

## First Supplement to Memorandum 2021-55

### **Stock Cooperatives and Revocable Transfer on Death Deeds: (Staff Draft Recommendation)**

---

Memorandum 2021-55 presents a draft of a final recommendation.<sup>1</sup> Since releasing that memorandum, the staff has been thinking further about one element of the proposed law and has concluded that an adjustment might be warranted. This supplement discusses that possibility.

All statutory references in this memorandum are to the Probate Code.

#### INTERESTS ENFORCEABLE AGAINST PROPERTY TRANSFERRED BY RTODD

Existing Section 5652(b) provides that property transferred by a revocable transfer on death deed (“RTODD”) remains subject to any limitations on the transferred interest *that were of record at the time of the transferor’s death*. That affirmative rule implies its opposite, that limitations on transferred property that were *not* recorded at the time of the transferor’s death are *not* enforceable against property transferred by an RTODD.

On the Commission’s recommendation, Section 5652(b) was just amended to make it more forgiving.<sup>2</sup> Rather than requiring recordation before death, the section now provides a grace period of at least 120 days after the transferor’s death.<sup>3</sup>

Despite that relaxation, Section 5652 could still produce harsh results. A person who has an off-record interest in the property (e.g., an unrecorded option to purchase) may lose the ability to enforce their interest after an RTODD transfers the property, simply because they did not act to record the interest in time.

---

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. 2021 Cal. Stat. ch. 215.

3. *Id.* The period for recordation is 120 days after the beneficiary of the RTODD completes the process of giving notice to heirs, which is now a precondition to the transfer becoming fully effective.

That rule appears to be stricter than the general law's treatment of unrecorded interests in property. As a general matter, an unrecorded instrument is "valid as between the parties thereto *and those who have notice thereof.*"<sup>4</sup> Section 5652(b) takes no account of whether a beneficiary or subsequent purchaser has notice of an off-record restriction.

Why is Section 5652(b) stricter than general law? As with other issues in this study, the answer rests on operational need, rather than policy. As a matter of policy the staff sees no reason why property transferred by RTODD should be treated any differently than property conveyed by other means. However, in the context of the RTODD, it is considered operationally necessary for there to be certainty in the title records, to facilitate the issuance of title insurance, which in turn facilitates the marketability of the transferred property.

Having thought further about the matter, the staff is not sure that the strict approach in Section 5652(b) makes sense when dealing with property restrictions in a stock cooperative. There are two reasons for this.

First, the result of error seems unduly problematic for the kinds of restrictions that can exist in a stock cooperative. For example, in a limited equity housing development, the "transfer price" of a separate interest is fixed below the market rate, as a way of providing more affordable housing. It would be a serious problem if the use of an RTODD could defeat such a limitation, simply because the stock cooperative failed to record evidence of the restriction.

Second, the strict approach might not be operationally necessary. The staff has learned that the standard California Land Title Association ("CLTA") title insurance policy includes an express exception that is relevant to this issue. The standard policy does not cover *unrecorded interests that are 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 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.<sup>5</sup>

---

4. Civ. Code § 1217. See also 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").

5. 3 Cal. Real Est. § 7:61 (4th ed.) (footnotes omitted).

Assuming that the existence of off-record restrictions on the use of an interest in a stock cooperative could be discovered by inspection or inquiry (a point discussed further below), the standard CLTA policy would not cover those restrictions. Consequently, it appears that the insurer would not be liable if a stock cooperative's unrecorded restrictions remained enforceable against an interest that was transferred by an RTODD. This suggests that the existence of such restrictions would not be an obstacle to obtaining title insurance.

Is an unrecorded use restriction in a stock cooperative the kind of fact that can be ascertained through inspection and inquiry? The staff believes that it is.

Recall that ownership of an interest in a stock cooperative does not grant title to a particular volume of physical space. Instead, it grants a use right. The parameters of that use right are not established in a deed. They are prescribed in one or more off-record instruments — the stock certificate itself, an “occupancy agreement” or other contract between the stock cooperative and the owner of the separate interest, and the governing documents of the stock cooperative.

This means that a person who is acquiring an interest in a stock cooperative cannot know the location, dimensions, amenities, and other characteristics of the interest without seeing the documents that define it. This suggests that even a minimal degree of inspection and inquiry should be sufficient to ascertain the existence of restrictions on the interest. *Such restrictions are part of the definition of the property interest at issue.*

Recall also that a stock cooperative is essentially a form of joint ownership. The stock cooperative as an entity holds title to the real property. It then grants use rights to shareholders, to occupy specified parts of the real property. Given that, the staff believes that any reasonable inquiry into the character of a separate interest that is being sold or encumbered would involve an inquiry into the rights retained by the stock cooperative, as the dominant owner.

It also appears that general law imposes a duty of inquiry on a prospective purchaser or encumbrancer:

A purchaser or encumbrancer is required to inspect the property to be transferred or which will become collateral and is charged with knowledge of information that would be revealed by a reasonable inspection of the property. “One who purchases real estate is bound to know who is in possession thereof and is chargeable with notice of the occupant's title.”<sup>6</sup>

---

6. 4 Cal. Real Est. § 10:84 (4th ed.) (footnotes omitted).

Consequently:

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.<sup>7</sup>

In light of the points discussed above, the staff is now wondering whether the proposed law should be revised to create an exception for stock cooperative restrictions, such that they would remain enforceable after a transfer by RTODD, without regard for whether they are recorded. That could be implemented by amending Section 5652 along the following 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.

That language would avoid the serious harm that could result if an unrecorded property restriction in a stock cooperative (e.g., the transfer price cap in a limited equity housing development) could be defeated by use of an RTODD.

Such a revision would not seem to cause any problems for title insurers, because the standard insurance policies already contain an exception that shields insurers from liability for off-record restrictions that can be ascertained through inspection or inquiry.

Further, the revision would seem to be consistent with existing law, which provides that an unrecorded interest is enforceable against a purchaser or encumbrancer with notice of the interest (with such notice being *imputed* if the existence of the off-record interest could be ascertained through inspection or inquiry). That rule seems to encompass a restriction on an interest in a stock cooperative, because any reasonable inspection or inquiry should disclose the existence of the restriction.

**Because of the timing of this issue, with it being raised for the first time shortly before the November meeting, the staff recommends against trying to approve the draft recommendation at the November meeting.** This new issue

---

7. *Id.*

seems important enough to justify slowing down the process until the Commission can find the proper solution. In particular, the staff needs time to think further about whether the issue discussed above might have broader implications, beyond just the treatment of stock cooperatives.

Respectfully submitted,

Brian Hebert  
Executive Director