

Memorandum 2020-56

**Stock Cooperatives and Uniform TOD Security Registration Act:  
Execution and Revocation**

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In this study, the Commission<sup>1</sup> is considering whether the Uniform TOD Security Registration Act (“Uniform Securities Act”)<sup>2</sup> could be used as a model for a statute that authorizes the nonprobate transfer on death of an interest in a stock cooperative. The Uniform Securities Act provides a relatively simple mechanism for the registration of securities in transfer on death (“TOD”) form. Securities registered in that form pass to a named beneficiary on the registering owner’s death, without probate administration.

The study is moving progressively through the issues that need to be addressed in developing a proposed law for the nonprobate transfer of an interest in a stock cooperative. This memorandum discusses execution and revocation.

Unless otherwise indicated, all of the statutory citations below are to the Probate Code.

FORM OF EXECUTION

**Uniform Securities Act**

The Uniform Securities Act is mostly an enabling statute. It allows for securities to be registered in TOD form and for such registration to be given effect on the owner’s death

That Act provides a great deal of flexibility as to the method of executing a TOD registration or revoking one:

5510. (a) A registering entity offering to accept registrations in beneficiary form may establish the terms and conditions under

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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](http://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.

2. Prob. Code §§ 5500-5512.

which it will receive requests for (1) registrations in beneficiary form, and (2) implementation of registrations in beneficiary form, including requests for cancellation of previously registered TOD beneficiary designations and requests for reregistration to effect a change of beneficiary.

(b) The terms and conditions established pursuant to subdivision (a) may provide for (1) proving death, (2) avoiding or resolving any problems concerning fractional shares, (3) designating primary and contingent beneficiaries, and (4) substituting a named beneficiary's descendants to take in the place of the named beneficiary in the event of the beneficiary's death. Substitution may be indicated by appending to the name of the primary beneficiary the letters LDPS, standing for "lineal descendants per stirpes." This designation substitutes a deceased beneficiary's descendants who survive the owner for a beneficiary who fails to so survive, the descendants to be identified and to share in accordance with the law of the beneficiary's domicile at the owner's death governing inheritance by descendants of an intestate. Other forms of identifying beneficiaries who are to take on one or more contingencies, and rules for providing proofs and assurances needed to satisfy reasonable concerns by registering entities regarding conditions and identities relevant to accurate implementation of registrations in beneficiary form, may be contained in a registering entity's terms and conditions.

(c) The following are illustrations of registrations in beneficiary form that a registering entity may authorize:

(1) Sole owner-sole beneficiary: John S. Brown TOD (or POD) John S. Brown, Jr.

(2) Multiple owners-sole beneficiary: John S. Brown Mary B. Brown, JT TEN TOD John S. Brown, Jr.

(3) Multiple owners-primary and secondary (substituted) beneficiaries: John S. Brown Mary B. Brown, JT TEN TOD John S. Brown, Jr. SUB BENE Peter Q. Brown , or John S. Brown Mary B. Brown JT TEN TOD John S. Brown Jr. LDPS.

One of the main issues that the Commission will need to decide is whether a proposed law on TOD registration of an interest in a stock cooperative should also be a flexible enabling statute, or should instead be strict and narrow in what it permits.

### **Relevance of Revocable Transfer on Death Deed Statute**

This study is derived from the Commission's follow-up study of the revocable transfer on death deed ("RTODD") statute. It was started because the Commission found a mismatch between the RTODD statute (which relies on the use of a *deed* to effect a transfer of real property) and the form of ownership in a stock

cooperative (which relies on the conveyance of a *share of corporate stock* to effect a transfer of a separate ownership interest). Based on that mismatch, the Commission recommended that the RTODD statute not apply to an interest in a stock cooperative. Instead, the Commission would conduct a separate study of whether the existing Uniform Securities Act could be adapted for use in making a nonprobate transfer of such an interest.

While that decision was based on a conclusion that *some* aspects of RTODD law would be a poor fit for stock cooperatives, it did not reflect a wholesale rejection of the lessons learned from studying RTODDs. To the contrary, the staff believes that most of the policies developed for RTODDs should also govern the proposed law in this study. Aside from the difference in evidence of ownership (i.e., a deed versus a share of stock), a transfer of an interest in a stock cooperative would be very similar to the transfer of real property by RTODD.

With that in mind, it is worth considering how existing law addresses the formalities of execution and revocation of an RTODD, and how those rules came about.

### **Enabling Statute v. Narrow Constraints**

When the Commission approved its first iteration of a recommendation on RTODDs, it proposed a similar approach to that used in the Uniform Securities Act. The original RTODD statute was an enabling statute. If it had been enacted in that form, transferors would have been free to draft RTODDs with whatever terms they wished, including a conveyance of a life estate with a remainder (i.e., to A for her life and then to B), unequal beneficiary shares (i.e., 80% to A, 20% to B), or a transfer based on a specified contingency (i.e., to A if she completes law school before 2025, otherwise to B).<sup>3</sup>

The Legislature emphatically rejected that approach. Instead, the implementing legislation was amended to *eliminate nearly all flexibility*. As enacted, the RTODD law requires the use of a statutory form<sup>4</sup> (which included a lengthy statutory FAQ).<sup>5</sup> The mandatory form can only be used in a single narrow scenario, where the owner transfers specified residential property to named beneficiaries, in equal shares. If a named beneficiary predeceases the transferor,

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3. See *Revocable Transfer on Death (TOD) Deed* (Oct. 2006); Minutes (Oct. 27, 2006), p. 19.

4. Section 5642(a).

5. Section 5642(b).

the gift to that beneficiary fails (i.e., it does not pass on to the beneficiary's children).<sup>6</sup>

Those narrow guard rails were added to address one of the Legislature's most significant concerns about the RTODD — the risk of mistake and misunderstanding. One of the main policy advantages of the RTODD is that it can be used by laypeople to effect a nonprobate transfer of real property on death, without the cost of a professionally prepared trust. This also means that many laypeople will be transferring their most valuable asset without assistance.

If laypeople were allowed to draft their own instruments, using their own language, to effect complicated arrangements, the risk of error and uncertainty would be high. The Legislature was unwilling to accept that level of risk and did all that it could to make RTODDs simple and uniform in their effect.

Those concerns would seem to apply with equal force to a nonprobate transfer of an interest in a stock cooperative. It seems almost certain that the Legislature would prefer that the strictures it imposed on the RTODD statute also be imposed on the nonprobate transfer of an interest in a stock cooperative.

**The staff recommends that approach — the proposed law in this study should also use a mandatory statutory form (with FAQ) that limits the transfer to a single scenario — equal division between named beneficiaries with no lineal descent if a beneficiary predeceases the transferor.** Aside from the merits of the Legislature's position, which seem sound, there is virtue in having a single approach for both RTODDs and the law being developed in this study. Both govern very similar circumstances and there is no obvious reason for the two laws to diverge on this point.

#### REVOCATION

The RTODD statute provides two ways in which an RTODD can be revoked:

- (1) By the use of a statutory revocation form.<sup>7</sup>
- (2) By the execution of a new RTODD, which revokes all prior RTODDs by operation of law.<sup>8</sup>

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6. Section 5652(a)(a)(2).

7. Section 5644.

8. Section 5628.

That approach is sound. It should cover all contingencies, in a workable way. It allows both express revocation (by use of a statutory form) and de facto revocation (by the execution of a superseding transfer document).

**The staff recommends that the proposed law in this study adopt the same approach to revocation that is used in the RTODD statute.**

#### CAPACITY

The registration of an interest in a stock cooperative in TOD form would be a will substitute. The legal capacity to make a will is governed by a lower standard than the legal capacity to make a real property transfer:

- To make a will, the decedent must understand the nature of the act, the nature of the property, and the decedent's relationship to family members and others.<sup>9</sup>
- To make a real property transfer, the decedent must have the capacity to contract; that requires that the decedent understand the rights, duties, and responsibilities created by the act being performed, the probable consequences of the act for the decedent and other persons affected by it, and the significant risks, benefits, and reasonable alternatives to the act.<sup>10</sup>

Based on prior case law involving a gift deed (i.e., a grant deed), the Commission recommended that the standard for execution of an RTODD should be testamentary capacity.<sup>11</sup> This is another point where the Legislature rejected the Commission's recommendation. As enacted, the RTODD statute applies the higher standard, requiring the capacity to contract.<sup>12</sup>

Arguments can be made for the merits of either approach. On one hand, the nonprobate transfer on death is a form of gift, which should arguably be governed by the capacity standard that applies to wills and other donative transfers. On the other hand, a nonprobate transfer of real property on death is legally complicated and the stakes are quite high. Given the Legislature's concerns about error and uncertainty when laypeople take such action without the assistance of counsel, it makes sense to require a higher level of understanding of the consequences.

Aside from those merits, the Legislature has already decided on the proper policy in a situation that is directly analogous to the one in this study. Given the

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9. Section 6100.5.

10. Section 812.

11. *Revocable Transfer on Death (TOD) Deed*, 36 Cal. L. Revision Comm'n Reports 103, 220 (2006).

12. Section 5260.

rule in the RTODD statute, **the staff recommends that the same rule be applied to the proposed law in this study.** The two situations are almost identical. The only difference (the use of a deed or stock certificate as the basis of ownership) does not have any obvious relevance to the question of the proper capacity standard. Given that, the same standard should be applied in both statutes.

#### AUTHENTICATION

Another important decision that must be made is to specify the method of authentication that would be used when executing or revoking an instrument that registers a stock cooperative in TOD form.

As the Commission has recommended revising it, the RTODD statute would require three forms of authentication:<sup>13</sup>

- Witnessing
- Acknowledgement by a notary public.
- Recordation

The staff has made inquiries with professionals who are familiar with the transfer of an interest in a stock cooperative, to learn whether the procedure used to effectuate such a transfer involves recordation and title insurance. The initial response suggests that practices vary, depending on whether there is a lender involved.

Until the results of the staff's inquiry are firmly in hand, it would not make sense to proceed with consideration of the authentication issue. The staff will bring the matter back for consideration in a future memorandum.

#### RECOMMENDATIONS

To summarize, the staff has made the following recommendations relating to the execution and revocation of an instrument registering an interest in a stock cooperative in TOD form:

- The proposed law should require the use of a statutory form (with FAQ) to register a stock cooperative interest in TOD form. The mandatory form should only allow for a single straightforward scenario: transfer of the entire interest, in equal shares to named

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13. See *Revocable Transfer on Death Deed: Follow-Up Study*, 46 Cal. L. Revision Comm'n Reports 135, 150-51 (2019).

beneficiaries, with no lineal descent in the event that a beneficiary predeceases the transferor.

- The rules for revocation of a registration should be the same as those used in the RTODD statute. The proposed law should provide for express revocation by use of a statutory form or de facto revocation by execution of a later registration for the same property.
- The capacity standard used in the proposed law should be the same as the standard used in the RTODD statute — capacity to contract (rather than the capacity to make a gift).

**The Commission needs to decide how it wishes to address each of those issues, for the purposes of preparing a tentative recommendation.**

The staff will continue its inquiry into the use of recordation and title insurance when transferring an interest in a stock cooperative. That issue will be discussed further in a future memorandum.

Respectfully submitted,

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