

Memorandum 2009-21

Marketable Record Title: Unexercised Option (Introduction of Study)

Civil Code Sections 880.020 through 886.050, inclusive, were enacted to implement a Commission recommendation on *Marketable Title of Real Property*, 16 Cal. L. Revision Comm'n Reports 401 (1982). See 1982 Cal. Stat. ch 1268.

The general purpose of those provisions is discussed in Civil Code Section 880.020:

880.020. (a) The Legislature declares as public policy that:

(1) Real property is a basic resource of the people of the state and should be made freely alienable and marketable to the extent practicable in order to enable and encourage full use and development of the real property, including both surface and subsurface interests.

(2) Interests in real property and defects in titles created at remote times, whether or not of record, often constitute unreasonable restraints on alienation and marketability of real property because the interests are no longer valid or have been abandoned or have otherwise become obsolete.

(3) Such interests and defects produce litigation to clear and quiet titles, cause delays in real property title transactions, and hinder marketability of real property.

(4) Real property title transactions should be possible with economy and expediency. The status and security of recorded real property titles should be determinable to the extent practicable from an examination of recent records only.

(b) It is the purpose of the Legislature in enacting this title to simplify and facilitate real property title transactions in [furtherance] of public policy by enabling persons to rely on record title to the extent provided in this title, with respect to the property interests specified in this title, subject only to the limitations expressly provided in this title and notwithstanding any provision or implication to the contrary in any other statute or in the common law. This title shall be liberally construed to effect the legislative purpose.

In this study, the Commission will be examining one aspect of the Marketable Record Title statute, an apparent defect in Civil Code Section 884.010, which relates to recorded notice of an option to buy real property.

Unless otherwise indicated, all statutory references in this memorandum are to the Civil Code.

BACKGROUND

Prior to enactment of the Marketable Record Title statute, recorded notice of an option to purchase real property was governed by former Section 1213.5, which provided as follows:

1213.5. When a recorded instrument has created, or shall hereafter create, an option to purchase real property, which, according to its terms, or by operation of law, has expired, and one year has elapsed since such time of expiration, and no conveyance, contract or other instrument has been recorded showing that such option has been exercised or extended, then the written instrument whereby such option was created shall cease to be notice to any person or put any person on inquiry, with respect to the exercise or existence of such option or of any contract, conveyance or other writing which may have been executed pursuant thereto.

1965 Cal. Stat. ch. 1948. In other words, a recorded option no longer operated as record notice of the option if (1) the option had expired (whether by its terms or by operation of law), (2) one year or more had passed after expiration, and (3) no instrument had been recorded showing that the option had been exercised or extended.

The Commission had two concerns about that provision. First, it felt that one year was too long for the unrecorded option to remain a cloud upon title:

The apparent function of the one-year cloud after expiration of an option is to allow the option holder sufficient time to record an exercise or extension of the option that occurs at the end of the term of the option. For that purpose one year is excessive; six months should be sufficient.

Marketable Title of Real Property, supra, at 412 (notes omitted).

The Commission was also concerned about the operation of Section 1213.5 when the recorded option does not state an expiration date. An option without a fixed term expires by operation of law “within a reasonable time after it is executed.” *Id.* See also 1 B. Witkin, *Contracts* § 175, at 210 (10th ed. 2005).

Under that rule, the status of a recorded option could not be determined from the title records, because it depended on an off-record fact: whether the option had been exercised “within a reasonable time.” Litigation would be required to determine that fact.

In order to enhance marketability of real property burdened by an open-ended option, the Commission recommended that notice of an option without a fixed term should expire by operation of law six months after the notice is recorded:

This will avoid the need for a court determination of the date of expiration and will enable the option holder to be aware of the exact time when notice of exercise or extension of the option must be recorded. The provision will enhance the marketability of property if notice of exercise or extension is not recorded within the statutory period by removing the cloud on title simply by the passage of time without the need for resort to judicial proceedings.

Marketable Title of Real Property, supra, at 412-13.

Those two reforms were effectuated by repealing Section 1213.5 and adding Civil Code Sections 884.010 and 884.020. As enacted, those sections read as follows:

Civ. Code § 884.010. Expiration of record

884.010. If a recorded instrument creates or gives constructive notice of an option to purchase real property, the option expires of record if no conveyance, contract, or other instrument that gives notice of exercise or extends the option is recorded within the following times:

- (a) Six months after the option expires according to its terms.
- (b) If the option provides no expiration date, six months after the date the instrument that creates or gives constructive notice of the option is recorded.

Civ. Code § 884.020. Effect of expiration

884.020. Upon the expiration of record of an option to purchase real property, the recorded instrument that creates or gives constructive notice of the option ceases to be notice to any person or to put any person on inquiry with respect to the exercise or existence of the option or of any contract, conveyance, or other writing that may have been executed pursuant to the option.

1982 Cal. Stat. ch. 1268. Those provisions have not been amended since.

THE PROBLEM

In addition to effectuating the two reforms described above, the Commission's language also made one other change in the law. Unlike former Section 1213.5 (which refers only to the recording of an instrument that *creates* an option), Sections 884.010 and 884.020 also govern the effect of a recorded instrument that "*gives constructive notice*" of an option to purchase real property.

That change simplifies the process of recording notice of an option, because it allows for the recording of an abstract, rather than the option itself. However, it also creates a potential problem.

There is no statutory guidance regarding the content of the instrument that gives constructive notice of an option. It is therefore possible that the instrument will not include any information about the expiration of the option. That is a problem, because the operation of Section 884.010 depends on such information. It provides for expiration of record notice of an option at either of the following times:

- (a) Six months after the option expires according to its terms.
- (b) If the option provides no expiration date, six months after the date the instrument that creates or gives constructive notice of the option is recorded.

If expiration date information is not included in the recorded notice of the option, then the effect of the recorded notice cannot be determined from the title records. The status of the option would depend on off-record information (whether and when the option expires). That defeats the purpose of the provision, to make the validity of a recorded notice of option determinable from the record.

This problem was pointed out to the Commission by an attorney who encountered it in his practice. See CLRC Memorandum 2008-40, pp. 28-29. The California Land Title Association agrees that the existing provision is problematic. See CLRC Memorandum 2008-54, pp. 1-2.

There are no published cases discussing the operation of Section 884.010.

POSSIBLE SOLUTION

A possible solution to the problem described above is suggested by another provision of the Marketable Record Title statute. Section 882.020 governs the expiration of a "lien of a mortgage, deed of trust, or other instrument that creates

a security interest of record in real property to secure a debt or other obligation....” Subdivision (a) of that section provides for expiration of the lien at the later of the following times:

(1) If the final maturity date or the last date fixed for payment of the debt or performance of the obligation *is ascertainable from the recorded evidence of indebtedness*, 10 years after that date.

(2) If the final maturity date or the last date fixed for payment of the debt or performance of the obligation *is not ascertainable from the recorded evidence of indebtedness*, or if there is no final maturity date or last date fixed for payment of the debt or performance of the obligation, 60 years after the date the instrument that created the security interest was recorded.

(3) If a notice of intent to preserve the security interest is recorded within the time prescribed in paragraph (1) or (2), 10 years after the date the notice is recorded.

(Emphasis added.)

As the italicized language above emphasizes, Section 882.020 relies exclusively on information that is *ascertainable from the record*. That facilitates one of the general goals of the Marketable Record Title statute: “The status and security of recorded real property titles should be determinable to the extent practicable from an examination of recent records only.” Section 880.020(a)(4).

That approach could be easily adapted to the option provision, by amending Section 884.010 as follows:

Civ. Code § 884.010. Expiration of record

884.010. If a recorded instrument creates or gives constructive notice of an option to purchase real property, the option expires of record if no conveyance, contract, or other instrument that gives notice of exercise or extends the option is recorded within the following times:

(a) ~~Six~~ If the expiration date of the option is ascertainable from the recorded instrument, six months after the option expires according to its terms that expiration date.

(b) If the expiration date of the option is not ascertainable from the recorded instrument or the recorded instrument indicates that the option provides no expiration date, six months after the date the instrument that creates or gives constructive notice of the option is recorded.

That amendment would seem to cover all possible contingencies:

(1) *The recorded instrument states the expiration date of the option.* Under subdivision (a), the notice expires six months after the expiration date of the option.

- (2) *The recorded notice makes clear that the option has no expiration date.* Under subdivision (b), the notice expires six months after it is recorded.
- (3) *The recorded notice is silent as to whether the option has an expiration date.* Under subdivision (b), the notice expires six months after it is recorded.

The staff sees no situation in which the proposed language would produce an uncertain result or require the use of off-record information to produce a result.

The proposed language would further the general goal of clearing obsolete interests of record by operation of law, using only information within the record to determine the status of the interest. It would also parallel the approach taken in another provision of the same statute, Section 880.020 (expiration of lien), increasing uniformity between related provisions.

One possible downside of the proposed language is that it could frustrate the expectations of some option holders, by causing a recorded notice to expire earlier than expected.

For example, suppose that a person holds an option to purchase a piece of real property, with a fixed five-year period to exercise the option. That person records a notice indicating that the option exists, but does not include the five-year expiration date in the notice. Existing Section 884.010 provides for expiration of the notice at either of the following times:

- (a) Six months after the option expires according to its terms.
- (b) If the option provides no expiration date, six months after the date the instrument that creates or gives constructive notice of the option is recorded.

Based on that language, it would be reasonable for the option holder to assume that the recorded notice will be effective until the end of the five-year period specified in the option, plus six months.

If Section 884.010 were amended as proposed above, the notice would expire six months after the date on which it was recorded (because the expiration date of the option would not be ascertainable from the recorded notice). That change would come about without any warning to those who recorded notices under the former law, in reliance on that law.

For that reason, it might make sense to make the proposed change in the law prospective only, so that it does not affect a notice recorded prior to the change in the law.

RECOMMENDATION

The staff believes that the problem described in this memorandum is real and should be fixed. It also appears that there is a fairly straightforward solution. However, this is only the first memorandum in the study. There may be other alternatives or considerations that are not yet apparent. **The staff invites comment from interested persons on any of the matters discussed in this memorandum.**

Barring some new information or policy arguments, the staff recommends that the Commission move forward with the proposal described above. If the Commission agrees, the staff will prepare a draft of a tentative recommendation implementing that approach, for consideration at a future meeting.

Respectfully submitted,

Brian Hebert
Executive Secretary