Closing Opinions for Common Law Trusts

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In Our Opinion
July 29, 2016 by James Gadsden

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[Editors' Note: The following article by Jim Gadsden discusses the status and power opinions for non-statutory trusts used as investment vehicles. These trusts often are formed under New York law. As Jim points out, non-statutory or common law trusts are to be distinguished from statutory trusts formed under the statutes of states like Delaware and Maryland that provide for the organization of business trusts as separate legal entities. Non-statutory trusts also are formed for other purposes, including as mutual funds, REITS and holding companies. These non-statutory trusts are typically referred to as "business trusts." Opinion practice for them can differ from the practice described by Jim for the trusts he addresses. Opinion practice for business trusts will be discussed in a future issue of the Newsletter.]

Status and Power Opinions for Common Law Trusts Used as Investment Vehicles

Closing opinions delivered in connection with transactions by corporations have been extensively addressed in the opinion literature, including in many state reports.[1] Closing opinions for limited liability companies and limited partnerships also have been addressed, although less extensively.[2] With few exceptions, the literature does not address closing opinions for trusts.[3] This article discusses the status and power opinions for common law trusts used as investment vehicles[4] and opinion practices followed by lawyers who give opinions on these trusts. For federal income tax purposes, these trusts are generally treated as either partnerships or corporations rather than as ordinary trusts.[5]

Common Law Trusts v. Statutory Trusts

Trusts used as investment vehicles may be organized as either common law trusts or statutory trusts, depending on the laws of the state in which the trust is formed.

Statutory trusts are created under a state statute that requires for their formation the filing of a declaration or certificate of trust with the state's secretary of state or other appropriate official. These statutes have typically specified that the trust is a separate entity. For example, Maryland's REIT Law, MD Code § 8-101 *et seq*., provides for formation of a real estate investment trust as "a separate legal entity," § 8-102(2), and requires the filing of a declaration of trust with Maryland's Department of Assessments and Taxation to form a REIT. § 8-201(1). *See also* Maryland's Statutory Trust Act, § 12-101 *et seq*. (including § 12-103 (a Maryland statutory trust "is a separate legal entity")), § 12-204 (requirements for certificate of trust to form the trust). Delaware also has a statute providing for the formation of statutory trusts. *See* Delaware's Statutory Trust Act, DE Code § 12-3801 *et seq*., and § 3810(a)(2) ("A statutory trust formed under this chapter shall be a separate legal entity, . . ."),[6] and § 3810(a)(1) (requirements for contents and filing of a certificate of trust).

The status and power opinions for statutory trusts are similar to their counterparts for corporations, limited liability companies and limited partnerships. The opinion preparers satisfy themselves as to the due formation of the entity, its status (certificates of status can be obtained for

statutory trusts), and the power of the entity under its organizational documents and the governing statute to enter into the transaction that is the subject of the closing opinion.

The focus of this article is not on statutory trusts but on common law trusts used as investment vehicles created under state non-statutory trust law.

The Status and Power Opinions for Corporations and Alternative Entities

The foundation for many of the opinions given on corporations, limited liability companies and limited partnerships is the entity status opinion. A typical status opinion for a corporation may state that the corporation is validly existing[7] and is in good standing in the state of its incorporation, and, if relevant, is in good standing and qualified to do business in a state other than the state of incorporation that has a nexus with the transaction.[8] The building blocks of the opinion are a certified copy of the certificate or articles of incorporation filed with the proper state official, typically the secretary of state, and a certificate of recent date from the secretary of state that the corporation exists and is in good standing or that its certificate or articles of incorporation has not been cancelled.[9] This construct cannot be applied to common law trusts for two principal reasons, which are discussed further below. First, common law trusts do not require a filing to be formed. Second, the traditional understanding of a trust, at least in New York, is that a trust, even one formed for a business or investment purpose, is viewed as a "fiduciary relationship" rather than as a separate legal entity.

The Nature of a New York Common Law Trust

Under New York law, there are four essential elements of a valid common law trust: (1) a designated beneficiary, (2) a designated trustee who is not the beneficiary, (3) a fund or other identifiable property, and (4) the delivery of the fund or other property to the trustee with the intention of passing legal title to the property to the trustee to hold in trust for the beneficiary.[10] As expressed in the Restatement (Third) of Trusts § 2, a trust is a "relationship" involving a trustee who undertakes duties with respect to the trust property for the beneficiary of the trust.[11] A trust is a "fiduciary relationship in which one person holds a property interest, subject to an equitable obligation to keep or use that interest for the benefit of another."[12] The traditional common law rule is that a trustee is personally liable on contracts entered into as trustee, but is entitled to indemnification from the trust property.[13] To negate the application of this rule, trustees typically insist on the inclusion in contracts to which they are a party as trustee of an explicit statement that the only recourse of the counterparty under the contract is to the trust property and not to the assets of the trustee, and they sign the agreements under signature blocks making clear that they are signing the document as a trustee and not in their individual or entity capacity.

The Status Opinion

Although, as with a partnership, a written agreement is not necessary to create a common law trust,[14] as is the common practice with partnerships, opinion givers typically require that a common law trust have a written trust agreement before they will deliver a closing opinion. No public filing is required for creation of the trust.[15] In this respect a trust is analogous to a general partnership, another form of doing business that is not extensively treated in the opinion literature,[16] and where, for example, no filing of a public record is necessary to create the partnership.[17] The written trust agreement should be reviewed to determine that it establishes all the necessary elements for a valid trust—that it identifies the beneficiary, the trustee and the trust property, and that the property has been delivered to the trustee.

Since no public filing is necessary to form a common law trust, a valid existence certificate from the secretary of state typically is not available. Similarly, a certificate of good standing ordinarily is not available.[18] Instead the opinion preparers have to satisfy themselves as to the trust's continued existence in other ways.

The relevant consideration is whether the trust continues to exist and has not been terminated.[19]

The Power Opinion

To give a power opinion, the opinion preparers need to satisfy themselves that the trustee has the power to act as trustee on behalf of the trust and that the trustee has the power under the trust agreement to engage in the activities covered by the opinions.[20]

Because the trustee exercises the powers of the trust, the power of the trustee is relevant to the power opinion. There are several ways of handling the trustee's power in order to give the opinion.

If a trustee is an entity, the opinion preparers must either determine or assume that the trustee is a validly existing entity and has taken the steps required by its organizational documents to execute the agreement (in this case as trustee). The opinion preparers may obtain certificates of good standing and other necessary documentation from the appropriate governmental official to establish that the entity is validly existing. If the trustee is not the trustee named in the original trust agreement, then the opinion preparers should obtain satisfactory evidence (or assume) that the succession was accomplished in the manner authorized by the trust agreement or otherwise applicable law.

Sometimes counsel for the trust takes these steps to satisfy itself regarding a trustee. In other situations, the trustee's counsel, which may be inside or outside counsel, may do the work and give an opinion regarding the trustee. In that case, counsel for the trust may rely on the opinion of trustee's counsel or assume the matters relating to the trustee. Another alternative that may be acceptable to a recipient, especially when a major institution is the trustee, is for the trust's counsel to assume the status, power and authority of the trustee without a separate opinion as to those matters and to address just the trust itself.

The inquiry as to the status of a trustee of a common law trust for purposes of the status opinion is arguably more important than an inquiry for opinion purposes as to the status, when an entity, of a member, manager or general partner of a limited liability company or a limited partnership. Customary practice for such opinions does not require, in the case of entity members, managers, or general partners, that the opinion preparers confirm those entities' status, power, or authority to act for and on behalf of the limited liability company or limited partnership.[21] For a common law trust, however, the trustee is the only "actor," and accordingly an examination of the trustee's capacity to act as trustee is typically undertaken or assumed.

Whether the trustee is an individual or an entity, and whether the trustee is the original trustee or a successor, the opinion preparers satisfy themselves (or assume) that the trustee is authorized under applicable law to act as trustee and that the trustee has taken the necessary steps, if any, to qualify as trustee. For example, state and federal banks and trust companies are typically authorized to exercise trust powers under the laws of their chartering jurisdictions.[22] As a result, the state or federal official of the chartering jurisdiction can supply a certificate that a bank has trust powers and is in good standing with the chartering authority. For an individual trustee, the opinion preparers confirm that the trustee is not subject to any limitations on his or her ability to act as trustee in the transaction.[23]

The second step in the analysis is a review of the trust agreement to determine the scope of the powers of the trustee, the trust's permissible activities, and the consents required of the beneficiaries or others, which is similar to the review of the certificate or articles of incorporation, bylaws and resolutions of a corporation in connection with a closing opinion for a corporation. The investigation will also confirm that the trust does not have a stated term that has expired and that no events have occurred causing the termination of the trust.

Forms of Status and Power Opinions

The following are forms of the status and power opinions for a New York common law trust used as an investment vehicle[24]:

[The Client] is the trustee of [the Trust] pursuant to the provisions of the Trust Agreement dated _____ ___, 20__.

[The Client], as trustee of the Trust, has the trust power to execute and deliver the [transaction documents] and to perform [the Client's] obligations thereunder.

For the reasons discussed above, no opinion is given that the Trust is validity existing.

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Endnotes

[1] *See, e.g.*, TriBar Opinion Committee, *Third-Party "Closing" Opinions* § 6.1, 53 Bus. Law. 592, 641 (1998) ("TriBar Report"); D. Glazer, S. FitzGibbon and S. Weise, Glazer and FitzGibbon on Legal Opinions § 6.1 (3d ed. 2008) (hereinafter "Glazer and FitzGibbon"); 1 A. Field and J. Smith, Legal Opinions in Business Transactions §§ 9.2.2 – 9.2.4 (3d ed. 2014) (hereinafter "Field and Smith"). The section references in each of these works is to the report's or treatise's discussion of the corporate status opinion.

[2] *See, e.g.*, TriBar Opinion Committee, *Third Party Closing Opinions: Limited Liability Companies*, 61 Bus. Law. 679 (2006) ("TriBar LLC Report"), and various state reports. The TriBar Opinion Committee is currently preparing a report on closing opinions for limited partnerships.

[3] The Florida State Bar's report on closing opinions discusses opinions on trusts. *See* Legal Opinions Standards Committee, Business Law Section, Florida State Bar, and Legal Opinions Committee, Real Property, Probate and Trust Law Section, Florida State Bar, Report on Third-Party Legal Opinion Customary Practice in Florida 52-54, 72-75, and 85-87 (2011) (the "Florida Report").

The Maryland State Bar report on closing opinions discusses closing opinions on statutory trusts. *See* Special Joint Committee, Section of Business Law and Section of Real Property, Planning and Zoning, Maryland State Bar Association, Report on Lawyers' Opinions in Business Transactions 107-110 (2007, revised 2009) (the "Maryland Report").

For a Legal Opinions Committee listserve dialogue on the status opinion for trusts, see "Notes from the Listserve — The Due Formation and Validly Existing Opinion for Trusts," *In Our Opinion* (Fall 2015, vol. 15, no. 1) at 21-22.

[4] In the corporate context, these opinions are referred to as the "corporate status" and "corporate power" opinions. *See* TriBar Report §§ 6.1, 6.3, 53 Bus. Law. at 641-647.

[5] *See* William P. Streng et al., Tax Management (3rd): Choice of Entity § II.M.7.5, II.M.7.7 (2008); William S. McKee et al., 1 Fed. Taxation of Partnerships and Partners § 3.02[4] (4th ed. 2015) ("The 1980s saw the development of a new type of multi-party investment vehicle in which multiple investors would acquire a fixed pool of assets (e.g., mortgages or credit card receivables) and use state law trust vehicles to carve up the economics in the asset pool . . . . [T]he Treasury acted to force all multiple-class investments in a single business or asset pool into the income tax regimes (the corporate or partnership rules) that are designed to tax complex interests in common asset pools.").

[6] Delaware recently amended its Statutory Trust Act to permit a trust to be formed under the Act that is not a separate legal entity if so specified in the trust's certificate of trust and governing instrument. A Richards Layton & Finger, P.A. client advisory provides the following explanation for the change:

Notwithstanding the many advantages of a statutory trust under the DSTA . . . some sectors of the structured finance industry have continued to utilize common law trusts. These sectors have expressed concerns that a trust which is a separate legal entity might be treated differently

than a common law trust under various provisions of federal and state law. There is also a growing trend in some transactions to use a federally chartered financial institution, such as a national bank, as the trustee to hold title to the trust assets rather than holding title in the name of the trust. The trend reflects a concern that the trust might be a target for regulators and others who would not otherwise have authority over a federally chartered financial institution engaged in a similar transaction.

The 2016 Amendments to the Delaware Statutory Trust Act (Jul. 13, 2016), http://www.rlf.com/Publications/6520 (last visited July 13, 2016).

[7] Historically, the status opinion for a corporation also included an opinion that it was "duly incorporated." For corporations that have been in existence for a long time, increasingly opinion recipients accept a status opinion that simply states that the company is "validly existing as a corporation under the law of" the jurisdiction in which it is incorporated, without also referring to the "incorporation." *See* TriBar Report § 6.1.3(b), 53 Bus. Law. at 644–645.

[8] *See* Field & Smith § 9.2.4.

[9] In some states the certificate has prima facie or conclusive effect establishing that the corporation has been formed and is validly existing in good standing. *See* Delaware General Corporation Law § 105; Florida Report at 39; Joint Opinion Committee, Sections of Real Estate Law and Business Law, Tennessee Bar Association, Report on Third Party Closing Opinions 9 (2011).

[10] *In re Doman*, 68 A.D.3d 862, 863, 890 N.Y.S.2d 632 (N.Y. App. Div. 2009); *In re Manarra*, 5 Misc.3d 556, 558, 785 N.Y.S.2d 274, 275 (N.Y. Sur. Ct. 2004); *In re Fontanella's Estate*, 33 A.D.2d 29, 30, 304 N.Y.S.2d 829, 831 (N.Y. App. Div. 1969).

[11] The commentary to the Restatement (Third) of Trusts notes the development of the concept that a trust is an entity—Reporter's Notes to comments a and i; A. Scott, W. Fratchner and M. Ascher, Scott and Ascher on Trusts §§ 2.1.4., 2.3 (5th ed. 2006) [hereinafter "Scott on Trusts"].

[12] Bogert *et al*., The Law of Trusts and Trustees § 1 (3rd ed. 2012) (hereinafter "Bogert") (internal citations omitted) (citing *In re Estate of Luccio*, 982 N.E.2d 927 (Ill. App. Ct. 2012)).

Just this year, the Supreme Court of the United States referred to the "tradition" that "a trust was not considered a distinct legal entity, but a 'fiduciary relationship' between multiple people" in determining that, for purposes of diversity jurisdiction, a Maryland real estate investment trust was considered to be a citizen of the states of all of its members. *Americold Realty Trust v. Conagra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016). The diversity statute, 28 U.S.C. § 1332, specifies in subsection (c)(1) that a corporation is treated as a citizen of the state where it is incorporated and where it has its principal place of business. Consistent with its treatment of limited partnerships and other unincorporated associations, the Supreme Court has declined to extend that rule to a trust.

[13] Bogert § 247 K; 4 Scott on Trusts § 26.1; Restatement (Second) of Trusts § 261.

[14] Restatement (Third) of Trusts § 4, subject to an applicable statue of frauds (generally applicable to a trust involving real property). Bogert § 63.

[15] In the terms of Article 9 of the Uniform Commercial Code, a common law trust is not a "registered organization" formed by the filing of a "public organic record." UCC § 9-102(a)(71), (68). For a comprehensive treatment of trusts and trustees under Article 9, *see* N. Powell, *Filings Against Trusts and Trustees Under the Proposed 2010 Revisions to Current Article 9—Thirteen Variations*, 4 UCC L.J. Art. 2 (2010).

[16] For an example of a report addressing opinions on general partnerships, *see* Business Law Section, State Bar of California, *Report on Legal Opinions Concerning California Partnerships*, (1998). The presently circulating exposure draft of the California Business Law Section's revised

report on Third Party Closing Opinions: Limited Liability Companies and Partnerships (currently available at The Legal Opinion Resource Center at http://apps.americanbar.org/buslaw/tribar/) contains a discussion of opinions on general partnerships at pages 54–57.

[17] *See, e.g.*, Uniform Partnership Act § 202. The members of a limited liability partnership obtain their shield from personal liability from the registration of the partnership as a limited liability partnership, but the partnership exists independent of that filing. Uniform Partnership Law § 901; New York Partnership Law § 121-1500.

[18] Some opinion literature takes the position that "good standing" is a concept that has no meaning outside the certificates delivered by a secretary of state.

[19] One issue that must be considered in connection with a trust is the Rule Against Perpetuities. There is a statutory exception in New York to the application of the Rule to a "business trust," defined as having transferable certificates of interest offered for sale to the public. N.Y. Estates Powers and Trusts Law § 9-1.5. Note that business trusts or investment trusts are not otherwise excluded from New York's Estates Powers and Trusts Law, which addresses trusts for family or charitable purposes and decedents' estates.

[20] *See* Florida Report at 52, 72.

[21] See TriBar LLC Report § 2.0 n. 32 and § 4.0 n. 52, 61 Bus. Law. at 685 n. 32 and 689 n. 52.

[22] For state chartered institutions, see, for example, New York Banking Law § 100. States also regulate the right of institutions charted under federal law or the laws of other states to exercise trust powers in the state. *E.g.*, New York Banking Law §§ 131(3), (4), 200, 201-b (out-of-state banks); §§ 226-227 (interstate branches). For federally chartered national associations, see 12 U.S.C. § 92a.

[23] For example, if an aircraft is to be titled in an owner trust in a leveraged lease transaction, each trustee must be a U.S. citizen or a resident alien. 14 C.F.R. § 47.7(c)(2). Opinion preparers may assume, without so stating, that an individual trustee has the requisite capacity to contract and is not subject to a disability, unless they have knowledge to the contrary. *See* TriBar Report § 2.3(a), 53 Bus. Law. at 615.

[24] Adapted from the Florida Report at 52, 72.

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