

Memorandum 2021-62

Stock Cooperatives and Revocable Transfer on Death Deeds: Enforcement of Unrecorded Interests

At its November meeting, the Commission¹ considered the First Supplement to Memorandum 2021-55, which discussed the extent to which unrecorded interests in real property should remain enforceable against that property after it has been transferred by a revocable transfer on death deed (“RTODD”). The supplement began by discussing that question in the narrow context of property in a stock cooperative; it concluded by considering the issue more broadly, as it might bear on any property that is transferred by RTODD.

The Commission did not reach a conclusion on those issues, instead directing the staff to bring the matter back for consideration at the December meeting. This memorandum provides background for that discussion.

The Commission also directed the staff to reach out to the California Land Title Association (“CLTA”) and invite its input on the topic. The issue directly involves the recordation and title insurance system. Input from experts in that field would be very helpful.

SUMMARY OF ISSUE

Probate Code Section 5652(b) currently provides as follows:

Property is transferred by a revocable transfer on death deed subject to any limitation on the transferor’s interest that is of record at the transferor’s death, including, but not limited to, a lien, encumbrance, easement, lease, or other instrument affecting the transferor’s interest, whether recorded before or after recordation of the revocable transfer on death deed. The holder of rights under that instrument may enforce those rights against the property

1. Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission’s website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission’s staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting. However, comments that are received less than five business days prior to a Commission meeting may be presented without staff analysis.

notwithstanding its transfer by the revocable transfer on death deed.²

Why should the law require that an off-record interest be recorded in order for it to be enforceable against property transferred by an RTODD? The only explanation offered in the Commission’s 2006 RTODD recommendation is a suggestion that enforcement of off-record interests would impair the availability of title insurance and thereby impair the marketability of the transferred property:

A few jurisdictions also subject the revocable TOD deed to off-record limitations. See, e.g., Colo. Rev. Stat. § 15-15-407(3) (giving effect to an instrument unrecorded at the transferor’s death, so long as the instrument is recorded within four months after death). The Commission does not recommend adoption of a rule that recognizes a limitation not of record; that would hinder the insurability and efficacy of a revocable TOD deed title.³

The Commission generally does not propose changes to law enacted pursuant to its own prior recommendation, “[u]nless there is a good reason for doing so.”⁴ In this instance, the Legislature has directed the Commission to conduct two follow-up studies of the RTODD statute (with the initial study having been due in 2020 and a second study due in 2032).⁵ That mandate will sometimes require the Commission to reassess its initial conclusions in this area.

DISCUSSION

Section 5652(b) Stricter than General Law

As discussed in the First Supplement to Memorandum 2021-55, the rule in Section 5652(b) appears to be stricter than general law. The staff sees two ways in which this is true:

- (1) *Deadline.* Section 5652(b) sets a deadline for the use of recordation to preserve the validity of an interest. An interest that is not recorded before that deadline is no longer enforceable against the transferred property.

That rule is stricter than general law, which does not provide a deadline for recordation. So long as an instrument is recorded *before*

2. Effective January 1, 2022, legislation enacted on the Commission’s recommendation will relax this rule, by allowing a 120-day grace period for recordation after the transferor’s death. 2021 Cal. Stat. ch. 215.

3. *Revocable Transfer on Death (TOD) Deed*, 36 Cal. L. Revision Comm’n Reports 103, 168 (2006).

4. *CLRC Handbook of Practices and Procedures*, § 70 (Oct. 2019).

5. See 2015 Cal. Stat. ch. 293; 2021 Cal. Stat. ch. 215.

the property is sold or encumbered, the subsequent purchaser or encumbrancer will have constructive notice of the interest⁶ and be subject to it.⁷

Under Section 5652, an interest that is recorded one day late is invalid as to a subsequent purchaser or encumbrancer, even if it was eventually recorded, before the sale or encumbrance.

- (2) *Notice.* Under Section 5652(b), an unrecorded interest is invalid, without exception.

This is not true under general law, where an unrecorded interest is enforceable against a purchaser or encumbrancer if that person has actual or constructive knowledge of the interest.⁸

Under Section 5652 an unrecorded interest would be invalidated by the operation of an RTODD. This would be true even if a subsequent purchaser or encumbrancer has knowledge of the interest.

Is a Stricter Rule Necessary for the Effective Operation of the RTODD Statute?

As noted above, the Commission's 2006 recommendation justifies the stricter approach taken in Section 5652 as being necessary to facilitate the issuance of title insurance, thereby avoiding a potential obstacle to marketability.

To test that proposition, it would be helpful to understand the effect of an off-record interest (e.g., an unrecorded option to purchase) on a simple sale or encumbrance of real property during the owner's life. Would the existence of that unrecorded interest create a burden on marketability by impairing the availability of title insurance? What effect would the off-record interest have on a subsequent purchaser or encumbrancer?

Effect on Title Insurance. The staff does not believe that the existence of the unrecorded interest would be an obstacle to obtaining title insurance. Why? Because the standard CLTA title insurance policy contains an exception for an unrecorded interest, if the interest is ascertainable by inspection or inquiry:

The CLTA standard coverage policy excepts the obligation to indemnify for losses by reason of any facts, rights, interests, or claims that are not shown by the public records but that could be

6. 4 Cal. Real Est. § 10:60 (4th ed.) (recording as constructive notice).

7. 4 Cal. Real Est. § 10:52 (4th ed.) (notice defeats bona fide status).

8. *Id.* ("An interest or a lien on real property that is not recorded is enforceable between the parties and against any third party who acquires a subsequent interest or lien with knowledge or notice of the prior interest and is therefore not a bona fide purchaser or encumbrancer.") See also Civ. Code § 1217 ("An unrecorded instrument is valid as between the parties thereto and those who have notice thereof."); 4 Cal. Real Est. § 10:2 (4th ed.) ("An unrecorded instrument is also valid and enforceable against any party who subsequently acquires an interest in the property, who has notice of the prior unrecorded interest").

ascertained by an inspection of the property or by making inquiry of persons in possession of the property. This exclusion protects the insurer when the claim does not appear in the public records, but is disclosed by an inspection of the premises or by inquiry of persons in possession.⁹

Because standard title insurance policies do not cover an off-record interest that is ascertainable through inspection or inquiry, the existence of such an interest should not result in liability for the insurer and therefore should not be an obstacle to the issuance of a policy.

What result if the off-record interest is not ascertainable through inspection or inquiry? In that case, a bona fide purchaser or encumbrancer for value (“BFP”) would not be subject to the off-record interest.¹⁰ Thus, in this situation as well, the insurer should not face any liability. Because the BFP would not be subject to the off-record interest, there would be no losses for the insurer to indemnify.

It seems possible that there might be cases where a title insurer is required to defend a purported BFP against claims that the BFP had notice of an off-record interest. But the staff sees no reason why that risk would be more likely to arise if property is transferred by RTODD than by any other kind of deed.

Effect on Subsequent Purchaser or Encumbrancer. Under existing law, a purchaser or encumbrancer is subject to an off-record interest if that interest is ascertainable through inspection or inquiry.

Even though the insured is not protected by the terms of the CLTA standard coverage policy, these same types of matters may be enforceable against a purchaser or encumbrancer. A person who acquires a lien or title interest in property has implied notice of any matter that could be discovered where circumstances require a reasonable investigation and of matters that would be discovered by an inspection of the property or inquiry of persons in possession.¹¹

9. 3 Cal. Real Est. § 7:61 (4th ed.) (footnotes omitted). The American Land Title Association (“ALTA”) provides an alternative standard policy. 3 Cal. Real Est. § 7:61 (4th ed.). In California, the ALTA policy includes a “regional exception” of the type discussed here. 3 Cal. Real Est. § 7:59 (4th ed.) (excepting “Any facts, rights, interests or claims that are not shown by the public records, but that could be ascertained by an inspection of the land or that may be asserted by persons in possession of the land.”).

10. 4 Cal. Real Est. § 10:50 (4th ed.) (“Bona fide purchaser takes priority over prior unrecorded interests of which he or she has no notice, actual or constructive.”). See, e.g., *Vasquez v. LBS Fin. Credit Union* (2020) 52 Cal.App.5th 97, 107 (“It is ‘black-letter law’ that a bona fide purchaser for value who acquires his or her interest in real property without knowledge or notice of another’s prior rights or interest in the property takes the property free of such unknown interests.”).

11. *Id.*

The staff sees no reason why the effect of an unrecorded interest on a BFP would be any different if property is transferred by RTODD as compared to any other form of deed.

Comment Invited

If the analysis above is correct, then it is not clear how an off-record interest in real property would pose a risk to a title insurer. If the off-record interest is ascertainable through inquiry, it's carved out of the policy. If it is not ascertainable, then the BFP will not be bound by it and there will be no losses to indemnify.

Nor is it clear how a BFP would be any worse off with regard to the effect of unrecorded interests if the property at issue was transferred by RTODD as opposed to any other means of conveyance.

The staff would appreciate input from subject matter experts on these issues. In particular, the staff is interested in hearing about whether the burdens of off-record interests would be more likely to occur or be more severe in their effect for property that is transferred by RTODD, as compared to property conveyed by any other form of deed.

Possible Alternative Approach

If the analysis above is correct and complete, or if there is no difference in the level of risk posed by an RTODD and any other kind of conveyance, then there is no clear need for Section 5652(b) to be stricter than existing law.

In that case, Section 5652 could perhaps be revised to remove the stricter rules. This could be done in one of two ways:

- (1) *Silence*. Section 5652 could be revised to entirely delete subdivision (b). To make sure that the import of that change is noted and understood, language could be added to the Comment to explain the reason for the deletion.
- (2) *Express disclaimer*. Subdivision (b) could be revised to expressly state that the use of an RTODD does not disturb existing law on the effect of an off-record interest on a subsequent purchaser or encumbrancer. That approach would rely less on the Comment to explain the intended effect of the revision.

CONCLUSION

The Commission needs to decide how it wishes to handle Section 5652(b). It could decide to revise the section to create an exception for stock cooperatives, as discussed in the First Supplement to Memorandum 2021-55, along these lines:

(c) Notwithstanding subdivision (b), an interest in a stock cooperative is transferred by a revocable transfer on death deed subject to any limitation on the transferor's interest that is expressed in the governing documents of the stock cooperative or in an agreement between the stock cooperative and the transferor, without regard for whether those instruments are recorded.

Alternatively, the Commission could decide to address the issue more broadly, by making one of the two reforms listed above.

If time permits before the meeting, the staff will prepare a supplement to this memorandum that presents the draft recommendation that was attached to Memorandum 2021-55, along with alternative language that could be substituted in the draft to implement the approaches described above. That might enable the Commission to approve a final recommendation at the December meeting.

Respectfully submitted,

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