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SUBDIVISION TRUSTS: A PROPOSED STANDARD FORM

by Leon J. Alexander*

The institutions and practices of the law have as one major objective the creation of problem-solving devices which will effectively meet the evolving needs of the commercial community.¹ In the area of real estate subdivision and financing, this goal finds reflection in the subdivision trust or, as it is sometimes called, the subdivision financing trust. Because of many practical difficulties attending the use of traditional security devices, the subdivision trust is becoming increasingly popular to facilitate the rapid purchase, subdivision and resale of large tracts of land. When land was cheap and subdivision regulation minimal, the industry could operate despite the legal shackles imposed by traditional financing devices. Today, however, the dramatic increases in the values of both improved and unimproved land,² and the mounting governmental regulations demanding substantial improvements in the nature of roads, drainage installation and utilities,³ all of which increase

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1. Cf. K. POPPER, *The Nature of Philosophical Problems*, in CONJECTURES AND REFUTATIONS 72-73 (1962):

[W]e are not students of some subject matter but students of problems
Genuine philosophical problems are always rooted in urgent problems outside philosophy. . . . Only if he understands the contemporary problem situation in the sciences can the student of the great philosophers understand that they tried to solve urgent and concrete problems. . . .

The same is true of the lawyer and commercial legal concepts.

2. See J.B. SMITH, *REAL ESTATE IN CALIFORNIA* 234 (8th ed. 1970).

3. In California, recognition of improvements and designs is accomplished under the authority of the Subdivision Map Act. CAL. BUS. & PROF. CODE ANN. §§ 11500-641 (West 1964 & Supp. 1972). The main purposes of the Act are (1) to control and regulate subdivisions with consideration of their relation to adjoining areas (*Newport Bldg. Corp. v. Santa Ana*, 210 Cal. App. 2d 771, 776, 26 Cal. Rptr. 797, 800 (1962); *Kelber v. Upland*, 155 Cal. App. 2d 631, 638, 318 P.2d 561, 565 (1957)); (2) to require a subdivider to install streets and other public improvements of a proper quality (*see County of Kern v. Edgemont Dev. Corp.*, 222 Cal. App. 2d 874, 35 Cal. Rptr. 629 (1963); *Buena Park v. Boyar*, 186 Cal. App. 2d 61, 67, 8 Cal. Rptr. 674, 679 (1960)); and (3) to protect the public from fraud (*Pratt v. Adams*, 229 Cal. App. 2d 602, 606, 40 Cal. Rptr. 505, 508 (1964) *citing* 10 OP. CAL. ATT'Y GEN. 203, 204; 27 OP. CAL. ATT'Y GEN. 66). Local governing bodies are permitted to control the design and improvement of subdivisions per regulating ordinances which every county and city is required to adopt. (CAL. BUS. & PROF. CODE ANN. § 11525 (West Supp. 1972)). Thus, the City of Los Angeles purports to regulate corner cut-offs, degree of curves, in-

costs to the developer,⁴ have combined to call for a better legal instrument. The subdivision trust is such a device.

Under the subdivision trust concept, land is conveyed in fee simple by the original vendor to a corporate trustee rather than to the developer, and it is the trustee who conveys the fee simple title to the ultimate lot purchaser(s). In return, the vendor and the holders of prior liens on the property take priority beneficial interests in the proceeds of the resales, while foregoing recourse to the land as security for their venture. The developer takes the junior-most interest and ultimately protects all concerned.⁵

The subdivision trust, however, has not been popularly utilized. The major impediment to its widespread employment is the absence of an acknowledged standard form. At present, each subdivision trust must be individually drafted. Since few lawyers are sufficiently versed in the operations of subdivision developments, rarely are the trust forms easily composed. The documents are long and the technical questions raised thereby are often hidden in a mass of verbiage. Unfamiliarity with the device further breeds an inordinate amount of suspicion. Words are scrutinized for hidden meanings and paragraphs serve as the basis for endless debates. As a result, and at great loss to all concerned, the subdivision trust is used less frequently than should be the case.

This article will consider some pitfalls encountered when employing the traditional security devices for mass subdivision developments. The nature and operation of the subdivision trust will be explored, and it will be shown that the subdivision trust presents a workable

tersections, cul-de-sac streets, alleys, pedestrian walks, size and shape of blocks, lot sizes, hillside grading, size and quality of lighting, storm drains, and installation of utilities and street trees. CITY OF LOS ANGELES PLANNING AND ZONING CODE §§ 17.0-17.60 (L.A. City Planning Dept. 1969). All of these required improvements must be complied with and meet the approval of the City Engineer and the City Council. *Id.* § 17.07. Since local regulations are in addition to any applicable state or federal requirements, the cost involved becomes apparent. See generally 3 H. MILLER & M. STARR, CURRENT LAW OF CALIFORNIA REAL ESTATE §§ 874, 878-86 (1971) [hereinafter cited as MILLER & STARR]. See also *Friends of Mammoth v. Board of Supervisors*, 8 Cal. 3d 1, 500 P.2d 1360, 104 Cal. Rptr. 16 (1972) (holding that both public and private developments fall within the purview of the California Environmental Quality Act of 1970 and that environmental impact reports must be filed prior to the issuance of building permits whenever such developments may have a "significant impact" ("non-trivial effect") on the environment).

4. See J.B. SMITH, REAL ESTATE IN CALIFORNIA 234 (8th ed. 1970).

5. Form art. III.9, p. 519 *infra*. See note 51 *infra*; see G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 250 (2d ed. 1964).

solution for many of the problems currently confronting real estate subdivision entrepreneurs and their attorneys. Finally, with the intention of initiating the adoption of a standardized form, a suggested subdivision trust form with comments will be set forth in the appendix to this article.

The standard mechanisms employed in financing the sale of unsubdivided land are the mortgage and deed of trust. A mortgage is defined by statute in California as "a contract by which specific property is hypothecated for the performance of an act, without the necessity of a change of possession."⁶ At common law, a mortgage constituted a fee simple estate in the mortgagee, subject to the subsequent condition that the mortgagor perform some act. The mortgagee thus retained title to the land, until or unless the mortgagor performed the necessary condition of the transaction.⁷ This title theory is retained today in various American states.⁸ In California, however, a mortgage does not convey title and is merely a lien upon the property.⁹ This is so notwithstanding that it may be cast in the form of an absolute con-

6. CAL. CIV. CODE § 2920 (West 1970). In *Spect v. Spect*, 88 Cal. 437, 441, 26 P. 203, 204 (1891), the California Supreme Court indicated that "hypothecate" signifies that possession is not an incident of the mortgage, and that the *fact* of possession is entirely distinct from the *contract* of hypothecation."

7. 2 E. WASHBURN, A TREATISE ON THE AMERICAN LAW OF REAL PROPERTY 34-35 (4th ed. 1876), *see* G. OSBORNE, HANDBOOK OF THE LAW OF MORTGAGES § 14 (2d ed. 1970) [hereinafter cited as OSBORNE].

The fee simple conveyance theory often led to harsh results in the law courts, particularly where the mortgagor was left in possession. As a result, it became established that equity would grant relief to the mortgagor in the nature of an "equity of redemption." *See, e.g.,* *Duchess of Hamilton v. Countess of Dirlton*, 21 Eng. Rep. 539 (Ch. 1654). The mortgagor would be allowed to exercise this equitable right subject to the condition of full payment by a date fixed by the court. OSBORNE, *supra* note 7, § 6. The right to an equity of redemption is guaranteed in California. CAL. CIV. CODE § 2903 (West 1970). California also provides for a right of reinstatement. *Id.* § 2924c. This right cannot be waived as the mortgagor may reinstate the obligation if within three months of a notice of intention to exercise a power of sale or any time prior to the entry of a decree of foreclosure he pays the delinquent amount. *Id.* §§ 2924c, 2953.

The California statutes also provide for "statutory redemption," which is the right to redeem after foreclosure by payment of the purchase price, interest, assessments, and other applicable expenses. CAL. CODE CIV. PROC. § 702 (West Supp. 1972).

8. OSBORNE, *supra* note 7, § 14.

9. *See* *Bank of Italy Nat'l. Trust and Sav. Ass'n v. Bentley*, 217 Cal. 644, 654, 20 P.2d 940, 944 (1933); CAL. CODE CIV. PROC. § 744 (West 1967); CAL. CIV. CODE § 2888 (West 1970). The lien is special (*id.* § 2923) and is therefore one which can be enforced only as security for the performance of a particular act or obligation. *Id.* § 2875. The time of creation of the lien establishes priority of security (*id.* § 2897), although a purchase money mortgage (one given for the purpose of purchasing the security property) is given a first priority subject to the recording laws. *Id.* § 2898.

veyance. The deed of trust, which purports to transfer legal title to a trustee for the benefit of both the debtor and the secured party,¹⁰ is similarly construed in California. Though the trustee is recognized as the holder of legal title,¹¹ the deed of trust merely creates a lien and is construed to be substantially identical to a mortgage with a power of sale.¹²

Both the mortgage and the deed of trust afford the seller or lender a reasonable assurance that the debt which the land secures will either be paid or that an acceptable remedy can be invoked.¹³ At the same time, these devices permit the purchaser to make use of the land. Thus, where the vendee intends to use the property as a single unit

10. See OSBORNE, *supra* note 7, § 17.

11. Bryant v. Hobert, 44 Cal. App. 315, 317, 186 P. 379 (1919); 1 MILLER & STARR, *supra* note 3, at 372. Cf. J. HETLAND, CALIFORNIA REAL ESTATE SECURED TRANSACTIONS § 2.7 (C.E.B. 1970) [hereinafter cited as HETLAND]; Kidd, *Trust Deeds and Mortgages in California*, 3 CALIF. L. REV. 381, 383 (1915).

12. Bank of Italy Nat'l. Trust and Sav. Ass'n v. Bentley, 217 Cal. 644, 656-57, 20 P.2d 940, 944-45 (1933). See Bank of America v. Embry, 188 Cal. App. 2d 425, 428, 10 Cal. Rptr. 602, 604 (1961); Lancaster Security Inv. Corp. v. Kessler, 159 Cal. App. 2d 649, 656, 324 P.2d 634, 638 (1958). The deed of trust is subject to the same restrictions as is the mortgage on (1) foreclosure (CAL. CIV. CODE § 2924 (West 1970)), (2) right of redemption in the event of judicial foreclosure (CAL. CODE CIV. PROC. §§ 702, 725(a) (West 1967)), and (3) the anti-deficiency legislation. *Id.* §§ 580b, 580d, 726 (West 1967 & Supp. 1972).

The total effect is to treat the deed of trust as creating only a lien. Nevertheless, a few distinctions remain between the mortgage and the deed of trust. Where the statute of limitations has run on the underlying debt, a mortgagee may not enforce his lien since it is extinguished. CAL. CIV. CODE § 2911 (West 1970). However, a deed of trust is not made unenforceable since for this purpose it is not a lien to be extinguished. The power of sale may thus be exercised without regard to the enforceability of the underlying debt. Sipe v. McKenna, 88 Cal. App. 2d 1001, 1005-06, 200 P.2d 61, 64 (1948); Summers v. Hallam Cooley Enterprises, Ltd., 56 Cal. App. 2d 112, 114, 132 P.2d 60 (1942). Nor is a trust deed an "encumbrance" within the provision of CAL. PROBATE CODE § 735 (West 1970) requiring discharge by the estate. Weber v. McCleverty, 149 Cal. 316, 321, 86 P. 706, 708 (1906).

13. Upon default, the secured party may, in the absence of a statute to the contrary, either sue on the underlying obligation or proceed to foreclose against the security. In practice, generally, he is effectively limited to the remedy of foreclosure. For instance, the secured party is required to proceed against the security first (CAL. CODE CIV. PROC. §§ 580a, 725a, 726 (West 1967 & Supp. 1972); Roseleaf Corp. v. Chierighino, 59 Cal. 2d 35, 38, 378 P.2d 97, 98, 27 Cal. Rptr. 873, 874 (1963)); he cannot proceed on the underlying obligation for any deficiency if foreclosure is under a power of sale (CAL. CODE CIV. PROC. § 580d (West 1967)); and he cannot in any event proceed on the underlying obligation if it is a purchase money trust deed or mortgage. *Id.* § 580b; 1 MILLER & STARR, *supra* note 3, § 545. There are various exceptions to the general rule that the security must first be foreclosed against: (1) where the security becomes valueless, (2) where relief is sought to prevent waste or to obtain possession, and (3) where there is an endorser of the secured note. *Id.* at 468-72.

and looks to the land as a means of production rather than as a product to be repackaged and sold, these traditional devices are completely adequate. However, where the purchaser is a developer, and the land itself is to be subdivided into saleable lots, the property takes on the aspects of inventory, and the subdivided land becomes the retail merchandise of the "subdivision business."¹⁴

The problems inherent in financing the rapid turnover of land inventory far outstrip the limited capacities of the mortgage or deed of trust. For instance, a developer-mortgagor is unable to record a tract map, dedicate a road, make substantial improvements, or issue bonds without the mortgagee's consent.¹⁵ Even if the mortgagee agrees to join in such matters in the future, his unavailability, incompetence, subsequent refusal or death could severely hamper the development work necessary in the subdivision business.¹⁶ Additionally, employment of the mortgage or the deed of trust as a means of subdivision financing raises the often unattractive problems encountered when foreclosure is sought by the vendor.¹⁷

14. As used herein, "subdivision business" refers to the purchase of large parcels of raw land by the developer which, after being subdivided and improved per governmental requirements, are publicly sold in individual parcels.

15. See Annot., 63 A.L.R.2d 1160 (1959) (discussing the power of a mortgagor to dedicate land). If the land is subject to a lien, it is even more likely that the mortgagor cannot take action affecting the land without the consent of the mortgagee. See *Cherry v. Home Sav. & Loan Ass'n*, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969).

16. It should be noted here that the value of a single lot is affected by the saleability of all parcels in the subdivision.

17. The foreclosure process under either a power of sale in a mortgage or a trust deed is substantially the same and is prescribed by statute. In either case, however, the foreclosure process is burdensome and time-consuming. Moreover, the procedure requires the land to be sold at auction and will rarely bring a market price. The procedure requires first, in the case of the exercise of a power of sale, the recordation of a "Notice of Default and Election to Sell" which must expressly exercise the vendor's right to sell, if any, specify the breach and identify the security instrument. CAL. CIV. CODE § 2924 (West 1970). The notice is for the benefit of the debtor and cannot be waived in the instrument. *Id.* § 2953. The "Notice of Sale" may not be given by the mortgagee until three months after the notice of default has been recorded. *Id.* § 2924. The notice of sale must be mailed to the mortgagor, must be posted on the property and must be published for at least three successive weeks prior to the sale. CAL. CODE CIV. PROC. § 692 (West Supp. 1972). Thus, the shortest period in which sale can be had is one-hundred and eleven (111) days, and in practice the period is actually much longer. Further, failure to comply with notice requirements may invalidate the sale where the mortgagor is the purchaser. See, e.g., *Seccombe v. Roe*, 22 Cal. App. 139, 143, 133 P. 507, 508 (1913) (foreclosure sale conducted prematurely); See 1 MILLER & STARR, *supra* note 3, at 507-08. The same result obtains where there is a defect in the description of the property and the notices are improperly recorded. See, e.g., *Saterstrom v. Glick Bros. Sash, Door & Mill Co.*, 118 Cal. App. 379, 5 P.2d 21 (1931). However, the sale will be held valid where made to third per-

Substitutes designed to ameliorate the effects of the mortgage and the deed of trust have proved inadequate. One such device is the subordination agreement, whereby a debtor and a lien holder agree that the latter will place his lien in a position junior to a subsequently recorded lien.¹⁸ In the process of subdividing land, such agreements are commonly entered into between developers and vendors because of the necessity of obtaining construction loans. Since an institutional lender rarely will take a junior position on such a loan,¹⁹ the seller must agree that his purchase money mortgage will be inferior to the mortgage of the lender.²⁰

By their very nature, subordination agreements are unfavorable to vendors. The only inducement for entering into such agreements seems to be the higher purchase price which may be commanded.²¹ However, the spectre of (1) losing all recourse to the land taken as security and (2) the difficulty of personally suing the developer for any deficiency,²² should be sufficient to put vendors on guard.

sons purchasing for value without notice and there is a recitation of compliance in the sale deed. CAL. CIV. CODE § 2924(c) (West 1970). The sale must be by auction conducted by the trustee, mortgagor, or his agent, and is usually conducted without reservation. CAL. CODE CIV. PROC. § 694 (West 1967); 1 MILLER & STARR *supra* note 3, §§ 496-501. Proceeds of the sale are first applied to costs and attorney's fees, then to lien holders in order of priority; any remaining sums are remitted to the debtor. *Id.* at 501-03. Prior to sale the mortgagor has both a right of equitable redemption (CAL. CIV. CODE § 2903 (West 1970)) and a right of reinstatement of the default obligation. *See* note 7 *supra*. Subsequent to sale the mortgagor has a right of statutory redemption where there has been a judicial foreclosure. *See* note 7 *supra*. However, there is no right of statutory redemption from an exercise of a power of sale. *Penryn Fruit Co. v. Sherman-Worrell Fruit Co.*, 142 Cal. 643, 645, 76 P. 484, 485 (1904); *Py v. Pleitner*, 70 Cal. App. 2d 576, 579, 161 P.2d 393, 395 (1945); *Heney v. Heney*, 80 Cal. App. 301, 317, 251 P. 841, 848 (1926).

In the case of subdivided lands, a single mortgage or deed of trust covering many lots raises all of the problems of blanket encumbrances. *See* notes 31 & 32 *infra*.

18. HETLAND, *supra* note 11, § 5.4. *See* *Middlebrook-Anderson Co. v. Southwest Sav. & Loan Ass'n*, 18 Cal. App. 3d 1023, 1029-30, 96 Cal. Rptr. 338, 341 (1971):

Subordination is, strictly speaking, a status, not an agreement or form of litigation. It refers to the establishment of priority between different existing encumbrances on the same parcel of property, by some means other than the basic priority involved in the concept of "first in time, first in priority," or the automatic priority accorded purchase money liens.

19. HETLAND, *supra* note 11, § 5.4. While by statute a purchase money deed of trust is prior to other liens on real property (CAL. CIV. CODE § 2898 (West 1970)), banks and savings and loans institutions may not lend money on the security of real property unless they hold first-priority liens. CAL. FIN. CODE ANN. §§ 1413(d), 1560, and 7102(a) (West 1968 and Supp. 1971).

20. *See* N. PENNY & R. BROUDE, *CASES AND MATERIALS ON LAND FINANCING* 419 (1970) [hereinafter cited as PENNY & BROUDE].

21. A rule of thumb in the subdivision business puts the price of land with a subordination agreement at 125% of the price of similar land without such an agreement.

22. CAL. CODE CIV. PROC. § 580b (West 1967); *see* *Brown v. Jensen*, 41 Cal. 2d

Nevertheless, the courts have imposed rigid requirements upon the employment of subordination agreements. In *Handy v. Gordon*,²³ the California Supreme Court established that, in order to be enforceable, subordination agreements "must contain terms that will define and minimize the risk that the subordinating liens will impair or destroy the seller's security."²⁴ Finding that the particular contract was not "just and reasonable" as to the parties,²⁵ the *Handy* court noted many specific deficiencies in the suspect subordination clause.²⁶ Though developers and lenders have adopted subordination forms which satisfy the *Handy* requirements, the generally hostile attitude of the courts renders subordination a risky financing device.²⁷

193, 259 P.2d 425 (1953) (section 580b prevents a junior purchase money lender from recovering a personal judgment against the borrower notwithstanding that his security had been exhausted by a senior sale and the junior had no further recourse to the security). *But see* Spangler v. Memel, 7 Cal. 3d 603, 498 P.2d 1055, 102 Cal. Rptr. 807 (1972).

23. 65 Cal. 2d 578, 422 P.2d 329, 55 Cal. Rptr. 769 (1967).

24. *Id.* at 581, 422 P.2d at 330-31, 55 Cal. Rptr. at 770-71.

25. *Id.* at 582, 422 P.2d at 331-32, 55 Cal. Rptr. at 771-72. A contract cannot be specifically enforced against a party unless it is just and reasonable as to him. CAL. CIV. CODE § 3391 (West 1970).

26. *Id.* at 581-82, 422 P.2d at 331, 55 Cal. Rptr. at 771 (e.g., absence of restrictions on the developer's use of the funds, thus leaving the vendor with no assurance that all of the proceeds of the loans would be used to improve the security; the lack of limits on the size and number of lots into which the property was to be divided; the low down payment which failed to provide any security to the vendor; and the three year deferred payment of principal).

Subordination agreements are of several types, but all are contracts between the buyer and seller, and sometimes include the lender. "Express" subordination agreements are those in which a vendor with a recorded lien agrees that it will be treated as junior to a subsequently recorded lien. The subsequent lien can be either a specific loan or any loan meeting certain standards set forth in the agreement. "Automatic" subordination agreements, on the other hand, call for recordation of the lender's lien before a lien in favor of the vendor is recorded. Thus, the lender seeks to secure priority through the operation of the recording statutes and so the term "automatic" is applied. *Handy* considered express subordination, but all such agreements are now held subject to the same legal principles whether "express" or "automatic." *See* Middlebrook-Anderson Co. v. Southwest Sav. & Loan Ass'n, 18 Cal. App. 3d 1023, 1029, 1036-37, 96 Cal. Rptr. 338, 341, 346-47 (1971).

There are statutory requirements for subordination agreements which are under \$25,000 or connected with loans under \$25,000. CAL. CIV. CODE §§ 2953.1-2953.5 (West 1970).

27. *See, e.g.,* Middlebrook-Anderson Co. v. Southwest Sav. & Loan Ass'n, 18 Cal. App. 3d 1023, 96 Cal. Rptr. 338 (1971) (lender's failure to protect seller's security under an automatic subordination agreement affords seller a cause of action); *Butcher v. Daus*, 257 Cal. App. 2d 524, 65 Cal. Rptr. 166 (1967) (in invalidating an unfair express subordination agreement, court took notice of the vendor's relative lack of commercial sophistication as well as his inability to speak English); *Spellman v. Dixon*, 256 Cal. App. 2d 1, 63 Cal. Rptr. 668 (1967) (in invalidating unfair express

Tract-release provisions (release clauses) are a second method of piecemeal financing sometimes used by the retailer of lots. The release clause permits a developer to purchase a large tract of land, release a portion from the vendor's lien by a partial payment, subdivide that portion, and use the sales proceeds from lots in that subdivision to release additional acreage for further subdivision and sale.²⁸ Release clauses are to be found in nearly all transactions involving incremental development of unimproved property,²⁹ and they are apparently subject to the same measure of judicial scrutiny as are subordination agreements.³⁰ The high cost of land, however, makes a tract release provision of little value when lots are sold in a low-payment, rapid sales program. Thus, though they provide a useful means of financing a large development, such provisions are at best a stopgap solution.

Mortgages and deeds of trust are also poorly adapted to the land business because of complex statutory provisions regulating "blanket encumbrances."³¹ These provisions were enacted to remove the danger of foreclosure by the holder of a blanket encumbrance against a subsequent buyer of a portion of the encumbered property.³² Thus, unless

subordination agreement, court took notice of the old age of the vendor).

Additionally, since the terms in subordination agreements are conditions precedent to the waiver of priority by the seller, subordination agreements must meet all the judicial requirements *exactly* in order for there to be a change in priority. See *United States Building & Loan Ass'n v. Salisbury*, 217 Cal. 35, 41-42, 17 P.2d 140, 142-43 (1932); see also *Miller v. Citizens Sav. & Loan Ass'n*, 248 Cal. App. 2d 655, 663, 56 Cal. Rptr. 844, 850-51 (1967).

28. See HETLAND, *supra* note 11, § 5.23; see also Annot., 41 A.L.R.3d 7 (1972).

29. HETLAND, *supra* note 11, § 5.23.

30. See *Lawrence v. Shutt*, 269 Cal. App. 2d 749, 763, 75 Cal. Rptr. 533, 541 (1969); *White Point Co. v. Herrington*, 268 Cal. App. 2d 458, 461, 467-69. 73 Cal. Rptr. 885, 886, 889-91 (1968).

31. See CAL. BUS. & PROF. CODE ANN. §§ 11013-13.5 (West 1964); 10 CAL. AD. CODE §§ 2810-19 (1971).

A "blanket encumbrance" is defined by CAL. BUS. & PROF. CODE ANN. § 11013 (West 1964) as

a trust deed or mortgage or any other lien or encumbrance . . . securing or evidencing the payment of money and affecting land to be subdivided or affecting more than one lot or parcel of subdivided land, or an agreement affecting more than one such lot or parcel by which the owner or subdivider holds said subdivision under an option, contract to sell, or trust agreement.

Such public regulation is, of course, a necessary and proper protection for the retail buyer.

32. State Bar Comm. on Continuing Educ. of the Bar, *Selected 1963 Legislation*, 38 CAL. ST. B.J. 603, 622-24 (1963). Cf. Warren, *California Installment Land Sales Contracts: A Time for Reform*, 9 U.C.L.A.L. REV. 608, 635-36 (1962); Wenig & Schulz, *Government Regulation of Condominium in California*, 14 HAST. L.J. 222, 230 (1963).

The term "blanket encumbrance" is not limited to express liens. CAL. BUS. & PROF.

a blanket encumbrance is accompanied by an unconditional release clause in the sale documents,³³ statutory requirements must be met³⁴ which are much more burdensome than those required when no blanket encumbrance exists.³⁵ Since under the subdivision trust scheme there is no blanket vendor's or lender's encumbrance on the land,³⁶ the problem of such encumbrances is avoided.³⁷

The subdivision trust must be differentiated from the static or land holding trust. The latter is merely a device to place title in a trustee for the convenience of the true owner of the land. Lots are sold on contract from the developer whose interest in the land is held in trust. The trustee is only required to transfer title to the purchaser when an appropriate proportion of the purchase price has been paid to the developer, who in turn pays over a portion to the vendor in satisfaction of the original vendor-developer sale.³⁸ In the land holding trust, the vendor retains a traditional mortgage, and the trust thereby acts as an escrow device, raising the same financing problems as do the traditional security devices. The subdivision trust, on the other hand, is an active financing trust.³⁹ The trustee takes the land of record in his own

CODE ANN. § 11013 (West 1964); See 3 MILLER & STARR, *supra* note 3, § 859. Thus where work is performed or material is delivered affecting more than one lot of a subdivision, a blanket encumbrance arises in favor of the improver. 37 OP. ATT'Y. GEN. 180, 181-82 (1961). Taxes and assessments, however, are specifically excluded from the definition of blanket encumbrances. CAL. BUS. & PROF. CODE ANN. § 11013.3 (West 1964).

33. CAL. BUS. & PROF. CODE ANN. § 11013.1 (West Supp. 1972).

34. *Id.* § 11013.2.

35. Compare 10 CAL. ADM. CODE §§ 2814-14.5 (1971) and CAL. BUS. & PROF. CODE ANN. § 11013.4 (West Supp. 1972) with CAL. BUS. & PROF. CODE ANN. § 11013.2 (West 1964).

36. See note 37 *infra*.

37. The trustee is fee owner in a subdivision trust, and his contract is ahead of the claims of the trust beneficiaries. The release provisions of the subdivision trust form are not title matters at all, but relate to payments to the secured beneficiaries. See Form, art. XII.5 and comments, p. 541 *infra*. The regulations for situations not involving blanket encumbrances are also detailed, but are not as demanding as those applicable when such encumbrances exist. See note 35 *supra*.

38. See Schwind, *Land Trusts*, 101 TRUSTS & ESTATES 650 (1962). The land holding trust must be further differentiated from the Real Estate Investment Trust (REIT), wherein the trustee or trustees actively control and invest the funds contributed by the beneficiaries for the purposes of gain and profit. See 37 ST. JOHN'S L. REV. 123, 124 (1962). The REIT, like the real estate syndicate, is heavily regulated by both state and federal law. *E.g.*, INT. REV. CODE of 1954, §§ 46(d)(1)(B), 58(f) and 856-58; CAL. CORP. CODE ANN. §§ 2300-003 (West Supp. 1972); CAL. REV. & TAX. CODE ANN. § 24413 (West Supp. 1972). See Furin, *Legal Considerations With Respect to the Formation of a Real Estate Investment Trust*, 7 LAW NOTES 22 (1970).

39. While much of the law developed around the land holding trust should be equally applicable to the subdivision trust, it should be noted that the land holding

name in fee simple. While the deed in fee to the trustee is recorded, the trust agreement is not. This gives record title to the trustee in fee with the power to convey full title to third parties who purchase from the trustee without notice and for value.⁴⁰ The reliance of the secured parties thus shifts from the land to its proceeds and, since the trustee is a corporation charging a fee for the service,⁴¹ from the recording statutes to the integrity of the trustee. The trustee is empowered to convey the land, just as in the land holding trust, and holds all title and interest to the property in fee with no real property interest in any other party.⁴² The vendor, prior sellers, and the developer are beneficiaries of the trust and hold both personal property interests in the trust proceeds and the right to enforce the trust provisions; however, they have no in-

trust, unlike the subdivision trust, is often used as a holding device for improved property. As such, it has been condemned as a device which allows landlords to hide their identity and thereby avoid performance of their legal duties. *But see* Garret, *Land Trusts*, 1955 U. ILL. L.F. 655, 660. The subdivision trust, however, has many of the characteristics of the familiar trust deed: the operating beneficiary under the subdivision trust has the right to dissolve the trust as to unsold lots by paying off the note and taking the land, much as the trustor of a trust deed has the right to take full title to the land by paying his debt to the trust deed beneficiary.

40. *See* CAL. CIV. CODE § 869 (West 1970). The ultimate lot purchaser would qualify as a purchaser for value under section 869, except in unusual circumstances. *See, e.g.*, *Title Guarantee & Trust Co. v. Henry*, 208 Cal. 185, 191-92, 280 P. 959, 961 (1929). In any event, the purchaser would have recourse against the trustee as seller for breach of contract. *See* 50 CAL. JUR. 2d, *Vendor & Purchaser* §§ 272-98 (1959).

41. *See* CAL. FINANCIAL CODE ANN. § 1500 (West 1968); 10 CAL. ADM. CODE § 2814.6(a) (1969) (trustee must be a qualified corporate trustee in order to comply with the subdivision regulations).

42. CAL. CIV. CODE § 863 (West 1970);

[E]very express trust in real property, valid as such in its creation, vests the whole estate in the Trustees, subject only to the execution of the trust. The beneficiaries take no estate or interest in the property, but may enforce the performance of the trust.

The trustee does not necessarily take a fee estate, but only such estate as is required to execute the trust. *Title Ins. & Trust Co. v. Duffill*, 191 Cal. 629, 648-49, 218 P. 14, 21 (1923); *Keating v. Smith*, 154 Cal. 186, 192, 97 P. 300, 303 (1908). Nevertheless, this estate is generally considered to have most, if not all, of the attributes of fee title. *Cf.* *Security Trust & Sav. Bank v. Southern Pac. R.R.*, 214 Cal. 81, 87, 3 P.2d 1015, 1018 (1931); *Houghton v. Pacific Southwest Trust & Sav. Bank*, 111 Cal. App. 509, 511, 295 P. 1079, 1080 (1931). Additionally, it is settled in California that in a land or subdivision trust where the trustee is empowered to convey, the power vests both legal and equitable title in the trustee and gives no title to the beneficiaries on the ground that the grant of such power is an expression of the intent of the parties to convey full title. *See* *Ephraim v. Metropolitan Trust Co.*, 28 Cal. 2d 824, 835, 172 P.2d 501, 508 (1946); *Smith v. Bank of America Nat'l Trust & Sav. Ass'n*, 14 Cal. App. 2d 78, 86, 57 P.2d 1363, 1367-68 (1936) (upholding a provision in a subdivision land trust which gave the beneficiaries only a personal property interest in the proceeds of the trust). *Cf.* G. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* §§ 184, 185, 250 (2d ed. 1964-65); *see also* *Lake v. Dowd*, 207 Cal. 290, 277 P. 1047 (1929).

terest in the land as such.⁴³ Thus, the trustee can convey the land for its full value free of all encumbrances and can enter into sales agreements with the ultimate purchasers without fear of potential beclouded titles. Additionally, the buyer cannot lose his lot or be forced to pre-pay his debt.⁴⁴ These provisions thus enhance the saleability of the property, the protection of the purchasers, and the ultimate success of the development.⁴⁵

The subdivision trust contemplates no limit to the number of beneficiaries. They are assigned priorities of beneficial interest and, in consideration of the transfer of land or liens to the trust, are guar-

43. See *Ephraim v. Metropolitan Trust Co.*, 28 Cal. 2d 824, 835-36, 172 P.2d 501, 508-09 (1946); *Wright v. Security-First Nat'l Bank*, 35 Cal. App. 2d 264, 272-77, 95 P.2d 194, 198-200 (1939); *Bank of America Nat'l Trust & Sav. Ass'n v. Sparr Realty Corp.*, 20 Cal. App. 2d 10, 14-17, 66 P.2d 476, 478-80 (1937); *Smith v. Bank of America Nat'l Trust & Sav. Ass'n*, 14 Cal. App. 2d 78, 86, 57 P.2d 1363, 1367-68 (1936); *cf. Estate of Tutles*, 204 Cal. App. 2d 481, 490-92, 22 Cal. Rptr. 427, 433-34 (1962).

The beneficiary is deemed to have a personal property interest either because of the express terms of the trust or on grounds of equitable conversion. See G. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 185 (2d ed. 1965); DeWitt, *The Illinois Land Trust—Its Undeveloped Potential in California*, 41 L.A.B. BULL. 20, 59-60 (1965); Garrett, *Land Trusts*, 1955 U. ILL. L.F. 655, 662-63.

Should a beneficiary's share of the flow of the proceeds be insufficient to satisfy the monthly note payments due him, he may cut off the interests of all junior beneficiaries. By doing so, he does not affect the rights or duties of the trustee or the purchasers of the land (see Form art. VII.4, p. 533 *infra*), but merely assumes the rights of the junior claimants. Although it is a personal property interest which is terminated, it is procedurally treated in the subdivision trust as though it were a real property foreclosure under a power of sale. See Form art. VII, p. 532 *infra*.

Since the vendor in effect conveys real property to the trustee in return for a personal interest in the proceeds of the sale, it might be asserted that the subdivision trust constitutes a secured transaction within the ambit of article 9 of the UCC, thereby requiring perfection. However, section 9-104(j) of the code provides that: "This Article does not apply . . . to the creation or transfer of an interest in or lien on real estate. . . ." Although the article does apply to the giving of a mortgage to secure payment of a note, the beneficiary under the subdivision trust is given no lien against the property to enforce his security. His remedy is limited to enforcement of the trust rights granted under the agreement. He has no recourse to the property itself. See 4 ANDERSON, *UNIFORM COMMERCIAL CODE* § 9104.4(j) (1971). However, the interest in the proceeds would itself be a general intangible requiring the filing of a financing statement should the beneficiary offer it as security to a lender. *Id.*, citing *Levine v. Pascal*, 94 Ill. App. 2d 43, 236 N.E.2d 425 (1968).

44. See Form art. III.1, p. 514 *infra*.

45. For example, creditors of the beneficiaries cannot attach the land or place a lien against the trust corpus. *Houghton v. Pacific Southwest Trust & Sav. Bank*, 111 Cal. App. 509, 295 P. 1079 (1931). This view is in accordance with the rule that a creditor cannot hold an interest greater than that held by the beneficiary of the trust. *Walker v. Doak*, 210 Cal. 30, 34-35, 290 P. 290, 292 (1930). See DeWitt, *The Illinois Land Trust—Its Undeveloped Potential in California*, 41 L.A.B. BULL. 20, 60-61 (1965).

anted certain receipts from the proceeds of the sale of each lot, fixed payments on the notes given by the developer, or other remuneration agreed upon by the parties. The vendor-trustor is the first beneficiary and, with reference to his personal property interest in the trust, is placed in a position similar to that of the holder of a first trust deed note. The second beneficiary is in a position analogous to the holder of a second trust deed note, and so on.⁴⁶ These beneficiaries are collectively designated as "secured beneficiaries." The lowest in priority is the developer or "operating beneficiary," and it is he who indemnifies the trustee. The operating beneficiary is vested with the responsibility of paying taxes and managing the trust estate's real property,⁴⁷ conducting sales,⁴⁸ obtaining and maintaining licensing and advertising,⁴⁹ providing sufficient funds to redeem deficits on obligatory payments,⁵⁰ and, finally, indemnifying all of the other beneficiaries.⁵¹ Thus, although the trustee takes record title free of any control, the trust agreement, which is not recorded, affords the operating beneficiary the effective power to develop the land.⁵² He subdivides the land, though the subdivision map is filed in the name of the trustee.⁵³ He develops and improves the land, but the development is carried on in the name of the trustee. He conducts the sales campaigns, but the sales contracts or deeds are executed by the trustee.⁵⁴ In sum, it is the operating beneficiary who actually retails the land.

46. See Form arts. V.3.a-V.3.d, VII.1, pp. 527 *infra*.

47. See Form art. I.7, p. 508 *infra*.

48. See Form art. III.5, p. 516 *infra*.

49. See Form arts. III.6, III.7, pp. 517-19 *infra*.

50. See Form art. II.4, p. 513 *infra*.

51. See Form art. III.9, p. 519 *infra*. The trustee is contractually exempted from all liability (see Form arts. I.4, I.6, pp. 507-08 *infra*), but may carry and demand insurance at the expense of the trust estate. Form. art. I.5, p. 509 *infra*.

As long as the beneficiaries and the trustee have no control over the management of the trust property, it is arguable that they may not be held responsible for injuries to third parties resulting from negligent construction, misrepresentation, or other tortious conduct. See *Richman v. Green*, 143 Cal. App. 2d 470, 299 P.2d 890 (1956); G. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 731, at 532 (2d ed. 1964):

Liability of the trustee is predicated not merely on the holding of title, but also on possession and control. . . . [I]f the cestui is in possession of the trust land under the terms of the trust, the duties of maintenance fall upon him. *Accord*, *Pena v. Steward*, 78 Ariz. 272, —, 278 P.2d 892, 897 (1955); *Fields v. 612J Indiana Ave. Apt's, Inc.*, 47 Ill. App. 2d 55, —, 196 N.E.2d 485, 487 (1964); *Compare Bianchi v. Western Title Ins. & Guar. Co.*, 14 Cal. App. 3d 235, 96 Cal. Rptr. 750 (1970) (holding trustee's activities sufficient to impose tort liability).

52. See Form art. III.1-III.7, pp. 514-19 *infra*.

53. Form art. III.2, p. 514 *infra*. The operating beneficiary is, however, identified in the public report required under California law.

54. See Form art. III.1-III.8, pp. 514-19 *infra*.

Sales to the ultimate purchasers may be conducted through land contracts, deeds and deeds of trust, or other conventional means of sale.⁵⁵ The purchase money is received and held by the trustee for the benefit of all beneficiaries.⁵⁶ As particular payments are received, the gross receipts are divided and distributed among the several beneficiaries as called for in the trust instrument.⁵⁷ A fixed sum may go to each secured beneficiary and the balance may go to the operating beneficiary; various percentages of each payment may be distributed to the beneficiaries; or a fixed sum may be distributed to the operating beneficiary and the balance to the secured beneficiaries. Notwithstanding the manner of allocation, the parties are assured by the integrity of the trustee that the funds will be properly and efficiently administered.

Since the device of the subdivision trust is in its legal infancy, certain unanswered questions remain regarding its operation. Particularly, it is still unsettled whether the provisions relating to deficiency judgments in the Code of Civil Procedure⁵⁸ will apply to forestall a de-

55. The trustee is to be treated in the same manner as any other vendor of real property. *See* *Goldwater v. Oltman*, 210 Cal. 408, 426, 292 P. 624, 631 (1930). Thus, in a buyer rescission action brought by a purchaser, the trustee is charged with the repayment of funds wrongfully received. *Newcomb v. Title Guar. & Trust Co.*, 131 Cal. App. 329, 332, 21 P.2d 456, 457 (1933). The trustee, who hires brokers in his own name, is also charged with the responsibility of paying the broker's sales commissions. *See Case v. McConnell & Forrester*, 5 Cal. App. 2d 688, 692-93, 44 P.2d 414, 416 (1935). Additionally, when the purchaser buys in reliance upon a misrepresentation by the developer or the developer's salesman, the trustee is treated as the principal of the misrepresentation so as to permit rescission of the contract. *See Graham v. Los Angeles First Nat'l Trust & Sav. Bank*, 3 Cal. 2d 37, 42, 43 P.2d 543, 546 (1935); *cf. Longway v. Newbery*, 13 Cal. 2d 603, 613-15, 91 P.2d 110, 114-115 (1939).

In an ordinary land trust situation, when the contract of sale is actually between the developer and the purchaser, the trustee is the agent while the developer is the misrepresenting principal. *Hill v. Citizens Nat'l Trust & Sav. Bank*, 9 Cal. 2d 172, 174-75, 69 P.2d 853, 855 (1937); *cf. Luce v. Sutton*, 115 Cal. App. 2d 428, 432, 252 P.2d 352, 355 (1953).

The trust agreement form proposed herein provides for full indemnification of the trustee for liability ensuing from actions taken under the direction of the developer, and for any other liability the trustee may incur in connection with a conveyance of the property. *See* Form art. I.6, p. 508 *infra*.

56. *See* Form art. II.3, pp. 511-13 *infra*.

57. *See id.*

58. CAL. CODE CIV. PROC. § 580a (West Supp. 1972) (limiting the creditor's judgment after exhaustion of the security to the difference between the fair market value of the property at the time of a nonjudicial foreclosure sale, and the amount of the judgment or obligation for which the property was security); *id.* § 580b (West 1967) (barring a deficiency judgment if the secured obligation represents part of the purchase price of the real property by which the obligation is secured); *id.* § 580d

iciency judgment against a defaulted developer. The subdivision trust characterizes the developer's beneficial interest as a personal property interest.⁵⁹ Should the courts concur, a deficiency judgment against the developer would not be expressly barred by the statutes.⁶⁰ However, should the courts deem the subdivision trust analogous to the trust deed—the developer as trustor, the subdivision trustee as trustee, and the lender as beneficiary—the anti-deficiency legislation would apply. It is probable that in the first such case to test the applicability of the anti-deficiency statutes the actual equities before the court will control; nevertheless, the essentially active nature of the trustee,⁶¹ the record title in favor of the trustee,⁶² and the clear terms of the trust⁶³ would indicate that, technically, the operating beneficiary's interest should fall beyond the scope of the anti-deficiency legislation. It is not necessary, however, to leave resolution of this issue to the vagaries of future litigation. It is both fair and expedient to provide in the express terms of the trust whether the operating beneficiary shall incur personal liability by reason of the trust, and whether the remedy of the secured beneficiaries should be limited to termination of his interest in the trust. Such a provision is in fact included in the following form.⁶⁴

Today, the deed of trust is almost universally employed because a standard printed form is available. A standard form should also be made available for the use of the subdivision trust,⁶⁵ particularly because of the advantages of the device, only briefly outlined in the preceding pages. The form presented in the following appendix is hereby

(barring a deficiency judgment after foreclosure by power of sale). *See id.* § 726 (West Supp. 1972) (prescribing that the secured creditor may be required to foreclose by the court if he wants judicial action to collect a secured obligation).

59. Form art. VIII.1, p. 535 *infra*. *See* text accompanying notes 39-43 *supra*.

60. The statutes are limited to deficiency judgments following a sale of *real property*. *Cf.* *Smith v. Bank of America Nat'l Trust and Sav. Ass'n*, 14 Cal. App. 2d 78, 57 P.2d 1363 (1936) (upholding a provision in a subdivision land trust which gave the beneficiaries only a personal property interest in the proceeds of the trust).

61. *See* text accompanying notes 39-45 *supra*.

62. *See* text accompanying note 40 *supra*.

63. *See* Form art. VIII.1, p. 535 *infra* (declaring beneficiaries' interests to be personal property only); *Smith v. Bank of America Nat'l Trust & Sav. Ass'n*, 14 Cal. App. 2d 78, 57 P.2d 1363 (1936).

64. *See* Form art. VII.5, p. 535 *infra*. Of course, an agreement in the trust that a deficiency is permitted may be held to be contrary to public policy and therefore unenforceable.

65. An abbreviated form, designed to meet the needs of Arizona subdivision transactions, was proposed in Carlock, *The Subdivision Trust—A Useful Device in Real Estate Transactions*, 5 ARIZ. L. REV. 1, 15 (1963).

submitted as the first tentative step toward development of a model standard form. The proposed form has been compiled with a view to the needs of the developer, the vendor, and the buyer. It is the author's hope that through extensive public debate and analysis a final document may be modeled that will enable the entire subdivision industry to use a simplified and equitable standard printed form for the complicated business of subdividing and retailing land.

APPENDIX

TRUST AGREEMENT AND DECLARATION OF TRUST

SECURED BENEFICIARIES:

FIRST BENEFICIARY

SECOND BENEFICIARY

ETC.

OPERATING BENEFICIARY:

[Last] BENEFICIARY:

TRUSTEE:

DATE:

TRUST NUMBER:

Comment:

A cover sheet and index are useful when the forms are individually prepared, although they may not be needed in a standard printed form. There is no need for a separate Trust Agreement and Declaration of Trust. The single subdivision trust instrument contains both, for it is usually best to have the entire transaction contained in a single document. The Trust Number is necessary for reference and accounting purposes. The following index should be helpful in locating particular provisions as well as providing an overview of the trust.

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A	Real Estate	I.1, I.2, I.3.
B	Title Exceptions	I.5.
C	Request for Reconveyance	II.2.c.
D	Note to First Beneficiary	II.1.a, VII.5.

TRUST AGREEMENT AND DECLARATION OF TRUST

Trust Number _____

This Trust Agreement and Declaration of Trust made, declared and entered into this [Date], by and between [list secured parties in order, ascribing numbered beneficial interests in sequence to each] (herein "First Beneficiary"), [at end of names of secured parties, insert name of Developer] (herein [Number] "Beneficiary" or "Operating Beneficiary"), and _____, a corporation duly authorized to transact trust business under the laws of the State of California (herein "Trustee"):

ARTICLE I.

THE TRUST

I.1. *Trust Estate.* The Beneficiaries hereof have caused to be transferred and delivered to Trustee, without consideration, their several interests in and to that certain real property described in Exhibit "A" annexed hereto and hereby incorporated herein by reference, which property, together with all other property which may hereafter become

subject to this Trust, shall constitute and be hereinafter designated as the "Trust estate". The Exhibit "A" property is located in [specify County and State]. Whenever any act or thing is to be done in the County and/or State where the real property is located, it means the aforesaid County and/or State, as the case may be.

Comment:

Although the primary trust asset is the real property, the trust will also encompass existing appurtenances, sales receivables and other assets arising from time to time. Note that the trust does not exist until the land is placed of record in the name of the trustee. See text accompanying notes 39-40 *supra*.

I.2. *Trust Purposes.* The Exhibit "A" property has heretofore been purchased by Operating Beneficiary from [Number] Beneficiary. The purposes of this Trust are (a) to provide a convenient method for the subdivision, resubdivision, improvement, sale and resale by Operating Beneficiary of the Exhibit "A" real property or any part thereof, and of the several lots which may be created out of the same, and (b) to secure to all Beneficiaries their respective rights and interests in the Trust Estate and the proceeds thereof, and (c) to protect the legitimate interests in specific portions of the Exhibit "A" real property of all persons purchasing or otherwise acquiring such portions thereof or interests therein, all as more particularly hereinafter set forth.

Comment:

This general statement of purposes is necessary gloss designed to give the developer flexibility. Subsection c is essential for the protection of buyers. See text accompanying notes 43-44 *supra*.

I.3. *Right of Possession.* As between Trustee and all Beneficiaries, the Beneficiaries have reserved to themselves the exclusive possession, control and use of the Trust Estate's real property, without rental or other accounting therefor to Trustee. As among the Beneficiaries, subject to the rights set forth herein of each Secured Beneficiary, Operating Beneficiary shall be entitled to, and shall retain, the exclusive possession, control, management and use of the Trust Estate's real property for the purposes specified herein; except that any Beneficiary and/or Trustee may enter upon any property then subject to his beneficial interest at all reasonable times to assure himself that all parties are adhering to the terms hereof.

Comment:

This clause gives general control of land use for the purposes specified in the preceding clause to the operating beneficiary, similar to that of the trustor of a deed of trust, even though the operating beneficiary

never acquires "title" to the property. See text accompanying notes 42-43 *supra*. Note also that the secured beneficiaries retain here a limited right to enter and inspect.

I.4. *Liability of Trustee.* No Beneficiary shall under any circumstance have any power to do or to perform any act for or in the name of or binding upon Trustee unless previously authorized in writing by Trustee to do so; and no Beneficiary shall incur any liability nor suffer any to be incurred in connection herewith for which Trustee may become chargeable. Should they or any of them incur or suffer to be incurred any such liability, Trustee shall have in addition to any other rights granted hereunder or by law, a lien upon the income and/or corpus of the Trust Estate payable to such Beneficiary to assure reimbursement therefor, together with the right to collect and take the same into its possession.

Comment:

It is clear from the nature of the property interests in the trust that the beneficiaries should not be able to intentionally encumber the land. This clause is intended to protect the trustee, to the extent any contract could do so, from other kinds of liability. It does not answer the issue of the trustee's or secured beneficiaries' ultimate liability, resolution of which must await judicial clarification. See notes 40 & 51 *supra*, discussing liability of the trustee.

I.5 *Insurance.* Trustee may carry at the expense of the Trust Estate such kinds and amounts of insurance as it may deem necessary from time to time for its own protection. Concurrently with the delivery to Trustee of the Exhibit "A" real property, [Insert Number] Beneficiary shall provide Trustee with a policy of title insurance assuring Trustee that Trustee is the record owner of all of said property free and clear of all liens, claims or encumbrances, except as set forth in Exhibit "B", attached hereto and hereby incorporated herein by reference.

Comment:

Ordinarily only standard title insurance is economically available, as the parties are usually dealing with large tracts of vacant land. In special cases, other title endorsements might be used. If there are existing improvements, they must also be insured upon delivery. Public liability insurance is usually demanded by the trustee. Exhibit "B", *infra*, uses the title insurance policy list of exceptions and should include the printed exclusions. Which beneficiary is to bear the cost of title insurance and title search is a matter of business negotiation. Since the trust usually is created at the time of a land purchase, those costs are generally treated as part of the sales escrow.

I.6 *Indemnification of Trustee.* Any Beneficiary may direct Trustee to do any act contemplated herein or to prosecute or defend any action affecting such Beneficiary, Trustee and/or the Trust Estate. Trustee, however, shall in no event be required (a) to so prosecute or defend, or (b) to execute any deed, contract or other instrument (except that Trustee must deliver a deed in pursuance of an executory land sales contract on compliance by the Buyer with all of the terms and conditions thereof), or (c) to do any act or thing which in Trustee's absolute judgment may subject it to liability to any person whomsoever, unless the Beneficiary giving such direction shall in manner and amount satisfactory to Trustee, and in Trustee's absolute judgment, indemnify Trustee against such liability, and all costs and expenses in connection therewith.

Comment:

The project will be handled by the developer in the trustee's name, and this section is intended to protect the trustee by giving him some measure of control over the developer. See text accompanying notes 51-55 *supra*. Obviously the operating beneficiary takes the risk that the trustee may arbitrarily refuse to do a "reasonable" act. This is a necessary business risk to the developer, and one which is not very serious in fact, so long as the developer acts in a normal manner. Corporate trustees desire trust business; to act too arbitrarily would lose the business. Thus, the clause is primarily for the benefit of the trustee and operates as a sword to accompany the indemnity shield of clause I.4. Moreover, the clause again emphasizes the duty to convey to the lot purchaser first set forth in clause I.2.

I.7. *Taxes, Management, etc.* Operating Beneficiary alone, and not Trustee nor any other Beneficiary, shall insure, pay taxes and assessments, both general and special, upon and, generally, manage, care for and protect the Trust Estate's real property. The owners of personal property located on the real property, and not Trustee, shall severally be responsible for the insurance and safety thereof. Each Beneficiary shall have the sole and exclusive right to amend this Trust Agreement in any particular affecting or involving only the rights or privileges of such Beneficiary and not any other Beneficiary or other party interested hereunder or Trustee; or, together with all Beneficiaries, other parties interested hereunder and Trustee, amend this Trust generally; but no amendment shall deprive Trustee of fees or reimbursement to which it is then entitled under the terms hereof nor in any way adversely affect the position of any party interested hereunder, expressly including any contract purchaser of land from Trustee, with-

out its or their prior written consent. Copies of such proposed amendment(s) shall be served at least five (5) days before the effective date(s) upon Trustee and any Beneficiary junior to the Beneficiary requesting such amendment.

Comment:

Generally, personal property on the land will not be placed in the trust, as it is usually of small value; therefore, it seems appropriate to require the owner to insure. In the operation of a tract, many day-to-day decisions of operation are needed, and some may be contrary to the express terms of the trust, although not to its purpose. The amendment language permits operations which only affect one party. It also permits larger changes after some of the secured beneficiaries have been paid in full, for example the splitting of the trust into identical sub-trusts to facilitate the assignment or sale of the operating beneficiary's interest in proceeds of sold lots, while retaining his interest and duties toward unsold lots. Of course, the operating beneficiary must convince the trustee that the change affects only that beneficiary. The reference to "other parties" is intended to include contract lot purchasers.

I.8. *Advance of Funds.* To carry out the purposes of this Trust, Trustee may advance funds for the account of any Beneficiary in this Trust for any trust purpose and may reimburse itself from principal or income accruing to such Beneficiary for the same and any loss or expense incurred thereby, and may exercise such other rights, privileges and powers granted herein or by law. All such advances for the account of any Beneficiary, with interest at then current rates, shall be a first lien on the interest of such Beneficiary, and be repaid out of such Beneficiary's share of principal and/or income hereof.

I.9. *Separate Trusts.* Should real property held in the Trust Estate be situated in more than one local assessment district, property within each district shall be treated as though it were a separate Trust in all matters in any way affecting impounding and payment of any taxes and assessments hereunder.

Comment:

Special problems of tax impounds may arise when lot purchaser payments are being received on only part of a tract or if a tract overlaps separate districts. In these cases, the lots for which payments are made may be called upon to bear all taxes for the tract districts. The buyer only pays his proper amount; the excess would therefore derive from sums otherwise payable to the operating beneficiary. This provision creates separate impounds by districts, so that the flow from lots outside a given district will not be burdened with impounds for that district. Thus, it operates for the benefit of the operating beneficiary.

ARTICLE II

BENEFICIARIES

II.1.a. *Interest of First Beneficiary.* The interest of First Beneficiary in this Trust and the Trust Estate is hereby declared to be the payment, in lawful money of the United States, of the principal sum of [Insert Amount] represented by a note in said sum made payable to First Beneficiary, dated concurrently herewith and declared therein to be secured hereby, all as set forth in Exhibit "D" annexed hereto and incorporated herein by reference.

[Repeat II.1.a. with different principal amounts and exhibit numbers as to all secured beneficiaries, numbering the paragraphs II.1.b. etc.].

Comment:

Some trusts operate without a separate note executed by the operating beneficiary to the vendor, relying solely on the trust instrument. It would seem better to employ a note, so that the beneficiary has a demonstrable interest which can be pledged or otherwise given as security, and also to facilitate proof of payment. Further, use of a note is similar to a traditional real estate transaction and is thus more likely to be found acceptable by the seller. The note alone, of course, is not an encumbrance on the property, even though it refers to the trust agreement.

II.2.a. *Obligatory and Optional Payments.* The minimum required payments or principal and/or interest called for in each note payable to a Secured Beneficiary hereunder are herein called "obligatory payments." All permitted payments in excess of obligatory payments are herein called "optional payments".

Comment:

These are simply definitions, and could be placed elsewhere in the instrument, but this position following the clause dealing with the note seems most appropriate.

II.2.b. *Prepayment.* Operating Beneficiary reserves the right to pay in advance at any time and without penalty any part or portion of any installment of principal and/or interest called for in each note payable to a Secured Beneficiary hereunder, except that no optional payment may be made prior to the first day of January immediately following the date hereof.

This, of course is a business matter. In practice, optional payments are only made as lots are released or out of sales proceeds. The last clause is to protect the vendor's election of installment sale tax treatment. See INT. REV. CODE of 1954 § 453.

II.2.c. *Request for Reconveyance.* Upon payment in full of all

sums secured thereby, each Secured Beneficiary shall return the note(s) evidencing the same to Trustee for cancellation together with an acknowledgment of receipt of payment and request for reconveyance in the form annexed hereto as Exhibit "C" hereof or on such other form as Trustee may reasonable require.

Comment:

A separate request for a reconveyance document seems indicated to facilitate demonstration that the beneficiary has been paid in full. The reconveyance procedure has heretofore been acceptable to trustees.

II.3.a. *Gross Receipts.* The parties recognize that Operating Beneficiary intends to cause the subject property to be subdivided and to sell or lease portions of the property thereafter to others. In such event all funds derived therefrom shall be received by Trustee. Except for release payments made pursuant to this Agreement, all funds are to be received by only the Trustee from the sale and/or lease of any portion of the Trust Estate's real property or any interest therein, or from any other disposition thereof, and include, but are not limited to, down payments, principal and interest on deferred payments, penalties and other charges if imposed. Improvement bond payments if included in the purchase price, rental and option payments, less all refunds authorized by Operating Beneficiary and also less property taxes or other imponds paid in trust to trustee, but without any other offsets or deductions, are herein called "gross receipts".

Comment:

This provision is necessary to assure the secured beneficiaries that the proceeds will be collected solely by the trustee and for their protection. The clause presented here is inclusive of all sums; business reasons may dictate a different allocation. In some cases down payments or other specific classes of payments have been made payable to the developer.

This clause also excepts release payments, as defined in clause II. 3.b, from the definition of "gross receipts", since they relate to different economic events. Release payments are payments made by the developer for release of certain lots to him, or by purchasers to release their lots from any interest of the trust, whereas gross receipts payments are interim payments by lot purchasers on their sale contracts and represent the ordinary cash flow of the trust. *See also* Form art. IV.

II.3.b. *Payments to Secured Beneficiary.* Any payments to be made to any Secured Beneficiary from gross receipts currently as received will be hereinafter described as "gross receipts payments". Payments for the release of lots or acreage may periodically be paid to each Secured Beneficiary. Such payments will be hereinafter described

as "release payments." Gross receipts payments, if called for, and release payments shall be accounted for and disbursed monthly to each applicable Beneficiary at such reasonable time as Trustee may determine. Monthly statements of all such payments to each Secured Beneficiary shall be given to every Secured Beneficiary. Each such payment shall apply first to interest, if any, due up to the time of such payment, and the balance, if any, of such payment shall apply to principal. All principal paid by gross receipts payments and/or release payments shall be applied against the next as yet unpaid obligatory payment due on the note to the Secured Beneficiary so paid.

Comment:

There are many ways secured beneficiaries can be paid. This and the succeeding paragraphs adopt a payment procedure requiring payment to them of a percentage of the trust's cash flow and of release payments, both of which are applied against obligatory payments as defined in article II.2.a. In some trusts there are no "flow" payments, but merely obligatory and release payments. Payment provisions must be adjusted to fit each particular case; the application of payments is also a matter for negotiation. Thus, gross receipts payments or release payments, in addition to obligatory payments, may be made payable to the secured beneficiaries, and optional payments need not apply to the next obligatory payment, but may be deferred until the end of the debt.

II.3.c. *Shares of Gross Receipts.* There shall be applied against the obligations owing to each Secured Beneficiary a sum equal to [Insert portion] per cent of the gross receipts. All gross receipts payments payable under this Declaration jointly to several Secured Beneficiaries shall be allocated among them in the ratio of [Insert] until such time as one of said Beneficiaries shall be paid in full; thereupon, the entire amount of such payments shall be paid to the remainder of such Beneficiaries; and upon payment in full to all Secured Beneficiaries, the payments shall cease.

Comment:

This section covers the situation where there are several secured beneficiaries who may have different interests. This might occur when the vendor or the developer himself owed money to a prior lender, and both are willing to take beneficial interests in the trust, or where several vendors agree that their property shall be in a single trust, and share in the total proceeds.

II.3.d. *Payments Cumulative.* Notwithstanding any other provision hereof or of any Exhibit hereto, Operating Beneficiary shall not be in default under its note to any Secured Beneficiary if the total cumula-

tive payments paid to all Secured Beneficiaries (regardless of how allocated among them) shall be at least equal to the cumulative obligatory payments specified in all of said notes.

Comment:

This clause is intended to protect the operating beneficiary from claims of default on a note where the cash flow is divided in a proportion different from that of the sums owing to each secured party and in effect is an agreement among the secured parties to accept such a division.

II.3.e. *Release Payment Allocation.* All release payments payable to several Secured Beneficiaries shall be allocated among them in the same ratio as hereinabove provided for the division of gross receipts payments.

Comment:

This clause provides for the allocation of release payments in a manner analogous to that of gross receipts. See Form art. IV. Other dispositions of the funds may of course be provided.

II.4. *Deficits.* Should release payments [add "and gross receipts payments" if applicable] theretofore paid be insufficient to pay in full the obligatory payment due any Secured Beneficiary on any obligatory payment date, Operating Beneficiary shall provide sufficient funds to Trustee to enable it to make such payment, all as more particularly hereinafter set forth.

Comment:

This clause insures that the secured beneficiaries will receive the obligatory payments on the notes. Rarely are release payments and sale contract payments sufficient in the early years to make all payments. Thus a provision such as this is necessary. Of course, in some trusts only gross receipts payments and release payments need be paid and there are no obligatory payments at all.

II.5. *Interest of Operating Beneficiary.* Subject to (a) the obligations to pay each Secured Beneficiary his beneficial interest as hereinabove set forth, and (b) the obligation to the Trustee hereunder, and (c) the obligations inherent in such bond or assessments as may now or hereafter exist, and (d) the rights of purchasers, Operating Beneficiary shall have the entire beneficial interest in this Trust and the Trust Estate.

Comment:

This paragraph is merely declaratory of the priority of interests of the parties established in greater detail in article VII. It is important to establish that the operating beneficiary is entitled to the surplus in the cash flow or special increments, if any, of the trust, without impairment of the protections afforded all prior parties.

ARTICLE III

SUBDIVISION AND SALE

III.1. *Contract Buyers' Rights.* Operating Beneficiary shall have the sole responsibility to formulate a plan for the division, subdivision, resubdivision, improvement and sale of the Trust Estate's real property, and, subject only to the rights and duties expressly vested in Trustee, to carry the same into effect. The right and obligation of Trustee to execute and deliver deeds to each purchaser under such plan free and clear of all rights of any Beneficiary under this Trust upon full performance by such purchaser of his contract obligations, shall not be abridged nor affected in any way by any provision hereof, it being mutually covenanted, agreed and understood that the indebtedness due each Secured Beneficiary shall be paid according to its terms out of, and is secured only by, the beneficial interest of such Secured Beneficiary hereunder, and shall be and is subordinate to the rights of any such contract purchaser.

Comment:

This clause is essential for the protection of the lot purchaser and the fulfillment of the purposes set forth in article I.2. One of the objects of the subdivision trust is to assure the lot purchaser that he will be unaffected by any controversies that may arise among the parties to the trust concerning the effect or operation of the trust. See text accompanying notes 43-45 *supra*. This clause assures that object.

Further, this clause expressly states the secured interest of the beneficiaries is junior to the claims on specific lots of contract buyers. The clause is thus a corollary to article VII.1, establishing the personal property interest of the secured beneficiaries, and articles XII. 5A through E, establishing the absolute right of the lot purchaser to the status of beneficiary for certain purposes. See also notes 43 & 45 *supra*.

III.2. *Subdivision Maps.* Operating Beneficiary may at any time, and from time to time, during the continuance of this Trust, prepare subdivision map(s) affecting some or all of the Trust Estate's real property. Trustee is hereby authorized and instructed to execute, acknowledge and file of record from time to time in the office of the applicable County Recorder such subdivision map(s) and all other documents consistent with the provisions hereof, on the instructions of and at the request of Operating Beneficiary, and without further approval of any Secured Beneficiary, and to show such easements and to make such dedications to public use of all streets, alleys and public places shown thereon, whether included within the subdivided property

or excluded therefrom but constituting a further or separate part of the Trust Estate, all as Operating Beneficiary may from time to time designate. Trustee is further authorized to convey on the instructions of Operating Beneficiary, any common areas shown and designated on a recorded map as being for the common benefit of the owners of all the lots designated therein to a Community Association, municipal agency or district, or to a membership non-profit corporation, without any further authorization or approval from any Secured Beneficiary, the same as though a dedication hereunder. Operating Beneficiary may also instruct Trustee to sell said land or any part or portion thereof as acreage, without the need of filing a subdivision map or in any way improving said land, except as may be required by law.

Comment:

This and the subsequent paragraphs are needed in order to give the operating beneficiary freedom to act without the specific approval of the secured beneficiaries. Limits on the rights of the operating beneficiary, if any, should be stated in this clause. Thus, should it be desired that only certain areas of the property be subdivided, or only certain dedications made, or certain improvements installed, these restrictions should be included here. The reference to non-profit corporations is intended to permit the use of streets and common areas as private improvements where the county has refused to accept them for maintenance because they do not meet county standards or where the county has no obligation to provide certain facilities which the developer wants included as a feature of the project. Thus, if for sales reasons a network of horseback riding trails are desired which the county refuses to maintain and operate, a membership corporation of lot owners can be created to perform this service and it can be funded by individual dues and by assessments on the several lots. For a discussion of the Subdivision Map Act, see note 3 *supra*. See also *Friends of Mammoth v. Board of Supervisors*, 8 Cal. 3d 1, 500 P.2d 1360, 104 Cal. Rptr. 16 (1972) (holding environmental impact report must be submitted as a condition to receiving building permit).

II.3. *Covenants, etc.* Consistent with the terms of this Agreement, Trustee is hereby authorized to execute and record such easements, covenants, restrictions, reservations, plans and or declarations thereof as Operating Beneficiary may from time to time designate, and all thereof shall be a charge on the Trust Estate's real property superior to the interests of all Beneficiaries herein.

Comment:

This extremely important provision is made separate to emphasize it. Of course, all such covenants are ahead of and binding upon the secured

beneficiaries since the former are recorded while the latter are not. Such covenants must have this priority to protect the buyers.

III.4. *Municipal Districts.* Trustee is hereby authorized and directed from time to time at the expense of Operating Beneficiary and on its instructions, but with the written approval of all prior Beneficiaries, to initiate or participate in proceedings for annexation of any part, up to the whole, or the Trust Estate's real property (or the formation out of any part, up to the whole thereof, of one or more such to be newly created) to any local improvement district, water district, assessment district or municipality of any type(s) or nature(s) and for any purpose(s) authorized by law, and to vote in any election(s) regarding the same. Operating Beneficiary and/or Trustee may also from time to time cause such resolutions and notices of intent to be passed, published and recorded as may be necessary to establish public improvement bonds under any applicable Bond Act, or any combination thereof, on the, or any of the, real property included within the Trust Estate.

Comment:

This form calls for annexation to districts and formation of new districts, but only with the approval of the secured parties. A provision that their approval would not be required would also be given effect, since the powers granted the trustee are determinative of the rights of the beneficiaries. However, since taxes and bonds may be involved, it seems proper to require their consent. These matters raise important problems in any subdivision situation and should be negotiated to the satisfaction of all parties, and any limitations should be expressly set forth at this point.

III.5. *Sales Program.* From time to time and on the instructions and direction of Operating Beneficiary, individual subdivided lots and/or unsubdivided acreage shall be sold by Trustee to other parties. Each sale may be for cash or on terms. Any balance owing on any such sale may be evidenced by a land sales contract, by a note secured by deed or trust, by a mortgage, by a subdivision trust, or by any other comparable instrument, all as specified by Operating Beneficiary. All notes or contracts receivable derived from such sales, and the security instruments therefor, shall be retained as part of the Trust Estate.

Comment:

This section grants the absolute right to the operating beneficiary to order the trustee to convey, subject primarily to the restrictions of articles I.4, I.6, V, and VI (all generally relating to the inability of a beneficiary to cause the trustee to do an act exposing the trustee to liability,

and the duty of the trustee to distribute) and to any other desired restriction imposed in this section. The additional restrictions imposed in this clause may include those relating to minimum sales price, minimum down payment, maximum term of sales paper, and so forth.

The last sentence of the clause insures the proceeds of the sales will pass into the trust estate and will not be diverted to non-trust purposes. The effect of the clause is in furtherance of the intention of the trust to transfer the beneficial interest of the secured beneficiaries from the land to the sale proceeds, as sales are made.

The clause should also be compared with article V.4 which is designed to protect the lot purchaser.

III.6. *Public Approvals.* Operating Beneficiary, on behalf of Trustee, shall obtain all necessary permits, reports, licenses and permissions necessary to improve or sell any of the real property included with the Trust Estate, including all necessary authorization by the appropriate County of the State of California, in accordance with the laws, statutes and ordinances of the United States, the State of California, and the County, and any and all applicable rules and regulations of any duly constituted governmental or administrative body of every state or nation in which the property shall be improved or sold.

Comment:

Subdivisions are highly regulated by federal, state and local law. See notes 3 & 38 *supra*. In most cases governmental approval, or at least the filing of disclosure reports, is required. See, e.g., *Friends of Mammoth v. Board of Supervisors*, 8 Cal. 3d 1, 500 P.2d 1360, 104 Cal. Rptr. 16 (1972) (holding an environmental impact report must be submitted as a condition to receiving building permit). This section is designed to give the operating beneficiary complete control and discretion over these procedures, thus assuring flexibility of operation necessary to the enterprise. The property cannot be sold or improved without full compliance with these controls. The operating beneficiary exercises power on behalf of the trustee who, as record owner, is the party technically required by the regulations to perform the procedures demanded. Presumably the operating beneficiary acts as agent of the trustee in this context, although if liability were in issue the question of agency might be very different.

III.7. *Costs of Sales.* Operating Beneficiary shall have the exclusive right to determine both the manner and the methods to be used by Operating Beneficiary in advertising the property for sale; subject, however, to the conditions that Operating Beneficiary shall comply with all governmental requirements and shall not use Trustee's or any other Beneficiary's name in any public statement, whether written or oral, without obtaining the prior written consent of Trustee or

such Beneficiary, as the case may be. Operating Beneficiary, and not Trustee nor any other Beneficiary, shall pay the costs and expense of any and all advertising and also the commissions, fees and other compensation earned by real estate brokers and salesmen employed in selling the property. Operating Beneficiary shall also pay all other costs which are incurred in improving or selling said property, including, but not limited to, the costs of surveying, installation of roads and other public and/or offsite improvements as may be required as a condition to the recording of a subdivision map, sales maps, order books, sales contract forms, printed copies of Real Estate Commissioner Reports and Federal Statements of Record and other comparable matters. Nothing in this Trust Agreement shall authorize or permit any of the foregoing fees or charges to be prior to the interest of Trustee or any other Beneficiary herein. The provisions of this Article III.7 are solely for the benefit of the parties hereto and shall not inure to the benefit of, nor be enforceable by, any other person whomsoever.

Comment:

This section makes it clear that the operating beneficiary, and no other party, is to bear the costs of development. The clause is in keeping with the security purpose of the trust. As typical of other devices, the secured parties contribute the capital and assume only the risk of its loss but do not assume liability for the expenses of the execution of the venture.

The clause also operates to preclude any power in the operating beneficiary to rely on the integrity or reputation of the other parties in inducing sales without their consent, or to authorize the subordination of their interests to that of the sales organization without the consent of the secured beneficiaries. Typically, sales commissions are paid over a period of years by the developer as buyers make payments and are subordinate to the interest of secured parties who have previously perfected interests. Often, however, sales personnel will insist on a right to payment out of the trust proceeds superior to that of the secured parties and even prior to payment into the trust. This demand is made in order to protect the commissions from becoming worthless claims against the operating beneficiary who may divert funds, become bankrupt, or sell his interest. If the sales organization is to have such a superior right, the trust agreement should expressly permit it, in order to avoid future disagreement.

The last sentence is intended to preclude the existence of a third party beneficiary contract in favor of either the sales organization or the property broker individually, thus allowing the operating beneficiary to pass the sales expenses on to the broker by separate agreement

and avoiding claims that the developer is responsible for commissions to salesmen, other than by a separate listing agreement.

III.8. *Form of Documents.* All deeds, contracts of sale or other instruments affecting title to the Trust Estate's real property, or any part thereof, or any interest therein, proposed to be executed by Trustee shall be approved as to form by Trustee in writing, and shall not be used until such approval has been obtained; provided that Trustee need not act on an approved form except in accordance with Article I.6 hereof.

Comment:

The trustee cannot, of course, be expected to enter into agreements whose form and content it has not approved in advance. Nor should the trustee be required to expose itself to liability even on an approved agreement unless it is indemnified in accordance with article I.6. An example might be a resale, where some question exists as to whether an earlier sale has been validly cancelled.

III.9 *Indemnification.* Operating Beneficiary shall, and hereby so agrees, indemnify and save each Secured Beneficiary free and harmless of and from any and all loss, damage, cost or expense, including reasonable attorney's fees, incurred by reason of Operating Beneficiary's subdivision and sales activities affecting the Trust Estate's real property.

Comment:

This clause, and article I.6, operate to place all responsibility for the subdivision upon the operating beneficiary insofar as his activities upon the land and in connection with sales operations are concerned. The question of tort liability is discussed in note 51*supra*.

III.10. *Notice of Non-Responsibility.* Promptly upon receipt of written notice from any Beneficiary of any work of improvement being done on property owned of record by the Trust, the Trustee shall, upon the written demand and at the expense of any Beneficiary, cause to be recorded and posted a notice of non-responsibility in the form and manner prescribed by law.

Comment:

This section authorizes the filing of a notice of non-responsibility as provided in CALIFORNIA CIVIL CODE § 3129 (West 1970). The effect of the notice is to preclude responsibility of the secured beneficiaries or the trustee to lien claimants for work done on the property. However, this protection is afforded only to owners of interests in the property who are unaware of or did not authorize the construction. The typical example of such an owner is the lessor of property, where the lessee improves the property. The effectiveness of the notice is therefore open to question in the subdivision trust context; however, the

fact that all control is effectively in the operating beneficiary may permit the trustee to file a notice of non-responsibility as an innocent and non-contracting owner. Also, since the interests of the secured beneficiaries in the funds are of a personal property nature, they would not be subject to any liens upon the land. In this respect the subdivision trust may be likened to the land holding trust under which the trustee merely is a holder of legal title. His authorization, therefore, is not required for construction, rendering his title superior to that of a mechanics' lien. See *Hammond Lumber Co. v. Goldberg*, 125 Cal. App. 120, 13 P.2d 814 (1932).

ARTICLE IV

RELEASE AND SUBORDINATION

IV.1.a. *Duty to Release.* From time to time, and at any time, Trustee shall release from the Trust Estate any and all lots and/or acreage that may have been sold to bona fide purchasers who have paid the entire purchase price therefor in cash, and Trustee shall also pay the release price hereafter set forth. Such payment is an independent covenant, and is not a condition of the release. Nothing in this agreement or otherwise shall limit the right, power and obligation of Trustee to deliver clear title in accordance with the terms of the contract of sale thereof to any lot or parcel to any purchaser who has paid the entire purchase price therefor, whether or not the release price is paid in accordance with the terms hereof. Each Secured Beneficiary who is not paid such release price agrees that his sole remedy therefor is by action against Trustee for its breach of the provisions hereof.

Comment:

The "release price" is also mentioned in the context of payments to secured beneficiaries in article II.3 and is defined both in that clause and in article IV.1.b *infra*. The provision for release is essential to the protection of the ultimate buyer and to the flexibility of the operating beneficiary's operations. With regard to the former, payment of the release price by the trustee is not a condition of the conveyance of title but is an independent covenant of the trustee; the clause makes it clear that once the purchaser has paid the required sum his title is unencumbered by any interest the secured beneficiary may have had. This result is consistent with the last sentence of the clause, providing that the sole remedy of the secured beneficiaries for the release price is against the trustee.

In trusts where a portion of the cash flow is distributed to the secured beneficiaries it may be provided that the release price is, in ef-

fect, paid automatically therefrom, since on full payment by the buyer, the secured beneficiary will have received all he is entitled to obtain from that particular sale. In the alternative, it may be provided that the trustee is to withhold a proportional amount from the purchaser's payments, to be paid over to the beneficiaries upon completion of the contract.

For a discussion of release clauses and the effect of blanket encumbrances see text accompanying notes 27-37 *supra*. This section may also be profitably compared with article XII.5.E *infra*.

IV.1.b. *Release Price.* From time to time at the request of Operating Beneficiary, Trustee shall release from the interest of any Secured Beneficiary in this Trust any acreage and/or individual lot, whether or not then purchased by a bona fide purchaser, upon payment to such Secured Beneficiary of a cash release payment computed at the rate of [State rate], together with accrued and unpaid interest on such sum. When any property has been so released and is thereafter sold, the gross sales price, in cash, and any evidence of indebtedness may then be transferred to Operating Beneficiary out of and free from the Trust, or may be held by Trustee in this Trust free of any claim or beneficial interest of the Secured Beneficiary whose release price has been so paid, as Operation Beneficiary may from time to time determine and as otherwise provided herein.

Comment:

It may happen that the operating beneficiary will require clear title in himself for some proper trust purpose. This article permits him to acquire such title on payment of a release price (which may or may not be the same as that required of the lot purchaser in article IV.1.a) computed at a rate considered by the parties to be adequate to secure the interest of the secured beneficiaries. This clause also provides that the proceeds of a subsequent sale of the released property by the operating beneficiary may be returned to the trust or held free of the trust, thus reflecting the ownership interest of the operating beneficiary. Of course, even though the release price has been paid, the State requires that the contract stay in the trust except in special circumstances.

IV.1.c. *Application To Obligatory Payments.* All principal of release payments shall be applied against the balances due each Secured Beneficiary on his note. All principal of release payments in excess of sums then due, shall apply to the next obligatory principal payment due to each such Beneficiary, and, when said obligatory payment is made in full, to the next following obligatory principal payment, and so forth, until such Beneficiary is paid in full.

Comment:

This provision is comparable to articles II.3.b and II.3.c. Note that the allocation among the secured beneficiaries of the release payments is provided in article II.3.e. Of course, the business agreement might not apply release payments to the next obligatory payments, but could put them at the end or any other appropriate place.

IV.1.d. *Release Entitlements.* All principal payments, whether obligatory or optional, shall entitle Operating Beneficiary to releases hereunder at the rate hereinbefore set forth. Operating Beneficiary may (i) at the time of making such obligatory or optional principal payment specify the lot(s) or acreage to be released concurrently, or Operating Beneficiary may (ii) make an obligatory or optional payment without then specifying the lot(s) or acreage to be released, but rather may direct Trustee to treat such payment as an entitlement against future releases. When this right to an entitlement is elected, Operating Beneficiary may draw against said right thereafter in directing releases under any provision hereof, and may have the same done automatically by Trustee, without making any further payment whatsoever therefor.

Comment:

A release "entitlement" is helpful, since the developer cannot know in advance which lots will be paid off or their sequence. This clause allows for such contingencies.

IV.1.e. *Easements.* There shall be reserved to the Trust across any parcel of unsubdivided property released from the Trust Estate such non-exclusive easement(s) for access and utility lines as may be reasonably necessary for the benefit of the unreleased property, which reservations may be initially shown upon, or thereafter replaced by, a final subdivision map.

Comment:

Released parcels often lack public access. It is necessary to provide specifically for a means of access so that the entire property is not subject to an indefinite way of necessity. It is of course not phrased in terms of a grant to the purchaser but rather in the form of a reservation of a non-exclusive easement.

IV.1.f. *Transfer of Land on Release.* Upon payment of the release price and the release of any lot or parcel according to the provisions hereof, Trustee may grant or assign the same or its proceeds to Operating Beneficiary or his nominee, or to any outside purchaser or grantee, or may retain the same within the Trust Estate, to be dealt with thereafter free and clear of any beneficial interest therein

of any Secured Beneficiary to whom a release price has been paid, subject, however, to the termination provisions hereof.

IV.2.a. *Subordination.* From time to time at the request of and on the instructions of Operating Beneficiary, and subject to the limitations contained herein, Trustee may execute deed(s) of trust securing notes(s) executed by Operating Beneficiary or its nominee as the then equitable owner of the lot in favor of institutional lender(s), on not more than a total of [Insert Amount] per cent of the lots still owned of record by Trustee and not yet sold to a bona fide purchaser, as security for construction loans for residential and/or commercial purposes and/or to refinance, renew, take out or replace such loans, and any such deed of trust so executed by Trustee shall constitute a lien prior and superior to the lien of Trustee and every Secured Beneficiary hereunder. Trustee is further authorized to transfer any of such lots prior to the execution and recordation of such deed(s) of trust to any nominee or designee, including Operating Beneficiary, in order that such designee may execute the deed(s) of trust, provided that said lot or parcel be reconveyed to Trustee forthwith upon the execution and recordation of the deed(s) of trust, in the same condition of title as when granted to such designee, except for the deed(s) of trust so executed and recorded.

Comment:

Subordination may not be necessary if there is a liberal release policy. Since the developer has paid for the financing of the purchase price, this provision is proper and should be part of his bargain. Subordination is typically provided to encourage "seed" development (extensive and rapid improvement of a small portion of the subdivision), whether by the operating beneficiary or a buyer. It also is used if any major construction is to be carried on with borrowed funds, as for a motel, sales office or the like. Limitations, if any, on the use of funds obtained from new loans should be set forth here, as well as provisions alleviating the general problems of subordination agreements. See text accompanying notes 17-27 *supra*.

IV.2.b. *Subordination of Trust Deeds for Buyers.* From time to time at the request and on the instructions of Operating Beneficiary, and in addition to the rights provided in the prior paragraphs of this Article, Trustee shall subordinate the lien and priority of any deed of trust (which has been received by Trustee on the sale of real property to an outside purchaser) to that of a new deed of trust securing a note executed by such purchaser or his designee to any institutional lender made for the purpose of constructing improvements

on said property. From and after the effective date of such subordination, such outside construction loan shall be prior and superior to the interests of Trustee hereunder and of every Beneficiary hereof.

Comment:

This provision gives the operating beneficiary the right to permit subordination. It does not operate automatically for the benefit of contract buyers. The provision creates rights as between the operating and secured beneficiaries designed to permit the operating beneficiary to negotiate special improvement agreements with his buyers if he deems it wise to do so.

IV.3. *Effect of Default.* All of the release and subordination provisions hereof shall be effective only when no Declaration of Default, as herein provided, shall then be set forth, delivered to Trustee, effective and unrescinded; except, that neither this nor any other provision of this Trust Agreement and Declaration of Trust shall prevent Trustee from delivering clear title to any purchaser who has entered into a purchase agreement and has paid the full purchase price therefor; and, despite any subsequent default, Trustee shall continue to release lots or acreage as to which a release entitlement exists pursuant to the terms hereof.

Comment:

Nothing may prohibit transfers to paying buyers. Whether to permit releases to the operating beneficiary during a default is a business question.

IV.4. *Reports.* Trustee shall notify each Beneficiary in writing as to all real property released from the Trust and/or the beneficial interest of any Secured Beneficiary since the last prior report, stating the details thereof, and the balance, if any, of the release entitlement fund and the allocation of all release payments among the Beneficiaries as well as details of other pertinent activities in such regard.

ARTICLE V

SALES AND THEIR PROCEEDS

V.1.a. *Impounds.* All impounds, if any, required under this Trust Declaration shall be accumulated and retained by the Trustee prior to any distribution of funds to any Beneficiary hereunder.

Comment:

Impounds such as are provided for in the following article are typically created to insure the payment of taxes and assessments. They

may also be used to accumulate a fund to pay other anticipated expenses, for example improvement costs, obligatory payments or other funded debt. *See also* Form art. I.9 *supra*.

V.1.b. *Payment of Bonds.* All deposits received from purchasers at the time of sale, whether the sale be for cash or on terms, all down payments and all payments made toward the purchase price of said lots and all other cash receipts affecting the said real property shall be deposited with Trustee and held by Trustee in accordance with the provisions hereof. Trustee shall withhold monthly from the deposited funds one-twelfth (1/12) of such amount as Trustee shall determine to be necessary and adequate to pay all of the principal of and interest on any applicable improvement bonds as and when due during the ensuing year, except to the extent that such payments will be made by the district or municipality involved from funds in its possession, or by Trustee as a result of prior accumulated deposits. Deposits pursuant to this Article and amounts withheld shall not include sums equal to the principal of and interest on bonds assumed by contract or lot purchasers who acquire title and agree to pay such principal and interest separately.

Comment:

If there are improvement bonds, disputes may arise over allocation of the bond debt because not all the lots are sold at one time. Thus, if 1/12 of the annual anticipated bond cost is withheld in each month, the effect is to change the net available for the beneficiaries each month. These provisions are to assure the operating beneficiary both that excess impounds do not occur, and that enough is amassed to cover the debt due. The special provisions regarding rights of bond holders are intended to make bonds a more attractive investment, and may be omitted if there are not to be bonds.

V.1.c. *Excess Impounds.* The parties hereto agree that any excess funds impounded to cover estimated bond or other payments are funds belonging to Operating Beneficiary, to the extent that they were deducted from funds otherwise payable to Operating Beneficiary, and that Trustee will only impound such sums as may actually be necessary for bond or other payment purposes. If in any period (but not longer than one year) excess funds are impounded, such excess shall be used to reduce the impound requirements of the next subsequent period. Trustee shall annually impound from receipts such sums as it estimates to be necessary to pay prior to delinquency the semi-annual installments of principal and interest of special assessments levied upon lots during the period that Trustee holds title there-

to, even though under contract of sale to others, but only after there has been applied thereto any funds capitalized therefor in said assessment proceeding.

Comment:

This article provides for the carryover of excess impounds. The provision of ownership in the operating beneficiary is merely an outgrowth of the principle that he is entitled to the net profit from the subdivision trust venture, as provided in article V.3.

V.1.d. *Prepayment of Assessments.* If a purchaser shall have paid the full amount of the sales price of a lot prior to the due date thereof, Trustee shall separately impound sufficient of the funds so received and cause the assessment on said lot to be prepaid and removed. Trustee shall use any surplus funds derived therefrom for the call and retirement of other bonds prior to their fixed date of maturity.

Comment:

This provision allows the transfer of the property without encumbrance by special assessments. Bonds typically can only be paid on an installment date.

V.1.e. *Transfer Subject to Assessment.* When the unpaid principal amount of a contract of sale on any lot shall approximately equal, but be not less than, the principle amount due on the assessment on such lot, Trustee, upon instructions of Operating Beneficiary, shall either (i) deed said lot to the purchaser with his consent, subject to said unpaid assessment, or (ii) impound monthly during the remainder of the period that said contract shall be outstanding an equal aliquot part of the unpaid principal and interest of said assessment for the remainder of the term of the bonds representing said assessment, or (iii) prepay and retire said assessment, using such funds available therefor as may be designated by Operating Beneficiary.

Comment:

Article V.1.e allows a buyer in effect to apply his bond to the contract debt.

V.1.f. *Rights of Bond Holders.* Trustee at the request of Operating Beneficiary shall by appropriate document grant to the successive holder(s) of any special assessment improvement bond(s) issued for the improvement of the property, the rights of the legislative body that issued said bonds to foreclose in court the lien of any delinquent assessment installments levied therefor and to cause said properties to be publicly sold for the nonpayment thereof; and also the right to accelerate the maturity of the installments of said assess-

ments, subject to the rights of interested parties to redeem the same prior to the issuance of a deed therefor, and of a purchaser at said sale or of a property owner to use and apply matured bonds and coupons and unmatured bonds at par on account of the purchase price or in redemption of said property.

Comment:

This section increases the attractiveness of the bonds by making certain rights transferable. The clause permits the trustee to grant an assignee the same rights as his assignor may have had.

V.2. *Deficit of Obligatory Payments.* If Trustee has not theretofore distributed to each Secured Beneficiary sufficient amounts to pay any part or portion of any obligatory payment of principal or interest when due, Operating Beneficiary shall upon request of Trustee deposit sufficient funds with Trustee to make such payment. If the amounts so demanded have not been deposited by Operating Beneficiary with Trustee on the fifth day before the due date, Trustee shall notify each Secured Beneficiary at that time of the failure to deposit such funds. Failure of Trustee to give any Secured Beneficiary said notice on time or at all shall not excuse or relieve Operating Beneficiary from its obligation to pay the full amount of the obligatory payment on the due dates thereof.

Comment:

It is ultimately the operating beneficiary's duty to make payments, not the trustee's. This provision recognizes that fact, and gives the trustee the right to demand payment to it so that it may meet the obligatory payment. The section also provides for courtesy notice of default to the secured beneficiaries.

V.3. *Distribution of Remaining Funds.* The funds in the possession of Trustee shall be used by Trustee in priority as follows:

V.3.a. To pay sums impounded to be paid on behalf of lot purchasers, including tax and improvement bond payments, as required, if any; and then

V.3.b. To pay each Secured Beneficiary all sums then due, whether principal or interest; and then

V.3.c. To pay Trustee its fees and expenses, as set out in this Trust Instrument; and finally

V.3.d. To pay Operating Beneficiary the entire balance thereof.

Comment:

This section is the key to the operation of the subdivision trust because it provides for the priority of the secured beneficiary, the fees

of the trustee, and the right of the operating beneficiary to the net profits of the venture. In essence the section sets up the priority beneficial interest which the secured beneficiaries have taken in lieu of any right or interest in the land itself. See text accompanying notes 4-5 & note 46 *supra*. For a discussion of the nature of the interest created see note 43 *supra*.

V.4. *Lot Sales.* Trustee agrees to execute and deliver land sales contracts and/or grant deed to purchasers designated by Operating Beneficiary immediately upon notification in writing by Operating Beneficiary that a sale has been negotiated as to any lot, and to deliver the appropriate sales documents to the purchaser, with a copy to Operating Beneficiary. Trustee further agrees that upon payment in full of any sales contract, upon a sale for cash or upon a sale in which Trustee takes back a note secured by a purchase money deed of trust, Trustee will execute its grant deed to the purchaser entitled thereto, or such purchaser's nominee, whether or not any release price for the property, the subject thereof, has been paid.

Comment:

Here again land must be delivered when the buyer pays, regardless of the payment of the release price. Notice that this form calls for a grant deed. Although most trustees will issue a grant deed, sometimes trustees insist on using a quitclaim deed so that problems of statutory warranty will not arise. See CAL. CIV. CODE § 1113 (West 1970).

In order to protect the buyers, the trustee must issue the deed, and not merely the operating beneficiary. See notes 40 & 42 *supra*.

V.5. *Cancellation of Contracts.* No contract for the sale of any of said property shall be cancelled without the consent of both Trustee and Operating Beneficiary if said contract is less than ninety (90) days delinquent. After any contract for the sale of any of said property is ninety (90) days delinquent, Trustee may forward to the lot purchaser a letter demanding that the delinquency be corrected within fifteen (15) days from the date of said notice. Trustee may cancel any contract which is one hundred twenty (120) days delinquent and, upon request of Operating Beneficiary, must cancel any contract which is more than one hundred twenty (120) days delinquent; Trustee shall institute foreclosure proceedings under the terms of a deed of trust, if it is the beneficiary of the deed of trust, when payments on the note secured by such deed of trust are more than forty-five (45) days delinquent, unless otherwise directed in writing by Operating Beneficiary.

Comment:

The actual dates are not important, but the ones used here are typical.

Since the sale is made in the trustee's name, it is the party who must cancel and initiate foreclosure proceedings. For a discussion of foreclosure and exercise of the power of sale under the typical land security devices, see note 17 *supra*. Article V.5. illustrates one of the attributes of the subdivision trust. This clause, in conjunction with others granting the power of possession and direction of the trustee to the operating beneficiary, creates in the developer a personal property interest which encompasses all of the important rights of an owner of real property. He possesses not only the right of possession and development, but the right to in effect receive income from the property and the right to foreclose on a purchaser's interests as well—all, of course, through the conduit of the trust. Similarly, the preceding clause granted to the secured beneficiaries rights analogous to those of the typical party whose interest is secured by land. *See also* Form art. VII (dealing with the right of foreclosure of the beneficial interest) and Form art. VI (dealing with the duties of the operating beneficiary with regard to his operations) which are modeled after those ordinarily imposed upon a mortgagor or trustor.

V.6. *Oral Instructions.* Subject to the terms and conditions hereof, Trustee shall act upon the written instructions of Operating Beneficiary and may act upon its oral instructions. Operating Beneficiary agrees hereby to hold Trustee free and harmless from any and all liability for damage and/or losses that may result from following any such directions, whether oral or written.

Comment:

This clause allows the operating beneficiary the flexibility of oral instructions and also grants the trustee the power to insist on written instructions.

V.7. *Release.* Trustee is hereby released from any and all liability for damage and/or loss to any Beneficiary that may result from following the directions of such Beneficiary.

Comment:

Some provisions of the trust may appear redundant, but matters for the protection of the secured beneficiaries, trustee and purchasers cannot be repeated too often.

ARTICLE VI.

DUTIES OF OPERATING BENEFICIARY

Comment:

The following provisions of article VI are drafted in terms analogous to the covenants of a trustor of a standard deed of trust. *See* J.B. SMITH, REAL ESTATE IN CALIFORNIA 130-31 (8th Ed. 1970). Thus, there are provisions requiring the operating beneficiary to provide in-

insurance, pay taxes, and not to commit waste. The purpose is once again to render the rights and duties of the parties as similar as possible to those under other security devices while retaining the advantages of the subdivision trust configuration. Significant departures from the standard devices will be commented upon where they occur. A related purpose is to minimize as much as possible the confusion and suspicions of parties unfamiliar with the trust mode. As the device becomes more familiar through general use, modification of these provisions to fit specific business goals will likewise become more acceptable.

To protect the beneficial interest of each Secured Beneficiary herein, Operating Beneficiary agrees:

VI.1. *No Waste.* (a) To keep the Trust Estate's real property in good condition and repair and (b) to pay the cost thereof; to commit or permit (c) no waste on said premises and (d) no violation of laws relating to improvements or otherwise; and (e) to do all other acts which the character and use of said property may require to preserve it.

VI.2. *Insurance.* To provide, maintain and deliver to Trustee such kinds and amounts of insurance as Trustee may deem reasonably necessary, said insurance policies to name as its beneficiaries Trustee and the several Beneficiaries of this Trust, as their interests may appear.

VI.3. *Taxes.* To pay at least ten (10) days before delinquency all taxes and assessments, including improvement bond assessments, if any, affecting the Trust Estate's real property; to pay when due all encumbrances, charges and liens, with interest, on said property or any part thereof which appear to be prior to or superior to the interest of any Secured Beneficiary or Trustee, and to pay all costs, fees and expenses of this Trust. Trustee shall promptly notify all Secured Beneficiaries if any of such taxes, assessments, encumbrances, charges or liens are not paid when due. Trustee shall not be liable at all to any Beneficiary for failure to give such notice promptly or at all.

VI.4. *Advances for Beneficiary.* Should any Beneficiary fail to make any payment or do any act in this Agreement and Declaration of Trust provided, then any of the prior Beneficiaries or Trustee, but with no obligation thereof, and without prior notice or demand upon any defaulting Beneficiary and without releasing any Beneficiary from any obligation thereof, may make or do the same in such manner and to the same extent as any may deem necessary to protect the interest of such Beneficiary or Trustee hereunder. Such Beneficiary or Trustee is

authorized to enter upon said property for such purpose(s), appear in and defend any action(s) or proceeding(s) purporting to affect the Trust or the Trust Estate or the rights or powers of any such Beneficiary or Trustee; to pay, purchases, contest or compromise any encumbrance, charge or lien which in the judgment of any thereof appears to be prior to or superior to the interest of any such Beneficiary or Trustee, and in exercising any such powers, pay necessary expenses, employ counsel and pay his reasonable fees.

Comment:

This provision is analagous to the standard advance clause permitting the trustee or beneficiary of a deed of trust to make direct advances in order to prevent foreclosure by a prior lien holder. Note that the clause expressly includes defaulting beneficiaries other than the operating beneficiary. Articles VI.5 and VI.6 insure the advancing beneficiary the right to reimbursement as well as the right to interest on the advance.

VI.5. *Reimbursement for Advances.* Upon the payment by any such prior Beneficiary of any sums so advanced for the protection of the Trust or the Trust Estate, said Beneficiary may upon making such advance notify Trustee and all junior Beneficiaries that such advance has been made by mailing Trustee and such junior Beneficiaries a notice of such advance. If such advance has been made by Trustee, Trustee shall notify all affected Beneficiaries. Said notice shall contain a statement of the date and amount of each such advance, the name(s) and address(s) of the person(s) to whom said advance was made and the purpose(s) for which said advance was made. Said notice shall be mailed to the junior Beneficiaries at the last address of each such Beneficiary on file with the Trustee. Upon receipt of such notice, Trustee is authorized to rely upon such advice in determining whether advances have been made and the amounts thereof.

VI.6. *Interest on Advances.* Operating Beneficiary further agrees to pay immediately and without further demand all sums so expended by any prior Beneficiary or by Trustee, with simple interest thereon from date of expenditure at 7 per cent per annum.

VI.7. *Improvement Work.* No Beneficiary shall under any circumstances whatsoever have any power or authority to do or perform any act for or in the name of or binding upon Trustee, and it is mutually covenanted and agreed that any and all work of improvement done on or about or in connection with the Trust property shall be carried out under the exclusive direction and control of Operating Beneficiary and that Trustee shall have no responsibility whatsoever in connection there-

with. Operating Beneficiary further covenants and agrees that it will keep the Trust Property free and clear of any mechanic's lien arising from any and all works of improvement done at its direction on or about or in connection with the Trust Property, and that if any such lien(s) are filed and Operating Beneficiary desires to dispute the validity or amount thereof, it will take all steps necessary to free the Trust Property from such lien or liens, or otherwise protect the property to the satisfaction of Trustee.

Comment:

This section is analogous to the standard section requiring the trustor to keep the property free of mechanics' liens. In addition, the clause also negates the right of and responsibility for improving the land in any party except the operating beneficiary.

ARTICLE VII

FORECLOSURE

Comment:

Article VII deals primarily with foreclosure of beneficial interests in the trust. However, article VII.1 also sets up the priority of the beneficiaries' interests, and article VII.2 deals with the effect of condemnation. The foreclosure proceedings, beginning with article VII.4, is intended to parallel the foreclosure procedure prescribed by statute in the foreclosure of an interest in real property by power of sale. See note 17 *supra*. As in the case of article VI, the purpose of the similarity is the assurance of the familiar rights granted under other devices. However, it should be noted that the form does provide for a period analogous to the period of statutory reinstatement on a trust deed, although that time is measured from delivery of the Notice of Default rather than recordation, since the Notice is not recorded. Finally, as a business matter, article VII.5 expressly provides that no deficiency may be had. See note 58 *supra*.

ALL BENEFICIARIES mutually agree:

VII.1. *Priority.* The several Beneficiaries have priority in this Trust in accordance with their number; that is, First Beneficiary is of highest priority, then Second Beneficiary, and so forth.

VII.2. *Condemnation.* Any award of damages in connection with any condemnation or public use of or injury to the Trust or the Trust Estate or any part thereof, after payment of bona fide costs, attorney's fees and expenses of defense, is assigned to Trustee and is to be applied as though a release payment hereunder. The net award, to the extent that it exceeds the release price, shall be given to Operating Beneficiary.

Comment:

Subdivision trusts typically cover large tracts of remote land which are particularly subject to highway condemnation. This form calls for attorney's fees to be paid from the top of the award, as condemnation counsel is typically paid on a percentage basis. Variants might provide that all of the condemnation award is to be paid to secured parties, or only some of them, or that the award is to be divided in some other agreed manner.

VII.3. *Waiver.* By accepting payment of any sum due hereunder after its due date, no Beneficiary waives its rights either (a) to require payment when due of all other sums due then, or (b) to exercise rights of foreclosure, as hereinafter set forth.

VII.4. *Default.* Should Trustee fail to make payment to any Beneficiary of any of the sums as hereinabove provided because sufficient money to make said payment has not been received by Trustee, or if any Beneficiary fails to do any act herein provided to be done by such Beneficiary, any prior Beneficiary may, as its sole and only remedy therefor, declare all sums secured hereby for its benefit immediately due and payable, by delivering to Trustee a written Declaration of Default and Demand for Sale (herein "Declaration of Default"), and shall deposit with Trustee all documents evidencing sums and expenditures secured hereby. All persons sharing in a single beneficial interest so involved must join in the Declaration of Default. At least three (3) months having elapsed after the delivery of said Declaration of Default to all junior Beneficiaries, Trustee without demand on any person, shall sell the interest(s) under this Trust of all junior Beneficiaries to pay said sums, with interest, and Trustee's fees and expenditures. Said sale shall be made in the following manner:

Comment:

The three months here runs from delivery of the Declaration, not from recordation, since there are no recorded interests under the trust. This form requires joint action if a single beneficial interest is shared by several people. This seems the proper course to follow in order to protect all concerned.

VII.4.a.i. *Notice of Sale.* Trustee shall first publish notice of the time and place of such sale with a description of the beneficial interest(s) so to be sold, at least once a week for three (3) consecutive weeks in a newspaper of general circulation published in the County within the State of California in which the real property held in the Trust shall be located, and shall give such other notice(s) as may then be required by law; and from time to time may postpone such sale by public announcement at the time fixed for the sale. Each

of the undersigned Beneficiaries requests that a copy of any Declaration of Default hereunder by a prior Beneficiary be mailed to him at the address shown on the signature page of this Declaration, or such other address hereafter given to Trustee for this purpose, and Trustee shall give all Beneficiaries such notice.

Comment:

Some trusts require publication of the Notice of Sale in the main business area of the operating beneficiary as well as in the county where the land is located.

VII.4.a.ii. *Public Sale.* At the time and place of sale so fixed, Trustee may sell the beneficial interest(s) so advertised to pay said sums and advances, with interest, and Trustee's fees and expenses, at public auction to the highest bidder for cash in lawful money of the United States. Trustee, and/or Beneficiary or any person on behalf of any thereof, and/or any other person, may bid and purchase at such sale. Upon such sale and after due payment made to it, Trustee shall deliver to the purchaser an assignment of beneficial interest covering the beneficial interest(s) sold, but without covenant or warranty, expressed or implied, whereupon such purchaser shall have all the rights and privileges of the beneficial interest(s) which properly pass with said assignment, subject, however, to all terms, conditions and obligations of this Trust to Beneficiaries prior in interest to the Beneficiary for whose account said property has been sold. Trustee's fees for making said sale shall be based on the aggregate of all sums secured under this Trust for which the interest(s) are so sold and shall be equal to the then effective schedule of fees of Trustee relative to sales under deeds of trust.

VII.4.a.iii. *Application of Proceeds.* After (a) deducting all costs, fees and expenses of Trustee and of this Trust, Trustee shall apply the proceeds of sale to (b) the payment of all sums expended by Trustee under the terms hereof not then repaid, with accrued interest at 7 per cent per annum, and the payment (c) of all of the then remaining outstanding fees and expenses of Trustee for its services hereunder, the payment (d) to the foreclosing Beneficiary of all unpaid sums then secured hereby and the payment (e) of the remainder, if any, to the person or persons legally entitled thereto.

VII.4.a.iv. *Conclusive Effect.* The recitals in any such assignment of beneficial interest(s) of any matters or facts shall be conclusive proof of the truthfulness thereof.

VII.4.a.v. *Title to Beneficiary's Interest.* Each Beneficiary by the execution hereof, severally, for himself, his successors and as-

signs, does transfer, assign and convey to Trustee his title to the entire beneficial interest under this Trust, sufficient to enable Trustee to transfer, assign and convey said interest, or any part thereof, upon any sale provided for in this Trust, and in the dealings between Trustee and contract purchasers, as in this Trust provided.

VII.4.b. *Multiple Foreclosures.* Foreclosure and sale proceedings hereunder may be taken in sequence by several Beneficiaries and several foreclosure and sale proceedings may be pending concurrently.

VII.4.c. *Other Remedies.* The methods herein set forth are not exclusive, but are in addition to all other rights granted hereunder or by law, unless inconsistent with the terms hereof.

VII.5. *No Personal Liability.* Notwithstanding any other provisions hereof or of law, all parties hereto agree that no personal liability shall exist upon Operating Beneficiary hereunder, and that the only remedy available by reason of default hereunder or under Exhibits [Refer to Notes] shall be to foreclose and repossess the interest of junior beneficiaries in the Trust Estate and its proceeds, as herein set forth.

Comment:

It is not clear whether a subdivision trust is a property interest within the anti-deficiency judgment legislation. This question should therefore be settled in the declaration either by a provision as herein set forth or by one providing to the contrary. See note 58 *supra*.

ARTICLE VIII

TERMINATION

VIII.1. *Personal Property.* The interest under this Trust of every Beneficiary is hereby declared to be personal property, and no Beneficiary has and shall not have any right, title or interest in and to any real property within the Trust Estate, the sole right of every Beneficiary being to enforce the performance of the terms hereof as expressly set forth herein.

Comment:

This is an express declaration that the beneficial interest under the trust is personal property and is effective. See note 43 *supra*. The clause is the essence of the trust and is discussed in the text. See text accompanying notes 42-43 *supra*.

VIII.2. *Term.* The Trust declared hereunder, unless terminated by agreement of the parties or revoked by Operating Beneficiary or its successor(s) following sale on foreclosure or otherwise, as herein

provided, shall continue until the expiration of twenty (20) years from the date hereof.

Comment:

This is an anti-perpetuities clause and is designed to avoid the doctrine under all circumstances. It is possible that a longer period may be permitted under California law. See CAL. CIV. CODE § 715.6 (West 1970).

VIII.3. *Irrevocable as to Contract Sales.* Notwithstanding any other provisions of this Agreement and Declaration of Trust, this Trust shall be and is declared irrevocable as to any portion of the real property held in the Trust Estate which has been sold on a land sales contract subsequent to the execution hereof and which contract has not been paid in full or cancelled prior to the termination or revocation date.

Comment:

This clause provides complete protection to the lot purchaser against the possibility that his vendor, the trustee, will not have title at the time set for conveyance. The clause is not in violation of the rule against perpetuities, since all interests with regard to the property which is contracted for sale are not subject to termination and therefore are vested. Of course, the possibility that title may revert in the vendor by reason of the vendee's default is not subject to the rule.

VIII.4. *Transfer on Termination.* At the time of termination of this Trust, unless revoked by common agreement of all Beneficiaries, whether such termination be by revocation or by the expiration of twenty (20) years from the date hereof or otherwise, Trustee shall transfer and deliver to Operating Beneficiary or its successor(s) all the property, real and personal, comprising the Trust Estate, excepting such real property as has been theretofore sold on contract and which contract has not theretofore been paid in full or cancelled as in this Trust Agreement provided. After the termination of the Trust as provided in this Article, Trustee shall retain any contract which has not theretofore been paid in full or cancelled as herein provided and the real property the subject thereof, and shall continue to receive all payments due thereon, and upon payment in full, deliver the land to the contract purchaser. All deferred payments shall be paid Operating Beneficiary or its successor(s) in the same manner as though they were paid prior to the termination hereof.

Comment:

Article VIII.4 provides for conveyance of the property to the operating beneficiary upon termination as provided in clause VIII.2, excepting the property remaining in trust under article VIII.3. The secured bene-

ficiaries by virtue of their notes and the provisions for payment out of the trust will have been paid off prior to this time.

VIII.5. *Notices.* Each Beneficiary hereby declares that its address is as set forth after its respective name on the signature page hereof, unless and until changed by notice in writing given to Trustee and all other Beneficiaries. All notices required or permitted hereunder must be in writing and delivered to the person to be served personally or by certified mail, postage prepaid, addressed as set forth above. All notices shall be deemed served forty eight (48) hours after deposit thereof in any United States post office in the State of California or seventy-two (72) hours after deposit in any United States post office elsewhere. Notice is deemed given when and if received, if posted outside the United States or given in any other manner.

Comment:

This is a simple notice provision and could be placed anywhere within the document.

ARTICLE IX

REVOCATION

IX.1. *Revocation.* Operating Beneficiary or its successor(s) (a) upon thirty (30) days written notice to the Trustee of intent so to do, and (b) by paying in full any and all sums due each Secured Beneficiary and Trustee, and (c) upon releasing Trustee from and assuming all obligations affecting the Trust and the Trust Estate, and (d) upon indemnifying Trustee to its satisfaction against any liability incurred by it or any Beneficiary in the administration of this Trust, may (y) revoke this Trust in whole or in part and/or thereupon (z) withdraw from the Trust all or any part of the Trust Estate (except such real property held therein subject to then outstanding contracts of sale). Trustee shall thereupon convey, transfer and deliver the property affected thereby to Operating Beneficiary or its successor(s). It is expressly declared, however, that Operating Beneficiary may not revoke this Trust in whole or in part until such time as each Secured Beneficiary has been paid in full all sums due or owing to him as hereinabove provided.

Comment:

This clause in effect permits the operating beneficiary to remove unsold lots from the trust, after paying all other parties. Note, however, that the lot purchasers are completely protected. Once the property is sold by the trustee it cannot be taken out of trust at the request of the trust beneficiaries.

IX.2. *Assignment.* Operating Beneficiary may not assign its beneficial interest in whole or in part to a new or substitute Operating Beneficiary without the prior written consent of Trustee. Such assignment, if made, shall not release Operating Beneficiary from any or all of its obligations to each Secured Beneficiary hereunder or to Trustee, and the assignee shall also expressly assume all obligations of Operating Beneficiary hereunder. Nothing herein shall prevent Operating Beneficiary from directing the manner of payment of funds due or to become due to Operating Beneficiary, subject to the rights of every prior Beneficiary hereunder. No assignment shall be valid or binding as against Trustee until 5 days after written notice thereof is served on Trustee.

Comment:

This provision requires the trustee's, but not any secured beneficiary's, approval for an assignment by the operating beneficiary of his beneficial interest, which otherwise would be fully transferable. There are, however, no limits on the right of a secured beneficiary to assign its interest, and the operating beneficiary is not prohibited from offering his interest as security. The purpose of the clause is to assure the trust the personal talents and continuing liability of the operating beneficiary.

ARTICLE X

CHANGES OF TRUSTEE

Comment:

The following provisions of article X are usually required by the trustee and are necessary to the orderly administration of the trust. In general they provide that the trustee may resign and that another will be selected by the beneficiaries or appointed by the court. The article also provides for the transfer of title to the substitute trustee by the resigning trustee.

X.1. *Resignation.* Trustee may resign and discharge itself of the Trust created hereby by written notice to all Beneficiaries at their last address on file with the Trustee, given thirty (30) days before such resignation shall take effect. Upon Trustee's resignation, a successor Trustee shall thereupon be appointed by an instrument in writing executed by all Beneficiaries.

X.2. *Successor Trustee.* Should the Beneficiaries fail to make such appointment before the expiration of thirty (30) days after notice of the intended resignation by Trustee is given to them, a Successor Trustee shall be appointed by a court of competent jurisdiction

upon the petition of the resigning Trustee or upon the petition of any Beneficiary.

X.3. *Vesting.* Any Trustee appointed hereunder as Successor Trustee shall execute, acknowledge and deliver to the previously resigned Trustee a written instrument accepting such appointment, and thereupon such Successor, without further action on its part, shall become fully vested with the duties, estates, rights, title and powers of Trustee herein. Trustee upon being paid all sums due it, or being indemnified for such amounts to its satisfaction, shall execute and deliver an instrument quitclaiming and transferring to such Successor Trustee all of the right and title then held by it in and to the Trust Estate, and shall quitclaim and deliver all property, documents and monies then held by it hereunder to such Successor Trustee; and thereupon Trustee shall be fully released and discharged from all further liability and responsibility hereunder.

X.4. *Successor to Trustee.* Any successor to Trustee, whether by consolidation, merger, transfer of Trust business, resignation or otherwise, shall succeed as Trustee with like effect as though originally named. All authority, powers and direction herein conferred upon the named Trustee shall pass to all Successor Trustees.

ARTICLE XI

FEEES

XI.1. *Amount of Fees.* Exclusive of all sums received by Trustee which are payable to any Secured Beneficiary in accordance with this Declaration, and impounds, if any, Trustee shall pay itself out of cash receipts the amounts due it for its services, in such sum as may be reasonably agreed upon between Trustee and Operating Beneficiary or which may be reasonable in the circumstances, and in addition thereto all taxes, assessments, insurance, costs, charges, attorney's fees, and expenses incurred or expended in the care, management, administration, protection and/or distribution of all or any part of the Trust Estate, for the payment of which the Trust Estate and/or the Trustee may become chargeable, including the protection of this Trust and its defense against legal attack.

XI.2. *Extraordinary Fees.* In addition to the foregoing, Trustee shall be entitled to reasonable fees for extraordinary services.

XI.3. *Fee Schedule.* Trustee and Operating Beneficiary shall concurrently herewith prepare a schedule of ordinary fees to be paid

to Trustee. Said schedule shall remain in full force and effect unless amended by the written concurrence of Trustee and Operating Beneficiary. Said amended schedule shall not be binding or effective as to any of the remaining Beneficiaries hereunder unless such remaining Beneficiaries shall expressly approve or adopt the same.

Comment:

This article provides for fees and fee schedules. Fee schedules are negotiable, but must be fixed. They are typically negotiated between the trustee and the operating beneficiary at the outset of the trust. Fees will vary depending on the amount of services to be performed and trust related benefits to be received by the trustee, such as sale of title policies and so forth.

ARTICLE XII

MISCELLANEOUS

XII.1. *Gender.* Throughout this Agreement and Declaration of Trust, the masculine shall include the feminine and neuter gender, the neuter shall include the masculine and feminine gender, and the singular shall include the plural.

XII.2. *Binding Effect.* This Agreement and Declaration of Trust shall inure to the benefit of and be binding upon the heirs, executors, administrators, successors and assigns of the parties hereto.

XII.3. *Paragraph Headings.* The various headings to the provisions hereof, and the Table of Contents attached hereto are not part of this document, but are for convenience only, and not to be treated as a part of this Agreement and Declaration of Trust.

XII.4. *California Law.* This Agreement and Declaration of Trust shall be interpreted according to the laws of the State of California. If any provision hereof shall be held void or unenforceable by any Court, the balance hereof shall still be valid and of like effect as if said void provision had never been part hereof.

Comment:

These of course are the miscellaneous provisions which should appear in any form if it is to have general application.

XII.5. *Subdivided Interest Defined.* Notwithstanding anything to the contrary in the Trust Agreement or in any applicable instrument, with respect to any Subdivided Interest (which is defined herein to mean any lot or parcel or condominium unit, or whatever other interest is to be transferred to any contract vendee on contract of sale), the following provisions shall control at all times:

XII.5.a. *Buyer Limited Beneficiary.* Every vendee of a subdivided interest, as to his subdivided interest, shall be a Beneficiary of this Trust for the purpose of conveyance of title as provided herein and shall have an interest in the said property co-extensive with his subdivided interest.

XII.5.b. *Encumbrances.* The Trustee shall not encumber any subdivided interest without the written consent of said vendee.

XII.5.c. *Amendments.* No amendment to the Trust Agreement which would directly affect the interest of any vendee as to said vendee's title shall have any effect without the written consent of the vendee.

XII.5.d. *Revocation.* The Trust shall not be revoked or terminated as to any subdivided interest then subject to a contract of sale, and title to subdivided interests shall remain in the Trustee until the vendee has performed or defaulted under his contract; provided, however, that the Trustee may resign if a successor trustee approved by the Department of Real Estate of the State of California expressly assumes any and all liability of the resigning Trustee with respect to any vendee of a subdivided interest.

XII.5.e. *Conveyance.* When the vendee has performed his contract, the Trust shall convey to him title to the subdivided interest free and clear of all liens and encumbrances except restrictions and easements of record as of the date of the California Public Report and permit, and except any lien or encumbrance caused or created by the vendee, and also except for taxes and assessments.

Comment:

The provisions of articles XII.5 through XII.5.e are those requested by the California Department of Real Estate for the protection of the lot purchaser. It is apparent that they are redundant in their provisions, since in fact their subject matter is elaborately treated elsewhere. See, e.g., Form arts. VIII.3 and X. The necessity for these provisions would be reduced should a standard form for the subdivision trust with which the Department may become familiar be adopted.

IN WITNESS WHEREOF, the parties hereto have hereunto set their hands and seals as of the date first hereinabove set forth.

These provisions are fairly standard. Sometimes trusts are signed in counterparts, but this is best avoided if possible.

FIRST BENEFICIARY

 SECOND BENEFICIARY

By _____

By _____

(TRUSTEE)

Comment:

The signatures should not be acknowledged. It is intended that the trust be unrecorded for otherwise the beneficiaries would have a record interest clouding the trustee's title and thereby thwarting one of the purposes of the trust.

EXHIBITS

Exhibit A is a legal description of the trust property and should set forth all of the particulars of location. *See* Form arts. I.1-I.3 *supra*.

Exhibit B is a list of title exceptions if any, taken or provided by the company insuring the title. *See* Form art. I.5 *supra*.

Exhibit D is the operating beneficiary's note, and may be cast in the standard form typically used under a deed of trust. It specifically states that it is secured by a beneficial interest in a subdivision trust. *See* Form arts. II.b § VII.5 *supra*.

Exhibit C is a request for reconveyance as provided in article II.2.c, and should provide substantially as follows:

REQUEST FOR RECONVEYANCE OF
BENEFICIAL INTEREST

TO: [Name of Trustee] TRUST NO: [State Number]

The undersigned is the legal owner and holder of the Note in the original sum of [Amount] secured by a beneficial interest in that certain Trust Agreement and Declaration of Trust dated [Date] and entered into by and among [Parties], relating to certain real and personal property in [County] County, California.

Said Note, together with all other indebtedness to the undersigned secured by said beneficial interest under the Trust Agreement and Declaration of Trust, has been fully paid and satisfied; and you are hereby requested and directed, upon payment to you of any sums owing to you under the terms of said Trust Agreement and Declaration of Trust, to cancel said Note above mentioned, and all other evidences

of indebtedness to the undersigned secured by said beneficial interest under the Trust Agreement and Declaration of Trust in your possession, and to reconvey, without warranty, to the parties designated by the terms of said Trust Agreement and Declaration of Trust, all of the estate held by you under the same for the use and benefit of the undersigned.

Said Note is hereby delivered to you for cancellation.

Dated: _____.

[Signed]