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The Top 10 Things Practitioners Should Know About Upcoming Changes to Washington Probate and Trust Law

by Kelly Bowra – Stokes Lawrence, P.S.

House Bill 1051, an act relating to trusts and estates (the “Act”), is the most significant piece of Washington State probate and trust legislation since the Trust and Estate Dispute Resolution Act (“TEDRA”) was enacted in 1999. The Act has passed the legislature and the governor has signed it into law; however, it will not take effect until January 1, 2012. The Act is the result of nearly a decade of work by a Task Force established by the Washington State Bar Association’s Executive Committee of the Real Property, Probate and Trust Section to investigate whether to adopt the Uniform Trust Code (“UTC”) in Washington.¹ While the Act does not adopt the UTC in its entirety, it integrates portions of the UTC and other non-UTC provisions into existing probate and trust statutes. Some of the changes codify existing common law rules. The Washington probate and trust statutes, as amended by the Act, will provide more comprehensive guidance for trustees and allow for clearer expectations by beneficiaries than under current law (*i.e.*, through the end of this year). This article, which is intended to serve as a basic primer on the Act, summarizes its key provisions and contrasts such provisions to current Washington law.

1. The Act Clarifies the Duty of a Trustee to Inform Interested Parties About the Administration of the Trust

The Act provides that the trustee has a specific duty to notify the beneficiaries about the existence of a trust once it becomes irrevocable and keep the beneficiaries informed about the administration of the trust. This notice requirement applies

only to irrevocable trusts established after December 31, 2011, and revocable trusts that became irrevocable after December 31, 2011, provided that all common law duties of a trustee to notify beneficiaries that applied to trusts created or that became irrevocable before such date are not affected. The trustor may not relieve the trustee from this duty to provide notice. This is significant because the trustor may modify many other statutory duties and powers of the trustee through the terms of the trust.

The Act outlines precise steps that the trustee can take to satisfy such duties. Within 60 days of assuming the role of trustee, the trustee must notify all “interested parties” as defined by TEDRA² about (1) the existence of the trust; (2) the identity of the trustor; (3) the trustee’s contact information; and (4) the right of a beneficiary to request certain information from the trustee. The Act also clarifies which beneficiaries are entitled to such notice and amends the virtual representation statute so that an income beneficiary with a general power of appointment (or certain limited powers of appointment) can accept notice on behalf of the takers in default. Through these changes to the virtual representation statute, a trustor who wants to limit notice to remainder beneficiaries will now have a clear mechanism to do so.

The Act provides that the trustee also has an ongoing duty to inform all interested parties about the administration of the trust. A trustee can satisfy this duty by giving a statement that contains the following information for the relevant period of trust administration:

- (A) Receipts and disbursements of trust principal and income;
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- (B) Trust assets and liabilities and the values thereof;
- (C) The compensation of the trustee and that of the trustee's agents;
- (D) Disclosure of any pledge, mortgage, option or lease of trust property, or other agreement affecting trust property for at least a five-year period; and
- (E) Disclosure of all transactions that could have been affected by a conflict between the trustee's fiduciary and personal interests.

The statement must also notify the recipient that he or she may petition the superior court to obtain review of the statement or of the underlying actions by the trustee. Furthermore, as discussed in section 6 below, the statement must disclose that the statute of limitations for a breach of trust claim is three years from receipt of the statement.

Under the Act, if an interested party requests information from a trustee about his or her rights under the trust, the trustee has 60 days to respond to the request. The trustee may satisfy this duty to provide information by giving the requesting party a copy of the trust instrument.

The duties of a trustee are governed by the trust terms, statute, and common law. The current Washington statute does not specifically require the trustee to notify beneficiaries about the existence of a trust and the extent of the duty of the trustee to notify the beneficiaries under common law is vague. Similarly, the current Washington statute mandates only a few situations in which the trustee must provide information to beneficiaries, leaving the trustee to look to common law to provide guidance regarding the extent to which the trustee must inform beneficiaries about the administration of the trust. For example, the current statute provides that a trustee cannot enter into a significant non-routine transaction³ without notifying the beneficiaries and the trustee must provide each adult income trust beneficiary with an itemized statement of all current receipts and disbursements made by the trustee unless the trustor provides otherwise in the trust instrument. RCW 11.106.020. For a statement of the common law, see *Esmieu v. Schrag*, 88 Wash.2d 490, 498, 563 P.2d 203 (1977) (finding that the trustee's duties of good faith, care, loyalty and integrity to the beneficiaries include informing beneficiaries of all facts to aid them in protecting their interests).

The foregoing changes to the statute flesh out the duties of a trustee and should facilitate trust administration by clarifying what the trustee must do to inform interested parties about trust administration and what such parties can do if the trustee does not satisfy this duty.

2. Trustees Have New Specifically Enumerated Powers to Manage Trust Property

The current Washington statute enumerates several specific actions and powers the trustee may use to administer the trust.

RCW 11.98.070. The Act adds to this list, providing that the trustee has the authority to (1) contest or settle claims by or against the trust; (2) exercise tax elections; (3) prosecute or defend an action regarding trust property or actions by the trustee; (4) exercise appropriate powers to wind up the administration of the trust due to the termination of the trust; (5) clarify the method of making distributions to minors; and (6) select a mode of payment under a retirement plan, annuity, or life insurance payable to the trustee. Practitioners often include these powers in the trust instrument, but this change should increase the number of trustees who have the aforementioned powers as well as facilitate communication between trustees and third parties who feel more comfortable relying on statutory authority than that of the trust instrument.

3. New Bright Line Rules Help Determine Whether a Trust Has a Washington Situs

The Act provides that a trust has a Washington situs if the trust has at least one connection to Washington that is of the type enumerated in the Act, described more particularly below, and (1) the trust designates Washington as the trust situs; (2) the trustee registers the trust as a Washington trust;⁴ or (3) the trust is an *inter vivos* trust and the trustor was domiciled in Washington when the trust became irrevocable.

The Act lists the following factors as ones that demonstrate a connection to Washington:

- (A) The trustee has a place of business in Washington or resides in the state;
- (B) More than an insignificant amount of the trust administration occurs in Washington;
- (C) The trustor resided in Washington when the trust was established or when the trust became irrevocable;
- (D) At least one beneficiary resides in Washington; or
- (E) The trust holds at least one piece of Washington real property.

In addition to the foregoing, the situs of a testamentary trust is Washington if the will was admitted to probate in Washington, or if the trust satisfies one of the factors corresponding to (A), (D), or (E) above. Alternatively, if the trust does not designate Washington as the situs and the trustee has not registered the trust, then a court can determine whether the trust has a Washington situs.

Washington law currently provides that if the trust does not identify a trust situs, the trust situs is based on the principal place of administration of the trust (*i.e.*, the trustee's usual place of business where the day-to-day records pertaining to the trust are kept or the trustee's residence if the trustee has no such place of business). RCW 11.96A.030. By creating new bright-line rules, the Act not only makes it easier to determine whether a trust has a Washington situs, but it enables additional trusts to claim a Washington situs.

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4. The Act Streamlines the Procedure for Changing the Trust Situs

In order to transfer a Washington situs trust to another state, the Act requires that the trust have a specific connection to the new jurisdiction. Just as under the current statute, the trustee may only transfer the trust if it also determines that a trust transfer (1) facilitates the administration of the trust; (2) does not violate the terms of the trust; and (3) would be administered by a qualified trustee. RCW 11.98.045.

The Act modifies the procedural requirements for transferring a Washington situs trust. The Act provides that before the trustee may initiate a transfer of trust situs, the trustee must notify all interested parties and give such individuals at least 60 days to object. If any party objects, the authority of the trustee to transfer the trust situs terminates. If no party objects and the trustee transfers the trust situs, the trustee must file a notice of transfer of situs and termination of registration with the court of the county, if the trust was registered under RCW 11.98.045. Just as under the existing statute, a trustee may transfer the situs of a trust through the use of a non-judicial binding agreement. RCW 11.98.051.

These new provisions clarify that if the trust does not authorize the trustee to change the trust situs, the trustee can change the trust situs if the trustee provides proper notice to the interested parties along with a form on which the interested parties can consent or object and the trustee receives no written objection within 60 days of the date of the notice. RCW 11.98.051. It is important to note that a change of trust situs is different than a change of trustee. A change of trust situs does not authorize a change of trustee. A change of trustee must comply with RCW 11.98.039. Similarly, a change of trustee to a foreign trustee does not by itself change the situs of the trust.

5. A Court Can Now Correct Trust and Will Terms that Are the Result of a Mistake of Law or of Fact

Currently, courts do not have specific statutory authority to correct trust or will terms that are the product of a mistake. The Act adds a new section that provides that if there is clear, cogent, and convincing evidence of the trustor's or testator's intent and the terms of the trust or will were the result of a mistake of fact or law, such terms can be reformed through a judicial proceeding or binding non-judicial agreement. Likewise, the Act modifies the definition of matter under TEDRA to include the reformation of a trust or will to correct a mistake. RCW 11.96A.030. Under common law, the intent of a trustor or testator is of paramount concern in interpreting and administering a trust or will, and the Act now provides a mechanism to correct mistakes and give effect to the trustor's or testator's intent.

6. New Factors Start the Clock Running for the Three-Year Statute-of-Limitations Period

The Act maintains the three-year statute of limitations but provides the limitations period commences the date the beneficiary (or the beneficiary's representative) receives a report that adequately discloses the existence of a potential claim for breach of trust and informs the beneficiary of the limitations period for bringing such a claim. If the trustee does not provide adequate disclosure to the beneficiary, then the beneficiary has three years to bring suit against the trustee for breach of trust from the earliest of (1) the trustee ceasing to act as trustee; (2) the end of the beneficiary's interest in the trust; or (3) the trust termination. If the beneficiary fails to bring suit timely, his or her claim will be time-barred.

Under current Washington law, a beneficiary must file a lawsuit for breach of trust against the trustee within three years from the earliest of (1) the time the alleged breach was (or should have been) discovered; (2) the discharge of the trustee; or (3) the trust termination. RCW 11.96A.070. By adding the report requirement, the Act gives trustees

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greater control over when the limitations period commences and benefits the beneficiaries by disclosing the existence of a potential claim for breach of trust.

7. The Act Expands the Doctrine of Virtual Representation to Include Representation by Fiduciaries

The Act expands the doctrine of virtual representation found under TEDRA to enable fiduciaries to virtually represent the beneficiaries in situations in which the interests of the fiduciary and the beneficiaries are not in conflict. In such cases, (1) a guardian may represent and bind the estate that the guardian controls; (2) an agent having authority to act with respect to the particular question or dispute may represent and bind the principal; (3) a trustee may represent and bind the beneficiaries of the trust; and (4) a personal representative of a decedent's estate may represent and bind persons interested in the estate. This change to the statute should streamline the process of certain TEDRA matters by requiring the involvement of fewer parties.

8. New Provisions Apply Specifically to Revocable Living Trusts, Recognizing the Use of Such Trusts as Will Substitutes

The current Washington statute does not have any provisions that apply specifically to revocable living trusts. The Act adds a new chapter to title 11 that applies to revocable living trusts. It states that the capacity required for a trustor of a revocable living trust to create, amend, revoke or add property to such trust is the same as that required to make a will. Current Washington law provides that "any person of sound mind who has attained the age of eighteen years may, by last will, devise all his or her estate, both real and personal." RCW 11.12.010. Therefore, under the Act, any person who is at least eighteen years old and of sound mind may create, amend, revoke or add property to a revocable living trust. "Sound mind" is not defined by the statute, but has been developed through common law.

The Act provides that the trustor may not revoke or amend the trust unless the trust states that it is revocable. If the trust is revocable, then the trustor may revoke or amend the trust (only with regard to the trustor's portion of the property if there is more than one trustor) by substantially complying with the method provided in the trust. Alternatively, if the trust does not provide such a method, then the trustor may revoke or amend the trust by a written instrument signed by the trustor evidencing the trustor's intent to revoke or amend. A later will or codicil that expressly refers to the trust would constitute such an amendment or revocation.

The Act also adds a provision regarding contesting the validity of a revocable living trust. Specifically, the Act provides that a person may contest the validity of the trust within the earlier of 24 months of the trustor's death or four months after the trustee sent the person notice as discussed in section 1 above. This

shortened four-month time period in which to contest a trust is similar to that of will contests. See RCW 11.24.010.

9. The Act Codifies the Cy Pres Doctrine

The Act codifies the common law *Cy Pres* Doctrine, which provides that when the original objective of the trustor is impossible or impracticable to perform, the trust terms must be interpreted as closely as possible to the original intention of the trustor to prevent the trust from failing. Specifically, the Act provides that if any charitable⁵ disposition made in a trust becomes unlawful or impracticable to achieve, the disposition does not fail and the subject property does not revert to the alternate beneficiary, but instead the court may order that the property be distributed in a manner consistent with the trustor's charitable purposes.

10. The Act Codifies the Common Law Duty of Loyalty

The Act also codifies the trustee's common law duty of loyalty, namely that the trustee not profit at the expense of any beneficiary and the trustee not be in a position of a conflict of interest with any beneficiary. If a transaction involves a conflict between the trustee's fiduciary and personal interests, it is voidable by a beneficiary "otherwise affected"⁶ unless: (1) the transaction was authorized by the terms of the trust; (2) the transaction was approved by the court or in a nonjudicial binding agreement under TEDRA; (3) the beneficiary is time barred (see section 6 above); (4) the beneficiary consented to the trustee's conduct or ratified the transaction; or (5) the transaction involved a contract entered into before the person was the trustee. The Act also provides that the court may appoint a "special fiduciary" to make a decision for a proposed transaction that could violate the trustee's duty of loyalty.

The Act provides that the following transactions are not voidable if they were fair to the beneficiaries: (1) an agreement between a trustee and a beneficiary about the appointment or compensation of the trustee; (2) payment of reasonable compensation to the trustee; (3) a transaction between a trust and another trust of which the trustee is a fiduciary or in which a beneficiary has an interest; (4) a deposit of trust funds in a financial-service institution operated by the trustee or its affiliate; (5) a delegation and any transaction made pursuant to the delegation from a trustee to an agent that is affiliated or associated with the trustee; or (6) any loan from the trustee or its affiliate.

Conclusion

In conclusion, Washington law, as modified by the Act, will provide a more comprehensive statutory framework regarding the duty of the trustees, the rights of the beneficiaries, and the procedures relating to trust administration in general. This clarity should benefit all parties to the trust. Among other things ac-

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Limitations on Debtor and Guarantor Exposure After Judicial and Nonjudicial Foreclosure

by Luke Campbell and Jeff Bashaw - Montgomery Purdue Blankinship & Austin

Commercial real estate loans made over the last decade – including retail properties, office space, industrial facilities, hotels and apartments – totaling \$1.4 trillion will require refinancing from 2011 through 2014. Nearly half are at present “underwater,” meaning the borrower owes more on the loan than the underlying property is worth. Commercial property values have fallen more than 40 percent since the beginning of 2007. Commercial Real Estate Losses and the Risk to Financial Stability, Congressional Oversight Panel, February Oversight Report, February 11, 2010, available at <http://cop.senate.gov/documents/cop-021110-report.pdf>.

It is also estimated that nearly a quarter of U.S. homeowners are in the same boat (or more accurately, the same submarine). U.S. Housing and Mortgage Trends, CoreLogic, March 2011, available at http://www.corelogic.com/uploadedFiles/Pages/About_Us/ResearchTrends/CL_Q4_2010_Negative_Equity_FINAL.pdf.

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completed by the Act, the trustee will have clearer guidance on the trustee’s duties; the beneficiaries will have clearer guidance to assess whether he trustee satisfies those duties; and should the trustee violate his or her duties, the Act clarifies how long a beneficiary has to file a claim against the trustee.

- 1 Members of the Task Force include Watson Blair, Karen Boxx, Michael Carrico, Tom Culbertson, Fred Emry, Al Falk, Marcia Fujimoto, Ivan Landreth, Twig Mills, and Ann Wilson.
- 2 “Persons interested in the estate or trust” means the trustor, if living, all persons beneficially interested in the estate or trust, persons holding powers over the trust or estate assets, the attorney general in the case of any charitable trust where the attorney general would be a necessary party to judicial proceedings concerning the trust, and any personal representative or trustee of the estate or trust. RCW 11.96A.030.
- 3 A “significant non-routine transaction” means: (1) certain transactions involving real estate that constitute 25% or more of the trust; (2) the sale of tangible personal property that constitutes 25% or more of the trust; (3) the sale of closely held stock if the stock in question constitutes more than 25% of the corporation’s outstanding shares; or (4) the sale of shares of stock that would cause the trust to no longer own a controlling interest in the corporation. RCW 11.100.140.
- 4 The trustee may register the trust with the clerk of court in the county of the trust venue and notifies the interested parties of the filing within five days. A sample form for the notice of registration is included in the Act. The statement must include the contact information for the trustee; the name and date of the trust, name of the trustor, and the factors that qualify the trust for registration. A party receiving the statement has 30 days from the filing date to object to the registration.
- 5 Under the Act, a “charitable purpose” means one for the relief of poverty, the advancement of education or religion, the promotion of health, governmental or municipal purposes, or other purposes the achievement of which is beneficial to a community.
- 6 A transaction involving the management of trust property is presumed to be “otherwise affected” by a conflict between fiduciary and personal interests if it is entered into by the trustee with (1) the trustee’s spouse or registered domestic partner; (2) the trustee’s descendants, siblings, parents, or their spouses or registered domestic partners; (3) an agent or attorney of the trustee; or (4) a corporation or other enterprise in which the trustee has an interest that might affect the trustee’s best judgment.

Thus, a significant number of loans – both commercial and residential – face the prospect of default, whether because the owner cannot continue to make the required payments, because the owner strategically chooses to default, or because the lender has exercised its option to declare a default based on an “insecurity” clause or the debtor falling outside of specified loan coverage ratios. When the inevitable default occurs, the lender must evaluate its options, including, among other things, pursuing a judicial or non-judicial foreclosure. That decision may ultimately be made based on the financial situation and assets of the borrower or its guarantor(s), weighing whether it is worth pursuing a more expensive, time-consuming judicial foreclosure in order to preserve the ability to proceed to recover a deficiency, and considering what limitations may exist under that process.

In a judicial foreclosure, the creditor may proceed against the debtor or guarantor for the deficiency – the amount that remains owing on the debt once the property has been sold. After a non-judicial foreclosure involving a commercial property, while the lender generally cannot proceed against the debtor, the lender may proceed against a guarantor for the deficiency.

This article describes how the statutory concepts of “fair value” and “upset price” can limit a lender’s ability to proceed against the debtor and guarantor for a deficiency after foreclosure.

Judicial Foreclosure

A. Deficiency Judgments Against Debtors and Guarantors Are Limited by the “Upset Price”

A judicial foreclosure is the exclusive method of foreclosing a straight mortgage, but may optionally be used to foreclose deeds of trust and real estate contracts. Generally, the steps in a judicial foreclosure consist of the following: (1) file a summons and complaint in superior court, naming and serving all the parties whose interests need to be foreclosed (i.e., the debtor, all junior lien holders identified in a title report, etc.); (2) reduce the complaint to judgment against each defendant, either by a motion for default, motion for summary judgment, or proof at trial; and (3) use of the sheriff in the county in which the property is located to execute and sell the real property.

Generally, judicial foreclosures are considered more costly and complicated than non-judicial foreclosures. Further, judicial foreclosures usually result in a redemption period, which allows the debtor and certain junior lien holders to buy the foreclosed property back after the foreclosure by paying the amount paid at the foreclosure sale rather than the amount owed under the debt. The redemption period is generally twelve months, but can be reduced to eight months if a deficiency judgment is waived. However, judicial foreclosures may allow for acceleration of an

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installment obligation and, as noted above and further discussed below, they may allow for a deficiency judgment.

After a judicial foreclosure, a lender may pursue the debtor or guarantor for a deficiency, or the difference between the sale price of the property and the total debt. However, Washington law provides that the court may, prior to the sale, establish a minimum “upset” price that could trump the actual high bid:

... The court, in ordering the sale, may in its discretion, take judicial notice of economic conditions, and after a proper hearing, fix a minimum or upset price to which the mortgaged premises must be bid or sold before confirmation of the sale.

The court may, upon application for the confirmation of a sale, if it has not theretofore fixed an upset price, conduct a hearing, establish the value of the property, and, as a condition to confirmation, require that the fair value of the property be credited upon the foreclosure judgment. If an upset price has been established, the plaintiff may be required to credit this amount upon the judgment as a condition to confirmation. If the fair value as found by the court, when applied to the mortgage debt, discharges it, no deficiency judgment shall be granted.
RCW 61.12.060.¹

The concept of the upset price originated in Washington state during the depression years, *National Bank of Washington v. Equity Investors*, 81 Wn.2d 886, 925 (1973), when property values were, like today, substantially depressed and bidding on foreclosed properties was likely to be uncompetitive. The aim of the upset price is to give the borrower and guarantor credit for what the foreclosed property would have sold for had genuinely competitive bidding occurred in the foreclosure sale, presumably a fairer reflection of the lender’s actual security in the foreclosed property.

Though guarantor rights with respect to an upset price have not been specifically addressed by case law, the upset price statute (RCW 61.12.060) appears to apply equally to borrowers and guarantors, such that crediting the upset price to the foreclosure judgment will benefit both the borrower and the guarantor. A guarantor looking to take advantage of this should make sure to assert this right prior to the court confirming the foreclosure sale.

B. When Is an Upset Price Warranted?

A minimum price or upset price is warranted when competitive bidding is unlikely to occur at the sale. It is irrelevant whether the bidding will be stifled due to temporary economic fluctuations, local conditions in the particular real estate market, or even a national economic depression. Whether an upset price should be imposed depends on the *effect* – the absence of competitive bidding – and not the *causes* of that effect.

The Washington State Supreme Court clearly stated this rule in *American Federal Savings & Loan Ass’n of Tacoma v. McCaffrey*, 107 Wn.2d 181, 187 (1986), when it wrote that an upset price may be appropriate “[i]f, because of the kind, nature, scope or peculiarities of the property, or a depressed economy, local or general, genuinely competitive bidding will be substantially discouraged or even stifled.”

C. How Is the Upset Price Determined?

The upset price is determined by establishing a “fair bid,” as calculated at the time of sale, but under normal (i.e., competitive bidding) conditions. *Lee v. Barnes*, 61 Wn.2d 581, 587 (1963); *McCaffrey* at 183. Thus, the upset price mechanism does not ignore present economic conditions, which may well have reduced the fair value of the property. Instead, the aim of the upset price is to ensure that the minimum price of the property is reflective of the value the property would command, at the time of sale, if it were the subject of a genuinely competitive bidding process, not one where bidding would be stifled or discouraged for whatever reason. *See McCaffrey* at 188.

In fixing an upset price, a court will consider several factors, including (i) the state of the economy and local economic conditions; (ii) the usefulness of the property under normal conditions; (iii) its potential or future value; (iv) the type of property involved; (v) its unique qualities, if any; and (vi) any other characteristics or conditions affecting its marketability, along with any other factors which a bidder might consider in determining a fair bid. *McCaffrey* at 188-89. Assessed value is *not* a consideration in determining a fair bid. *McClure v. Delguzzi*, 53 Wn. App. 404, 408 (1989).

D. How Much Do Upset Prices Differ from Sale Prices or Appraisals in Practice?

There is not an abundance of examples of the effect of the upset price in recent years, at least not in circumstances that have been addressed in reported cases. In past cases in Washington, courts have indeed used the discretion granted to them by statute and fixed upset prices that were significantly higher than the highest bid at a foreclosure sale and sometimes even the parties’ own appraised values.

In *McCaffrey*, the court set the upset price at \$360,000, 25% greater than the price bid at the judicial sale (\$288,000). The debtor’s expert had testified to a current market value of \$432,000, while the creditor’s expert testified to a market value of \$355,000 (but further argued that number would need to be severely discounted in light of the nature of the sheriff’s sale and the possibility of redemption).

In *Farm Credit Bureau of Spokane v. Tucker*, 62 Wn. App. 196 (1991), the court fixed the upset price at \$956,400. The property had been purchased in 1981 for \$1,600,000, appraised in 1988

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by the creditor's expert witness at \$790,000, and appraised by the debtor's expert at the time of the hearing at \$1,065,000 or \$1,283,200 under "normal conditions."

In *National Bank of Washington v. Equity Investors*, 81 Wn.2d 886 (1973), the trial court refused to confirm the highest bid of \$1,880,000, submitted by the foreclosing bank. The court fixed the upset price at \$2,247,500, nearly 20% above the highest bid. At the time it made the loan, the bank had relied upon an appraisal of \$2,500,000. The actual investment made in the property was \$2,300,000. At the hearing, two expert witnesses set the value at \$2,000,000 and \$2,150,000. The trial court's upset price was affirmed as a valid exercise of the court's discretion.

Non-Judicial Foreclosures

A. Proceeding Against Guarantors After a Non-judicial Foreclosure Is Limited by a "Fair Value" Determination

Unless an exception applies, a non-judicial foreclosure prevents a creditor from seeking a deficiency judgment against the borrower, grantor, or guarantor. RCW 61.24.100(1). The creditor can obtain a deficiency judgment against a guarantor for a deed of trust executed after June 11, 1998 which secures a commercial loan. RCW 61.24.100(3)(c), (4).² However, when a guarantor is sued for a deficiency they have the right to request that the court determine the "fair value" of the property and credit against the guarantor's obligation the difference between the "fair value" and sale price at the auction. RCW 61.24.100(5). The statute defines "fair value" as follows:

the most probable price, as of the date of the trustee's sale, which would be paid in cash or other immediately available funds, after deduction of prior liens and encumbrances with interest to the date of the trustee's sale, for which the property would sell on such date after reasonable exposure in the market under conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under duress.

RCW 61.24.005(5).

B. How Is Fair Value Determined?

Under general rules of statutory construction, the courts must interpret the legislative intent of a statute by first examining the language of the statute itself. The phrase "reasonable exposure in the market" eliminates the possibility that "fair value" is simply the price established by a fair auction or fair trustee's sale. However, the remainder of the definition appears to leave the courts with significant discretion in determining the meaning of "fair value." For example, it could be argued that "fair value" was intended to establish a value more akin to "fair market value." The definition of "fair value" under the non-judicial foreclosure statute is in many

ways similar to case law definitions of "fair market value." *State v. Kleist*, 126 Wn.2d 432 (1995) (stating that "market value" or "fair market value" is "the price which a well-informed buyer would pay to a well-informed seller, where neither is obliged to enter into the transaction."). In fact, other states use identical definitions of "fair value" in similar statutory schemes, but use the phrase "fair market value" instead of the phrase "fair value." *E.g.*, ARIZ. REV. STAT. § 33-814(A). However, in the context of a corporate shareholder's rights of dissent, a Washington court held that the use of the phrase "fair value" in RCW 23B.13.020 did not, without further definition, equal "fair market value." *See Matthew G. Norton Co. v. Smyth*, 112 Wn. App. 65 (2002). Although valuation of less than full ownership of a corporation is distinguishable from an entire fee ownership in real property, this opinion supports an argument that the Legislature's use of "fair value" is not intended to mean "fair market value."

It could be argued that the use of the phrase "upset price" in the judicial foreclosure statute and the use of the phrase "fair value" in the non-judicial foreclosure statute represent the Legislature's intent that the valuation of real property under each statute be evaluated under distinct concepts. This argument could be supported by the fact that the definition of "fair value" under the non-judicial foreclosure statute does not include specific references to economic factors and property specific facts that are discussed in the body of case law that has evolved in the context of the "upset price." RCW 61.24.100(5) may also lend further support to the argument for distinct valuation concepts in providing that the guarantors right to establish "fair value" is "in lieu of any right ... to establish an upset price pursuant to RCW 61.12.060 prior to a trustee's sale."³

On the other hand, as noted above, the definition of "fair value" includes concepts that are very similar to "fair market value" and specifically references the "most probable price... after reasonable exposure in the market under conditions requisite to a fair sale." Thus, it is also arguable that the "upset price" case law should apply to the determination of "fair value" because the definition of "fair value" incorporates many of the economic and property specific factors discussed in that case law. This argument is further supported by the fact that this body of case law is interpreting the meaning of "upset price" under RCW 61.12.060, a statutory provision that specifically provides (a) "that the *fair value* of the property be credited upon the foreclosure judgment; and specifically refers to the (b) "*fair value* as found by the court." (emphasis added).

Conclusion and Practice Pointers

Although a significant number of commercial and residential loans are presently underwater, and therefore at risk of going into default and possibly foreclosure without adequate security to cover the debtor's obligations, there are procedures available that can

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Limitations on Debtor and Guarantor Exposure ...

limit a lender's ability to proceed against the debtor or guarantor for a deficiency after a judicial or non-judicial foreclosure.

A debtor or guarantor whose property is being foreclosed judicially may reduce or even eliminate a possible deficiency judgment by asking the court to invoke its discretion and fix an upset price. Likewise, in a non-judicial foreclosure, a guarantor may request that the court determine the fair value of the property as of the time of the sale, and in that event the deficiency judgment against the guarantor shall be limited to the difference between the amount owed and the fair value.

Secured creditors should be cognizant of the possibility of an upset price or fair value when negotiating workouts, as it may reduce their negotiating leverage. They should also consider the possibility of an upset price when bidding at a judicial foreclosure sale, as a low bid that takes advantage of and is reflective of uncompetitive bidding is more likely to encourage a debtor to invoke the upset price mechanism.

Likewise, debtors and guarantors should be aware of these options when negotiating workouts and obtain their own appraisals,

as their potential exposure may be less than a creditor's calculation. A debtor or guarantor having its own appraisal may give the court the evidence it requires to fix a higher upset price or fair value, thereby limiting or eliminating the possible deficiency.

- 1 After the sale, the sheriff files a return of sale with the clerk and the clerk notes a motion for the "confirmation" of the sale. RCW 6.21.110. The court can establish the upset price prior to the sale or after the sale and prior to confirmation.
- 2 Other important prerequisites to holding a guarantor liable remain. RCW 61.24.100(3)(c) and RCW 61.24.042 (requiring special notice to guarantor); RCW 61.24.100(4) (generally requiring commencement of an action against the guarantor within one year of the sale); RCW 61.24.100(6) (providing for application of the homestead exemption if the property is the guarantor's principal residence); RCW 61.24.100(7) (discharging the obligation of the guarantor if the creditor accepts a deed in lieu of foreclosure without the guarantor agreeing to an ongoing obligation).
- 3 A guarantor looking aggressively for defenses could potentially argue that RCW 61.24.100(5) provides a right in a non-judicial foreclosure for the guarantor to request that a court establish an upset price prior to a trustee's sale. However, while RCW 61.24.020 generally applies the law of mortgages to deeds of trust, RCW 61.12.060 contemplates establishing an upset price by the court when "ordering the sale" or "upon application for the confirmation of sale." Neither of these events occurs in a non-judicial foreclosure. Thus, an ambiguity remains that could be leveraged by a guarantor looking for defenses in a non-judicial foreclosure.

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Recent Developments

Probate and Trust

by Kirsten L. Ambach, Karr Tuttle Campbell and Kathryn M. Andersson, Lane Powell P.C.

The trial court did not abuse its discretion in approving the interim accounting of a trust created by decedent and the final accounting for her estate. *In re Estate of Mettle*, 2011 Wash. App. Lexis 737 (Div. II March 29, 2011) UNPUBLISHED.

Dorothy Mettle died in December 2002. Her son Gregg was the personal representative of her estate as well as successor trustee of the trust she created. Gregg and his brothers Guy and John were equal beneficiaries of Dorothy's trust.

In September 2003, Gregg filed a petition for an order admitting Dorothy's will to probate, appointing him personal representative, and adjudicating the solvency of the estate. Pursuant to the will's instructions, the court granted Gregg nonintervention powers. Dorothy's will further directed that the assets in her estate be transferred to the trustee and placed in the trust.

In October 2004, Gregg filed a declaration of completion of probate in order to complete administration of the estate. In November 2004, Guy filed a petition challenging Gregg's proposed completion of the administration and as a result the estate administration continued. In December 2004, Gregg made a partial distribution of trust funds to each beneficiary.

During the period of administration of the estate, Guy filed numerous pleadings that delayed closure of the estate. In March 2008, Gregg filed a petition for an order approving the estate's final accounting and decree of distribution. On the same day, Gregg also filed a petition to approve the trustee's interim accounting for the trust. The court granted Gregg's subsequent motion to consolidate the trust hearing with the estate hearing.

Following a hearing in June 2008, the trial court entered orders approving the final accounting of the estate and the interim accounting of the trust. Both orders denied Guy's many requests for relief. Guy appealed the orders.

The Court of Appeals upheld the trial court's approval of the final accounting for the estate and the interim accounting for the trust. One of Guy's principal arguments was that the trial court should not have approved Gregg's actions as personal representative, since he failed to file the will within the thirty-day period after receiving notice of the testator's death, as set forth under RCW 11.20.010. Citing to *In re Hyde's Estate*, 190 Wash 88, 93, 66 P.2d 856 (1937), the Court found that, although Gregg had failed to timely file the will, Guy was not damaged by the delay in filing, and therefore liability under the statute was not triggered.

Guy also complained that Gregg failed to file annual accountings. The Court stated that, because of his nonintervention powers under RCW 11.68.090, he was not required to file annual accountings under RCW 11.76.010. In addition, Guy complained that Gregg unnecessarily delayed the closing of the estate and

incurred unnecessary fees, but the Court found the fees incurred by Gregg as personal representative to be reasonable.

Similarly, the Court upheld the trial court's decision approving the interim accounting for the trust and the partial distribution to the trust beneficiaries. Although Guy again complained that Gregg failed to provide an annual accounting, the Court of Appeals, citing to *In re Park's Trust*, 39 Wn.2d 763 773, 238 P.2d 1205 (1951), found that counsel for the estate kept Guy informed of trust matters, and since any failure to provide annual trust accountings did not prejudice Guy, his claim failed.

Appellant failed to meet burden of showing that mother lacked testamentary capacity and that her will was the result of undue influence. *In the Matter of the Estate of Jacquelyn Bussler*, 2011 Wash. App. LEXIS 571, 247 P.3d 821 (Div. II, March 8, 2011).

Jacquelyn Bussler died in March 2009, survived by four children, Kathleen, Karen, James and Michael. Only Karen inherited under Jacquelyn's 2009 will, but both Karen and Kathleen had inherited under her 1997 will. In 2008, Jacquelyn's health was declining so Karen moved from Illinois to live with her mother in Washington and serve as her primary caregiver. Kathleen had last seen her mother in 2008 when she visited for five weeks.

Karen was also named as Jacquelyn's attorney in fact under a durable power of attorney prepared in 2003, which by its terms became effective upon Jacquelyn's "disability or incompetence." In late 2008 and early 2009, Karen signed documents on her mother's behalf. She testified that she did not consider her mother to be mentally disabled but rather physically disabled, stating that she had problems with shakiness that made writing difficult.

Karen stated that her mother asked her to contact an attorney in early 2009 to prepare a new will, and that she contacted the attorney who ultimately prepared Jacquelyn's 2009 after unsuccessfully trying to contact the attorney who had prepared her prior 1997 will. In March 2009, a week before her death, she executed a will that left her entire estate to Karen. She executed the will at her home with two neighbors as witnesses. The preparing attorney's legal assistant reviewed the terms of the will with Jacquelyn and witnessed and notarized Jacquelyn's and the witnesses' signatures on the will. On the same day she signed the will, she also executed a deed transferring her residence to Karen.

After Jacquelyn's death, Karen filed the 2009 will. Kathleen filed a petition requesting that the court invalidate the 2009 will and admit the 1997 will to probate, stating that the 2009 will was executed without competency or capacity and was the product

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of undue influence. Karen then filed a petition asking the court to revoke the 1997 will and probate the 2009 will.

At trial, the legal assistant to the attorney who prepared the will testified that she had reviewed the terms of the will for an hour alone with Jacquelyn, and that she appeared alert, cognizant, and to understand the terms of the documents she was signing. The neighbors who witnessed the will stated that she knew who they were, and that they were there to witness her will, but that she had to be shown where to sign the will and appeared shaky when signing. Although medical records filed with the court indicated that Jacquelyn's cognitive abilities were "mildly impaired," they also indicated that she was alert to time, place and person.

The Court of Appeals found that there was sufficient evidence to support the trial court's finding that Jacquelyn had testamentary capacity at her death. Kathleen also argued that the 2009 will was a radical departure from her prior dispositive scheme, which supported a finding that she lacked testamentary capacity. The Court of Appeals found that, to the contrary, the evidence suggested a gradual change in testamentary disposition favoring Karen over several years, including a codicil to the 1997 will replacing Kathleen with Karen as alternate personal representative, designating Karen as primary beneficiary of her life insurance policy in 2001, and appointing her attorney in fact in 2003.

Therefore, the Court of Appeals found that the trial court's findings of fact that Jacquelyn had testamentary capacity when she executed the 2009 will was based on substantial evidence, and that Kathleen had failed to prove by clear, cogent and convincing evidence that she lacked testamentary capacity.

Citing to *In re Smith's Estate*, 68 Wash.2d 145, 411 P.2d 879 (1966), and *Dean v. Jordan*, 194 Wash. 661, 79 P.2d 331 (1938), the Court also found that Kathleen had failed to show by clear, cogent and convincing evidence that the 2009 will had interfered with Jacquelyn's free will, preventing her from exercising her own judgment and choice. The Court distinguished between Kathleen's duty of production and duty of persuasion, finding that, while she had met her duty to produce substantial evidence that raised a question for the trier of fact as to whether there was undue influence, she had failed to meet her duty of persuasion by showing by clear, cogent and convincing evidence that Jacquelyn was vulnerable and susceptible to the exertion of undue influence by Karen to change her will.

The trial court's power to "review and approve" a trust accounting does not give it authority to order a reallocation plan where the trustee did not breach any fiduciary duties or otherwise abuse its discretion. *In the Matter of the Mark Anthony Fowler Special Needs Trust*, 2011 Wash. App. LEXIS 358 (Div. II, February 8, 2011) UNPUBLISHED.

In 2001, the superior court approved a special needs trust agreement created to hold 13-year old Mark Fowler's settlement proceeds stemming from an incident resulting in brain damage. Under the trust agreement, Wells Fargo was designated trustee

and as trustee may "exercise all power granted by law, including the Washington Trust Act (RCW 11.98)." Under the trust the trustee's exercise of discretion was conclusive and binding on all persons. The trust agreement required the trustee to submit an annual accounting to the court for "review and approval." The superior court approved Wells Fargo's accounting and fees each year from 2002 through 2007.

On December 16, 2008, Wells Fargo filed its accounting for October 1, 2007, through September 30, 2008. The accounting showed a loss of 13.32% (including fees), an asset allocation of 66% stocks, 31% bonds, and 3% cash, and a slight outperformance of most asset class measures for the same period. At several subsequent hearings over the next 6 months, the trial court repeatedly expressed concern about the allocation, especially the portfolio's lack of FDIC insured funds. Wells Fargo submitted a declaration from the trust's investment manager to explain its asset allocation decision, stating the portfolio's objective of a "balance between current income and long term capital appreciation." The declaration also provided a depletion analysis if the funds were invested only in insured deposits and found it would be fully depleted by 2019, 5 years before the current portfolio.

The trial court appointed a GAL to determine whether Wells Fargo 1) "complied with the prudent investor rule; 2) whether funds should be invested in insured deposits; and 3) whether the Trustee fees should be approved." The GAL's report concluded Wells Fargo had complied with the prudent investor rule, including the "total asset management" approach given the objective for a 22-year old beneficiary with special needs. It recommended that the trial court approve the trustee fees. The report stated "the 'prudent investment rule' does not require trustees to act to avoid all risk, but simply to be prudent in that risk allocation." On June 30, 2009, the trial court entered an order requiring the trustee to "present the court with a plan to transfer a portion of assets to insured deposits," and deferred approval of the trustee's fees. Wells Fargo appealed.

The issue before the Court of Appeals was "whether the trial court had authority to order the trustee to reallocate the trust's investments where the trust agreement required the trustee to submit accountings to the court 'for review and approval,' but where the trial court did not find that the trustee breached any fiduciary duty and where no evidence supported a finding of breach," and the Court held that it did not. Here the trust agreement incorporated the Washington Trust Act's prudent investor rule, which the court applies by focusing on the trustee's conduct, not overall performance. The Court restated the trustee's duty to administer the trust in the interests of the beneficiary, and asset security must be balanced with asset productivity in that regard.

The trial court had not found that Wells Fargo violated the prudent investor rule nor breached its fiduciary duties to the beneficiary. Instead, the trial court found "1) the trust's assets lost

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over 13% of their market value from October 2007 to September 2008, 2) the trust did not include insured deposits, and 3) the trust held 60 percent of its assets in equities.” The Court held these findings do not support the conclusion that Wells Fargo had abused its discretion. The trust losses resulted from market volatility rather than from selection of inferior assets. Citing the *Restatement (Third) of Trusts*, the Court stated that “judicial intervention is not warranted merely because the court would have differently exercised the discretion,” and that “beneficiaries can be disserved by undue conservatism as well as by excessive risk-taking.” The Court of Appeals held that although the trial court’s concern was understandable, it did not have the “authority to order a reallocation plan where the trustee did not breach any fiduciary duties or otherwise abuse its discretion.” The Court vacated the June 30th orders and remanded for entry of an order approving the accounting and for an award of appropriate trustee fees.

Failure to actually comply with RCW 11.24.010’s personal service requirement within the 90-day period does not toll the four-month statute of limitations for a will contest. *In the Matter of the Estate of Shirley A. Hallmeyer*, 2011 Wash. App. LEXIS 357 (Div. II, Feb. 8, 2011). UNPUBLISHED.

Shirley Hallmeyer’s will was admitted to probate on November 20, 2008, and Melissa Dowd was appointed as personal representative (PR). On March 19, 2009, Laura Conway, Hallmeyer’s daughter and the PR’s aunt, filed a petition contesting Hallmeyer’s will. On May 20, 2009, Conway’s process server began a series of 19 attempts to serve the PR. At several of these attempts, the server met with a man the server later identified as a resident of the PR’s home. But the PR was never present at these attempts and the server never left copies with the man until June 23, 2009, 96 days after the petition was filed, which the man delivered to the PR later that same day.

The PR brought a motion to dismiss the petition for time bar and lack of jurisdiction for failure to comply with the 90-day service requirement under RCW 11.24.010. The trial court agreed with Conway that she substantially complied with the requirement and denied the motion. The PR appealed.

The Court of Appeals reversed and held that there must be actual compliance with the 90-day service requirement to toll the four-month statute of limitations. Under the plain language of RCW 11.24.010, a petitioner must commence a will contest action by filing a petition within four months of the will’s acceptance for probate, and commencement only tolls the statute of limitations if personal service on the PR is made within 90 days of the filing of the petition. If personal service is not actually made in this 90-day period, the will contest action is “deemed not to have commenced.”

Because Conway failed to serve the PR or anyone residing at her residence until 96 days after the commencement of the action, the petition is considered not to have tolled the statute of

limitation and the action is now time barred. The Court agreed with the PR’s argument that “substantial compliance cannot substitute for service within the statute of limitations.” The Court also awarded the PR’s attorney fees against Conway personally because the contest was unsuccessful, delayed distribution to the beneficiaries, and the award would preserve the estate for the beneficiaries.

The trial court correctly dismissed claim of undue influence against beneficiary of an account passing at decedent’s death by joint tenancy with right of survivorship. *In the Matter of the Estate of Shirley A. Harty*, 2011 Wash. App. LEXIS 345 (Div. I, February 7, 2011) UNPUBLISHED.

Shortly before her death, Shirley Harty put one of her three sons on bank accounts in her name as a joint tenant with right of survivorship. In 2004, Shirley sold her home in Renton and moved into an assisted living facility in Bellevue at the urging of her son Patrick, close to where he lived and worked. Shirley did not like living there and in the Spring of 2005 enlisted the help of her son Greg, who lived in Portland, to help her move back to Renton. Greg, an Oregon resident, located an apartment, helped Shirley move in, and retained the services of a friend to help with errands and chores. Greg’s assistance angered the rest of the family, who felt Shirley was safer in the assisted living facility. In the summer of 2005 Greg visited Shirley and, at her request, took her to the credit union where she signed forms adding him as a joint tenant with rights of survivorship to all her accounts. Shirley died in the fall of 2005 after a sudden illness. Her will named Patrick as personal representative and her three sons as equal one-third beneficiaries. Patrick filed a petition alleging that Shirley had never intended for Greg to receive such a disproportionate share of her estate, and that Greg’s involvement in the changes to her credit union accounts amounted to a breach of his fiduciary duties to her. Greg moved to dismiss the action and the trial court granted his motion.

The Court of Appeals upheld the trial court’s decision, finding that, under RCW 30.22.100(3), “Funds belonging to a deceased depositor which remain on deposit in a joint account with right of survivorship belong to the surviving depositors unless there is clear and convincing evidence of a contrary intent at the time the account was created,” and that Patrick had not produced clear and convincing evidence of a contrary intent. Citing to *Doty v. Anderson*, 17 Wash.App. 464, 563 P.2d 1307 (1977), the Court found that this statutory presumption prevails, unless the challenger proves undue influence. Greg argued that he presented facts which gave rise to a presumption of undue influence. The Court of Appeals, citing to *In re Estate of Lint*, 135 Wash.2d 518, 957 P.2d 755 (1998) found that, although a presumption of undue influence could be raised by showing certain suspicious facts and circumstances, and even if a presumption had been

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Recent Developments

Real Property

by Samantha Waltz, Cairncross & Hempelmann, P.S.

Statute of Limitations on a Promissory Note

In *Westar Funding, Inc. v. Sorrels*, 157 Wn. App. 777, 239 P.3d 1109 (2010), the Court of Appeals, Division 2, held that the six-year statute of limitations on an action to foreclose on a promissory note began to run on the date the note became due. In addition, because the claimant failed to satisfy the statute of frauds by providing proof, in writing, that the maturity date had been extended, the statute of limitations was not tolled.

In 1992, Sorrels sold property (“Property”) to David Brown, who executed a promissory note (the “1992 note”), and a deed of trust against the Property (the “1992 deed”). Sorrels alleged that Brown failed to pay the 1992 note; however Sorrels took no action to collect or to foreclose at that time.

In 1995, Brown conveyed the Property to Sorrels as trustee for The R.E.S. Trust, noting on the excise tax affidavit that the deed was executed in lieu of foreclosure.

In 2002, Sorrels as trustee of The R.E.S. Trust, borrowed \$61,500 from Westar Financial. A promissory note and deed of trust on the Property in favor of Westar were executed to secure the loan. In the loan application, Sorrels represented that the Property was free and clear of encumbrances and that the loan would be secured by a first mortgage or deed of trust on the Property.

The R.E.S. Trust did not pay as it had agreed and Xui, the only bidder at the foreclosure sale, took title. Despite the sale, Sorrels attempted to conduct his own non-judicial foreclosure sale based on the 1992 deed. The trial court granted Westar and Xui’s motion for summary judgment seeking to quiet title and Sorrels appealed.

The Court of Appeals held that the statute of limitations barred Sorrels’s collection action and upheld the trial court’s ruling quieting title in favor of Xui. “Former RCW 4.16.040

(1989) governs the statute of limitations on promissory notes and deeds of trust,” and imposes a six-year limitation on a written contract. “When an action for foreclosure on a deed of trust is barred by the statute of limitations, RCW 7.28.300 authorizes an action to quiet title.” Because Sorrels did not file an action to collect on the 1992 note until February 16, 2007, over 12 years after it became due, he was time barred from foreclosing on it. Moreover, since Xui was a record owner of the Property through Westar’s foreclosure sale, he had the right to maintain the action to quiet title to the Property.

Sorrels attempted to argue that the statute of limitations was tolled through a series of ratified agreements. However, “[u]nder the statute of frauds, an oral contract assuming and agreeing to pay the debt of another is unenforceable.” The statute requires a writing, signed by the party to be charged, for “every special promise to answer for the debt, default, or misdoings of another person.” Since Sorrels failed to produce evidence of any such writing, there were no genuine issues of material fact as to whether the statute of limitations had run.

Construction Lien

In *Colorado Structures, Inc v. Blue Mountain Plaza, LLC*, 159 Wn. App. 654, 246 P.3d 835 (2011), the Court of Appeals, Division 3, held that a contractor could not obtain a construction lien based on test drilling because the requirements under Washington’s construction lien statutes had not been met.

Western Development Partners, LLC (“WDP”) engaged Colorado Structures, Inc. (“CSI”) to help WDP determine whether it should exercise its right to purchase a mall owned by Meyer Equities, LLC (“Meyer”). On August 7, 2007, CSI drilled test pits to determine the depth of groundwater discovered on the property.

Later that year, WDP sold its right to purchase to Blue Mountain Plaza, LLC (“BMP”). BMP contracted with CSI to perform construction work on the mall; however, Meyer refused to allow CSI access to the site until after the sale between Meyer and BMP closed on February 7, 2008.

Once construction began, BMP failed to make its payments and CSI filed liens all reflecting a work start date of February 28, 2008. BMP also failed to pay WDP under a deed of trust filed February 11, 2008 and WDP instituted a non-judicial foreclosure sale. CSI received notice of the sale and amended its liens to reflect a work start date of August 7, 2007. After the sale, CSI sought to establish that its liens had a higher priority than WDP’s deed of trust.

In order to establish a valid construction lien, Washington’s construction lien statute, RCW 60.04.021, sets forth four distinct

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established (which the trial court did not find), the result would not have been to impose upon Greg the burden of proving absence of undue influence; it would have merely been to impose upon Greg the burden of coming forward with evidence to “balance the scales.” The Court of Appeals reasoned that this is because the ultimate burden of proving undue influence by clear, cogent, and convincing evidence always remains with the challenger of the account designation. The Court of Appeals found that Patrick did not meet this burden, and therefore upheld the trial court’s decision dismissing his action.

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requirements: “(1) furnishing services or equipment (2) for improvement of real property (3) at contract prices (4) at the behest of the owner or owner’s agent.” The court found that at least the last three elements had not been met and therefore, CSI’s claim that the liens attached earlier was properly rejected.

First, “[t]he test holes did not constitute an “improvement” of the land.” The definition of improvement under RCW 60.04.011(5) suggests that the resulting product will be “permanently affixed to or part of the realty,” while “minor preparatory activities do not amount to an improvement of realty.” While the digging here provided information for future construction, it was not itself an improvement.

Second, CSI failed to meet the requirement that the lien be “for the contract price” of the professional services. The court of appeals interpreted this language to mean that a contract for the professional service must be in place in order to claim a lien. CSI had no contract when it performed the drilling and the absence of such contract precluded CSI’s claim.

Lastly, CSI’s lien claim also failed the requirement that the service be furnished at the request of the owner or the owner’s agent or contractor. Although the holes were dug at the request of WDP, Meyer, not CSI, was the owner of the property. Because Meyer had refused to let CSI work on the property until the sale of the property had closed, no liens could have been asserted by CSI prior to the time BMP became the owner.

Notices of Foreclosure to Tenants in Common

In *Homeowners Solutions, LLC v. Nguyen*, 148 Wn. App. 545, 200 P.3d 743 (2009) the Court of Appeals, Division 1, held that owners as tenants in common were each entitled to their own separate notice of foreclosure.

Sy and Lyly owned property in Seattle. Between 1999 through 2002, the property taxes were not paid and in May of 2002, King County filed a proceeding to foreclose its liens for the delinquent taxes. In order to determine who to notify of the proceeding, the county obtained a title report identifying Sy and Lyly as the owners of the property as tenants in common.

King County sent two foreclosure notices to Sy in June 2002. Both notices were returned for address deficiencies. In September, the county sent a single notice to both Sy and Lyly at an apartment address that had once been Lyly’s address. The county also published a copy of the summons and complaint in the newspaper listing Sy and Lyly as interested individuals.

The property was purchased at a foreclosure auction and Sy and Lyly brought an action against King County to vacate the judgment of foreclosure. The trial court held that notice was deficient under RCW 84.64.050 and vacated the judgment. The county appealed.

RCW 84.64.050 requires that notice be given to “the owner or owners.” The term “owners” includes record title holders as determined through a title search by a county. Because Sy and Lyly were both shown on the title report obtained by the county

as owning the parcel as tenants in common, both had a separate and distinct interest and were entitled to their own notice. The court said “where a common property is assessed as an entirety, and the county seeks to foreclose on the parcel as a whole, notice must be provided to every cotenant.” The court reasoned that it is unreasonable to expect that a single notice to one co-tenant will reasonably inform the “owners” because one cannot safely assume they will all live at the same address or will all see the notice. Since the county failed to send a separate notice to Lyly, the decision to vacate the foreclosure judgment was affirmed.

Deeds of Trust Act Requirements

In *Albice v. Premier Mortgage Services of Washington, Inc.*, 157 Wn. App. 912, 239 P.3d 1148 (2010), the Court of Appeals, Division 2, reversed the lower court’s refusal to set aside a non-judicial deed of trust foreclosure sale because the sale failed to comply with certain statutory requirements.

Washington’s Deeds of Trust Act, RCW 61.24 (the “Act”) sets forth the procedures to properly foreclose a debt secured by a deed of trust.

First, the Act requires that the foreclosing trustee issue a deed that shall recite the facts showing that the sale was conducted in compliance with the Act. In this case, the deed stated that “[a]ll legal requirements and all provisions of said Deed of Trust have been complied with, as to acts to be performed and notices to be given, as provided in Chapter 61.24 RCW.” However, the deed failed to mention the facts surrounding the sale including the six continuances, the correct original sale date, the forbearance agreement, and the make-up payments offered by the borrowers which would have cured the default if accepted. Consequently, the court found that the purchasers at the trustee’s sale were not entitled to claim the protections of RCW 61.24.040(7) that presume the sale occurred within the required time and that the defaults had not been cured.

The Act also grants a trustee authority to continue a sale for any cause the trustee deems advantageous. The court held that without an agreement restricting a continuance, the grounds for continuance are immaterial; however, the trustee’s discretion to continue a sale is limited by RCW 61.24.040(6), which provides that the trustee may continue the sale for a period or periods not exceeding a total of 120 days. The court held that this provision divests a trustee of authority to conduct a sale more than 120 days from the date in the Notice of Sale. Here, because the sale was held 161 days after the date set forth in the notice, the sale was adjudged to be void.

The court also concluded that the purchaser at the trustee’s sale, Dickinson, was not a bona fide purchaser. “A bona fide purchaser,” said the court, “is one who purchases property without actual or constructive knowledge of competing interests and pays the vendor valuable consideration. A purchaser is on notice if

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Recent Developments: Real Property

he has knowledge of facts sufficient to put an ordinary prudent man on inquiry and a reasonable diligent inquiry would lead to the discovery of title or sale defects.” Here, because Dickinson was in the business of investing in real estate investments, had experience with the foreclosure process, had been told by the owner that she didn’t ever intend to sell the property, had been tracking the continuances of this particular sale, and because the sale price was markedly low in comparison to the equity in the property, the court held, Dickinson had a duty to inquire into the legitimacy of the sale. Additionally, the court found it was clear that had an inquiry been made, serious defects in the sale would have been discovered. Accordingly, the court determined that Dickinson was not a bona fide purchaser protected under RCW 61.24.040(7).

The sale was also found void by the court based on equitable grounds. Not only was the sale price inadequate, but the trustee’s continuances and delayed start time of the actual bidding were found to have likely chilled the bidding process. Additionally, although the make-up payments offered by the borrowers before the sale would not have automatically discontinued the sale, the court held they were sufficient to require the lender, as a fiduciary to both lender and borrower, to cancel the sale.

Article Ideas?

Please contact Jeremie Lipton if you are interested in writing an article for the newsletter or if you have ideas for article topics. Jeremie’s phone number is (206) 838-9100 and his email is jlipton@sociuslaw.com.

Notes from the Chair

by Kathryn R. McKinley

As my year as Chair of the Real Property Probate and Trust Section comes to an end, I want to thank all those Executive Committee and Section members who have worked so tirelessly on behalf of the Section again this past year. In his final Note as RPPT Chair, Steve Crossland (now president-elect of the Washington State Bar Association) wrote: “I am truly honored to have been able to lead what is far and away the best Section in the Washington State Bar Association.” I have to say that I heartily concur with Steve. I have worked side by side with some of the best lawyers in Washington. I want to particularly recognize the efforts of the CLE Committees for another year of high-quality, well-attended seminars: Heidi Orr and Elizabeth Stephan on the Probate and Trust side, and Mike Larson and Brian McGinn on the Real Property side.

Again this year, the Section made its mark on legislation. At the March meeting of the Board of Governors, the Section was singled out by the WSBA legislative liaison for our “extraordinary efforts” on legislation during the 2011 session. On the Real Property side, we commented on a number of bills, including proposed Transfer Tax legislation, which passed with our recommended changes. On the Probate and Trust side, we were successful in passing an amendment to the Trusts and Estates statutes (by a rare unanimous vote) and assisted on legislation concerning the income tax to be paid by a trustee. I received a letter from Senator Adam Kline specifically thanking the Section for its work on these bills. I am so grateful for the hard work of the Executive Committee members serving on the Legislative Committees: Joe McCarthy and Brian Danzig for the Real Property Council, and Paul Fitzpatrick and Akane Suzuki on the Probate and Trust Council.

We continue to have what I think is the most useful website of any section, and I am thankful for the high-quality work of our web editors, Doug Lawrence and Brett Sullivan, in maintaining and improving our site. Similarly, the Section consistently puts out a high-quality newsletter for the benefit of our members. Getting the newsletter out timely is no small feat and our editor, RoseMary Reed, and assistant editor, Jeremie Lipton, have done a wonderful job.

I have been fortunate to have been assisted by extremely hard-working officers: Beth McCaw, the incoming chair, Mike Barrett incoming chair-elect, Karen Boxx, director of the Probate and Trust Council, and Tim Burkart, past chair. Finally, we have all benefited from the sage counsel of Mike Carrico as the emeritus member. One of the strengths of the RPPT Section is the continuity of leadership and institutional knowledge. Thank you to all the Executive Committee members during my tenure. And thank you to all the Section members for your continued membership and support and for the opportunity to serve.

Reasons to Use an Exemption Trust Despite the Portability Exemption

by Darin T. Jensen - Lasher Holzapfel Sperry & Ebberson PLLC

We are now six months in to this new and unprecedented gift from Congress, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act"). While many of the new tools given to estate planners through this Act are great, the purpose of this article is to advise that caution be given to reliance on the Portability Exemption. First, a quick overview of what the new Act provides for the next year and a half:

- A new estate tax rate of 35% and a \$5 million per person exemption (adjusted for certain lifetime gifts). Tax historians have noted that except for the temporary repeal of the estate tax in 2010, the estate tax rate has not been less than 45% since 1931.
- The law in effect prior to 2010 provided a \$3.5 million lifetime exemption for estates, but only a \$1 million lifetime exemption for gifts. Under the new law, the estate and gift tax exemptions have been reunified, which means that the \$5 million estate tax exemption is also available for lifetime gifts. The gift tax rate for gifts in excess of the \$5 million gift tax exemption is 35%.
- The exemption from the generation-skipping tax (GST) – the additional tax on gifts and bequests to individuals two or more generations younger than the transferor – has also increased to \$5 million from the \$1 million it would have been without the new law. The GST tax rate for transfers made in 2011 and 2012 which exceed the exemption amount is 35%.
- The new law also gives heirs of decedents dying in 2010 a choice of which estate-tax rules to apply – 2010's or 2011's. That's important because although there was no estate tax in 2010, some inherited assets are subject to potentially higher capital gains tax under the 2010 rules, a situation that actually raises the tax burden for some heirs. Inherited assets under the 2010 rules have a tax basis equal to the price when they were purchased (referred to in tax parlance as "carryover basis") rather than the price at death. That could lead to a significant income tax burden for heirs who sell assets such as stocks that had been held for many years and have greatly appreciated in value.
- The Portability Exemption was introduced, which makes it easier for those without proper tax planning in their wills to transfer the \$5 million exemption to a surviving spouse, so married couples can shield \$10 million of their assets from federal estate taxes. In the language of tax professionals, the estate tax exemption will be "portable." However, for the reasons contained in the remainder of this article, very careful analysis suggests that, in most cases, this Portability Exemption should not be relied upon.

Much has been written about how to utilize this new and short-lived law to benefit clients. Clearly, now is the time to advise clients to make large gifts since gifting will freeze the value of the gifted property as well as avoid the Washington state estate tax. But, does the Act, under the Portability Exemption, provide a license to stop drafting credit shelter trusts?

In most cases it will still be much more beneficial to clients to draft the time-honored credit shelter trust into their wills rather than rely on the Portability Exemption. A credit shelter trust is a trust that is established in the will or living trust of the first to die of a married couple, most often for the benefit of a surviving spouse. It is generally created to avoid estate taxes at a first spouse's death by taking advantage of the available federal estate tax credit. The credit shelter trust may also be referred to as an A/B trust, B trust, bypass trust, exemption equivalent, or unified credit trust. Here, such trust will simply be referred to as the Credit Trust.

The reasons to use a Credit Trust despite the Portability Exemption are as follows:

1. **Creditor Protection.** One of the best and main reasons to utilize a Credit Trust is to protect assets. A Credit Trust is great for asset protection since the Trust's assets will be protected from creditors, second spouses, etc.
2. **Certainty and Simplicity.** A Credit Trust guarantees who the remainder interest will pass to (e.g. children of a prior marriage). Furthermore, this is a very simple part of the estate plan that the family can understand.
3. **State Law Problems.** There is no comparable state portability exemption. In Washington, where there is a combined community estate greater than \$2 million, the current \$2 million Washington state tax exemption will be partially or wholly lost on the first death unless it is used to fund a Credit Trust. Losing this exemption can result in higher Washington state estate taxes on the death of the second spouse. Consequently, in order to take complete advantage of both spouses' exemptions and minimize state estate taxes on the surviving spouse's estate a Credit Trust must be used.
4. **Post Death Asset Appreciation.** The value of the Credit Trust's assets will be "frozen" and any future appreciation of those assets will escape estate taxes. Note that the appreciation component will not benefit from step up in basis at the second death.

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Reasons to Use an Exemption Trust Despite the Portability Exemption

5. **Election Must Be Made.** To be able to transfer the unused exclusion amount over to the surviving spouse, the estate of the first spouse to die must file an election on a timely filed estate tax return (including extensions), regardless of whether the estate of the first spouse to die is required to file an estate tax return. If the election is not timely made, the exemption is lost. This presents an additional expense in the first estate and a trap for the unwary.
6. **Statute of Limitations Waived.** If the election to use the Portability Exemption is made, the IRS, under the new law, is permitted to review the gift and estate tax returns of first spouse to die to determine the proper amount of unused exclusion, notwithstanding that the statute of limitations with respect to those returns may have closed. This opens the second estate to possible large audit costs and possible taxes due to assets being revalued in the first estate.
7. **No Portability of GST Exemption.** The 2010 Act does not provide for portability of the generation-skipping transfer tax exemption (the "GST Exemption"). Therefore, unless the GST Exemption is allocated elsewhere in the first estate, GST Exemption of the first spouse to die is lost if a Credit Trust is not used.
8. **Remarriage Issues.** If a surviving spouse receives some portable exemption, then remarries and her new spouse predeceases her, she could lose some of the first deceased spouse's exemption. A Credit Trust protects the amount of the exemption allocated to it regardless of future marriages.
9. **Valuation Adjustments for Assets.** A Credit Trust can be funded on the first death with assets that have been given valuation adjustments due to minority discounts, which under case law are kept separate from the surviving spouse's Credit Trust.
10. **Income Tax Savings.** There are possible income tax savings if the beneficiaries of the Credit Trust (typically children) are in a lower tax bracket.
11. **Portable Exemption Could Sunset.** While the likelihood for extending the Portability Exemption in the next estate tax bill is high, the law in its present form is set to see the Portability Exemption sunset at the end of 2012. Before abandoning the use of a Credit Trust or having spouses equalize the property they own, be aware that the portability exemption rules currently are set to expire in 2013. Even then, if the surviving spouse lives at least until 2013, there is some uncertainty as to how the portable amount of the exemption received from the deceased spouse will be treated in subsequent years.

For those who might still come away thinking that the Credit Trust has forever been replaced by the Portability Exemption here are a few reasons you can proudly give for why the Portability Exemption is better:

1. **No Credit Trust Tax Returns, Trustee Fees, etc.** Use of the Portability Exemption eliminates the need for annual income tax returns for the Credit Trust as well as potential trustee fees, separate bank accounts, etc.
2. **Portable Gift Tax Exemption.** It appears that if the transfer of the unused exemption amount is elected, it may also be used for gifts by the surviving spouse during his/her remaining life.
3. **Second Step Up in Income Tax Basis.** Appreciation between the first spouse's death and the surviving spouse's death can be sheltered from the capital gains tax.

While the Portability Exemption has its limited place, the role of and the need for the Credit Trust remains relatively unchanged. Indeed, its importance is multifaceted. The Credit Trust provides asset protection, certainty, and simplicity. To boot, it provides valuable tax savings by preserving the federal and state estate tax exemptions, freezing asset values, and preserving an asset's valuation adjustment.

The Codicil

The Smart Bank Always Files a Creditor's Claim

by Catherine C. Clark - Law Office of Catherine C. Clark, PLLC

Should a bank with a deed of trust file a creditor's claim? The prudent bank does, but most banks don't. The reason is that RCW 11.40.135 provides that a bank maintains its lien and foreclosure rights outside of probate. So for most banks, it doesn't matter.

Sometimes it does. In an estate my firm recently handled, the home of the decedent was burglarized and stripped. They took the kitchen, the light switches and even the commodes. We made a claim to the insurer for the home which issued a check to the Estate and the bank for about \$190,000.

The next question was: "Who gets the money?" The bank under the deed of trust or the Estate as the bank failed to file a creditor's claim? The bank was named as a co-loss payee as required by the deed of trust. Additionally, the Estate was insolvent. As with so many other properties, the recorded liens against the residence exceeded its assessed value.

We filed a petition for instruction laying out two arguments. The first was that the proceeds would be paid to the bank per the terms of the deed of trust. The second was that the proceeds (which were now personal property) were no longer subject to the terms of the deed of trust because of the effect of the probate statutes. Additionally, the deed of trust did not grant a security interest in such proceeds nor was there a UCC-2 security instrument that we could find.

In support of the second argument, we cited *City of Bellevue v. Cashiers Check*, 70 Wn. App. 697, 855 P.2d 330 (1993). There, Division One of the Court of Appeals was asked to decide whether a check representing the proceeds of the sale of real property to

an administrator constituted real property subject to the controlled substances forfeiture laws or personal property available to the creditors of the estate. The court stated:

... regardless of whether the check itself is viewed as personal or real property, we conclude that the personal representative had an ownership interest in it to the extent that the money was needed to meet the claims of creditors who had fulfilled the statutory requirements for filing claims against the estate.

Id. at 702. We also cited to *In re: Whitmire*, 134 Wn. App. 440, 140 P.3d 618 (2006) where the Court of Appeals was asked to decide whether an attorney's lien was entitled to priority to surplus funds from the foreclosure of real property outside of the probate statutes. The Court noted that the attorney's lien statute did not exclude attorney's liens from probate and was thus subject to the probate procedures.

We served our petition on the bank at seven different addresses (including the trustee who was conducting the foreclosure process) and gave 28 days' notice of the hearing. The bank did not respond or appear at the hearing.

The court ruled that the proceeds were an asset of the Estate available to creditors who had filed creditor's claims and thus, the bank had no claim to them.

What is the moral of the story? File a creditor's claim irrespective of whether or not your client has a deed of trust or other similar security interest. In most situations it won't matter but, sometimes, like in the above case, it does.



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For further information contact Sharlene Steele, WSBA access to justice liaison, at 206-727-8262 or sharlene@wsba.org.

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