

Memorandum 90-131

Subject: Study H-409 - Application of Marketable Title Act to Executory Interests

In the course of reviewing peripheral issues related to the Uniform Statutory Rule Against Perpetuities, the Commission decided to consider whether the marketable title statute should be expanded to cover executory interests. An executory interest following a fee simple determinable is similar to a right of entry for condition broken retained by a transferor of an interest in real property, except that an executory interest is created in a transferee, rather than retained by the transferor.

The attached staff draft of a tentative recommendation would treat executory limitations the same as powers of termination under the marketable title statute. The issue of disparate treatment of these two types of interests was raised by Professor Jesse Dukeminier in a letter considered in connection with the Uniform Statutory Rule Against Perpetuities (USRAP). (See Memorandum 90-126, at 12-14, considered at September meeting.)

By way of background, the marketable title legislation (enacted on Commission recommendation in 1982) focused in part on the problems of powers of termination. In fact, one possibility considered by the Commission in preparation of the marketable title recommendation was to impose the rule against perpetuities on powers of termination, as had been done in some other jurisdictions. This approach was rejected, however, because of the rule's complexity and difficulty of application, its voiding effect, and the likelihood that period under the rule would be 21 years in the case of reversionary interests, which was thought to be too short. See *Recommendation Relating to Marketable Title of Real Property*, 16 Cal. L. Revision Comm'n Reports 401, 420 (1982).

Since executory interests were covered by the rule against perpetuities, consideration was apparently not given to the possibility of treating them the same as powers of termination in the course of

preparing the marketable title recommendation. This possibility now seems more appealing and is proposed in the draft tentative recommendation. If the Commission approves this tentative recommendation, we will circulate it to people on our probate and real property lists and consider the comments at the next meeting. If the recommendation is finally approved, the implementing legislation can be included in the USRAP bill in the 1991 legislative session.

The Commission may still want to consider whether the potential existence of executory interests for 90 years under USRAP is really a problem, however. Executory interests can come in several flavors. Under the traditional common law rule against perpetuities, such an interest, depending on its terms, might be void from the start (if open ended so that it would not vest or fail within lives in being plus 21 years) or might last for 100 years or more (if it satisfied the rule). Under the *cy pres* rule in Civil Code Section 715.5, the result could be different. A court might very well permit an executory interest that violates the common law rule to exist for 21 years. And an interest could be drafted to comply with the 60-year rule of Civil Code Section 715.6. Under USRAP, of course, the interest generally could not be invalidated until the end of the 90-year wait-and-see period.

In sum, since we do not know whether very many of these executory interests exist, whether they present a practical problem, how long they might endure under existing law, or what a court would do if faced with one under *cy pres*, it is difficult to estimate the impact of USRAP or any other alternative. In any event, it seems clear that the marketable title situation would be potentially improved if executory interests are treated in the same fashion as powers of termination. This is true whether or not USRAP is enacted.

Respectfully submitted,

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TENTATIVE RECOMMENDATION

relating to

APPLICATION OF MARKETABLE TITLE ACT TO
EXECUTORY LIMITATIONS

In a separate recommendation, the Commission proposes enactment of the Uniform Statutory Rule Against Perpetuities.¹ The Uniform Statutory Rule adopts a 90-year wait-and-see period in place of the common law period of lives in being plus 21 years. During the wait-and-see period, property dispositions that violate the common law rule are generally not invalidated or subjected to reformation. One type of future interest in real property that, in theory, could be greatly affected by the new perpetuities statute is the executory interest preceded by a fee simple determinable or the executory limitation on a fee simple.² For example, the owner of a home devises the property to A and his heirs so long as the property is used for

1. See *Recommendation Relating to Uniform Statutory Rule Against Perpetuities* [September 1990], 20 Cal. L. Revision Comm'n Reports 2501 (1990).

2. A variety of phrases have been used to describe this class of interest, including the executory interest subject to an unfulfilled condition precedent and the executory interest preceded by a fee simple determinable. See Restatement (Second) of Property: Donative Transfers § 1.4 comment m (1983); H. Miller & M. Starr, *Current Law of California Real Estate* § 11.15, at 23-24 (2d ed. 1989); L. Simes & A. Smith, *The Law of Future Interests* §§ 191-192, 221 (2d ed. 1956); Waggoner, *Future Interests in a Nutshell* § 2.1 (1981). At common law, the fee simple interest in this situation was known as a fee simple determinable or a fee simple subject to a condition subsequent. The fee simple determinable terminated automatically on occurrence of the stated condition, whereas the fee simple subject to a condition subsequent terminated only by divestment by a person entitled to take advantage of breach of the condition. See 4 B. Witkin, *Summary of California Law Real Property* § 238, at 442-43 (9th ed. 1987). The fee simple determinable was abolished in the 1982 marketable title legislation; such an interest is now deemed to be a "fee simple subject to a restriction in the form of a condition subsequent." See Civil Code § 885.020 & Comment.

residential purposes, then to B and her heirs.³ Under the common law rule against perpetuities, the interest of B and her heirs is void because it is not certain to vest (or fail) within lives in being plus 21 years.⁴ However, under the proposed Uniform Statutory Rule Against Perpetuities, an executory limitation invalid under the common law rule could last for 90 years.

Although the Commission is not aware that such executory interests are encountered with any frequency in practice, the existence of such interests for 90 years could act as an undesirable cloud on title. The law would be improved if executory interests were to be treated the same as powers of termination under the marketable title statute.⁵ A power of termination is a reversionary interest retained by the testator or transferor rather than an interest created in a devisee or transferee. A power of termination may accomplish the same purpose as the executory interest in the example given above: O devises the property to A and his heirs so long as the property is used for residential purposes, but if the property ceases to be so used, O's heirs have the power to terminate the estate devised to A. The interest of O's heirs in this example may be transferred,⁶ and so could be held by the same person (B's heirs) who held the executory interest in the first example.

3. See Restatement (Second) of Property: Donative Transfers § 1.4 comment m, illus. 19 (1983). Another example would be a devise of land to a church so long as they maintain their present religious belief, then to B and his heirs. See Fellows, *Testing Perpetuity Reforms: A Study of Perpetuity Cases 1984-1989*, __ Real Prop. Prob. & Tr. J. __, __ [100-01] (19__).

4. The result in California is not certain, in view of the *cy pres* rule in Civil Code Section 715.5. A court might permit the executory interest to last for 21 years or might invalidate it.

5. See Civil Code §§ 885.010-885.070. These sections are part of a comprehensive statute concerning marketable title of real property, enacted on Commission recommendation. See *Recommendation Relating to Marketable Title of Real Property*, 16 Cal. L. Revision Comm'n Reports 401, 420 (1982), implemented by 1985 Cal. Stat. ch. 1268, § 1.

6. See Civil Code § 885.010(a) (last sentence).

A power of termination is not subject to the rule against perpetuities,⁷ but the marketable title act causes a power of termination to expire 30 years after recordation of the instrument evidencing the power or a notice of intent to preserve the interest, whichever is the later event.⁸ As defined in the marketable title act, a power of termination is

the power to terminate a fee simple estate in real property to enforce a restriction in the form of a condition subsequent to which the fee simple estate is subject, whether the power is characterized in the instrument that creates or evidences it as a power of termination, right of entry or reentry, right of possession or repossession, reserved power of revocation, or otherwise, and includes a possibility of reverter that is deemed to be and is enforceable as a power of termination pursuant to Section 885.020.⁹

As already discussed, in traditional terms a power of termination is an interest retained by the transferor of real property, although the statutory definition is not specifically so limited.¹⁰

The power of termination and the executory interest are functionally equivalent. These interests operate in the same fashion on the preceding fee simple, the distinguishing characteristic being the person in whom the interest is originally created. But since both types of interest are transferable, the nature of the interest's origin does not restrict the class of persons who may ultimately hold the interest. One important difference does remain: An executory interest (but not a power of termination) is subject to the rule against

7. See 4 B. Witkin, *Summary of California Law Real Property* § 397, at 586 (9th ed. 1987); *Restatement (Second) of Property: Donative Transfers* § 1.4 comment c (1983).

8. Civil Code § 885.030.

9. Civil Code § 885.010(a).

10. It should be noted that the 1872 Civil Code does not make the traditional distinctions between reversionary and executory interests, although California courts have adopted the general usage. See 4 B. Witkin, *Summary of California Law Real Property* § 335, at 534 (9th ed. 1987).

perpetuities,¹¹ and, conversely, a power of termination (but not an executory interest) is subject to the 30-year marketable title recording limitations.

The Commission recommends that these interests be treated in the same manner under the marketable title statute by applying the 30-year recording rule to executory interests. Under this rule, an executory interest would terminate if the instrument creating the interest or a notice of intent to renew the interest is not recorded within a 30-year period.¹² Executory interests do not deserve greater protection than similar interests retained by a testator or grantor which are subject to the 30-year renewable rule. Treating powers of termination and executory interests in the same fashion under the marketable title statute would also apply the rules concerning expiration of an obsolete power of termination,¹³ the procedure for exercising a power of termination,¹⁴ and the effect of expiration of a power of termination.¹⁵ The proposed law would apply to existing executory interests, but provides a five-year grace period for holders of existing executory interests to record a notice of intent to preserve the interest.¹⁶

11. See Civil Code § 885.030 Comment; *Recommendation Relating to Marketable Title of Real Property*, 16 Cal. L. Revision Comm'n Reports 401, 419-20 (1982); 4 B. Witkin, *Summary of California Law Real Property* § 397, at 586 (9th ed. 1987).

12. The traditional rule that includes executory interests within the coverage of the rule against perpetuities while excluding powers of termination retained by a transferor would not be changed. It would not be appropriate to extend the rule against perpetuities to reversionary interests at this late stage. Consistency of treatment would not justify removing the perpetuities limitations from executory interests.

13. See Civil Code § 885.040.

14. See Civil Code § 885.050.

15. See Civil Code § 885.060.

16. The grace period is the same as that provided by the 1982 legislation applicable to powers of termination. See Civil Code § 885.070; *Recommendation Relating to Marketable Title of Real Property*, 16 Cal. L. Revision Comm'n Reports 401, 421-22 (1982).

PROPOSED LEGISLATION

The Commission's recommendation would be effectuated by the following legislation:

Civil Code § 885.010 (amended). "Power of termination" defined

SECTION 1. Section 885.010 of the Civil Code is amended to read:

885.010 (a) As used in this chapter, ~~"power:~~

(1) "Power of termination" means the power to terminate a fee simple estate in real property to enforce a restriction in the form of a condition subsequent to which the fee simple estate is subject, whether the power is characterized in the instrument that creates or evidences it as a power of termination, right of entry or reentry, right of possession or repossession, reserved power of revocation, or otherwise, and includes a possibility of reverter that is deemed to be and is enforceable as a power of termination pursuant to Section 885.020.

(2) "Power of termination" includes the power created in a transferee to terminate a fee simple estate in real property to enforce a restriction in the form of a condition subsequent to which the fee simple estate is subject, whether the power is characterized in the instrument that creates or evidences it as an executory interest, or executory limitation, or otherwise, and includes the interest known at common law as an executory interest preceded by a fee simple determinable.

(b) A power of termination is an interest in the real property.

~~(b)~~ (c) For the purpose of applying this chapter to other statutes relating to powers of termination, the terms "right of reentry," "right of repossession for breach of condition subsequent," and comparable terms used in the other statutes mean "power of termination" as defined in this section.

Comment. Section 885.010 is amended to include an executory limitation on a fee simple within the scope of this chapter. The language of subdivision (a)(2) extends the definition of "power of termination" to include an executory interest created in a transferee of real property. For the purpose of this chapter, the inclusion of such executory interests extends the traditional use of the term "power of termination" beyond rights of entry and related interests that were retained by the grantor. The traditional description of an executory interest preceded by a fee simple determinable in subdivision (a)(2)

makes the coverage of this provision complete. The fee simple determinable is abolished in Section 885.020. See Comment to Section 885.020.

Civil Code § 885.010 (amended). "Power of termination" defined

SEC. 2. Section 885.070 of the Civil Code is amended to read:

885.070. (a) Subject to Section 880.370 (grace period for recording notice) and except as otherwise provided in this section, this chapter applies on the operative date to all powers of termination, whether executed or recorded before, on, or after the operative date.

(b) If breach of the restriction to which the fee simple estate is subject occurred before the operative date of this chapter and the power of termination is not exercised before the operative date of this chapter, the power of termination shall be exercised, or in the case of a power of termination of record, exercised of record, within the earlier of the following times:

(1) The time that would be applicable pursuant to the law in effect immediately prior to the operative date of this chapter.

(2) Five years after the operative date of this chapter.

(c) As used in this section, "operative date" means the operative date of this chapter as enacted or, with respect to any amendment of a section of this chapter, the operative date of the amendment.

Comment. Subdivision (c) is added to Section 885.070 to clarify the application of this section to executory interests included within the scope of this chapter by the amendment of Section 885.010. The effect is the same as the effect on powers of termination when this chapter was enacted. See 1982 Cal. Stat. ch. 1268, § 1.