an alternative approach to allocating the tax, the income beneficiary gets the entire $100,000 and the trustee must find other sources of cash to pay the trust's income tax liability.

The first approach was advocated by James Gamble, a co-reporter of the 1997 version of the Revised Uniform Principal and Income Act ("RUPIA")[1] promulgated by the National Conference of Commissioners on Uniform State Laws ("NCCUSL"). Both the Gamble approach[2] and the alternative approach[3] are based on defensible interpretations of the current tax allocation provisions of RUPIA and its progeny, the Washington Revised Uniform Principal and Income Act of 2002 ("Washington's RUPIA").[4]

This article discusses the two approaches and possible amendments to Washington's RUPIA that may eliminate the ambiguity in our current tax allocation statute.

III. Examples

The five examples below illustrate the different results under the two approaches. Example #1 assumes zero distributions from the flow-through entity to the trust, Example #3 assumes distributions equal to the tax on the K-1 income and Example #5 assumes distributions equal to the trust's K-1 income. Examples #2 and #4 assume points in between.

In these examples, we assume $1,000,000 of K-1 income and that both the trust and the income beneficiary are in the 35% marginal income tax bracket.[5] The total after-tax economic benefit in each example is $650,000 ($1,000,000 less $350,000 of tax). The charts below compare how much of the after-tax economic benefit each of the income and principal beneficiaries receive under the two approaches. The differences in the results are dramatic.

Gamble's approach reflects his belief that the first priority of the tax allocation rules should be to use the distributions from the flow-through entity to first pay the trust's income taxes and then to make distributions to the income beneficiary. In contrast, the alternative approach achieves a net economic benefit to the income and principal beneficiaries in the same proportion as the distributions from the flow-through entity bear to the total K-1 income. For example, in Example #4 below, where the $500,000 of distributions from the flow-through entity to the trust represents 50% of the total K-1 income, the total net economic benefit of $650,000 under the alternative approach is shared equally by the income and principal beneficiaries.

	Net Economic Benefit to Income Beneficiary	Net Economic Benefit to Principal Beneficiary
Example #1 – Zero Distributions		
Gamble Approach	Zero	$650,000
Alternative Approach	Zero	$650,000 (100%)
Example #2 – $100,000 of Distributions; 10% of K-1 Income; Less than Tax on K-1 Income		
Gamble Approach	Zero	$650,000
Alternative Approach	$65,000 (10%)	$585,000 (90%)
Example #3 – $350,000 of Distributions; 35% of K-1 Income; Equal to Tax on K-1 Income		
Gamble Approach	Zero	$650,000
Alternative Approach	$227,500 (35%)	$422,500 (65%)
Example #4 – $500,000 of Distributions; 50% of K-1 Income; Greater than Tax on K-1 Income But less than K-1 Income		
Gamble Approach	$150,000	$500,000
Alternative Approach	$325,000 (50%)	$325,500 (50%)
Example #5 – $1,000,000 of Distribution; 100% of K-1 Income; Equal to K-1 Income		
Gamble Approach	$650,000	Zero
Alternative Approach	$650,000 (100%)	Zero

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Flow-Through Entities Owned by Trusts and Estates

IV. Current Tax Allocation Rules

Absent contrary language in the trust agreement, Washington's RUPIA[6] sets forth the following rules governing the allocation of income taxes, which is taken verbatim from Section 505 of RUPIA.

SECTION 505. INCOME TAXES

(a) A tax required to be paid by a trustee based on receipts allocated to income must be paid from income.

(b) A tax required to be paid by a trustee based on receipts allocated to principal must be paid from principal, even if the tax is called an income tax by the taxing authority.

(c) A tax required to be paid by a trustee on the trust's share of an entity's taxable income must be paid proportionately:

(1) From income to the extent that receipts from the entity are allocated to income; and
(2) From principal to the extent that:

(i) Receipts from the entity are allocated to principal; and

(ii) The trust's share of the entity's taxable income exceeds the total receipts described in (1) and (2)(i) of this subsection.

(d) For purposes of this section, receipts allocated to principal or income must be reduced by the amount distributed to a beneficiary from principal or income for which the trust receives a deduction in calculating the tax.

V. Proposed NCCUSL Amendment to Tax Allocation Rules

Apparently, even Gamble acknowledged that a plain reading of subsections (c) and (d) of Section 505 does not produce his intended result. NCCUSL is proposing a technical amendment to Section 505 of RUPIA, which is compared below to the current statutory language. The proposed amendment codifies Gamble's interpretation that the current language of Section 505 requires the trustee to first calculate the trust's tax liability on the K-1 income and subtract all or a portion of the trust's tax liability from the flow-through entity's distributions before making the trust's distribution to the income beneficiary.

The amendment is proposed by the Subcommittee on Uniform State Laws of the State Law Committee of the American College of Trust and Estate Counsel ("ACTEC"). The proposed amendment has been formally approved by ACTEC, the American Bar Association's Real Property, Trust & Estate Law Section, the American Institute of Certified Public Accountants and the joint Editorial Board for Uniform Trust and Estate Acts. The proposed amendment also has been informally approved by the National Conference of Lawyers and Corporate Fiduciaries.

A. Proposed Amendment to RUPIA Section 505

The amendment to Section 505 proposed by NCCUSL would change Section 505 as shown below:

SECTION 505. INCOME TAXES

(a) A tax required to be paid by a trustee based on receipts allocated to income must be paid from income.

(b) A tax required to be paid by a trustee based on receipts allocated to principal must be paid from principal, even if the tax is called an income tax by the taxing authority.

(c) A tax required to be paid by a trustee on the trust's share of an entity's taxable income must be paid ~~proportionately:~~**:**

(1) from income to the extent that receipts from the entity are allocated only to income;
(2) from principal to the extent that receipts from the entity are allocated only to principal;
(~~1~~) ~~From~~**3) proportionally from principal and** income to the extent that receipts from the entity are allocated to ~~income; and~~**both income and principal;** ~~(2~~
(**4**) ~~From~~**from** principal to the extent that~~:~~

~~(i) Receipts from the entity are allocated to principal; and~~

~~(ii) The trust's share of the entity's taxable income exceeds the total receipts described in (1) and (2)(i) of this subsection.~~

~~(d) For purposes of this section, receipts allocated to principal or income must be reduced by the amount distributed to a beneficiary from principal or income for which the trust receives a deduction in calculating the tax.~~ **the tax exceeds the total receipts from the entity.**

(d) After applying subsections (a)-(c) of this section, the trustee must adjust income or principal receipts to the extent that its taxes are reduced because it receives a deduction for payments made to a beneficiary.

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Flow-Through Entities Owned by Trusts and Estates

B. Proposed Official Comments for Amended Statutory Language

1. Explanation of Tax Allocation Scheme

The proposed official comments to the amended Section 505 include the following explanation of the tax allocation scheme:

> Subsection (c) requires the trust to pay the taxes on its share of an entity's taxable income from income or principal receipts to the extent that receipts from the entity are allocable to each. This assures the trust a source of cash to pay some or all of the taxes on its share of the entity's taxable income. Subsection 505(d) recognizes that, except in the case of an Electing Small Business Trust ("ESBT"), a trust normally receives a deduction for amounts distributed to a beneficiary. Accordingly, subsection 505(d) requires the trust to increase receipts payable to a beneficiary as determined under subsection (c) to the extent the trust's taxes are reduced by distributing those receipts to the beneficiary.
>
> Because the trust's taxes and amounts distributed to a beneficiary are interrelated, the trust may be required to apply a formula to determine the correct amount payable to a beneficiary. This formula should take into account that each time a distribution is made to a beneficiary, the trust taxes are reduced and amounts distributable to a beneficiary are increased. The formula assures that after deducting distributions to a beneficiary, the trust has enough to satisfy its taxes on its share of the entity's taxable income as reduced by distributions to beneficiaries.

2. Examples in Proposed Official Comments

The proposed comments include two examples, the first of which is the same as Example #2 above. In the second example in the proposed official comments, the flow-through entity distributes an amount to the trust that is greater than the tax on the K-1 income, but less than the K-1 income. This is the same example as Example #4 above.

> **Example (2) -** Trust T receives a Schedule K-1 from Partnership P reflecting taxable income of $1 million. Partnership P distributes $500,000 to T, which allocates the receipts to income. Both Trust T and income Beneficiary B are in the 35% tax bracket.

Trust T's tax on $1 million of taxable income is $350,000. Under Subsection (c), T's tax must be paid from income receipts because receipts from P are allocated only to income. Therefore, T uses $350,000 of the $500,000 to pay its taxes and distributes the remaining $150,000 to B. The $150,000 payment to B reduces T's taxes by $52,500, which it must pay to B. But the $52,500 further reduces T's taxes by $18,375, which it also must pay to B. In fact, each time T makes a distribution to B, its taxes are further reduced, causing another payment to be due B.

Alternatively, T can apply the following algebraic formula to determine the amount payable to B:

$$D = (C-R*K)/(1-R)$$

D = Distribution to income beneficiary
C = Cash paid by the entity to the trust
R = Tax rate on income
K = Entity's K-1 taxable income

Applying the formula to Example (2) above, Trust T must pay $230,769 to B so that after deducting the payment, T has exactly enough to pay its tax on the remaining taxable income from P.

Taxable Income per K-1		$1,000,000
Payment to beneficiary		$230,769†
Trust Taxable Income		$769,231
35% tax	$269,231	
Partnership Distribution		$500,000
Fiduciary's Tax Liability		($269,231)
Payable to the Beneficiary		$230,769

† D = (C-R*K)/(1-R) = ($500,000 – $350,000)/(1 - .35) = $230,769. (D is the amount payable to the income beneficiary, K is the entity's K-1 taxable income, R is the trust ordinary tax rate, and C is the cash distributed by the entity).

In addition, B will report $230,769 on his or her own personal income tax return, paying taxes of $80,769. Because Trust T withheld $269,231 to pay its taxes and B paid $80,769 taxes of its own, B bore the entire $350,000 tax burden on the $1 million of entity taxable income, including the $500,000 that the entity retained that presumably increased the value of the trust's investment entity.

VI. Evaluating the Two Approaches

The alternative approach appears to achieve a more intuitive result than the Gamble approach. The trustee is likely to have an easier time explaining the proportional sharing of the after-tax economic benefit from a flow-through entity to the trust's income and principal beneficiaries. The income beneficiary may legitimately view the Gamble approach as unfair in those years when distributions from the flow-through entity are minimal in comparison to K-1 income because the income beneficiary bears the tax on income accumulating inside the flow-through entity that will ultimately benefit the principal beneficiary. The iterative computations required under the Gamble approach, even when assisted by an algebraic formula, sacrifice simplicity.

Admittedly, a trustee may be in more of a predicament than an individual owner of an interest in a flow-through entity because the trustee may not have selected the flow-through entity as an investment and because the trustee has fiduciary duties that

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would not burden an individual. Query, however, as to whether it is appropriate for an accounting system to attempt to resolve a trust's liquidity issues.

Another troublesome aspect of the Gamble approach is that distributions from the trust affect the trust's tax liability because distributions are an integral part of determining the trust's distribution deduction. The time delay in receiving the Schedule K-1 from the flow-through entity may necessitate cash distributions that lag behind the K-1 income, causing seemingly never-ending matching issues for the trustee.

The alternative approach is not perfect. In years when the flow-through entity has less K-1 income than its distributions to its owners, the income beneficiary will receive the large distributions with little or no associated tax liability. The principal beneficiary will likely view this as unfair.

Even if the codification of the Gamble approach as proposed in the NCCUSL amendment to Section 505 is not adopted in the State of Washington, an amendment to RCW 11.104A.290 that deletes RCW 11.104A.290(d) may eliminate the strained reading of the statute required to justify the alternative approach.

Under either approach, Washington's RUPIA and RUPIA allow a trustee to cure perceived inequities in the sharing of the tax burden. A trustee "… may make adjustments between principal and income" including those resulting from "[t]he ownership by an estate or trust of an interest in an entity whose taxable income, whether or not distributed, is includible in the taxable income of the estate, trust, or a beneficiary."[7] The trustee may have a more difficult time, however, determining an appropriate adjustment between principal and income under the Gamble approach if the perceived disparity results from an artificial attempt to cure the liquidity issue.

VII. Conclusion

Flow-through entities, particularly family limited partnerships and limited liability companies are increasingly popular entities for estate planning. As a result, estate planning advisors are often asked to provide counsel about the complex issues that arise when estates and trusts own or will own interests in flow-through entities.[8] Advisors need to be mindful of the issues related to making an equitable allocation of the income tax on the estate or trust's share of the income from the flow-through entities between the income and principal beneficiaries.

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1 Unif. Principal & Income Act (amended 2000).

2 E. James Gamble, *Trust Accounting and Income Taxes*, AICPA Advanced Estate Planning Conference (July 2005).

3 Carol Cantrell, *Handling Partnership Interests in Estate and Trust Administration*, Seattle 51st Annual Estate Planning Seminar (November 2006) and David Keene, *Partnerships Held by Trusts and Estates: Discovering the Rules and Optimizing the Opportunities*, TAXES – THE TAX MAGAZINE (Oct. 2007).

4 RCW 11.104A.

5 We also assume the following in all five of the examples:

- The trust's K-1 income (*i.e.*, the trust's share of the flow-through entity's taxable income) is $1,000,000, all of which is taxable ordinary income.
- The trust is a "simple" trust. That is, the trust agreement requires that fiduciary accounting income be distributed and the trustee makes no other distributions during the year in question.
- The trust agreement does not contain instructions contrary to the Washington's RUPIA for determining fiduciary accounting income.
- The distributions from the flow-through entity, if any, to the trust are made in cash and are properly classified as fiduciary accounting income, rather than principal.
- Both the trust and the individual trust beneficiaries are in the 35% marginal income tax bracket.

6 RCW 11.104A.290.

7 RCW 11.104A.300; Unif. Principal & Income Act § 506 (amended 2000).

8 David Keene and Dean V. Butler, *Accounting for Partnership Interest held by Estates or Trusts: Planning to Avoid Pitfalls*, TAXES – THE TAX MAGAZINE (April 2002).

The New ALTA Title Insurance Policies: Making the Leap from 1970 to the 21st Century

by Shannon J. Skinner – Kirkpatrick & Lockhart Preston Gates Ellis LLP, Seattle

The American Land Title Association (ALTA) adopted new forms of owners' and lenders' title insurance policies and endorsements as of June 2006, and these new forms are now widely available in Washington. The 2006 policy forms were the product of a multi-year process to update, improve and address issues with the 1992 policies. Most of the written material compares the 2006 forms to the 1992 forms. However, for the long list of sophisticated consumers of title insurance who rarely used the 1992 forms because they preferred the 1970 policy forms, a more useful comparison is with the 1970 forms.

The 2006 policies incorporate several new express insuring clauses and revise or make available additional endorsements, thus improving the overall coverage. Very little about the 2006 forms is less favorable to insureds, and endorsements are available to address most of those matters. Thus, commercial real estate owners and lenders who previously requested the 1970 policy forms should become familiar with the 2006 forms and begin using them in their transactions.

One principal feature of the new policies is new express insuring clauses. At least two appellate cases have held that for there to be coverage in a title policy, it must be expressly stated in the insuring clauses.[1] In other words, an exception from an exclusion from coverage may not provide insurance. The title companies increasingly take the view that an express insuring clause is required, and the 2006 forms provide such express clauses for many of the covered risks. For example, the 1970 policy does not include insuring clauses affirmatively covering police power actions or environmental liens; rather, there is an exception to these exclusions if notice has been recorded. The 2006 policies expressly cover these to the extent that notice is recorded in the appropriate records.

New coverages are also automatically included in the 2006 forms that were not included in the 1970 forms, such as coverage against preferences arising from untimely recording and gap recordings. The list of insured parties is expanded and the 90 day requirement for giving proof of loss is deleted. A check-the-box list of ALTA endorsements is also added, allowing many endorsements to be incorporated into a loan policy by reference.

Insureds under a 2006 form policy should still request an ALTA 21-06 endorsement deleting the creditor's rights exclusion and should also request deletion of the arbitration provision (for policies under $2 million).

Tables providing non-exhaustive summaries of the more significant changes to the policy forms are set forth below.

Major Differences Between 2006 and 1970 ALTA Lenders' and Owners' Policies

2006 Covered Risks	1970 Covered Risks
Lien of real estate taxes or assessments due but unpaid.	Not expressly included; subsumed in lack of priority.
Encroachments, encumbrance, violation, variation or adverse circumstance that would be disclosed by accurate survey. Encroachment includes encroachment of improvements on insured land onto adjoining property.	Not expressly included; was thought to be achieved by deleting the survey exception. Encroachments off of land possibly not covered because outside of insured land. See *Transamerica Title Ins. Co. v. Northwest Building Corp.*, 733 P.2d 431 (Wn. App. 1989).
Unmarketable title (including right to refuse to buy, lease or lend).	Unmarketable does not include refusal to lease or lend.
Violation or enforcement of laws (including those relating to building and zoning) restricting, regulating, prohibiting or relating to occupancy, use and enjoyment of the land, dimensions, subdivision, environmental protection or under exercise of police powers IF notice is recorded in public records (which includes district court for environmental liens).	Coverage was thought to be included through exception to exclusion from coverage.
Exercise of rights of eminent domain if notice recorded in public records.	Coverage was thought to be included through exception to exclusion from coverage.
A taking that has occurred and is binding on rights of BFP.	Not expressly included; subsumed in title being vested other than as stated.
Any other defect or encumbrance on title or other matters included in covered risks that is created, attaches or is recorded in public records after date of policy but before recording of insured mortgage.	New express gap coverage.
Express statement that title co. will pay costs and attorney's fees incurred in defense of insured matter to extent provided in conditions.	

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2006 Exclusions from Coverage	**1970 Exclusions from Coverage**
Claim under bankruptcy or other creditors' rights laws that the insured mortgage is a fraudulent conveyance or preference UNLESS covered under insuring clause (which covers such matters occurring before the insured mortgage transaction).	1970 policy does not have creditors' rights exclusion; this was one of the main objections to the 1992 policy. With 2006 policy, need to request endorsement to delete creditor's rights exclusion. This is frequently available for routine mortgage loan transactions.
Lien for taxes and assessments imposed between date of policy and recording of insured mortgage.	Not in 1970 policy; added as exception to new gap coverage in 2006 policy.
Conditions	**Conditions**
New definitions included for Amount of Insurance, Date of Policy, Entity, Title.	
Expanded definition of Insured, including successor in interest by operation of law (or successor owner of debt for Lender's policies, whether for own account or as trustee); holder of transferable electronic record; successors of entity conversions, dissolutions, mergers, reorganizations; and grantee under deed given without consideration to affiliates and subsidiaries. On Lender's policy, also includes governmental agencies or instrumentalities that insure or guaranty the debt.	Includes successor owner of debt and governmental insurers/guarantors.
Proof of loss; duty to cooperate: Specifies details for proof of loss; includes duty to make books and records available; requires insured claimant to submit to examination under oath. Ninety day period deleted but cooperation is more onerous on insured than 1970 policy.	Includes requirement to give proof of loss within 90 days after loss is determined. Details on proof and cooperation not included.
Extent of liability: includes new provision that if title co. defends/prosecutes and is unsuccessful, amount of insurance is increased by 10% or insured has right to have loss determined either as of date or claim or date settled and paid.	Equivalent, except does not include bump up in damages if title co. does not settle and unsuccessfully pursues litigation. (Note: does not include co-insurance provision in 1992 owner's policy.)
Arbitration: requires arbitration under ALTA rules for policies of $2 million or less. (AAA dropped its rules for title insurance disputes.)	Arbitration not included in 1970 policy. Note: Endorsement can be requested to delete arbitration requirement.
Policy is entire contract: provides for incorporation of endorsements (which don't modify policy, extend date or increase amount unless expressed).	
Choice of law and forum is state where land is located.	Not included.

Note: A future advance endorsement is required for future advance coverage. Advances to protect security are not future advances, so no endorsement is required for those.

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Additional Changes Specific to Lender's Policies

2006 Covered Risks	**1970 Covered Risks**
Lack of priority of insured mortgage over any other lien or encumbrance.	Did not include coverage for pari passu liens.
Lack of priority of insured mortgage over lien of assessments for street improvements under construction or completed as of date of policy.	Not covered.
Invalidity of insured mortgage by reason of (i) avoidance of transfer of land constituting fraudulent conveyance or preference under bankruptcy or other creditor's rights laws occurring BEFORE the transaction creating the lien of the insured mortgage; or (ii) insured mortgage constituting a preference because of untimely or improper recording.	Not addressed in 1970 policy and was subsumed in insuring clause 1 (title being vested other than as shown). Was exception to exclusion in 1992 policy. Clause (ii) is express new coverage in 2006 policy.
Exclusions from Coverage	**Exclusions from Coverage**
Laws (including those relating to building and zoning) restricting, regulating, prohibiting or relating to occupancy, use and enjoyment of the land, dimensions, subdivision, environmental protection, or violations/enforcement thereof, or police powers; rights of eminent domain (all UNLESS covered under insuring clause, which covers if notice is recorded before date of policy).	Same or similar, except coverage if notice is recorded was exception to exclusion, not affirmative coverage.
Defects, liens, encumbrances, adverse claims and other matters resulting in loss that would not have been sustained if insured had paid value for the insured mortgage.	Not previously included in relevant paragraph of policy form.
Conditions	**Conditions**
New definitions included for Indebtedness, Insured Mortgage. Note that "Indebtedness" includes post-policy advances (e.g., principal, interest, prepayment and exit fees, taxes and insurance, protective advances), payable as a matter of damages.	

1 *See, e.g., Somerset Savings Bank v. Chicago Title Insurance Co.*, 649 N.E. 2nd 1123 (Mass. 1995); *Lick Mill Creek Apartments v. Chicago Title Insurance Co.*, 283 Cal. Rptr. 231 (Cal. App. Dist. 1991).

Getting to the Root of the Matter by Going Out on a Limb

by Steve Tubbs – Attorney at Law, Vancouver

This is a tale of the law of dirt and the trees that grow in it. Trees are nice. They provide shade. They cool the air. They breathe in carbon dioxide and transpire oxygen in return. Trees are your friends—trees are "green."

But sometimes trees are a problem. Roots grow wherever they will, cracking foundations and sidewalks, clogging drain pipes. Leaves, needles, cones, and dead blossoms clutter gutters and lawns, adding to an already endless chore of home maintenance. Some trees, such as black walnuts, tend to kill competing vegetation within their root line.[1] Trees can become your sworn enemy.

Land law has been relatively constant since the days of *olde*. Once the notion of fee ownership settled into place, it became accepted that a fee owner held title going down to the center of the earth, and extending to the heavens.[2] This is a fairly straightforward and easily grasped concept. Unfortunately, trees and Mother Nature in general do not understand or respect boundaries and legal titles. Good fences make for good neighbors,[3] unless they consist of a line of trees or a hedge row.

I. The Historical Remedy

If an owner is aggrieved by a neighbor's offending tree, what may the owner do? This question was seemingly answered in Washington in 1921 by *Gostina v Ryland*.[4] The claimant, Gostina, was aggrieved by Ryland's trees and sued for an equitable remedy, alleging that the trees were a nuisance. The *Ryland* court declined judicial relief.[5] Apparently, mere irritation with the intrusion was not sufficient to sustain a legal remedy. The court recited, "[t]he overhanging branches of a tree, not poisonous or noxious in its nature, are not a nuisance per se, in such a sense as to sustain an action for damages. Some real, sensible damage must be shown to result therefrom…."[6]

However, the *Ryland* court was not wholly unsympathetic. It suggested in dicta that a self-help remedy was always appropriate. "One adjoining owner cannot maintain an action against another for the intrusion of roots or branches of a tree which is not poisonous or noxious in its nature. His remedy in such case is to clip or lop off the branches or cut the roots at the line."[7]

II. The *Happy Bunch* Approach

Against this backdrop, the case of *Happy Bunch, LLC v. Grandview N., LLC*[8] was decided. Here are the facts as set forth in the opinion:

> On September 6, 2002, Grandview purchased a parcel of property adjacent to the Happy Bunch property in order to construct a Wienerschnitzel drive-through restaurant. The city of Mount Vernon building code required that approximately four feet of fill be placed onto the Grandview property as part of the planned development.
>
> At the time of Grandview's purchase, 12 mature trees stood either on or near the boundary line between the Happy Bunch and Grandview properties. Some portion of the trunks of 10 of the trees extended from the Happy Bunch property onto the Grandview property. The trial court found that because the center of most of the trees lay on the Happy Bunch side of the boundary line, it is likely that all of the trees were originally planted on Happy Bunch's property. From the time the Wongs purchased their property in 1985, they maintained the trees and the area around them.
>
> [Grandview] did not believe that Grandview could meet the city's fill requirement without constructing a retaining wall along the Happy Bunch/Grandview property line. Because the roots and trunks of the trees extended onto Grandview's property, [Grandview] believed that they would interfere with the construction of the retaining wall. Accordingly, he decided to remove the trees. From a survey taken around the time Grandview purchased its property, [Grandview] knew that 10 of the trees were located on the Happy Bunch/Grandview property line and that the remaining two trees were located entirely on Happy Bunch's property.[9]

Grandview then contacted the Wongs on three separate occasions, asking for permission to remove the offending trees. Each time, the Wongs refused consent. In response, Grandview threatened to remove the trees. Grandview then hired a logger to begin logging. After nine of the twelve trees in question were removed, the Wongs' lawyer sent a letter to Grandview and its attorney, demanding that logging cease. That letter notwithstanding, Grandview waited until the Wongs were away, cut down the remaining trees, and arranged for a stump grinder to remove the trunk portions located on Grandview's side.

Obviously, litigation ensued. But that was only the first of several problems for Grandview. At trial, Grandview stipulated to the tree value.[10] With *Ryland* aforethought, the question immediately arises: stipulate to the value of what? Surely not the whole tree! If the dicta in *Ryland* held sway, the issue was the value of a de-limbed and de-rooted tree, at least to the extent that the limbs and roots intruded upon Grandview's land. In other words, Grandview had the legal right "to lop off at his boundary line the branches and roots" of his neighbor's trees.[11] If so, the legally denuded flora hence became a significant potential liability, and Grandview did the neighbor a favor![12] The stipulation is a verity that dogs Grandview.

But things went further awry. Grandview asserted assignments of error of its own, including "one seek[ing] modification of the trial court's determination of liability."[13] However, Grandview did not file a notice of appeal.[14] The court not only declined to consider the assignments, it went further:

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"we construe the assignments of error and the accompanying arguments Grandview presents as urging affirmance of the trial court's judgment."[15] The court was clearly unhappy with Grandview.

Against this backdrop, the *Happy Bunch* court, finding no precedent in Washington, concluded, "we join the courts of a sister state and hold that '[a] tree, standing directly upon the line between adjoining owners, so that the line passes through it, is the common property of both parties, whether marked or not; and trespass will lie if one cuts and destroys it without the consent of the other.'"[16]

III. Some Problems with *Happy Bunch*

> *"A tree, standing directly upon the line between adjoining owners, so that the line passes through it, is the common property of both [owners]."*[17]

Without elaboration or qualification, *Happy Bunch* holds that any tree, whether planted by man or nature, is a boundary tree so long as it intersects a property line. This blanket statement is at the root of many a prospective evil. It may undermine the foundations of many an owner's plans, who naively but mistakenly believe that a boundary is a boundary.[18]

In its analysis, the *Happy Bunch* Court ruled:

> In most jurisdictions, a tree standing on a common property line is considered the property of both landowners as tenants in common. *See, e.g.*, *Patterson v. Oye*, 214 Neb. 167, 333 N.W.2d 389 (1983); *Ridge v. Blaha*, 166 Ill. App. 3d 662, 520 N.E.2d 980 (1988); *Higdon v. Henderson*, 304 P.2d 1001 (Okla. 1956); *Cathcart v. Malone*, 33 Tenn. App. 93, 229 S.W.2d 157 (1950). However, courts in other states have held that a tree planted on one parcel which grows across a boundary line does not automatically become common property but, rather, becomes so only if both landowners treat it as such pursuant to either an expressed agreement or a course of conduct. *See Garcia v. Sanchez*, 108 N.M. 388, 772 P.2d 1311 (1989); *Holmberg v. Bergin*, 285 Minn. 250, 172 N.W.2d 739 (1969).

However, many of the authorities upon which the court relied do not support the proposition asserted. The principal case with which the court aligns itself, *Patterson v. Oye*,[19] is not an "automatic" common ownership case as cited, but rather aligns itself with the "courts in other states." The *Patterson* court took pains to note that "[b]etween 1973 and August 1, 1977, both parties cared for and maintained the bushes…."[20] *Patterson* in turn relied upon the *Weisel v. Hobbs* decision,[21] which likewise held that evidence of common maintenance was critical.[22]

Similarly, the conclusion drawn from *Higdon v. Henderson*[23] is untenable. In that case, the plaintiffs sought to recover damages from the defendant who had destroyed a tree located on the lot line between the adjoining property of the plaintiffs and defendant.[24] That court held that the plaintiffs failed to state a cause of action and sustained the trial court's demurrer![25]

Moreover, the Court's disregard of the trial court finding that the trees "likely" originated on Wongs' side and grew over onto Grandview's property is troublesome. It appears from the language of its decision that the Court relied significantly upon an annotation in American Jurisprudence Second Edition.[26] However, this same annotation, after reciting that a "boundary" tree is owned by adjoining property owners as "tenants in common," continues, "[w]hether a tree planted wholly on the ground of one owner of land which subsequently grows into the common boundary of an adjoining owner becomes the property of both owners depends upon whether such owners treat the trees as their common property pursuant to an agreement or course of conduct."[27] Given that these were the facts as found by the trial court in *Happy Bunch* and unchallenged upon appeal, it is uncertain why this latter rule was not applied in the case.

IV. The Lingering Roots of a Problem

The policy underpinnings of the "automatic common ownership" theory are weak. For example, the *Happy Bunch*[28] court cited to *Cathcart v. Malone,*[29] citing Vol. 1 of AmJur 1st, the latter explaining:

> A tree standing on the division line between adjoining proprietors, so that the line passes through the trunk or body of the tree above the surface of the soil is the common property of both proprietors as tenants in common. This is another instance where the maxim, "he who owns land owns to the sky above it" is qualified and made to give way to a rule of convenience more just and equitable, and more beneficial to both parties.

However, contrary to the surmise of the foregoing author, the "common tenancy" rule is neither equitable nor beneficial, particularly to an owner contemplating a change in the physical use of their property. Consider Grandview's perspective. It purchased its property with an eye toward improvement. It applied to the local authorities for permission and was told that certain fill requirements were necessary. There is nothing in the record to suggest that Grandview incorrectly determined that (1) a retaining wall was necessary to install the fill, and (2) that the impinging trees were a material impediment to the construction and maintenance of the required wall. Assuming this to be the case, and further that Grandview's property was zoned for the use contemplated, the balancing of equities requires more precise measuring, *i.e.*, between Happy Bunch's trees that had gradually encroached upon its neighbor, and Grandview's right to the

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lawful use and possession of the property to which it held legal title.

The *Happy Bunch* decision poses many other unanswered questions. For example, how do the facts in *Higdon*, where the removal of intruding roots cause the neighboring tree to die, apply? Is *Happy Bunch* limited to cases where the tree trunk has grown over the boundary line? Heed the generic warning in *Happy Bunch*: "[W]here a person has been given notice that another has an ownership interest in trees, and the person nonetheless cuts them down [or injures them], the actor will be liable for treble damages under RCW 64.12.030."[30] Is self-help a viable remedy? Or, if the resulting harm causes the tree to die, does a cause of action arise? Do significant and punitive damages hinge on the growth of trees nearing a boundary?

The *Happy Bunch* decision implies that RCW 64.12.030 allows for a damage award if limbing or de-rooting thereby damages or harms a tree even if the tree trunk is located solely on the land of a neighbor.[31] However, that statute applies only if the conduct was "without lawful authority."[32] Hopefully the decision is limited only to cases where the tree is owned "in common" by virtue of the location of its trunk. Nonetheless, once the trunk has grown a mere quarter inch into the neighbor's property, the tree becomes "common" property, thereby precluding any measure of self-help without risk of a claim for treble damages and emotional distress.[33]

Although the appellate court did not reach the claim of adverse possession as a result of the failure of the claimant to perfect its record, the case appears to work a comparable result. Strictly as a consequence of the expansion of the girth of the trees originally planted on one property, the planter has acquired undefined possessory rights over the neighbor's property by virtue of the invading trunk, limbs, and roots.[34] The nature of the common interest is left largely undefined, the court directing specifically only that neither common owner could remove the tree without the other's consent.

This in turn raises a question regarding maintenance. If the common tree is mostly on one property, but a limb that originates from a portion of the trunk located on the abutting owner's land becomes infested with tent caterpillars, may the majority owner remedy the concern, or must the majority owner simply stand by and watch? What, exactly, is the nature of this tenancy in common? If the infestation will result in certain death, may the minority owner be compelled to share in the costs of prevention? Or is an owner on his own? Is the issue of commonality limited strictly to active physical removal by one of the owners? If each common owner may use the tree as their own, is the minority owner entitled to cut off floral branches extending on the majority owner's side for use in an ikebana display, so long as it is done without material injury to the health of the tree? If one owner objects, may that practice continue? May an owner build a tree house and exclude the neighbor's kids from it?

The dangers of the decision may be far reaching. If self-help is no longer available or has limited application, then due diligence for the potential buyer contemplating construction should include a tree survey, identifying significant root intrusions and limb overhangs, and any trunk intrusions, however *de minimus*. Will title insurers need to add yet another exception, noting that it does not insure title where trunks, limbs or roots may extend? If a seller tenders a warranty deed, but boundary trees are within the described area, has the seller breached warranty of rights of possession?

V. The Better Rule

The fundamental problem with *Happy Bunch* is its failure to squarely address the definition of a "boundary tree." That term ought to be reserved for vegetation that clearly serves as a monument of the boundary. The happenstance where plantings eventually encroach upon their neighbor ought not to create a shared ownership interest as a matter of law. To the contrary, it should be presumed that, in the absence of clear indicia of contrary intent,[35] no common interest may be inferred. *Holmberg v. Raymond* offers the following rule:

> Plaintiffs and defendant did not own the trees as tenants in common since there was no agreement or consent concerning ownership. The court set out a test to be used in determining common ownership: Trees are boundary-line trees if they were planted jointly, cared for jointly, or treated as a partition between adjoining properties..… [W]e hold that something more than the mere presence of a portion of a tree trunk on a boundary line is necessary to make the tree itself a boundary-line tree—that whether a hedge, tree, or fence is in fact a boundary-line hedge, tree or fence depends either upon the intention, acquiescence, or agreement of the adjoining owners or upon the fact that they jointly planted the hedge or tree or jointly constructed the fence. [36]

Consider as well an original planter's uses. If, for example, a glorious flowering cherry tree is planted adjacent to a boundary, considered by the planter as an "heirloom" or "heritage" tree, the planter surely is entitled to move the tree to a more desirable viewing location without concern over compensating a neighbor upon whose property a small measure of the tree trunk and a larger measure of the flowering branches has gradually intruded. However, under the *Happy Bunch* rationale, it has become the common property of the abutting title holder solely by virtue its expansion in girth, subjecting the planter to a claim for damages when the planter moves and takes the prized flora with her or simply relocates the same.

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Getting to the Root of the Matter by Going Out on a Limb

In volume 1, *American Jurisprudence*, Second Edition, *Adjoining Landowners*, §18, the rule quoted by *Happy Bunch* regarding "common ownership" is recited, but limited immediately thereafter: "However, this rule is qualified by the right of an abutting owner to use his or her property in a reasonable way and conversely, not in an unreasonable way."[37] Ironically, *American Jurisprudence* cited to *Higdon v. Henderson*[38] for this proposition, the same case that *Happy Bunch* relied on for its holding.[39] It is respectfully submitted that this is the better rule.

Under this rule, the tougher questions will be reserved for those circumstances where Mother Nature was the planting agent,[40] and the straddling tree adds significant fair market value to one or both of the properties,[41] but its presence conflicts with a legitimate use contemplated by one of the owners. In that case, if the court upon trial finds that the proposed use is reasonable, then the tree cannot preclude that use.[42] Whether the owner removing the same should pay fair, but not punitive,[43] damages for its removal is simply a question of policy and risk of loss. This issue depends upon *Ryland*. If an owner "owns to the heavens and the depths," then no award is appropriate. If there are grounds showing that the tree is common, based upon the circumstances, but the proposed use is also reasonable, and removal of the tree is thereby reasonably necessary, then ordinary, but not punitive, damages are appropriate.

VI. The Final Analysis

As a practical matter, Grandview should have initiated litigation before logging. Before doing so, a certain determination regarding the need for fill in the specific area of concern was necessary. Having a witness from the City Building Department to confirm that tree removal was the only viable alternative to the use contemplated establishes that tree removal is reasonable and perhaps necessary. If the city had waffled, then the conflict may have evaporated. Courts have favored those whose contemplated use is reasonable, but frustrated by the presence of the trees or shrubbery in question.[44]

After securing the same, Grandview should then have sought judicial relief, invoking the "weighing of equities" suggested by case authorities. The trees were arguably a nuisance, interfering with Grandview's lawful use and possession of its property. Notice to Grandview's seller would also be warranted, since rescission or a reduction in price might be a remedy if the Court determined that Happy Bunch, by virtue of its planting and steady maintenance, had acquired title by adverse possession.[45]

Until the Supreme Court rules upon the matter, *Happy Bunch* will doubtless make litigators a happy bunch. There's plenty on both sides of the argument to root for.

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1. Purdue Plant & Pest Diagnostic Laboratory, *Black Walnut Toxicity*, *http://www.ppdl.purdue.edu/ppdl/expert/black_walnut_toxicity.html* (last visited July 30, 2008).
2. *Gostina v. Ryland*, 116 Wn. 228, 232, 199 P. 298, 300 (1921) ("From ancient times it has been a principle of law that the landowner has the exclusive right to the space above the surface of his property. To whomsoever the soil belongs, he also owns to the sky and to the depths. The owner of a piece of land owns everything above it and below it to an indefinite extent.") (citation omitted).
3. *See Baillargeon v. Press*, 11 Wn. App. 59 n.5, 521 P.2d 746 n.5 (1974).
4. 116 Wn. 228, 199 P. 298 (1921).
5. *Ryland*, 116 Wn. at 235–236, 199 P. at 301.
6. *Ryland*, 116 Wn. at 233, 199 P. at 300.
7. *Id.* (citing 1 C.J. 1233 § 94); *see also* W.W. Allen, Annotation, *Rights and Remedies Where True or Shrubbery on Common Boundary Line Causes, or Is Likely to Cause, Damage to One of the Owners*, 64 A.L.R.2d 665, (1959) (annotating *Lemon v. Curington*, 306 P.2d 1091 (1057)) ("It is well established that an owner of land may, without liability, lop off at his boundary line the branches and roots of trees growing on neighboring premises.").
8. 142 Wn. App. 81, 85, 173 P.3d 959 (2007).
9. *Id.* at 85–86, 173 P.3d at 961.
10. *Id.* ("The parties stipulated that the method used by Happy Bunch's expert arborist, Jim Barborinas, accurately assessed the value of the cut trees. The parties also stipulated to the gross value arrived at by Barborinas, $40,033."). Grandview may have simply intended to agree to the testimony of an expert witness, without stipulating that this was to be the applicable legal measure. Stipulations are dangerous things; it is best handled with great care.
11. *See supra* text accompanying note 7.
12. *See Lady Willie Forbus v. Knight*, 24 Wn.2d 297, 163 P.2d 822 (1945) ("It is the duty of the one who is the owner of the offending [branches or roots] to restrain its encroachment upon the property of another, not the duty of the victim to defend or protect himself against such encroachment and its consequent injury."); *see also*, *Albin v. Nat'l Bank*, 60 Wn.2d 745, 375 P.2d 487 (1962). Given that wind and rain visit the Pacific Northwest on a regular basis, it does not require a lot of imagination to conclude that a tree with a significant portion of its limbs and roots missing will present a foreseeable risk of harm to any structure lying within the tree's fall zone. *See generally*, *Lewis v. Krussell*, 101 Wn. App. 178, 2 P.3d 486 (2000).
13. *Happy Bunch, LLC v. Grandview N., LLC*, 142 Wn. App. 81, 90-91 n.2 ,173 P.3d 959, 964 n.2 (2007).
14. *Id.*
15. *Id.*
16. *Id.* at 93,173 P.3d at 965 (quoting *Patterson v. Oye*, 333 N.W.2d 389, 391 (Neb. 1983)).
17. *Id.*
18. Adverse possession by more "traditional" means is not within the purview of this discussion.
19. 333 N.W. 2d 389 (Neb. 1983).
20. *Id.* at 390.
21. 294 N.W. 448 (Neb. 1940).
22. *Id.* at 452.
    In the case at bar, where the trunk of the tree impinges upon the lot line, *and when the respective owners have for years jointly cared for the tree, and divided the expenses of protecting it … then* each has an interest in the tree sufficient to demand that the owner of the other portion shall not destroy the tree." *Id.* (emphasis added).
23. 304 P.2d 1001 (Okla. 1956).
24. *Id.* at 1002.
25. *Id.*
26. 1 Am. Jur. 2d *Adjoining Landowners* §17 (2005).
27. *Id.*
28. *Happy Bunch*, 142 Wn. App. at 96, 173 P.3d at 967; *see* RCW 64.12.030 (2005). (Whenever any person shall … injure … any tree, timber or shrub on the land of another person … without lawful authority, in an action by such person, if judgment be given for the plaintiff, it shall be given for treble the amount of damages claimed or assessed therefor, as the case may be.).
29. 33 Tenn. App. 93, 229 S.W.2d 157 (1950).
30. It may not even be plausible to argue that you were not aware that a tree would be injured by removing its roots from one side, so as to remove the "bite" of punitive damages.
31. RCW 64.12.030 (2005).
32. *See Birchler v. Castello Land Co.*, 81 Wn. App. 603, 915 P.2d 564 (1996).

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Recent Developments

Probate and Trust

by Brinette Bobb Rounds – Oak Street Law Group, PLLC, Bellevue

Irrevocable Trust of McKean, 144 Wn. App. 333 (Division Two, 2008)

Summary:

For the first time in a trust proceeding, a Washington court adopted the concept of a "de facto trustee." The court defined a de facto trustee as a person who "(1) assumed the office of trustee under a color of right or title and (2) exercised the duties of the office." The court further held that a de facto trustee's good faith actions are binding on third persons. By recognizing the concept of a de facto trustee, the court expanded the parties who can avail themselves of the Trust and Estate Dispute Resolution Act, RCW 11.96A ("TEDRA"). Specifically, the court held that a de facto trustee would be considered "a person who has an interest in the subject of the particular proceeding," and would, therefore, be a "party," as defined under RCW 11.96A.030(4)(i), that could bring a judicial proceeding for the declaration of rights or legal relations with respect to the trust under RCW 11.96A.080(1).

Facts:

Michael A. McKean established a trust in 1992 for his daughter and any future children he may have. At the time of the case, Michael had two daughters who were beneficiaries of the trust. Michael appointed his close friend as trustee of the trust, assuring his friend that he would not really need to do anything with regard to the trust unless Michael died. As such, no trust administration or management formalities were followed. Michael continued to manage the trust's assets as if he was trustee, no trust tax returns were filed, and Michael comingled trust assets with his personal assets.

In 1996 Michael ran into some civil and criminal trouble with the federal government. Learning of his impending legal issues, Michael used the trust to try to hide assets from the government. In 1998, Michael filed an action to dissolve his marriage. The dissolution court found that Michael abused the trust and that a corporate trustee should be appointed. Michael appealed the court's order. While the appeal was pending, the dissolution court appointed a professional guardianship agency, Commencement Bay, as trustee of the trust. After its appointment, Commencement Bay initiated the action in this case by filing a petition for instructions under TEDRA. In 2002, the appellate court reversed the dissolution court's decision to appoint a corporate trustee, holding that it lacked jurisdiction to do so. Shortly after the appellate court's reversal was issued, Commencement Bay petitioned the trial court for an order appointing it as Trustee, which Michael opposed. The trial court granted its motion, and appointed Commencement Bay as trustee. Michael moved to vacate the order appointing Commencement Bay, which the trial court denied.

This case involves Michael's appeal of the trial court's denial of his motion to vacate the order appointing Commencement Bay as trustee.

Discussion:

The first issue was whether the dissolution court had authority to appoint Commencement Bay as trustee while the appeal of its ruling was still pending. Under RAP 7.2(c), in a civil case, "except to the extent enforcement of a judgment or decision has been stayed as provided in rules 8.1 or 8.2, the trial court has authority to enforce any decision of the trial court." The rule additionally states that "[a]ny person may take action premised on the validity of a trial court judgment or decision until enforcement of the judgment or decision is stayed as provided in rules 8.1 or 8.3." As such, Commencement Bay could validly petition the trial court for its appointment of trustee.

The second issue was whether Commencement Bay had standing to initiate this case after the appellate court ruled against the dissolution court's appointment of it as trustee. The court stated that because the dissolution court had authority to enforce its decision by appointing Commencement Bay as trustee, as of the date Commencement Bay commenced this action, it was the trust's trustee. As trustee, the court held it had standing under RCW 11.96A.080(1) because RCW 11.96A.030(4)(b) defines a "party" to include a trustee.

The final issue was whether the trial court could appoint Commencement Bay as trustee after the appellate court invalidated the dissolution court's order requiring appointment of a corporate trustee. The theory supporting the trial court's authority was that Commencement Bay was a de facto trustee because it assumed the position of trustee under color of right and exercised a trustee's duties in good faith. In support of the de facto trustee theory, the court quoted an Oregon Court of Appeals' case that adopted the de facto trustee concept. In that case, the court held that a person or entity is a de facto trustee if two factors are met: "(1) the person assumed the office of trustee under a color of right or title, and (2) the person exercised the duties of the office." The Oregon court further defined the first factor by stating that a person is determined to have "assume[d] the position of trustee under color of right or title where the person assert[ed] an authority that was derived from an election or appointment, no matter how irregular the election or appointment might be." To clarify a de facto trustee's rights, the Oregon court further held that once a person or entity is found to be a de facto trustee, such de facto trustee's actions are binding on third persons. The court adopted these holdings on the basis that the concept of a de facto trustee is consistent with Washington law because Washington courts have recognized a similar concept in de facto guardians.

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Call for Nominations: Public Legal Education Award

The Council on Public Legal Education is accepting nominations for its Flame of Democracy Award, given to an individual, organization or program in Washington state that has made a significant contribution to increasing the public's understanding of law, the justice system or government. The mission of the CPLE, a committee of the Washington State Bar Association, is to promote public understanding of the law and civic rights and responsibilities.

First presented in 2002 to the late journalist Richard Larsen, the award was established to highlight the important educational work being done by teachers, lawyers and judges, the media, and a variety of advocacy and community organizations and individuals. Other recipients have been the Yakima County Prosecuting Attorney's Office for its school outreach program, the Northwest Justice Project for its self-help website, and the League of Women Voters of Washington Education Fund for its numerous efforts to strengthen citizen knowledge of and participation in government.

Nominations, which are due December 1, 2008, should be made in the form of a letter (maximum 500 words) describing the nominee's work and how it addresses the mission of the CPLE. The letter also should include the name of a reference who can provide additional information about the nominee. Supporting materials may be submitted; please limit print materials to 10 pages and audio-visual materials to 30 minutes. Self-nominations are encouraged. All nominations will be kept confidential. Nominations should be addressed to: Pam Inglesby, WSBA, 1325 Fourth Avenue, Suite 600, Seattle, WA 98101-2539. Email submissions are acceptable, and may be sent to *pami@wsba.org*. Further information about the CPLE may be found at *www.wsba.org/ple*.

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Getting to the Root of the Matter by Going out on a Limb

33. *But see Anderson v. Hudak*, 80 Wn. App. 398, 907 P.2d 305 (1995) (holding that the mere planting of trees, without more, did not establish title by adverse possession).
34. Contrary intent includes evidence of express or implied consent, or joint care and maintenance. *See generally*, 1 Am. Jur. 2d *Adjoining Landowners* §17 (2005); *Weisel v. Hobbs*, 294 N.W. 448 (Neb. 1940); *Rhodig v. Keck*, 421 P.2d 729 (Colo. 1966).
35. *Holmeberg v. Raymond*, 172 N.W.2d 739 (1969) (citing *Rhodig v. Keck*, 421 P.2d 729 (Colo. 1966)).
36. 1 Am. Jur. 2d *Adjoining Landowners* §18 (2005) (citing *Higdon v. Henderson*, 304 P.2d 1001 (Okla. 1956)).
37. 304 P.2d 1001, 1002 (Okla. 1956).
38. The *Happy Bunch* court also cited to *Higdon* in support of authority. *See supra* notes 23–25 and accompanying text.
39. If an owner planted the tree on or adjacent to a boundary, then that owner assumed any risk of loss when the abutting owner removed intruding roots or limbs in the absence of evidence to prove that the tree was "common."
40. *See generally*, *Allyn v. Boe*, 87 Wn. App. 722, 943 P.2d 364 (1997) (holding that damages for a tree that is neither ornamental nor productive hinge on the loss of fair market value of the injured property).
41. *Higdon v. Henderson*, 304 P.2d 1001, 1002 (Okla. 1956).

    Plaintiffs argue that since the tree standing on the boundary line is the common property of both abutting owners that neither had (or has) the right to damage or destroy the tree without the consent or permission of the other. Generally, as a proposition of law this is true, but the rule is qualified by the right of an abutting owner to use his property in a reasonable way and conversely, not in an unreasonable way … The allegations show that defendant was excavating on his own lot to build a residence and nothing more, which was not an unreasonable use of defendant's property. Under such circumstances, the resulting incidental injury to the tree did not create a right to recover damages. *Id.* (citations omitted).
42. RCW 64.12.040 (stating that if the trespass was involuntary, then "judgment shall only be given for single damages").
43. *See, e.g.*, *Robinson v. Spokane*, 66 Wn. 527, 530 120 P. 101, 102 (1912) ("'Where it appears that the city's action is not wanton or unreasonable, and that the trees stand in the way of the completed improvement or interfere with the use of the street, the abutting owner cannot prevent their removal.'") (citations omitted); *Schaller v. Tacoma*, 99 Wn. 166, 168 P. 1136 (1917).
44. *Compare Anderson v. Hudak*, 80 Wn. App. 398, 907 P.2d 305 (1995) with *Riley v. Andres*, 107 Wn. App. 391, 27 P.3d 618 (2001).

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Recent Developments: Probate and Trust

Here, Commencement Bay assumed the office of trustee under color of right when the dissolution court appointed it trustee, and it then acted as trustee by marshalling and protecting the Trust assets, thereby meeting the two factors. The court, therefore, held it was a de facto trustee.

The court then applied Commencement Bay's position as de facto trustee to the question of whether the trial court had personal jurisdiction over Commencement Bay even after the appellate court invalidated the dissolution court's appointment. Because Commencement Bay was a de facto trustee, it qualified as a party under RCW 11.96A.030(4)(i), and, as a "party" it was entitled to a judicial proceeding for the declaration of rights or legal relations with respect to the Trust under RCW 11.96A.080(1). As such, the court held that the trial court had personal jurisdiction.

Article Ideas?

Please contact Aleana Harris if you are interested in writing an article for the newsletter or if you have ideas for article topics. Aleana's phone number is 206-623-7600 and her email is *aharris@alcourt.com*.

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