

Fourth Supplement to Memorandum 2019-16

Revocable Transfer on Death Deed: Follow-Up Study — Survival of Unrecorded Interests

This supplement addresses an issue raised by the Executive Committee of the Trusts and Estates Section of the California Lawyers Association (“TEXCOM”) in a letter that is attached to Memorandum 2019-16.¹

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

Effect of RTODD on Unrecorded Interests

Section 5652 prescribes the effect of a revocable transfer on death deed (“RTODD”) on the transferor’s death. Subdivision (b) provides that property transferred by RTODD passes subject to any limitation of the transferor’s interest that is “of record at the transferor’s death:”

5652. (a) A revocable transfer on death deed transfers all of the transferor’s interest in the property on the transferor’s death according to the following rules:

(1) Subject to the beneficiary’s right to disclaim the transfer, the interest in the property is transferred to the beneficiary in accordance with the deed.

(2) The interest of a beneficiary is contingent on the beneficiary surviving the transferor. Notwithstanding Section 21110, the interest of a beneficiary that fails to survive the transferor lapses.

(3) Except as provided in paragraph (4), if there is more than one beneficiary, they take the property as tenants in common, in equal shares.

(4) If there is more than one beneficiary, the share of a beneficiary that lapses or fails for any reason is transferred to the others in equal shares.

(b) Property is transferred by a revocable transfer on death deed subject to any limitation on the transferor’s interest that is of record

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.

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 notwithstanding its transfer by the revocable transfer on death deed.

(c) A revocable transfer on death deed transfers the property without covenant or warranty of title.

TEXCOM expresses the following concern about that approach:

Pursuant to section 5652, subdivision (b), property is transferred by RTODD, "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." Section 5652 seems to create a special rule for encumbrances on property held pursuant to a RTODD, to the effect that the property passes free and clear of any unrecorded liens, encumbrances, leases, etc., at the transferor's death. This is contrary to the general rule relating to real property liens and encumbrances, and could have significant effects. Suppose an owner of real property held pursuant to a RTODD enters into an agreement to sell the property, but dies during the escrow period. Were the property not held pursuant to a RTODD, the decedent's successor would be required to perform under the contract made by the decedent. However, section 5652 seems to allow for the beneficiary under a RTODD to disavow without any consequence any unrecorded agreements made with respect to the property by the transferor while living. This should be addressed.²

TEXCOM is correct that Section 5652 does not protect off-record limitations. That was by design. The Commission discussed the issue briefly in its recommendation, in the course of describing the RTODD statutes of other jurisdictions:

Property passes under a revocable TOD deed subject to any limitations on the transferor's interest of record at the time of the transferor's death. Every jurisdiction that has revocable TOD deed legislation makes that rule clear.^{/216/}

...
^{/216./} 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,

2. See Memorandum 2019-16, Exhibit p. 9.

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's recommendation on that point is not surprising, considering the importance of ensuring that the validity and effect of an RTODD be entirely determinable from the title records. As noted before, the efficacy of an RTODD as a means of transferring real property without court involvement depends on the title record and title insurance systems. If property transferred by RTODD could be burdened by off-record limitations, title insurers would risk liability if they were to insure the beneficiary's title to the property. This would make it difficult for beneficiaries to obtain title insurance, which would make it difficult to encumber or sell the property. A court order might be required to establish the beneficiary's title to the property, before it could be sold or encumbered.

However, the approach taken in Section 5652 is not without costs. There are many kinds of interests in real property that are not routinely recorded. TEXCOM mentions one scenario. A purchaser contracts to buy property that is subject to an RTODD. The seller dies before the sale is completed. Under Section 5652(b), the availability of specific performance as a contract remedy may be cut off by the operation of the RTODD — because the sale contract was not recorded, the property passes to the beneficiary free of any interest created by the contract. Other examples occur to the staff. An unrecorded lease could be cut off by operation of the RTODD. A mechanics lien right, that has not yet been evidenced by a recorded lien claim, would likely be terminated. A person could have an alleged adverse possession claim or prescriptive easement, which has not yet been affirmed and recorded.

Thus, existing Section 5652(b) represents a compromise between two legitimate policy interests. In order to facilitate the operation of the RTODD, the law curtails the ability to enforce an otherwise valid unrecorded interest in property that is transferred by RTODD.

3. *Revocable Transfer on Death (TOD) Deed*, 36 Cal. L. Revision Comm'n Reports 103, 168 & n.216 (2006).

Possible Alternative

The Commission's recommendation notes that Colorado takes a different approach. Colorado Revised Statutes Section 15-15-407(2)-(3) provides that property transferred by "beneficiary deed" passes subject to any interests that were of record at the time of the transferor's death *or were recorded within four months after the transferor's death*:

(2) A grantee-beneficiary of a beneficiary deed takes title to the owner's interest in the real property conveyed by the beneficiary deed at the death of the owner subject to all conveyances, encumbrances, assignments, contracts, mortgages, liens, and other interests, affecting title to the property, whether created before or after the recording of the beneficiary deed, or to which the owner was subject during the owner's lifetime including, but not limited to, any executory contract of sale, option to purchase, lease, license, easement, mortgage, deed of trust, or other lien. The grantee-beneficiary also takes title subject to any interest in the property of which the grantee-beneficiary has either actual or constructive notice.

(3) (a) A person having an interest described in subsection (2) of this section whose interest is not recorded in the records of the office of the clerk and recorder of the county in which the property is located at the time of the death of the owner, shall record evidence or a notice of the interest in the property not later than four months after the death of the owner. The notice shall name the person asserting the interest, describe the real property, and describe the nature of the interest asserted.

(b) Failure to record evidence or notice of interest in the property described in subsection (2) of this section within four months after the death of the owner shall forever bar the person from asserting an interest in the property as against all persons who do not have notice of the interest. A person who, without notice, obtains an interest in the property acquired by the grantee-beneficiary shall take the interest free from all persons who have not recorded their notice of interest in the property or evidence of their interest prior to the expiration of the four-month period.

Under that statute, a person who holds an unrecorded interest in property transferred by RTODD could preserve that interest after the transferor's death, by recording evidence of the interest within four months. For example, a person who holds a residential lease on RTODD property could, on learning that the owner has died, record notice of the lease. This would preserve the lessee's right to stay in the property for the rest of the lease term. Otherwise, the lease would be truncated by operation of law on the transferor's death.

As noted above, the Commission's initial reluctance to follow such an approach was based on the impairment of marketability that would result. Under the Colorado approach, the full extent of any third party interests in the property will not be known until the four-month period has run. Title insurers might understandably be wary about insuring title during that period, because of the chance that an enforceable off-record interest might exist. Any difficulty obtaining title insurance would significantly impair the beneficiary's ability to sell or encumber the property. Thus, the Colorado rule would create a four-month period of impaired marketability.

Existing Limbo Period

The period of impairment created by the Colorado rule may not be as significant a problem as it once appeared. As discussed in the Third Supplement to Memorandum 2019-16, property transferred by RTODD in California *is already subject to a roughly four-month period during which marketability is impaired.*

Under existing Section 5694, a court may void an RTODD and order the property transferred to a person other than the beneficiary if (1) the validity of the RTODD is successfully contested, (2) the contest was filed within 120 days of the transferor's death, and (3) a lis pendens was recorded in the county where the property is located, within 120 days of the transferor's death. Because there is no exception to that remedy for property that has been sold by the beneficiary to a bona fide purchaser in good faith, there is a significant cloud on title for 120 days after the transferor's death. Any person who buys the property during that period does so at the risk that the beneficiary/seller's title might be voided and the property transferred to another person. This would make it difficult for a beneficiary to obtain title insurance during the 120-day period during which a lis pendens might be recorded.

The point of the Third Supplement is to consider whether to modify the existing 120-day limbo period. In that supplement, the staff recommends retaining existing law on that point. If the Commission agrees, then there is already a four-month period during which marketability is impaired. Allowing for the continuation of third party interests in RTODDs if they are recorded during the existing limbo period would not seem to create any new period of marketability impairment. It would coincide with the existing one.

Given that, the justification for curtailing the enforcement of unrecorded interests of third parties in RTODD-transferred property is not as compelling as

it would otherwise be. **The Commission should consider whether, for the purposes of a tentative recommendation, the law should be revised to adopt the Colorado approach.** If so, the staff will prepare implementing language tailored to the California statute.

Actual or Constructive Notice

If the Commission decides to proceed with the Colorado approach, it would be helpful to decide one implementation detail up front. In addition to allowing enforcement of interests that are recorded within four months of the transferor's death, the Colorado statute also provides for enforcement of a limitation, if the beneficiary has actual or constructive notice of it. While that makes some substantive sense, it would also cause a significant problem. A rule that determines the scope of the beneficiary's title based on the beneficiary's actual or constructive knowledge would often depend on off-record information, thereby re-opening the door to problems obtaining title insurance. **All things considered, the staff would recommend against including Colorado's "actual or constructive notice" rule.**

Respectfully submitted,

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Executive Director