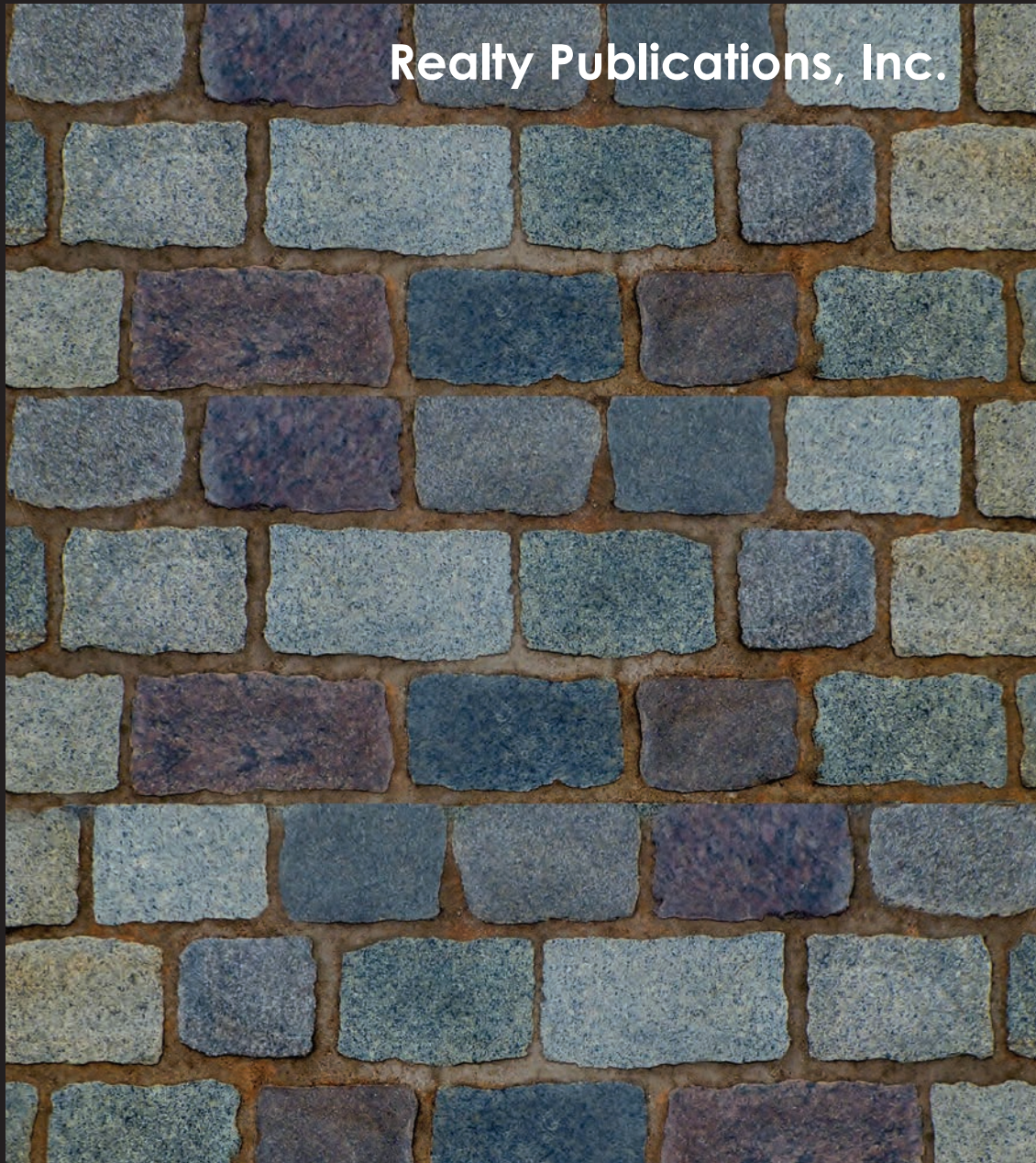




# Legal Aspects of Real Estate

Realty Publications, Inc.





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# California real estate law

## Chapter 1

After reading this chapter, you will be able to:

- understand the origins of California real estate law;
- distinguish which branches of law are responsible for which legal activities;
- understand the nature and extent of federal and state law controlling California real estate; and
- identify the constitutional protections in place if the government abuses its power.

**administrative agencies**

**civil law**

**common law**

**due process**

**eminent domain**

**equal protection**

**executive branch**

**federalism**

**interstate commerce**

**inverse condemnation**

**judicial branch**

**legislative branch**

**police power**

## Learning Objectives

## Key Terms

Historically, California real estate law has been influenced by two key sources of human conduct:

- the English legal system, or **common law**; and
- the Spanish legal system, or **civil law**.

The *common law* of England has been the predominant influence on California real estate law. This legal framework was officially adopted by California soon after obtaining statehood in 1850.<sup>1</sup>

## The English and Spanish influence

<sup>1</sup> Calif. Civil Code §22.2



**common law**

An English legal system in which disputes are decided on a case-by-case basis before a judge applying codes and prior cases.

**civil law**

A Spanish legal system in which an elaborate system of statutes address permissible conduct of the people in advance of disputes.

Under the common law, legal disputes are decided on a case-by-case basis before a judge. Even today, the common law is often called “judge-made” law. When similar legal disputes arise, the judges refer back to the logic of earlier decisions to decide current cases. The reliance on an earlier decision to decide a current case is called **stare decisis**. The earlier case relied on is called **precedent**.

Similarly, the *civil law* of Spain had a significant impact on California real estate law. Civil law establishes statutes to settle legal disputes in advance, rather than on a case-by-case basis.

These legal traditions continue to exist today in the form of:

- statutes, regulations and ordinances; and
- case law. [See Chapter 2]

## The role of the U.S. Constitution

The United States Constitution (U.S. Constitution) is the supreme law of the United States.<sup>2</sup>

All powers which the state and federal governments possess are derived from the U.S. Constitution.

The U.S. Constitution lists and explains the powers of the federal government. All other powers not given to the federal government rest with the individual states or **with the people**.<sup>3</sup>

The form of government in which individual states share powers with a national or central government is called **federalism**.

Under *federalism*, the individual states remain independent (*sovereign*) to regulate any matters within their own borders which are not already controlled by the federal government.

Each state has its own constitution to regulate state matters remaining under their control. A state may provide more constitutional protection than the federal government if it chooses, but it may not provide less.

## Separated powers

**legislative branch**

The branch of government which enacts the codes and statutes which regulate most aspects of real estate interests.

Both the federal and state governments created under the U.S. Constitution are separated into three branches:

- the **legislative**;<sup>4</sup>
- the **executive**;<sup>5</sup> and
- the **judicial**.<sup>6</sup>

The state and federal *legislatures* enact the *codes and statutes* which regulate most aspects of real estate interests.

<sup>2</sup> United States Constitution, Article VI, clause 2

<sup>3</sup> U.S. Const., Amend. X

<sup>4</sup> U.S. Const., Art. I

<sup>5</sup> U.S. Const., Art. II

<sup>6</sup> U.S. Const., Art. III

The *executive* polices the law and establishes *regulations* to carry out the administration of government as established by the legislature.

The *judiciary* settles disputes and issues *case opinions* regarding the application of the law and regulations.

No branch may exercise a power given to another branch. However, as will be later illustrated, all three branches of the government actually make law.

#### executive branch

The branch of government which polices the law and establishes regulations to carry out the administration of government as established by the legislature.

The federal and California legislatures and local governments may only enact laws if they have been given the power to do so by the U.S. Constitution or the California Constitution.<sup>7</sup>

## Authority to legislate

The authority of the California legislature to enact laws regulating real estate activities comes from three main constitutional powers:

- the police power;
- the power of eminent domain; and
- the power to tax.

The U.S. Constitution confers on California the right to enact laws to protect public health, safety and welfare.<sup>8</sup>

The California Constitution confers an equal power to local cities and counties to likewise protect the public good.<sup>9</sup>

This power to protect the public well-being is called **police power**. *Police power* is the source of the state or local government's authority to act.

Police power is the basis for laws governing such things as highway construction and maintenance, rent control, zoning and traffic.<sup>10</sup>

#### judicial branch

The branch of government which settles disputes and issues case opinions regarding the application of the codes, cases and regulations.

A statute or ordinance passed under the government's constitutional police power and affecting real estate-related activity is valid as long as the law:

- is fair and reasonable;
- addresses a legitimate state interest;
- does not unreasonably burden the flow of interstate commerce; and
- does not conflict with related federal law.

#### police power

The constitutional source of the state or local government's authority to act.

The second key power of the state to regulate real estate is the power of **eminent domain**.<sup>11</sup>

## Eminent domain

*Eminent domain* is the right of the government to *take* private property for public use. The process of using the power of eminent domain is called **condemnation**.

#### eminent domain

The right of the government to take private property for public use on payment to the owner of the property's fair market value.

<sup>7</sup> U.S. Const., Art. I

<sup>8</sup> U.S. Const., Amend. X

<sup>9</sup> California Constitution, Article XI §7

<sup>10</sup> *Village of Euclid, Ohio v. Ambler Realty Co.* (1926) 272 US 365

<sup>11</sup> Calif. Const., Art. 1 §19

However, the government needs to pay the owner the fair market value of the property taken.<sup>12</sup>

Examples of eminent domain include condemning property to provide highways and roads, establish parks, construct flood control levees and provide land for redevelopment.

Consider a local agency that adopts an ordinance requiring the dedication of a portion of a parcel for construction of a road. The owner does not develop the property. The local agency later takes the portion of the land by eminent domain for the construction of the road, valuing the property at its current undeveloped condition as the price they pay to the owner for the taking.

The owner seeks compensation based on the highest and best use valuation, claiming the local agency by ordinance imposed dedication requirements on the development of the property after the city determined a road through the parcel was necessary.

Here, the fair market value is set as its value as an undeveloped portion of a parcel of property since the agency intended the parcel was to contain a road before the agency took the property by eminent domain proceedings to construct the road. When a dedication requirement arises before the date of probable inclusion, valuing the land in its current undeveloped state applies; when the date of probable inclusion arises later, the land is valued at its highest and best use.<sup>13</sup>

## Inverse condemnation

### inverse condemnation

A government taking of privately held real estate interests which does not constitute eminent domain and for which the property owner seeks compensation.

The government's exercise of police power may become a **taking** of an owner's real estate by **inverse condemnation** if the government surpasses their power of eminent domain.

For example, an owner demolishes their beachfront bungalow. The owner intends to rebuild a better home and submits an application to the coastal commission which has jurisdiction over the use of beachfront property.

A public beach is located nearby, but not directly adjacent to the owner's real estate.

The coastal commission grants the owner a permit to build, conditioned on the owner granting to the public a frontage easement across their beachfront property. The coastal commission claims its goal is to allow better public viewing of the coastline.

The owner refuses to comply with the condition unless the coastal commission pays for the easement. The coastal commission denies the owner's application and permit to build, claiming it is reasonably exercising its police power.

Does the coastal commission have to pay for the easement across the owner's beachfront?

<sup>12</sup> *Loretto v. Teleprompter Manhattan CATV Corp.* (1982) 458 US 419

<sup>13</sup> *City of Escondido v. Pacific Harmony Grove Development, LLC* (2021) 68 CA5th 213



Yes! The coastal commission has not merely restricted the owner's use of their land, it has required the owner to deed an interest away in the form of a frontage easement.<sup>14</sup>

Conditioning a permit to build on the granting of an easement to the public is a *taking* which requires **reimbursement** to the owner from the governmental agency. The coastal commission did not show the easement related to a legitimate state interest to constitute eminent domain. Instead, the government agency's action — in this case, demanding an easement as a condition of administratively granting a permit — leads to the taking of real estate and is **inverse condemnation**.

However, most California *inverse condemnation* cases filed by owners fail. California courts do not want to burden local governments with the obligation of paying for any diminution of property values which result each time it regulates or downgrades the use of real estate.<sup>15</sup>

State and local governments also regulate the crucial **power to tax** real estate activities to generate revenue and fund state and local governmental functions under their police power.<sup>16</sup>

## The power to tax

For example, a city passes an ordinance which imposes an **inspection fee** on all landlords renting residential properties. The fee charged is based on a flat rate per unit, not on current property values.

A landlord subject to the ordinance claims the ordinance is unenforceable since the city must have voter approval before adopting an ordinance which imposes a regulatory fee on property.

The city claims the ordinance is enforceable without voter approval since the fee is imposed on a **use** of the property — renting — not on the mere ownership of the property, which requires voter approval.

Here, the ordinance imposing the inspection fee on landlords based on a flat rate per unit offered for rent is enforceable. Voter approval is only required when fees and taxes are imposed on owners simply because they own real estate. Fees and taxes imposed on the owner's exercise of his uses and rights which come with owning the property do not require voter approval.<sup>17</sup>

The federal government's authority to regulate real estate also comes from the U.S. Constitution.

## Federal authority to regulate

Like the state, the federal government has the *power to tax* and the power to *take* private property for public use.<sup>18</sup>

However, the federal government has no police power. In its place, the federal government has a powerful clause to regulate areas of national concern, called the **commerce clause**.

<sup>14</sup> *Nollan v. California Coastal Commission* (1987) 483 US 825

<sup>15</sup> *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles* (1989) 210 CA3d 1353

<sup>16</sup> Calif. Const., Art. XIII D §6

<sup>17</sup> *Apartment Association of Los Angeles v. City of Los Angeles* (2001) 24 C4th 830

<sup>18</sup> U.S. Const., Amend. XVI; Calif. Const., Art. 1 §19

**interstate commerce**

The flow of goods and services between and within states.

The federal government has the right to regulate all commercial enterprises which affect **interstate commerce**.

Originally, the clause was designed to combat attempts by local states to pass protectionist laws under their police powers which would inhibit the flow of goods between states — *interstate commerce*.<sup>19</sup>

Today, the clause also applies to local and intrastate activities which have an indirect effect on the flow of goods, services and people from state to state.

For example, the federal government's interest in the flow of commerce between states outweighs a motel owner's right to exclude specific classes of patrons. The owner's exclusion interferes with the flow of commerce – which includes the mobility of people.<sup>20</sup>

The federal government's ability to regulate a purely local activity even extends to local real estate brokers' activities within their trade unions.

For example, a broker sues the local board of realtors for federal **antitrust violations**, claiming the association **fixes rates** charged by its members for their services.

The association ostracizes brokers who refuse to comply with the fee-setting policies established by the association based on the maintenance of a minimum acceptable level of income for its union members.

The association claims the federal government may not regulate their activities as their services are purely local and have no effect on interstate commerce.

Do the federal antitrust laws cover local brokerage activities?

Yes! The association's fee-setting of the charges for their members' services affects housing locally, which in turn affects the desire to live in the area, which in turn affects the mobility of people in interstate commerce.<sup>21</sup>

## Federal and state law conflicts

States have the *sovereignty* to regulate within their own borders. At the same time, the federal government has the right to regulate local activities affecting commerce.

What happens when federal and state law conflict? Consider the following example.

An airport is established under the Federal Aviation Act of 1958. The airport expands its number of late-night and early-morning flights. The residents around the airport complain of the noise during late and early hours.

The city where the airport is located passes an ordinance restricting the number of flights between 11 p.m. and 7 a.m.

<sup>19</sup> *Gibbons v. Ogden* (1824) 22 US 1

<sup>20</sup> *Heart of Atlanta Motel, Inc. v. United States* (1964) 379 US 241

<sup>21</sup> *McLain v. Real Estate Board of New Orleans, Inc.* (1980) 444 US 232

The airport objects, claiming it was established under the sole jurisdiction of federal law and the Federal Aviation Act of 1958 set forth by the Federal Aviation Administration (FAA) which has no restriction on flights between 11 p.m. and 7 a.m.

Does the federal law **preempt** (supersede) state law?

Yes! The goals of national flight service and the role of the FAA outweigh local laws inhibiting flight times.<sup>22</sup>

A federal law will *preempt* state and local statutes and ordinances when:

- federal interests outweigh local interests;
- the federal law is so pervasive as to exclude inconsistent state law; and
- inconsistent treatment nationwide would result if state law controls.

Thus, it is possible for federal and state law to regulate the same real estate activity.

For example, federal and state **fair housing** laws prohibiting discrimination exist. Both the state and federal governments can regulate *fair housing*. The state may provide more, but may not allow less, protection than the federal law.<sup>23</sup>

The U.S. Constitution gives owners guarantees when the federal or state government attempts to abuse their powers.

Two key constitutional guarantees exist for real estate owners:

- the **due process clause**; and
- the equal protection clause.

Under the *due process clause*, the government needs to deal fairly with real estate owners.

Even if the owner does not win their case, the courts oversee that the owner is treated fairly by the government.

The due process clause covers both:

- the content of laws, called **substantive due process**; and
- how the government procedurally applies those laws, called **procedural due process**.

For example, a city places a tax on parking lot owners to fund traffic services.

The parking lot owners feel the tax is excessive and an unfair burden on their business. They claim the tax violates the due process clause of the U.S. Constitution.

The city claims the parking lot tax is a reasonable exercise of its police power.

## Constitutional guarantees

### due process

A constitutional guarantee of fair dealings between the government and property owners.

<sup>22</sup> *City of Burbank v. Lockheed Air Terminal, Inc.* (1973) 411 US 624

<sup>23</sup> CC §51



When the tax itself is unreasonably high and burdensome, it violates the due process clause in the U.S. Constitution and is invalid.<sup>24</sup>

However, if the tax does not overly burden owners, the tax survives a *substantive due process* attack.

## Procedural due process

Procedurally, an owner needs to be given **notice** of any government action or law and an **opportunity** to be heard on the matter.<sup>25</sup>

For example, a city passes a zoning ordinance restricting the extent to which a newsstand may block a city sidewalk. Additionally, the city delegates to itself the authority to seize and close newsstands it feels violate the ordinance.

A newsstand owner's business is closed by the city government without warning to the owner. The city claims it may do so since the ordinance exists.

Does the city's seizure and closing of the owner's newsstand violate the owner's due process rights?

Yes! The city did not provide the newsstand owner with a notice of the violation or an opportunity to be heard before their business was closed.<sup>26</sup>

## Equal protection

**Equal protection** laws provide for similarly-situated persons to be treated similarly under the law.

For example, a subdivision's **covenants, conditions and restrictions (CC&Rs)** contain a restriction limiting sales to non-minorities only.

A minority couple seeks to purchase a home, but the CC&R restriction is enforced by the association governing the subdivision.

Does the restriction violate the couple's rights to *equal protection* under the law?

Yes! Enforcement of the restriction unfairly separates buyers into arbitrary and suspect classifications.<sup>27</sup>

**equal protection**  
A constitutional guarantee that similarly-situated persons be treated similarly under the law.

## Judicial decisions

The preceding discussion addressed the legislative authority to enact laws.

In theory, only the legislative branch may enact laws and no branch of the government may exercise the powers of another. However, the other two branches of government (the executive and judicial) also create law.

Every time a judge interprets a statute or a prior case decision, a new *common law* is created by the opinion produced in their decision. It is as if the legislature introduced and passed an amendment into existing law, and the governor signed the amendment into law.

<sup>24</sup> *City of Pittsburgh v. Alco Parking Corp.* (1974) 417 US 369

<sup>25</sup> *Mullane v. Central Hanover Bank & Trust Co.* (1950) 339 US 306

<sup>26</sup> *Kash Enterprises, Inc. v. City of Los Angeles* (1977) 19 C3d 294

<sup>27</sup> *Shelley v. Kraemer* (1948) 334 US 1

For example, each time the Civil Rights Act is analyzed and applied to the facts of a case before a judge, the opinion is written in light of prior case law *interpreting* the Civil Rights Act.

As general real estate law becomes more specialized, the role of **administrative agencies** becomes increasingly important.

Many *administrative agencies* are given the powers of all three branches of the government: legislative, executive and judicial.

Consider a rent control board established by a local city council under **rent control ordinances**.

The board is given authority to enact regulations to implement the *rent control ordinance*. This enactment of regulations is a legislative activity.

The board is also given the power to hear disputes between tenants and landlords, and dispense penalties for a landlord's failure to comply with the law. This is a judicial activity.

In this way, the administrative rent control board has the authority to enact regulations (entailing legislative authority) and hear disputes and administer penalties for noncompliance (entailing judicial authority).

A landlord may always challenge the board in court to determine whether the board has overstepped its power.

The courts continue to give administrative agencies the necessary powers to judge cases involving their own regulations. Thus, the courts are relieved of processing and resolving these disputes.

## Administrative agencies

### administrative agencies

A government entity created by the state or federal legislature and local governing bodies to oversee specialized matters. Most have legislative, executive and judicial authority.

The United States Constitution (U.S. Constitution) lists and explains the powers of the federal government. All other powers not given to the federal government rest with the individual states or with the people. A state may provide more constitutional protection than the federal government if it chooses, but it may not provide less.

Both the federal and state governments created under the U.S. Constitution are separated into three branches:

- the legislative;
- the executive; and
- the judicial.

The state and federal legislatures enact the codes and statutes which regulate most aspects of real estate interests. The executive polices the law and establishes regulations to carry out the administration of government as established by the legislature. The judiciary settles disputes and issues case opinions regarding the application of the law and regulations.

## Chapter 1 Summary

The authority of the California legislature to enact laws regulating real estate activities comes from three main constitutional powers:

- the police power;
- the power of eminent domain; and
- the power to tax.

The federal government has the right to regulate all commercial enterprises which affect interstate commerce.

A federal law will preempt state and local statutes and ordinances when:

- the federal interests outweigh local interests;
- the federal law is so pervasive as to exclude inconsistent state law; and
- inconsistent treatment nationwide would result if state law controls.

The U.S. Constitution gives owners guarantees when the federal or state government attempts to abuse their powers. Two key constitutional guarantees exist for real estate owners:

- the due process clause; and
- the equal protection clause.

As general real estate law becomes more specialized, the role of administrative agencies becomes increasingly important. Many administrative agencies are given the powers of all three branches of the government.

## Chapter 1 Key Terms

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**Quiz 1 Covering Chapters 1-2 is located on page 441.**





# Understanding the court system

## Chapter 2

After reading this chapter, you will be able to:

- identify the different types of courts;
- distinguish between the state and federal court systems;
- learn which types of real estate claims fall under the jurisdiction of each court; and
- understand how to apply state and federal law to various real estate claims.

**appellate courts**

**choice-of-law clause**

**equitable remedies**

**jurisdiction**

**small claims**

**superior court system**

**Supreme Court**

**trial courts**

**venue**

## Learning Objectives

## Key Terms

Two separate and mutually exclusive court systems hear disputes arising in California: the **state courts** and the **federal courts**.

Whether a legal dispute belongs in the state or federal court system depends on which court has **jurisdiction**. *Jurisdiction* is the power of a court to hear a case and rule on a legal matter granted by the state or federal constitution, the state legislature or Congress.

Two types of jurisdiction exist within each court system:

- jurisdiction over the **subject matter** of the lawsuit, such as the ownership of real estate; and
- jurisdiction over the **persons** in the lawsuit, such as a buyer and seller.

## Federal and state

### **jurisdiction**

The power of a court to hear a dispute and rule on a legal issue.

## State court jurisdiction

### trial courts

Courts which hear and decide the facts of a case and apply the proper rules of law to resolve the dispute.

### superior court system

California's trial court system.

### appellate courts

Courts which review trial court decisions to determine whether the proper rules of law were correctly applied.

### Supreme Court

The final court for appeals in both the state and federal court systems.

### small claims

An informal court proceeding for disputes over amounts of \$5,000 or less, or \$10,000 or less for individuals.

### equitable remedies

Non-money remedies based on issues of fairness.

The state of California has a three-tiered court system which includes:

- **trial courts**, called the **superior court system**;
- **appellate courts**; and
- the California **Supreme Court**.<sup>1</sup>

California's *superior court system* is comprised of county courts which hear disputes arising in their respective counties. All legal disputes, both civil and criminal, are first filed in a *superior court* unless jurisdiction has been given by statute to a separately established court.<sup>2</sup>

Within the superior court system, proceedings are classified depending on the amount of money in dispute. Legal disputes involving:

- more than \$25,000 are classified as **unlimited civil actions**;
- \$25,000 or less are classified as **limited civil actions**; and
- \$10,000 or less brought by natural persons (or \$5,000 or less by other than a natural person) are allocated to the **small claims** division.<sup>3</sup>

For example, foreclosure of *mechanic's liens* for dollar amounts less than \$25,000 may be brought as a *limited civil action* in superior court.<sup>4</sup>

Additionally, limited civil actions may *rescind or reform* contracts, called **equitable remedies**.<sup>5</sup>

An *equitable remedy* is a **non-money remedy** based on issues of fairness. Specific performance of a purchase agreement and an injunction ordering a nuisance to be stopped are examples of equitable remedies.

The small claims courts also have the authority to issue equitable remedies including rescission, restitution, reformation and specific performance.<sup>6</sup>

*Small claims* courts are informal, barring the use of an attorney to represent a party. The court's rules are designed for quick resolutions of minor legal disputes.

A superior court limited civil action may be filed in a small claims court if it falls within the small claims jurisdiction. In this event, small claims court rules govern.<sup>7</sup>

<sup>1</sup> California Constitution, Article VI §4

<sup>2</sup> Calif. Const., Art. VI §10

<sup>3</sup> Calif. Code of Civil Procedure §§86, 88, 116.220(a)

<sup>4</sup> CCP §86(a)(6)

<sup>5</sup> CCP §86(a)(3)

<sup>6</sup> CCP §116.220

<sup>7</sup> CCP §87

The proper location to hear a legal dispute depends on **venue**, not jurisdiction.

Jurisdiction is concerned with which **type of court** is empowered to hear the subject matter of a dispute, such as the superior court or the small claims division within it, or whether the case will be heard in state or federal court.

In contrast, *venue* determines the physical **location of the court** which has jurisdiction and the correct forum to hear the matter.<sup>8</sup>

For example, the proper venue for a suit involving real estate is in the county where all or part of the real estate is located.<sup>9</sup>

For contracts, the appropriate venue is where the contract was entered into or is to be performed, or where the defendant resides.<sup>10</sup>

Most promissory notes indicate where payment is to be made to establish where the contract (the note) is to be performed.

The federal courts are constitutionally established courts of *limited jurisdiction*. Thus, the federal courts are strictly limited in the types of cases they can hear and decide.<sup>11</sup>

On the other hand, the state courts are considered courts of *general jurisdiction* since they are not limited to certain types of controversies. Unless the person suing can show their case belongs in federal court, it needs to be brought in a state court.<sup>12</sup>

For the purposes of real estate law, a federal court has jurisdiction over two types of cases:

- disputes involving questions of **federal law**; or
- legal disputes between citizens of different states.

A *federal law* case is any case arising under the United States Constitution (U.S. Consitution) or the laws or treaties of the United States, regardless of the dollar amount of the lawsuit.<sup>13</sup>

Thus, a suit under federal antitrust law, federal securities law or federal fair housing law may be brought in federal court without regard for the amount of monetary loss involved.

However, most suits involving federal law are permitted in state court. The defendant may remove a federal law case to the federal courts if it was originally brought in a state court, a process called **removal**.

The federal courts may refuse to hear a case otherwise properly heard in federal court if a legitimate state interest is involved, such as in water rights.<sup>14</sup>

## Venue in the county of the land

### venue

The physical location of the court which has jurisdiction and the correct forum to hear a dispute.

## Federal jurisdiction of limited use

<sup>8</sup> CCP §5392 et seq.

<sup>9</sup> CCP §392(a)(1)

<sup>10</sup> CCP §395(a)

<sup>11</sup> United States Constitution, Article III §2

<sup>12</sup> Federal Rule of Civil Procedure 8(a)(1)

<sup>13</sup> 28 United States Code §1331

<sup>14</sup> **National Audubon Society v. Department of Water & Power of the City of Los Angeles** (9th Cir. 1988) 858 F2d 1409

Additionally, the federal court may require the person suing to exhaust their state court rights before suing on federal court grounds.

In some cases, the federal courts have **exclusive jurisdiction**, such as in admiralty, patent law or bankruptcy cases, which state courts may not decide.

Some government agencies are granted the authority to create and enforce federal regulations, such as the U.S. Food and Drug Administration (FDA) and U.S. Environmental Protection Agency (EPA). After Congress passes a law, these agencies create *regulations* designed to implement and enforce the new law. **The Federal Register** publishes general notice of proposed regulations and interested persons are given the right to challenge the regulations.<sup>1</sup>

An *Administrative Law Judge (ALJ)* hears the dispute. The ALJ is granted authority by the Administrative Procedures Act (APA) to regulate the course of the hearing, rule on offers of proof, receive relevant evidence, subpoena witnesses and records and make or recommend legislation.<sup>2</sup>

Once a regulation is implemented, it is published in the Federal Register and the Code of Federal Regulations (CFR).

ALJs also exist on the state level and hear disputes controlled by government agencies, such as the California Department of Consumer Affairs, over matters such as environmental protection or labor management relations.

## Interstate citizens have diversity

Legal disputes between citizens of different states may also be brought in federal court as long as the dollar value is \$75,000 or more, excluding interest and costs.<sup>3</sup>

These cases are called **diversity of citizenship** cases. Diversity of citizenship also applies to suits involving disputes between citizens of the United States and foreigners or foreign nations.<sup>4</sup>

A person filing an action in federal court based on diversity of citizenship first needs to establish whether the court has jurisdiction to hear the dispute.<sup>5</sup>

The theory behind a diversity of citizenship case is to prevent one person from obtaining an unfair “home court advantage” in one state against a person from another state.

## State/ federal court strategies

When a federal court accepts a case between citizens of different states it needs to decide which state law to apply. Ordinarily, the court applies the state law where the federal court is located.<sup>6</sup>

<sup>1</sup> 5 USC §553

<sup>2</sup> 5 USC §§556(c); 1305

<sup>3</sup> 28 USC §1332

<sup>4</sup> 28 USC §1332(a)

<sup>5</sup> FRCP Rule 8 (a)(1)

<sup>6</sup> **Erie R. Co. v. Tompkins** (1938) 304 US 64

However, the court also weighs the interests of each state on the result of the case. The question of which state law applies occasionally determines the success or failure of a case.

Consider an Arizona resident who decides to sell real estate they own in Arizona.

The Arizona seller lists the property with a California broker who is not licensed in Arizona. The seller signs the listing agreement at their residence in Arizona.

The broker locates a buyer in California and prepares an offer to purchase the property. The seller accepts the offer in Arizona and opens an escrow in California.

The broker performs all their brokerage activities related to the transaction in California. The broker does not cooperate with an Arizona broker.

Later, the buyer and seller mutually agree to cancel the transaction.

The broker demands their fee from the seller for producing a ready, willing and able buyer.

The Arizona seller denies any brokerage fee is owed since the real estate is located in Arizona and the broker does not hold an Arizona real estate broker license and did not cooperate with an Arizona broker.

For the purpose of protecting its residents, Arizona law requires a broker to have an Arizona license to enforce collection of a fee in Arizona courts. For the same reason, California law requires a broker to have a California license to enforce collection of a fee in California courts.

Where is the best place for the broker to sue the seller for their fee?

California! The broker is licensed in California and performed all their brokerage activities in California. The broker's best chance to enforce collection of the brokerage fee is in a California superior court.<sup>7</sup>

What legal maneuvers may the Arizona seller use to avoid paying the brokerage fee based on subject matter jurisdiction of the federal courts?

Strategically, the Arizona seller wants the case removed to Arizona to increase the broker's costs of bringing the suit.

However, it is unlikely for the case to be properly removed to Arizona since California has a vested interest in the legal result. The broker and escrow are controlled by legislation relating to their conduct, and the transaction was to be performed (escrowed) in California.<sup>8</sup>

Thus, the seller needs to attempt to remove the case to federal court.

## Legal maneuvers and choice of law

<sup>7</sup> *Cochran v. Ellsworth* (1954) 126 CA2d 429

<sup>8</sup> *University Financing Consultants, Inc. v. Barouche* (1983) 148 CA3d 1165



However, even if the seller is able to remove the case to federal court, it is not advantageous for the seller since the federal court is located in California and will likely apply California law, resulting in the broker receiving their fee.

The seller's next step is to transfer the case from the federal district court in California to a federal district court in Arizona based on *venue*.<sup>1</sup>

Naturally, the Arizona seller claims the Arizona federal district court is most appropriate since:

- the seller is a resident of Arizona;
- the seller signed the listing agreement employing the broker in Arizona; and
- the real estate is located in Arizona.

On the contrary, the broker claims California is the proper forum since:

- the brokerage activities justifying payment of the fee occurred in California;
- the sale was escrowed in California; and
- the buyer is a Californian.

A federal court judge decides the correct forum to resolve the dispute.<sup>2</sup>

However, one final issue remains no matter which court hears the dispute: which state's laws apply?

If the state law to be applied is not agreed to in the listing agreement, then the state law applied is based on the state with the greater interest in the result.

Brokers with interstate practices eliminate this uncertainty by inserting a California **choice-of-law clause** in the listing agreement. With a *choice-of-law clause*, the clients agree in advance which state's law applies if a dispute arises. For example, when a California broker enters into a listing agreement calling for Arizona law to apply, the broker agrees the fee provisions in the listing agreement are unenforceable. [See **RPI** Form 102 §4.9]

#### **choice-of-law clause**

A clause which sets the state law applicable in the event of a dispute.

## **Jurisdiction over a person's fate**

In addition to subject matter jurisdiction, a court must have jurisdiction over the person being sued, called **personal jurisdiction**.<sup>3</sup>

For *constitutional due process* purposes, a person being sued in California must have at least **minimum contacts** with the state.<sup>4</sup>

California has interpreted *minimum contacts* to include:

- residence in the state;
- a legal appearance to defend the legal action;<sup>5</sup>

<sup>1</sup> 28 USC §1404

<sup>2</sup> **Consul Limited v. Solide Enterprises, Inc.** (9th Cir. 1986) 802 F2d 1143

<sup>3</sup> CCP §410.10

<sup>4</sup> **International Shoe Co. v. State of Washington, Office of Unemployment Compensation and Placement** (1945) 326 US 310

<sup>5</sup> **RCA Corporation v. Superior Court of City and County of San Francisco** (1975) 47 CA3d 1007

- doing business in the state;<sup>6</sup>
- torts committed within the state;
- torts committed outside the state which directly affect activities inside the state;<sup>7</sup>
- contracts entered into, negotiated or to be performed in the state;<sup>8</sup>
- ownership or use of real estate within the state; or
- availing oneself of the benefits of California laws.<sup>9</sup>

California's *personal jurisdiction law* extends long enough to haul out-of-state or out-of-country defendants into the state to defend themselves.

The out-of-state or out-of-county defendant needs to receive proper *service of process* (notice of the lawsuit) to implement personal jurisdiction.<sup>10</sup>

Both the federal and the California courts have a three-tiered system: trial courts, appellate courts and one Supreme Court.

As previously discussed, the principal trial court in California is the superior court, with its jurisdiction divided between *limited* and *unlimited civil cases* as well as a *small claims* court division.

The main trial court in the federal system is called the *district court*.

Other trial courts exist in the federal system to hear claims in particular areas of law, such as the:

- United States Bankruptcy Court;
- United States Tax Court; and
- United States Claims Court.

The principal task of a trial court is to decide the facts of a case and apply the proper rules of law to resolve the dispute. A judgment is handed down as the judge's decision in the case.

The person losing the dispute on the trial court level may appeal the judgment to the appellate court.

The appellate court has the authority to review whether the trial court:

- used the appropriate law to decide the case; and
- properly applied the law.

Determining the facts of a case when the evidence is in dispute is the exclusive domain of the trial court. Thus, the appellate court does not have the authority to decide which facts to believe as long as some substantial evidence exists to support the facts.

## Trial and appellate courts

<sup>6</sup> *McGee v. International Life Insurance Company* (1957) 355 US 220

<sup>7</sup> *Buckeye Boiler Company v. Superior Court of Los Angeles County* (1969) 71 C2d 893

<sup>8</sup> *Beirut Universal Bank S.A.L. v. Superior Court for County of Los Angeles* (1969) 268 CA2d 832

<sup>9</sup> *Quattrone v. Superior Court for County of Los Angeles* (1975) 44 CA3d 296

<sup>10</sup> CCP §§413.10 et seq.

The appellate court selects which opinions are published to become the basis of future trial court decisions.

## Supreme Court petitions over errors

The final court for appeals in both the state and federal court systems is the **Supreme Court** of each.

With the exception of certain criminal law cases and procedural cases, the *Supreme Court's* review of most appellate decisions is entirely discretionary.

The losing party before an appellate court may **petition** the Supreme Court by asking the court to review the appellate court decision for its correctness.

The petition is accepted or rejected by the United States Supreme Court or California Supreme Court.

If the case is accepted, the court is said to grant *certiorari* to review the case.

Only a small percentage of the cases appealed to the Supreme Courts are ever accepted and heard.

As a result, the opinions of the appellate courts most often become the final statement of the law on the case.

Supreme Court decisions are also published and become the highest statement on the law, to be followed by all of the lower courts within their jurisdictions.

## Chapter 2 Summary

Two separate and mutually exclusive court systems hear disputes arising in California: the state courts and the federal courts. Whether a legal dispute belongs in the state or federal court system depends on which court has jurisdiction.

Two types of jurisdiction exist within each court system:

- jurisdiction over the subject matter of the lawsuit, such as the ownership of real estate; and
- jurisdiction over the persons in the lawsuit, such as a buyer and seller.

The state of California has a three-tiered court system which includes:

- trial courts, called the superior court system;
- appellate courts; and
- the California Supreme Court.

All legal disputes, both civil and criminal, are filed in superior court unless jurisdiction has been given by statute to a separately established court. Within the superior court system, proceedings are classified depending on the amount of money in dispute. Legal disputes involving:

- more than \$25,000 are classified as unlimited civil actions;
- \$25,000 or less are classified as limited civil actions; and
- \$10,000 or less brought by natural persons (or \$5,000 or less by other than a natural person) are allocated to the small claims division.

The proper location to hear a legal dispute depends on venue, not jurisdiction.

Unless the person suing can show their case belongs in federal court, it needs to be brought in a state court.

For the purposes of real estate law, a federal court has jurisdiction over two types of cases:

- disputes involving questions of federal law; or
- legal disputes between citizens of different states.

When a federal court accepts a case between citizens of different states it needs to decide which state law to apply. Ordinarily, the court applies the state law where the federal court is located. However, the court also weighs the interests of each state on the result of the case.

In addition to subject matter jurisdiction, a court needs to have jurisdiction over the person being sued, called personal jurisdiction.

The main trial court in the federal system is called the district court.

**Chapter 2**  
**Key Terms**

Other trial courts exist in the federal system to hear claims in particular areas of law, such as the:

- United States Bankruptcy Court;
- United States Tax Court; and
- United States Claims Court.

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**Quiz 1 Covering Chapters 1-2 is located on page 441.**





# The real estate exists

## Chapter 3

After reading this chapter, you will be able to:

- distinguish between personal property and real estate;
- comprehend the physical characteristics of real estate;
- understand a property's appurtenant and riparian rights; and
- determine whether an item is a property fixture or trade fixture.

**appropriation right**

**appurtenant rights**

**common interest development (CID)**

**fixture**

**lien**

**personal property**

**prescriptive right**

**profit a prendre**

**real estate**

**riparian right**

**trade fixtures**

## Learning Objectives

## Key Terms

For most situations, the term “**property**” means a physical or tangible *thing*. However, property can be more broadly defined, focusing on the *rights* which arise out of the object. Thus, property is referred to as a *bundle of rights*, which for the purposes of this material is real estate.

Further, property is anything which may be owned. In turn, *ownership* is the right to possess the property owned and use it to the exclusion of others.<sup>1</sup>

The *right to possess* and use property includes the rights to:

- occupy;
- sell or dispose;

## Physical and legal aspects

<sup>1</sup> Calif. Civil Code §654

**real estate**

Land and anything permanently affixed or appurtenant to it.

**personal property**

Moveable property not classified as part of real estate, such as trade fixtures.

- encumber; or
- lease.

Property is divided by types into two primary categories:

- **real estate**, also called *real property* or *realty*; and
- **personal property**, also called *personalty*.<sup>1</sup>

*Real estate* is characterized as **immovable**, whereas personal property is **movable**.<sup>2</sup>

*Personal property* is defined, by way of exclusion, as all property which is not classified as real estate.<sup>3</sup>

While the distinction between real estate and personal property seems apparent at first glance, the difference is not always so clear.

## Cutting up the real estate

Real estate may be physically cut up by **severance** of a part of the earth (i.e., removal of minerals). **Title** to real estate may also be cut up in terms of time, providing sequential ownership.

For example, *fee ownership* may be conveyed to one person for life, and on their death, transferred by the fee owner to another. *Time sharing* is another example of the allocation of ownership by time, such as the exclusive right to occupy a space for only three weeks during the year.

*Title* to real estate may also be *fractionalized* by concurrently vesting title in the name of co-owners, such as tenants-in-common, who each hold an undivided (fractional) ownership interest in the real estate.

*Possession* to real estate may be cut out of the fee ownership and conveyed for a period of time. For instance, the fee owner of real estate acting as a landlord conveys possession of the property to a tenant under a lease agreement for a fixed term, called a *tenancy*. When the tenancy expires or is terminated, possession of the property *reverts* to the landlord. The landlord retains fee title to the real estate at all times, subject to the *lease*.

**Possession** may also be cut up by creating *divided interests* in a property, as opposed to undivided interests. For example, an owner may lease a portion of their property to a tenant. The tenant, in turn, may sublease a portion of their space to yet another person, known as a *subtenant*.

Other non-possessory interests in real estate may be created, such as **liens**. *Liens* are interests in real estate which secure payment or performance of a debt or other monetary obligation, such as a:

- trust deed lien; or
- local property tax lien.

**lien**

Interests in real estate which secure payment or performance of a debt or other monetary obligation.

<sup>1</sup> CC §657

<sup>2</sup> CC §§659, 657

<sup>3</sup> CC §§658, 663

On nonpayment of a lien amount, the lienholder may force the sale of the real estate to pay off and satisfy the lien.

Thus, an owner's rights in a parcel of real estate extend beyond the mere physical aspects of the land, airspace and improvements located within the legally described boundaries of the property.

The **physical components** of real estate include:

- the land;
- anything affixed to the land;
- anything appurtenant (incidental rights in adjoining property) to the land; and
- anything which cannot be removed from the land by law.<sup>4</sup>

Real estate includes buildings, fences, trees, watercourses and easements within a parcel's horizontal and vertical boundaries. Anything below the surface, such as water and minerals, or above the surface in the air space, such as crops and timber, is part of the real estate.

For example, the rental of a boat slip includes the water and the land below it, both of which comprise the total of the rented real estate. Thus, landlord/tenant law controls the rental of the slip.<sup>5</sup>

In the case of a condominium unit, the **air space** enclosed within the walls is the real estate. The structure itself, land and air space outside the unit are the property of the association or all the owners of the separate parcels of air space within the condominium project, creating what is called a **common interest development (CID)**.<sup>6</sup>

## Real estate components

### common interest development (CID)

Condominium projects, cooperatives or single family residences in a planned unit development.

A parcel of real estate is located by defining its legal description on the face of the earth. Using the property's *legal description*, a surveyor locates and sets the corners and *horizontal boundaries* of the parcel.

The legal, horizontal boundary description of real estate is documented in numerous locations, such as:

- deeds;
- public records of the county where the parcel is located;
- subdivision maps; and
- government surveys relating to the property.

Real estate is three-dimensional and reaches perpendicular to the horizontal boundary. In addition to the surface area between boundaries, the classic definition of real estate consists of the soil below to the core of the earth as well as the air space above to infinity.

## The boundaries of real estate

<sup>4</sup> CC §658

<sup>5</sup> *Smith v. Municipal Court* (1988) 202 CA3d 685

<sup>6</sup> CC §4125

All permanent structures, crops and timber within this *inverse pyramid* are also a part of the parcel of real estate. The three-dimensional aspect of real estate has its source in the English common law.<sup>1</sup>

## Land

The first component of real estate is **land**. *Land* includes:

- soil;
- rocks;
- other materials of the earth; and
- the reasonable airspace above the earth.<sup>2</sup>

The soil and solid materials, such as ores and minerals, are considered land while they remain undisturbed as a part of the earth. For example, unmined gold dormant in the earth is real estate.

However, when the gold is mined, it becomes *personal property* since it is no longer embedded in the earth. The gold has been converted from something immovable — part of the rock below the soil — to something movable.

Minerals in the soil are *severable* from the earth. Also, fee ownership to the soil and minerals may be conveyed away from the ownership of the remainder of the land.

When ownership of minerals in a parcel of land is transferred, the transfer establishes two fee owners of the real estate located within the same legal description — an owner of the **surface rights** and an owner of the **mineral rights** beneath the surface.

These parties are not co-owners of the real estate, but individual owners of separate vertically-located portions of the same real estate. Both fee owners are entitled to reasonable use and access to their ownership interest in the real estate.

For example, an owner sells and conveys the right to extract minerals to a buyer. On conveyance, there now exists:

- a surface owner; and
- a mineral rights owner.

Later, the surface owner conveys the real estate to a developer. The developer subdivides the parcel of real estate and plans to construct homes on the lots.

The mineral rights owner objects to the construction, claiming the homes, if built, will interfere with their right to enter the property and remove their minerals.

Is the mineral rights owner entitled to enter the property to remove the minerals?

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<sup>1</sup> CC §659

<sup>2</sup> CC §659

Yes! But only as necessary to use their mineral rights. The rights of the surface owner and the mineral rights owner are thus *balanced* to determine the precise surface location to be used to extract the minerals.<sup>3</sup>

The right to remove minerals from another's real estate is called a **profit a prendre**.

**profit a prendre**

The right to remove minerals from another's real estate.

Unlike solid minerals which are stationary, oil and gas are mobile. Oil and gas are referred to as being **fugacious matter** as they are transitory.

Oil and gas are perpetually percolating under the earth's surface. Due to their fleeting nature, a real estate owner does not hold title to the physical oil and gas situated under the surface of their real estate. At any given time, a real estate owner will have more or less oil or gas depending on the earth's movements. The ownership interest in unremoved oil and gas is referred to as a **corporeal hereditament**.

In California, oil and gas are incapable of being owned until they are actually possessed. Once they have been removed, they become personal property.<sup>4</sup>

A fee owner has the exclusive right to drill for oil and gas on their premises, unless that right has been conveyed away to others.

Rather than owning the physical oil and gas, the fee owner has a right, called an *incorporeal hereditament*, to remove the oil or gas for their purposes.<sup>5</sup>

A land owner has the right to extract all the oil and gas brought up from their real estate even if it is taken from an underground pool extending into an adjoining owners' real estate.<sup>6</sup>

However, an owner may not slant drill onto another's property to reclaim the oil or gas that has flowed from their property.<sup>7</sup>

## Oil and gas

Land also includes the *airspace* above the surface of a property. Under traditional English common law, the right to airspace continued to infinity. However, modern technological advances have altered the legal view on airspace.

For example, an owner runs a farm near a military airport with heavy air traffic. The government expands the military base by extending the runway to accommodate larger (and louder) aircraft. The aircraft, on their approach to the airport, now fly directly over the farmer's barn, scaring the animals and causing the farmer financial loss.

The farmer sues the government for trespass on their real estate since the airspace is being occupied by others — the military.

## Airspace

<sup>3</sup> *Callahan v. Martin* (1935) 3 C2d 110

<sup>4</sup> *Callahan, supra*

<sup>5</sup> *Gerhard v. Stephens* (1968) 68 C2d 864

<sup>6</sup> *Alphonzo E. Bell Corporation v. Bell View Oil Syndicate* (1938) 24 CA2d 587

<sup>7</sup> *Alphonzo E. Bell Corporation, supra*



Can the owner keep the aircraft from flying into their real estate?

No! The common law doctrine regarding the ownership of airspace to the edge of the universe is obsolete. The owner only owns the airspace necessary to allow them a *reasonable use* of their real estate. The owner's real estate extends only so far above the surface of the earth as can be reasonably occupied or used in connection with the land.<sup>1</sup>

However, when the flight of airborne vehicles intrudes upon an owner's *use and enjoyment* of their real estate below, the intrusive entry may constitute a **taking** of the real estate. The continued noise and disturbance of low-flying aircraft has effectively *taken* something from the owner — the quiet use and enjoyment of their property. Thus, the owner needs to be compensated for their loss.<sup>2</sup>

## Other blue sky to be sold

The *airspace* portion of land has also been modernized with the concept of the **condominium**. An owner of a condominium unit legally owns the right to occupy the *parcel of airspace* they have acquired which is enclosed between the walls, ceilings and floors of the structure.

Included in these ownership rights are incidental rights of *ingress and egress*, called **appurtenances**. Also included is the *exclusive right* to use other portions of the real estate for storage and parking, plus an undivided fractional interest in the common areas, directly or through a homeowners' association (HOA).<sup>3</sup>

Also, the installation of **active solar collectors** has led to the right of access to sunlight and air which passes through airspace above property owned by others. This right of access to the sun for a solar collector is considered an *easement*.<sup>4</sup> [See Chapter 13]

## Water

Water in its natural state is considered real estate since it is part of the material of the earth. While water is real estate, the right to use water is an *appurtenant* (incidental) right to the ownership of real estate. [See Chapter 8]

Three key rights in water need to be separately understood:

- the right to **use water**;
- the right to take water by **appropriation rights**; and
- the right to take water by **prescriptive rights**.

The right to use water is called a **riparian right**. *Riparian rights* refer to the rights of a real estate owner to take surface water from a running water source contiguous to their land, such as a river or stream.<sup>5</sup>

### appropriation right

The right to divert water from a river or watercourse to real estate for reasonable use.

### riparian right

The right of a real estate owner to take surface water from a running water source contiguous to their land.

<sup>1</sup> **United States v. Causby** (1946) 328 US 256

<sup>2</sup> Causby, *supra*

<sup>3</sup> CC §4125

<sup>4</sup> Calif. Public Resources Code §52598o et seq.; CC §801.5(a)(1)

<sup>5</sup> Calif. Water Code §101

The right to take water may be acquired by *appropriation*. The appropriator of water diverts water from a river or watercourse to their real estate for reasonable use.<sup>6</sup>

Also, an individual may obtain *prescriptive rights* in water by wrongfully appropriating nonsurplus water openly and adversely under a claim of right for an uninterrupted period of at least five years.<sup>7</sup>

However, all water in the state of California belongs to the people based on a *public trust doctrine*. Riparian, appropriation and prescriptive rights are subject to the state's interest in conserving and regulating water use.<sup>8</sup>

#### prescriptive right

The right to use water established by appropriating nonsurplus water openly and adversely for an uninterrupted period of five years without documentation of a legal right.

Real estate includes things which are affixed to the land. Things may be affixed to the land by:

- roots (e.g., shrubs and trees);
- embedment (e.g., walls);
- permanently resting (e.g., structures); or
- physically attached (e.g., by cement or nails).<sup>9</sup>

Things attached to the earth naturally are real estate. Natural fixtures to the land, called **fructus naturales**, include:

- trees;
- shrubs; and
- grass.

However, natural items planted and cultivated for human consumption and use are fruits of labor, called **fructus industriales**, also known as **emblements**.

*Fructus industriales* include such things as crops and standing timber. Crops and timber are ordinarily considered real estate. However, industrial crops and standing timber sold under a purchase agreement and scheduled to be removed are considered personal property.<sup>10</sup>

## Affixed to the land

#### fixture

Personal property permanently attached to real estate and conveyed with it.

A **fixture** is personal property which has become *permanently attached* to real estate. As it is permanently attached, it effectively becomes part of the real estate and is conveyed with it.<sup>11</sup>

Factors which determine whether an item is a fixture or removable improvement include:

- relationship of the parties;
- agreement between the parties;

## Fixtures

<sup>6</sup> *In re Water of Hallett Creek Stream System* (1988) 44 C3d 448

<sup>7</sup> *City of Barstow v. Mojave Water Agency* (2000) 23 C4th 1224

<sup>8</sup> Wat C §101

<sup>9</sup> CC §660

<sup>10</sup> Calif. Commercial Code §9102(a)(44)

<sup>11</sup> CC §660

- intention of the parties;
- manner of attachment; and
- adaptability of attachment to the real estate's use.<sup>12</sup>

Individuals most likely to dispute whether an item is a fixture include:

- buyers and sellers;
- landlords and tenants;
- a builder and an owner;
- a lender and an owner; and
- the county assessor and an owner.

The most important factor when determining whether an item is a fixture or improvement is the **intent of the parties**.

Intent to make an item a permanent part of the real estate as a fixture is determined by:

- the manner of attachment; and
- the use and purpose of the item in dispute.

For example, when an item is attached to real estate by bolts, screws, cement or the like, the item is a fixture and part of the real estate. An item need not be attached to the real estate in this manner to be a fixture. Items of such weight and size that gravity maintains them in place are sufficient to give the item the character of permanence and affixation to be real estate.

Also, the item may be *constructively attached* when the item is a necessary, integral or working part of improvements on the real estate.

## Trade fixtures

### trade fixtures

Fixtures used to render services or make products in the trade or business of a tenant.

Fixtures which are used to render services or make products for the trade or business of a tenant are called **trade fixtures**.

*Trade fixtures* are removed by the tenant on termination of the tenancy, unless agreed to the contrary with the landlord. The removal may not unduly damage the real estate.<sup>13</sup>

Thus, trade fixtures are considered *personal property*.

To be considered a trade fixture, a fixture needs to be an essential part of the tenant's business and its removal may not substantially damage the real estate.

In the instance of a beauty salon, trade fixtures include:

- mirrors;
- sink bowls;
- dryers; and

<sup>12</sup> *San Diego Trust & Savings Bank v. San Diego County* (1940) 16 C2d 142

<sup>13</sup> CC §1019

- installed wash stations.<sup>14</sup>

Real estate also includes any **incidental rights** which are not located on the real estate nor reflected on its title, called **appurtenant rights**. *Appurtenant rights* include the right of ingress and egress (entry and exit) across adjoining properties.<sup>15</sup>

An *appurtenant easement* is an interest held by an owner of one parcel of real estate to use adjoining real estate.

Under an appurtenant easement, an owner's **right to use** adjoining real estate is part of their real estate, although it is not reflected on the title to the real estate. This right to use adjoining property *runs with the land* and is automatically conveyed with the real estate when the owner sells it. Appurtenant rights remain with the real estate they benefit and do not transfer from person to person.

Other appurtenant rights to real estate include the right to the *lateral and subjacent support* provided by the existence of adjoining real estate. For example, the owner of real estate may not remove soil from their land if doing so causes the adjoining real estate to subside or collapse.

Appurtenant rights held by an owner of one property are a recorded encumbrance on title to the adjacent property burdened by the appurtenant rights, such as an easement.

## Appurtenant rights

### appurtenant rights

Incidental property rights which are not located on a parcel of real estate nor reflected on its title, including the right of ingress and egress across adjoining properties.

<sup>14</sup> **Beebe v. Richards** (1953) 115 CA2d 589

<sup>15</sup> CC §662

## Chapter 3 Summary

Property is divided into two primary categories: real estate and personal property. Real estate is immovable whereas personal property is movable.

The first component of real estate is land, which includes materials of earth and reasonable airspace above the earth. Oil and gas are incapable of being owned until they are actually possessed. Once they have been removed, they become personal property. While water is considered real estate, the right to use water is an appurtenant (incidental) right to the ownership of real estate

Real estate also includes objects which are affixed to the land, such as fixtures. A fixture is personal property which has become permanently attached to real estate and is conveyed with it. Fixtures which are used to render services or make products for the trade or business of a tenant are trade fixtures. Trade fixtures are removed by the tenant on termination of the tenancy, unless agreed to the contrary with the landlord or the removal will cause undue damage to the real estate.

Real estate also includes incidental rights, such as an appurtenant easement held by an owner of one parcel of real estate to use adjoining real estate.

## Chapter 3 Key Terms

<b>appropriation right .....</b>	<b>pg. 26</b>
<b>appurtenant rights .....</b>	<b>pg. 29</b>
<b>common interest development (CID).....</b>	<b>pg. 23</b>
<b>fixture .....</b>	<b>pg. 27</b>
<b>lien.....</b>	<b>pg. 22</b>
<b>personal property .....</b>	<b>pg. 22</b>
<b>prescriptive right.....</b>	<b>pg. 27</b>
<b>profit a prendre .....</b>	<b>pg. 25</b>
<b>real estate .....</b>	<b>pg. 22</b>
<b>riparian right .....</b>	<b>pg. 26</b>
<b>trade fixtures.....</b>	<b>pg. 28</b>

**Quiz 2 Covering Chapters 3-4 is located on page 442.**





# Fee vs. leasehold

## Chapter 4

After reading this chapter, you will be able to:

- identify the different possessory interests held in real estate, and the rights and obligations associated with each;
- distinguish the individual rights which collectively comprise real property;
- identify the different types of leasehold interests held by tenants; and
- understand leasehold interests which convey special rights, such as a ground lease, master lease or sublease.

**covenants, conditions and restrictions (CC&Rs)**

**easement**

**estate**

**fee estate**

**fixed-term tenancy**

**ground lease**

**leasehold estate**

**license**

**life estate**

**master lease**

**periodic tenancy**

**profit a prendre**

**sublease**

**tenancy-at-sufferance**

**tenancy-at-will**

## Learning Objectives

## Key Terms

The ownership interests a person may hold in real estate are called **estates**. Four types of *estates* exist in real estate:

- **fee estates**, also known as *fee simple estates*, *inheritance estates*, *perpetual estates*, or simply, *the fee*;
- **life estates**;

## Possessory interests in real estate

**estate**

The ownership interest a person may hold in real estate.

## Fee estates: unbundling the rights

**fee estate**

An indefinite, exclusive and absolute legal ownership interest in a parcel of real estate.

**profit a prendre**

The right to remove minerals from another's real estate.

- **leasehold estates**, sometimes called *leaseholds*, or *estates for years*; and
- **estates at will**, also known as *tenancies-at-will*.<sup>1</sup>

In practice, these estates are separated into three categories: *fee estates*, *life estates* and *leasehold estates*. Estates at will are considered part of the leasehold estates category. Leasehold estates are controlled by landlord/tenant law.

A person who holds a **fee estate** interest in real estate is a fee owner.

A fee owner has the right to possess and control their property indefinitely. A fee owner's possession is exclusive and absolute. Thus, the owner has the right to deny others permission to cross their boundaries. No one may be on the owner's property without their consent, otherwise they are *trespassing*. The owner may recover any money losses caused by the trespass.

A fee owner has the exclusive right to use and enjoy the property. As long as local ordinances such as building codes and zoning ordinances are obeyed, a fee owner may do as they please with their property. A fee owner may build new buildings, tear down old ones, plant trees and shrubs, grow crops or simply leave the property unattended.

A fee owner may occupy, lease, encumber or sell their parcel of real estate. They may give it away or pass it on to anyone they choose on their death. The *fee estate* is the interest in real estate transferred in a sales transaction, unless a lesser interest such as an easement or life estate is noted. However, one cannot transfer an interest greater than they received.

A fee owner is entitled to the land's surface and anything permanently located above or below it.<sup>2</sup>

The ownership interests in one parcel may be separated into several fee interests. One person may own the mineral rights beneath the surface, another may own the surface rights, and yet another may own the rights to the air space. Each solely owned interest is held in fee in the same parcel.

In most cases, one or more individuals own the entire fee and lease the rights to extract underground oil or minerals to others. Thus, a fee owner may convey a leasehold estate in the oil and minerals while retaining their fee interest. The drilling right separated from the fee ownership is called a **profit a prendre**.<sup>3</sup>

A *profit a prendre* is the right to remove profitable materials from property owned and possessed by another. If the profit a prendre is created by a lease agreement, it is a type of easement.<sup>4</sup>

<sup>1</sup> Calif. Civil Code §761

<sup>2</sup> CC §829

<sup>3</sup> *Rousselot v. Spanier* (1976) 60 CA3d 238

<sup>4</sup> *Gerhard v. Stephens* (1968) 68 C2d 864

*Consider a fee owner who grants separate fee interests in their property to two individuals. One individual receives the land's surface and air space rights. The other individual receives the subsurface oil and mineral rights.*

*The surface owner claims title to the entire parcel of real estate should be vested — quieted — in their name. The subsurface owner objects, claiming the surface owner's real estate interest is less than the entire fee estate in the property.*

*Here, the surface owner's fee interest in the parcel of real estate is separate from the subsurface ownership and possession of the oil and mineral rights. Also, they are not co-owners of the real estate. Both owners hold an individual fee estate in mutually exclusive and divided portions of the same parcel. [In re Waltz (1925) 197 C 263]*

## Separation of fee interests

A **life estate** is an interest in a parcel of real estate lasting the lifetime of a named individual, usually the life of the tenant. *Life estates* are granted by a deed entered into by the fee owner, an executor under the owner's will or by a trustee under the owner's inter vivos trust.

Life estates are commonly established by a fee owner who wishes to provide a home or financial security for another person (here the life tenant) during that person's lifetime, called the controlling life.

Life estates terminate on the death of the controlling life. Life estates may also be terminated by agreement or by merger of different ownership interests in the property.

For example, the fee owner of a vacation home has an elderly relative who needs a place to live. The fee owner grants the relative a life estate in the vacation home for the duration of their lifetime. The relative may live there for the rest of their life, even if they outlive the fee owner who granted them the life estate.

Although the relative has the right of exclusive possession of the entire parcel of real estate, the fee owner retains title to the fee estate. Thus, the conveyance of a life estate transfers a right of possession which has been "carved out" of the fee estate. This possession is comparable to occupancy under a leasehold estate since both are conveyed for their duration out of a fee estate.

On the relative's death, possession of the property reverts to the fee owner, their successors or heirs. The right of possession under the life estate is extinguished on the relative's death.

The holder of a life estate based on their life has the right of possession until death, as though they were the owner in fee. Unlike a lease, a life estate does not require rent to be paid. However, the holder of a life estate is responsible for taxes, maintenance and a reasonable amount of property assessments.<sup>5</sup>

## Life estates and the life tenant

### Life estate

An interest in a parcel of real estate lasting the lifetime of the life tenant.

<sup>5</sup> CC §840

## The life estate improves or impairs the fee

The holder of a life estate may not impair the fee interest.<sup>6</sup>

For instance, the holder of a life estate may not make alterations which decrease the property's value, such as removing or failing to care for valuable plants or demolishing portions of the improvements or land.

Conversely, the owner of the life estate has the right to lease the property to others and collect and retain all rents produced by the property during the term of the life estate.

In addition, a life tenant is entitled to be reimbursed by the fee owner for the fee owner's share of the costs to improve the property.

## Leasehold estates held by tenants

### leasehold estate

The right to possess a parcel of real estate, conveyed by a fee owner (landlord) to a tenant.

**Leasehold estates**, or *tenancies*, are the result of rights conveyed to a tenant by a fee owner (or by the life estate tenant or master lessee) to possess a parcel of real estate.

Tenancies are created when the landlord and the tenant enter into a rental or lease agreement that conveys a possessory interest in the real estate to the tenant.

The tenant becomes the owner of a leasehold with the right to possess and use the entire property they leased until the lease expires. The ownership and title to the fee interest in the property remains with the landlord throughout the term of the leasehold. The landlord's fee interest is subject to the tenant's right of possession, which is carved out of the fee on entering into the lease agreement.

In exchange for conveying the right to occupy and use the property, the landlord is entitled to rental income from the tenant during the period of the tenancy.

## Types of leaseholds

### fixed-term tenancy

A leasehold interest which lasts for the specific lease period set forth in a lease agreement. A fixed-term tenancy automatically terminates at the end of the lease period. [See RPI Form 550 and 552]

Four types of leasehold estates exist which a tenant may hold. The interests are classified by the length of their term:

- a **fixed-term tenancy**, simply known as a lease and legally called an *estate for years*;
- a **periodic tenancy**, usually referred to as a *rental*;
- a **tenancy-at-will**, previously introduced as an *estate at will*; and
- a **tenancy-at-sufferance**, commonly called a *holdover tenancy*.

A *fixed-term tenancy* lasts for a specific length of time as stated in a lease agreement entered into by a landlord and tenant. On expiration of the lease term, the tenant's right of possession automatically terminates unless it is extended or renewed by another agreement, such as an option agreement. [See Figure 1]

**Periodic tenancies** also last for a specific length of time, such as a week, month or year. Under a *periodic tenancy*, the landlord and tenant agree

<sup>6</sup> CC §818

**2. TERM OF LEASE:**

- 2.1 The lease granted commences \_\_\_\_\_, 20\_\_\_\_\_, and expires \_\_\_\_\_, 20\_\_\_\_\_.  
 a. The month of commencement is the anniversary month.
- 2.2 The lease terminates on the last day of the term without further notice.
- 2.3 If Tenant holds over, the monthly rent will be increased to 120% of the monthly rent applicable immediately preceding the termination of this lease agreement, prorated at 1/30th of the monthly rent for each day until the Premises is delivered to Landlord.
- 2.4 Tenant may surrender this lease only by a written surrender agreement with Landlord. [See RPI Form 587]
- 2.5 ☐ This lease agreement is a sublease of the Premises which is limited in its terms by the terms and conditions of the attached master lease agreement.

to automatic successive rental periods of the same length of time, such as in a month-to-month tenancy, until terminated by notice from either the landlord or the tenant.

In a **tenancy-at-will** (also known as an *estate at will*) the tenant has the right to possess a property with the consent of the fee owner. *Tenancies-at-will* may be terminated at any time by an advance notice from either the landlord or the tenant or as set by agreement. Tenancies-at-will do not have a fixed duration and are usually not in writing. A rent obligation typically does not exist.

A **tenancy-at-sufferance** occurs when a tenant retains possession of the rented premises after the tenancy granted terminates.

In addition to the typical residential and nonresidential leases, *special use* leases exist.

*Oil, gas, water* and *mineral leases* convey the right to use mineral deposits below the earth's surface.

The purpose of an oil lease is to locate and remove oil or gas. The lease is a tool used by the fee owner of the property to induce others to develop and realize the wealth of the land. The tenant provides the money and machinery for exploration, development and operations.

The tenant pays the landlord rent, called a *royalty*. The tenant then keeps any profits from the sale of oil or minerals the tenant extracts from beneath the surface of the parcel.

A **ground lease** on a parcel of real estate is granted to a tenant in exchange for the payment of rent. In a *ground lease*, rent is set based on the rental value of the land in the parcel, whether the parcel is improved or unimproved. Fee owners of unimproved land use leases to induce others to acquire an interest in the property and develop it.

*Ground leases* are common in densely populated areas. Developers often need financial assistance from fee owners to avoid massive cash outlays to acquire unimproved parcels. Also, fee owners of developable property often refuse to sell, choosing to become landlords for the long-term rental income they receive.

Figure 1

Excerpt from  
Form 552Commercial  
Lease  
Agreement**periodic tenancy**

A leasehold interest which lasts for automatic successive rental periods of the same length of time, terminating upon notice from either party. [See RPI Form 551 and 552-5]

**Leaseholds  
conveying  
special uses****tenancy-at-will**

A leasehold interest granted to a tenant, with no fixed duration or rent owed. A tenancy-at-will can be terminated at any time by an advance notice from either party.

**tenancy-at-sufferance**

A leasehold condition created when a tenant retains possession of the rented premises after the tenancy has terminated. [See RPI Form 550 §3.4]

**ground lease**

A leasehold interest for which rent is based on the rental value of the land, whether the parcel is improved or unimproved.

An original tenant under a ground lease constructs their own improvements. The tenant encumbers the possessory interest they own, evidenced by the ground lease, with a trust deed lien to provide security for a construction loan.

**Master leases** benefit fee owners who want the financial advantages of renting fully improved property, but do not want the day-to-day obligations and risks of managing the property.

For instance, the fee owner of a shopping center and a prospective owner-operator agree to a *master lease*.

As the master tenant, the owner-operator collects rent from the many subtenants, addresses their needs and maintains the property. The master tenant is responsible for the rent due the fee owner under the master lease, even if the subtenants do not pay their rents to the master tenant.

The *master lease* is sometimes called a *sandwich lease* since the master tenant is “sandwiched” between the fee owner (the landlord on the master lease) and the many subtenants with their possession under subleases.

The master lease is a regular, nonresidential lease agreement form with the clauses prohibiting subletting removed. A **sublease** is also a regular, nonresidential lease agreement with an additional clause referencing the attached master lease and declaring the *sublease* subject to the terms of the master lease. [See **RPI** Form 552 §2.5]

Another type of special-use lease is the *farm lease*, sometimes called a *cropping agreement* or *grazing lease*. Here, the tenant operates the farm and pays the landlord either a flat fee rent or a percentage of the price received for the crops or livestock produced on the land.

## The rights of others in a property

### **easement**

The right to use another's property for a specific purpose.

### **license**

The personal, unassignable right held by an individual to the non-exclusive use of property owned by another.

**Easements** and **use licenses** are not real estate, but they give a holder of the rights a limited and **nonexclusive use** of someone else's property.

An *easement* is a *right to use* another's property for a specific purpose. An easement is an interest in someone else's real estate, as it grants its holder the right to limit the activities of others on the property which is burdened by the easement.<sup>7</sup> [See Chapter 13]

For example, a landowner holds an easement allowing them to construct and have access to a pipeline across their neighbor's property. The neighbor's right to develop their own property is limited since they may do nothing to interfere with the easement owner's access to the pipeline.

A **license** grants its holder a personal privilege to use another's property, but no right to occupy it to the exclusion of anyone. Unlike easements, *licenses* are not exclusive rights — an owner may give many licenses to perform the same or different activity in the same area, such as advertising with billboards. [See Chapter 7]

<sup>7</sup> CC §5801 et seq.



Unlike an easement, a license may be revoked at the will of the person who grants it, unless agreed to the contrary or it has become irrevocable.

For example, a landowner wishes to enjoin a neighbor from continuing to use a roadway across the landowner's property that the prior owner of the neighboring property used for ingress and egress to his property. The landowner claims the right to pass is a license, not an easement. The neighbor contends the grant of the right to use the road created an easement.

The landowner claims only a revocable license to use the road was created, as the previous neighbor was only granted a personal *in gross* right to use the road and that right is not assignable to the current neighbor.

Although the previous owner is mentioned, the document creating the right to use a roadway contains the crucial phrase "*their heirs or assigns*" when referring to the prior neighbor's right to use the roadway.

Thus, when the neighbor bought the property they obtained the irrevocable right to use the road as part of their ownership rights. The easement is an *appurtenant right* running with their land since it is physically located on the property of another and is an encumbrance on that property's title.

The roadway document created an easement which entitled the new owner of the neighboring property to cross the adjacent property for ingress and egress to their property from the main road.<sup>8</sup>

**Covenants, conditions and restrictions (CC&Rs)**, collectively called *encumbrances*, are recorded against title to a property and limit an owner's right to use their property. By recording restrictions against the title to real estate on a sale, a seller may prohibit certain uses of the property, or require the property be used for specific purposes only.

Rules governing how a condominium owner may use their unit and the rights and responsibilities of the common interest development (CID) are contained in a declaration of CC&Rs filed with the condominium subdivision plan.

The CC&Rs bind all future owners to comply with the CC&Rs since the use restrictions they contain run with the land.

**covenants, conditions and restrictions (CC&Rs)**  
Recorded restrictions against the title to real estate prohibiting or limiting specified uses of the property.

<sup>8</sup> **Eastman v. Piper** (1924) 68 CA 554

## Chapter 4 Summary

The ownership interests a person may hold in real estate are called estates. Four types of estates exist in real estate:

- fee estates;
- life estates;
- leasehold estates; and
- estates at will.

In practice, estates at will are considered leasehold estates.

Four types of leasehold interests exist and may be held by tenants. The interests are classified by the length of their term:

- fixed-term tenancies;
- periodic tenancies;
- tenancies-at-will; and
- tenancies-at-sufferance.

A fixed-term tenancy lasts for a specific length of time as stated in a lease agreement entered into by a landlord and tenant. On expiration of the lease term, the tenant's right of possession automatically terminates unless it is extended or renewed by another agreement.

Periodic tenancies also last for a specific length of time, such as a week, month or year. Under a periodic tenancy, the landlord and tenant agree to automatic successive rental periods of the same length of time, such as in a month-to-month tenancy, until terminated by notice by either the landlord or the tenant.

Under a tenancy-at-will, the tenant has the right to possess a property with the consent of the fee owner. Tenancies-at-will may be terminated at any time by an advance notice from either the landlord or the tenant or as set by agreement. Tenancies-at-will do not have a fixed duration.

A tenancy-at-sufferance occurs when a tenant retains possession of the rented premises after the tenancy granted terminates.

In addition, several special use leases exist, including ground leases, master leases and subleases.

An easement is a right to use another's property for a specific purpose. An easement is an interest in someone else's real estate, as it grants its holder the right to limit the activities of others on the property which is burdened by the easement.

A license grants its holder a personal privilege to use another's property, but no right to occupy it to the exclusion of anyone.

## Chapter 4 Key Terms

covenants, conditions and restrictions (CC&Rs) .....	pg. 37
easement .....	pg. 36
estate .....	pg. 32
fee estate .....	pg. 32
fixed-term tenancy .....	pg. 34
ground lease .....	pg. 35
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life estate .....	pg. 33
master lease .....	pg. 36
periodic tenancy .....	pg. 35
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tenancy-at-sufferance .....	pg. 35
tenancy-at-will .....	pg. 35

**Quiz 2 Covering Chapters 3-4 is located on page 442.**

*Notes:*



# Leasehold improvements

## Chapter 5

After reading this chapter, you will be able to:

- identify the different types of tenant improvements;
- understand the landlord's rights regarding tenant improvements on the termination of a lease; and
- determine the landlord or tenant's obligation to complete or pay for the construction of tenant improvements.

**fixture**

**further-improvements provision**

**mandatory improvement**

**mechanic's lien**

**notice of nonresponsibility**

**permissive improvement**

**reversion**

**tenant improvements**

**trade fixtures**

## Learning Objectives

## Key Terms

A retail business owner enters into a commercial lease agreement to occupy space as a tenant. The leased premises is nothing more than a shell containing no **tenant improvements**.

The tenant agrees to make all the *tenant improvements* necessary to occupy and operate a retail business on the premises (e.g., interior walls, flooring, ceilings, air conditioning, electrical outlets and lighting, plumbing, sprinklers, telephone and electronic wiring, etc.).

The lease agreement provides for the property to be delivered to the landlord on expiration of the lease "in the condition the tenant received it," less normal wear and tear. No other lease provision addresses whether tenant improvements will remain with the property or that the tenant is to restore the property to its original condition when the lease expires.

## Ownership rights when a tenant vacates

### **tenant improvements**

Improvements made to leased property to meet the needs of the occupying tenant. [See RPI Form 552 §11]

On expiration of the lease, the tenant strips the premises of all of the tenant improvements and vacates. The tenant returns the building to the landlord in the condition it was in when the tenant took possession: an empty shell, less wear and tear. In order to relet the space, the landlord replaces nearly all the tenant improvements that were removed.

Is the tenant liable for the landlord's costs to replace the tenant improvements the tenant removed on vacating?

#### **fixture**

Personal property permanently attached to real estate and conveyed with it.

Yes! The improvements made by the tenant were permanently *affixed* to the real estate, called **fixtures**, and became part of the real estate. *Fixtures* remain with the property on expiration of the tenancy, unless the lease agreement explicitly states the tenant is to remove the tenant improvements and the property restored to its original condition on vacating.<sup>1</sup>

## Landlord's right to improvements

However, the landlord's right to improvements added to the property or paid for by the tenant depends upon whether:

- the tenant improvements are permanent (built-in) or temporary (free-standing); and
- the lease agreement requires the tenant to remove improvements and restore the premises.

All improvements attached to the building become part of the real estate, except for *trade fixtures* (discussed later in this chapter).<sup>2</sup>

Examples of improvements that become part of the real estate include:

- built-ins (e.g., central air conditioning and heating, cabinets and stairwells);
- fixtures (e.g., electrical and plumbing);
- walls, doors and dropped ceilings; and
- attached flooring (e.g., carpeting, tile or linoleum).

## Leasehold improvement provisions

#### **further-improvements provision**

A commercial lease provision which allows a landlord to retain tenant improvements or require the restoration of the property to its original condition upon expiration of the lease. [See **RPI** Form 552 §11.3]

Commercial lease agreements often contain a **further-improvements provision** allowing the landlord to either:

- retain tenant improvements and alterations made by the tenant; or
- require restoration of the property to its original condition on expiration of the lease. [See **RPI** Form 552 through 552-5]

*Further-improvement provisions* usually include clauses stating:

- who will make the improvements (landlord or tenant);
- who will pay for the improvements (landlord or tenant);
- the landlord's consent is required before the tenant makes improvements;

<sup>1</sup> Calif. Civil Code §1013

<sup>2</sup> CC §660



- any *mechanic's liens* due to improvements contracted by the tenant will be removed;
- the condition of the premises on expiration of the lease; and
- whether the improvements are to remain or be removed on expiration of the lease.

A landlord who enters into a lease agreement with a provision agreeing they are to make improvements to the leased premises needs to complete the improvements in a timely manner. When the landlord fails to make timely improvements, the tenant may cancel the lease agreement. [See **RPI** Form 552 §3.3]

For example, a landlord agrees to make all the improvements necessary to convert a ranch into a dairy farm for a tenant who operates a dairy.

The landlord is obligated to construct a barn and several sheds that are essential to the operation of the tenant's dairy business. The tenant moves into the property before construction of the improvements begin.

Several months pass and the landlord does not begin construction on the promised improvements. The tenant vacates the property since it is impossible to conduct a dairy business without the dairy barn.

Here, the landlord's failure to make the promised improvements is a *breach* of the lease agreement.

Since the landlord has breached an essential provision of the lease, the tenant may vacate the property and cancel the lease agreement without obligation to pay further rent.<sup>3</sup>

Conversely, lease agreement provisions may obligate a tenant to construct or install improvements on the rented property, whether improved or unimproved. The time period for commencement and completion needs to be provided for in the lease agreement. When not agreed to, a reasonable period of time is allowed.<sup>4</sup>

However, a tenant may fail to make or complete **mandatory improvements** prior to expiration of the lease. When a tenant is not required to remove tenant improvements on vacating the premises, the tenant is liable to the landlord for the cost the landlord incurs to complete the agreed-to improvements.

For example, a tenant agrees to construct additional buildings on a leased property in lieu of paying rent for one year. When the lease expires, the improvements are to remain with the property since the lease agreement does not call for restoration of the premises.

## Failure to make improvements

## Improvements promised by the tenant

### **mandatory improvement**

An improvement required to be made by the tenant under the terms of the rental or lease agreement.

<sup>3</sup> *Souza v. Joseph* (1913) 22 CA 179

<sup>4</sup> CC §1657

### The controlling lease agreement

*A landlord agrees to construct the shell of a building for a tenant. The tenant agrees to install all other improvements and fixtures required to occupy and use the property.*

*Before the building is completed by the landlord, the building code is changed to require the installation of a sprinkler system. The tenant demands the landlord pay the cost of installing the sprinkler system since the tenant may not occupy the premises without the sprinkler system.*

*The landlord refuses to pay the additional cost to install the sprinkler system, claiming the lease agreement calls for them to build the structure, not to make it ready for occupancy.*

*Is the tenant responsible for the costs to install the sprinkler system?*

*Yes! The tenant is responsible for making the alterations or improvements required to bring the building into compliance with use ordinances. The tenant had agreed in the lease agreement to make all improvements within the structure needed to take occupancy. [Wong v. diGrazia (1963) 60 C2d 525]*

The tenant fails to construct the buildings during the term of the lease. The tenant claims the obligation to build was not a *mandatory improvement*, but **permissive**. According to the tenant, the obligation to build only existed if it was necessary for the operation of the tenant's business.

Here, the improvements were agreed to in exchange for rent. Accordingly, the tenant was required to make the improvements since the landlord bargained for them in the lease agreement. Thus, the landlord is entitled to recover an amount equal to the cost of the improvements the tenant failed to construct.<sup>5</sup>

Additionally, when the tenant agrees to but does not complete the construction of improvements that are to remain with the property on expiration of the lease, the landlord may complete those improvements. The tenant is then financially responsible for the landlord's expenditures to construct the improvements.<sup>6</sup>

Even after the expiration of the lease, a landlord is entitled to recover lost rent and expenses resulting from the tenant's failure to construct the improvements as promised.

### Tenant's failure to construct improvements

Consider a landlord who enters into a lease agreement calling for the landlord to construct a building on the leased property. After the foundation is laid, the landlord and tenant orally modify the construction provisions. The tenant agrees to finish construction of the building in exchange for the landlord forgoing their construction profit.

The tenant then breaches the oral modification of the written lease agreement by failing to complete the construction. The breach places the landlord in

<sup>5</sup> *Simen v. Sam Aftergut Co.* (1915) 26 CA 361

<sup>6</sup> *Sprague v. Fauver* (1945) 71 CA2d 333

financial jeopardy as they now need to complete the building. The landlord terminates the tenant's right to occupancy, evicts the tenant and completes the construction promised by the tenant.

Here, the responsibility of the tenant is not only for the landlord's costs of construction, they are also liable for future rents under the lease agreement. In addition, they are liable for any expenses the landlord incurs to relet the property since the landlord's conduct did not cancel the lease agreement.<sup>7</sup>

Lease provisions often allow a tenant to make improvements to the leased premises. However, *further-improvement provisions* typically call for the landlord to approve the planned improvements before construction is commenced.

## Landlord's consent to improvements

For example, a tenant wishes to add additional space to the premises they leased for use in the operation of their business. The tenant begins construction without obtaining the landlord's prior approval as required by the lease agreement. Further, the addition is located outside the leased premises, an **encroachment** on other land owned by the landlord.

In the past, the landlord had approved tenant improvements. This time, however, the landlord refuses to give consent and complains about the construction and the encroachment.

The landlord continues to accept rent while the landlord and tenant negotiate the approval of the additional improvements and the modification of the lease agreement to include use of the area subject to the encroachment.

After a few years of negotiations without resolution, the landlord declares a **forfeiture** of the lease. The forfeiture is based on both the breach of the provision requiring the landlord's prior consent to construction and the encroachment of the unapproved improvements.

The tenant defends, claiming the landlord waived their right to declare a forfeiture of the lease since the landlord continued to accept the rent from the tenant after the breach of the tenant-improvement provision and encroachment.

However, as long as negotiations to resolve the breach continue, a landlord may accept rent from the tenant without waiving their right to consent to additional improvements.<sup>8</sup>

Likewise, consider a tenant with an option to buy the property they rent. The tenant makes improvements with the expectation of ultimately becoming the owner of the property by exercising the option to buy.

Here, if the tenant fails to exercise their purchase option, they are not entitled to reimbursement for the cost of improvements. Holding an option to buy is

<sup>7</sup> *Sanders Construction Company, Inc. v. San Joaquin First Federal Savings and Loan Association* (1982) 136 CA3d 387

<sup>8</sup> *ThriftyMart, Inc. v. Me & Tex* (1981) 123 CA3d 751

not fee ownership and the improvements become part of the real estate. Thus, the improvements do not belong to the tenant unless the tenant exercises their option to buy and becomes the owner of the property.<sup>9</sup>

## Permissive improvements by the tenant

### permissive improvement

A nonmandatory improvement the tenant is authorized to complete without further landlord consent.

Some lease agreement provisions allow a tenant to make necessary improvements without the landlord's further consent. These improvements are not specifically mandated, or required to be completed in exchange for a reduction in rent. Recall that this nonmandatory type of improvement is called a **permissive improvement**.

For example, a landlord and tenant sign a long-term lease agreement. Its further-improvements provision authorizes the tenant to demolish an existing building located on the property and construct a new one in its place without first obtaining the landlord's consent. The rent is based solely on the current value of the premises.

The further-improvements provision does not state a specific time period for demolition or construction.

The tenant makes no effort to tear down the old building or erect a new one. Ultimately, the landlord claims the tenant has breached the lease agreement for failing to demolish the existing building and construct a new one.

Here, the tenant has not breached the lease agreement. The lease agreement did not contain a promise by the tenant to build and the basis for setting the rental amount did not consider the construction. The tenant was authorized to build without need for the landlord's approval, but was not obligated to do so. Thus, the improvements on the tenant's part were *permissive*, not mandatory.<sup>10</sup>

## Mandatory improvements

A further-improvements provision that requires a tenant to construct improvements at a rent rate reflecting the value of the land has different consequences.

When the lease agreement does not include a date for completion of the improvements, the tenant needs to complete construction within a reasonable period of time since construction of improvements is mandated to occur.

For example, a landlord leases unimproved land to a developer who is obligated to build improvements, contingent on obtaining a construction loan. A time period is not set for commencement or completion of the construction. However, a **cancellation provision** gives the tenant/developer the right to cancel the lease agreement within one year if financing is not found to fund the construction. No provision authorizes the landlord to terminate the lease when the required construction is not completed.

<sup>9</sup> *Whipple v. Haberle* (1963) 223 CA2d 477

<sup>10</sup> *Kusmark v. Montgomery Ward and Co.* (1967) 249 CA2d 585

Due to the onset of a recession, the tenant is unable to arrange financing within the one-year period. However, the tenant does not exercise their right to cancel the lease agreement and avoid payment of future rents. Instead, the tenant continues their good faith effort to locate and qualify for construction financing. Ultimately, financing is not located and construction is not commenced.

A few years later, as the economy is showing signs of recovery, the landlord terminates the lease. The landlord claims the lease agreement has been breached since the promised construction was not completed.

The tenant claims the landlord may not terminate the lease as long as the tenant continues their good faith effort to locate financing and remains solvent to qualify for the financing.

Here, the tenant has breached the lease agreement. They failed to construct the intended improvements within a *reasonable period of time*. The original purpose of the lease was to have buildings erected without specifying a completion date. Following the expiration of the right to cancel, the landlord gave the tenant a reasonable amount of time in which to commence construction before terminating the lease.

When the original purpose for the lease was the construction of a building by the tenant, a landlord may not be forced to forgo the bargained-for improvements.<sup>11</sup>

All tenant improvements are to remain with the leased property on termination of a lease unless the lease agreement permits or mandates their removal by the tenant as a restoration of the premises.

## Surrender of improvements

Most lease agreements merely provide for the property to be returned in good condition, minus ordinary wear and tear for the years of the tenant's occupancy. Thus, the tenant is not required to restore the property to its actual condition when they took possession since tenant improvements are part of the real estate.

A provision calling for the tenant's ordinary care of the premises does not also require the tenant to remove their improvements or renovate the premises to eliminate deterioration, obsolescence or normal wear and tear caused by the tenant's permitted use of the property.<sup>12</sup>

Now consider a landlord and tenant who enter into a lease of commercial property. The lease agreement contains a provision requiring the tenant, at the landlord's demand, to restore the premises to the original condition received by the tenant, less normal wear and tear.

The tenant makes all the tenant improvements necessary to operate their business, such as installation of a concrete vault, the removal of partitions and a stairway, and the closing of two entrances into the premises.

<sup>11</sup> *City of Stockton v. Stockton Plaza Corporation* (1968) 261 CA2d 639

<sup>12</sup> *Kanner v. Globe Bottling Co.* (1969) 273 CA2d 559

On expiration of the lease, the tenant vacates the premises. The landlord exercises their right to require removal of tenant improvements by making a demand on the tenant to restore the premises. The tenant rejects the landlord's demand.

The landlord incurs costs to restore the premises for reletting to a new tenant.

The landlord claims the tenant is liable for the landlord's costs incurred to restore the premises since the tenant's improvements radically altered the premises and made it unrentable to others.

The tenant claims they are not liable for the landlord's costs to restore the premises to its original condition since the alterations became part of the real estate and were beneficial to the property.

Is the tenant liable for the landlord's costs to restore the premises to a rentable condition?

Yes! Here, the landlord exercised their option to call for removal of the improvements under the lease agreement provisions. The lease provisions called for restoration of the premises to its original condition on a demand from the landlord.

On the tenant's failure to restore the premises, the landlord was forced to incur restoration costs to relet the premises. The tenant is liable for the landlord's expenditures to restore and relet the premises to a new tenant.<sup>13</sup>

When a lease does not require the tenant to restore the property to the condition it was in when received, the tenant may only remove their personal improvements, called *trade fixtures*.

## Fixtures vs. trade fixtures

Two types of fixtures exist distinguishing improvements installed in a building:

- **fixtures**; and
- *trade fixtures*.

A *fixture*, is personal property attached to the real estate. It becomes part of the real estate it is attached to and is conveyed with the property.<sup>14</sup>

For example, when a tenant rents an office and builds bookshelves into the wall rather than merely anchoring them to the wall, the bookshelves become part of the improvements located on the real estate.

When the lease expires, fixtures become the landlord's property. The landlord takes possession of the fixtures as part of the real estate forfeited or surrendered to the landlord, unless the lease agreement provides for restoration or permits removal by the tenant. The conveyance of fixtures from tenant to landlord on expiration of the lease is called **reversion**.<sup>15</sup>

### reversion

The conveyance of fixtures from a tenant to landlord on expiration of a lease.

<sup>13</sup> *Masonic Temple Ass'n. of Sacramento v. Stockholders Auxiliary Corporation* (1933) 130 CA 234

<sup>14</sup> CC §5660; 1013

<sup>15</sup> *City of Beverly Hills v. Albright* (1960) 184 CA2d 562



Conversely, *trade fixtures* do not revert to the landlord on expiration of the lease. A **trade fixture** is an improvement the tenant attaches to the real estate that is unique to the operation of the tenant's business, not the use of the building.

#### trade fixtures

Fixtures used to render services or make products in the trade or business of a tenant.

Consider a tenant who leases property to operate a beauty salon. The tenant moves in work-related furnishings (e.g., mirrors, salon chairs, wash stations and dryers) necessary to run the business. The items are attached to the floor, walls, plumbing and electrical leads.

On expiration of the lease, the tenant removes the fixtures that were used to render the services offered by the business. The landlord claims the fixtures are improvements to the property and may not be removed since they became part of the real estate when installed.

However, furnishings unique to the operation of a business are considered trade fixtures even though the furnishings are attached and built into the structure. Trade fixtures are removable by the tenant.

A tenant may, at the end of or anytime during the lease term, remove any fixture used for trade purposes if the removal can be done without damaging the premises.<sup>16</sup>

Fixtures that have become an integral part of the building's structure due to the way they are attached or the general purpose they serve may not be removed. Examples of fixtures which may not be removed include toilets, air conditioners, vent conduits, sprinkler systems and lowered ceilings.<sup>17</sup>

What compensation may be due to a tenant who has improved the property and is *wrongfully evicted* prior to expiration of a lease?

A tenant who is wrongfully evicted is entitled to the rental value of their improvements for the remainder of their unexpired lease term. Without reimbursement, the landlord receives a windfall profit for their use of the tenant's improvements until they revert to the landlord on expiration of the original lease.

The tenant is not, however, entitled to reimbursement for the market value or cost of the improvements.

Thus, a wrongfully evicted tenant is limited to collecting the *reasonable value* for the landlord's use of the improvements during the remainder of the term on the original lease.<sup>18</sup>

## Reimbursement for tenant improvements on wrongful eviction

Lease agreements often contain a default provision prohibiting the tenant from removing the trade fixtures when the agreement is breached. The tenant (and their unsecured creditors) no longer has a right to the trade fixtures under a default provision.

## Trade fixtures as security

<sup>16</sup> *Beebe v. Richards* (1953) 115 CA2d 589

<sup>17</sup> CC §1019

<sup>18</sup> *Asell v. Rodrigues* (1973) 32 CA3d 817

Consider a tenant who signs a commercial lease agreement to use the premises to operate a frozen packaging plant. The lease agreement states all fixtures, trade or leasehold, belong to the landlord when the landlord terminates the lease due to a breach by the tenant.

The tenant later encumbers the existing trade fixtures by borrowing money against them. The tenant then defaults on their lease payments. While in default on the lease, the tenant surrenders the property to the landlord, including all trade fixtures.

Does the lender on the loan secured by the trade fixtures have a right to repossess them?

No! The tenant lost their ownership right to remove the trade fixtures under the terms of the lease agreement that was entered into before they encumbered the trade fixtures. Any right to the fixtures held by the secured lender is similarly lost since the lender is junior in time and thus subordinate to the landlord's interest in the fixtures under the lease agreement.

However, when a third party owns the trade fixtures installed by the tenant, or a third party had a lien on them at the time of their installation, the landlord has no more right to them than the tenant.<sup>19</sup>

## Notice of nonresponsibility

### **mechanic's lien**

A lien entitling a contractor or subcontractor to foreclose on a job site property to recover the amount due and unpaid for labor and materials they provided.

### **notice of nonresponsibility**

A notice used by a landlord to declare that they are not responsible for any claim arising out of improvements the tenant is constructing on their property. [See **RPI** Form 597]

Tenants occasionally contract for improvements to be constructed on the premises they have leased. Any **mechanic's lien** by a contractor for nonpayment initially attaches to the tenant's leasehold interest in the property.<sup>20</sup>

However, the *mechanic's lien* for unpaid labor and materials may also attach to the *fee simple interest* held by the landlord when the landlord or the landlord's property manager:

- acquires knowledge the construction is taking place; and
- fails to post and record a **notice of nonresponsibility**.

A *notice of nonresponsibility* is a written notice which needs to be:

- posted in a conspicuous place on the premises within ten days after the landlord or their property manager first has knowledge of the construction; and
- recorded with the county recorder's office within the same ten-day period.<sup>21</sup>

However, a landlord who becomes aware of the construction and fails to post and record the notice of nonresponsibility is not personally liable to the contractor. Rather, the contractor may only lien the landlord's interest in the

<sup>19</sup> *Goldie v. Bauchet Properties* (1975) 15 C3d 307

<sup>20</sup> CC §8442(a)

<sup>21</sup> CC §8444

real estate and foreclose on their mechanic's lien to collect for unpaid labor and materials delivered to improve the property under contract with the tenant.<sup>22</sup> [See Chapter 29]

Further, when the lease requires the tenant to make *mandatory improvements*, a mechanic's lien attaches to the landlord's interest even when the landlord has posted and recorded a notice of nonresponsibility.

For example, a lease states the tenant is to make specified improvements as a condition of renting the property. Since the improvements are mandatory improvements rather than permissive improvements, the tenant is deemed to be the landlord's agent. The tenant is contracting for the construction of the mandated improvements on behalf of the landlord.

Thus, the mechanic's lien incurred by the tenant attaches to both the tenant's and the landlord's interest in the property, despite any posted and recorded notice of nonresponsibility.<sup>23</sup>

When lease provisions merely authorized the tenant to make nonmandatory (permissive) improvements, the tenant does not act as an agent for the landlord. In that case, the landlord's interest in the property is not subjected to a mechanic's lien when the notice of nonresponsibility is timely posted and recorded on discovery of the tenant improvements.<sup>24</sup>

Additionally, a mechanic's lien may not be recorded against the landlord when the improvements are removed by the contractor recording the lien.

For example, a tenant contracts to have air conditioning installed in the building the tenant rents. The contractor sells the equipment to the tenant under a conditional sales contract. The contractor retains title to the equipment as security until the sales contract debt is paid.

The landlord's consent to the improvements is not obtained by the tenant, but the landlord has knowledge the work has commenced. The landlord does not post a *notice of nonresponsibility*.

Later, after the air conditioning units are installed, the tenant vacates the property.

The contractor is not paid and files a mechanic's lien against the landlord's fee interest in the property. Further, the contractor repossesses the air conditioning units and resells them at a loss. The contractor then seeks to recover their losses under the mechanic's lien.

However, by electing to **repossess** the units, the contractor waived their right to pursue the mechanic's lien to foreclosure.

## Nonresponsibility on mandatory improvements

## Removal of fixtures by contractor

<sup>22</sup> *Peterson v. Freiermuth* (1911) 17 CA 609

<sup>23</sup> *Los Banos Gravel Company v. Freeman* (1976) 58 CA3d 785

<sup>24</sup> *Baker v. Hubbard* (1980) 101 CA3d 226

## UCC-1 Financing Statement

[illegible]

For illustrative purposes only

Click on the UCC-1 Financing Statement published by the California Secretary of State which may be filed.

**Instructions for UCC Financing Statement Addendum (Form UCC1A)**

Please type or stamp print this form. Be sure to completely legible. Exclude and void all indorsements, use of the correct name for the Debtor is essential. If the form contains any illegible, mistakes have been important legal consequences. If you have questions, consult your attorney. The filing officer cannot give legal advice.

**ITEM INSTRUCTIONS**

**8. Name of the Debtor.** Enter name of the Debtor exactly as shown on item 1 of Financing Statement (Form UCC1) which this Addendum relates. The name and address information is a separate filing. The Debtor name entry, such as a branch or division address the Addendum with the name of the Debtor (Form UCC1).

**9. If the box is not a Financing Statement (Form UCC1) was checked because Individual Debtor name did not fit, the box is one of the following Addendum should be checked:**

**Additional Debtor's name.** If the Addendum adds an additional Debtor, complete item 10 in accordance with Additional 1 of Financing Statement (Form UCC1). For additional debitors, attach either an additional Addendum or Additional Party (Form UCC1A) and include each additional 1 of Financing Statement (Form UCC1) by indorsement and forwarding additional.

**Additional Secured Party's name or Assignee Secured Party's name.** If this Addendum adds an additional Secured Party, complete item 11 in accordance with Indorsement 2 of Financing Statement (Form UCC1). For additional Secured Parties, attach either an additional Addendum or Additional Party (Form UCC1A) and include each additional 1 of Financing Statement (Form UCC1) by indorsement and forwarding additional. In the case of a third assignment of the Secured Party's interest before the filing of this financing statement, if the Party provided the name and mailing address of the Assignee in item 10, use the Assignee's name. Do not use either Assignee Secured Party's name and mailing address in item 11.

**Additional Collateral Description.** If space on item 4 of Financing Statement (Form UCC1) is insufficient or additional information must be provided, enter additional information in item 12 or attach additional collateral(s) and incorporate by reference in item 12 (e.g., See Exhibit A). Do not attach social security numbers or other personally identifiable information.

**10. Bank Record Information.** If the Financing Statement is to be filed in the real estate mortgage and cannot be filed for real estate, complete an attached collateral, attach a list of a future filing, items 3-4 of the Financing Statement (Form UCC1), attach the form in item 13, check the box in item 14, and the Debtor does not have an interest in account, attach the name and address of the record owner in item 15. Provide a sufficient description of real estate in accordance with the applicable law for the real estate and real estate is located in item 16. Repeat in item 17 to 16 as necessary, attach additional pages and incorporate by reference in items 15 to 16 to file. See Exhibit A, and complete the real estate record information. Do not include social security numbers or other personally identifiable information.

**11. Miscellaneous.** Under certain circumstances, additional information and provided on the Financing Statement (Form UCC1) may be required. See, examples and instructions for reference in item 12 of the Debtor's Addendum to complete the financing statement, item 12 of the Debtor's Addendum to complete the financing statement or to comply with such requirements, examples, items 12. Do not include social security numbers or other personally identifiable information.

Whether the air conditioning units are considered a removable fixture due to the financing, or a property improvement permitting the recording of a mechanic's lien, is no longer an issue after their removal. The contractor removed the units and chose to treat the units as personal property. Thus, the contractor lost their lien rights for nonpayment.<sup>25</sup>

Consider the tenant who leases a property containing tanks for holding gasoline. The tenant negotiates a reduced rental payment in exchange for installing fuel pumps free of any liens.

The tenant purchases the pumps on credit and the pumps are installed. The supplier of the pumps does not receive a **Uniform Commercial Code (UCC-1)** financing statement from the tenant. Thus, the supplier does not file a UCC-1 with the Secretary of State, a requisite to perfecting the supplier's lien on the pumps. [See Figure 1; see **RPI** Form 436-1]

Later, the pump supplier claims title to the pumps due to the unpaid installation debt and seeks to repossess them.

However, the landlord owns the pumps as fixtures which became part of the real estate. The landlord gave consideration in the form of reduced rent to acquire the pumps. More importantly, the pump supplier failed to perfect its lien on installation of the pumps.<sup>26</sup>

<sup>26</sup> *Southland Corp. v. Emerald Oil Company* (9th Cir. 1986) 789 F2d 1441

Tenant improvements are improvements made to leased property to meet the needs of the occupying tenant. The landlord's right to tenant improvements depends upon whether the tenant improvements are a fixture or a trade fixture, and whether the further-improvements provision in the lease agreement requires the tenant to remove improvements and restore the premises.

A tenant's or landlord's liability for failing to construct or pay for tenant improvements depends on whether the tenant improvements are mandatory or permissive.

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<b>further-improvements provision.....</b>	<b>pg. 42</b>
<b>mandatory improvement.....</b>	<b>pg. 43</b>
<b>mechanic's lien .....</b>	<b>pg. 50</b>
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## Chapter 5 Summary

## Chapter 5 Key Terms

**Quiz 3 Covering Chapters 5-6 is located on page 443.**

*Notes:*





## Chapter 6

# Types of tenancies

After reading this chapter, you will be able to:

- differentiate between the four distinct possessory types of tenancies;
- understand the rights held under each type of tenancy;
- determine how a tenancy is established or changed; and
- serve the proper notice required to terminate a tenancy.

**fixed-term tenancy**

**guest occupancy agreement**

**holdover rent**

**holdover tenant**

**lease agreement**

**periodic tenancy**

**rental agreement**

**transient occupancy**

**trespasser**

**unlawful detainer**

## Learning Objectives

## Key Terms

A landlord and tenant enter into a lease agreement. The lease agreement does not include an option to renew or extend the term of the occupancy on expiration of the lease.

Several months before the lease expires, they begin negotiations to enter into a modified or new lease agreement to extend the term of occupancy. The landlord and tenant do not reach an agreement before the lease expires. On expiration of the lease, the tenant remains in possession of the property.

The landlord and tenant continue lease negotiations. Meanwhile, the landlord accepts monthly rent at the same rate the tenant paid under the expired lease agreement.

## Know your tenancy or lose time

Ultimately, they fail to agree on the terms for an extension or a new lease agreement. The landlord serves a notice on the tenant to either stay and pay a substantially higher monthly rent, or vacate and forfeit the right of possession. [See **RPI** Form 571 and 569]

The tenant does neither. The tenant remains in possession on expiration of the notice, but does not pay the increased rent.

May the landlord evict the tenant by filing an *unlawful detainer (UD)* action on expiration of the notice?

Yes! The tenant's right of possession went from an initial *fixed-term tenancy* to a *tenancy-at-sufferance* on the date the lease expired. When the landlord accepted rent for the continued occupancy, the tenancy-at-sufferance became a *periodic tenancy*. The tenant's failure to pay the higher rent demanded in the notice terminated the tenant's right of possession under the periodic tenancy on expiration of the notice to pay rent or quit.

Different types of tenancies and properties trigger different termination procedures for the landlord, and different rights for the tenant.

## Tenancies as leasehold estates

Recall that *leasehold estates*, or *tenancies*, are possessory interests in real estate. Four types of *tenancies* exist:

- *fixed-term tenancies*;
- *periodic tenancies*;
- *tenancies-at-will*; and
- *tenancies-at-sufferance*, also called *holdover tenancies*.

To initially establish a tenancy, a landlord needs to convey to the tenant the right to occupy the real estate. This right is conveyed orally, in writing or by the landlord's conduct, called a *grant*. When the landlord does not transfer the right to occupy, the person who takes possession as the occupant is a **trespasser**.

### trespasser

A person who occupies a property without the owner's transfer of the right to occupy.

Fixed-term tenancies, periodic tenancies and tenancies-at-will have agreed-to termination dates or may be terminated by notice.

A *holdover tenancy* occurs when a tenant unlawfully continues in possession of the property after their right to occupy has expired. This unlawful possession of the property without contractual right is called **unlawful detainer (UD)**.

### unlawful detainer

The unlawful possession of a property. [See **RPI** Form 575-578]

A landlord needs to file a *UD* action in court to evict a holdover tenant. A tenant's right of possession under the tenancy is terminated either by service of the proper notice or expiration of the lease before they may be evicted. Plainly speaking, the tenant needs to unlawfully detain possession of the property before the landlord may evict a tenant for unlawfully detaining the property.

*A landlord and tenant orally agree to a six-month lease, with rent payable monthly. At the end of six months, the landlord and tenant orally agree to another six-month lease term, rent payable monthly.*

*At the end of the second term, the tenant refuses to vacate, claiming the landlord needs to first serve them with a notice to vacate.*

*Here, the tenant is not entitled to any further notice beyond the agreed-to termination date. The oral occupancy agreement was not a periodic tenancy, even though it called for monthly rent payments. Instead, the occupancy agreement created a fixed-term lease with a set expiration date. Thus, the tenant's right of possession terminated on expiration of the orally agreed-to six-month period. The oral lease agreement was enforceable since it was for a term of less than one year. [Camp v. Matich (1948) 87 CA2d 660]*

### Case in Point

Second lease term is not a periodic tenancy

Since the type of notice required to terminate a tenancy depends on the period of the tenancy, period of the occupancy and location of the property (e.g., rent control), landlords and property managers need to understand what conduct creates each type of tenancy.<sup>1</sup>

A **fixed-term tenancy**, also called a *lease* or *estate for years*, is the result of an agreement between the landlord and a tenant conveying possession of property to the tenant for a fixed period, called a term. When the lease term is greater than one year, the lease arrangements need to be in writing and signed by the landlord and tenant to be enforceable.

The written document which sets the terms and conditions of a *fixed-term tenancy* is called a **lease agreement**. A *lease agreement* has a commencement date and an expiration date.<sup>2</sup> [See Form 550 accompanying this chapter]

During the term of the lease, the tenancy may only be terminated and the tenant evicted for cause. Even then, service of a three-day notice to cure the breach or vacate the property is required. [See **RPI** Form 576]

Without an exercise of a renewal or extension option, a fixed-term tenancy automatically terminates on the expiration date, no further notice required.<sup>3</sup>

When a renewal or extension option exists, the lease is renewed or extended by the tenant's exercise of the option or the landlord's acceptance of rent called for in the option.<sup>4</sup>

A fixed-term tenancy provides a tenant with several advantages:

- the right to occupy for the fixed term;
- a predetermined rental amount; and
- limitations on termination or modification.

## The fixed-term tenancy

### fixed-term tenancy

A leasehold interest which lasts for the specific lease period set forth in a lease agreement. A fixed-term tenancy automatically terminates at the end of the lease period. [See **RPI** Form 550 and 552]

### lease agreement

The written document which sets the terms of a fixed-term tenancy. [See **RPI** Form 550 and 552—552-4]

<sup>1</sup> *Colyear v. Tobriner* (1936) 7 C2d 735

<sup>2</sup> Calif Civil Code §§761, 1624

<sup>3</sup> Calif. Code of Civil Procedure §1161(1)

<sup>4</sup> CC §1945

Figure 1

## Form 550

Residential  
Lease  
Agreement

**RESIDENTIAL LEASE AGREEMENT**

Prepared by Agent \_\_\_\_\_ Phone \_\_\_\_\_  
Broker \_\_\_\_\_ Email \_\_\_\_\_

**NOTE:** This form is used by a leasing agent, property manager or landlord when leasing a residential property on a fixed rental-rate basis for a specific period of time to grant the tenancy and set the amount of rents to be paid. Identify who will provide and pay for utilities, and the allocation of maintenance responsibilities and their costs between the landlord and tenant.

**DATE:** \_\_\_\_\_ 20\_\_\_\_ of \_\_\_\_\_ California  
Items left blank or unchecked are not applicable.

**FACTS:**  
1. This lease agreement is entered into by \_\_\_\_\_ as the Landlord,  
and \_\_\_\_\_ as the Tenant(s).  
1.1 regarding residential real estate referred to as \_\_\_\_\_  
1.2 including the following:  
Garage/parking space # \_\_\_\_\_  
Storage space # \_\_\_\_\_  
Furnishings \_\_\_\_\_  
1.3 The following **included attachments** are part of this agreement:  
Rent control disclosures Option to Renew/Extend Lease [See RPI Form 560]  
House/Building rules Lead-Based Paint Disclosures [See RPI Form 507]  
Brokerage Fee Addendum [See RPI Form 273] Credit Application [See RPI Form 523]  
Condition of Premises Addendum [See RPI Form 560]  
Condition/Inventory of Furnishings Addendum [See RPI Form 561]

**AGREEMENT:**  
2. **DEPOSIT:**  
2.1 Landlord acknowledges receipt of \$ \_\_\_\_\_ as a security deposit.  
2.2 The deposit is security for the diligent performance of Tenant's obligations, including payment of rent, repair of damage, reasonable repair and cleaning of premises on termination, and any loss, damages or excess wear and tear on furnishings provided to Tenant.  
2.3 No interest will be paid on the deposit and Landlord may place the deposit with their own funds, except where controlled by law.  
2.4 Within 21 days after Tenant vacates, Landlord to furnish Tenant with a security deposit statement itemizing any deductions, with a refund of the remaining amount.  
3. **TERM OF LEASE:**  
3.1 This lease will begin on \_\_\_\_\_ 20\_\_\_\_ and continue until \_\_\_\_\_ 20\_\_\_\_.  
3.2 The lease terminates on the last day of the month without further notice.  
3.3 Landlord's acceptance of rent after expiration of the lease term creates a month-to-month tenancy.  
3.4 If Tenant holds over, Tenant to be liable for rent at the daily rate of \$ \_\_\_\_\_  
4. **RENT:**  
4.1 Tenant to pay, in advance, \$ \_\_\_\_\_ rent monthly, on the \_\_\_\_\_ day of each month.  
4.2 Rent to be paid by:  
a. cash, check, or cashier's check, made payable to Landlord or his agent and delivered to: \_\_\_\_\_  
b. \_\_\_\_\_  
Personal delivery of rent to be accepted at Landlord's address during the hours of \_\_\_\_\_ of the following days:  
a. credit card # \_\_\_\_\_ / \_\_\_\_\_ / \_\_\_\_\_ issued by \_\_\_\_\_  
b. \_\_\_\_\_  
c. Landlord is authorized to charge each month for rent due.  
d. deposit into account number \_\_\_\_\_ at \_\_\_\_\_  
\_\_\_\_\_

**GENERAL PROVISIONS:**  
7.1 Tenant agrees to indemnify and hold Landlord harmless from claims, demands, damages or liability arising out of the premises caused by or permitted by Tenant, Tenant's family, agents, employees and guests.  
a. Tenant to obtain insurance for this purpose naming Landlord as an additional insured.

**7.2** If the property contains an exercise or recreation facility, Tenant agrees to indemnify and hold Landlord harmless from claims, demands, damages or liability arising from Tenant's use of the facility.  
**7.3** Landlord to maintain the premises and common areas in a safe and sanitary condition and comply with all applicable ordinances and regulations.  
**7.4** Waiver of a breach of any provision does not constitute a waiver of any subsequent breach. Landlord's receipt of rent with knowledge of Tenant's breach does not waive Landlord's right to enforce the breached provision.  
**7.5** In any action to enforce this agreement, the prevailing party will receive attorney fees.  
**7.6** Notice: Pursuant to Civil Procedure Code §202.46, information about specified registered sex offenders is made available to the public via an Internet Web site maintained by the Department of Justice at [www.registrator.ca.gov](http://www.registrator.ca.gov). Depending on an offender's criminal history, the information will include either the address at which the offender resides or the community of residence and ZIP code in which he or she resides.  
**7.7** Notice: Landlord has actual knowledge the property is located in a special flood hazard area or an area of potential flooding. Tenant may obtain information about flood and other hazards at <http://myhazards.ca.gov>. Landlord's insurance does not cover Tenant's possessions. Tenant may purchase renter's insurance and flood insurance to insure their possessions from loss. Landlord is not required to provide additional information about flood hazards beyond this notice.  
**7.8** See attached addendum for additional terms and conditions. [See RPI Form 200]  
**7.9** If lease exceeds one year, Tenant and Landlord acknowledge receipt of the Agency Law Disclosure. [See RPI Form 550-2]

**8. DESTRUCTION:**  
8.1 If the premises are totally or partially destroyed and uninhabitable, either Landlord or Tenant may terminate the lease upon written notice.  
a. If the lease is not terminated, Landlord will repair the premises and rent will be prorated based on a 30-day month for the period the premises were uninhabitable.

**9. TEMPORARY DISPLACEMENT:**  
9.1 Tenant agrees to temporarily vacate the premises on Landlord's written demand to allow for invasive repairs or fumigation of the premises which will render the premises uninhabitable, subject to local rent control law. [See RPI Form 588]  
a. Tenant to comply with instructions provided by Landlord to accommodate the work needed.  
b. Tenant to receive rent credit equal to the per diem rent for the duration of the displacement.  
c. Landlord to provide written notice to Tenant prior to \_\_\_\_\_ days before the date of displacement.

**10. I agree to let on the terms stated above.**  
Date: \_\_\_\_\_ 20\_\_\_\_  
Landlord: \_\_\_\_\_  
Signature: \_\_\_\_\_  
Landlord's Broker: \_\_\_\_\_  
Broker's DRE #: \_\_\_\_\_  
Is the broker for: Landlord  
both Tenant and Landlord (dual agent)  
Landlord's Agent: \_\_\_\_\_  
Agent's DRE #: \_\_\_\_\_  
Is Landlord's agent (salesperson or broker-associate)  
both Tenant's and Landlord's agent (dual agent)  
Signature: \_\_\_\_\_  
Address: \_\_\_\_\_  
Phone: \_\_\_\_\_ Cell: \_\_\_\_\_  
Email: \_\_\_\_\_

**I agree to occupy on the terms stated above.**  
Date: \_\_\_\_\_ 20\_\_\_\_  
Tenant: \_\_\_\_\_  
Signature: \_\_\_\_\_  
Tenant: \_\_\_\_\_  
Signature: \_\_\_\_\_  
Tenant's Broker: \_\_\_\_\_  
Broker's DRE #: \_\_\_\_\_  
Is the broker for: Tenant  
both Tenant and Landlord (dual agent)  
Tenant's Agent: \_\_\_\_\_  
Agent's DRE #: \_\_\_\_\_  
Is Tenant's agent (salesperson or broker-associate)  
both Tenant's and Landlord's agent (dual agent)  
Signature: \_\_\_\_\_  
Address: \_\_\_\_\_  
Phone: \_\_\_\_\_ Cell: \_\_\_\_\_  
Email: \_\_\_\_\_

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However, a fixed-term tenancy also has disadvantages for the fixed-term tenant:

- the tenant is liable for the total amount of rent due over the entire term of the lease (less rent paid by any replacement tenant located by the landlord to mitigate his losses); and
- the tenant may not vacate prior to expiration of the rental period or assign or sublet the premises to another person when prohibited by the lease agreement.

*Consider a property manager who rents an apartment to a tenant under a fixed-term lease. At the end of the leasing period, the tenant retains possession and continues to pay rent monthly, which the property manager accepts.*

*Later, the tenant is served with an appropriate notice to vacate. On the running of the notice period, the tenant refuses to vacate. The tenant claims the notice to vacate merely terminated the tenant's right of possession and made it a tenancy-at-will on expiration of the notice. As a tenant-at-will, they are entitled to an additional three-day notice to vacate before they are unlawfully detaining the property.*

*However, an occupancy agreement for an indefinite term with a monthly rent schedule is a month-to-month tenancy. Thus, a tenant is only entitled to one notice to vacate which needs to expire before the landlord may file a unlawful detainer (UD) action to evict them. [Palmer v. Zeis (1944) 65 CA2d Supp. 859]*

### Case in Point

Periodic tenant  
or tenancy-at-  
will?

If the landlord finds a fixed-term tenancy too restrictive or inflexible for their expectations, a periodic tenancy may better suit the landlord.

A **periodic tenancy** automatically continues for equal, successive periods of time, such as a week or a month. The length of each successive period of time is determined by the interval between scheduled rental payments.

Examples of periodic payment intervals include:

- annual rental payments, indicating a year-to-year tenancy;
- monthly rental payments, indicating a month-to-month tenancy; and
- weekly rental payments, indicating a week-to-week tenancy.

A periodic tenancy is intentionally created by a landlord and tenant entering into a **rental agreement**. A *rental agreement* sets the terms and conditions to be met during a periodic tenancy.

However, the tenancy may also arise due to a defective lease agreement. A tenant who enters into possession under an unenforceable lease agreement (e.g., oral or unsigned) and pays rent in monthly intervals the landlord accepts is a month-to-month tenant.

A periodic tenancy continues until terminated by a notice to vacate by either the landlord or the tenant. This makes a periodic tenancy flexible, since it allows the landlord and the tenant to terminate a month-to-month tenancy by giving the appropriate notice to vacate to the other party.<sup>5</sup> [See **RPI** Form 569 and 572]

To terminate a periodic tenancy, the notice period needs to be at least as long as the interval between scheduled rental payments. The period need not exceed 30 days, with the exception of a 60-day notice needed to terminate a residential periodic tenancy when the tenant has occupied the property for more than 12 months.<sup>6</sup> [See **RPI** Form 569-1]

## The periodic tenancy

### periodic tenancy

A leasehold interest which lasts for automatic successive rental periods of the same length of time, terminating upon notice from either party. [See **RPI** Form 551 and 552-5]

### rental agreement

The written document which sets the terms and conditions of a periodic tenancy. [See **RPI** Form 551 and 552-5]

<sup>5</sup> **Kingston v. Colburn** (1956) 139 CA2d 623; CC §1946

<sup>6</sup> CC §1946.1

**Case in Point**

What steps does a landlord take to serve an unlawful detainer on a holdover tenant?

*An apartment landlord files an unlawful detainer (UD) against an occupant who is a holdover tenant. The landlord attempts to personally serve the UD on the tenant at the apartment address numerous times but the tenant is out of state. The landlord posts the notice on the property and mails a copy to the tenant's last known address, which was the apartment. No other address for the tenant was available. The tenant does not receive or respond to the UD and the landlord is awarded possession of the property.*

*The tenant seeks to restore their tenancy, claiming the landlord's attempts to serve the UD were deficient since all the attempts were at the apartment address while the tenant was out of state and no other action was taken to reach the tenant.*

*The landlord seeks to prevent the tenant from restoring their tenancy, claiming sufficient actions were taken to notify the tenant of the UD since multiple attempts to notify the tenant were carried out at the apartment address without response before posting the premises and no other address for the tenant was available.*

*Here, a California court of appeals held the tenant was not entitled to regain possession since personal service was attempted and the notice was posted at the apartment address, and no other address for the tenant was available for personal service or mailing. [**The Board of Trustees of the Leland Stanford Junior University v. Ham** (2013) 216 CA4th 330]*

*Editor's note – A landlord is not required to expend an indeterminate amount of time and resources to track down an absent tenant in order to serve a UD. When the UD cannot be personally delivered, the landlord may leave a copy with a competent adult at the property or post it on the property, then send the documents by mail to the last known address of the tenant.*

On a breach of the rental agreement, a three-day notice to pay or vacate terminates a periodic tenancy when the tenant does not pay within the three-day notice period. [See **RPI** Form 577]

## **The tenancy-at-will: consent but no rent**

The characteristics of a tenancy-at-will include:

- possession delivered to the tenant with the landlord's knowledge and consent;
- possession for an indefinite and unspecified period; and
- no provision for the payment of rent.

Situations giving rise to a tenancy-at-will include:

- when a tenant is granted the right to indefinitely occupy the property in exchange for services rendered [See **RPI** Form 591];<sup>7</sup>
- when a tenant takes possession of the property under an unenforceable lease agreement (e.g., a written lease not signed by either party or terms orally agreed to) — unless rent is accepted to create a periodic tenancy;<sup>8</sup> or
- when a tenant is given possession of the property while lease negotiations regarding the rent amount are still in progress and rent is not accepted.<sup>9</sup>

<sup>7</sup> **Covina Manor Inc. v. Hatch** (1955) 133 CA2d Supp. 790

<sup>8</sup> **Psihozios v. Humberg** (1947) 80 CA2d 215

<sup>9</sup> **Miller v. Smith** (1960) 179 CA2d 114



For a tenancy-at-will, a written notice to pay rent or quit is required to implement a rent charge for the right to continue to occupy the premises, e.g., change it to a different kind of tenancy or terminate the tenancy. Also, the parties may always agree to a shorter or longer notice period to accommodate any change.<sup>10</sup>

Consider an owner-occupant who agrees to sell their office building. The terms of the purchase agreement allow them to retain the free use and possession of the property until they are able to occupy an office building they are constructing. Thus, a tenancy-at-will is created.

The buyer agrees in the purchase agreement to give the seller a 90-day written notice to pay rent or vacate the property.

The buyer resells the property to a new owner. The new owner serves notice on the tenant-seller to pay rent or vacate in three days' time. The new owner claims they are not subject to the prior owner's unrecorded agreement to give a 90-day notice.

However, a new owner acquires property subject to unrecorded rights held by a tenant in possession. Thus, the new owner is charged with constructive knowledge of the unrecorded agreement regarding 90-day notices to vacate and took title subject to the terms of the prior agreement with the tenant.

Until the tenant-at-will receives the appropriate notice to vacate, they are not unlawfully detaining the property and the owner/landlord may not proceed with a UD action to recover possession.<sup>11</sup>

However, a tenancy-at-will is automatically terminated when the tenant assigns or sublets their right to occupy the property to another tenant. The new tenant becomes a holdover tenant, the transfer of possession creating a tenancy at sufferance. Either form of possession is an unlawful detainer and grounds for eviction without notice.<sup>12</sup>

Also, a tenancy-at-will terminates on the death of either the landlord or tenant, unless an agreement to the contrary exists.<sup>13</sup>

When a prior agreement or notice terminates a fixed-term or periodic tenancy, the tenant who remains in possession unlawfully detains the property from the landlord. Likewise, a tenant-at-will who receives the appropriate notice to vacate and who remains in the property on expiration of the notice also unlawfully detains the property. These scenarios create a tenancy-at-sufferance, commonly referred to as a **holdover tenancy**.

A holdover tenancy also arises on termination of a resident manager when the resident manager's compensation includes the right to occupy a unit

**Written notice  
required before  
any change  
in the right to  
occupancy**

**The holdover  
tenancy**

<sup>10</sup> CC §5789, 1946

<sup>11</sup> **First & C. Corporation v. Wencke** (1967) 253 CA2d 719

<sup>12</sup> **McLeran v. Benton** (1887) 73 C 329

<sup>13</sup> **Dugand v. Magnus** (1930) 107 CA 243

## Case in Point

Reasonable  
rental value  
in a holdover  
tenancy

*A tenant with a fixed-term lease holds over after the lease agreement expires. The lease agreement contains no provisions for the amount of rent due during any holdover period.*

*On the tenant's failure to vacate, the landlord serves the tenant a notice to either pay a rent amount substantially higher than rental market rates, or vacate. The tenant refuses to pay any rent or vacate.*

*On expiration of the notice, the landlord files an unlawful detainer (UD) action seeking payment of rent at the rate stated in the notice, since the tenant did not vacate.*

*At the UD hearing, the landlord is awarded the reasonable market rental value for the entire time the tenant held over after the lease expired, not the higher rent demanded in the notice.*

*A UD court will only award a reasonable rental value for the time period the tenant held over when the tenant has not agreed to a different amount or when a residential rental is involved. [Shenson v. Shenson (1954) 124 CA2d 747]*

**holdover tenant**

A tenant who retains possession of the rented premises after their right of possession has been terminated, called a tenant-at-sufferance.

rent-free. When the landlord terminates the employment and the resident manager fails to vacate immediately, the resident manager unlawfully detains the premises as a **holdover tenant**.<sup>14</sup> [See **RPI** Form 591]

A *holdover tenant* retains possession of the premises without any contractual right to do so. Their tenancy has previously been terminated. Thus, the landlord is not required to provide a holdover tenant with any additional notice prior to commencing eviction proceedings.<sup>15</sup>

**holdover rent**

Rent owed by a holdover tenant for the tenant's unlawful detainer of the rented premises as a tenant-at-sufferance. [See **RPI** Form 550 §3.4]

A *holdover tenant* no longer owes rent under the expired lease or terminated rental agreement since they no longer have the right of possession. However, the rental or lease agreement usually includes a **holdover rent** provision which calls for a penalty rate of daily rent owed for each day the tenant holds over.

When the rental or lease agreement does not contain a *holdover rent* provision, the tenant owes the landlord the reasonable rental value of the property. This is a daily rate owed for each day the tenant holds over. [See Form 550]

Holdover rent is due and payable after the tenant vacates or is evicted. At the time the landlord recovers possession, the holdover period is known. Only then can the amount owed be determined and demanded. If it is not paid on demand, it may be collected by obtaining a money judgment.

But a caution to landlords and property managers: acceptance of holdover rent prior to a tenant vacating or being evicted has unintended consequences, as discussed in the next section.

<sup>14</sup> **Karz v. Mecham** (1981) 120 CA3d Supp. 1

<sup>15</sup> CCP §1161

A landlord, by using an improper notice, can create a different tenancy relationship from the one they initially conveyed to the tenant. A tenant's possessory interest in real estate can shift from one type of tenancy to another due to:

- a notice;
- expiration of a lease; or
- conduct.

A classic example involves a change in the type of tenancy which arises when a holdover tenant becomes a month-to-month (periodic) tenant.

A landlord who accepts any rent from a holdover tenant under an expired lease without an option to renew or extend has elected by their conduct to treat the continued occupancy as a periodic tenancy.<sup>16</sup>

Thus, the prerequisite to a UD eviction is the service of a proper notice to vacate on the holdover tenant who paid rent for the continued occupancy, rent the landlord accepted to end the holdover and create a periodic tenancy.<sup>17</sup>

When a landlord accepts rent from a holdover tenant after a fixed-term tenancy expires without options to renew or extend, the expired lease agreement is extended on the same terms except for the period of occupancy, which is now periodic.<sup>18</sup>

On expiration of a fixed-term lease, the landlord's continued acceptance of rental payments does not renew the tenancy for another term equal to the term of the original lease. Rather, the tenancy is extended as a periodic tenancy for consecutive periods equal to the interval between rent payments — hence, one month when rent is paid monthly.<sup>19</sup>

A landlord who wants to terminate a periodic tenancy they created by accepting rent after expiration of a lease needs to serve the tenant with the proper notice to vacate and let it expire. On expiration of the notice, the tenant who remains in possession of the premises is unlawfully detaining the premises and the landlord may file a UD action to evict them.

A landlord and tenant may establish a shorter or longer notice period by agreement. However, the notice period agreed to may not be less than seven days.

Other specialized rules exist for different types of properties and situations. For example, in a rent-controlled tenancy, terminating the right of possession is restricted by local ordinances.

In a tenancy-at-will in a mobile home park, the tenant needs to be given a 60-day written notice.<sup>20</sup>

## Changing the type of tenancy

## Other rules for terminating a tenancy

<sup>16</sup> *Peter Kiewit Sons Co. v. Richmond Redevelopment Agency* (1986) 178 CA3d 435

<sup>17</sup> Colyear, *supra*

<sup>18</sup> CC §1945

<sup>19</sup> CC §1945

<sup>20</sup> CC §798.55(b)

Industrial and commercial tenants tend to require three months' minimum notice due to the time spent receiving and responding to a notice since it goes through multiple tiers of corporate management before a decision is made.<sup>21</sup>

In some instances, an extended 90-day notice is required to terminate residential tenancies in foreclosed properties.

## Transient occupants and their removal

### **transient occupancy**

The occupancy of a vacation property, hotel, motel, inn, boarding house, lodging house, tourist home or similar sleeping accommodation for a period of 30 days or less. [See **RPI** Form 593]

### **guest occupancy agreement**

The written document which sets the terms of a transient occupancy. [See **RPI** Form 593]

Another type of occupancy is to be differentiated from the leasehold interests discussed in this chapter. **Transient occupancy** is the occupancy of a vacation property, hotel, motel, inn, boarding house, lodging house, tourist home or similar sleeping accommodation for a period of 30 days or less. This type of occupant is classified as a *guest*, also called a *transient occupant*.

A transient occupant occupies property known as lodging, accommodation or unit, not space or premises. The property is not called a rental. The term "rental" implies a landlord/tenant relationship exists. Significantly, landlord/tenant law does not control *transient occupancies*.

The guest's occupancy is labeled a *stay*, not possession. During a guest's stay in the lodging, the owner or manager of the property is entitled to enter the unit at check-out time even though the guest may not yet have departed.

The contract entered into for the lodging is usually called a **guest occupancy agreement**, but never a rental agreement or lease agreement. [See **RPI** Form 593]

Guests pay a daily rate, not a daily or weekly rent. They arrive at a pre-set date and time for check-in, not for commencement of possession. Likewise, guests depart at an hour on a date agreed to as the check-out time. Unlike a tenant, a guest does not vacate the premises; they check out.

When a guest fails to depart at the scheduled check-out hour on the date agreed, no holdover tenancy is created. Thus, an unlawful detainer does not exist as with a tenancy conveyed by a rental or lease agreement. A UD action or court involvement is not required to remove the guest.<sup>22</sup>

However, for the owner or manager to avoid the landlord-tenant UD eviction process, the guest, when checking in, needs to sign a notice stating:

- the unit is needed at check-out time for another guest who has been promised the unit; and
- when the guest has not departed at check-out time, the owner or manager may enter, take possession of the guest's property, re-key the doors and clean up the unit for the next guest.<sup>23</sup> [See **RPI** Form 593]

<sup>21</sup> CC §1946

<sup>22</sup> CC §1940(b)

<sup>23</sup> CC §1865

To remove a guest who fails to timely depart the unit and remains in the unit after a demand has been made to leave, the manager may intervene to remove the guest, a solution called **self-help**. If the manager's intervention might cause a breach of the peace, the manager may call the police. The police or the sheriff assists, without the need for a court order, to remove the guest and prevent a danger to persons or property during the re-keying, removal of possessions and clean up for the arrival of the next guest.<sup>24</sup>

## Property manager's self-help to remove guests

Transient occupancies include all occupancies that are taxed as such by local city or county ordinances.

Tax-wise, the guest occupancy is considered a personal privilege, not a tenancy. Time share units when occupied by their owners are not transient occupancies and are not subject to those ordinances and taxes.<sup>25</sup>

Transient units do not include residential hotels since the occupants of residential hotels treat the dwelling they occupy as their *primary residence*. Also, the occupancy of most individuals in residential hotels is for a period exceeding 30 days.

Also, the operator of a residential hotel may not require a resident to change units or to check out and re-register in order to avoid creating a month-to-month tenancy, which would place the occupancy under landlord/tenant law. A residential hotel operator violating this rule is liable for a \$500 civil penalty and attorney fees.<sup>26</sup>

A broker or any other person who manages "vacation rental" stays for owners of single family homes, units in a common interest development (condominium project), units in an apartment complex or any other residence subject to a local transient occupancy tax is to maintain accounting records.

Further, the property manager needs to send a monthly accounting statement to each landlord they represent and make the records available for inspection and reproduction by the owner. They need to also comply with the transient occupancy tax regarding collection, payment and recordkeeping.<sup>27</sup>

<sup>24</sup> Calif. Penal Code §602(s)

<sup>25</sup> Calif. Revenue and Taxation Code §7280

<sup>26</sup> CC §1940.1

<sup>27</sup> CC §1864

**Chapter 6**  
**Summary**

A fixed-term tenancy is the result of an agreement between the landlord and the tenant for a fixed rental period. A periodic tenancy automatically continues for equal, successive periods of time, such as a week or a month.

In a tenancy-at-will, possession is delivered to the tenant with the landlord's knowledge and consent for an indefinite and unspecified period, usually without requiring rent. A holdover tenancy retains possession of the premises without any contractual right to do so.

A tenant's possessory interest in real estate can shift from one type of tenancy to another based on conduct of the landlord.

The type of notice required to terminate occupancy depends on the period of the tenancy or occupancy, the period of the occupancy, the property type and location.

**Chapter 6**  
**Key Terms**

<b>fixed-term tenancy</b> .....	<b>pg. 57</b>
<b>guest occupancy agreement</b> .....	<b>pg. 64</b>
<b>holdover rent</b> .....	<b>pg. 62</b>
<b>holdover tenant</b> .....	<b>pg. 62</b>
<b>lease agreement</b> .....	<b>pg. 57</b>
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**Quiz 3 Covering Chapters 5-6 is located on page 443.**





# License to use land

## Chapter 7

After reading this chapter, you will be able to:

- identify the limited rights to use another person's real estate that comprise a license to use land; and
- distinguish a license to use land from the use of property under a leasehold or due to an easement.

**dominant tenement**  
**irrevocable license**

**license**  
**servient tenement**

### Learning Objectives

### Key Terms

By granting a license, a property owner transfers rights to use the property to another. A license is similar to an easement and a lease since it transfers a right to use a property, yet it is neither. The use granted by a license is a personal right, not a right held due to ownership of another property.

Similar to an easement or a lease, a license is an agreement. However, a license is often oral instead of written. Unlike an easement, a license does not have a perpetual life, nor need it have a specific expiration date like a lease.

As with an easement, a property burdened with a license is referred to as the **servient tenement**. Unlike an easement, a license is a personal right and thus has no **dominant tenement** (another property) which benefits from the license. Accordingly, a license is not appurtenant to any property.

Unlike an easement or a lease, a license is a personal privilege held by an individual, not an appurtenant right belonging to another property for its future owners to receive and use. Since a license is not an appurtenant right

### A personal right to use another's property

**servient tenement**  
A property burdened by a license or easement.

**dominant tenement**  
The property benefitting from an easement on a servient tenement.

but is a personal right, called *in gross*, and thus does not benefit another property, the right given by the license cannot be conveyed to another individual as there can be no *successors or assigns* to the interest.

As with an easement, the holder of a license does not usually pay rent for the right to use the burdened property. When consideration for the license exists, it is typically in the form of an expenditure of time and money by the licensee to improve or maintain the use authorized on the burdened property, such as an irrigation ditch, roadway, fence, recreational activity, etc.

No right to exclusive possession of a burdened property (the *servient tenement*) for an authorized use exists. Therefore a license — like an easement and unlike a lease — permits only the nonexclusive use of the property by the licensee. The licensee may not exclude others from the property.

Unlike either a rental or lease agreement or an easement deed, which are conveyances of possessory interests in real estate, a license agreement conveys no interest in real estate. The right to use a property granted by a license is a mere personal privilege. It is held by an individual under an agreement with the owner of the burdened property. The license is revocable by the owner of the burdened property at any time, unless revocation is deemed unfair to the licensee.

A license agreement often arises from an informal agreement between a property owner and a neighbor or friend. For example, a property owner may accept of an informal offer by their neighbor to jointly or separately make use of the owner's property for hunting activities. Thus, the neighbor is given a license to use the property. The individual given the license agrees to maintain or improve the property for the agreed-to hunting privileges.

## A license to use

### license

The personal, unassignable right held by an individual to the non-exclusive use of property owned by another.

A **license** is the nonexclusive right to use a space or area within a parcel of real estate (or its improvements) which is owned by another person. The individual who holds the right to use by agreement does not receive any rights to assign the right or to privacy. A *license* is subject to termination at will by the owner of the burdened property, unless it has become irrevocable.

Consider a property owner who contracts for development work to be done on their property. The owner allows the construction company to store excess excavated dirt on one of the owner's adjacent lots until the construction company can haul it away.

While the dirt remains on the vacant lot, an adventurous dirt biker enters the property and is injured. The injured dirt biker claims the construction company is a licensee who is not in possession of the real estate and thus is liable for their injuries. The construction company claims they have a *recreational use immunity* since they have an interest in the property as a licensee with a right to use it for the agreed-to purpose.

*A broker wants to increase the exposure of their business to the public by billboard advertising.*

*The broker has a friend and business acquaintance who owns vacant property adjacent to a highway. The property owner is willing to allow the broker to place a billboard on their vacant land.*

*The broker and property owner enter into an oral understanding allowing the broker to put up a billboard for the broker's use only. It is agreed the broker may enter and exit the property at will to install and maintain the billboard.*

*A time limitation is not specified for maintaining the billboard on the property, nor is any fee or other compensation established. Critically, the property owner does not relinquish any control over the real estate since they do not give the broker any other right to use the property.*

*Have the broker and property owner established a landlord/tenant relationship or an easement?*

*Neither! The broker has only been given a license to use the owner's property.*

*Unlike a landlord/tenant relationship or an easement, a license to use real estate is a personal privilege, unattached to any property owned by the broker. Thus, the use is non-assignable to others by the broker and, unless agreed to the contrary or is unfair, is revocable by the property owner at any time.*

### Case in Point

Use as a  
personal  
privilege

In this example, the holder of any interest in the property is exempt from liability for injuries incurred by others arising out of their **recreational use** of private property. The property interest exempt from liability may be either possessory or nonpossessory.

Since a licensee has a *nonpossessory* interest in the property, they also have recreational use immunity even though the owner remains in possession and control of the land and the licensee has only a nonexclusive personal right to use the property.<sup>1</sup>

Thus, the construction company is not liable for injuries which occur during the dirt biker's recreational use of the property since the construction company holds an interest in the property under their license to use.

A license is often confused with a lease. A **lease** conveys a possessory interest in real estate which allows the tenant to exclude others from occupying the leased premises.<sup>2</sup>

A license to use another person's real estate is a personal privilege held by an individual. However, a license is neither personal property nor real property. Also, a license is neither owned by a person nor is it an appurtenance to adjoining real estate. Thus, a license, not being property or capable of ownership, cannot be transferred to the licensee's successors or assigns.<sup>3</sup>

## License vs. lease

<sup>1</sup> Calif. Civil Code §846

<sup>2</sup> CC §761

<sup>3</sup> **Beckett v. City of Paris Dry Goods Co.** (1939) 14 C2d 633

Characteristics which distinguish a license from a lease include:

- no writing to formalize the agreement;
- no rental payments;
- no specific location on or within the property where the use will occur;
- no intent to convey a leasehold estate;
- no right to exclude others;
- no termination date; and
- termination at the owner's will, unless the license is irrevocable.

In our previous example, the broker may use their business acquaintance's property to set up their billboard and leave it in place on the property. Also, the broker (or their representative) has the right to go back and forth across the property to maintain or repair the billboard. Thus, the property is a servient tenement subject to the terms of the license held by the broker. However, no *dominant tenement* exists since no other property benefits from the license; only the broker individually benefits as the licensee.

Thus, the owner of the property may demand removal of the broker's billboard from the property at any time, and the broker needs to immediately remove it.

A common thread which runs through both a lease and license is the right to use the property. The glaring distinction between the two is that the license does not include the right to exclude any other person from possession, as does a lease.

Continuing with our example, the broker may not fence off, lock out or quarantine in any way the ground under or around their billboard from the property owner or any other person. The license affords the broker no greater right to be on the property than anyone else the owner might allow to concurrently use the property.

## License distinguished from a lease

When an agreement with a property owner gives another person an exclusive right to *possess* the property against all others, including the owner, it is a leasehold estate — not a license.

Conversely, when the agreement confers only the *privilege to use* property which remains under the owner's day-to-day control, it is a license.<sup>4</sup>

For example, an owner of a packing company enters into an agreement to purchase raw materials from a wholesale merchant. The wholesale merchant supplies the packing company with raw materials over a three-year period. In exchange, the packing company pays the agreed-to price for the materials and allows the wholesale merchant the right to use an unlocked storage unit to temporarily stockpile their materials. The packing company also allows the merchant to use desk space in an office at the packing facility to conduct business.

<sup>4</sup> Von Goerlitz v. Turner (1944) 65 CA2d 425

The agreement does not designate the exact spaces to be used by the merchant. Also, the packing company concurrently uses the same space used by the merchant.

Two years into the arrangement, the packing company is sold. The new owner demands the wholesale merchant move out immediately. The wholesale merchant claims a lease existed between himself and the previous owner, allowing him to remain on the property until the lease expires.

However, no dollar rental amount had been established. Importantly, the wholesale merchant did not have exclusive possession of the spaces they occupied.

Instead of a lease, the wholesale merchant held a license agreement to use space under which the packing company had a superior possessory right to the premises. Thus, the wholesale merchant's use of unlocked space, concurrently occupied by the original owner, was not a lease.

The mere permission of an owner to let someone use and occupy non-specific space in a structure in a non-exclusive manner when the owner retains possession and total control over the premises constitutes a license.<sup>5</sup>

Even if a written agreement identifies the interest given as a license, the actual language and provisions of the agreement may render it a lease which is improperly titled and referred to as a license.

For example, an optometrist enters into a written agreement with an operator of a box store to establish an optical department on the premises. The written agreement is entitled a license.

The agreement allows the store to determine the space the optometrist will occupy, set the rent at a percentage of the optometrist's total sales and require the optometrist to make nightly deposits of receipts with the store's cashier. Also, the optometrist has the exclusive right to manage and operate their trade within their space. The agreement prohibits the optometrist from assigning their business and the occupancy to another without the store's prior consent.

The agreement is for a term of three years, at which time the optometrist agrees to surrender the premises in good condition.

Two years after commencement of the agreement, the store hands the optometrist a notice of cancellation of their agreement (rather than a three-day notice to perform or quit) for the optometrist's failure to deposit their daily cash receipts with the store cashier.

The optometrist refuses to vacate, claiming they are a tenant of the store under the written agreement. The store contends the agreement was a license, terminable at any time and the optometrist must leave.

## Terms implying a lease

<sup>5</sup> *Caldwell v. Gem Packing Co.*, (1942) 52 CA2d 80

## Case in Point

What steps does a landlord take to serve an unlawful detainer on a holdover tenant?

*Consider a corporation which owns 150 units in a resort condominium and sells time-share memberships in the resort. A member may purchase up to four one-week time share interests.*

*However, a member is not entitled to reserve any particular unit in advance of occupancy. The assignment of units for actual occupancy during the time period selected is left up to the discretion of the corporation's board of directors.*

*The **Department of Real Estate (DRE)** issues a restraining order, stopping sales of these time-share memberships because the corporation failed to first obtain a permit and a public report from the DRE to sell fractional interests in real estate.*

*The corporation contends the memberships are mere licenses held by the members to use unidentified space and are not a lease or other conveyance of space to the members which require a permit and public report. The corporation further contends the members do not hold an interest in the real estate since they do not have exclusive right to the possession of any specific unit.*

*Here, the occupancy rights held by the members constitute a lease. The units to be occupied are identical, the duration of occupancy is specific and each member has the right to exclusive occupancy of a unit. [**Cal-Am Corporation v. Department of Real Estate** (1980) 104 CA3d 453]*

However, the terminology in their agreement and the payment of rent is more in line with a lease than a license, indicating the parties created a landlord/tenant relationship by their arrangements.

Similar to a lease, the provision prohibiting assignment is only applicable to the ownership of an interest in real estate since a license is non-assumable as nothing is actually owned for the licensee to assign. Also, the optometrist was given exclusive possession of a designated space within the store for a fixed period of time which eliminates the owner's right to enter the optometrist's space at any time.

Thus, the arrangement by the content of the written agreement was a lease. The right to exclude others from entry for a stated term, coupled with assignment rights and rent, are characteristics of a landlord/tenant relationship, not a license.<sup>6</sup>

If an occupancy agreement contains words or phrases like "lease," "rental," "demise" or "good tenantable condition," the agreement will be construed to be a lease rather than a license.

## Know your tenancy or lose time

A license is usually oral with very few terms agreed to except the permission to use or conduct an activity on a property. All the while, the owner remains in actual possession and retains the right to exclude others, including the licensee. Above all else, a license does not carry with it the right to exclude anyone from the property.

<sup>6</sup> Beckett, *supra*



However, with every additional condition agreed to between an owner and user, a license begins to **recharacterize** itself more and more into a lease.

For example, a broker has an office with unoccupied desks. The broker wants to operate alone and avoid commitments to manage and supervise associate licensees. However, the broker is willing to share space in the office with other brokers.

The broker offers another broker the use of an office, desk space, a telephone line and secretarial services. The brokers orally agree each will pay their own proportionate share of utilities, secretarial services and rent.

A time period for the use is not specified. The office space selected by the other broker is unlocked and open to the entire office.

In this instance, the original broker may terminate this “rent-a-space” relationship at any time without prior notice or cause since the other broker has been given no more rights than a licensee to use office space.

Conversely, when a broker offers space in their office under a written agreement providing for lockable office space and a specific period for occupancy, the agreement is a lease. With a lease (or a month-to-month rental agreement) in hand, the broker creates a landlord/tenant relationship, not a license.

On some occasions, a license and a lease co-exist and are held by the same person.

A person who is a tenant with exclusive occupancy to part of the space on the premises of a shopping center also holds a license to use an adjacent portion of the premises as well.

For example, a retail tenant leases space in a shopping center. The tenant has exclusive possession of their store space controlling who may enter. However, the tenant shares use of the sidewalks and parking lots with other shopping center tenants and all the customers of the shopping center.

The tenant has no right to exclusive possession of the sidewalk and parking area, only the space enclosed within their unit. Thus, the tenant holds a license for access and non-exclusive use of the parking area and a lease for the space within the shopping center.

Occasionally an individual makes substantial expenditures to improve or maintain their use of another person’s property. When they do so over a long period of time in reliance on their oral agreement with the owner of the property, the license becomes *irrevocable*. A property owner may not terminate an irrevocable license at will.

## A license coupled with a lease

## An irrevocable license



**irrevocable license**

The right to enter and use property when the specific activity granted by the license is maintained by the licensee's on-going expenditure of money or equivalent labor, and remains feasible.

An **irrevocable license** grants an individual the right to enter and use property when the specific activity granted by the license remains feasible, maintained by the licensee's on-going expenditure of money or equivalent labor.

Consider the construction of a privacy wall between adjacent lots. The lots are located on a hillside, one above the other. Each lot is flat with a graded slope between them to adjust for the difference in the elevation. Each lot is improved with a residence.

The boundary line between the lots is located at the bottom of the slope. However, for a wall to give the owner of each lot privacy, the wall needs to be located at the top of the slope, entirely on the uphill parcel and several feet from the boundary line.

The owner of the uphill lot agrees to allow the neighbor below to construct a masonry wall with its foundation on the top of the slope. The owner and the neighbor agree on the height of the wall and that the neighbor may use the slope between the wall and the property line.

The uphill lot owner orally agrees to the wall as an encroachment. However, they do not reduce the agreement to a writing and thus no easement is created.

The neighbor constructs the masonry wall as agreed at the top of the slope. They also build a gazebo within the slope area between the fence and property line.

The owner of the uphill lot sells the property. The buyer as the new owner has the lot surveyed and demands the neighbor remove the wall and gazebo since they encroach on the buyer's property.

The neighbor claims they have an *irrevocable license* to maintain the encroachments. The neighbor may use the slope since they spent considerable time and money to construct the encroaching wall and gazebo structures in reliance on the prior owner's oral agreement which allowed them to build the wall and use the slope.

The buyer claims they cannot be barred from revoking the license since they had no notice the license existed and the use was not reduced to an enforceable easement.

However, the license became irrevocable due to the neighbor's substantial effort or expenditures made in reliance on the oral agreement with the property owner allowing the use. Further, the buyer — as a successor owner of the property burdened with the use allowed by the oral license agreement — need not have any knowledge of the irrevocable license to be barred from denying the neighbor's continual use to maintain the existing wall and gazebo under the oral agreement.<sup>7</sup>

<sup>7</sup> *Noronha v. Stewart* (1988) 199 CA3d 485

Unlike an easement or a lease, a license is a personal privilege held by an individual, not an appurtenant right belonging to another property for its future owners to receive and use. Since a license is a personal right and does not benefit another property, the right given by the license cannot be conveyed to another individual as there can be no successors or assigns to the interest.

A holder of a license does not usually pay rent for the right to use the burdened property. If consideration for the license exists, it is typically in the form of an expenditure of time and money by the licensee to improve or maintain the use authorized on the burdened property.

On some occasions, a license and a lease may sometimes co-exist and be held by the same person. For example, a person who is a tenant with exclusive occupancy to part of the space on the premises of a shopping center also holds a license to use an adjacent portion of the premises as well.

However, with every additional condition agreed to between an owner and user, a license begins to recharacterize itself more and more into a lease. Words or phrases like "lease," "rental," "demise" or "good tenantable condition" are characteristic of a lease rather than a license.

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## Chapter 7 Summary

## Chapter 7 Key Terms

**Quiz 4 Covering Chapters 7-9 is located on page 444.**

*Notes:*



# Chapter 8

## Water rights

After reading this chapter, you will be able to:

- identify the appurtenant water rights attached to riparian land; and
- understand the extent and terms of riparian rights.

**appropriation right**

**correlative right**

**overlying right**

**prescriptive right**

**riparian land**

**riparian right**

**State Water Resources Control Board**

**usufructuary right**

### Learning Objectives

### Key Terms

Water belongs in one of two categories:

- **surface water**, consisting of watercourses, lakes, springs, marshes, ponds, sloughs and any other water flowing over the surface of the earth caused by rain, snow, springs or seepage; or
- **ground water**, consisting of percolating, subterranean bodies of water located in underground *basins*.<sup>1</sup>

Holders of rights to withdraw *surface waters* have **riparian rights**. Holders of rights to pump *ground water* have **overlying rights**.

The legal rights to extract and use water are based on priorities and are classified as:

- *land owner's rights* consisting of both riparian and overlying rights;

### Water is used, not owned

#### **riparian right**

The right of a real estate owner to take surface water from a running water source contiguous to their land.

<sup>1</sup> Restatement of the Law 2d Torts §§841, 845, 846

- *appropriation rights* to withdraw water under license from the state; and
- *prescriptive rights* to withdraw water legally entitled to be used by others.

*Riparian rights* refer to a land owner's appurtenant property right to withdraw water from an adjacent river or lake for beneficial use on their riparian land.

*Overlying rights* refer to a land owner's right to the use of ground water below the surface of their land.

#### **overlying right**

The right of a real estate owner to take the ground water below the surface of their land.

An overlying land owner has rights to an allotment of water which is measured by the ground water in the basin over which their land is located. Overlying land owners have equal rights against other overlying land owners to a basin's ground water percolating underneath their land, subject to their *reasonable use* of the water.

Overlying and riparian rights are legally analogous to one another, except for the limitations placed on overlying land owners to use ground water and riparian land owners to use surface water.<sup>2</sup>

A land owner's use of water in the exercise of their riparian or overlying water rights has *priority* over water rights held by appropriators licensed by the state.

Riparian and overlying water rights are part of the ownership of land, and run with the title to the land when it is sold. Water rights are not personal property which may be assigned or used for the benefit of other property.

## **Land entitled to water rights**

#### **riparian land**

A parcel of real estate located next to a water source with surface water and within the watershed of the surface water.

**Riparian land** is a parcel of real estate located both adjacent to a water source with surface water and within the *watershed* (basin) of the surface water. Similarly, **littoral land** specifically borders a pooled body of water.

A parcel is considered riparian land when it:

- touches the surface water; or
- was part of a larger riparian parcel and retained its riparian rights by reassignment when parceled.

The amount of frontage in actual contact with the surface water of a river or lake does not determine whether a parcel is considered riparian land. For example, a 40-acre tract of land, of which only 250 feet abuts a stream, is considered riparian land.<sup>3</sup>

To constitute riparian land, a property also needs to be located within the watershed surrounding the watercourse. Should a portion of riparian land extend outside the watershed, only the portion within the watershed is entitled to use the water from the watercourse.

<sup>2</sup> *City of Barstow v. Mojave Water Agency* (2000) 23 C4th 1224

<sup>3</sup> *Joeger v. Mt. Shasta Power Corp.* (1932) 214 C 630

Surface water used on land located within its watershed will eventually return to the watercourse, minus the water consumed, in a natural process called **percolation**. Additionally, rain falling on lands within the watershed of a watercourse feeds the watercourse. Thus, a riparian land owner may only divert water to the portion of their land which allows the water to return to the watercourse.

Land lying within the watershed of one stream above the point where the two streams unite, called a **confluence**, is not considered to be riparian to the other. Further, the surface flow (river) below the *confluence* of two streams is a new and entirely different watershed, justifying a new name for the river below the confluence, as is the practice in Mexico to distinguish the watershed.<sup>4</sup>

The right to use riparian water is an **appurtenant** (incidental) right attached to and transferred with the ownership of real estate.<sup>5</sup>

Each riparian land owner is entitled to a *reasonable use* of the natural flow of stream water running through or adjacent to their land. However, the quantity of the water withdrawn is subject to an upstream riparian land owner's *priority right* to first withdraw water for reasonable use on their upstream riparian land.

Additionally, a riparian land owner may not divert stream water to nonriparian lands, even when they are entitled to use the water on their riparian land, since they are subject to the rules of percolation within the watershed. The land owner's riparian right to use the surface water is appurtenant to the land bordering the stream, not other lands without a border on the stream.<sup>6</sup>

Riparian rights are limited by the requirement that water taken from a stream needs to be put to a **reasonable and beneficial use**. Water is a state resource which, when used under a legal right, needs to be put to reasonable and beneficial use to the fullest extent possible. No one has a protectable interest in the unreasonable use of water.<sup>7</sup>

Reasonable and beneficial uses include:

- domestic uses; and
- agricultural irrigation.

Whether a particular use of water is reasonable and beneficial is determined on a case by case basis.<sup>8</sup>

**Riparian  
rights are  
appurtenant**

**Reasonable  
use and  
domestic  
priorities**

<sup>4</sup> **Anaheim Union Water Co. v. Fuller** (1907) 150 C 327

<sup>5</sup> Calif. Civil Code §§658, 662

<sup>6</sup> **Gould v. Eaton** (1897) 117 C 539

<sup>7</sup> Calif. Constitution, Article X §2

<sup>8</sup> Calif. Constitution, Article X §2

**Case in Point**

Use as a  
personal  
privilege

*Consider two land owners with riparian rights to the water in a creek. Both owners use the creek water for domestic purposes. The upstream owner begins to divert all of the creek's water with a dam to their riparian land for use in their domestic consumption and agricultural irrigation.*

*The downstream owner removes the diversion dam and starts to draw water flowing in the creek to their property again. The upstream owner seeks to bar the downstream owner from preventing the diversion of the creek water.*

*The upstream owner claims their diversion of the creek water may not be prevented by the downstream owner since the upstream owner by location on the creek has priority and is entitled to first use of the water for domestic and irrigation uses as a riparian owner.*

*The downstream owner claims they may prevent the diversion of the creek water since the upstream owner's diversion is completely depriving them of their riparian right to the water for domestic use.*

*In this scenario, the downstream owner is entitled to satisfy their domestic water needs before the upstream owner may use the water for agricultural irrigation. It is unreasonable for the upstream owner to use water for irrigation before the domestic uses of the downstream owner are satisfied. [Drake v. Tucker (1919) 43 CA 53]*

**correlative right**

The sharing of water between riparian land owners based on a tiered variety of priority and subordinate uses across the entire group of riparian owners.

While riparian land owners hold the same classification of legal rights to water, they need to share the water, giving priority to domestic uses over other uses, including agricultural irrigation.

The sharing of water between riparian land owners, with priority to upstream owners, is based on a tiered variety of priority and subordinate uses across the entire group of riparian owners, called **correlative rights**. Each land owner holds *correlative rights* within the riparian class of water rights.

## Water rights are usufructuary

**usufructuary right**

The right to reasonable use of water subject to changing circumstances controlling the use of water.

Owners of land and water providers (appropriators) who hold water rights do not legally own water. They own rights to the reasonable use of the water. Their right-to-use is subject to change when circumstances controlling the use of water change, called **usufructuary rights**. It is a sort of "here today, gone tomorrow" approach to access and possession.

When a riparian land owner is not using water, downstream riparian land owners are entitled to the full flow of the water, subject to the upstream riparian owner's future reasonable use. Thus, the lack of use of the appurtenant right to water is not lost by mere nonuse alone.

However, an upstream riparian owner who is not using their allotment of water may not divert water to nonriparian land since the water does not percolate into the watershed.<sup>9</sup>

<sup>9</sup> Gould, *supra*



In 1943, California established the **State Water Resources Control Board (Board)**. The Board acts as a referee for all disputes over water rights. The Board advises the California courts on the appropriate water allotment each of the disputing parties is entitled to take. Also, on a request from holders of water rights, the Board itself may hear legitimate disputes between the parties to determine the water allotment each party is entitled to take.<sup>10</sup>

When the Board determines the allotment of water to each holder of riparian rights, the needs of all riparian land owners within the watershed are taken into account. The amount of water allocated to a riparian owner is individually determined based on numerous factors, such as the need for domestic use, irrigation and generating power.

For example, an upstream owner of 66 acres of riparian land suitable for profitable irrigation is entitled to a smaller proportion of the water from a watercourse running through their land than a downstream owner of 96 acres of riparian land also suitable for profitable irrigation.<sup>11</sup>

An owner of riparian land has water rights which are “part and parcel” of their land, called *appurtenant rights*. As appurtenant rights, riparian water rights cannot be lost by disuse.

For example, co-owners of riparian land partition the land, providing each with separate ownership of a pro rata portion. The partition is made by deeds which grant each owner their pro rata share of the original parcel’s riparian right to the stream flow running through the parcels. Concurrently, the co-owner receiving the southern parcel is given an easement across the northern parcel to construct a pipeline to divert their share of the water from the stream to their parcel.

The southern owner never builds the pipeline and never diverts the water. Later, the northern owner begins to divert all the water from the stream to their parcel above the point where the pipeline easement meets the stream.

The southern owner claims the northern owner may not divert all the water from the stream since, as a riparian owner, the southern owner is entitled to their pro rata share of the stream’s flow, whether or not they use their share.

The northern owner claims they may divert all of the stream water since the rights of the southern owner to divert the water were contingent on the construction of the pipeline and the diversion of the water, which was never done.

However, the northern owner may not interfere with the southern owner’s riparian right to their reasonable share of the stream’s flow. The riparian rights of the southern owner are “**part and parcel**” of their land, appurtenant rights which cannot be lost by disuse alone. The pipeline easement also cannot be lost by disuse alone.<sup>12</sup>

## Competing water rights and allotments

### State Water Resources Control Board

Government entity established to ensure the proper allocation and efficient use of state water resources.

## Riparian rights not lost by disuse

<sup>10</sup> Calif. Water Code §2501

<sup>11</sup> **Half Moon Bay Land Co. v. Cowell** (1916) 173 C 543

<sup>12</sup> **Parker v. Swett** (1922) 188 C 474

Consider two appropriators who have no riparian rights appurtenant to any land but are allowed to withdraw water up to a set amount in the river. Additionally, both appropriators are entitled to take water unused by senior appropriators.

The senior appropriator fails to take their entitled amount of unused water during a five-year period. The junior appropriator seeks to reduce the amount of the senior appropriator's entitlement to the amount actually used each month during the prior five years, claiming the senior appropriator's nonuse forfeited the unused portion of their entitlement.

The senior appropriator claims they did not forfeit their right by nonuse since the amount of unused water available is unpredictable and therefore cannot be forfeited. Did the senior appropriator forfeit the unused portion of their entitlement to unused water?

Yes! The senior appropriator's nonuse forfeited their right to take unused water, entitling the junior appropriator to take the unused water up to the amount of their entitlement.<sup>13</sup>

## Public dedication by allowing use

For example, a downstream riparian owner constructs a canal to divert a large portion of a river's flow. The water is diverted for the domestic and irrigation uses of towns which were established and grew in reliance on the diverted water. The extent of the diversion is known to an upstream owner who allows the diversion to continue uninterrupted for several years.

Later, the upstream owner begins to take water from the river for irrigation of their lands, diminishing the amount of water available for the public use. The downstream owner seeks to bar the upstream owner from diverting the water, claiming the diversion upstream now deprives the downstream riparian owner of the water they were accustomed to diverting for the public use.

The upstream riparian owner claims they are entitled to divert the water for irrigation of their riparian lands since, as a riparian owner, they are entitled to use a reasonable share of the river water.

The downstream riparian owner claims the upstream riparian owner is not entitled to divert water for irrigation since the water taken by the downstream owner is devoted to public use in reliance on the upstream owner's disuse.

In this instance, the upstream riparian owner may not now interfere with the downstream diversion of water. The diversion of water for public use was allowed to continue unchecked for a period of years. This non-interference conduct constituted a dedication of the upstream owner's water rights to public use. The upstream riparian owner's only recourse is to seek compensation for their lost riparian rights from the downstream owner.<sup>14</sup>

<sup>13</sup> *North Kern Water Storage District v. Ken Delta Water District* (2007) 147CA4th 555

<sup>14</sup> *Miller & Lux v. Enterprise Canal & Land Co.* (1915) 169 C 415

Consider riparian land fronting a river or lake which is parceled. One of the parcels created has no frontage on the watercourse. The parcel is later conveyed without a provision in the deed transferring the riparian rights. Here, the parcel conveyed without reference to its riparian rights loses its riparian land status forever.

The conveyance of a parcel, severed from a larger parcel which has riparian rights, terminates the conveyed parcel's riparian rights unless the rights are transferred by the deed which severed the parcel. Even when the severed parcel is eventually conveyed to waterfront owners of portions of the original riparian tract, the severed parcel's status remains nonriparian.<sup>15</sup>

The right to the use of water located within the state of California may be acquired by **appropriation** by applying for a permit from the Board<sup>16</sup>

On the approval of an application for an *appropriation* permit by the Board, the permit is issued granting the appropriator the right to use water only to the extent and for the purpose described in the permit, called **appropriation rights**.<sup>17</sup>

Waters flowing underground or surface waters flowing in natural channels in excess of the entitlement of riparian, overlying and previously appropriated water rights are considered the public water of the State of California. These excess waters are subject to appropriation by anyone.<sup>18</sup>

An appropriator's rights against other appropriators are based on the "first in time, first in right" theory. Thus, prior appropriators may divert all the water allotted for use under their permit before later appropriators may divert water, a tiered condition called *priority*.<sup>19</sup>

The excess water previously allotted to later (junior) appropriators may not now exist after prior (senior) appropriators take their allotment, leaving no water to be taken by junior appropriators. Correlative rights to a parity share do not exist among appropriators since they are not riparian or overlying land owners.

Additionally, land owners possessing riparian and overlying rights have water rights which are superior to the rights of appropriators, called **priority rights**. Appropriators may only appropriate water which is not presently being used by a riparian or overlying land owner and has not already been appropriated by anyone else, called *surplus water*.

In the event of a water shortage, appropriators have to yield to riparian and overlying land owners since land owners have priority rights to divert or pump water. These rights are appurtenant to their property.<sup>20</sup>

## Termination of riparian rights

## Appropriation by nonriparian owners

**appropriation right**  
The right to divert water from a river or watercourse to real estate for reasonable use.

## Rights of appropriator against others

<sup>15</sup> Anaheim Union Water Co., *supra*

<sup>16</sup> Wat C §102

<sup>17</sup> Wat C §1381

<sup>18</sup> Wat C §1201

<sup>19</sup> CC §1414

<sup>20</sup> City of Barstow, *supra*

When a person licensed to appropriate water fails to use the water for a period of five years, their appropriation rights terminate and the water allocated to the appropriator reverts back to the public. Once the water reverts to the public, it is once again regarded as unappropriated.<sup>21</sup>

## Prescriptive rights by converting water

### prescriptive rights

The right to use water established by appropriating nonsurplus water openly and adversely for an uninterrupted period of five years without documentation of a legal right.

**Prescriptive rights** to the use of water may be established when a person appropriates nonsurplus water **openly and adversely** for an uninterrupted period of five years, and does so without documentation or evidence of a legal right, called a *claim of right*. Essentially, an adverse user is *converting* water, which riparian or overlying land owners have the right to withdraw, to their use without a good faith belief they hold any legal rights to its use.

Riparian and overlying owners may interrupt anyone trying to obtain *prescriptive rights* by continuing to use their allotment of water. Holders of riparian and overlying rights lose priority to those who obtain prescriptive rights to water, since their water rights have been lost to the extent taken by prescription.<sup>22</sup>

For example, an upstream riparian owner builds a dam which stops the flow of a stream to a downstream riparian owner. The downstream riparian owner is aware of the dam and allows the upstream owner to divert the flow of the stream for over five years.

Later, the downstream riparian owner seeks to stop the upstream riparian owner from diverting the flow of the stream, claiming they are entitled to a portion of the stream's flow since they are a riparian owner.

The upstream riparian owner claims the downstream riparian owner may not stop the upstream riparian owner from diverting the stream since the upstream riparian owner have been openly and adversely diverting the water for over five years and now hold prescriptive rights in the water which may not be taken from them.

In this situation, the downstream riparian owner may not stop the upstream riparian owner from diverting the stream. The upstream riparian owner has been adversely diverting the water with the downstream riparian owner's knowledge for over five years. Thus, the upstream riparian owner now has prescriptive rights in the water which are superior to the riparian rights of the downstream riparian owner.<sup>23</sup>

Prescriptive rights, like appropriation rights, may also be lost by **abandonment** after five years.<sup>24</sup>

<sup>21</sup> Wat C §1241

<sup>22</sup> City of Barstow, *supra*

<sup>23</sup> *Sibbett v. Babcock* (1954) 124 CA2d 567

<sup>24</sup> CC §811

Riparian, overlying and appropriation rights are subject to the state's interest in conserving and regulating water use. The state government, under its Board, controls unclaimed water rights and partitions water for the highest and most beneficial use.<sup>25</sup>

## Regulation of water rights by the Board

The state government regulates the use of water in California when disputes arise between riparian/overlying land owners and appropriators. The Board determines the respective water rights of individuals and makes decisions by weighing the public interest versus the needs of individuals.<sup>26</sup>

Consider a city whose water supply is experiencing a shortage since the underground water basin is being overdrawn. A resolution is adopted by the city calling for those land owners and appropriators who agree to be bound by the solution to give up their water rights in exchange for an allotment of water. Each user agreeing to the allotment is given an amount they may pump without charge. The amount of the allotment is based on the highest quantity of water the user consumed annually during the last five years. A fee will be charged to pay for the purchase and replacement of water used beyond the allotted amount.

Additionally, the terms of the resolution are imposed on all land owners with overlying water rights even if they do not agree to the resolution, thus eliminating their priority water rights.

An overlying land owner subjected to the resolution claims a taking of their priority water rights has occurred without compensation since the city's allocation solution elevates the rights of appropriators and those without any water rights to the status of riparian owners.

The city claims placing the owner under the city's water resolution is not a taking since the state Constitution requires the water supply to be made available to the largest number of users the water supply can reasonably support.

However, placing the overlying land owner under the city's water resolution does constitute a taking. The city may impose a water resolution to achieve a practical allocation of water among those with competing interests in the water. However, the city's resolution may not ignore priority rights of overlying land owners who assert them, change priorities among the class of holders of water rights nor eliminate vested water rights. Thus, the overlying land owners have priority over appropriators to the ground water and may pump to satisfy their domestic and agricultural irrigation needs which are reasonable and beneficial.<sup>27</sup>

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<sup>25</sup> Wat C §101

<sup>26</sup> Wat C §2501

<sup>27</sup> City of Barstow, *supra*

## Chapter 8 Summary

Holders of rights to withdraw surface waters have riparian rights. Holders of rights to pump ground water have overlying rights.

The legal rights to extract and use water are based on priorities and are classified as:

- land owner's rights consisting of both riparian and overlying rights;
- appropriation rights to withdraw water under license from the state; and
- prescriptive rights to withdraw water legally entitled to be used by others.

Riparian land is a parcel of real estate located both adjacent to a water source with surface water and within the watershed (basin) of the surface water.

The right to use riparian water is an appurtenant (incidental) right attached to and transferred with the ownership of real estate. As appurtenant rights, riparian water rights cannot be lost by disuse.

Riparian rights are limited by the requirement that water taken from a stream needs to be put to a reasonable and beneficial use.

The sharing of water between riparian land owners, with priority to upstream owners, is based on a tiered variety of priority and subordinate uses across the entire group of riparian owners, called correlative rights.

The conduct of an adversely affected land owner may cause their riparian rights to be dedicated to the public use. Once dedicated, the land owner may only seek compensation for the loss of their riparian rights and may not get their rights back.

The conveyance of a parcel, severed from a larger parcel which has riparian rights, terminates the conveyed parcel's riparian rights unless the rights are transferred by the deed which severed the parcel.

Prescriptive rights to the use of water may be established when a person appropriates nonsurplus water openly and adversely for an uninterrupted period of five years and does so without documentation or evidence of a legal right.

Riparian, overlying and appropriation rights are subject to the state's interest in conserving and regulating water use. The State Water Resources Control Board controls unclaimed water rights and partitions water for the highest and most beneficial use.

<b>appropriation right .....</b>	<b>pg. 83</b>
<b>correlative right .....</b>	<b>pg. 80</b>
<b>overlying rights .....</b>	<b>pg. 78</b>
<b>prescriptive right.....</b>	<b>pg. 84</b>
<b>riparian land .....</b>	<b>pg. 78</b>
<b>riparian right .....</b>	<b>pg. 77</b>
<b>State Water Resources Control Board.....</b>	<b>pg. 81</b>
<b>usufructuary right.....</b>	<b>pg. 80</b>

## **Chapter 8 Key Terms**

**Quiz 4 Covering Chapters 7-9 is located on page 444.**



*Notes:*



# Boundary lines

## Chapter 9

After reading this chapter, you will be able to:

- understand the agreed-boundary doctrine;
- know the elements needed to establish a boundary line under the agreed-boundary doctrine;
- identify common boundaries and common boundary improvements; and
- understand the types of common boundaries and the rights of adjacent property owners relative to them.

**agreed-boundary doctrine**

**common boundary improvement**

**common boundary trees**

**lot line adjustment**

**nuisance**

**party wall**

**statute of limitations**

## Learning Objectives

## Key Terms

Boundaries between parcels of real estate are set out by a survey and recorded as the legal description of each parcel. When the boundary line in a recorded deed is readily ascertainable by a surveyor, the description in the record controls.

However, uncertainty over the exact location of a boundary line may arise in a number of circumstances. For example, where natural markers, such as trees, boulders or a creek, were used to mark a boundary line, the location of the markers may have changed or disappeared over time.

Section posts and other surveyor's monuments which indicate boundary lines are also subject to earth movement, climatic changes and human

## Setting boundaries

activity. Additionally, the legal descriptions for parcels of real estate may be conflicting or simply fail to correctly set a boundary line, or may not coincide with another line or boundary.

## Doctrine of agreed boundaries

### agreed-boundary doctrine

When owners of adjacent properties uncertain over the true boundary agree to establish the location of their common lot line and acquiesce to the boundary line for at least five years.

Absent an ascertainable location of a boundary line, the **agreed-boundary doctrine** sets the parameters for the boundary between adjoining parcels.

To establish a boundary line under the *agreed-boundary doctrine*, the following facts need to exist:

- *uncertainty* as to the boundary's exact location;
- an *agreement* between the owners to set the boundary line; and
- *acquiescence* to the boundary line for a period of at least five years.

Alternatively, when a *substantial loss* might be suffered due to a change in the location of the boundary line to the legally described location, a new boundary may be established under the *agreed-boundary doctrine*.<sup>1</sup>

The agreed-boundary doctrine was developed during a time when less advanced surveying techniques occasionally made it too difficult or expensive to locate the boundary line described in the deeds.

Thus, the more practical way to set a boundary line in rural and relatively unpopulated areas was often for owners of adjacent parcels to agree between themselves on the location of a common marker, such as a fence, as the boundary.

Today, surveying techniques are significantly improved. Now, when a deed is clear and a competent surveyor is available, the true boundary line can easily be established and the uncertainty of the boundary's location is eliminated. Thus, the ancient agreed-boundary doctrine has been reduced to the status of a legal last resort.

In the absence of an oral or written agreement between an owner and their neighbor to set the boundary line at some place other than a documented deed line, the boundary line described in their deeds remains as the boundary.<sup>2</sup>

Consider a parcel of real estate divided into two equally sized parcels by a recorded survey. Later, the owners erect a fence between the parcels which is not located on the recorded common boundary line. Thus, one parcel appears to be physically larger than the other.

Multiple years later, the owner of the smaller parcel sells their land. The new owner hires a surveyor to determine the location of the boundary between the properties.

The survey sets the boundary at the location described in recorded documents. The survey shows the fence is not located on the legally described boundary between the adjacent properties.

<sup>1</sup> *Ernie v. Trinity Lutheran Church* (1959) 51 C2d 702

<sup>2</sup> *Armitage v. Decker* (1990) 218 CA3d 887

The new owner of the smaller parcel seeks to recover possession of the land between the fence and the boundary.

The neighboring owner of the larger parcel claims the fence is the agreed boundary since it is reasonable to infer the previous owners agreed the location of the fence to be their common boundary.

The owner of the smaller parcel claims the agreed-boundary doctrine does not apply since a recorded legal description of the boundary is available and the true boundary is known and can be located by a survey.

Is the owner of the smaller parcel correct in relying on the legal description of the property to establish the actual boundary location?

Yes! The doctrine of title by agreed boundaries, commonly referred to as the agreed-boundary doctrine, does not apply since:

- the exact boundary location can be readily located; and
- the owner of the larger parcel defending the fence as the boundary provided no evidence the prior owners were **uncertain** as to the true boundary description and then, to resolve their uncertainties of location, **agreed** the fence would mark the boundary.<sup>3</sup>

Once owners of adjacent properties uncertain over the true boundary agree to establish the location of their common lot line, the location they set replaces the legal line provided either:

- a five-year **statute of limitations** has run; or
- a substantial loss might result from the boundary line being moved to the legally described location.

For example, two farms are operated on adjacent parcels of real estate. When the parcels were originally surveyed decades earlier, the federal government placed a five-inch section post to mark the boundary line. The neighbors search but cannot locate the section post to help them set their property lines. Instead of surveying their parcels, they mutually erect a fence intending it to set the boundary between their properties.

The fence is eventually taken down, but the owners continue to farm up to the spot where the fence had been located.

Over five years later, each owner sells their respective property to different buyers. The new buyers continue to farm their parcels within the parameters set by the original owners.

Later, one of the new owners surveys their parcel which reveals the owner's neighbor has been farming 2.5 acres on their side of the property line described in the public records.

## Agreeing to the boundary

<sup>3</sup> Bryant v. Blevins (1994) 9 C4th 47

The owner sues to quiet title and reclaim possession to the 2.5 acres. The neighbor claims the fence line became the boundary line when the original owners set the fence as the property line between the adjacent parcels.

Is the fence line the true boundary line?

Yes! When the owners of adjacent real estate are *uncertain* where their boundary is located, they may agree to set a new boundary line.

Further, the agreed-to boundary which remains in place for more than **five years** is binding on subsequent owners even though the recorded legal description is different.<sup>4</sup>

## Agreement to make certain

An agreement to mark a boundary line may be oral, written or result from the conduct of neighboring property owners.

Oral or written agreements on the boundary's location are called **express agreements** since they are not implied.

*Written agreements* are the most effective type of express agreement since they formally document the mutual intentions of both owners. However, they usually exist only in the case of a lot line adjustment map. Unlike the conveyance of real estate, owners do not have to put their boundary agreement in writing for it to be enforceable.

With the setting of an agreed boundary, neither owner is conveying real estate to the other. Instead, the owners are agreeing to what land constitutes their own property.<sup>5</sup>

## The element of duration

### statute of limitations

A period of time establishing the deadline for filing a lawsuit to resolve a dispute.

Owners need to acquiesce to the agreed boundary for a period of at least five years. This five-year period is the **statute of limitations** for the recovery of real estate.<sup>6</sup>

The *statute of limitations* requires the adjacent owners to resolve a dispute within the five-year period. When disputes are not settled within this period, the claims are put to rest. Thus, an owner who fails to object to a boundary dispute during the statute of limitations period is presumed to have agreed to the boundary set by the adjacent property owner.

However, an exception to the five-year rule arises when *substantial loss* will be caused by the movement of the agreed boundary to the true lot line.

For example, when an adjacent owner builds improvements near the line established in reliance on an agreement that it is the boundary, the new boundary is allowed without the enforcement of the five-year period.

<sup>4</sup> *Joaquin v. Shiloh Orchards* (1978) 84 CA3d 192

<sup>5</sup> *Young v. Blakeman* (1908) 153 C 477

<sup>6</sup> Calif. Code of Civil Procedure §318

However, the new boundary is only allowed when the adjacent owner can show that moving the boundary will result in substantial loss due to the existence of improvements.<sup>7</sup>

When a writing setting the boundary is not available, subsequent owners need to look to the prior owner's activities for an *implication* that an agreement existed as to the location of the boundary line.

## Marking the line

For example, the construction of a fence may imply an agreement to set a boundary. However, in order for the fence to control in an agreed-boundary dispute, the owner relying on the fence as a boundary needs to present evidence to show the fence was erected to resolve a *boundary uncertainty known* to previous owners.

For example, a fence is erected between two parcels of real estate by the owners of the parcels. Both parcels are sold 20 years later.

The new owner of one of the parcels commissions a survey. The survey reveals the 20-year old fence dividing the owner's property and the neighboring property is not in the correct location.

The owner builds a new fence on the actual boundary line located by the survey.

The neighbor then seeks to remove the new fence and obtain possession to the real estate up to the old fence line. The neighbor claims the agreed-boundary doctrine sets the boundary at the original fence line since the fence existed for 20 years without dispute.

The owner claims the agreed-boundary doctrine does not apply since the previous landowners did not agree to erect the fence based on any uncertainty as to the location of the true boundary.

Can an agreement be implied to set the boundary line at the old fence?

No! The mere acquiescence to the placement of a fence, absent evidence of uncertainty and an agreement to resolve the uncertainty, is not enough to establish a boundary under the agreed-boundary doctrine.<sup>8</sup>

Fences are built for a variety of reasons, one of which is to establish a boundary. Other reasons for erecting fences include controlling animals, aesthetics or to prevent children from wandering off a property.

Further, the location and condition of a fence may be influenced by the topography of the property, the terrain on which it is placed, requirements of an animal enclosure or the loss of lateral and subjacent support.<sup>9</sup>

While a fence or wall is evidence of a line for something, a fence does not necessarily set the property boundary.

<sup>7</sup> **Roman v. Ries** (1968) 259 CA2d 65

<sup>8</sup> **Mehdizadeh v. Mincer** (1996) 46 CA4th 1296

<sup>9</sup> Bryant, *supra*

## Limitations of the doctrine

### lot line adjustment

When adjacent property owners move an existing property line.

The agreed-boundary doctrine has limitations. The doctrine cannot be used to convey property. Further, the agreed-boundary doctrine can only set a boundary, the exact location of which is unknown to the adjacent owners without a survey or litigation.

Any attempt to convey a portion of a lot to the owner of an adjacent property by use of the agreed-boundary doctrine violates the *statute of frauds* which requires a writing documenting the intent to convey land. Thus, the agreed-boundary doctrine may not be used to make **lot line adjustments** in which adjacent owners move an existing line, the location of which is known to them.

## Shared rights and responsibilities

### common boundary improvement

An improvement which acts as a demarcation of the property line.

In addition to knowing the boundaries of parcels of property, prospective buyers interested in a property are concerned about:

- the ownership of any **common boundary improvements**; and
- who is responsible for their maintenance.

The rights of the adjacent property owners when setting up, maintaining or removing *common boundary improvements* depend on the type of improvement which exists.

A common boundary improvement may be a:

- party wall;
- boundary fence;
- tree line;
- driveway; or
- ditch.

## Party walls are owned by both

### party wall

A common boundary improvement located on a property line between adjacent properties, such as a wall, fence or building co-owned by the adjacent property owners.

Common boundary improvements, other than trees, located on a property line between adjacent properties are called **party walls**.

A *party wall* may be in the form of a wall, fence or building wall co-owned by the adjacent property owners.

The use and ownership of a party wall is best set forth in a *written agreement* between adjacent property owners. The agreement defines each owner's responsibility for sharing the cost of maintaining the party wall. However, these written agreements rarely exist.

An adjoining property owner may not remove or destroy a party wall without the consent of the other owner since each has an interest in the party wall.

An owner may alter a party wall, such as by installing cosmetic ornamentation on their side. However, they may not injure the wall or interfere with the adjoining property owner's use of the party wall.<sup>10</sup>

<sup>10</sup> *McCarthy v. Mutual Relief Ass'n of Petaluma* (1889) 81 C 584; Tate, *supra*



For security and privacy purposes, many properties are fenced in by a **boundary fence**. A *boundary fence* may be a party wall co-owned by the adjacent property owners.

When an owner leaves their land unfenced and later decides to enclose it by using the existing fence as part of the enclosure, they need to compensate the neighbor who built the fence for the pro rata value of the neighbor's fence used by the owner.<sup>11</sup>

Owners of adjoining properties are presumed to benefit equally from boundary fences. Under this presumption, all adjoining owners are equally responsible for constructing, maintaining and replacing boundary fences.<sup>12</sup>

The responsibility for constructing, maintaining or replacing boundary fences may be altered or removed only by:

- a *written agreement* between all affected owners; or
- an adjoining owner's *judicial petition* to remove or alter their responsibility.

On an owner's petition to a court, factors considered when determining an owner's responsibility for a boundary fence include:

- whether the boundary fence presents a financial burden disproportionate to the owner's benefit;
- the cost of the construction, maintenance or replacement in relation to the value added to the owner's property;
- whether financial responsibility for the boundary fence imposes unjustifiable financial hardship;
- the reasonableness of the construction, maintenance or replacement; and
- any other unequal impact the construction, maintenance or replacement of the boundary fence may have on the owner.<sup>13</sup>

When neighbors are responsible for a boundary fence, the owner who plans to construct, replace or maintain the fence is to provide a **30-day written notice** to the affected adjoining property owners. The notice is to include:

- a notification of the presumption of equal responsibility for the boundary fence;
- the problem to be addressed;
- the proposed solution;
- estimated costs;
- the proposed division of costs; and
- the proposed timeline to address the problem.<sup>14</sup> [See **RPI** Form 323]

## Boundary fences and cost contributions

## Maintaining the good neighbor fence

<sup>11</sup> Calif. Civil Code §841(b)(2)

<sup>12</sup> CC §841(b)(1)

<sup>13</sup> CC §841(b)(3)

<sup>14</sup> CC §841(b)(2)

## Line trees, a trunk with common owners

### common boundary trees

Shrubbery or trees with trunks which stand partly on the land of two adjacent properties belonging to the adjacent owners.

Trees are:

- solely owned;
- government owned; or
- commonly owned.

A tree's ownership is determined by the location of its trunk.

Solely owned trees belong to the owner of the property on which the trunk is growing.<sup>15</sup>

Trees growing on government-owned parcels, such as a right of way for streets and sidewalks, belong to the local government.

However, shrubbery or trees whose trunks stand partly on the land of two adjacent property owners belong to the adjacent owners as **tenants in common**. These trees are called **line trees** or **common boundary trees**.<sup>16</sup>

Adjacent owners who own boundary trees as *tenants in common* are jointly responsible for maintaining the trees.<sup>17</sup>

## Sharing boundary trees

Co-owners of *boundary trees*, as adjoining property owners, both enjoy the use of the trees.

For example, use of a boundary tree by adjacent property owners includes trimming and maintaining the trees. The co-owner who trims the tree needs to carry away and dispose of the tree trimmings. The co-owner needs also to take care not to damage the tree or interfere with the other co-owner's use of the tree.

The use allowed a co-owner of boundary trees is the same as the use allowed the owner of solely-owned trees, as long as the use does not interfere with the other co-owner's use and enjoyment of the trees.

## Remedies

### nuisance

An action which is injurious to health, offensive to the senses, or obstructs the use and enjoyment of surrounding property.

To avoid disputes, adjacent property owners enter into an agreement detailing how they will handle the maintenance of boundary trees.

When a boundary tree injures the *health and safety* of a property owner or prevents them from enjoying their property, the tree may constitute a **nuisance** and be removed.<sup>18</sup>

A co-owner of a boundary tree might refuse to consent to the removal of a boundary tree. If the tree constitutes a *nuisance*, an abatement of the nuisance is allowed.

<sup>15</sup> CC §833

<sup>16</sup> CC §834

<sup>17</sup> CC §841

<sup>18</sup> CC §3479

For example, boundary trees may be a nuisance if their branches or the trees themselves continually fall, threatening the safety of people using the adjacent property or damaging improvements on the adjacent property.<sup>19</sup>

<sup>19</sup> *Parsons v. Luhr* (1928) 205 C 193

## Chapter 9 Summary

The agreed-boundary doctrine was developed when surveying techniques were less advanced. Under the agreed-boundary doctrine, owners of adjacent properties uncertain over the true boundary may agree to establish the location of their common lot line. The location they set replaces the legal line provided either a five-year statute of limitations has run or a substantial loss might result from the boundary line being moved to the legally described location. However, due to advances in surveyor capabilities, the agreed-boundary doctrine is a legal last resort.

Now, when a deed is clear and a competent surveyor is available, the true boundary line can easily be established to eliminate the uncertainty of the boundary's location.

An agreement to mark a boundary line may be oral or written or result from the conduct of neighboring property owners. Construction of a fence does not necessarily imply an agreement about the location of a boundary unless the owner can prove the fence was erected to resolve a boundary uncertainty.

The agreed-boundary doctrine may not be used to convey property, nor may it be used to make lot line adjustments to move an already existing line.

Most properties have three property lines setting the common boundary. The location of the common property lines are frequently represented by a common boundary improvement. The rights of adjacent property owners when setting up, maintaining or removing common boundary improvements depend on the type of improvement which exists.

A party wall is a type of common boundary improvement which is co-owned by the adjacent property owners. The owners share the cost of maintaining the party wall.

Shrubby or trees whose trunks stand partly on the land of two adjacent property owners are called common boundary trees. Much like party walls, co-ownership of common boundary trees includes maintenance of the trees. Additionally, co-owners may not alter or remove party walls or common boundary trees without the consent of the other co-owner.

**Chapter 9**  
**Key Terms**

<b>agreed-boundary doctrine .....</b>	<b>pg. 90</b>
<b>common boundary improvement .....</b>	<b>pg. 94</b>
<b>common boundary trees.....</b>	<b>pg. 96</b>
<b>lot line adjustment.....</b>	<b>pg. 94</b>
<b>nuisance.....</b>	<b>pg. 96</b>
<b>party wall.....</b>	<b>pg. 94</b>
<b>statute of limitations .....</b>	<b>pg. 92</b>

<p><b>Quiz 4 Covering Chapters 7-9 is located on page 444.</b></p>
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# Encroachments: crossing the line

## Chapter 10

After reading this chapter, you will be able to:

- determine whether an encroachment exists on a parcel of real estate;
- understand and apply the remedies available to an owner whose property is burdened with an encroachment; and
- identify whether an encroachment was created by a neighbor in good faith.

**balancing hardships**

**continuing nuisance**

**encroachment**

**equitable easement**

**good faith**

**lashes**

**permanent nuisance**

**trespass**

## Learning Objectives

## Key Terms

Shortly after their purchase of an unimproved parcel of real estate, a new owner discovers the garage on their neighbor's property extends two feet over the boundary line onto the owner's property, called an **encroachment**.

The owner demands the neighbor remove the *encroachment*. When the neighbor refuses, the owner seeks to compel the neighbor's removal of the portion of the garage which encroaches on the owner's property.

The neighbor claims the owner is not entitled to a removal of the improvement due to evidence that:

- the encroachment was unknown and unintentional;
- the square footage of the owner's property affected by the encroachment is minor; and

## Boundaries violated and hardships balanced

### **encroachment**

An improvement on one parcel of real estate which extends onto real estate owned by another.

- the cost to remove the garage far exceeds the monetary loss to the owner if the encroachment were allowed to continue.

May the owner obtain a court order forcing the removal of the encroaching garage, called an *injunction*?

No! The encroachment is unintentional and minor in its effect on the burdened owner. Thus, the burden to the owner does not justify ordering the neighbor to undertake an expensive reconstruction activity.

Instead, the owner is awarded money losses representing the rental value for the lost use of their property, and the neighbor is granted an easement over the owner's property for the life of the garage.<sup>1</sup>

#### continuing nuisance

An ongoing nuisance that can be entirely eliminated by those adversely affected by the activity or condition.

## Encroachment, trespass and nuisance

#### trespass

Any wrongful and unauthorized entry onto real estate in the possession of another.

#### permanent nuisance

A nuisance which cannot be abated at a reasonable cost and by reasonable means.

An **encroachment** is an improvement on real estate, such as a building, fence, driveway or tree, which extends onto real estate belonging to another person without their consent.

Encroachment is closely related to trespass, nuisance and boundary disputes. All involve an interference with another person's property rights.

Any encroachment qualifies as a *nuisance*, be it a **permanent** or **continuing nuisance**, since nuisance is broadly defined as any obstruction of another's use and enjoyment of their real estate.

An encroachment is also a **trespass** when it actually rests on the ground of the neighbor's property.

However, the names used for an interference are unimportant. One way or another, an owner is entitled to recover for an **unauthorized interference** with their property rights.

## Rights affected

Besides the fee owner of real estate, others may seek to stop an encroachment. Any person holding rights in real estate may protect those rights against outside interference. Thus, the rights affected by an encroachment include:

- *leasehold* interests;<sup>2</sup>
- *deed restrictions*, such as limitations on the height of improvements;<sup>3</sup>
- *setback* requirements;<sup>4</sup>
- *easements*;<sup>5</sup> and
- *prescriptive easements*.<sup>6</sup>

<sup>1</sup> *Christensen v. Tucker* (1952) 114 CA2d 554

<sup>2</sup> *Brown Derby Hollywood Corporation v. Hatton* (1964) 61 C2d 855

<sup>3</sup> *Seligman v. Tucker* (1970) 6 CA3d 691

<sup>4</sup> *Morgan v. Veach* (1943) 59 CA2d 682

<sup>5</sup> *City of Dunsmuir v. Silva* (1957) 154 CA2d 825

<sup>6</sup> *Warsaw v. Chicago Metallic Ceilings, Inc.* (1984) 35 C3d 564

For instance, an owner uses a strip of their neighbor's property for access to a commercial building located on the owner's property. After the owner uses the strip for more than five years, the neighbor constructs a warehouse on the strip of land, restricting the owner's access to their building.

Here, the owner's use of the strip of their neighbor's land matured into an **easement by prescription**. Thus, the owner is able to obtain an injunction against the warehouse improvements as they encroach on the owner's easement rights.<sup>7</sup>

The existence of an encroachment is easily determined. All that is needed is a survey to locate the property line. When an improvement on one parcel extends over the line onto an adjacent parcel, it is an encroachment.

Occasionally, neighboring owners disputing the existence of an encroachment rely on contradictory surveys to establish the property line. When the owners are not able to agree on the location of the property line, the boundary dispute needs to be resolved before any remedy for the encroachment — if one exists — may be granted.

The resolution of the boundary dispute frequently amounts to no more than a court determining which of the surveys is more accurate.<sup>8</sup>

However, where the boundary is marked by a physical structure, such as a fence or a row of trees, a survey is not always to be relied on.

For instance, a common boundary line marked by a fence or other structure is not located on the recorded description of the lot line. Both neighbors treat the fence as the boundary for a number of years. The agreed-to location of the property line due to creating the fence is the boundary, regardless of deeds and surveys to the contrary.

Once an **encroachment** has been determined, the remedies available to the owner include:

- an **injunction** ordering the removal of the encroaching structure; and
- **money losses** for the diminished value of the property.

An owner is entitled to terminate or prevent an unauthorized intrusion onto their real estate. However, when a building or other substantial improvement encroaches on an owner's property, the neighbor's cost of removing the encroachment might far exceed the damage inflicted on the owner burdened by the encroachment.

Thus, the encroachment is allowed to continue and the owner is awarded money losses for the lost use of their property, called **balancing hardships** or *balancing equities*.

## Drawing the line

## Balancing the hardships

### balancing hardships

The awarding of money to an owner to compensate for lost use of their property burdened with an encroachment.

<sup>7</sup> Warsaw, *supra*

<sup>8</sup> **Iacovitti v. Fardin** (1954) 127 CA2d 348



## Tree encroachment

*Trees with trunks which are planted on one side of a boundary line belong solely to the owner of the property on which the trunks grow. [Calif. Civil Code §833]*

*A solely-owned tree encroaches on a neighboring property when its branches or roots reach past the boundary line, sometimes called the contiguous line or common property line with the adjacent property.*

*A property owner confronted with encroaching branches and roots from a neighbor's tree has three potential remedies:*

- *recover their money losses from the neighbor [Bonde v. Bishop (1952) 112 CA2d 1];*
- *use self-help to eliminate the encroachment; or*
- *obtain a mandatory injunction ordering the neighbor to remove the encroachment.*

*The remedy available depends on the extent of the encroachment.*

*An encroachment may be either:*

- *a permanent encroachment; or*
- *a continuous encroachment. [Tracy v. Ferrera (1956) 144 CA2d 827]*

***Physical damage** caused to the neighbor's property by an encroaching tree is considered a permanent encroachment. The neighbor may recover **money losses** from the adjoining property owner for the cost of repairing the physical damage to their property caused by the encroaching tree. [Bonde, supra]*

*When an encroachment can be abated (discontinued), it is considered a **continuous encroachment**. For example, a tree that does not cause physical damage, but only encroaches on a neighbor's property by its overhanging branches or invading roots, is a continuous encroachment.*

*A neighbor subjected to a continuous tree encroachment may resort to **self-help** by cutting the offending branches and roots back to the property line. [Grandona v. Lovdal (1886) 70 C 161]*

*A neighbor who cuts off overhanging branches from an encroaching tree may keep or discard any firewood or fruit from the overhanging branches. [Grandona, supra]*

*However, a neighbor may not cut the encroaching branches or roots beyond the boundary line, kill the tree or enter the adjoining owner's property without the owner's permission. [Fick v. Nilson (1950) 98 CA2d 683]*

*Another type of continuous encroachment is a nuisance. A nuisance is any condition which prevents a neighbor's free use or enjoyment of their property or is injurious to their health. [CC §3479; see Chapter 12]*

*The mandatory injunction remedy to remove the encroaching branches or roots is only available when the encroachment constitutes a nuisance, such as when tree roots deplete the nutrients in the soil of a neighboring property. [Bonde, supra; Crance v. Hems (1936) 17 CA2d 450]*

The conditions for *balancing hardships* — i.e., merely granting money losses and allowing an encroachment to continue — are:

- the owner of the property affected by the encroachment may not suffer an *irreparable injury* due to the continued existence of the encroachment;

- the neighbor who owns the encroaching structure needs to have acted innocently and in *good faith* when constructing the encroaching structure; and
- the **cost** to the neighbor to remove the encroachment needs to greatly exceed the damage done to the value of the property on which it encroaches.<sup>9</sup>

For instance, the foundation to a neighbor's residence is located close to the property line. The eaves of the house and a bay window hang out over the line. The encroaching portions of the structure can be removed without great expense or loss of value.

The owner demands the removal of the encroaching structures.

The neighbor claims removal is not appropriate since the encroachment is minimal.

However, since the encroachment is minimal and the cost of removing it is small, the encroaching portion of the residence needs to be removed — tipping the balance in favor of eliminating the encroachment.<sup>10</sup>

Further, an encroachment need not be removed if removal adversely affects a large segment of the public.

For example, a reservoir constructed by a water company encroaches on an owner's property. The owner seeks to remove the encroachment. However, the encroaching reservoir may remain partly because the reservoir supplies water to over 500 homes.<sup>11</sup>

A neighbor who constructs improvements which encroach on the land of another needs to do so innocently and without knowledge of negative effects to someone else, called acting in **good faith**, before any balancing of the hardship of removal or remaining may take place.

The *good faith* requirement prevents an **intentional exploitation** of the balancing hardships rule.

For example, an unimproved parcel of real estate is subject to setback requirements. The owner begins building a residence on the property.

Soon after construction commences, the owner's neighbor notices the residence is being constructed within the setback — too close to the property line. The owner is informed the location of their improvements violate setback requirements. The neighbor also threatens legal action unless the owner complies with the setback requirements.

## Good faith and innocence

### good faith

Acting innocently and without knowledge of negative effects to someone else.

<sup>9</sup> Christensen, *supra*

<sup>10</sup> **Harland v. Noto** (1951) 105 CA2d 740

<sup>11</sup> **Ukhtomski v. Tioga Mutual Water Co.** (1936) 12 CA2d 726

However, the owner does not cease work on the residence. They complete the construction knowing the improvements violate the setback requirements. The neighbor seeks to enforce the setback requirements by forcing the removal of the structure from within the setback.

The cost to the owner of removing the residence far exceeds the damage to the neighbor.

However, the owner built the residence with full knowledge of both the setback violation and the neighbor's objection. Thus, the owner did not complete the construction in good faith and the portion of the structure within the setback is to be removed.<sup>12</sup>

## The encroachment easement

### equitable easement

An easement granted to a neighbor allowing them to maintain an improvement encroaching on another owner's property.

When the continuance of an encroachment on the owner's property is allowed, the encroaching neighbor is granted an **equitable easement** to maintain the improvement on the owner's property.

Further, the neighbor needs to compensate the owner for the **rental value** of the lost use of their property. The easement lasts for the lifetime of the encroachment.<sup>13</sup>

To resolve one case, the encroaching neighbor seeks fee title to the portion of the property covered by their encroachment. However, to grant title is excessive. Instead, an easement is granted since an easement is sufficient to protect the neighbor's right to maintain the encroaching improvements and avoid **lot line adjustment laws**.<sup>14</sup>

## Limitations and delay

Normally, an owner seeking to terminate an encroachment or recover money losses is subject to a **three-year statute of limitations** running from the *commencement* of the encroachment.<sup>15</sup>

The limitations period for an encroachment is the same as for a *permanent nuisance* since the damage to the owner is complete and certain as soon as the encroachment is created.

The **date** the encroachment was created is the critical date. Whether an owner has knowledge an encroachment exists on their property does not affect application of the statute of limitations to bar their claims for removal or money. The limitations period runs from the creation of the encroachment, not its discovery.<sup>16</sup>

However, in the rare case where damage resulting from an encroachment is progressive over time, the three-year statute of limitations does not apply from the date of creation.

<sup>12</sup> Morgan, *supra*

<sup>13</sup> **Romero v. Shih** (2022) 78 CA5th 326

<sup>14</sup> Christensen, *supra*

<sup>15</sup> **Bertram v. Orlando** (1951) 102 CA2d 506

<sup>16</sup> **Castelletto v. Bendon** (1961) 193 CA2d 64

For instance, an owner's building is damaged when a neighbor's building leans on it, due to a poorly compacted fill. The degree of the tilt, and the resulting damage, increases over time.

More than three years after the damage commences, the owner seeks to recover monetary losses from the neighbor. The neighbor claims the owner is barred from recovering money losses by the running of the three-year limitations period from the date the encroachment first occurred.

However, the intrusion on the owner's building is not only continuous but progressive — a further intrusion. As with a *continuing nuisance*, a new claim accrues each time the loss increases. Thus, while the three-year statute of limitations does apply, it does not begin to run on the commencement of the encroachment, but runs from the date of the last increase in damage from the progressively increasing encroachment.<sup>17</sup>

In addition to barring an owner's relief for an encroachment on their property due to the statute of limitations, an action seeking money losses or an injunction against an encroachment may be barred by the equitable doctrine of **laches**, also called *prejudicial delay* or *detrimental reliance*.<sup>18</sup>

**laches**

An unreasonable delay which bars pursuit of a claim.

A property owner loses their right to enforce a removal of an encroachment or recover money against the encroaching neighbor when the owner delays in making the claim, causing the neighbor to rely on the owner's acquiescence to their detriment.

For example, an owner discovers their neighbor is constructing a potential encroachment. However, the owner refrains from saying anything or taking any action until the construction is completed. Here they are barred from enforcing its removal. The encroaching neighbor has relied on the owner's acquiescence in undertaking and completing the construction.<sup>19</sup>

Finally, an owner who allows a known encroachment on their property to continue for over five years risks losing property rights through a prescriptive easement or adverse possession since the adverse use of the owner's property by the encroaching neighbor is known to the owner and continuous.

Thus, an owner needs to act promptly to enforce their right to remove the encroachment or receive compensation for lost value when a neighbor's improvements encroach on their property.

<sup>17</sup> *Kafka v. Bozio* (1923) 191 C 746

<sup>18</sup> *Johnson v. Little Rock Ranch, LLC* (2022) 73 CA5th 576

<sup>19</sup> *Rankin v. De Bare* (1928) 205 C 639

## Chapter 10

### Summary

An encroachment is an improvement on real estate, such as a building, fence, driveway or tree, which extends onto real estate belonging to another person without their consent. When an encroachment is made in good faith, without knowledge, owners are not entitled to an injunction forcing the removal of the encroaching subject.

An owner needs to act within the three-year period of the statute of limitations to recover money losses unless the damage from an encroachment is progressive over time. The limitations period does not run from the discovery of the encroachment, but from the date the encroachment was created.

Once an encroachment has been determined, the remedies available to the owner include an injunction ordering removal of that encroachment or money losses for the diminished value of the property.

An owner is entitled to terminate or prevent an unauthorized intrusion onto their real estate. However, when the cost of removing an encroachment far exceeds the damage inflicted on the burdened owner, the owner may be awarded money losses, called balancing hardships.

An owner needs to act promptly to enforce their right to remove the encroachment or receive compensation for lost value when a neighbor's improvements encroach on their property.

## Chapter 10

### Key Terms

<b>balancing hardships</b> .....	<b>pg. 101</b>
<b>continuing nuisance</b> .....	<b>pg. 100</b>
<b>encroachment</b> .....	<b>pg. 99</b>
<b>equitable easement</b> .....	<b>pg. 104</b>
<b>good faith</b> .....	<b>pg. 103</b>
<b>lashes</b> .....	<b>pg. 105</b>
<b>permanent nuisance</b> .....	<b>pg. 100</b>
<b>trespass</b> .....	<b>pg. 100</b>

**Quiz 5 Covering Chapters 10-12 is located on page 445.**



# Trespass: a violation of possession

## Chapter 11

After reading this chapter, you will be able to:

- identify the different types of trespass on property; and
- understand the remedies a rightful occupant of property has against trespassers.

**actual money losses**

**adverse possession**

**ejectment**

**misdemeanor**

**nominal money losses**

**prescription**

**trespass**

## Learning Objectives

## Key Terms

A **trespass** is any wrongful and unauthorized entry onto real estate in the possession of another.

Thus, a *trespass* is fundamentally an interference with another's *possession* of real estate. It is distinct from any interference with **title** or an **ownership interest**.<sup>1</sup>

Anyone in possession of the property, such as the fee owner, a life estate owner, a tenant or even a person in wrongful possession, has the right to stop a trespass.<sup>2</sup>

A fee owner can even trespass on the property they own in fee simple when the property is in the legal possession of another person, such as a tenant.

## Ejectment, liabilities and title risks

### trespass

Any wrongful and unauthorized entry onto real estate in the possession of another.

<sup>1</sup> **Brenner v. Haley** (1960) 185 CA2d 183

<sup>2</sup> **Allen v. McMillion** (1978) 82 CA3d 211

## Trespasser liability for harm done

### nominal money losses

Monetary recovery when no injury has occurred.

### actual money losses

Monetary losses recovered for injury to the real estate, lost use of the property, personal injury or injury to the occupant's personal property, also called damages.

When an entry is not *privileged*, it is considered a trespass. A trespasser incurs **civil liability** for the monetary amount of any losses or injury they cause to the occupant's person, real estate or personal property.

Conversely, damage to the fee owner's property caused by the person who is in rightful possession, such as a tenant, is not a trespass. When damage is caused by someone in rightful possession, it constitutes **waste** as they have impaired the property's value.<sup>3</sup>

An owner may bring an action for trespass against a trespasser even when the trespasser caused no actual injury by their presence on the owner's property. When no injury has occurred, the owner may only recover **nominal money losses** from the trespasser. *Nominal money losses* are awarded when a wrong has taken place but has not resulted in a money loss.<sup>4</sup>

To recover **actual money losses** for a trespass, a rightful occupant needs to sustain a real, actual loss of money. *Actual money losses* recoverable for a trespass are based on:

- injury to the value of the real estate;
- lost rental value in the use of the property;
- personal injury; and
- injury to the occupant's personal property.

## Indirect trespass

A trespass does not require the trespasser's direct physical presence on the property. A trespass may result from an *indirect entry* into another's property, sometimes called **trespass on the case**.

For example, one may be liable on a trespass for losses caused by activities such as:

- depositing dirt or debris on another's property;<sup>5</sup>
- leaving toxic waste on another's property;<sup>6</sup>
- leaving personal property on real estate belonging to another;<sup>7</sup>
- diverting a river or surface waters across another's property;<sup>8</sup>
- starting a fire and negligently allowing the fire to move onto a neighbor's property;<sup>9</sup> or
- allowing one's animals to wander across another's property.<sup>10</sup>

<sup>3</sup> *Smith v. Cap Concrete* (1982) 133 CA3d 769

<sup>4</sup> *Staples v. Hoefke* (1987) 189 CA3d 1397

<sup>5</sup> *Armitage v. Decker* (1990) 218 CA3d 887

<sup>6</sup> *Mangini v. Aerojet-General Corporation* (1991) 230 CA3d 1125

<sup>7</sup> *Herond v. Bonsall* (1943) 60 CA2d 152

<sup>8</sup> *Salstrom v. Orleans Bar Gold Mining Co.* (1908) 153 C 551

<sup>9</sup> *Elton v. Anheuser-Busch Beverage Group, Inc.* (1996) 50 CA4th 1301

<sup>10</sup> *Montezuma Improvement Co. v. Simmerly* (1919) 181 C 722



An owner who is completely deprived of the use of their property by a trespasser is entitled to recover the **rental value** for the use of the property during the period of the trespass.<sup>11</sup>

For example, a tenant who leases property for the purpose of running a restaurant leaves restaurant equipment on the premises after the lease expires. Due to the presence of the equipment, the owner is unable to use the property. Thus, the owner may recover the rental value of the premises from the former tenant for as long as the equipment remains on the premises.<sup>12</sup>

The amount of money losses recoverable for injuries to the real estate caused by a trespasser is based on either **lost property value** or the **cost of restoring** the property to its condition prior to the trespass. Under most circumstances, an owner of real estate damaged by a trespass is awarded the lesser of the two amounts or a dollar amount most appropriate to cover their loss.<sup>13</sup>

The most straightforward recovery situation arises when a trespasser inflicts an injury to a property which diminishes its value, since the owner simply recovers the amount of the lost property value. For example, an owner may recover the lost value of their property from a neighboring property owner who diverts water across the owner's property, washing away soil and crops.<sup>14</sup>

However, many trespasses involve more than a simple loss in property value. An owner is not required to accept any changes to their property caused by a trespasser without their consent, and may recover **costs of restoration** regardless of any change in the value of the property.

For example, a neighbor builds a road across an owner's property without the owner's consent, destroying a number of trees in the process. The construction of the road actually increases the value of the owner's property, but the owner prefers the trees for their aesthetic value. Thus, the owner is able to recover the reasonable cost of restoring the property to its condition before the trespass, i.e., replacing the trees.<sup>15</sup>

*Reasonable* means the restoration costs needs to be balanced against the lost value **actually suffered** by the owner. In the example above, the owner did not recover the cost of restoring the property to its **exact** condition before the trespass, since the cost to replace trees of the same growth was several hundred thousand dollars more than the value of the real estate itself. The reasonable cost of restoration was limited to planting young trees that will grow over time to the size of the trees destroyed.

Additionally, for an owner to recover money from a trespasser for the restoration of a property to its pre-trespass condition, out-of-pocket money losses need to have actually been spent by the owner on the restoration.<sup>16</sup>

## Money losses of value and rents

<sup>11</sup> Calif. Civil Code §3334(b)

<sup>12</sup> Herond, *supra*

<sup>13</sup> Armitage, *supra*

<sup>14</sup> Salstrom, *supra*

<sup>15</sup> **Heninger v. Dunn** (1980) 101 CA3d 858

<sup>16</sup> Heninger, *supra*

Aside from the money losses sustained by the owner, a trespasser has liability exposure for **punitive losses** when the trespass and resulting property damage is intentional and malicious.<sup>17</sup>

For example, when a property owner's neighbor trespasses and is intentionally malicious, such as trampling flower beds or removing plants from the property, the neighbor is liable for punitive losses, a judicial money award constituting a penalty.<sup>18</sup>

## Injunction to abate a trespass

Besides recovering money losses, an owner may obtain a court ordered **injunction** to stop a person who is a continuing trespasser.

A single isolated trespass is not a basis for an *injunction*. However, if seeking money losses will not prevent a trespass from being repeated in the future, the rightful occupant may obtain an injunction against the trespasser to forbid future trespasses.<sup>19</sup>

## Criminal trespass on refusal to leave

### **misdemeanor**

A lesser crime punishable by a fine and/or county jail sentence.

In addition to liability for property damages, a trespasser may also incur **criminal liability**. Trespassing becomes a **misdemeanor** when the trespasser:

- *refuses to leave the property* on foot or in a vehicle when requested by the owner, the owner's agent, a person in lawful possession of the property or a law enforcement officer acting on a request from the person entitled to possession;<sup>20</sup>
- *enters and occupies the property* without the rightful owner's consent;<sup>21</sup>
- *refuses to leave a transient occupancy* establishment (hotel/motel/vacation property) on the request of the owner or manager;<sup>22</sup>
- *enters a private dwelling*;<sup>23</sup> or
- *enters industrial property* (such as an oil field, a gas or electric plant or a railroad yard) where posted signs forbid trespassing.<sup>24</sup>

A crime is not committed by merely entering another's property, except when the property is a *private residence* or posted *industrial property*.

For example, a group of individuals who camped for one night on an owner's property without the owner's permission are arrested for trespassing at the request of the owner. The owner claims the campers have committed a misdemeanor since they occupied the property without the owner's consent.

<sup>17</sup> CC §3294

<sup>18</sup> *Griffin v. Northridge* (1944) 67 CA2d 69

<sup>19</sup> *Standard Lumber Co. v. Madarys Planing Mill* (1921) 54 CA 107

<sup>20</sup> Calif. Penal Code §602(k), (n)

<sup>21</sup> Pen C §602(m)

<sup>22</sup> Pen C §602(s)

<sup>23</sup> Pen C §602.5

<sup>24</sup> Pen C §554

However, the mere *transient use* of a property for a campsite does not constitute occupation of the property, resulting in a criminal trespass. Criminal occupancy requires an ongoing *continuing possession*. Thus, the campers committed no crime.<sup>25</sup>

An owner's first course of action when confronted with a trespasser is to simply request the trespasser to leave. If the trespasser does not leave when requested, they commit a *misdemeanor*.<sup>26</sup>

An owner may not forcibly eject a trespasser. To discourage disturbances of the peace caused by self-help, California law allows both tenants and trespassers to recover losses from the landlord or property owner for *forcible entry and detainer* — a forcible interference with an individual's peaceful possession of a property, even if that individual's possession is wrongful.<sup>27</sup>

An owner may only recover possession of their property from a trespasser through a court action, except when the trespasser is a *transient occupant* who failed to depart as agreed. The type of action brought to recover property depends on the type of possession held in the property.

For example, the action to recover possession of a property from a tenant in default on their lease obligations is referred to as an **unlawful detainer (UD)**. In the case of a trespasser occupying property, the legal remedy is an **ejectment** action.

*Ejectment* is similar to a UD action but has less stringent proof of trespass requirements. The trespasser in an ejectment action, unlike the tenant in a UD action, never had legal possession of the property for an owner to have the trespasser legally removed.

In an action to eject a trespasser, an owner (or other occupant) needs to prove they have a superior right to possession of the property. The owner may then obtain a court order for the removal of the trespasser from their property, called a **writ of possession**. The court order is carried out by the sheriff, not the owner.<sup>28</sup>

Even when an owner is not troubled by trespassers who are actually using their property, the owner needs to consider their risk of:

- liability for *injuries to others* entering into their property; and
- *losing* some or all of their *property rights* through prescription or adverse possession.

Every property owner needs to take reasonable precautions to prevent injuries to others on their property caused by unsafe conditions since they are liable for injuries occurring on the property.<sup>29</sup>

## Removing trespassers by ejectment

### ejectment

A civil action to recover possession or title to land from someone wrongfully in possession.

## Owner's risk of liability or lost rights

<sup>25</sup> **People v. Wilkinson** (1967) 248 CA2d Supp. 906

<sup>26</sup> Pen C §602(l)

<sup>27</sup> Calif. Civil Code of Procedure §§1159, 1161, 1172

<sup>28</sup> CCP §715.010

<sup>29</sup> CC §1714

Two exceptions to ownership liability exist. A property owner is not liable for injuries to persons using their property when:

- the injuries are sustained during the commission of a felony;<sup>30</sup> or
- the owner permits others to use the property for recreational purposes.

However, the recreational purpose exception does not apply when the property owner:

- invites the users onto their property, rather than merely permits the use;
- charges consideration for entry; or
- intentionally or maliciously fails to warn or protect against a known hazardous condition.<sup>31</sup>

## The prescription in an ongoing trespass

### prescription

A process for acquiring property rights to use another's property, such as an easement, through adverse use hostile to the rights of the owner.

**Prescription** is a process for acquiring property rights to use another's property, such as an easement, through **adverse use** hostile to the rights of the owner.

An adverse user of real estate, hostile to the owner's rights, is a trespasser. When allowed to continue long enough without interruption, a trespass matures into a property right through *prescription*. An owner needs to take steps to avoid the risk of a trespasser establishing permanent prescriptive rights to their property.

One easy solution for an owner is to grant a trespasser a **revocable right** to use their property. When an owner gives **permission** for someone to use their property, the use is not adverse, and thus a prescriptive right to use is not established.

Additionally, an owner may post signs on their property stating the right to pass is by permission, subject to revocation and the control of the owner. No prescriptive easement may be established based on the period of time after the revocable permission signs are posted.<sup>32</sup>

Finally, to best protect their property rights, an owner needs to record a notice stating permission to use their property is revocable.<sup>33</sup>

## Adverse possession and owner inattention

A trespasser who occupies property without the consent of the owner may be ejected by a court order at any time and charged with a misdemeanor.<sup>34</sup>

However, a trespasser can acquire title to the entire property by **adverse possession** when they maintain *exclusive possession* of the property as a

<sup>30</sup> CC §847

<sup>31</sup> CC §846

<sup>32</sup> CC §1008

<sup>33</sup> CC §813

<sup>34</sup> Pen C 602

trespasser for a period of five years. To establish title by adverse possession, the trespasser's possession needs to be open and known to the owner, and the trespasser needs to pay all property taxes.<sup>35</sup>

One safeguard against adverse possession is to grant the wrongful occupant permission to use the property.

However, merely granting permission does not always prevent adverse possession. For example, when possession of a property is based on **color of title** — meaning the occupant has a deed which is defective for some reason and a good faith belief they own the property — granting permission does not affect a claim for adverse possession.

The most prudent remedy against a trespasser seeking to establish adverse possession is an action for ejectment. Conversely, when the trespasser occupies under *color of title*, a **quiet title** action is required to clear title of the cloud created by the color of title. [See Chapter 23]

#### adverse possession

A method of acquiring title to real estate owned by another by openly maintaining exclusive possession of the property for a period of five years and paying all property taxes.

<sup>35</sup> *Gilardi v. Hallam* (1981) 30 C3d 317

A trespass is any wrongful and unauthorized entry onto real estate in the possession of another. A trespasser incurs civil liability for the monetary amount of any losses or injury caused to the occupant's person, real estate or personal property. When no injury has occurred, the occupant may only recover nominal money losses from the trespasser.

A trespasser may incur criminal liability if they do not leave when requested since the trespass becomes a misdemeanor. When a trespasser does not leave when requested, the owner may recover possession of their property through a court action, except when the trespasser is a transient occupant who failed to depart as agreed. The type of action brought to recover property depends on the type of possession held in the property.

Every property owner needs to take reasonable precautions to prevent injuries to others on their property, since they are liable for injuries to others, even trespassers, caused by unsafe conditions on the property. The ownership liability applies whether the injured person is a trespasser or an invited guest on the owner's property.

When allowed to continue long enough without interruption, a trespass matures into a property right through prescription. Prescription is a process for acquiring property rights to use another's property, such as an easement, through adverse use hostile to the rights of the owner.

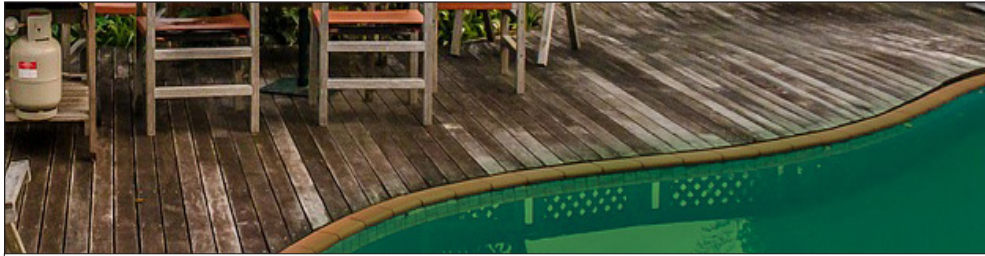
## Chapter 11 Summary

A trespasser can acquire title to the entire property by adverse possession when they openly maintain exclusive possession of the property as a trespasser for a period of five years and pay all property taxes. The most prudent remedy against a trespasser seeking to establish adverse possession is an action for ejectment.

## Chapter 11 Key Terms

<b>actual money losses .....</b>	<b>pg. 108</b>
<b>adverse possession .....</b>	<b>pg. 113</b>
<b>ejectment .....</b>	<b>pg. 111</b>
<b>misdemeanor .....</b>	<b>pg. 110</b>
<b>nominal money losses .....</b>	<b>pg. 108</b>
<b>prescription .....</b>	<b>pg. 112</b>
<b>trespass .....</b>	<b>pg. 107</b>

**Quiz 5 Covering Chapters 10-12 is located on page 445.**



# Nuisance: offensive, unhealthful or obstructive

## Chapter 12

After reading this chapter, you will be able to:

- identify what constitutes a nuisance per se;
- apply the balancing of the rights of neighboring property owners to determine whether a nuisance exists;
- distinguish between a nuisance and trespass; and
- understand the different remedies available in the instance of a permanent or continuing nuisance.

**balancing of the rights**  
**continuing nuisance**  
**nuisance**

**nuisance per se**  
**permanent nuisance**  
**public nuisance**

## Learning Objectives

## Key Terms

A **nuisance** is anything which:

- is *offensive* to the senses;
- is *injurious* to health; or
- *obstructs* the use of property.<sup>1</sup>

Simply, a *nuisance* is any activity which interferes with an owner's **use and enjoyment** of their property, including conditions which are unhealthy or offensive to the senses. A nuisance is broadly interpreted to encompass a wide variety of activities.

Consider a residential landlord who maintains their rental units in an unsafe condition. In addition to the landlord's breach of the implied warranty of

## Interference with use and enjoyment

### nuisance

An action which is injurious to health, offensive to the senses, or obstructs the use and enjoyment of surrounding property.

<sup>1</sup> Calif. Civil Code §3479



habitability, the tenants may also pursue an action against the landlord for maintaining a nuisance by failing to care for the units. In this instance, the landlord is liable to the tenant for their losses, including relocation expenses.<sup>2</sup>

A nuisance does not need to be offensive to the senses or injurious to health. A nuisance only needs to interfere with the *use and enjoyment* of a property right in some physical manner.

Neighboring property owners inevitably create some degree of *annoyance or inconvenience* for each other, but not every annoyance rises to the level of a nuisance.

Consider an owner of a business operating on premises located next to an airport. Above-ground fuel storage tanks are located on the airport property approximately 500 feet from the business premises.

The business owner claims the tanks are a nuisance since the owner fears they will die if the tanks rupture or explode due to an accident, and that fear interferes with their use and enjoyment of their property.

However, the proximity of the fuel storage tanks is not a nuisance. An occupant's fear of future invasion does not constitute a present physical interference with their use and enjoyment of their land.<sup>3</sup>

#### nuisance per se

Any activity specifically declared by statute to be a nuisance, such as construction of fences of excessive height or the illegal sale of controlled substances.

#### balancing of the rights

A determination of whether a nuisance exists when an activity is not classified as a nuisance per se.

An activity becomes a nuisance based on either:

- a statutory provision identifying conduct that is a **nuisance per se**; or
- a **balancing of the conflicting rights** and interests of the neighboring property owners.

## Nuisance per se by statute

A *nuisance per se* is any activity specifically declared by statute to be a nuisance. When an activity is a statutory nuisance, it is ordered stopped by a court without proof of its harmful or offensive effect.

The list of nuisances per se is wide and diverse, including:

- fences of excessive height unnecessarily exceeding ten feet, called **spite fences**;<sup>4</sup>
- the illegal sale of controlled substances;<sup>5</sup>
- fire hazards;<sup>6</sup> and
- swimming pools which do not comply with statutory health and safety standards.<sup>7</sup>

Conversely, some activities are declared by statute not to be nuisances.

<sup>2</sup> **Stoiber v. Honeychuck** (1980) 101 CA3d 903

<sup>3</sup> **Koll-Irvine Center Property Owners Association v. County of Orange** (1994) 24 CA4th 1036

<sup>4</sup> CC §841.4

<sup>5</sup> CC §3479

<sup>6</sup> Calif. Public Resources Code §4171

<sup>7</sup> Calif. Health and Safety Code §116060

Activities done or maintained under the express authority of a statute, called *statutory authority*, are not nuisances. For example, the activities of a commercial agricultural processing plant are maintained under statutory authority and do not constitute a nuisance.<sup>8</sup>

To determine whether a nuisance exists when an activity is not classified as a nuisance per se, a *balancing of the rights* of the neighboring property owners is applied.

Every owner is entitled to use their property for any lawful purpose. However, an owner is limited in their conduct since their permitted use may not unreasonably interfere with the right of others to use and enjoy their property.<sup>9</sup>

An owner's use of their property often creates some degree of inconvenience for the occupants of neighboring properties. However, to constitute a nuisance, the inconvenience created by an owner's use must be serious enough to be an *improper interference* with another's use and enjoyment of their property.

Whether an activity is a nuisance is determined on a case-by-case basis. An activity which is a nuisance in one set of circumstances may not be a nuisance in another, depending on:

- the frequency and time of day of the activity;
- the number of inhabitants in the area; and
- the injury or inconvenience caused to occupants of surrounding property by the activity.<sup>10</sup>

For instance, the typical day-to-day use of a family-occupied residence inevitably creates noise which is audible to the neighbors. However, production of family noise, within reasonable limits, is not a nuisance.

Consider a homeowner who constructs a basketball court in his backyard for recreational use. The court is only used during the afternoon and never for more than one hour on any day.

The owner's neighbor complains of the noise from the basketball games and claims the owner is maintaining a nuisance. The neighbor seeks an injunction to prevent the owner from playing basketball on his court.

In this instance, the owner's use of the basketball court is well within reasonable limits. Basketball noise, so long as it is not excessive, is not a nuisance. Thus, an injunction to abate reasonable amounts of game noise cannot be obtained by the neighbor.<sup>11</sup>

**Balancing  
rights:  
inconvenient  
or improper**

<sup>8</sup> CC §§3482, 3482.6

<sup>9</sup> CC §3514

<sup>10</sup> *McIntosh v. Brimmer* (1924) 68 CA 770

<sup>11</sup> *Schild v. Rubin* (1991) 232 CA3d 755

## Nuisance vs. trespass

**Nuisance** and **trespass** are closely related. The two categories overlap since both involve injury to or interference with the property rights of another. The distinction is based on whether a physical entry onto another's property occurs.

Trespass requires a physical entry on another's property which may be direct or indirect — i.e., the trespasser may either personally enter the property or deposit materials indirectly, such as dirt and debris from construction activity.

In contrast, a nuisance is an outside interference with an owner's or tenant's use and enjoyment of their property resulting from a condition or activity which physically remains outside the property.

Thus, **trespass** is based on an interference with the possession. A **nuisance** is an interference with the enjoyment of property since it affects the senses of the occupants.

For instance, noise is a nuisance to occupants of another property when the noise is loud, annoying and continuous. Noise is not a trespass since no physical invasion of property occurs, except for sound waves which affect the senses, not the property. The noise creates no interference with the possessory rights in another's property and thus is not a trespass. [*Wilson v. Interlake Steel Company* (1982) 32 C3d 229]

However, the distinction between nuisance and trespass does not mean the categories are mutually exclusive. Nuisance is broadly defined by statute as anything which is injurious to health or obstructs the use of property, regardless of whether the condition exists on or off the affected property. Thus, an invasion of property which qualifies as a trespass is also a nuisance when the trespass rises to an unhealthful or offensive condition.

In a similar case with the opposite outcome, basketball playing was enjoined as a nuisance since very noisy and rancorous games were repeatedly carried on late at night.<sup>12</sup>

## Public vs. private nuisance

### public nuisance

A nuisance affecting an entire segment of the public.

A nuisance may be a **public nuisance**, a **private nuisance** or both.

A **public nuisance** is a nuisance which affects an entire segment of the public, such as a neighborhood.<sup>13</sup>

Stopping a public nuisance is the responsibility of state or local government authorities.

Officials may seek to:

- *abate* or *enjoin* the nuisance;
- recover *money damages*; or
- bring *criminal misdemeanor charges* against the offender responsible for the nuisance.<sup>14</sup>

A private property owner may not stop a public nuisance unless the public nuisance especially obstructs the owner's use of their property, making the interference a *private nuisance* as well.<sup>15</sup>

<sup>12</sup> *Alexander v. McKnight* (1992) 7 CA4th 973

<sup>13</sup> CC §3480; Calif. Penal Code §370

<sup>14</sup> Pen C §372

<sup>15</sup> CC §3493

For a private owner to abate a public nuisance by an injunction, they need to sustain injuries to themselves or their property which are *different in kind* from the interference or injuries sustained by the public at large.

A difference in the **degree of interference** alone does not make a public nuisance a private nuisance.<sup>16</sup>

The remedies for a public or private nuisance are:

- **abatement**, by suppression or termination of the interference;<sup>17</sup> and
- an **injunction** and **money losses** in a civil action.<sup>18</sup>

An owner has the right to take self-help actions to end a private nuisance affecting their property when they are able to do so without creating a disturbance of the peace or causing injury.<sup>19</sup>

For instance, *self-help abatement* of a private nuisance occurs when an owner cuts off the limbs of a neighbor's tree which encroach onto the airspace of their property.

A civil action to end a nuisance involves seeking an injunction to stop the activity or condition creating the nuisance, *money losses* from those responsible for the nuisance, or both.

The money losses an owner seeks to recover for a neighbor's nuisance are based on either:

- actual money losses for injury or loss of value to the owner's real estate, or for injury to the owner; or
- *intangibles*, such as emotional distress and personal discomfort.

For example, a homeowner affected by noxious odors emanating from a neighboring sewage treatment plant may recover money losses based on:

- diminution in the property's value caused by the odors; and
- personal discomfort resulting from the odors, including nausea and burning eyes.<sup>20</sup>

Additionally, an owner may recover **punitive losses** for the willful or malicious creation of a nuisance.

Consider a homeowner's neighbor who uses their property for the excavation of sand and gravel.

The owner fears the neighbor's excavation will damage their property due to the lack of lateral support and complains to the neighbor. Also, the city informs the neighbor the excavation violates zoning laws. The neighbor continues the excavation despite the protests.

## Remedies of suppression or money

<sup>16</sup> *Venuto v. Owens-Corning Fiberglas Corporation* (1971) 22 CA3d 116

<sup>17</sup> CC §3495

<sup>18</sup> CC §3501, 3493

<sup>19</sup> CC §3502

<sup>20</sup> *Varjabedian v. City of Madera* (1977) 20 C3d 285

After a portion of the owner's property subsides due to the neighbor's excavation, the owner sues the neighbor for maintaining a nuisance.

In addition to their money losses for the diminished value of their property, the owner recovers punitive losses. The neighbor continued excavating after the owner and the city complained, and had full knowledge of the potential damage they might inflict on the owner's property.<sup>21</sup>

Once a nuisance is **fully abated**, the property subjected to the nuisance is freed from any *loss in value*. Thus, the basis for calculating the recovery of money for the pre-existing nuisance no longer exists since the nuisance no longer exists.

Consider an owner of real estate who discovers a contamination from a neighboring property has intruded into their property. The contamination is a nuisance which is fully abatable since it can be cleaned and completely removed from the property.

The owner claims they are entitled to recover the future loss of the property's market value from the neighbor since a stigma will remain with the property after the contamination is removed.

However, the owner is unable to recover any loss of market value since the *nuisance* which impaired their property will no longer exist once the contamination is fully removed.<sup>22</sup>

## Remedies held by local government

Any public body or officer authorized by law may take steps to abate a public nuisance.<sup>23</sup>

When an agency succeeds in any action or proceeding against an owner of real estate to abate a nuisance, the owner responsible for the nuisance is liable to the agency for their **costs of abatement**, including administrative costs, abatement expenses and court costs.<sup>24</sup>

Additionally, the owner is liable for the agency's attorney fees when a local ordinance allows for recovery of attorney fees in an action to abate a nuisance.<sup>25</sup>

A local governmental agency may choose one of two methods to collect abatement expenses from an owner of real estate:

- record a *nuisance abatement lien* against the property for the amount of the abatement expenses;<sup>26</sup> or
- add the abatement expenses to the property's tax bill as a *special nuisance abatement tax assessment*.<sup>27</sup>

<sup>21</sup> *McIvor v. Mercer-Fraser Co.* (1946) 76 CA2d 247

<sup>22</sup> *Santa Fe Partnership v. Arco Products Company* (1996) 46 CA4th 967

<sup>23</sup> CC §3494

<sup>24</sup> Calif. Government Code §25845(b)

<sup>25</sup> Gov C §25845(c)

<sup>26</sup> Gov C §38773.1

<sup>27</sup> Gov C §38773.5(a)

A nuisance abatement lien may be foreclosed by a governmental agency as a judgment lien.<sup>28</sup>

Should a nuisance abatement tax assessment remain unpaid for three years, the assessed property may be sold by the tax collector.<sup>29</sup>

The type of money losses an owner may recover for property damage caused by a nuisance depends on whether the nuisance is *permanent* or *continuing*. A **permanent nuisance** exists when the nuisance cannot be abated at a reasonable cost and by reasonable means.<sup>30</sup>

Conversely, a **continuing nuisance** exists when the nuisance can be reduced or terminated at any time and at a reasonable expense.

The money losses inflicted by a *permanent nuisance* are determined at the time the permanent nuisance is created. Losses inflicted by a *continuing nuisance* are limited to the actual injuries suffered prior to termination of the nuisance.<sup>31</sup>

A permanent nuisance cannot be abated at a reasonable expense or by reasonable means. Thus, an owner's only remedy is a recovery of money losses. The money losses are calculated based on the diminished value of the owner's property caused by the nuisance.

For instance, a building on a neighbor's property **encroaches** on the adjacent owner's property. The *encroachment* is a permanent nuisance since it perpetually obstructs the use and enjoyment of the owner's property and cannot be removed at a reasonable cost to the neighbor.

In balancing the rights of the adjacent owner and the encroaching neighbor, the cost to the neighbor to abate the nuisance by removing the encroaching improvements far exceeds the loss of the owner's use. Thus, the owner is entitled to monetary compensation for the lost use of the portion of their property hindered by the encroachment, but cannot abate the encroachment itself.<sup>32</sup>

In the case of a permanent nuisance, an owner may recover *money losses* equal to the permanent decline in the property's value caused by the nuisance.

However, recovery for a continuing nuisance may not include lost property value since the nuisance can be entirely eliminated. The condition causing the diminished value no longer exists once the nuisance is removed. Thus, no permanent loss in value occurs to be recovered.<sup>33</sup>

#### **permanent nuisance**

A nuisance which cannot be abated at a reasonable cost and by reasonable means.

## **Permanent or continuing nuisance**

#### **continuing nuisance**

An ongoing nuisance that can be entirely eliminated by those adversely affected by the activity or condition.

## **Permanent nuisance remedies**

## **Continuing nuisance remedies**

<sup>28</sup> Gov C §38773.1(c)(3)

<sup>29</sup> Gov C §38773.5(c)

<sup>30</sup> **Mangini v. Aerojet-General Corporation** (1996) 12 C4th 1087

<sup>31</sup> **Spar v. Pacific Bell** (1991) 235 CA3d 1480

<sup>32</sup> **Christensen v. Tucker** (1952) 114 CA2d 554

<sup>33</sup> Alexander, *supra*

The primary remedy for a continuing nuisance is an *abatement* to remove the nuisance or an *injunction* ordering the nuisance to be stopped.

In addition to an injunction, other money losses which may be recovered by the owner are limited to:

- the lost use of the property until the nuisance is abated, such as rental value;
- the costs incurred to remedy the damage done by the nuisance to the owner's real estate;
- the cost of cleanup or repairs necessary to eliminate the nuisance; and
- any expenses incurred due to personal injury or emotional distress caused by the nuisance.

### Statute of limitations on recovery

Under the applicable statute of limitations, an action on a permanent nuisance needs to be brought within **three years** after the nuisance becomes permanent.

In the case of a continuing nuisance, a new cause of action accrues and the three-year statute of limitations begins to run anew each day the nuisance continues, or when further damage is inflicted on the property.

## Chapter 12 Summary

A nuisance is anything which is offensive to the senses, injurious to health or obstructs the use of property.

A nuisance per se is any activity specifically declared by statute to be a nuisance. Conversely, when an activity is not a nuisance per se, a balancing of the rights of neighboring property owners is applied to determine whether a nuisance exists.

A nuisance may be classified as public or private. A public nuisance affects an entire segment of the public and is the state or local government's responsibility to stop. An owner may take actions to reduce or end a private nuisance affecting their property when they are able to do so without creating a disturbance of the peace, called self-help abatement.

The type of money losses an owner may recover for property damage caused by a nuisance depends on whether the nuisance is permanent or continuing. For permanent nuisances, the owner may be entitled to money losses based on the diminished value of the owner's property caused by the nuisance. Recovery for a continuing nuisance may not include lost property value since the nuisance can be entirely



eliminated. The primary remedy for a continuing nuisance is an abatement to remove the nuisance or an injunction ordering the nuisance to be stopped.

<b>balancing of the rights .....</b>	<b>pg. 116</b>
<b>continuing nuisance .....</b>	<b>pg. 121</b>
<b>nuisance.....</b>	<b>pg. 115</b>
<b>nuisance per se .....</b>	<b>pg. 116</b>
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## Chapter 12 Key Terms

**Quiz 5 Covering Chapters 10-12 is located on page 445.**

*Notes:*



# Easements: running or personal

## Chapter 13

After reading this chapter, you will be able to:

- understand the tenement relationship between two parcels of real estate created by an easement;
- distinguish an appurtenant easement, which belongs to land, from an easement in gross, which belongs to an individual; and
- comprehend different easements for air, light, view, sun or conservation.

**appurtenant easement**

**conservation easement**

**dominant tenement**

**easement**

**easement for ingress and egress**

**easement in gross**

**servient tenement**

**solar easement**

## Learning Objectives

## Key Terms

An **easement** is the right of one property owner *to use* the property of another.

The most common *easement* is used for **ingress and egress**. An easement for *ingress and egress* creates a right of way allowing one property owner to traverse a portion of another's land to access their property.

Consider a right-of-way easement which is maintained as a road over an owner's property. The easement provides **access** through the owner's property from a public street to an adjoining neighbor's property.

The owner builds a fence on their entire property line, blocking the neighbor's use of the road and access to the public street in the process.

## Rights in another's property

### **easement**

The right to use another's property for a specific purpose.

### **easement for ingress and egress**

A type of easement granting one property owner the right to traverse a portion of another's land to access the property.

The neighbor with the property benefitting from the easement claims their easement gives them the right to use the roadway across the owner's property, a use the owner may not interfere with by fencing the perimeter of their property and barring the neighbor's use of the easement.

The neighbor demands the unobstructed use of the road and seeks to recover money losses incurred due to the owner's obstruction.

Is the owner wrongfully blocking the neighbor's use of the road?

Yes! The neighbor in title to the adjacent property holds a valuable **property right** in the owner's property which entitles the neighbor to use the right-of-way easement, classified as an *appurtenance* to the neighbor's property and an encumbrance on the owner's title.

When an owner whose property is burdened by an easement interferes with the use of the easement by a neighbor whose property benefits from the easement, the neighbor is entitled to have the use of the easement reinstated, either by removal, relocation or modification of the interference.

Further, the neighbor who holds the easement is entitled to compensation for their money losses caused by the owner's obstruction of the neighbor's use of the easement.<sup>1</sup>

#### **dominant tenement**

The property benefitting from an easement on a servient tenement.

#### **servient tenement**

A property burdened by a license or easement.

## Benefits and burdens of ownership

An easement creates a *tenement relationship* between two parcels of real estate since it:

- *benefits* one property, referred to as the **dominant tenement**, whose owner is entitled to use the easement; and
- *burdens* another property, referred to as the **servient tenement**, the owner's use of their property being subject to the easement.

## Appurtenant or in gross: does it run?

An easement burdening an owner's property as an *encumbrance on title* to that property is classified as either:

- an **appurtenant easement**, since the use allowed belongs to and benefits an adjacent property and *runs with the land* as a property interest held in the burdened real estate; or
- an **easement in gross**, which belongs to an individual, not another parcel of real estate, as their *personal right* in the burdened real estate.

For example, a development company sells parcels in a subdivision, reserving a right-of-way easement over each of the parcels. The deed creating the easement does not state the easement is *appurtenant* to other parcels.

Later, the successor to the developer attempts to build a road on the easement. The owners of the burdened property claim the easement is *in gross*, a benefit held only by the original developer.

#### **appurtenant easement**

A type of easement which is incidental to the ownership and belongs to the property which benefits from its use.

#### **easement in gross**

An easement which belongs to an individual and is not appurtenant to a property.

<sup>1</sup> **Moylan v. Dykes** (1986) 181 CA3d 561

Is the easement in gross (personal) since the grant deed does not specify the easement is appurtenant?

No! When the document creating an easement does not indicate whether the easement is appurtenant or in gross, the easement is classified as *appurtenant* if it **benefits a property** other than the burdened property.<sup>2</sup>

An *appurtenant easement* is incidental to the title of the property which benefits from its use. However, an easement is not reflected as a recorded interest on the title to the parcel of real estate it benefits. Nor is it a personal right held by a particular individual who may now or have previously owned the parcel benefitting from the easement.

Conversely, an appurtenant easement benefitting one parcel is recorded as an **encumbrance** on title to the burdened property. The easement remains on the burdened property's title after a conveyance to new owners of either the benefitting or burdened property. To be enforceable by a new owner of the benefitting property, the easement does not need to be referenced in the grant deed conveying either property to new owners since it *runs with the land*.<sup>3</sup>

Conversely, an *easement in gross* benefits a particular person – not any real estate the person might own. An easement in gross is personally held only by the individual who may use the easement. No parcel of real estate may benefit from an easement in gross since only the individual holding the easement may benefit.

For example, an easement held by a public utility company is an easement in gross. The utility company has the right to enter onto a property to install and maintain its equipment (power lines, gas or water pipes, etc.). In no way does any real estate owned by the utility company benefit from the easement.

While an easement in gross is a **personal right** which is not transferred with the sale of any real estate owned by the holder of the easement, the right may be *transferred* by the easement holder to another person by a writing — unless the transfer of the easement in gross is prohibited by a provision in the document creating the easement.<sup>4</sup>

A property owner has no automatic right, and may not acquire a *prescriptive right*, to air, light or an unaltered view over neighboring properties.

However, a property owner may enforce an easement created by a grant which restricts a neighbor's ability to erect or maintain any improvement which interferes with the owner's right to air, light or view. The easement might be the result of **covenants, conditions and restrictions (CC&Rs)** which blanket several properties with use restrictions, such as restrictions on the height of improvements.

**Runs with  
title to the  
benefitting  
property**

**Easements  
for light, air  
or view**

<sup>2</sup> *Elliot v. McCombs* (1941) 17 C2d 23

<sup>3</sup> Moylan, *supra*

<sup>4</sup> *LeDeit v. Ehlert* (1962) 205 CA2d 154

Consider a seller who conveys one of several parcels of real estate they own to a buyer – before the invention of television. The seller retains ownership of an adjoining parcel improved with an apartment complex. The seller, by a provision in the grant deed conveying the parcel, **reserves an easement** for light, air and an unobstructed view over the parcel conveyed to the buyer.

Later, the buyer of the burdened property erects a television antenna. The seller, as the owner of the adjacent apartment complex, demands the buyer remove the antenna, claiming the antenna interferes with the unobstructed view easement the seller reserved.

The buyer claims the seller did not intend to preclude the use of a television antenna since the easement was created before the invention of television.

Is the buyer obligated to remove the antenna from the space established as a view easement?

Yes! The easement precludes the buyer of the burdened property from erecting or maintaining **any type of improvement** obstructing the seller's (the apartment complex owner's) right to light, air or view.<sup>5</sup>

Easements for light, air and view can only be established by *written agreement* between neighboring owners, not by implication or prescription.<sup>6</sup>

## Solar easements and shady neighbors

### solar easement

An easement restricting an owner's ability to maintain improvements interfering with a neighbor's solar energy system.

A relatively recent type of easement is the **solar easement**. *Solar easements* were established with the intent of encouraging the productive use of solar energy systems as a matter of public policy.

A solar easement granted in a written instrument needs to state:

- the measured angles by which sunlight has to pass;
- the hours of the day during which the easement is effective;
- the limitations on any object which impairs the passage of sunlight through the easement; and
- the terms for terminating or revising the easement.<sup>7</sup>

Solar easements are similar to easements of light, air or view since they restrict an adjacent property owner's ability to maintain any improvements interfering with a neighbor's solar energy system.

Consider a recorded restrictive covenant which limits the height of improvements on parcels within a housing development. A property owner's tree exceeds the height limitation and a neighbor successfully enforces the restrictive covenant requiring the owner to maintain the tree below the designated height.

<sup>5</sup> **Petersen v. Friedman** (1958) 162 CA2d 245

<sup>6</sup> Petersen, *supra*

<sup>7</sup> Calif. Civil Code §801.5

In this instance, when the neighbor installs a solar collector on their property, they receive an incidental benefit from the height restriction since it limits the height of improvements on other parcels which hinder the passage of sunlight to their solar collector.<sup>8</sup>

Also, a neighboring property owner who installs an *active solar collector* is, by their conduct, granted a solar easement across adjacent properties under the **Solar Shade Control Act** without the need for a writing. The adjacent property owner may not later plant and maintain trees or shrubs which between 10 a.m. and 2 p.m. (standard time) shade an **active solar collector** previously installed by a neighboring property owner.<sup>9</sup>

For easements created on an owner's property by a neighbor's conduct under the Solar Shade Control Act, trees or shrubs growing on the owner's property prior to the neighbor's installation of a solar collector may remain and are not subject to height restrictions. They were in place before the neighbor's solar collector was installed. Thus, no height limit on preexisting trees or shrubs exist, unless established by a recorded height restriction on improvements.<sup>10</sup>

Additionally, when a tree or shrub has been growing before a neighbor installs an active solar collector, the owner of the property containing the tree or shrub may replace it if it dies after the solar collector is installed.<sup>11</sup>

A **conservation easement** is a voluntary conveyance of the right to keep the land in its natural, scenic, historical, agricultural, forested or open-space condition. It is conveyed by an owner of real estate to a conservation organization or government agency. A *conservation easement* is created in the form of an easement or CC&R, by use of a deed, will or other instrument to convey the easement.<sup>12</sup>

Conservation easements are *perpetual* in duration and thus are binding on all successive owners of the property burdened by the conservation easement.<sup>13</sup>

Conservation easements may only be granted to organizations established to acquire and hold a conservation easement, such as:

- a tax-exempt, nonprofit organization qualified to do business in the State of California whose primary purpose is to preserve, protect or enhance land in its natural, scenic, historical, agricultural, forested or open-space condition or use;
- a state or a governmental entity authorized to acquire and hold title to real estate, as long as the conservation easement is voluntarily conveyed; and
- a federally recognized California Native American tribe or a non-federally recognized California Native American tribe on the contact list of the Native American Heritage Commission.<sup>14</sup>

## Conservation easements

### conservation easement

A voluntary conveyance of the right to keep land in its natural or historical condition to a conservation organization or government agency.

<sup>8</sup> *Ezer v. Fuchsloch* (1979) 99 CA3d 849

<sup>9</sup> Calif. Public Resources Code §25982

<sup>10</sup> Pub Res C §§25980 et seq.

<sup>11</sup> Pub Res C §25984

<sup>12</sup> CC §815.1

<sup>13</sup> CC §§815.1, 815.2(b)

<sup>14</sup> CC §815.3



Consider a conservation easement recorded by the California Coastal Commission (Commission) on a parcel of real estate in an environmentally sensitive area. The owner of the parcel later builds a highly visible three-hole golf course on the property without notifying the Commission, violating the conservation easement.

Twenty years later, the owner sells the property to a buyer without disclosing the existence of the conservation easement. The title insurance company also does not reveal the easement to the buyer.

On discovering the existence of the golf course on the property protected by the conservation easement, the Commission orders the buyer to return the property to its natural state. The buyer refuses, claiming the Commission is prohibited, or *estopped*, from enforcing the easement since the Commission failed to act on the long-standing violation when the prior owner built the golf course, leading the buyer to believe no violation existed. The Commission claims it is not estopped from enforcing the conservation easement since its inaction was based on the belief the parcel was in compliance.

Can the buyer be forced to comply with the conservation easement even though they were not actually aware of its existence?

Yes! The Commission's inaction was based on the belief the parcel was in compliance with the easement, not an intent to mislead the buyer. Additionally, the public interest in the recorded and registered conservation easement supersedes the buyer's right to maintain a golf course on their property.<sup>15</sup>

*Editor's note — The title insurance company and the prior owner may be liable to the buyer for the loss of value caused by the undisclosed easement.*

## Public registry for conservation easements

Conservation easements held by the state are listed in a central public registry maintained by the Secretary of the Natural Resources Agency.

Information available on each conservation easement listed in the registry includes:

- the county recorder's document number;
- the date the easement was recorded;
- the purpose of the easement;
- the location of the easement, identified by county and nearest city;
- the identity of the easement holder; and
- the size of the easement in acres.

This registry is available to the public at <http://easements.resources.ca.gov/> and updated biennially.

<sup>15</sup> *Feduniak v. California Coastal Commission* (March 27, 2007) 148 CA4th 1346

An easement is the right of one property owner to use the property of another. An easement creates a relationship between two parcels of real estate as it benefits one property whose owner is entitled to use the easement, and burdens another property subject to the easement.

An easement is classified as either an appurtenant easement or an easement in gross. An appurtenant easement belongs to and benefits adjacent property and runs with the land. An easement in gross belongs to an individual, not land, and is a personal right.

Property owners may hold an easement restricting a neighbor's ability to interfere with the owner's right to air, light or view. Specifically, solar easements restrict an owner's ability to maintain any improvements interfering with a neighbor's solar energy system.

A conservation easement is a voluntary conveyance of the right to keep land in its natural, historical, or open-space condition to a conservation organization or government agency.

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## Chapter 13 Summary

## Chapter 13 Key Terms

**Quiz 6 Covering Chapters 13-14 is located on page 446.**

*Notes:*



# Creating an easement

## Chapter 14

After reading this chapter, you will be able to:

- understand how an easement is created in favor of one parcel of real estate and as a burden on another parcel;
- apply the requirements for establishing an implied easement and an easement of necessity;
- differentiate between reservations and exceptions when retaining interests on the conveyance of a parcel; and
- distinguish a prescriptive easement from a claim of adverse possession.

**bona fide purchaser (BFP)**  
**easement by necessity**

**implied easement**  
**prescriptive easement**

### Learning Objectives

### Key Terms

The basic method for creating an **easement** is by a writing. Any document which may be used to convey a legal interest in real estate may be used to create an easement.

An easement is created between the *benefitting* and *burdened* properties in a(n):

- easement agreement;
- will;
- grant deed;
- easement deed;
- quitclaim deed;
- lease;

### By grant, reservation or implication

- order of the court; or
- *covenants, conditions and restrictions (CC&Rs)*.

An easement is created in a conveyance either by:

- **grant**; or
- **reservation**.

For example, the owner of adjacent parcels of real estate may sell one parcel to a buyer and further *grant* the buyer an easement on the parcel retained by the owner.

Alternatively, an owner of adjacent parcels may sell a parcel, and in the grant deed conveying the parcel to the buyer, *reserve* to themselves an easement on the sold parcel for the benefit of the parcel the owner retained.

### Creative wording and certainty of purpose

Whether an easement is created by grant or reservation, uncertainties due to **omissions** and **ambiguities** in the words used to create the easement are often the cause of most disputes involving easements. To avoid uncertainties and thus disputes, the instrument creating the easement needs to fully state:

- the names of the grantor and grantee of the easement;
- a description of the parcel of real estate burdened by the easement;
- the legally described location on the burdened parcel of the easement granted or reserved by exception in a conveyance;
- the intended use for the easement; and
- whether the easement is *appurtenant* or *in gross*.

### Easement or fee title conveyed by deed

The terms “*reservation*” and “*exception*” in conveyances of real estate are used to distinguish whether the legally described reservation (easement) or exception (ownership) is:

- created as a burden on the property conveyed for the beneficial use of another property, such as an **easement by reservation**; or
- retained from the parcel conveyed as property of the seller, an *exception for land* which is not transferred on the conveyance of a portion of a larger parcel.

The terms “*reservation*” and “*exception*” are often mistakenly and thus improperly used interchangeably. However, their meanings and operative effects are very different.

For example, when a grantor conveys one of two adjoining parcels they own, **reserving** the **right to use** a road on the property conveyed, the grantor has created an *easement by reservation*. Here, the entire parcel was conveyed while imposing a burden on that property in the nature of an easement.

In contrast, when the grantor conveys the parcel noting the description of the portion of the parcel where the road is located is excepted from the conveyance, they have not conveyed title and retains ownership to the portion of the parcel described as the road.

The difference between a reservation and an exception is apparent in the manner title insurance companies write a policy on the transfer of title.

When a parcel is conveyed *reserving* a road, the title insurance policy insures title to the entire parcel, then states the title is subject to — encumbered by — the easement created by the reservation.

Alternatively, when a parcel is conveyed *excepting* the legal description of the road, the portion of the parcel described as the location of the road is not part of the legally described property conveyed and covered by the title insurance policy. The excepted portion did not become the buyer's property. The road did not become an easement burdening the portion of the parcel conveyed since it is located on the property cut out of the parcel by the exception. The seller retains fee ownership of the described portion containing the road since it was an exception from the parcel conveyed.

Consider a subdivider who sells a parcel of real estate to a buyer, “saving and excepting” a strip of the parcel for use as a future road.

The subdivider later claims they may build a railroad on the strip since the strip is their property, having been excepted from the legal description of the neighboring owner's parcel.

The buyer of the parcel containing the strip claims the subdivider may not build a railroad on the strip since it is reserved as a roadway easement.

Did the subdivider except the strip and thus retain ownership to the roadway portion of the parcel sold?

No! The subdivider's deed describing the roadway strip as an exception with the further reference to the **use of the exception** for roadway purposes creates an *ambiguity*. The ambiguity establishes an uncertainty as to whether or not fee title was retained by the subdivider.

When an ambiguity exists as to whether the seller has reserved an easement or excepted a portion of the property from the sale, the seller is presumed to have conveyed all the property and created an easement by reservation. Thus, a roadway easement exists since title to a portion of the parcel was not retained as a fee ownership exception in the conveyance.<sup>1</sup>

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<sup>1</sup> Coon v. Sonoma Magnesite Co. (1920) 182 C 597

## Conduct creates an implied easement

### implied easement

An easement created by the conduct of parties without prior agreement.

An easement can be created by conduct without any prior agreement between the owner and the user, called an **implied easement**.

*Implied easements* exist when the circumstances surrounding an owner's division of their property and sale of a portion of the property imply the owner (grantor) and the buyer (grantee) intended either:

- the grant of an easement on the portion retained by the owner; or
- the reservation of an easement by the owner on the portion sold.<sup>2</sup>

The requirements for establishing an implied easement are:

- a prior *common ownership* of adjoining parcels;
- a *transfer of one* of the adjoining parcels;
- an obvious and apparent *prior use* of one parcel for the benefit of the other parcel during the period of common ownership; and
- a *reasonable necessity* for creating the easement.<sup>3</sup>

## Prior common ownership of parcels

A transfer of one of two or more adjoining parcels by a **common owner** is required to create an implied easement.

For example, an implied easement may arise when a **co-ownership** of a property is terminated and the property is divided and parceled out to the individuals who were the co-owners.

Additionally, an implied easement may arise on the distribution of property under a will or trust.

For example, a beneficiary receives a parcel of real estate which is accessible only by a road over an adjoining parcel conveyed to another beneficiary under a will or *inter vivos (living) trust* which does not provide for an easement.

In this scenario, a right-of-way easement is created by implication since the common ownership of the adjoining parcels is the estate or trust.<sup>4</sup>

## Division by transfer

An owner of property who uses a portion of their property for the benefit of another portion of the same property does not create an easement on their own property.

An easement is a right to **use another's land** or **prevent another** from a particular use of the owner's land. Thus, an owner cannot hold an easement over their own land.<sup>5</sup>

Only the division of commonly owned parcels by the transfer of a parcel triggers the creation of an implied easement.

<sup>2</sup> Calif. Civil Code §1104; *Palvutjian v. Terkanian* (1920) 47 CA 47

<sup>3</sup> *Greene v. Fickert* (1942) 49 CA2d 511

<sup>4</sup> *Cheda v. Bodkin* (1916) 173 C 7

<sup>5</sup> CC §805



The prior use of one parcel for the benefit of an adjacent, commonly owned parcel needs to be *obvious* and *permanent* for the new owner on the transfer of one of the parcels to establish the right to an implied easement to use the other parcel.

To establish an implied easement, the **prior use** by the common owner needs to have been:

- either *known* to both the common owner (original grantor) and the buyer (grantee), or so obvious their knowledge may be presumed;
- *regularly used* during the common ownership before the transfer; and
- *intended* to be permanent.

The purpose for creating an implied easement is to establish the right to continue an existing use a buyer and seller intend to permanently maintain, but fail to mention.

Thus, an implied easement is not created when the common owner of adjacent parcels and the buyer of one parcel do not intend for an easement to exist on the adjoining parcels.

For example, a subdivider sells a parcel. The subdivider retains an adjacent parcel which has a heating plant with heat and water pipes running to the parcel sold.

At the time of the sale, the subdivider and the buyer enter into a service agreement providing for the buyer to receive the heat and water in exchange for payment of a service fee.

Later, the subdivider refuses to allow the buyer the continued use of the heat and water pipes on the subdivider's property.

The buyer seeks to establish an easement for the use of the pipes claiming an implied easement was created on the transfer of the parcel to the buyer by the subdivider.

Has an implied easement been created?

No! Although the criteria for an implied easement appears to be present, the written agreement charging a **fee for the use** of the pipes between the subdivider and buyer indicates the permanent benefits of an implied easement appurtenant to the property sold were not intended.<sup>6</sup>

For an implied easement to exist, the easement must be *reasonably necessary* for the beneficial use of the parcel whose owner is seeking to establish the easement.

Consider an owner who sells and conveys a parcel containing a driveway. The owner uses the driveway to access an adjoining parcel they own which is improved by their residence. The owner does not reserve an easement for use of the driveway in the conveyance to the buyer.

## Beneficial use of commonly owned parcels

## Reasonable necessity

<sup>6</sup> Warfield v. Basich (1958) 161 CA2d 493

The owner's residence fronts on a public road. The driveway through the buyer's parcel is the only improved access to the owner's home. The cost of building a road for access to the public road is a reasonable amount for the value of the residence.

On closing, the buyer refuses to allow the owner to use the driveway over the parcel sold to the buyer.

The owner claims they are entitled to an *implied easement* over the parcel sold to the buyer since, prior to the sale, the driveway provided access to the adjoining property they retained.

The buyer claims the owner is not entitled to an implied easement since they can build a new driveway to the public road.

Is the owner entitled to an implied easement to use the buyer's driveway?

No! An implied easement (by reservation) is not reasonably necessary to the owner's beneficial use of the adjacent property they retained since the owner can build a new driveway to the public road at a reasonable cost.<sup>7</sup>

Thus, an implied easement is created for the benefit of property only when a *reasonably convenient alternative* is not available to the property and a reasonable necessity for the easement exists.

## Implied grant vs. implied reservation

Although California codes only refer to implied grants of an easement by the owner of the burdened property, case law has established an *implied reservation* of an easement on property sold.<sup>8</sup>

For instance, a seller maintains irrigation ditches to control the flow of water on two adjoining parcels of real estate they own and operate for agricultural purposes.

The seller conveys the parcel containing the water source to an investor and the adjoining parcel to a farmer. The deeds do not make mention of irrigation or water easements.

The investor eliminates the irrigation ditches on their property, blocking the farmer's only access to the source of their water.

The farmer claims they have an implied easement for the use of the irrigation ditches for the flow of water.

Is the farmer entitled to an implied easement over property conveyed to the investor under a deed which does not reference an irrigation or water easement?

Yes! An implied reservation is created as though the easement had been reserved by the seller in the grant deed to the investor. The seller's **pre-existing use** of

<sup>7</sup> *Leonard v. Haydon* (1980) 110 CA3d 263

<sup>8</sup> CC §1104

the irrigation ditches on the property acquired by the investor is apparent, and the ditches were constructed to be **permanent** and are the only source of water to the parcel acquired by the farmer.<sup>9</sup>

Thus, the same criteria are used to establish an implied easement by either grant or reservation.

However, when a buyer does not have knowledge of the previous use of a parcel of real estate from the county records, or the existing use is not obvious on an inspection of the property, the buyer is considered a **bona fide purchaser (BFP)** and takes title to the property without the easement.

#### **bona fide purchaser (BFP)**

A buyer who purchases a property for valuable consideration in good faith without notice or knowledge of pre-existing encumbrances or conditions affecting their right to full ownership.

When a landowner records a subdivision map and offers to dedicate the roadways depicted on the map to a public use, a *public easement* is created on the **government's acceptance** of the right of ways legally described on the subdivision map.<sup>10</sup>

Similarly, when a recorded subdivision map lays out acreage into parcels and streets and sells the lots by reference to the subdivision map, the buyers of the lots have easements in the streets adjoining their lots.<sup>11</sup>

Regardless of how an implied easement is created, it is always a *burden* on one parcel of land for the *benefit* of another parcel.

Thus, an implied easement is always an **appurtenance** allowing the owner of the property benefitting from the easement to use the property of another which is burdened by the easement.

Most disputes over implied easements occur after the property burdened by the easement has been deeded out to new owners.

An **easement by necessity** is a variation of an implied easement. The demand for an *easement by necessity* arises when property is **landlocked**. Access to and from a public roadway across all adjacent properties is denied in landlocked property for the lack of the ability to create an easement by agreement or prior conduct.

Since public policy favors the productive use of land, an easement by necessity is created when property is landlocked.<sup>12</sup>

However, to establish an easement by necessity, the user needs to:

- show **strict necessity**; and
- defend against any claim that the property was intended to be landlocked.

## **Implied easement by reference to map**

## **An easement implied is another's appurtenance**

## **Easements by necessity**

#### **easement by necessity**

An easement providing access to a landlocked property.

<sup>9</sup> Palvutjian, *supra*

<sup>10</sup> Calif. Government Code §566410 et seq.

<sup>11</sup> **Danielson v. Sykes** (1910) 157 C 686

<sup>12</sup> **Reese v. Borghi** (1963) 216 CA2d 324

Strict necessity requires the easement to be the only possible means of access.<sup>13</sup>

Additionally, an easement by necessity lasts only as long as the necessity exists. Thus, when a public road is built or an existing adjacent road is dedicated to the public, an easement by necessity is terminated since the *need* is terminated.

No *time limitations* exist for bringing a quiet title action to establish an easement by necessity since the easement legally exists as long as the necessity exists.

Even when an easement is strictly necessary to access landlocked property, an easement will not be created contrary to the intent of the original grantor dividing and transferring the parcel.

For example, a subdivider sells one parcel and retains another parcel which is landlocked. The deed for the parcel sold does not make mention of an easement to provide access to the landlocked parcel. Also, physical roadways do not exist.

Later, a potential buyer inquires about purchasing the landlocked parcel. The subdivider advises the buyer an easement does not exist to provide access to the landlocked parcel.

The buyer closes the purchase transaction assuming they will be able to establish an easement for access at a later time. The neighboring property owners refuse to grant the buyer an easement.

Is the buyer entitled to an easement by necessity so they may access and make use of their property?

No! An easement by necessity across the neighboring parcels does not exist since the subdivider:

- did not intend for the property to be accessible; and
- advised the buyer that an easement does not exist which provides access to the property.<sup>14</sup>

## Prescription: easement by adverse use

Consider a property owner who has used a roadway on an adjoining property to access their vacation home for over five years. The owner has never received permission from the neighbor to use the roadway.

The neighbor sells their property to a buyer who informs the owner they may no longer use the roadway.

The owner claims their open and continuous use of the road to access their property for more than five years entitles them to a **right-of-way easement** over the adjoining property.

<sup>13</sup> *Zunino v. Gabriel* (1960) 182 CA2d 613

<sup>14</sup> *Hewitt v. Meaney* (1986) 181 CA3d 361

Is the owner entitled to a roadway easement over the adjoining property owned by the buyer?

Yes! A **prescriptive easement** is established by the *adverse use* of another's property for a period in excess of five years.<sup>15</sup>

An easement created by *prescription* is similar to acquiring land by adverse possession. The difference is prescription establishes the right to **mere use** of another's property, whereas adverse possession is an actual taking of **exclusive possession** under a claim of ownership and the payment of all property taxes.

To meet the legal requirements for acquiring an *easement by prescription*, the adverse use needs to be:

- *obvious* enough to give the owner of the property notice of the use;
- a *continuous* and uninterrupted pattern of use;
- a use *unauthorized* by the owner of the property;
- used under a *claim of right*; and
- used for a period of *five or more* years without the owner acting to terminate the adverse use.

The five-year requirement of uninterrupted use continues with the transfer of the benefitting property to new owner(s) as long as the new owner(s) continue the same unauthorized use of the burdened adjoining property established by the previous owner, called **tacking**.<sup>16</sup>

A prescriptive easement does not bar an owner of property burdened by the easement from all use of their land. To obtain the **exclusive use** and possession of real estate, a claim for adverse possession needs to be pursued which, unlike a prescriptive easement, requires the payment of liens and taxes on the property by the adverse possessor. [See Chapter 23]

Like all easements, a prescriptive easement is limited in its use to the *parameters of the use* which created the easement.

For example, a neighboring rancher acquires a prescriptive easement for a right of way over an owner's property — an easement benefitting the neighboring ranch.

The rancher only uses the easement for two months each year as the easiest means for accessing their ranch.

Later, the rancher subdivides their property into residential lots. The rancher claims their prescriptive easement allows them to construct a road on the easement for public access to the new development.

The owner claims the rancher may not use the easement for daily residential purposes since the rancher's prescriptive use was occasional and agricultural.

#### prescriptive easement

The right to use another's property established by the adverse use of the property for a period in excess of five years without a claim of ownership.

## Easement limited to use

<sup>15</sup> *Thomson v. Dypvik* (1985) 174 CA3d 329

<sup>16</sup> *Jones v. Young* (1957) 147 CA2d 496

May the owner limit the frequency and purpose of the neighbor's use of the easement to the pre-subdivision usage?

Yes! The use of a prescriptive easement is **limited to the adverse use** which created the easement.<sup>17</sup>

## Bona fide purchasers

After a neighbor continuously uses an owner's property for over five years without the owner's permission, an easement is established — even when the neighbor later ceases to use the easement.

However, whether an unrecorded easement by prescription is enforced against a *BFP* who becomes the new owner of the burdened property is open to different interpretations. Consider a pipeline beneath the surface with no sign of disturbance of the soil.

On one hand, the courts have applied *public policy* to allow the BFP to take title free and clear of unknown, unobservable and unrecorded easements.<sup>18</sup>

Conversely, courts have also allowed the user to enforce the easement against a new owner who is a BFP since prescriptive easements are *created by use* and are not controlled by recording requirements.<sup>19</sup>

A buyer is not considered a BFP when **physical conditions** on the property indicating an easement exists, such as a road or visible pipeline extending to the neighbor's property, since the improvements constitute *constructive notice* of the use.<sup>20</sup>

<sup>17</sup> *Cushman v. Davis* (1978) 80 CA3d 731

<sup>18</sup> *Mesmer v. Uharriet* (1916) 174 C 110

<sup>19</sup> *Jones v. Harmon* (1959) 175 CA2d 869

<sup>20</sup> *Rubio Cañon Land & Water Ass'n v. Everett* (1908) 154 C 29

## Chapter 14 Summary

The basic method for creating an easement is by a writing. Easements are created in a conveyance either by grant or reservation.

The terms "reservation" and "exception" in conveyances of real estate are used to distinguish when an owner is reserving an easement for themselves over the property conveyed, or excepting a portion of a parcel from conveyance on the sale.

Implied easements exist when the circumstances surrounding an owner's division of their property and sale of a portion of the property imply the owner and buyer intend either the grant of an easement for the buyer or the reservation of an easement for the owner.

An easement by necessity is a variation of an implied easement and arises when property is landlocked. In order to establish an easement by necessity, the owner needs to show strict necessity and defend against any claim that the property was intended to be landlocked.

A prescriptive easement is established by the adverse use of another's property for a period in excess of five years. A prescriptive easement is distinct from adverse possession in that a prescriptive easement provides the right to use another's property without a claim of ownership or payment of property taxes.

Whether an unrecorded easement by prescription is enforced against a bona fide purchaser (BFP) who becomes the new owner of the burdened property is open to different interpretations.

<b>bona fide purchaser (BFP) .....</b>	<b>pg. 139</b>
<b>easement by necessity .....</b>	<b>pg. 139</b>
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## Chapter 14 Key Terms

**Quiz 6 Covering Chapters 13-14 is located on page 446.**



*Notes:*



# Interference and termination of easements

After reading this chapter, you will be able to:

- identify conduct which constitutes unreasonable interference with an easement holder's rights;
- define the different methods of extinguishing an easement; and
- determine whether an easement holder's conduct indicates an abandonment or forfeiture of the easement.

**abandonment**  
**forfeiture**

**merger**

An owner of property benefitting from an easement allowing them to use a neighbor's property may stop any activity which interferes **with the intended use** of the easement.<sup>1</sup>

For example, consider an owner whose property is burdened with an easement granting a neighbor access across the owner's property for ingress and egress from the neighbor's property to a public road.

The owner places improvements in the form of water tanks and grapevines on their property within the legal description of the easement, but not on the actual roadway used for ingress and egress. The improvements do not interfere with the neighbor's ability to access their property by use of the easement.

The neighbor claims the easement granted them the exclusive use of the entire area within the description of the easement and demands the removal of the tanks and grapevines.

<sup>1</sup> Calif. Civil Code §809

## Chapter 15

### Learning Objectives

### Key Terms

### Burdens and benefits exceeded

In this situation, the improvements do not unreasonably interfere with the neighbor's ability to use the easement since the neighbor is able to continue using the existing roadway within the easement to access their property. Thus, the owner may continue to maintain water tanks and grow grapevines in the easement area, but not on the portion of the easement used by the neighbor for ingress and egress.<sup>2</sup>

## Intangible acts which interfere

Although an interference with an easement is generally physical in nature, an **intangible act** which does not physically invade the easement also constitutes interference.

Consider a neighbor who holds an unrecorded easement over an unpaved driveway on an owner's undeveloped land. The neighbor improves the driveway by paving it and building a retaining wall within the space of the easement, an improvement necessary to preserve the functional use of the road. As a condition for issuing a building permit after construction began, the building department requires the neighbor to obtain the owner's signature of consent to finish the wall.

The owner refuses to consent, halting construction.

The neighbor seeks to finish building the retaining wall, claiming the owner *unreasonably interfered* with the neighbor's use of the easement by refusing to sign the building department's permit since the retaining wall was necessary to preserve their use of the driveway.

The owner claims they did not unreasonably interfere with the neighbor's use of the easement since the neighbor did not hold a recorded easement agreement or building permit granting the neighbor the right to build an improvement on the easement.

Here, the owner unreasonably interfered with the neighbor's retaining wall since the wall was necessary to preserve the functional use of the driveway.<sup>3</sup>

Thus, for an intangible or passive activity of another to constitute interference with the use of an easement, it needs to directly impact the use of the easement.

Consider an easement across an owner's property which provides a neighbor with access to their property by a roadway within the easement. The neighbor entitled to use the easement constantly harasses the owner and their guests when they park cars within the legally described boundaries of the easement. The parked cars do not interfere with the neighbor's use of the roadway located within the easement.

<sup>2</sup> *Scruby v. Vintage Grapevine, Inc.* (1995) 37 CA4th 697

<sup>3</sup> *Dolnikov v. Ekizian* (2013) 222 CA4th 419

The owner is unable to sell their property since the easement holder (neighbor) intimidates potential buyers.

The owner seeks to **extinguish the easement** and clear title of this encumbrance, claiming the owner is unable to use the portion of their property which is subject to the easement because of the unreasonable conduct of the neighbor.

The neighbor claims their easement cannot be extinguished since their use of the easement does not permanently interfere with or exclude the owner from the easement or additionally burden the owner's property.

In this example, the easement cannot be extinguished. The harassment of the property owner by the neighbor holding the easement is not a use of the easement. Thus, the **neighbor's harassment** does not increase the burden of the *intended use* of the easement for ingress or egress.<sup>4</sup>

Consider a neighbor who holds an easement over an owner's property. The precise boundaries of the easement are not stated in the deed granting the easement. For numerous years, the neighbor limits their use to only one section of the easement. The remainder of the easement is used solely by the owner of the burdened property.

Later, the neighbor expands their use of the easement, encroaching on the section used by the owner.

The owner seeks to prevent the neighbor's expanded use of the easement, claiming the neighbor is not entitled to areas of the easement beyond their historic use since the neighbor established the boundaries of the easement through their continued use of only one section.

The neighbor claims they are entitled to the full easement since the deed granting the easement did not specifically define the boundaries of the easement.

Here, the neighbor may not expand their use of the easement since the boundaries of the easement and the extent of the neighbor's use were established by their historic use of the easement.<sup>5</sup>

In addition to **historic use**, limitations on an easement's use are established by the purpose intended at the time the easement is created. The intended purpose can include restrictions on property improvements and who may use the easement.

For example, an owner's parcel of land is subject to a recorded easement benefitting an adjacent parcel. The easement gives the adjacent neighbor the right of ingress and egress "for public road purposes" from the public road to the neighbor's parcel.

## Treatment of a changing use

<sup>4</sup> Reichardt v. Hoffman (1997) 52 CA4th 754

<sup>5</sup> Rye v. Tahoe Truckee Sierra Disposal Company, Inc. (2013) 222 CA4th 84

Later, the neighbor constructs a multi-family project on their parcel. Utilities and roadway improvements are constructed within the location of the easement for use by the occupants of the project.

The owner claims the neighbor's expanded use of the easement violates the easement restrictions since the easement does not grant the neighbor the right to increase the burden on the easement by constructing improvements or allowing roadway use by the occupants of the project.

The neighbor claims the easement is for public road purposes and thus grants a public right-of-way authorizing the neighbor to use the easement for development of the multi-family project and to open the use of the easement to occupants of the multi-family units.

Here, the use of the easement is limited to a right of ingress and egress for public road purposes solely by the neighbor. It does not include the right of the neighbor to construct utilities, a road and extend its use to the occupants of the project constructed on the neighbor's parcel.<sup>6</sup>

The neighbor's use of the easement is limited to the **intent** of the easement when it was created. The deed creating the easement included the phrase "for public road purposes." The phrase functions as a limitation on the right of ingress and egress reserved in the grant, and implies the easement is the neighbors' exclusive use. Any use exceeding the purpose of the easement is an additional onus placed on the property burdened by the easement, a violation of the easement rights and restrictions.

## Extinguishing an easement

An existing easement can be **extinguished**. Once extinguished, the easement no longer affects the burdened property as an encumbrance on its title.

Methods used to extinguish an easement include:

- *release* of the easement by a deed from the owner of the property holding the appurtenant right to the easement;
- *merger* by the acquisition of fee title to both the benefitting and burdened properties by the same owner;
- *destruction* of the burdened property which permanently prevents any further use of the easement;
- *forfeiture* due to the easement holder's abuse of their easement rights;
- *prescription* due to the burdened property owner's continuing interference with the easement; and
- *abandonment* by the conduct of the easement holder showing they do not intend to use their easement rights.

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<sup>6</sup> Schmidt v. Bank of America, N.A., et al (2014) 223 CA4th 1489

An owner of property benefitting from the use of an easement may voluntarily terminate it by **releasing the easement** to the owner of the burdened property.

The *release* is accomplished by the use of a *quitclaim* or *grant deed* in favor of the owner of the burdened property, signed by the owner of the property holding the appurtenant right to use the easement.

A **merger of legal interests** comprising the *servient* and *dominant* tenement rights and obligations in two properties due to common ownership of both properties extinguishes an easement.

A *merger* occurs when the same person acquires fee title to both the benefitting and burdened properties.

An owner cannot have an easement over their own property for the benefit of their own property. Thus, the easement is automatically extinguished on the **common ownership** of both the properties.<sup>7</sup>

However, no merger occurs when the owner of burdened property acquires a fractional interest in title to the benefitting property as a co-owner since the owner is not the **sole owner** of both properties.<sup>8</sup>

Additionally, acquiring a lien, such as a trust deed, encumbering either the benefitting or burdened property by the owner of the other property is not a merger of interests.

An easement is terminated by the **destruction** of the burdened property. Nonexistence of the burdened property renders the use of the easement impossible.

Consider an easement to use a stairway in an adjoining building. When the building burns down, the easement is extinguished since the owner is not required to rebuild the stairway.<sup>9</sup>

An easement is terminated by **forfeiture** when the easement holder exceeds their authorized use of the easement by placing an *excessive burden* on the property encumbered by the easement.

For example, consider a subdivider who owns land entitling them to use a right-of-way easement over a neighbor's property for access.

Later, the subdivider divides the property into several residential lots. For access, the subdivider constructs a road on the neighbor's property within

## Release by deed to burdened property

## Merger as an extinguisher

### merger

The termination of an easement when one owner acquires fee title to both the property benefitting from and the property burdened by an easement.

## Extinguished by destruction of property

## Forfeiture for exceeding authority

### forfeiture

The termination of an easement when the easement holder exceeds their authorized use of the easement by placing an excessive burden on the property encumbered by the easement.

<sup>7</sup> CC §805

<sup>8</sup> *Cheda v. Bodkin* (1916) 173 C 7

<sup>9</sup> *Cohen v. Adolph Kutner Co.* (1918) 177 C 592

the legally described easement to a public road. Here, the increased use of the easement constitutes an excessive burden on the property it encumbers, and thus the easement is *extinguished by forfeiture*.<sup>10</sup>

The standards for forfeiture are vague and often left to the discretion of the courts to determine, on a case-by-case basis, whether the easement holder's actions create an undue hardship on the owner of the property burdened by the easement.

## Prescription creates and destroys

An easement may be established through prescription by the adverse use of another's property. Likewise, an easement may be *extinguished* by prescription when the burdened property owner's use of the area within the easement which *permanently interferes* with their neighbor's ability to use the easement.

An adverse use which terminates an easement is any act by the burdened property owner which permanently obstructs the beneficial use enjoyed by the holder of the easement.

Consider a subdivider who sells an unimproved parcel of land, granting the buyer a right-of-way easement for ingress and egress over an adjoining parcel. Later, the subdivider constructs a concrete block wall on the common boundary line which blocks any use of the easement by the buyer.

More than five years after the block wall was constructed, the buyer of the parcel benefitting from the easement seeks to quiet title to the right-of-way.

Here, the obstruction of the easement is an adverse use by the subdivider of the property burdened by the easement. Thus, the easement is extinguished since the subdivider interfered with the use of the easement for a period of five years.<sup>11</sup>

## Abandonment as never to use again

### abandonment

The termination of an easement when the easement holder's actions demonstrate a clear intent to permanently abandon all future use of the easement.

An easement can also be terminated through **abandonment** by the easement holder. The termination of an easement by *abandonment* is not easily established.

The easement holder's actions need to demonstrate a clear intent to *permanently abandon* all future use of the easement, never to use it again.

Consider a subdivider who grants a buyer of a parcel a right-of-way easement over an adjoining parcel owned by the subdivider. The buyer plants trees on their property, blocking their access to their own easement over the adjoining parcel.

The subdivider later builds a fence between the parcels which further bars the buyer's access to the easement. The buyer makes a timely demand on

<sup>10</sup> *Crimmins v. Gould* (1957) 149 CA2d 383

<sup>11</sup> *Glatts v. Henson* (1948) 31 C2d 368



the subdivider to remove the fence. The subdivider claims the easement has been extinguished by the buyer's abandonment of the easement, evidenced by the trees blocking access to the easement.

Has the buyer abandoned their easement by planting trees blocking their access to the right-of-way?

No! Mere **nonuse of an easement** is not sufficient conduct to demonstrate an easement holder's *intent to terminate* an easement by abandonment. The buyer's planting of trees which block access to the easement does not indicate they have decided to never use the easement in the future.<sup>12</sup>

<sup>12</sup> *Tract Development Service, Inc. v. Kepler* (1988) 199 CA3d 1374

An owner of property benefitting from an easement allowing them to use a neighbor's property may stop any activity which interferes with their proper use of the easement. However, the interfering activity occurring within the parameters of the easement needs to actually interfere, either physically or by intangible action, with the intended use granted by the easement.

An existing easement can be extinguished, no longer affecting the burdened property as an encumbrance on its title.

Methods used to extinguish an easement include:

- release of the easement by a deed from the owner of the property;
- merger by the acquisition of both the benefitting and burdened properties by the same owner;
- destruction of the burdened property;
- forfeiture due to the easement holder's abuse of their easement rights;
- prescription due to the burdened property owner's continuing interference with the easement; and
- abandonment by the conduct of the easement holder showing they never intend to use their easement rights again.

The standards for forfeiture are vague and often left to the discretion of the courts to determine, on a case-by-case basis, whether the easement holder's actions create an undue hardship on the owner of the property burdened by the easement.

An adverse use which terminates an easement is any act by the burdened property owner which permanently obstructs the beneficial use enjoyed by the holder of the easement.

## Chapter 15 Summary

## **Chapter 15**

### **Key Terms**

<b>abandonment .....</b>	<b>pg. 150</b>
<b>forfeiture .....</b>	<b>pg. 149</b>
<b>merger.....</b>	<b>pg. 149</b>

**Quiz 7 Covering Chapters 15-17 is located on page 446.**



# Covenants, conditions and restrictions

## Chapter 16

After reading this chapter, you will be able to:

- understand the limitations and restrictions on use applicable to all property owners in a subdivision set out in the covenants, conditions and restrictions (CC&Rs);
- determine when a covenant runs with title to real estate;
- distinguish between affirmative and negative covenants; and
- understand the circumstances allowing CC&Rs to be amended or removed when they are an unlawful restriction.

**affirmative covenant amendment clause**

**covenants, conditions and restrictions (CC&Rs)**

**negative covenant**

### Learning Objectives

### Key Terms

The trees on a lot in a subdivision have grown so tall they obstruct a homeowner's ocean view from another lot in the subdivision. The homeowner, concerned about the loss of their view, reviews the title restrictions recorded on the neighbor's lot for any height restrictions.

From the title restrictions, the homeowner determines:

- both their lot and the neighbor's lot are part of the **same subdivision**; and
- the original subdivision documents contain a restrictive provision limiting the **height of structures** located within the subdivision.

The homeowner requests their neighbor comply with the title restrictions by trimming and topping the trees to conform to the height restriction on structures within the subdivision. The homeowner feels a reasonable interpretation of the subdivision height-of-structures restriction extends to improvements in the form of trees.

### Right-to-use limitations

The neighbor refuses to trim the trees, claiming the wording of the restrictive provision applies only to structural improvements, not to improvements such as the trees growing on their lot.

May the owner force the neighbor to trim their trees under the title restriction?

Yes! The neighbor needs to maintain their trees at a height equal to the height limitations imposed on all structures in the subdivision, which includes trees. One purpose of the structural height restriction is to protect the views of all owners in the subdivision. Title restrictions are enforced according to their intent.<sup>1</sup>

## Recording restrictive covenants

### covenants, conditions and restrictions (CC&Rs)

Recorded restrictions against the title to real estate prohibiting or limiting specified uses of the property.

Developers subdivide land into two or more horizontal or vertical sections called **lots, parcels** or **units**. Having created a subdivision, developers place **restrictive covenants** on how the parcels may be used by later owners, called successors.

Use restrictions are usually contained in a document called the **covenants, conditions and restrictions (CC&Rs)**. The subdivider typically records CC&Rs when recording the original subdivision map.

As the CC&Rs are recorded documents in the chain of title to a parcel of real estate, the buyer is placed on *constructive notice* of their contents.

A prospective buyer of a home in a subdivision protects themselves from unknowingly buying property burdened with unwanted restrictions by reviewing a **preliminary title report (prelim)** prior to closing and acquiring a property. A *prelim* discloses the results of the title company's search of the property's title history, which includes CC&Rs of record. [See Chapter 21]

The function of a *prelim* is for the limited purpose of the title company's revocable offer to issue a title policy. As a customer service, title companies supply copies of any CC&Rs of record to agents on request.

Consider a subdivider who, as the owner of a property, recorded CC&Rs with a subdivision map before any of the newly created lots are sold. The grant deeds initially conveying each lot to a buyer and the later grant deeds further transferring title of lots in the subdivision do not reference the recorded CC&Rs.

Later, an owner who bought one of the lots violates the CC&Rs. A neighbor in the subdivision seeks to enforce the CC&Rs against the owner.

The owner claims the CC&Rs are unenforceable since they were not referenced in any grant deeds which transferred title to the property after the subdivider recorded the CC&Rs.

<sup>1</sup> **Ezer v. Fuchsloch** (1979) 99 CA3d 849

In this example, the CC&Rs are enforceable. The CC&Rs were recorded on the subdivision before any of the lots were sold. Thus, all purchasers of the lots are on constructive notice of the CC&Rs and are to abide by them.<sup>2</sup>

A recording of the CC&Rs on the parcel subdivided prior to any conveyance of any newly created lot fulfills the intent of the subdivider, and the expectations of future buyers, regarding the use of the parcels, lots and units within the subdivision.

Next, consider a homeowners' association (HOA) that wants to trim trees on a parcel within the HOA to protect the view of other parcels. The CC&Rs on the parcel do not contain a tree-trimming provision for protecting the scenic views of other parcels in the HOA. Another parcel in the HOA with a tree-trimming provision in its CC&Rs lost its scenic view due to the growth of trees on the parcel without the tree-trimming CC&R provision. The differing CC&R provisions resulted from the later addition of new parcels to the HOA. The owner of the parcel with the trees blocking the view of other parcels seeks to prevent the HOA from cutting their trees.

Is the parcel subject to the tree-cutting covenant in other parcels' CC&Rs?

No! The trees on the parcel may not be trimmed by the HOA since the parcel is not subject to CC&Rs encumbering other parcels in the HOA and its CC&Rs do not contain a tree-trimming provision.<sup>3</sup>

A recorded restriction may **limit the use** of a property to a specific purpose (e.g., a school, railroad, highway, dwelling or irrigation system). This type of restriction is classified as an **affirmative covenant**.

Another type of recorded restriction may **prohibit identified uses** of the property. Prohibitive restrictions are classified as a **negative covenant**. For example, a typical *negative covenant* prohibits the sale of alcoholic beverages or other activities otherwise allowed to take place on the property.

Consider a neighbor in a subdivision who seeks to restrain another owner in the subdivision from violating a restrictive covenant, similar to the previous example of a neighbor's trees exceeding the height restriction on improvements.

May an owner of one lot enforce a restrictive covenant against an owner of another lot when the only relationship existing between them is ownership of a parcel, lot or unit within the same subdivision?

Yes! The right to enforce recorded subdivision restrictions transfers to the owners of each lot as part of the title they acquired to the property.

Further, the CC&Rs may provide for the property to revert to the original seller if the property is used in violation of a restriction.<sup>4</sup>

## Covenants limiting use are affirmative

### **affirmative covenant**

A recorded restriction limiting the use of a property to a specific purpose.

### **negative covenant**

A recorded restriction prohibiting identified uses of a property.

<sup>2</sup> *Citizens for Covenant Compliance v. Anderson* (1995) 12 C4th 345

<sup>3</sup> *Colyear v. Rolling Hills* (2024) 100 CA5th 110

<sup>4</sup> *Romero v. Department of Public Works* (1941) 17 C2d 189

## CC&Rs and future owners

Recorded CC&Rs bind future owners of the subdivided lots, a principle referred to as covenants *running with the land*.

For a covenant to run with the land and affect title and future owners, the restriction needs to **directly benefit** the property. Thus, to benefit one lot, all lots within the subdivision need to be burdened by the same restriction.<sup>5</sup>

Consider a restriction limiting the use of all subdivision lots to single family residences (SFRs). The use restriction equally *benefits* and *burdens* each lot in the subdivision, with the intent to assure consistent and compatible use throughout the subdivision — a benefit with an advantageous effect on each property. Since it benefits every lot, the restriction runs with the title to each lot and affects all future owners.<sup>6</sup>

Now consider a subdivider who sells a beachfront lot while retaining ownership of the surrounding lots in the subdivision. The grant deed conveying the beachfront lot to the buyer contains a use restriction, stating the buyer may only operate a hotel or yachting clubhouse on the lot.

The buyer, unable to develop the property for the purposes set out in the use restriction, sells the lot to a developer who plans to use the property for a ferry landing service. The subdivider seeks to prohibit the developer as the new owner from conducting a business which violates the restrictive use covenant in the recorded grant deed to the original buyer.

May the subdivider enforce the covenant entered into by the original buyer to stop the developer from using the lot for a ferry service?

No! The use restriction provides *no benefit* to the beachfront lot itself. It merely imposes a burden on the original buyer who agreed to limit their use of the property. Enforcement of the restriction is further unavailable due to its lack of wording binding the buyer's *successors in interest* to the restrictive covenant.

The restriction is only enforceable as long as the original buyer holds title. Thus, it is classified as a **personal covenant**. The restriction against use is a *personal* promise and does not run with the land. Thus, it may not be imposed on the developer who later acquired title.

## Unenforceable or unreasonable CC&Rs

A subdivider sells “exclusive” residential lots with a deed restriction prohibiting the sale of lots to persons of a certain race or religion. Later, a member of the excluded race or religion purchases and occupies a lot within the subdivision.

A neighbor attempts to invalidate the sale. The neighbor claims their rights under the subdivision plan have been violated since the neighbor purchased the lot subject to the restriction granting other owners the right not to live next to a person of the excluded race or religion.

<sup>5</sup> Calif. Civil Code §1462

<sup>6</sup> *Miles v. Hollingsworth* (1919) 44 CA 539

May the neighbor enforce the race/religion restriction?

No! California prohibits any restriction on the basis of race, national or ethnic origin, ancestry, sex, marital status, sexual orientation, religion or disability in a conveyance of any interest in real estate.<sup>7</sup>

Restrictions on selling, leasing or encumbering real estate may not *unreasonably restrict the marketability* of the property, even when the restriction is contained in a trust deed or lease agreement.<sup>8</sup>

Even when the CC&Rs restrict owners from leasing their individual units, the restrictions only apply if the prohibiting provision existed in the CC&Rs prior to their ownership of the individual unit. Before renting out their individual unit, owners exempt from a leasing prohibition need to:

- verify the date the owner acquired title to their individual unit; and
- provide the homeowners' association (HOA) with the name and contact information of the prospective tenant.<sup>9</sup>

CC&Rs on the installation or use of a **solar energy system** are unenforceable when the restrictions significantly increase the cost of the system or decrease its efficiency by:

- resulting in more than a 20% increase in the installation cost of the system; or
- decreasing the operating efficiency of the system by more than 20%.<sup>10</sup>

Otherwise, reasonable restrictions on the selling, leasing and encumbering the real estate are permissible. For instance, an HOA may amend CC&Rs to impose reasonable fees and rules regarding short-term rentals.<sup>11</sup>

An exception to the rule against unreasonable restrictions is the **due-on-sale clause** contained in a mortgage lender's trust deed. *Due-on-sale* clauses are no longer controlled by California law. Federal mortgage law permits all lenders to enforce their due-on clause on the transfer of any interest in the real estate, except:

- short-term leases up to three years not coupled with a purchase option; and
- intra-family transfers of one-to-four unit, owner-occupied residential property on the death of an owner or for equity financing.<sup>12</sup>

Government agencies have a broader standard of reasonableness for enforcing restrictions on resales when implemented to promote a public policy.

For example, an owner of coastal real estate obtains a coastal development permit by recombining 77 lots into two parcels and recording restrictions which prohibit the later division of the two recombined parcels.

**Covenants  
restricting  
transferability**

<sup>7</sup> CC §§53, 782

<sup>8</sup> CC §711

<sup>9</sup> CC §4740

<sup>10</sup> CC §714

<sup>11</sup> *Watts v. Oak Shores Community Association* (2015) 235 CA4th 466

<sup>12</sup> 12 Code of Federal Regulations §591.5(b)



To protect the public interest in coastal areas, a deed is recorded giving notice that a resale of an individual lot within the two recombined parcels will subject the owner to penalties under the Coastal Act, a classic restraint on alienation. No official map is recorded which reverts the lots into acreage consisting of two parcels.

An investor purchases 54 of the deed-restricted lots and sells them individually to buyers in defiance of the resale restriction.

Here, the investor is required to pay the maximum in fines allowed under the Coastal Act since the sale of individual lots is a violation of the deed restrictions imposed by the coastal development permit. Also, the investor is ordered to rescind their sales of the individual deed-restricted lots to the buyers to protect the public from further violations of the Coastal Act.<sup>13</sup>

## Amending CC&Rs

### **amendment clause**

A clause contained in covenants, conditions and restrictions (CC&Rs) establishing a procedure for modifying the CC&Rs.

An **amendment clause** usually exists in the originally recorded CC&Rs which establishes a procedure for making a change when the CC&Rs need to be altered.

For example, a condominium association's CC&Rs may be amended by a majority or other percentage vote of the association members as set forth in the *amendment clause* in the association's CC&Rs.<sup>14</sup>

Unlawful restrictive covenants in a common interest development's (CID's) CC&Rs may be removed from title under a program available through the California Civil Rights Department (CRD).

The CRD's **Restrictive Covenant Identification Service (RCIS)** reviews deeds, declarations and CC&Rs sent to them by CID associations to determine if they contain unlawful restrictive covenants, such as those based on:

- race or color;
- religion;
- sex;
- familial or marital status;
- sexual orientation;
- disability;
- national origin; or
- ancestry.

Upon receiving an application and the document containing the restrictive covenant in question, the CRD reviews the language in the document. The CRD then issues a written determination as to whether the identified language violates *fair housing laws*.

If the CRD determines the language constitutes an unlawful restrictive covenant, the property owner may strike out the unenforceable language by recording a modification of the CC&Rs with the county recorder.

<sup>13</sup> *Ojavan Investors, Inc. v. California Coastal Commission* (1997) 54 CA4th 373

<sup>14</sup> *Diamond Bar Development Corporation v. Superior Court of County of Los Angeles* (1976) 60 CA3d 330

However, the RCIS procedure is not available to owners of individual units in a CID since the CID association needs to act on its own. The board of directors of a CID association is required to delete any unlawful restrictive covenants from its CC&Rs and governing documents without the need to first obtain either the approval of their owners or the CRD.<sup>15</sup>

A seller restricts the future use of a property to residential purposes when it is conveyed to a buyer. Five years later, the road in front of the property is enlarged to a four lane thoroughfare and the property is rezoned for commercial use.

The buyer wants to develop the property for commercial use compatible with the surrounding area.

May the buyer develop the property for commercial use regardless of the CC&Rs limiting the property to residential use?

Yes! Due to *changed conditions* in the area surrounding the restricted property, the restrictive covenant is no longer enforceable. When conditions in the area near the property have changed so drastically that a covenant may no longer serve its *intended purpose*, it is unenforceable under the doctrine of **changed conditions**.<sup>16</sup>

Consider an owner of a parcel in a subdivision of lots which was acquired subject to CC&Rs restricting the use of each lot to one single-family residence. Also, structures are required to be set back a minimum distance from the adjoining lots. However, a number of lots in the subdivision have been improved with more than one residential unit in compliance with local zoning and use ordinances but in violation of the set-back requirement of the CC&Rs.

The owner obtains a building permit and begins construction of a rental unit on their lot, in violation of the CC&Rs.

A neighbor in the subdivision seeks to halt construction, claiming the second dwelling unit on the property violates the one-house and set-back restriction in the subdivision's CC&Rs.

The owner claims the CC&Rs are unenforceable since a number of lots in the subdivision already violate the one-house and set-back restriction, and thus the conduct of the neighbors indicate an abandonment of the CC&R restrictions.

May the neighbor stop the owner from constructing the second unit in violation of the CC&Rs?

No! Lack of uniform observance and enforcement against prior violations of the CC&Rs by other owners in the subdivision render the CC&Rs unenforceable.<sup>17</sup>

## Changed circumstances avoid CC&Rs

<sup>15</sup> CC §4225

<sup>16</sup> **Key v. McCabe** (1960) 54 C2d 736

<sup>17</sup> **Bryant v. Whitney** (1918) 178 C 640

## Environmental restrictions for personal benefit

A covenant limiting the use and maintenance of hazardous materials is recorded on title to a property by the owner. The covenant is for the benefit of neighboring property owners, not for the benefit of the property encumbered by the covenant. For the covenant to **run with the land** and be enforceable against the present and future owners of the burdened property by the other property owners named as beneficiaries in the covenant, the covenant needs to:

- provide the description of the property burdened by the covenant in the document containing the covenant;
- be necessary to protect human health and safety due to hazardous materials; and
- be recorded with the county recorder in a document entitled "Environmental Restriction."<sup>18</sup>

<sup>18</sup> CC §1471

## Chapter 16 Summary

Restrictive use covenants are contained in a subdivision's covenants, conditions and restrictions (CC&Rs). A recorded restriction limiting the use of a property to a specific purpose is referred to as an affirmative covenant. A recorded restriction prohibiting identified uses of a property is classified as a negative covenant.

Recorded CC&Rs run with the land, or bind future owners of the subdivided lots. For a covenant to run with the land and affect future owners, the restriction needs to directly benefit the property.

Restrictions on selling, leasing or encumbering real estate may not unreasonably restrict the marketability of a property, except as controlled by federal mortgage law under due-on clause enforcement.

Unlawful restrictive covenants in CC&Rs may be removed from title under a program available under the Restrictive Covenant Identification Service (RCIS) through the California Civil Rights Department (CRD).

When conditions in the area near a property have changed so drastically that a covenant may no longer serve its intended purpose, the covenant is unenforceable under the doctrine of changed conditions.

## Chapter 16 Key Terms

<b>affirmative covenant</b> .....	<b>pg. 155</b>
<b>amendment clause</b> .....	<b>pg. 158</b>
<b>covenants, conditions and restrictions (CC&amp;Rs)</b> .....	<b>pg. 154</b>
<b>negative covenant</b> .....	<b>pg. 155</b>

**Quiz 7 Covering Chapters 15-17 is located on page 446.**



# Easement maintenance costs



## Chapter 17

After reading this chapter, you will be able to:

- calculate the allocation of costs incurred to maintain an easement shared by multiple users;
- advise on the need for a written demand on other easement users for their share of costs before seeking court arbitration;
- understand the use of secondary easements used solely to maintain the use and repair of an easement; and
- determine whether an easement used by a property owner transfers with the sale of the property.

**arbitrator**  
**right-of-way**

**secondary easement**

## Learning Objectives

## Key Terms

When several property owners share in the use of an easement, they also share the responsibility to repair and maintain the easement.<sup>1</sup>

However, issues arise when considering the repair and maintenance of a shared easement, such as:

- who is responsible for maintenance;
- allocation of costs, by agreement or arbitration; and
- secondary easements for maintenance on adjoining properties.

A large development, such as a condominium project or other common interest development (CID), includes maintenance provisions in their covenants, conditions and restrictions (CC&Rs). The provisions authorize

## Repairs: who pays and how much?

## Maintenance responsibility

<sup>1</sup> Calif. Civil Code §845(b)

centralized management to perform necessary repairs and maintenance of commonly used roads and driveways and assess the co-owners for their share of the costs. Allocation of these CID costs are usually made based on the square footage in each unit as a percentage of footage in all units in the CID.

Owners of property having appurtenant easements and persons holding easements in gross hold the non-exclusive right to use another's property.

Consequently, they have the **duty to maintain** the easement they hold on another owner's property. An owner of property who holds a private right-of-way easement across another's property is responsible for maintenance of the **right-of-way**, not the owner of the property burdened by the easement.<sup>2</sup>

#### right-of-way

A privilege under an easement granted by the owner of property giving the owner of another property the right to pass over their property.

Owners of separate parcels who are entitled to use the same appurtenant easement occasionally are subject to a recorded easement maintenance agreement. No mandated maintenance agreement form exists.

*Editor's note – A maintenance agreement form will soon be available on the Realty Publications, Inc. Forms Download page.*

When any owner fails to contribute under the maintenance agreement, the other owners need to make a written demand on the easement user who defaults before taking legal action for reimbursement.<sup>3</sup>

When a written maintenance agreement does not exist between the holders of the easement and the owner of the burdened land, **maintenance costs are shared** in proportion to use of the easement.<sup>4</sup>

Any one of the easement owners may apply for a court arbitrator to apportion the maintenance costs when the easement holders are unable to reach an agreement.<sup>5</sup>

The maintenance and repair of an easement appurtenant to parcels owned by different owners includes the cost of **snow removal**, when snow removal:

- is not excluded by the terms of the maintenance and repair agreement;
- is necessary to provide access to the properties by way of the easement; and
- is approved by a vote of the property owners as called for in their maintenance agreement.<sup>6</sup>

## Sharing maintenance and repair costs

The maintenance and repair of a road requires keeping it usable and in its historic condition. This is different from *improving* a road, which entails upgrading it from its historic condition.

<sup>2</sup> CC §845(a)

<sup>3</sup> CC §845(c)

<sup>4</sup> CC §845(b)

<sup>5</sup> CC §845(c)

<sup>6</sup> CC §845(d)

Although all owners of property who use an easement need to share in the costs of maintaining the easement, no owner who **further improves** the easement may force nonconsenting owners to contribute to the costs of the further improvements.<sup>7</sup>

For example, a dirt road used as the easement has fallen into disrepair. Some of the easement owners widen the road, grade it, install culverts and cut trees along its borders. They then demand contributions from other owners who did not consent to the improvement. The other owners refuse to contribute more than their share of the costs limited to the repair and maintenance of the existing dirt road, claiming the easement was upgraded from its historic condition.

Since the improvements exceeded merely repairs to the old dirt road, the nonconsenting neighbors are not responsible for the **costs of upgrading** the road improvements.<sup>8</sup>

Determining the mathematical formula to set each neighbor's percentage of their beneficial use of an easement is problematic. Each neighbor travels a different distance on the road depending on where along the easement their property is located.

## Setting a formula

Additionally, some travel the road more frequently than others. Some may ride motorcycles or drive compact cars which may create less wear and tear on the road than large trucks, SUVs or vans.

Some owners of parcels entitled to use the appurtenant easement may not even use it. However, the existence and condition of the easement are factors that affect the value of their parcels.

Due to the variable circumstances surrounding each user's actual use of an easement, an approximation of each easement holder's percentage of use is the best mathematical allocation method available.

For instance, two siblings buy separate portions of their parents' farm. One sibling's property is granted an easement across the other's property for use as a private road leading to the public highway.

Eventually, the siblings come to a disagreement about who will maintain the *right-of-way* and how to split the maintenance costs.

Nothing in the easement grant specifies how the repair and maintenance expenses are to be divided.

The sibling using the road to access their farm at the rear travels a greater distance from the public highway than the other brother. Thus, the more distant sibling needs to pay a larger percentage of the costs.

An exact distribution of costs and labor is impossible to achieve among users of a private right-of-way. Here, the approximation reached is 60% for the

<sup>7</sup> **Holland v. Braun** (1956) 139 CA2d 626

<sup>8</sup> Holland, *supra*



sibling located farthest from the highway and 40% for the sibling closer to the highway. The allocation of costs is determined by the distance each sibling travels on the entire road as a percentage of the total distance traveled by all uses.

## Allocation by arbitration

### arbitrator

A neutral third-party who is appointed to hear a dispute, and authorized to make a decision as an award in favor of one of the parties.

When co-owners of an easement are unable to agree on the allocation of costs for repair and maintenance of a private road, an **arbitrator** will be appointed by the courts. The repairs may be performed before or after the *arbitrator* is requested.<sup>9</sup>

When the arbitrator's award is contested by any co-owner, the court reviews it and enters a judgment setting the liability of each owner in an amount proportionate to their use of the easement. The money judgment may be enforced by any co-owner against a defaulting co-owner.<sup>10</sup>

A court-appointed arbitrator may divide maintenance and repair costs equally, by the **distance** between an owner's driveway and the public road, or by **frequency** of use.<sup>11</sup>

In calculating the apportionment of maintenance costs, an arbitrator needs to take into account which residences are and which residences are not occupied year-round.<sup>12</sup>

## Secondary easements for maintenance

### secondary easement

An easement on a property which abuts a primary easement and allows the user of that easement to further enter upon the property for purposes of maintaining the primary easement.

In order to keep an easement in repair, a user of the easement or their contractors may need to enter a neighbor's property to maintain the easement. **Secondary easements** on the property abutting the easement allow an easement user to enter a property for purposes of maintaining the primary easement.

For example, an easement user places posts and reflectors along the edge of a narrow, steep right-of-way to prevent cars from going over the embankment.

The owner of the property subject to the easement removes the posts. The property owner finds them inconvenient even though they do not interfere with the owner's use or enjoyment of their property or road.

However, an easement gives users of the easement the right to do what is necessary to maintain the safe use of the easement.

Due to the fact that the road abuts a steep embankment, the posts and reflectors are reasonably necessary and not a needless burden on the property owner. Thus, the property owner has to replace the posts installed on their property by the user of the easement.<sup>13</sup>

<sup>9</sup> CC §845(c)

<sup>10</sup> CC §845(c)

<sup>11</sup> **Healy v. Onstott** (1987) 192 CA3d 612

<sup>12</sup> Healy, *supra*

<sup>13</sup> **Herzog v. Grosso** (1953) 41 C2d 219



Consider a landowner who grants an easement over a road to the county for use as a public highway. Without permission from the landowner, county officials bore a well on the highway to obtain subterranean water for watering the landscaping.

However, the easement is for a right-of-way only. The county does not have the right to drill wells on the landowner's property since watering the landscaping is not necessary to keep the road easement in repair.<sup>14</sup>

An easement in gross is a personal right held by an individual to use another's property, such as a hunting easement. It is not a right appurtenant to the title to any property the easement holder may own, and thus will not run with any property the easement holder may sell.

## Taking title subject to an easement

An **appurtenant easement** is a right of a property owner to use another's property. The right *runs with the ownership of the land* and is not a personal right of the owner. Even though an appurtenant easement is located on neighboring property, it is transferred whether or not referenced with the sale of the property it benefits. An appurtenant easement remains with the property it benefits even though it is not of record on its title.<sup>15</sup> [See Chapter 13]

A *right-of-way easement* is transferred along with the conveyance of the property it benefits unless it is excepted under the terms of the conveyance.<sup>16</sup>

Lenders sometimes have special requirements when lending funds on property which holds a right-of-way easement for ingress and egress.

Mortgage appraisers and underwriters want a written maintenance agreement for the easement. In the absence of a written agreement, the buyer may be asked by the appraisers or underwriters to acknowledge they are aware of no written agreement.

When the right-of-way is to be repaired as a condition to closing a sale on a parcel benefiting from the easement, payment of the repairs needs to be worked out between the seller and the other users of the easement.

Lenders often require private rights of way be usable in all types of weather. Also, many lenders want the right-of-way to be consistent with other roads in the area.

When the easement road is dirt and most of the roads in the area are paved, the lender may consider the property less valuable than a comparable property with a paved road.

<sup>14</sup> **Wright v. Austin** (1904) 143 C 236

<sup>15</sup> CC §1104

<sup>16</sup> **Lemos v. Farmin** (1932) 128 CA 195

**Chapter 17**  
**Summary**

When several owners share an easement, they also share the responsibility to repair and maintain the easement.

An owner of property who holds a private right-of-way easement across an adjacent property is responsible for maintenance of the right-of-way, not the owner of the adjacent property burdened by the easement.

Owners of separate parcels who are entitled to use the same appurtenant easement occasionally are subject to an easement maintenance agreement. When any owner fails to contribute under the maintenance agreement, the other owners need to make a written demand on the easement user who defaults before taking legal action for reimbursement.

When a written maintenance agreement does not exist between the holders of the easement and the owner of the burdened land, maintenance costs are shared in proportion to each user's use of the easement.

No owner who further improves an easement may force nonconsenting owners to contribute to the costs of the further improvements.

A court-appointed arbitrator may divide maintenance and repair costs equally, by the distance between an owner's driveway and the public road, or by frequency of use.

Secondary easements on the property abutting an easement allow an easement user to enter the property for maintenance purposes.

**Chapter 17**  
**Key Terms**

<b>arbitrator</b> .....	<b>pg. 164</b>
<b>right-of-way</b> .....	<b>pg. 162</b>
<b>secondary easement</b> .....	<b>pg. 164</b>

**Quiz 7 Covering Chapters 15-17 is located on page 446.**



# A deed as a transfer



After reading this chapter, you will be able to:

- identify the components a deed needs to contain to convey an interest in real estate;
- understand the exceptions to the requirement for a signed writing to transfer an interest in real estate; and
- determine who is capable of conveying and receiving an interest in real estate.

**adverse possession**

**amanuensis**

**common description**

**fee estate**

**grant**

**grant deed**

**grantee**

**grantor**

**legal description**

**quitclaim deed**

Real estate is *conveyed* when title is transferred from one individual to another.<sup>1</sup>

The transfer of an interest in title to real estate contained in a writing is called a **grant** or **conveyance**, no matter the form of writing.<sup>2</sup>

A deed is itself the *grant* which transfers title to property.<sup>3</sup>

Title by deed passes either:

- *voluntarily* by agreement with the owner, such as in a sale in the open market or foreclosure on a trust deed; or

<sup>1</sup> Calif. Civil Code §1039

<sup>2</sup> CC §1053

<sup>3</sup> **Hamilton v. Hubbard** (1901) 134 C 603

## Chapter 18

### Learning Objectives

### Key Terms

### A deed by any name is a grant

**grant**

The transfer of an interest in title to real estate.

- *involuntarily* without agreement, such as the enforcement of a creditor's judgment or tax lien.

No matter the form of writing, the individual conveying real estate is called the grantor. The individual acquiring title is called the grantee.

Ownership of *possessory interests* in real estate includes:

#### fee estate

An indefinite, exclusive and absolute legal ownership interest in a parcel of real estate.

- a **fee estate**, also known as *fee simple ownership*;
- a life estate;
- a leasehold estate; and
- an estate at will. [See Chapter 4]

A fee estate is presumed to pass by a grant of real estate, unless a lesser possessory interest is stated, such as an easement, life estate or leasehold interest.<sup>4</sup>

A *fee estate* in real estate is an indefinite, exclusive and absolute legal ownership interest in a parcel of real estate.

## Creating a valid deed for conveyancing

To be valid, a deed needs to:

- be in writing;
- identify the grantor and the grantee;
- contain a granting clause stating the grantor's intention to convey;
- adequately describe the real estate involved;
- be signed by the grantor; and
- be handed to and accepted by the grantee.

Form deeds used in real estate transactions conform to these validity requirements by containing words of conveyance, and contain provisions for the identification of the parties and a description of the real estate. They are of suitable size and format to also permit the document to be notarized and recorded. [See **RPI** Form 404 and 405]

## A deed in writing, with exceptions

To be valid, the *transfer* of an ownership interest in real estate needs to be in writing, except for:

- an estate at will or a lease for a term not exceeding one year;<sup>5</sup>
- an *executed* (partially or fully performed) oral agreement under which the buyer takes possession of the property and makes payments toward the purchase price or makes valuable improvements on the property; or
- adverse possession.

<sup>4</sup> CC §1105

<sup>5</sup> CC §1091

An *executed oral agreement* for the transfer of real estate ownership is enforced either under the doctrines of **specific performance** or **estoppel**. The application of both doctrines is unaffected by whether the property is sold under an oral agreement to a buyer for consideration, or given to a *donee* by gift.

A buyer and seller enter into an oral *land sales contract*. The buyer agrees to pay the purchase price by taking over payments on the mortgage of record and making an additional monthly payment to the seller.

The seller agrees to convey title to the buyer when the buyer has fully paid the purchase price by final payoff of the mortgage and the seller's remaining equity balance in the land sales agreement.

The buyer takes possession of the property. The buyer eventually completes payment of all amounts due. Having fully performed the oral agreement, the buyer makes a demand on the seller to convey title to the property.

The seller refuses, claiming the oral land sales contract is unenforceable since the **statute of frauds** requires an agreement for the sale of real estate to be in writing to be enforceable.

Is the buyer entitled to the specific performance of the oral land sales contract and conveyance of title to the property?

Yes! The buyer's **possession** of the property and **full or partial performance** of the oral land sales contract collectively acts as a substitute for the prerequisite signed writing required by the *statute of frauds* for enforcement of a sale of real estate.

However, *partial payment* of the purchase price under an oral agreement when the buyer is not given possession is insufficient to overcome the statute of frauds writing requirement.

The buyer needs to be given *possession* of the property for the oral purchase agreement to be enforceable on a partial payment of the price. The buyer's **open and notorious** possession indicates a claim of ownership in the property which is inconsistent with the seller's claim of ownership when a verbal agreement for payment of the agreed-to price has been acted upon.<sup>6</sup>

Additionally, the buyer's possession of the property is inconsistent with record title. Any purchaser obtaining title from the seller after the buyer takes possession is on *constructive notice* to further inquire into the interest of the buyer-in-possession of the property. Thus, the subsequent purchaser is not an innocent buyer who is without notice of the buyer-in-possession's interest, called a **bona fide purchaser (BFP)**.<sup>7</sup>

## Enforcing an oral promise to convey

<sup>6</sup> *Francis v. Colendich* (1961) 193 CA2d 128

<sup>7</sup> *Gates Rubber Company v. Ulman* (1989) 214 CA3d 356

## Unjustly enriched unless estopped

Consider an owner of real estate who **orally conveys** all their interest in a vacant parcel of real estate to their oldest child as a gift. The child takes possession of the property and makes substantial improvements, including the construction of a building. The value added to the property by the construction exceeds the fair rental value of the child's months of possession before completion of the construction.

Later, the owner dies. Other heirs of the owner now claim an ownership interest in the improved property. The oldest child seeks to quiet title to the property in their name, claiming they took possession and made substantial improvements to the property in reliance on the owner's gift of the real estate.

The heirs claim ownership to the property was not conveyed since the owner did not transfer title to the property by a signed writing.

Do the heirs have an ownership interest in the property orally conveyed to the child as a gift?

No! The heirs are barred, or *estopped*, from denying the oldest child's claim of ownership by asserting a written conveyance needs to be signed and delivered by the owner as required by the statute of frauds. To now require a writing to evidence the gift will *unjustly enrich* the heirs, due to the value added by the improvements.

The child **took possession** of the property in reliance on the owner's oral conveyance as a gift, and later placed **substantial** and **permanent improvements** on the property. To deny the child title to the property after they built the substantial improvements is *inequitable* and unfair. Thus, the equitable *doctrine of estoppel* does not allow the writing requirement in the statute of frauds to be used by challengers to defeat the gift made by an oral conveyance of the real estate.<sup>8</sup>

However, the expenditures and improvements on the property need to provide **lasting benefits** and enhance the property's value beyond its mere rental value. Slight or temporary improvements by occupants who claim ownership under an oral conveyance are not sufficient to quiet title in the occupant and defeat a challenge based on the need for a writing under the statute of frauds.

The value of the improvements made by the occupant-in-possession of a property in reliance on an owner's oral conveyance need to exceed the **fair rental value** for the possession and use of the property, such as to constitute a capital investment by the occupant. Without an investment exceeding the rental value, no basis exists to support enforcement of the oral conveyance and estop others who wish to deny the occupant's ownership for the lack of a written conveyance.<sup>9</sup>

<sup>8</sup> **Green v. Brown** (1951) 37 C2d 391

<sup>9</sup> **Burris v. Landers** (1896) 114 C 310

To establish title by **adverse possession**, an occupant needs to show:

- their possession is based on a *claim of right* or *color of title*;
- they have occupied the property in an open and notorious way which constitutes *reasonable notice* to the record owner;
- their occupancy is *hostile and inconsistent* with the owner's title;
- they have been in possession for a *continuous and uninterrupted period* of at least five years; and
- they have *paid all taxes* assessed against the property during their occupancy.<sup>10</sup> [See Chapter 23]

An occupant's ownership by *adverse possession* based on a claim of right avoids the statute of frauds writing requirement. To obtain title by adverse possession based on a claim of right, the occupant has, by the nature of adverse possession, no written documentation or evidence of title. Essentially, the adverse possessor is a *trespasser* in possession of the owner's property without any good faith belief they hold title to the property.<sup>11</sup>

Thus, in the case of adverse possession by a claim of right, the owner of the property has not orally conveyed title to the real estate to the occupant. The occupant is a trespasser until their conduct on the property, time in possession and payment of all property taxes meet the requirements for them to obtain a court ordered transfer of title by adverse possession.

Alternatively, title by adverse possession based on a color of title usually occurs when the occupant's title is based on a *defective deed*.

For example, a child forges their father's signature on a power of attorney form naming the child as the father's agent, called an *attorney in fact*. Using their authority under the power of attorney, the child sells the father's property, signing the grant deed conveying title to the buyer as their father's **attorney in fact**. [See **RPI** Form 447]

The buyer of the property, unaware of the child's forged authority, accepts the deed. The buyer takes possession of the property and acts as the owner of the property, including the payment of property taxes.

More than five years after title and possession of the property is delivered to the buyer, the father learns of the forged grant deed and seeks to eject the buyer from the property and clear (quiet) title of the cloud created by the forged deed (which is void).

Does the buyer hold title to the property by adverse possession — even though the deed of record is forged and void?

Yes! Although the deed to the buyer was void conveying no interest in the property due to the forged power of attorney, the buyer's possession was sufficient to put the true owner, the father, on notice of the buyer's claim. Since the buyer's conduct meets the requirements of adverse possession,

## Title by claims of adverse possession

### adverse possession

A method of acquiring title to real estate owned by another by openly maintaining exclusive possession of the property for a period of five years and paying all property taxes.

<sup>10</sup> Calif. Code of Civil Procedure §§318 et seq.

<sup>11</sup> **Brown v. Berman** (1962) 203 CA2d 327



## Grantor qualifications as capable

including the payment of property taxes, the buyer is entitled to title by adverse possession based on their *color of title* as a defense against the father's attempt to recover the property.<sup>12</sup>

A grantor of property needs to be capable of conveying an interest in real estate at the time the deed is signed for the deed to be an enforceable conveyance.<sup>13</sup>

To be *capable*, the grantor at the time the deed is signed needs to:

- be of *sound mind*;
- possess their *civil rights*; and
- be an *adult* at least 18 years of age.<sup>14</sup>

However, an exception exists to the "18 or over" age qualification. An **emancipated minor** is considered an adult capable of transferring an interest in real estate.<sup>15</sup>

An individual under the age of 18 is an *emancipated minor* when the individual:

- has entered into a valid marriage, even if the marriage is now dissolved;
- is on active duty with the United States armed forces; or
- has received a declaration of emancipation from the court.<sup>16</sup>

A **temporary conservator** may be appointed by the court to manage the affairs of a property owner who is deemed incapable of conveying an interest they hold in real estate.

To put the public on notice of a conservatorship, a **notice of conservatorship** is recorded in the county where the property is located. Unless the notice is recorded, the owner's conveyance to an individual who does not have **actual knowledge** of the conservatorship is valid.<sup>17</sup>

However, while the deed may be valid, the failure to record a notice of conservatorship does not eliminate the *rules of equity* when the incapable owner has conveyed property. A conveyance to a buyer who does not have actual or constructive knowledge of the conservatorship may be *rescinded* (set aside) as **voidable** by the owner when the owner did not understand the nature and consequences of the sales transaction they entered into it.<sup>18</sup>

Further, when a court not only decrees an owner to be **incompetent** but appoints a guardian as well, any later conveyance of real estate by the owner is **void** as having transferred nothing, not merely voidable. When the owner has been adjudicated as entirely incompetent and is appointed a guardian,

<sup>12</sup> CCP §§322, 323

<sup>13</sup> CC §38; Calif. Family Code §6701

<sup>14</sup> CC §1556

<sup>15</sup> Fam C §7050(e)(3)

<sup>16</sup> Fam C §7002

<sup>17</sup> Calif. Probate Code §1875

<sup>18</sup> Prob C §§1875, 1876

a later conveyance by the owner may be set aside as never having been effective, even when the grantee is a BFP for lack of actual or recorded notice of the guardianship.

The appointment of a guardian and decree of incompetency, even unrecorded, are considered notice to all individuals of the owner's legal incapacity to convey real estate under any circumstances.

Unlike a conservator, a guardian does not need to record a notice of the appointment to put buyers and lenders on notice. A court's determination of the owner's incompetence and appointment of a guardian constitutes *notice to the world* that the deed is void since the owner lacks all legal capacity to convey property.<sup>19</sup>

Consider an owner who conveys real estate before a court rules them incompetent. For the conveyance to be void and thus entirely unenforceable by the grantee, the owner needs to be so incompetent as to be entirely without understanding on all matters when the deed was signed.<sup>20</sup>

However, when the owner simply lacks an understanding of the nature and the consequences of the transaction but is not completely without understanding and has not been appointed a guardian, the conveyance may be merely *voidable*. Thus, the deed needs to be later rescinded by the owner to void its continued validity.<sup>21</sup>

In the instance of an incompetent owner not entirely without understanding, when the grantee is able to show they were unaware of the owner's incompetency at the time of the conveyance and provide valuable consideration, the conveyance is enforceable.<sup>22</sup>

The **grant provision** in a deed needs to identify each person who is conveying an interest in the property in the grant provision of the deed. When a conveyance such as a deed is signed by a person who is not named as the **grantor**, the deed does not convey that person's interest in the property.

The identity of the grantor in the provision containing words of conveyance needs to be stated by name, determined by an examination of the entire deed, not just the signatures.<sup>23</sup>

For example, a deed identifies several individuals by name as grantors in the grant provision and the document contains their signatures. However, the list of grantors named in the deed's grant provision is incomplete to convey 100% of the title. Several unnamed individuals also have an ownership interest in the property.

## Incompetency before court ruling

## Grantor identification in deed

**grantor**  
A individual capable of conveying an interest in real estate.

<sup>19</sup> *Hellman Commercial Trust & Savings Bank v. Alden* (1929) 206 C 592

<sup>20</sup> CC §38

<sup>21</sup> CC §39

<sup>22</sup> Prob C §1875

<sup>23</sup> *Childs v. Newfield* (1934) 136 CA 217

Further, the signatures on the grant deed include all the individuals who are co-owners of the property — even though some are not named as grantors in the grant provision.

In this instance, the deed transfers only the ownership and title held by those owners named as grantors in the grant provision in the deed. The deed by its wording does not show the necessary intent to convey title by the unnamed owners who were not listed as grantors and also signed the deed.<sup>24</sup>

On recording, the county recorder will only index as grantors those persons listed in the grant provisions since only they by their signatures conveyed their interests in the real estate.

## Grantor's vesting in the chain of title

The name of the grantor on a deed needs to match the name of the grantee named in the previous deed which conveyed title to them. Otherwise, a **break in the chain of title** occurs.

For example, an unmarried woman takes title in her maiden name “as an unmarried woman.”

Later, the woman marries and takes her husband’s last name as her own.

If the woman then conveys the property using her newly-acquired married name to identify herself as the grantor, it will cause a *break in the chain of title*. When a different name is used as the grantor from the name used to receive title under a prior deed, the new name cannot be located in the county recorder’s grantor-grantee index as the grantee who previously received and holds title to the property being conveyed. The title remains in her maiden name as no one is on notice (by the record) of her conveyance.

With a *break in title* between deeds due to the grantor’s name change after taking title as a grantee, a buyer receives an unmarketable title. In this example, the grantor received title in her maiden name as an unmarried woman and conveyed the property in her married name, causing a break in the chain of title.<sup>25</sup>

Any person conveying property whose name has changed after becoming vested in title needs to enter as grantor on the deed both:

- the name in which they previously received title to the real estate as a grantee; and
- the name by which they are acting as the grantor on the conveyance.<sup>26</sup>

When a deed does not identify the grantor by the precise name and spelling under which the grantor previously took title, the deed does not give constructive notice to later buyers or encumbrancers of the property that the grantor has already conveyed their interest. However, the deed with

<sup>24</sup> *Roberts v. Abbott* (1920) 48 CA 779

<sup>25</sup> *Benson v. Shotwell* (1890) 87 C 49

<sup>26</sup> CC §1096

the reference to the incorrect name of the grantor is valid and enforceable between the parties to the deed and those who have notice of the true identity of the grantor.<sup>27</sup>

Further, **possession** of real estate by the grantee is *constructive notice* to others that the defective deed exists. Possession places future buyers, lenders and tenants on notice to ask the grantee-in-possession what interest they hold in the property.

While the grantor needs to have the capacity to convey title, any existing person (individual or entity) may take and hold title to real estate as the **grantee**.<sup>28</sup>

A child or an incompetent person has the *capacity to receive* and hold title as a grantee even though that person does not have the legal capacity to convey the same property.<sup>29</sup>

Unless a deed *identifies* the grantee, the deed is void. The identity of the grantee needs to be sufficient to identify with certainty the individual to whom the seller intends title to be passed.<sup>30</sup>

Consider a seller who places their grant deed in escrow (a third party) without naming a grantee or instructing escrow to enter a grantee's name.

Later, the escrow agent inserts the name of the buyer in the deed as the grantee on the assumption the deed was to be used to convey title to the buyer. The buyer's name is inserted without the seller being present or the seller's written authority.

Is the deed enforceable after escrow inserted the buyer's name in the deed without receiving the seller's authority?

No! If a seller/grantor is not present when a buyer's/grantee's name is inserted in the grant deed, or if the name of the grantee is inserted by a person without the grantor's written authority to do so, the deed is *void*.<sup>31</sup>

Further, a deed is considered valid when the individual identified as the grantee takes title under a **fictitious name** by which they are also known or have assumed for the purpose of receiving title.

However, when the *fictitious name* is used to defraud the grantor, the grantor may set aside the deed as **voidable**.

Sometimes an unintentional error **misnames the grantee** in a recorded deed, such as by misspelling the grantee's name. A deed with a misnamed grantee is still a valid conveyance of the real estate.

## The grantee as any person

**grantee**  
An individual acquiring an interest in title to real estate.

<sup>27</sup> CC §1096

<sup>28</sup> CC §671

<sup>29</sup> *Turner v. Turner* (1916) 173 C 782

<sup>30</sup> *Tumansky v. Woodruff* (1936) 14 CA2d 279

<sup>31</sup> *Tannahill v. Greening* (1927) 85 CA 714

Another deed from the same grantor to the grantee named with the correct spelling of the grantee's name will not correct the error, nor will re-recording the original deed with an amendment containing the grantee's correct name. The recording of a corrective deed falls outside the chain of title in the grantor-grantee index since the grantor no longer has any interest to convey. The grantor has already conveyed their title, albeit to a grantee with an erroneously spelled name.<sup>32</sup>

However, the buyer may petition a court to establish the identity of a seller when a discrepancy with the seller's name exists in the chain of title.<sup>33</sup>

*Editor's note — Title companies are only concerned the grantor on a deed is the same person who took title under an incorrect name. Title companies will generally accept a deed conveying title which identifies the grantor by both their correct name and the incorrect (misspelled) name under which they originally took title as a grantee.*

## Corporations, partnerships and LLCs

Partnerships, limited liability companies (LLCs), corporations and real estate investment trusts (REITs) are entities which may acquire title to California real estate when they are established or qualified under California law to conduct business in the state.<sup>34</sup>

Consider a seller who sells property to a corporation which at the time does not yet legally exist. Further, a deed is signed and handed to escrow by the seller, naming the corporation as the grantee.

Prior to the close of escrow, the corporation files its articles of incorporation with the Secretary of State of California to establish its formation and existence. Later, escrow is closed and the deed is delivered (recorded) and accepted by the corporation.<sup>35</sup>

Is the deed enforceable?

Yes! A corporation has the capacity to receive title to real estate even though the deed was signed before the corporation legally existed. A deed **becomes effective** on its delivery to the grantee, not on the date it was signed.

However, a deed will not be considered delivered when the corporation does not exist at the time of the deed's delivery to the corporation since acceptance by the grantee is required for a delivery. The deed is not considered accepted when the corporation, as the grantee, does not legally exist at the time the deed is recorded. Thus, a deed delivered to a corporation after it files articles of incorporation is effective.<sup>36</sup>

<sup>32</sup> *Walters v. Mitchell* (1907) 6 CA 410

<sup>33</sup> CCP §5770.010 et seq.

<sup>34</sup> Calif. Corporations Code §5207, 16203, 17701.05

<sup>35</sup> Corp C §209

<sup>36</sup> *Wall v. Mines Girls' Directory Orphan Asylum* (1900) 130 C 27

The actual words of conveyance in a deed depend on whether the deed used is a **grant deed** or a **quitclaim deed**. [See Chapter 19]

A *grant deed* is used to pass a *fee estate* from the grantor to another individual, unless a lesser interest is stated in the deed. While no precise words of conveyance are necessary, use of the word “grant” in the granting clause, without noting a lesser interest in the description of the property, indicates the conveyance of a fee simple interest in the described property. [See **RPI Form 404**]

Alternatively, a *quitclaim deed* is intended to convey whatever interest, if any, the grantor may hold in the real estate. The words of conveyance historically used in a quitclaim deed are “remise, release and otherwise quitclaim.”

However, only the word “quitclaim” is required as the word of conveyance. The word “grant” is not used in a quitclaim deed since no implied warranties are included with a conveyance under a quitclaim deed. Yet, the parties to a quitclaim deed are referred to as the “grantor” and the “grantee.” [See **RPI Form 405**]

A deed conveying property needs to sufficiently *describe* the property being conveyed. The description in the deed is necessary so the property may be reasonably located. When the property cannot be located from the description, the conveyance is void.<sup>37</sup>

The description of a parcel in a deed needs to be sufficient to allow the real estate conveyed to be identified and located with reasonable certainty by a surveyor.<sup>38</sup>

Facts not stated in the deed, known as *extrinsic evidence*, may only be used when an ambiguity arises as to the description of the property conveyed.

Conversely, extrinsic evidence may not be used to supply the deed with a missing description or correct a defective description.

For example, real estate is conveyed by a deed describing the property as the “Occidental Mill Site, containing 4.95 acres, being a fraction of lot 2...” The use of the real estate’s **common name** in the deed is sufficient to locate the boundaries and identify the real estate being conveyed.<sup>39</sup>

*Editor’s note — Any dispute regarding the location of the 4.95 acres on lot 2 needs to be resolved as a boundary dispute. [See Chapter 9]*

Additionally, a deed which describes real estate by its street address, such as “123 Riverside Avenue, Riverside, CA 92507,” will be considered sufficient to identify the real estate located at the street address, sometimes called a **common description** or **common address**.<sup>40</sup>

## Words of conveyance for a fee or less

### quitclaim deed

A document used to convey whatever interest, if any, the grantor may hold in the real estate.

## Describing the property conveyed

### common description

Description of real estate by its street address. Also known as a common address.

<sup>37</sup> **Scott v. Woodworth** (1917) 34 CA 400

<sup>38</sup> **Best v. Wohlford** (1904) 144 C 733

<sup>39</sup> CC §1092

<sup>40</sup> **Brudvig v. Renner** (1959) 172 CA2d 522



**legal description**

Description of real estate in a deed by its parcel or lot number, or containing the property's metes and bounds description.

However, the best method of ensuring certainty of the parcel being conveyed is to include the property's **legal description** or a map designation, such as a parcel or lot number, which contains the *metes and bounds* description.

Thus, the real estate may be described by reference to other documents, such as a subdivision map as it contains the metes and bounds description of the parcel conveyed. The subdivision document referenced in a deed is incorporated into the deed as the source of the metes and bounds description of the property conveyed.<sup>41</sup>

## The grantor's signature

To transfer real estate by a deed, the deed needs to be signed by the grantor named in the deed.<sup>42</sup>

The grantor's agent may also sign a deed on behalf of the grantor when the agent is authorized in writing to convey the property on the grantor's behalf. The agent is called an **attorney in fact** and is operating under a written *power of attorney*.<sup>43</sup>

**amanuensis**

An individual who has the oral authority of the grantor to sign a grant deed by their own hand on behalf of the grantor.

Additionally, a deed may be signed in the name of the grantor by an **amanuensis** acting on oral instructions from the grantor. An *amanuensis* is an individual who has the oral authority of the grantor to sign the grantor's name on a grant deed by their own hand on behalf of the grantor.

Unlike an attorney in fact, who is an agent with *discretionary authority* to determine whether they are to enter into a deed without prior approval from the grantor, an amanuensis has a purely ministerial duty. The amanuensis signs a document as instructed by the grantor whose name they sign without exercising personal discretion or judgment.

Consider an owner who, prior to becoming blind, executes a power of attorney naming his heir as his attorney in fact. Under the power of attorney, the heir has the power to sell, convey and transfer the owner's property as though they were the owner. However, an attorney in fact does not have authority to convey the property to themselves or anyone else as a gift.

A grant deed is prepared for the owner's signature, conveying the property to the heir as a gift. On the verbal instruction of the now-blind owner, the heir signs the owner's name on the grant deed by their own hand. The deed is recorded and returned by the recorder to the owner.

The owner dies and another heir seeks to set the grant deed aside. The other heir claims the grant deed is invalid since as an attorney in fact, the heir does not have the authority to convey the property to themselves as a gift.

The heir claims the grant deed is valid since they signed the deed as an amanuensis on the instruction from the owner to sign the owner's name on the deed and did not act in their capacity of an attorney in fact.

Is the grant deed signed by the heir on behalf of the owner valid?

<sup>41</sup> **Edwards v. Lewis** (1938) 25 CA2d 168; see Figure 1

<sup>42</sup> CC §1091

<sup>43</sup> CC §1091



Yes! The deed is valid. When the heir signed the deed, they were not acting as an agent but as an instrument of the owner. Thus, the heir did not exercise their discretion as an agent of the owner acting under a power of attorney when the property was conveyed to them since they acted as an amanuensis. The heir followed the owner's oral instructions when they signed the owner's name to the grant deed.<sup>44</sup>

<sup>44</sup> *Estate of Stephens* (2002) 28 C4th 665

The individual conveying real estate is called the grantor. The individual acquiring title is called the grantee.

The transfer of title to real estate contained in writing is called a grant or conveyance. To be valid, a deed needs to:

- be in writing;
- identify the grantor and grantee;
- contain a granting clause stating the intention to convey;
- adequately describe the real estate so it may be reasonably located;
- be signed by the grantor or signed on behalf of the grantor by the grantor's agent; and
- be handed to and accepted by the grantee.

A transfer of ownership needs to be in writing to be valid, except for:

- an estate at will;
- a lease not exceeding one year;
- an executed oral agreement in which the buyer takes possession of the property; or
- adverse possession of the property.

A grant deed is used to pass a fee estate from the grantor to another individual, unless a lesser interest is stated in the deed. A quitclaim deed conveys whatever interest, if any, the grantor may hold in the real estate.

A grantor of property needs to be capable of conveying an interest in real estate at the time the deed is signed for the deed to be enforceable.

Partnerships, limited liability companies (LLCs), corporations and real estate investment trusts (REITs) are entities which may acquire title to California real estate when they are established or qualified under California law to conduct business in the state.

## Chapter 18 Summary

## **Chapter 18**

### **Key Terms**

<b>adverse possession .....</b>	<b>pg. 171</b>
<b>amanuensis .....</b>	<b>pg. 178</b>
<b>common description .....</b>	<b>pg. 177</b>
<b>fee estate .....</b>	<b>pg. 168</b>
<b>grant .....</b>	<b>pg. 167</b>
<b>grant deed .....</b>	<b>pg. 175</b>
<b>grantee .....</b>	<b>pg. 175</b>
<b>grantor .....</b>	<b>pg. 173</b>
<b>legal description .....</b>	<b>pg. 178</b>
<b>quitclaim deed .....</b>	<b>pg. 177</b>

**Quiz 8 Covering Chapters 18-20 is located on page 448.**



# Grant deed vs. quitclaim deed

## Chapter 19

After reading this chapter, you will be able to:

- understand the use of a grant deed to pass a fee simple interest in real estate;
- identify the implied covenants of grant deeds;
- determine when implied covenants in a grant deed run with the land and affect all later grantees/owners; and
- distinguish when a quitclaim deed is to be used to terminate any interest in real estate described in the deed which may be held by the grantor.

**encumbrance**

**grant deed**

**implied covenant**

**quitclaim deed**

**reformation**

**remote grantee**

**subrogation**

### Learning Objectives

### Key Terms

Consider a married individual who sells a parcel of real estate they solely own.

Before issuing a title insurance policy to insure the conveyance of marketable title to the property against any potential community property claim of the seller's spouse, the title insurance company requests the spouse join in the grant deed by signing it as the spouse of the grantor.

The spouse signs the grant deed for the sole purpose of releasing any community property interest possibly acquired as a result of the marriage — even though the spouse acquired no interest in the real estate.

### The deeds of conveyance

After closing, the buyer of the property discovers a tenant who holds a lease which the buyer did not agree to in the purchase agreement as a condition of title or by reference in the grant deed. As a result, the buyer incurs money losses to relocate the tenant. Meanwhile, the seller dies but is survived by the spouse who joined in the conveyance.

#### **implied covenant**

An implied warrant the grantor has not previously conveyed or encumbered their interest in the real estate.

The buyer now seeks to collect their tenant relocation expenses from the seller's spouse for breach of the **implied covenant** in the grant deed signed by the spouse. The *implied covenant* warrants the grantor has not *encumbered* title to the property in any manner, such as creating a lease not included as a title condition in the purchase agreement.

The seller's spouse who joined in the conveyance claims a spouse cannot be liable for the breach of the **covenant against further encumbrances** when the spouse never had an interest in the property to convey, and the buyer's only remedy is against the deceased seller.

Here, the spouse is liable for the breach of the implied covenant against further encumbrances. The spouse signed the grant deed as a grantor.

Since the spouse voluntarily participated as a grantor in the conveyance and did not enter into the conveyance through mistake or fraud, the spouse as a grantor **breached the implied covenant** against **further encumbrances** by failing to state the property was subject to the lease.<sup>1</sup>

To avoid the exposure to liability imposed by the implied covenants in the grant deed, the spouse needed to sign only a quitclaim deed to either the seller or the buyer.

## **A deed in writing, with exceptions**

#### **grant deed**

A document used to pass a fee simple interest in real estate from the grantor to another individual, unless a lesser interest is stated.

Two types of deeds are used nearly exclusively to convey a real estate interest:

- **grant deeds**; and
- **quitclaim deeds**.

Often, grant deeds and quitclaim deeds are erroneously viewed as interchangeable, occasionally creating unintended liability for grantors. Other documents used to convey ownership or possessory interests in real estate are:

- trustee's deeds [See **RPI** Form 475];
- **revocable transfer on death deeds (RTDDs)** [See **RPI** Form 411]; and
- lease agreements. [See **RPI** Form 550 and 552]

A *grant deed* is used to pass a *fee simple interest* in real estate from the grantor to another individual, unless a lesser interest is stated in the deed. While no precise words of conveyance are necessary, use of the word "grant" in the

<sup>1</sup> **Evans v. Faught** (1965) 231 CA2d 698

granting clause, without noting a lesser interest in the description of the property, indicates the conveyance of a fee simple interest in the described property.<sup>2</sup> [See Form 404 accompanying this chapter; see Chapter 18]

Alternatively, a quitclaim deed is intended to convey whatever interest, if any, the grantor may hold in the real estate. No warranty is imposed that the grantor actually holds any interest in the property to convey, and no warranty is imposed that they have not encumbered title during any ownership they may have had.

The words of conveyance historically used in a quitclaim deed are “remise, release and otherwise quitclaim.” However, only the word “quitclaim” is required as the word of conveyance. The word “grant” is not used in a quitclaim deed since to be a quitclaim deed, no warranties are included with a conveyance. However, the parties to a quitclaim deed are referred to as the “grantor” and the “grantee.” [See Form 405 accompanying this chapter]

The type of deed used to convey property is evidence of the **future role** the individual conveying title undertakes. Thus, a grant deed is used to convey real estate with **covenants** relating to the interest conveyed. A quitclaim deed is used to simply convey any interest in real estate without any assurance the individual named as grantor holds an interest to convey.

The covenants, sometimes called *warranties*, implied in a grant deed include:

- the interest conveyed in the real estate has not been *previously conveyed* to another, except as disclosed in the grant deed; and
- the grantor has not *further encumbered* the real estate, except as disclosed in the grant deed.<sup>3</sup>

Grant deed covenants are **implied**. Thus, they are not separately bargained for as provisions to be included in the grant deed conveyance.

If a grant deed covenant is breached by a seller (grantor), the buyer (grantee) may recover their money losses from the seller for the breach of the implied covenant, as though the covenant had been written into the grant deed.<sup>4</sup>

Consider a seller who owns a parcel of real estate with *appurtenant water rights* in other real estate. The seller enters into a purchase agreement with a buyer, agreeing to convey the real estate to the buyer.

The seller signs a grant deed and hands it to escrow to convey the real estate to the buyer on closing. However, before the grant deed is delivered to the buyer, the seller conveys the appurtenant water rights to another individual.

After closing, the buyer learns of the seller’s conveyance of the water rights and seeks damages for the seller’s breach of the implied covenant against previous conveyances in the grant deed.

**Grant deed  
covenants  
are implied**

**The covenant  
against prior  
conveyances**

<sup>2</sup> Calif. Civil Code §1092

<sup>3</sup> CC §1113

<sup>4</sup> CC §1113

In this example, the seller is liable to the buyer for the value of the water rights conveyed to another. The water rights were appurtenant to the property sold. The seller breached the implied covenant in the grant deed by conveying the water rights without noting the conveyance as an *exception* in the grant deed they delivered to the buyer.<sup>5</sup>

## The covenant against encumbrances

### encumbrance

A claim or lien on title to a parcel of real estate, such as property taxes, assessment bonds, trust deeds, easements and covenants, conditions and restrictions (CC&Rs).

**Encumbrances** are the subject of the implied warranty in the grant deed, since they burden title and depreciate its value. Real estate *encumbrances* include all liens, voluntary or involuntary, attached to the real estate.<sup>6</sup>

Examples of real estate encumbrances include:

- taxes;
- assessments;
- covenants, conditions and restrictions (CC&Rs), such as covenants and use restrictions running with the land;
- building restrictions;
- a reservation of a right-of-way;
- an easement;
- an encroachment;
- a lease; and
- a pendency of a condemnation action.<sup>7</sup>

Consider a buyer who is aware of an existing lease on the property which the seller entered into as the landlord. The lease is not referenced in the purchase agreement or the escrow instructions as a condition of the title to be conveyed to the buyer. The buyer never agrees in writing to take title subject to the existing lease.

Further, the grant deed to the buyer does not state they are receiving title to the legally described real estate *subject to* the existing lease created by the seller.

The transaction closes and the tenant refuses to vacate the property based on agreements entered into between the tenant and the seller. The buyer then incurs expenses relocating the tenant. The buyer makes a demand on the seller to reimburse them for the tenant relocation expenses. The buyer claims the seller breached the implied covenant against encumbrances in the grant deed delivered to the buyer.

The seller claims the buyer may not recover the seller's expenses for the tenant's relocation since the buyer had *constructive knowledge* the tenant was in possession and *actual knowledge* the lease existed at the time they accepted delivery of the seller's grant deed.

<sup>5</sup> **Lyles v. Perrin** (1901) 134 C 417

<sup>6</sup> CC §§1113, 1114

<sup>7</sup> Evans, *supra*

RECORDING REQUESTED BY  AND WHEN RECORDED MAIL TO <div style="border: 1px solid black; width: 100%; height: 100%; position: relative;"> <div style="position: absolute; top: 5px; left: 5px;">Name</div> <div style="position: absolute; top: 15px; left: 5px;">Street Address</div> <div style="position: absolute; top: 25px; left: 5px;">City &amp; State</div> </div>	<div style="border: 1px solid black; height: 40px; margin-bottom: 5px;"></div> SPACE ABOVE THIS LINE FOR RECORDER'S USE
Title Order # _____ Escrow # _____ APN # _____	<b>The undersigned grantor(s) declare(s):</b> DOCUMENTARY TRANSFER TAX \$ _____ <input type="checkbox"/> Computed on the consideration or value of property conveyed; or <input type="checkbox"/> Computed on the consideration or value less liens or encumbrances remaining at time of sale. <input type="checkbox"/> Unincorporated area <input type="checkbox"/> City of _____
<b>GRANT DEED</b>	
<b>NOTE:</b> This form is used by agents, escrow officers and owners when any or all of a fee simple interest in real estate other than a leasehold is transferred, to identify the parties to the transfer, describe the property transferred and record the transfer with the county.	
I/We, _____, grant to _____ the real property in the City of _____, County of _____, State of California, referred to as _____	
<input type="checkbox"/> See attached Signature Page Addendum. [RPI Form 251]	
Date: _____, 20_____ <div style="display: flex; justify-content: space-between;"> <span>(Print name)</span> <span>(Signature)</span> </div> <div style="display: flex; justify-content: space-between; margin-top: 10px;"> <span>(Print name)</span> <span>(Signature)</span> </div>	
A notary public or other officer completing this certificate verifies only the identity of the individual who signed the document to which this certificate is attached, and not the truthfulness, accuracy, or validity of that document.	
STATE OF CALIFORNIA COUNTY OF _____ On _____ before me, _____ <div style="text-align: right; font-size: small;">(Name and title of officer)</div> personally appeared _____, who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.	
<div style="display: flex; justify-content: space-between;"> <div style="width: 40%;">           I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.            WITNESS my hand and official seal.         </div> <div style="width: 50%;">           Signature: _____  <div style="text-align: right; font-size: small;">(Signature of notary public)</div> </div> </div> <div style="text-align: center; margin-top: 10px; font-size: x-small;"> <span>(This area for official notarial seal)</span> </div>	
<b>MAIL TAX STATEMENTS AS DIRECTED ABOVE</b>	
<div style="border: 1px solid black; display: flex; justify-content: space-between; align-items: center;"> <span><b>FORM 404</b></span> <span>03-15</span> <span>©2016 RPI — Realty Publications, Inc., P.O. BOX 5707, RIVERSIDE, CA 92517</span> </div>	

Form 404  
 Grant Deed

In this example, the **buyer's knowledge** that the lease existed does not bar recovery of their costs to relocate the tenant based on the seller's breach of the implied covenant against further encumbrances. The buyer is entitled to **rely** on the grant deed and the purchase agreement. Thus, the seller was obligated under the implied covenant in the grant deed to deliver title clear of the lease they created.<sup>8</sup>

<sup>8</sup> Evans, *supra*



## Form 405

## Quitclaim Deed

RECORDING REQUESTED BY  AND WHEN RECORDED MAIL TO <div style="border: 1px solid black; padding: 2px; margin: 5px 0;"> <input type="checkbox"/> </div> Name  Street Address  City & State  <div style="border: 1px solid black; padding: 2px; margin: 5px 0;"> <input type="checkbox"/> </div>	<div style="border: 1px solid black; height: 40px; margin-top: 10px;"></div> SPACE ABOVE THIS LINE FOR RECORDER'S USE
--	---

Title Order # _____  Escrow # _____  APN # _____	<b>The undersigned grantor(s) declare(s):</b> DOCUMENTARY TRANSFER TAX \$ _____ <input type="checkbox"/> Computed on the consideration or value of property conveyed; or <input type="checkbox"/> Computed on the consideration or value less liens or encumbrances remaining at time of sale. <input type="checkbox"/> Unincorporated area <input type="checkbox"/> City of _____
--	--

**QUITCLAIM DEED**

**NOTE:** This form is used by an agent, escrow officer, owner or title company when a person relinquishes any interest they may hold in title to real estate, to identify the parties to the transfer, describe the property involved and record the transfer with the county.

I/We, \_\_\_\_\_,  
 quitclaim to \_\_\_\_\_  
 the real property in the City of \_\_\_\_\_,  
 County of \_\_\_\_\_, State of California,  
 referred to as \_\_\_\_\_

☐ See attached Signature Page Addendum. [RPI Form 251]

Date: \_\_\_\_\_, 20\_\_\_\_

\_\_\_\_\_  
(Print name)

\_\_\_\_\_  
(Signature)

\_\_\_\_\_  
(Print name)

\_\_\_\_\_  
(Signature)

A notary public or other officer completing this certificate verifies only the identity of the individual who signed the document to which this certificate is attached, and not the truthfulness, accuracy, or validity of that document.

STATE OF CALIFORNIA  
 COUNTY OF \_\_\_\_\_  
 On \_\_\_\_\_ before me, \_\_\_\_\_  
(Name and title of officer)  
 personally appeared \_\_\_\_\_,  
 who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature: \_\_\_\_\_  
(Signature of notary public)

(This area for official notarial seal)

**MAIL TAX STATEMENTS AS DIRECTED ABOVE**

FORM 405	12-14	©2016 RPI — Realty Publications, Inc., P.O. BOX 5707, RIVERSIDE, CA 92517
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## Covenants restricted or limited

To avoid liability arising out of the implied covenants in a grant deed, the deed needs to state the **title conditions** (encumbrances) created by the seller during their ownership. These buyers may or may not have agreed to these conditions in the purchase agreement.

The implied covenants in a grant deed are *waived* by the buyer and do not apply when the seller and buyer agree to the contrary in the purchase agreement. In this instance, the buyer and seller list all the title changes made by the seller in the grant deed.

For example, when the grantee is taking title subject to encumbrances placed on the property by the seller, the grant deed needs to state the property is "subject to" encumbrances of record, and list each of these encumbrances.

The implied covenants in the grant deed only insure the property has not been previously conveyed or encumbered by the grantor. No other promises regarding the title or condition of the property are implied in the grant deed.

Implied covenants are only for the *personal benefit* of a buyer, not future owners, referred to as **remote grantees**. The implied covenants in a seller's grant deed to a buyer do not impose a condition on title and do not *run with the land*.

Thus, being personal to the seller and buyer, the implied covenants in a grant deed may only be enforced by the grantee named in the deed. Implied covenants cannot be enforced by future *remote grantees* who acquire the buyer's interest at a later date.

Conversely, covenants running with the land, such as CC&Rs and easements, bind all future owners of the property whether they take title by deed or court order, as covenants running with the land affect title.

For a covenant to run with the land and affect all remote grantees, the seller creating the covenant needs to state in their conveyance that **successors** are bound by the covenants and restrictions imposed on the property as contained in the deed.<sup>9</sup>

Consider an owner who encumbers their real estate with a first trust deed lien. The owner then sells the property to a buyer who agrees in the purchase agreement and escrow instructions to take title subject to the first trust deed.

Title is conveyed by grant deed to the buyer. However, the grant deed does not note the title is subject to the first trust deed created by the owner.

Later, the property is resold by the buyer. The purchase agreement and the escrow instructions for the resale disclose the existence of the first trust deed — specifically, the remaining balance on the first trust deed note to be assumed as part of the terms for payment of the purchase price on the resale to the new buyer.

The grant deed for the resale states the new buyer will take title subject to all encumbrances of record.

Later, on a search of the record title, the new buyer discovers the first trust deed lien they took over was not referenced in the grant deed conveyance to the seller from the prior owner of the property who created the trust deed lien.

The new buyer seeks to recover money from the prior owner for the amount of the debt secured by the trust deed based on the prior owner's breach of the implied covenant against encumbrances. The new buyer claims they have suffered losses since the trust deed created by the prior owner was not referenced in the prior owner's grant deed when they sold the property.

## Covenants personal to grantor/grantee

### remote grantee

A future owner of real estate who later takes title to a property, also known as a successor.

<sup>9</sup> CC §1468

Is the new buyer entitled to recover money losses from the prior owner for the breach of the implied covenant against encumbrances contained in the grant deed?

No! The covenant implying the real estate is free from further encumbrances created by the prior owner is a **personal covenant**, held by and for the benefit of the original buyer only. An implied covenant does not run with the land for the benefit of a subsequent buyer. Thus, the new buyer may not recover money losses for the breach of an implied covenant under a grant deed which did not name them as the grantee.

Further, the new buyer agreed to the first trust deed since it was referenced in their purchase agreement and escrow instructions. Usually, a buyer's knowledge of an encumbrance does not bar an action by the buyer against their seller for breach of implied covenants.

In this instance, the new buyer is not entitled to be *unjustly enriched* for the prior owner's breach of the covenant against encumbrances when the new buyer agrees in the purchase agreement to take title subject to the encumbrance.<sup>10</sup>

### Title insurer's right to pursue the seller

Title insurance companies issue policies of title insurance covering the conveyance of real estate interests based on the condition of title.

Occasionally, a title company fails to properly search or accurately document the record title of real estate. When this occurs, the title company issues a policy which fails to reference the seller's activity which affected title, such as a lien or conveyance entered into by the seller.

A title insurance policy insures the buyer against changes in the recorded title made by the seller when the changes are not excluded from coverage by the terms of the purchase agreement.

For example, a seller of real estate encumbers their property with a trust deed during their ownership. To sell the property, a purchase agreement is entered into calling for the buyer to take title clear of all encumbrances except those listed. The trust deed encumbrance is not mentioned in the purchase agreement. Also, the seller's grant deed to the buyer does not state the title is subject to the encumbrance.

Further, the title insurance company insuring the grant deed fails to discover and disclose the encumbrance as an exception to coverage. Thus, the title insurance company indemnifies the buyer against the existence of the trust deed encumbrance on the property.

The buyer claims both the title insurance company and the seller are liable under their agreements with the buyer; the title insurance company under its policy, the seller under the implied covenant against further encumbrances in the grant deed.

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<sup>10</sup> *Babb v. Weemer* (1964) 225 CA2d 546

When the title insurer pays this claim, the insurer is assigned by the terms of the policy the buyer's rights against the owner under the grant deed, called **subrogation**. The seller's liability is now owed to the title company.

**subrogation**

The replacement of one person with another in regard to a legal right or obligation.

Consider a property owner who grants a neighbor a view easement which imposes limits on the height of improvements on the owner's property. The neighbor records the document conveying the easement, called an *easement deed*.

The owner then sells the real estate, which is now subject to the view easement they created. Neither the purchase agreement nor the escrow instructions disclose the existence of the easement created by the owner.

Before closing, the owner **orally informs** the buyer of the view easement.

The owner further informs the buyer and the company providing title insurance they do not know whether the easement deed is recorded. A preliminary title report issued by the title company does not disclose the existence of the recorded easement deed.

Further, the owner's grant deed conveys the property to the buyer and makes no reference that the legally described real estate is subject to the easement created by the owner. The title insurance policy issued to the buyer does not list the view easement as an exception to the insured condition of title.

After closing, the buyer discovers the easement was recorded while the owner held title. The buyer makes a claim against the title insurance company for the amount of the decrease in the value of the property caused by the easement.

The title insurance company pays the buyer's claim since title was insured against the recorded existence of the view easement. In exchange, the buyer **assigns** to the title company any rights held by the buyer against the owner for breach of the implied covenants in the owner's grant deed.

The title insurance company then seeks to recover its payment of the claim from the owner based on the owner's breach of the implied covenant to the buyer under the grant deed.

The owner claims the title insurance company cannot enforce the claim, held by the buyer and assigned to the title company by *subrogation*, when the buyer and the title insurance company were both aware of the easement before closing.

Is the title insurance company entitled to be subrogated to the rights of the buyer under the grant deed and recover the amount it paid for the buyer's lost value caused by the easement?

## Recovery by subrogation to buyer's loss

Yes! The buyer's and title insurance company's knowledge of the easement does not prevent recovery from the owner. The buyer is entitled to rely on the implied covenant against further encumbrances, which automatically accompanies the grant deed, unless the covenant is:

- *restricted* by listing the easement in the grant deed; or
- *waived* by agreeing to take title subject to the encumbrances in the purchase agreement, escrow instructions or other writing.

Further, the owner will be **unjustly enriched** if they are allowed to keep the entire amount of the purchase price received from the buyer since the price paid by the buyer did not reflect the reduced value caused by the easement.

Thus, the title insurance company, by the assignment, is entitled to step into the shoes of the buyer for the claim against the owner by subrogation/equitable assignment on payment to the buyer under the title insurance policy. The title insurer then pursues enforcement of the buyer's claim under the grant deed covenant against encumbrances.<sup>11</sup>

*Editor's note — A buyer may not rely on an erroneous **preliminary title report** as a warranty by the title insurance company of the condition of recorded title. A preliminary title report is merely an offer to issue a policy on the same terms and conditions, unless amended before closing. However, a seller is entitled to offset the title insurance company's recovery of its losses when the seller can show they justifiably relied on the title insurance company's representation concerning the non-existence of a recorded easement.*

*For the seller to justifiably rely on the title company, the title insurance company needs to issue an **abstract of title** policy to the seller. If an abstract of title policy discloses no easement of record when one exists, the title company is liable to the seller for the negligent preparation of the abstract of title, unless the seller knew the easement existed.<sup>12</sup> [See Chapters 21 and 22]*

## Purchase agreement merges into deed

Title conditions bargained for and agreed to in the buyer's purchase agreement are **merged** into the grant deed accepted by the buyer on closing.

Thus, when a title condition, such as a reservation of an easement by a seller, is agreed to in the purchase agreement, it needs to be restated in the grant deed before the condition becomes enforceable by the seller.

The title condition agreed to in the purchase agreement is extinguished on closing by the *merger* of the bargained for title condition into the grant deed. Thus, the grant deed becomes the sole basis for enforcement of either the buyer's or seller's rights to title under a reservation or grant agreed to in the purchase agreement.

<sup>11</sup> *Fidelity National Title Insurance Company v. Miller* (1989) 215 CA3d 1163

<sup>12</sup> *Barthels v. Santa Barbara Title Company* (1994) 28 CA4th 674

However, when a title condition, covenant or CC&R is agreed to in the purchase agreement, but *erroneously omitted* when escrow prepares the grant deed, a court may order the grant deed corrected, a legal process called **reformation**.

**reformation**

A legal process to correct an omission or error in a grant deed by court action.

Once the grant deed is corrected to include the omitted title condition, the condition is then enforceable since it is present in the grant deed.<sup>13</sup>

Consider an individual (grantor) who conveys title by grant deed to real estate they purport to own, but do not actually own. If the grantor later acquires title to the real estate interest they previously conveyed by grant deed, the *after-acquired title* to the real estate legally passes to the grantee under the later grant deed.<sup>14</sup>

## Grant deeds and after-acquired title

For example, an owner decides to sell property which is subject to an oil and gas lease calling for royalties (rent) to be paid to the owner by the tenant. The owner conveys their oil and gas rights by grant deed and transfers the oil and gas lease by assignment to an investor. Thus, the owner no longer owns the oil and gas rights in the real estate and no longer is entitled to receive royalties from the tenant under the lease.

Later, the owner locates a buyer for their remaining fee interest in the real estate. Neither the purchase agreement with the buyer nor the escrow instructions disclose the owner's prior conveyance of the oil and gas rights or the lease they entered into regarding those rights.

When a preliminary title report discloses the existence of the oil and gas lease, but not the recorded grant deed conveying the oil and gas rights or the lease assignment, the transaction is renegotiated and escrow instructions are amended. The owner's broker amends the instructions to allow the owner to assign the oil and gas lease to the buyer. Further, the grant deed to the buyer does not limit the implied covenant against prior conveyance by referencing the prior transfer of the oil and gas rights held by the owner.

Later, after escrow closes, the owner reacquires the oil and gas rights by deed and the oil and gas lease by assignment.

However, on conveyance and assignment of the oil and gas rights back to the owner, these later acquired rights **automatically pass by operation of law** under the prior grant deed from the owner to the buyer who bought the real estate. The owner had previously conveyed the entire fee simple to the buyer, which included the oil and gas rights, subject only to the tenant's rights which exist under the oil and gas lease.<sup>15</sup>

<sup>13</sup> CC §3399

<sup>14</sup> CC §1106

<sup>15</sup> *Schwenn v. Kaye* (1984) 155 CA3d 949

## Conveying lesser estates than the fee

When a buyer of real estate receives an ownership interest less than fee simple, the grant deed needs to explicitly state the lesser interest being conveyed to the buyer.

For example, to convey a **life estate**, the grant deed states the grantee is to hold the property until the grantee's (or some other individual's) death, at which point the title will revert back to the grantor or the grantor's successors. [See Chapter 4]

## Covenants in a trustee's sale

The implied covenants of a grant deed apply to all private (*nonjudicial*) sales of property which transfer a fee simple interest by grant deed. Conversely, transfers of real estate by *judicial order*, as well as by quitclaim deeds, carry no covenants at all.

For example, a sale in a probate proceeding and the conveyance of real estate by a grant deed signed and delivered by an executor is a private, **nonjudicial sale**, not a **judicial sale**. The conveyance transferring title is not directed by an order of the court, though the court may have approved the sale. As a nonjudicial sale, the implied warranties of title in the executor's grant deed apply, unless the grant deed states otherwise.<sup>16</sup>

Now consider a trustee's foreclosure sale under a trust deed lien. The trustee acts on the authority given by the property owner (trustor) to sell and convey title to the real estate at a trustee's sale under the power-of-sale provision in the trust deed when the lender (beneficiary) declares a default and elects to foreclose.

Since the trustee's foreclosure process is a nonjudicial procedure, the implied covenants exist in the trustee's deed issued by the trustee on a foreclosure sale, unless the **Notice of Trustee's Sale (NOTS)** and the trustee's deed provisions eliminate the covenants. Standard NOTS and trustee's deeds avoid the implied covenants by stating the trustee transfers title with *no warranty*. [See **RPI** Form 474 and 475]

Additionally, a trustee's deed passes title to the real estate sold at the trustee's sale in the same condition as the title existed on the date the trust deed was recorded, called the *relation back theory*.

A trustee's deed conveys title to a buyer subject to all senior rights and encumbrances of record. The title received by the buyer at the trustee's sale is clear of any interest claimed by the prior owner or successors to the owner, and any liens, encumbrances or interests in the property junior in time of recording or subordinated to the trust deed which was foreclosed.<sup>17</sup>

## Quitclaim deeds: you have what I had if I had it

A **quitclaim deed** terminates any interest in the real estate described in the deed which may be held by the named person (grantor) signing and delivering the quitclaim deed.

<sup>16</sup> **Mains v. City Title Ins. Co.** (1949) 34 C2d 580

<sup>17</sup> **Hohn v. Riverside County Flood Control and Water Conservation District** (1964) 228 CA2d 605



Unlike a grant deed, a *quitclaim deed* operates to **release to the grantee all interest** the grantor may hold in the property.<sup>18</sup>

A quitclaim deed passes whatever title, legal or equitable, the grantor possessed on execution (signing and delivering) of the quitclaim deed.

While a quitclaim deed is not intended to assure the conveyance transfers a fee simple ownership, the named grantor who **holds fee title** and signs and delivers a quitclaim deed conveys fee simple ownership of the property, and all the benefits of holding fee simple title.<sup>19</sup>

**quitclaim deed**  
A document used to convey whatever interest, if any, the grantor may hold in the real estate.

Unlike a grant deed, a quitclaim deed does not also pass the grantor's after-acquired title to the real estate described in the quitclaim deed. The quitclaim deed is a *release* of the grantor's interest in the real estate at the time it is signed and delivered.

The individual signing and delivering a quitclaim deed does not promise to convey an interest in the real estate, much less agree they received it and have not previously conveyed or encumbered it.

However, after-acquired title will pass to a buyer named in a previous quitclaim deed if:

- the seller sold by use of a quitclaim deed an *unperfected right* in the property which will later ripen into ownership, called an *inchoate right*, such as the interest held by a beneficiary under a will or inter vivos (living) trust prior to the death of the property owner;<sup>20</sup> or
- the seller is *estopped* (barred) by their sales agreement or their conduct from claiming the after-acquired title does not pass to the buyer.

The seller may not claim the after-acquired title does not pass when:

- the quitclaim deed contains recitals or covenants, such as an *assignment clause*, showing the seller's intention was not to limit the interest conveyed to only the interest the seller had at the time the quitclaim deed was executed; or
- the seller has affirmed, or their conduct has implied, they actually had an interest in the property which was to be conveyed.<sup>21</sup>

Deeds executed by agents of the court, such as a **receiver** or **sheriff** to transfer title under a court-ordered sale, are similar to quitclaim deeds. Neither deed carries with them the *implied covenants* of a grant deed.

Only an owner's interest in a property, if any exists, which was subject to the judicially ordered sale is conveyed. Likewise, any after-acquired title later acquired in the property sold by judicial order does not later pass to the buyer.

## After-acquired title and quitclaims

## Judicial sales and sheriff's deed

<sup>18</sup> *Platner v. Vincent* (1924) 194 C 436

<sup>19</sup> *Spaulding v. Bradley* (1889) 79 C 449

<sup>20</sup> *Soares v. Steidtmann* (1955) 130 CA2d 401

<sup>21</sup> *In re Wilson's Estate* (1940) 40 CA2d 229

A sale is considered judicial when the property is conveyed by an order of the court to carry out a judgment, such as a sale on the execution of a money judgment or a judicial foreclosure sale.<sup>22</sup>

Additionally, a buyer and broker at a judicial foreclosure sale have the responsibility to investigate and determine the condition of the property. They also need to investigate the ownership interest and condition of the owner's title being conveyed by order of the court, since *no warranties exist*.<sup>23</sup>

<sup>22</sup> *In re Backesto's Estate* (1923) 63 CA 265

<sup>23</sup> Mains, *supra*

## Chapter 19 Summary

Two types of deeds are used nearly exclusively to convey a real estate interest: grant deeds and quitclaim deeds. A grant deed is used to pass a fee simple interest in real estate from the grantor to another individual, unless a lesser interest is stated in the deed. A quitclaim deed terminates any interest in the real estate described in the deed which may be held by the named person (grantor) signing and delivering the quitclaim deed.

The covenants, sometimes called warranties, implied in a grant deed include:

- the interest conveyed in the real estate has not been previously conveyed to another, except as disclosed in the grant deed; and
- the grantor has not further encumbered the real estate, except as disclosed in the grant deed.

To avoid liability arising out of the implied covenants in a grant deed, the deed needs to state the title conditions (encumbrances) created by the seller during their ownership. These buyers may or may not have agreed to these conditions in the purchase agreement.

Implied covenants are only for the personal benefit of a buyer, not future owners, referred to as remote grantees. The implied covenants in a seller's grant deed to a buyer do not impose a condition on title and do not run with the land. For a covenant to run with the land and affect all remote grantees, the seller creating the covenant needs to state in their conveyance that successors are bound by the covenants and restrictions imposed on the property as contained in the deed.

Title conditions bargained for and agreed to in the buyer's purchase agreement are merged into the grant deed accepted by the buyer on closing. Thus, when a title condition, such as a reservation of an easement by a seller, is agreed to in the purchase agreement, it needs to be restated in the grant deed before the condition becomes enforceable by the seller.

A quitclaim deed passes whatever title, legal or equitable, the grantor possesses on execution (signing and delivering) of the quitclaim deed. Unlike a grant deed, a quitclaim deed does not also pass the grantor's after-acquired title to the real estate described in the quitclaim deed.

<b>encumbrance .....</b>	<b>pg. 184</b>
<b>grant deed .....</b>	<b>pg. 182</b>
<b>implied covenant .....</b>	<b>pg. 182</b>
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## Chapter 19 Key Terms

**Quiz 8 Covering Chapters 18-20 is located on page 448.**

*Notes:*



# Delivery, acceptance and validity of deeds

## Chapter 20

After reading this chapter, you will be able to:

- identify the acts and conditions which constitute the delivery and acceptance of a deed;
- avoid the improper practice of using a grant deed in place of a trust deed as a security device to assure repayment of a debt;
- understand the purpose for recording a grant deed; and
- distinguish between a void deed and voidable deed.

**constructive delivery**

**documentary transfer tax**

**revocable transfer on death deed (RTDD)**

**security**

**void deed**

**voidable deed**

## Learning Objectives

## Key Terms

A grant deed conveying real estate *transfers ownership* from the owner as the **grantor** to the **grantee** when the deed is delivered. The signing of a deed by the grantor naming another person as the grantee is not enough to divest the owner of title to their real estate. **Delivery** of the signed deed is required to transfer ownership.

*Delivery* refers to two separate acts:

- the grantor's present **intent to convey title**, not just the act of physically handing the deed to the grantee; and
- the grantee's **acceptance** of the grant deed as an immediately effective conveyance.

**A recording is prudent, not a necessity**

While the grantor may *intend to convey title* when they hand over the deed, if the grantee does not accept the deed, the deed is not considered delivered and a conveyance does not occur.

The grant deed does not need to be **recorded** to deliver title to a new owner (or to alter a vesting between two or more persons). However, recording *perfects* the ownership received against third-parties, including existing but unknown off-record interests.

For example, a parent and their two grown children hold title to real estate as joint tenants.

The parent and older child sign a grant deed to their undivided two-thirds interest in the property naming themselves as joint tenants. The deed is not recorded but by delivery the older child has possession of the deed.

The parent passes away and the younger child seeks ownership of a one-half interest in the property. The younger child claims the grant deed did not sever the joint tenancy which existed among the parent and children since it was not recorded.

The older child claims the younger child only holds a one-third interest in the property since joint tenants who execute a deed to one another do not have to record the deed to sever the joint tenancy they hold with another co-owner.

Is the younger child entitled to a one-half interest in the property as one of the surviving joint tenants?

No! The grant deed between the parent and the older child severed their joint tenancy with the younger child. The deed only needed to be *delivered*, not recorded, to terminate the younger child's right of survivorship. Thus, the younger child owns no more than their original one-third interest in the property since they no longer are a joint tenant. The younger child became a tenant in common on delivery of the deed.<sup>1</sup>

## Constructive delivery inferred

### constructive delivery

Delivery of a deed occurring when the deed is understood by the grantor and grantee to be delivered by agreement, or when the deed is accepted by a third-party for the benefit of the grantee.

The delivery of a deed is *inferred* when the grantee receives or has possession of the deed. The deed may also be considered delivered without the grantee having or holding actual possession of the deed. When a grantee is not physically handed the deed, a **constructive delivery** of the deed may still have taken place.

*Constructive delivery* of a deed to the grantee occurs when:

- the deed is understood by the grantor and the grantee to be delivered by an agreement when the grantor signs the deed; or
- the deed is delivered to a third-party for the benefit of the grantee, and the grantee or an agent of the grantee demonstrates the grantee's acceptance of the deed.<sup>2</sup>

<sup>1</sup> **Re v. Re** (1995) 39 CA4th 91

<sup>2</sup> Calif. Civil Code §1059

For example, a property owner intends to deed property to a family member (the grantee). The owner prepares and signs a deed as the grantor and delivers it to their agent with instructions to record the deed on the owner's death. The agent accepts the deed and, as instructed, does not record it.

The grantee knows the deed exists and lives on the property with the owner under the presumption the grantee now owns the property. After the death of the owner, the deed is recorded and delivered to the grantee by the agent as instructed.

Was the deed constructively delivered to the grantee when it was handed to the agent?

Yes! *Constructive delivery* of the deed occurred when the deed was delivered to the agent since the owner was acting for the benefit of the grantee and the grantee's acceptance of the deed was reasonably presumed from the grantee's conduct.<sup>3</sup>

Consider an owner as grantor who hands a grantee a deed as a gift. The owner orally advises the grantee the deed is not to be effective until the owner dies. If the grantee dies first, the deed is to be returned to the owner.

The owner dies and the grantee records the deed. Heirs of the owner assert they own the real estate, claiming the deed was not delivered and therefore invalid since the owner did not intend for the deed to convey ownership at the time the deed was handed to the grantee.

The grantee claims the deed is a valid conveyance of the real estate since delivery took place when the owner personally handed the grantee the deed — which the grantee accepted subject to the delayed transfer condition.

Was the deed a valid conveyance of the real estate?

No! To be a *valid delivery*, both the owner and the grantee need to **intend** for title to the real estate to be **conveyed concurrent** with the handing of the deed to the grantee. The owner of the real estate needs to intend for the document used to convey the real estate to operate as a deed to immediately divest the owner of title.

Here, the owner intended the deed to become operative only upon their death. However, the use of a deed to transfer property on death is an improper *probate* avoidance device. Thus, the deed is void and conveys nothing.

A deed handed to the grantee may not act as a *will* or revocable *inter vivos* (living) trust agreement to transfer property on the death of the owner.

A will and an *inter vivos* (living) trust agreement are **testamentary documents** which take effect after they are signed and upon the owner's death. Thus, the owner does not give up control or ownership of the property until their death.

## Grantor's intent to convey

<sup>3</sup> Kelly v. Woolsey (1918) 177 C 325



Conversely, a deed is a document used to *immediately pass* fee simple title (or other estate). If the grantor does not intend to pass fee simple (or other estate) on handing the deed to the grantee, no actual delivery takes place and the deed is void.<sup>4</sup>

An exception to this rule exists for:

- real estate improved by a one-to-four unit residence;
- individual condominium units, including the right to use common areas; and
- agricultural land of no more than 40 acres which includes a single-family residence (SFR).<sup>5</sup>

**revocable transfer on death deed (RTDD)**

Any document created to transfer real estate without covenant or warranty of title to a beneficiary upon the owner's death. [See **RPI** Form 411]

For the above types of real estate, a **revocable transfer on death deed (RTDD)** may be recorded upon the death of the owner to transfer real estate without a probate proceeding. An *RTDD* is any document created to transfer real estate without covenant or warranty of title to a beneficiary upon the owner's death. The RTDD is revocable until the owner dies.<sup>6</sup> [See **RPI** Form 411]

To create an RTDD, the owner needs to:

- have the capacity to contract;
- name the beneficiary as the grantee;
- sign and date the RTDD in the presence of a notary; and
- record the RTDD within 60 days of its signing before a notary.<sup>7</sup>

RTDDs are only effective when recorded before January 1, 2021.<sup>8</sup>

## Grant deed as a mortgage-in-fact

A grant deed is typically used with the intent to pass full legal title to the described property when it is handed to the grantee or recorded by the grantor. [See **RPI** Form 404]

However, when a grant deed is intended to convey title to a lender as *security* for the repayment of a debt, in spite of its wording of conveyance, the grant deed does not transfer the right of ownership.

**security**

Collateral for a debt in the form of a lien imposed on property.

A grant deed given to provide a creditor with the property as **security**, also known as **collateral**, is a *mortgage-in-fact*. Thus, a *lien* is imposed on the property in favor of the lender when receiving a grant deed, similar in purpose to a trust deed lien.

For example, an owner wants a loan but has poor credit and is unable to qualify for an institutional mortgage. A private lender agrees to lend the owner the needed funds. The private lender receives a grant deed to the property as security in the event of a default on the loan. The real estate is to be *reconveyed* to the owner when the loan is fully repaid.

<sup>4</sup> **In re Estate of Pieper** (1964) 224 CA2d 670

<sup>5</sup> Calif. Probate Code §5610

<sup>6</sup> Prob C §5614

<sup>7</sup> Prob C §§5620-5626

<sup>8</sup> Prob C §5600(c)

The owner retains possession of the property and remains responsible for the payment of taxes, a trust deed lien of record and maintenance of the property. The grant deed to the lender is coupled with a lease and option to repurchase the property on an installment program (rent) with a final/balloon payment (when the option is exercised).

Before the loan is repaid, the owner seeks to sell the property by listing it with a broker.

To investigate the condition of title, the broker's agent pulls a property profile from the title company. It shows the recorded title to the property is vested in the name of the private lender, not the owner. The agent now questions whether their client is the true owner of the property and will be able to convey title when a buyer is located to acquire the property.

However, the owner is the legal owner of the property and the lender simply holds a lien on title, evidenced by the grant deed and all the unrecorded loan and lease-option documents.

In this instance, the owner and the lender entered into a loan arrangement in which the **grant deed was intended** to be used as a *security device* for the lender to hold the property as collateral until the loan is repaid in full, not to convey any real estate ownership rights to the lender.<sup>9</sup>

Brokers and their agents who arrange loans are to use a *trust deed* as the security device which attaches the debt as a lien on real estate. Using a grant deed as a *security device* is improper practice. A grant deed is usually equated to the grantor's intent to convey all rights and title in the property to the named grantee.

A trust deed does not convey any ownership rights in the property to the lender. Rather, a trust deed imposes a lien on the property in favor of the lender to secure the owner's performance of a money obligation, typically evidence by a promissory note. On executing a trust deed, the owner retains all ownership rights to the secured property, which is not the case when using a grant deed for its intended purpose.

A deed may not be delivered to the grantee with instructions placing conditions on its use, called a **conditional delivery**.

An *absolute conveyance* occurs when a deed is handed to the grantee or received by constructive delivery. Any conditions imposed by the grantor which are not stated in the deed are unenforceable. Once a deed is delivered, it operates free from conditions not written in the deed.<sup>10</sup>

The *conditional delivery* rule only applies to deeds handed to the grantee. On the contrary, a deed may be conditionally delivered to a **third party**, such as an escrow agent, broker or attorney when the owner is to convey the

## Conditional delivery of a deed

<sup>9</sup> *Orlando v. Berns* (1957) 154 CA2d 753

<sup>10</sup> CC §1056

property to a buyer under a purchase agreement. A deed delivered to a third party with instructions to hand the deed to the grantee on the occurrence or performance of a condition is valid.<sup>11</sup>

For example, a seller opens escrow and hands escrow a grant deed with written instructions authorizing escrow to deliver the deed when the buyer has fully performed and escrow is in a position to close.

For escrow to deliver the deed to the buyer, escrow records the deed with the county recorder who then mails it to the buyer under the return-of-document instructions set forth on the deed.

Once placed in escrow, the grant deed may only be returned to the grantor if the grantee fails to perform as agreed, or by the written instructions of the grantor and grantee to escrow.

### Deed erroneously released to buyer

Consider a seller whose broker locates a buyer who agrees to purchase the seller's real estate. Escrow is opened. The seller signs and delivers instructions to escrow together with their signed grant deed. Escrow is authorized to use the grant deed to transfer ownership of the property to the buyer on the close of escrow.

The escrow instructions state the deed is to be recorded and forwarded to the buyer when the buyer performs as agreed. The instructions further state that the deed is to be returned to the seller if the buyer fails to perform by the date specified in the instructions.

The buyer does not perform as agreed. However, escrow mistakenly records the grant deed. The deed is mailed to the buyer by the county recorder.

Did the buyer receive title to the real estate?

No! Escrow did not follow the seller's instructions regarding recording and delivery of the deed on closing. The escrow's **unauthorized recording** and the buyer's possession of the deed is improper; delivery was not intended by either the seller or buyer. Thus, title was not conveyed, the deed is void, and no interest was ever conveyed.<sup>12</sup>

### Irrevocable escrow creates life estate

Consider an owner who hands a deed to their broker or attorney with written instructions to hold the deed until the owner's death. On their death, the deed is to be delivered to the grantee.

Under the instructions, the owner does not retain the right to withdraw or revoke the deed, as they may if they had conveyed the property to an inter vivos (living) trust vesting.

Has the owner delivered an enforceable deed to the third party?

<sup>11</sup> CC §1057

<sup>12</sup> *Hildebrand v. Beck* (1925) 196 C 141

Yes! The owner's act of depositing the deed and instructions for its use with a third party and **relinquishing further control** over the deed constitutes delivery of the deed. Thus, the owner concurrently transfers title to the individual named as the grantee. The third party holding the deed becomes the *agent* of the grantee. The owner's interest in the real estate is reduced to a life estate on delivery since the owner intends to retain possession, not ownership, and use of the property until their death.<sup>13</sup>

Further, once the owner deposits their deed with the third party and relinquishes all control over the deed, the owner's later destruction of the grant deed, such as ripping it up, or the agent's redelivery of the grant deed back to the owner does not reconvey title.<sup>14</sup>

Additionally, an owner's instructions to escrow to record a deed when escrow is in a position to close creates a presumption of delivery, even if the owner dies before escrow closes.<sup>15</sup>

A grantee is *presumed* to have accepted a deed when the grant is beneficial to the grantee.

For example, an owner of real estate deposits in an escrow a deed conveying real estate to the grantee. The deed is not handed directly to the grantee. The owner's written instructions to escrow accompanying the deed state the deed is to be delivered to the grantee on the owner's death.

The instructions contain no provisions for the owner's withdrawal of the deed from escrow. Thus, the owner retains no power to revoke the deed. However, the grantee is not aware of the existence of the grant conveying title to the real estate.

On the owner's death, escrow delivers the deed to the grantee as instructed.

Is the deed considered valid even though the grantee, being unaware of the deed, did not act to accept it?

Yes! The delivery of the deed to a third party, such as an escrow or someone acting as the owner's agent, with instructions to deliver the deed to the grantee on the owner's death is considered *constructive acceptance* by the grantee — even though the deed's existence was unknown to the grantee.

The conveyance of the property was for the grantee's benefit. Thus, the deed was presumed to have been accepted by the grantee when the deed was conditionally delivered to the third party.<sup>16</sup>

Additionally, a deed is presumed to be accepted and the conveyance complete when the deed is:

- physically handed to the grantee;<sup>17</sup>

## Acceptance by the grantee

<sup>13</sup> *Husheon v. Kelley* (1912) 162 C 656

<sup>14</sup> CC §1058

<sup>15</sup> *Osterberg v. Osterberg* (1945) 68 CA2d 254

<sup>16</sup> *Windiate v. Moore* (1962) 201 CA2d 509

<sup>17</sup> *California Trust Co. v. Hughes* (1952) 111 CA2d 717

- recorded by the grantee;<sup>18</sup> or
- in the grantee's possession.<sup>19</sup>

## Conditional acceptance by grantee

The conditional acceptance of a deed by a grantee does not constitute delivery. A deed is not effective until the grantee or their agent *unconditionally accepts* the deed.<sup>20</sup>

For example, a secured lender initiates foreclosure proceedings on an owner's property. The owner does not want a foreclosure in their name since it will adversely affect their credit. Thus, the owner offers to deed the property to the lender in exchange for cancellation (satisfaction) of the debt secured by the property, called a **deed-in-lieu of foreclosure**.

However, the lender states the deed will not be accepted until:

- the property is free of any encumbrances junior to the lender's trust deed; and
- the title is insured under a policy issued by an insurance company.

The owner hands the lender the *deed-in-lieu of foreclosure*. However, a title search in anticipation of obtaining title insurance discloses a junior trust deed lien exists on the property. The lender proceeds with the foreclosure and does not record or rely on the deed-in-lieu of foreclosure since the condition of title is unacceptable to the lender.

The junior lienholder discovers the existence of the unrecorded deed-in-lieu of foreclosure and claims the lender may not foreclose since the lender accepted the deed-in-lieu of foreclosure subject to the junior trust deed (which would then become a first trust deed).

However, the lender agreed to accept the deed only on confirmation that title is clear of junior liens. The grantee's receipt of a deed, with acceptance of the deed **conditioned** on confirmation of the title condition, is not a delivery of the conveyance when received.

A deed is effective when handed to the grantee only when the grantee **unconditionally accepts** the deed. In this example, the lender did not receive the deed with the intention of accepting delivery of the deed as an *immediate conveyance* of title.<sup>21</sup>

Now consider a borrower who, aware of the lender's conditions for accepting a deed-in-lieu of foreclosure, records the deed with instructions to the recorder to mail the deed to the lender. The borrower's intent is to force the acceptance on the lender since the lender's conditions regarding junior liens are not met.

If the lender is unwilling to accept the deed when it is received from the recorder, the lender needs to act (in a writing or with litigation) to state that the deed is not accepted. The borrower is not able to force the lender to accept

<sup>18</sup> *Drummond v. Drummond* (1940) 39 CA2d 418

<sup>19</sup> *California Trust Co., supra*

<sup>20</sup> *Green v. Skinner* (1921) 185 C 435

<sup>21</sup> *Brereton v. Burton* (1938) 27 CA2d 464

a deed to property by simply recording it. The conveyance, while clouding the enforceability of the lender's trust deed, is ineffective until the lender's conditions for acceptance are met.

A grantor's receipt of consideration is not necessary for a voluntary conveyance of real estate by deed. A deed is not void for **lack of consideration** received by the grantor for conveying property.<sup>22</sup>

Further, without fraud or misrepresentation on the part of a buyer of real estate, a deed cannot be voided or rescinded by a seller for a buyer's **failure to pay** the balance due on the purchase price after delivery of the deed. A delivered deed is not void or voidable. The title remains with the buyer when the buyer fails to tender the balance of the purchase price the buyer and seller agreed the buyer was to pay after taking title.

The seller, having conveyed the property, may only recover their money losses in a judgment or by foreclosure of a carryback trust deed.<sup>23</sup>

However, when the buyer promises to pay a portion of the purchase price after taking title and buyer's performance of the debt owed the seller is unsecured, the seller is entitled to a *vendor's lien* on the property sold for the portion of the price that remains unpaid. [See Chapter 28]

Additionally, when a grantor conveys real estate to a grantee for the purpose of avoiding creditors by stripping the grantor/debtor of their assets, the conveyance may be set aside by the creditors as a *fraudulent conveyance*.<sup>24</sup>

A conveyance is considered **fraudulent** when:

- the grantor intends to defraud creditors by avoiding payment;
- a reasonably equivalent value is not received by the grantor in exchange for the property transferred; and
- the grantor is or will become insolvent on the conveyance.<sup>25</sup>

A deed does not need to be recorded to convey real estate. A deed that is delivered conveys an interest in real estate even when the deed is incapable of being recorded.

For example, title to an owner's undivided one-half interest in real estate is vested in the owner and a co-owner as joint tenants.

The owner signs and delivers a deed conveying the property to a grantee, an act which severs the joint tenancy with the co-owner. The owner's signature on the deed is not acknowledged by a notary public, which is a requisite to its being recorded.<sup>26</sup>

## Consideration given for deed's sake?

## Recording the grant deed

<sup>22</sup> CC §1040

<sup>23</sup> *Lavelly v. Nonemaker* (1931) 212 C 380

<sup>24</sup> CC §§3439 et seq.

<sup>25</sup> CC §3439.04

<sup>26</sup> Calif. Government Code §27287

The co-owner claims the deed signed by the owner was not delivered since the grantor's signature on the deed was not acknowledged by a notary.

In this instance, delivery of the deed is not affected by the fact that the deed was not acknowledged or recorded. The owner's delivery of the signed deed to the grantee was sufficient to convey the co-owner's interest and sever the joint tenancy.<sup>27</sup>

A deed only needs to be recorded to put future buyers or encumbrancers on notice of the transfer. Recording the deed *perfects ownership* of the interest conveyed against others who might later claim an ownership, security or leasehold interest in the property.

A deed *capable of being recorded* with the county recorder needs to include:

- identification of the person requesting the recording;
- identification of the person to whom the document will be returned by the county recorder;<sup>28</sup> and
- the address where tax statements are to be sent by the county tax collector.<sup>29</sup> [See **RPI** Form 404]

Failure to identify the person requesting the recording of the deed, where the deed is to be sent after recording, or where the local real estate tax statements are to be sent does not affect the validity of the deed. Nor does this affect the *constructive notice* to others implied by recording the deed.<sup>30</sup>

The deed submitted for recording needs to also include the amount of the **documentary transfer tax** to be paid. The deed will not be recorded by the recorder unless the *documentary transfer tax* is paid at the time of the recording. An additional transfer tax may be charged by the city, county or both.<sup>31</sup>

Once recorded, a deed constitutes a change of ownership which may subject the property to reassessment. Thus, the recording of a deed is accompanied by a **change of ownership statement** which the recorder hands to the county assessor.<sup>32</sup>

When the deed submitted to the county recorder does not include a *change of ownership statement*, the recorder will record the document and either:

- include a change of ownership form with the return of the recorded deed; or
- provide the assessor with the identification of the recorded document which was not accompanied by the change of ownership statement.<sup>33</sup>

Additionally, a **notary public** acknowledging an individual's signature on a deed affecting the title to real estate, such as a grant deed, quitclaim deed

**documentary transfer tax**

A tax imposed on a recorded document when real estate is transferred.

<sup>27</sup> **Gonzales v. Gonzales** (1968) 267 CA2d 428

<sup>28</sup> Gov C §27361.6

<sup>29</sup> Gov C §27321.5

<sup>30</sup> Gov C §§27321.5, 27361.6

<sup>31</sup> Calif. Revenue and Taxation Code §§11901 et seq.

<sup>32</sup> Gov C §27280; Rev & T C §480

<sup>33</sup> Gov C §27321



or trust deed, will require the individual to place their thumbprint in the notary's journal. The thumbprint requirement does not apply to a trustee's deed or reconveyance of a trust deed.<sup>34</sup>

**Void** and **voidable** are similar concepts. However, they are distinguishable by the *date* they affect the validity of a deed, and thus, the rights of those who relied on the deed.

*Void deeds* are unenforceable at all times and never convey an interest in real estate. This is referred to as *void ab initio* — without legal effect from the beginning.

When title is claimed under a void deed, any claim of ownership based on the deed fails – even if a further grantee purchases the property in good faith without any notice of a defect in title or in the deed held by the grantor.

For example, an owner of real estate has been adjudicated as insane and unable to manage their affairs (incompetent). The court appoints a guardian to manage the owner's affairs.

A buyer, unaware of the owner's condition or guardianship, purchases real estate from the owner. The buyer obtains a grant deed to the property from the owner.

Is the deed on the sale of the real estate a valid conveyance since the buyer was unaware of the owner's condition and paid a fair value for the property?

No! Prior to the conveyance, a court found the owner to be incompetent and appointed a guardian to manage their affairs. The **appointment of a guardian** by the court is considered notice to all of the owner's condition — whether or not a notice of appointment is recorded — since adjudication of the owner's incompetence is considered notice.

Thus, the buyer's status as a bona fide purchaser (BFP) of title from an adjudicated incompetent does not shield the deed from being set aside. The deed was void at its inception and had no legal effect at any time.<sup>35</sup>

Other examples of void deeds include:

- a deed handed directly to the grantee, not a third party, with the intent it is not to be effective until the owner's death;<sup>36</sup>
- a deed signed and delivered by a seller under the age of 18 who was not emancipated;<sup>37</sup>
- a deed materially altered without the grantor's consent;<sup>38</sup> or
- a forged deed.<sup>39</sup>

## Void vs. voidable deeds

### void deed

A deed that is unenforceable and conveys no interest in real estate.

<sup>34</sup> Gov C §8206(a)(2)(G)

<sup>35</sup> CC §40

<sup>36</sup> Estate of Pieper, *supra*

<sup>37</sup> Calif. Family Code §6701

<sup>38</sup> **Tannahill v. Greening** (1927) 85 CA 714

<sup>39</sup> **Meley v. Collins** (1871) 41 C 663

## Voidable deeds

### voidable deed

A deed that is valid and enforceable until it is challenged due to a defect and declared invalid by a court order.

A *voidable deed*, unlike a void deed, is a deed which is valid and enforceable after delivery, until it is challenged due to a defect and declared invalid by court order.

Examples of voidable deeds include:

- a deed obtained through **false representations**;<sup>40</sup>
- a deed obtained through **undue influence** or threat;<sup>41</sup> or
- a deed from a grantor of **unsound mind**, but not entirely without understanding, made before the grantor's incompetency to convey has been adjudicated.<sup>42</sup>

Unlike void deeds, a voidable deed is enforceable by a *BFP* or encumbrancer who acquires an interest in the property in reliance on the title held by the grantee under a deed which is voidable but has not at the time of the further conveyance been challenged as invalid.

For example, a loan secured by real estate is in default. The owner is concerned the property might be sold through foreclosure, negatively affecting their credit. The owner is approached by a foreclosure consultant who, through fraudulent threats and harassment, is able to obtain a grant deed from the owner.

The consultant, as the grantee under the deed, takes possession of the property and refinances it by obtaining a new loan to pay off the old loan. The new lender, unaware the grantee obtained the grant deed by fraud, is secured by a trust deed on the property now vested in the name of the foreclosure consultant.

Later, the original owner sues the foreclosure consultant to set aside the deed as voidable. The owner records a notice of **pendency of action**, referred to as a *lis pendens*. [See Chapter 31]

The grant deed is later declared invalid since the foreclosure consultant, as the grantee, used threats and undue influence to fraudulently obtain the deed.

Meanwhile, the new lender whose security interest rests on the voidable deed begins foreclosure under their trust deed.

The owner, having set aside the deed as voidable, claims the lender cannot foreclose since the deed for the ownership on which the lender's trust deed was acquired has been declared invalid.

May the lender enforce the trust deed created by the grantee under the fraudulent (and voidable) deed which has now been declared invalid?

<sup>40</sup> *Seeger v. Odell* (1941) 18 C2d 409

<sup>41</sup> *Campbell v. Genshlea* (1919) 180 C 213

<sup>42</sup> CC §39

Yes! The deed was *voidable*, not void, when it was signed and delivered to the grantee who executed the trust deed now in foreclosure. The lender became an encumbrancer before the defrauded grantor (prior owner) challenged the validity of the deed to the grantee (foreclosure consultant).

Thus, the lender is considered a bona fide encumbrancer for value and without notice of the defect. Thus, the lender is entitled to enforce the trust deed since it was recorded before the lender had actual or constructive notice (by the *lis pendens*) of the owner's challenge which ultimately declared the grant deed invalid.<sup>43</sup>

<sup>43</sup> *Fallon v. Triangle Management* (1985) 169 CA3d 1103

A deed conveys real estate from the grantor to the grantee when the deed is delivered. Delivery is based on:

- the grantor's intent to convey title; and
- the grantee's acceptance of the grant deed as an immediately effective conveyance.

The grant deed does not need to be recorded to deliver title. Recording simply puts future buyers or encumbrancers on notice of the transfer. Once recorded, a deed constitutes a change of ownership which may subject the property to reassessment.

The delivery of a deed is inferred when the grantee has possession of the deed. Constructive delivery occurs when:

- the deed is understood by the grantor and the grantee to be delivered by an agreement when the grantor signs the deed; or
- the deed is delivered to a third-party for the benefit of the grantee, and the grantee or an agent of the grantee demonstrates the grantee's acceptance of the deed.

When a grant deed is intended to convey title to a lender as security for the repayment of debt, the grant deed becomes a mortgage-in-fact and transfers no right of ownership to the lender.

A grantee is presumed to have accepted a deed if:

- the grant is beneficial to the grantee;
- the deed is physically handed to the grantee;
- the deed is recorded by the grantee; or
- the deed is in the grantee's possession.

Void deeds are unenforceable at all times and never convey an interest in real estate. A voidable deed is valid and enforceable until it is challenged due to a defect and a court order declares the deed invalid.

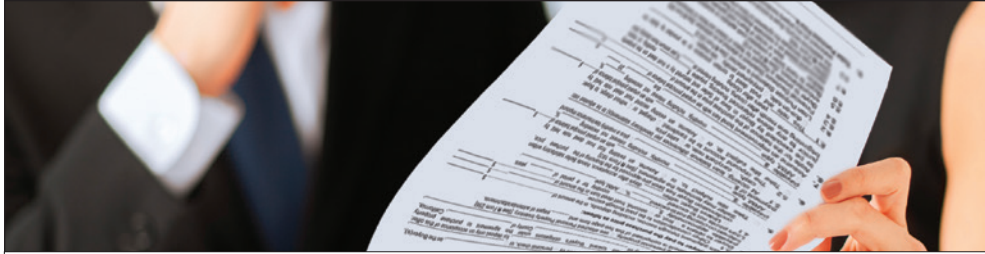
## Chapter 20 Summary

## **Chapter 20**

### **Key Terms**

<b>constructive delivery .....</b>	<b>pg. 198</b>
<b>documentary transfer tax.....</b>	<b>pg. 206</b>
<b>revocable transfer on death deed (RTDD) .....</b>	<b>pg. 200</b>
<b>security.....</b>	<b>pg. 200</b>
<b>void deed .....</b>	<b>pg. 207</b>
<b>voidable deed .....</b>	<b>pg. 208</b>

**Quiz 8 Covering Chapters 18-20 is located on page 448.**



# Preliminary title reports

## Chapter 21

After reading this chapter, you will be able to:

- explain the function of a preliminary title report in real estate transactions; and
- distinguish between a preliminary title report and an abstract of title for reliance on their content.

**abstract of title**

**date-down search**

**encumbrance**

**preliminary title report (prelim)**

### Learning Objectives

### Key Terms

A **preliminary title report** is intended to disclose the current vesting and *encumbrances* which may be reflected on the public record affecting a property's title. Encumbrances set out in a *preliminary title report* include:

- general and special taxes;
- assessments and bonds;
- covenants, conditions and restrictions (CC&Rs);
- easements;
- rights-of-way;
- liens; and
- interests of others.

A preliminary title report, also known as a *prelim*, is not a representation of the conditions of title or a title insurance policy. Unlike an abstract of title, a prelim may not be relied on by anyone and imposes no liability on the title company.

### An offer to issue title insurance

#### **preliminary title report (prelim)**

A report constituting a revocable offer by a title insurer to issue a policy of title insurance, used by a buyer and escrow for an initial review of the vesting and encumbrances recorded and affecting title to a property.

## No duty to accurately report title conditions

### encumbrance

A claim or lien on title to a parcel of real estate, such as property taxes, assessment bonds, trust deeds, easements and covenants, conditions and restrictions (CC&Rs).

A title insurer has no duty to accurately report **encumbrances** affecting title on the prelim, shown as *exceptions* for the proposed policy of title insurance.<sup>1</sup>

A prelim is no more than an *offer to issue* a title insurance policy based on the contents of the prelim. Further, the offer may be modified by the title company at any time before the policy is issued.<sup>2</sup>

The closing of purchase escrows is contingent on the buyer's approval of items in the prelim to set the conditions of title consistent with the expectations of the buyer on entering into a purchase agreement. The buyer, their agent and escrow review the report for encumbrances on title inconsistent with the terms for the seller's delivery of title set in the purchase agreement and escrow instructions.

Both the seller's agent and the buyer's agent review the prelim immediately for any reported conditions that may interfere with closing the transaction. In practice, the buyer's agent looks for title conditions which conflict with any intended use or change in the use of the property contemplated by the buyer. Interferences with use come in the form of unusual easements or use restrictions (CC&Rs) which obstruct known plans the buyer has to make or alter improvements.

The seller's agent is concerned about encumbrances the seller has created which are to be eliminated or referenced in the seller's grant deed transferring the property. A prelim includes a search of the general index for the names of the sellers, judgments or other claims which are attached to title and need to be eliminated or otherwise dealt with to close escrow.

## Escrow reliance

Escrow relies in part on items approved and disapproved in the prelim to carry out its instructions to record grant deeds, trust deeds, leaseholds or options which are to be insured.

Typically, escrow instructions call for closing when the deed can be recorded and insured, subject only to taxes, CC&Rs and any other encumbrances as agreed and approved in the instructions.

Ultimately, it is the escrow officer who, on review of the prelim, advises the seller of any need to eliminate defects or encumbrances on title which interfere with closing as instructed.

### date-down search

A further search of the public records performed by a title insurer after preparing a preliminary title report and immediately prior to issuance of a policy of title insurance.

The prelim and a last-minute **date-down search** of title conditions are used by escrow and the title insurer to reveal any title problems to be eliminated before closing and, as instructed, obtain title insurance for the documents when recorded.

The title insurer's *date-down* of the prelim prior to closing may turn up title defects or encumbrances not included in the prelim. These occur by error on the part of the insurer or by a recording after the preparation of the prelim.

<sup>1</sup> *Siegel v. Fidelity National Title Insurance Company* (1996) 46 CA4th 1181

<sup>2</sup> Calif. Insurance Code §12340.11

In any case, the title company *withdraws its offer* under the prelim. The title company then issues a new prelim, offering to issue a policy on different terms.

Title companies have long been aware of the public's reliance on their prelims. This reliance was so imbedded in real estate transactions that the California courts consistently held title companies liable for their erroneous reports. However, legislation drafted by the title insurance industry was introduced and enacted in 1981 to eliminate title insurer liability for their preparation of faulty prelims.

Prelims were once compared to **abstracts of title**. An *abstract of title* is an accurate, factual representation of title to the property being acquired, encumbered or leased. Thus, an abstract of title may be relied on by those who order them as an absolute representation of the conditions of title.<sup>3</sup>

An abstract of title is a *statement of facts* collected from the public records. It is not an insurance policy with a dollar limit on the insurer's liability as is set in a policy of title insurance. The content of an abstract is intended by the insurance company to be relied upon as fact. Thus, the insurer is liable for all money losses of the policy holder flowing from a failure to accurately state all recorded conditions of title in the abstract they issue.<sup>4</sup>

In an effort to shield title companies from an *abstractor's liability* on the issuance of a defectively prepared prelim, the prelim has been legislatively redefined as being neither an abstract of title nor a representation of the conditions of title. Instead, the prelim is defined as a report furnished in connection with an application for title insurance.

The prelim has become and is simply an *offer* by a title company to issue a title insurance policy. The prelim is thus merely a statement of terms and conditions on which the title company is willing to issue a policy — subject to any changes they may make prior to actually issuing the policy of title insurance.

## Prelim vs. abstract of title

### abstract of title

A representation issued by a title company as a guarantee to the named person, not an insurance policy, listing all recorded conveyances and encumbrances affecting title to the described real estate.

<sup>3</sup> Ins C §12340.10

<sup>4</sup> 1119 *Delaware v. Continental Land Title Company* (1993) 16 CA4th 992



**Chapter 21**  
**Summary**

A preliminary title report (prelim) is a report furnished by a title insurance company in connection with an application for a policy of title insurance which discloses the current vesting and encumbrances reflected on the public record. A title insurer has no duty to accurately report all title defects and encumbrances on the prelim.

Encumbrances set out in a preliminary title report include:

- general and special taxes;
- assessments and bonds;
- covenants, conditions and restrictions (CC&Rs);
- easements;
- rights of way;
- liens; and
- interests of others.

A prelim is not a representation of the conditions of title or a title insurance policy and may not be relied on by anyone. A prelim is no more than an offer to issue a title insurance policy based on the contents of the prelim and any modifications made by the title company before the policy is issued.

The prelim and a last-minute date-down search of title conditions are used by escrow and the title insurer to reveal any title problems to be eliminated before closing and, as instructed, obtain title insurance for the documents when recorded.

Conversely, an abstract of title is an accurate, factual representation of title to the property being acquired, encumbered or leased. Thus, an abstract of title may be relied on by those who order them as an absolute representation of the conditions of title.

**Chapter 21**  
**Key Terms**

<b>abstract of title</b> .....	<b>pg. 213</b>
<b>date-down search</b> .....	<b>pg. 212</b>
<b>encumbrance</b> .....	<b>pg. 212</b>
<b>preliminary title report (prelim)</b> .....	<b>pg. 211</b>

**Quiz 9 Covering Chapters 21-23 is located on page 449.**



# Title insurance

## Chapter 22

After reading this chapter, you will be able to:

- explain how a policy of title insurance indemnifies a person who acquires an interest in real estate against a monetary loss caused by an undisclosed encumbrance on title;
- differentiate between the various types of title insurance policies, endorsements and binders available;
- comprehend the six operative sections of a title insurance policy;
- understand the dollar limitations placed on coverage provided under title policy exclusions; and
- implement the insurer's process for settling a claim.

**abstract of title**

**binder**

**encumbrance**

**exception**

**exclusion**

**joint protection (JP) policy**

**preliminary title report (prelim)**

**proof-of-loss statement**

**Schedule A**

**Schedule B**

**title insurance**

## Learning Objectives

## Key Terms

A policy of **title insurance** is the contract issued by a title insurance company agreeing to reimburse or hold harmless an insured person who acquires an interest in real estate against a monetary loss caused by an encumbrance on title that:

- is not listed in the title insurance policy as an exception to coverage; and
- the insured policy holder was unaware of when the policy was issued.<sup>1</sup>

## Identifying an actual loss

<sup>1</sup> Calif. Insurance Code §12340.1

**title insurance**

A form of indemnity insurance issued by a title insurance company which holds harmless the named insureds against monetary loss caused by an encumbrance not listed in Schedule B of the policy and not known by the insured when the policy was issued.

Thus, a policy of *title insurance* is a form of **indemnity insurance**, not a guarantee of title conditions. Title insurance policies are issued on one of several general forms used by the entire title insurance industry in California. The policies are issued to:

- *buyers* of real estate;
- *tenants* acquiring long-term leases; and
- *lenders* originating mortgages secured by real estate.

As an *indemnity* agreement, a title insurance policy is a contract. The terms of coverage in the policy set forth the extent of the title insurance company's obligation, if any, to indemnify the policy holder for money losses caused by an encumbrance on title.<sup>2</sup>

For example, the agent of an equity purchase (EP) investor advises their client regarding inclusion in the EP agreement of a provision for title coverage in the form of either:

- a **California Land Title Association (CLTA)** policy;
- an **American Land Title Association (ALTA)** policy; or
- a **title insurance binder**.

## Binder: a commitment to issue a policy

**binder**

A written commitment of a title insurer to issue a title insurance policy in the future, usually acquired by a buyer intending to resell the described property.

A buyer acquiring property they intend to resell within two years after their purchase, usually an EP investor or other flipper, provides for the seller to pay for a title insurance **binder** on closing. A *binder*, also called a *commitment to issue*, is a written commitment of a title insurer to issue a title insurance policy in the future, usually acquired by a buyer intending to resell the described property.

The investor's request for a binder first begins by use of the title insurance provision in the EP agreement calling for the type of policy coverage to be a binder, not a title insurance policy.

The cost of a binder is 10% to 15% more expensive than a CLTA or ALTA policy. When the seller refuses to bear the extra cost, it is cost effective for the buyer to pay for it rather than buying another policy on the later resale or refinance of the property.

With a binder, the resale policy comes at no further charge, except for the premium due for any increased coverage requested for an increased resale price.

A binder provides the buyer with title insurance coverage until, at the buyer's request, a policy is issued to a new buyer on resale of the property or to a lender on a refinance.

Under a binder, a title insurance policy is issued in the name of the substitute buyer on close of the resale escrow – within two years of the buyer being issued the binder.

<sup>2</sup> Ins C §12340.2

Almost all losses due to the reduction in the value of real estate below the policy limits arise out of an **encumbrance**. An *encumbrance* is any condition which affects the ownership interest of the insured, whether the interest insured is a:

- fee;
- leasehold;
- life estate; or
- the security interest of a lender.

Any right or interest in real estate held by someone other than the owner is considered an encumbrance when it **diminishes the value** of the real estate.

Encumbrances on title which might diminish the property's market value include:

- covenants, conditions and restrictions (CC&Rs) limiting use;
- reservations of a right of way;
- easements;
- encroachments;
- trust deeds or other security devices;
- pendency of condemnation; and
- leases.<sup>3</sup>

**Physical conditions** on the property are not encumbrances since they do not affect title. Accordingly, title insurance policies do not insure against open and notorious *physical conditions* which exist on the property.

Physical conditions are existing uses visible on the property by observation, such as:

- canals;
- highways;
- irrigation ditches; and
- levees.

A buyer is always presumed to have acquired property subject to known and visible physical conditions which impede its use or impair its value. In the case of encumbrances on title, recorded or not, no such presumption of knowledge about title conditions exists.

A title insurance policy is not an **abstract of title** which warrants or *guarantees* the nonexistence of title encumbrances not listed as exceptions. Instead of receiving a guarantee of title conditions, the named insured on

## Encumbrances unknown and covered

### encumbrance

A claim or lien on title to a parcel of real estate, such as property taxes, assessment bonds, trust deeds, easements and covenants, conditions and restrictions (CC&Rs).

## Property improvements and use not covered

## Underwriting only indemnifies a loss

<sup>3</sup> Evans v. Faught (1965) 231 CA2d 698

**abstract of title**

A representation issued by a title company as a guarantee to the named person, not an insurance policy, listing all recorded conveyances and encumbrances affecting title to the described real estate.

**preliminary title report (prelim)**

A report constituting a revocable offer by a title insurer to issue a policy of title insurance, used by a buyer and escrow for an initial review of the vesting and encumbrances recorded and affecting title to a property.

the policy is *indemnified* up to the policy's *dollar limits* against a monetary loss caused by a title condition (encumbrance) not listed as an exception or exclusion in the policy.

Under a title insurance policy, the title company only covers the risks of a **monetary loss** caused by an encumbrance they did not list as an exception or exclusion to coverage which was actually unknown to the named insured at the time of closing. Thus, the title company has no obligation under an insurance policy to clear title of the unlisted encumbrance.

A title insurance company issuing a policy of title insurance has two underwriting options when its title search reveals an encumbrance affecting title:

- list the encumbrance in a **preliminary title report (prelim)**, requiring the parties to either eliminate it or accept it as an *exception* to coverage in the policy of title insurance to be issued; or
- insure against the encumbrance by **writing over** the encumbrance — i.e., not listing it as an exception — and assuming any risk of monetary loss connected to it.

When title companies *write over* a known encumbrance, they usually demand an indemnity agreement from the person responsible for eliminating the encumbrance. This encumbrance typically takes the form of a money lien, such as a mechanic's lien, money judgment or blanket encumbrance. Thus, the title company is able to recover from the third-party guarantor when a claim by the insured is later paid due to the encumbrance.

Additionally, a title policy is not a representation — guarantee — of the nonexistence of encumbrances that are not listed in the policy. Infrequently, an encumbrance exists that is not known to the named insured, such as the buyer or lender, or to the title insurer. Thus, it is not listed as an exception in the policy. Here, an insured's claim against the insurer for money in excess of the policy limits may not be based on the insurer's *negligent preparation* of the encumbrances excluded from coverage. Similarly, a claim on an erroneous *prelim* may not be based on negligent preparation.

However, a title insurer might intentionally write over encumbrances at the request of a seller. When the buyer is not notified the encumbrance exists, the insurer is liable for actual losses in excess of the policy coverage. In this instance, the insurer breached the implied covenant of good faith and fair dealing imposed on title companies as a duty owed to the insured.<sup>4</sup>

Title insurance is purchased to assure real estate buyers, tenants and lenders the interest in title they acquire is what they bargained for.

A policy of title insurance is broken down into six operative sections, including:

1. the *risks of loss covered*, called **insuring clauses**, which are based on a completely unencumbered title at the time of transfer;

## Introduction to title policy forms

<sup>4</sup> Jarchow v. Transamerica Title Insurance Company (1975) 48 CA3d 917

2. the *risks of loss not covered*, comprised of encumbrances arising after the transfer or known to or brought about by the insured, called **exclusions**, which are a boilerplate set of title conditions;
3. *identification* of the insured, the property, the vesting, the dollar amount of the coverage, the premium paid and the recording, called **Schedule A**;
4. the *recorded interests*, i.e., any encumbrances affecting title and any observable on-site activities which are listed as risks agreed to and assumed by the insured and not covered by the policy, called **exceptions**, which are itemized for all types of coverage in **Schedule B**;
5. the *procedures*, called **conditions**, for claims made by the named insured and for *settlement* by the insurance company on the occurrence of a money loss due to any encumbrance on title which is not an exclusion or exception to the coverage granted by the insuring clauses; and
6. any *endorsements* for additional coverage or removal of exclusions or pre-printed exceptions from the policy.

**exclusion**

Risks of loss not covered under a policy of title insurance, comprised of encumbrances arising after the transfer or known to or brought about by the insured.

**exception**

Any encumbrances affecting title and any observable on-site activities which are listed as risks assumed by the insured and not covered by a policy of title insurance under Schedule B.

Coverage under the broadly worded *insuring clause* of a policy of title insurance indemnifies the named insured for risks of loss **related to the title** due to:

- anyone making a claim against title to the real estate interest;
- the title being unmarketable for sale or as security for financing;
- any encumbrance on the title; and
- lack of recorded access to and from the described property.

## Insuring clauses

All title insurance policies contain a general **exclusions** section. The *exclusions* section eliminates from coverage those losses incurred by the insured buyer, tenant or lender due to:

- *use ordinances or zoning laws*;
- *unrecorded claims known* to the insured, but not to the title company;
- encumbrances or adverse *claims created after* the date of the policy;
- claims arising out of *bankruptcy* or due to a *fraudulent conveyance* to the insured;
- *police power* and *eminent domain*; and
- *post-closing events* caused by the insured.

## Exclusions from coverage

All policies of title insurance on **Schedule A** set forth:

- the property interest the insured acquired;
- the legal description of the insured property;
- the date and time coverage began;

## Schedule A information

- the premium paid for the policy; and
- the maximum total dollar amount to be paid for all claims settled.

## Exceptions to coverage

### Schedule B

Exceptions from coverage, both standard and itemized, by the title insurance policy.

In addition to the policy's standard exclusions, a policy's general coverage under its "no-encumbrance" insuring clause is further limited by the policy's **Schedule B** exceptions.

The *exceptions* section contains an itemized list of recorded and unrecorded encumbrances which are known to the title company and affect the insured title. While the existence of these known encumbrances is insured against in the insuring clauses, they are removed by *Schedule B* as a basis for recovery under the policy.

An ALTA policy includes a set of pre-printed exceptions setting forth risks assumed by the insured buyer, tenant or lender, including:

- taxes, assessments, liens, CC&Rs, or any other interests, claims or encumbrances which have not been recorded with the county recorder or tax collector on the date of closing;
- any unrecorded and observable on-site activity which includes conflicts regarding boundary lines, encroachments or any other facts which a survey discloses;
- unpatented mining claims; and
- all water rights.

### Schedule A

Identification of the property interest insured, the legal description of the insured property, the date and time coverage began, the premium paid for the policy and the total dollar amount to be paid for all claims settled.

## Claims and settlements

A policy of title insurance includes a *conditions* section. The conditions section outlines the procedures the insured policy holder needs to follow when making a claim for recovery under the policy. Also set forth are the settlement negotiations or legal actions available to the title company before paying a claim.

## Endorsements for special occasions

Lastly, a variety of **endorsements** may be added to title insurance policies to provide coverage for title conditions and use or economic conditions not covered by the basic policies. *Endorsements* are usually issued only to lenders, though modified endorsements may be used in owner's policies as well, particularly for developers and builders.

Endorsements cover losses incurred due to violations of:

- CC&Rs;
- damage from extraction of water or minerals;
- mechanic's liens;
- encroachments (conditions covered in an **American Land Title Association Residential (ALTA-R)** policy); and
- the effects of inflation.



Endorsements are also issued to remove an exclusion or exception which is an unwanted boilerplate provision in a policy.

Several types of title coverage are available, including:

- a **CLTA** standard policy;
- an **ALTA** owner's extended coverage policy;
- an **ALTA-R** policy; and
- an **ALTA homeowner's** policy.

When making an offer to purchase property, the agent representing a prospective buyer informs them about the coverage each type of title insurance policy provides. The buyer's need for title coverage is reviewed as part of their agent's counseling before the buyer signs a purchase agreement. The agreement's title insurance provision calls for the buyer to designate the type of title insurance policy and states who will pay its premium. [See **RPI** Form 150 §12.4; see Figure 1]

The buyer's choice of a title policy as selected in the purchase agreement depends on whether the buyer or seller is paying the title insurance premium. Customarily, the seller pays the premium, except in some northern California counties where it is custom for the buyer to pay the premium.

The choice of title insurance company is up to the person who pays for the policy. Further, the federal *Real Estate Settlement Procedures Act (RESPA)* prohibits a seller of residential real estate from requiring the buyer to use a particular title company.<sup>5</sup>

The *CLTA standard policy* is purchased solely by buyers, carryback sellers and private lenders.

The CLTA standard policy insures against all encumbrances affecting title which can be discovered by a search of **public records** prior to issuance of the policy. Any encumbrance not recorded, whether or not observable by an inspection or survey, is not covered due to the CLTA policy exclusions and exceptions.

For example, a deed conveying a parcel of real estate which is *recorded and indexed* by the county recorder's office becomes part of the public records. Thus, the recording imparts constructive notice to buyers and lenders who later acquire an interest in the property.<sup>6</sup>

Additionally, the CLTA standard policy (as well as the ALTA policy) protects the insured against:

- the unmarketability of title or the inability to use it as security for financing;
- lack of ingress and egress rights to the property; and

## Owner's policies for buyers

## The CLTA standard policy

<sup>5</sup> 12 United States Code §2608

<sup>6</sup> Calif. Civil Code §1213

Figure 1

Excerpt from  
Form 150Purchase  
Agreement

12.4 Title to be vested in Buyer or Assignee free of encumbrances other than those set forth herein. Buyer's interest in title to be insured under a policy issued by \_\_\_\_\_ title company on a(n) ☐ Homeowner(s) policy (one-to-four units), ☐ Residential ALTA-R policy (vacant or improved residential parcel), ☐ Owner's policy (other than one-to-four units), ☐ CLTA Joint Protection policy (also naming Carryback Seller or purchase-assist lender), or ☐ Binder (to insure resale or refinance within two years).

a. Endorsements \_\_\_\_\_

b. ☐ Seller, or ☐ Buyer, to pay the title insurance premium.

- losses due to the ownership being vested in someone other than the buyer.

All title insurance policies provide coverage perpetually after the date and time the policy is issued. However, coverage is limited to the dollar amount of the policy, adjusted for annual consumer inflation. Coverage is further limited by the exclusions, exceptions and conditions on claims.

## Policy exclusions

The CLTA standard policy (as well as the *ALTA policy*) contains general exclusions to coverage which bar recovery by the buyer or joint protection carryback seller for losses due to:

- zoning laws, ordinances or regulations restricting or regulating the *occupancy, use or enjoyment* of the land;
- the character, dimensions or location of any *improvement erected* on the property;
- a *change in ownership* or a parceling or combining of the described property by the insured buyer;
- *police power, eminent domain* or violations of *environmental protection laws*, unless a notice or encumbrance resulting from the violation was recorded with the county recorder before closing;
- *encumbrances known to the insured buyer* or lender which are not recorded or disclosed to the title company;
- encumbrances which do not result in a *monetary loss*;
- encumbrances which are created or become encumbrances *after issuance* of the policy;
- encumbrances resulting from the buyer's payment of *insufficient consideration* for the property or delivery of improper security to the lender also insured under the policy; and
- the unenforceability of the insured lender's trust deed lien due to the lender's *failure to comply* with laws regarding usury, consumer credit protection, truth-in-lending, bankruptcy or insolvency.

## CLTA pre- printed exceptions

The CLTA standard policy further contains **pre-printed exceptions** listed in the policy as Schedule B, also called **standard exceptions** or **regional exceptions**. It is the inclusion of these pre-printed boilerplate exceptions which makes the CLTA policy a *standard* policy.

An ALTA owner's policy does not contain pre-printed exceptions, only the typewritten exceptions listing the encumbrances which are known to the title company and affect title to the property.

The pre-printed standard exceptions in Schedule B of the CLTA standard policy eliminate coverage for losses incurred by the buyer due to:

- taxes or assessments not shown in the records of the county recorder, the county tax collector or any other agency which levies taxes on real property;
- unrecorded rights held by others which would have been discovered by the buyer on an inspection of the property or inquiry of persons in possession;
- easements or encumbrances which are not *recorded and indexed* by the county recorder;
- unrecorded encroachments or boundary line disputes which a survey discloses; and
- recorded or unrecorded, unpatented mining claims or water rights.

A lower premium is charged to issue a CLTA policy since the title company undertakes a lower level of risk for indemnified losses due to the CLTA pre-printed exceptions, as compared to the extended risks covered by the more expensive ALTA owner's policy.

Most policies issued today are of the ALTA variety since the CLTA policy format with pre-printed standard exceptions does not provide protection for unrecorded encumbrances or claims to title.

The ALTA owner's policy provides greater coverage than the CLTA policy. When the pre-printed exceptions are included in Schedule B and attached to the ALTA policy, the policy becomes an ALTA standard policy, comparable in cost and coverage to the CLTA standard policy since unrecorded encumbrances are not covered.

As the ALTA owner's policy covers **off-record matters** not covered under the CLTA standard policy, prior to issuance of a policy, the title company may require:

- the parcel to be surveyed; and
- those in possession of the property to be interviewed or estopped.

The exclusions section of an ALTA owner's policy is identical to exclusions in the CLTA policy, except for additional exclusions relating to an insured lender or carryback seller. The ALTA owner's policy is not issued to secured creditors. More precisely, a *joint protection* type of ALTA policy is never issued.

Separate policies and duplicate premiums are required for a lender's ALTA coverage when a buyer of property records a new mortgage. Thus, the premium is nearly doubled to pay for both a lender's policy and the buyer's

## The ALTA owner's policy and survey

policy when a new mortgage is recorded to fund the purchase of real estate acquired by the buyer. This is not the case for a CLTA joint protection policy covering both the lender and the buyer.

## The ALTA residential policy

For buyers of parcels of real estate containing one-to-four residential units, an *ALTA-R* policy is available in lieu of the ALTA owner's or homeowner's policies. Parcels insured include lots and units in common interest developments (CIDs), such as condominiums.

The ALTA-R is referred to by the title companies as the "plain language" policy. Thus, the ALTA-R is written with wording which avoids legalese. Also, the ALTA-R policy contains a user-friendly *table of contents* and an *owner's information sheet* which outlines the policy's features.

The coverage, exclusions and exceptions in the ALTA-R policy are similar to the ALTA owner's policy. In addition, the ALTA-R policy covers losses due to:

- *mechanic's liens* incurred by someone other than the buyer; and
- the inability of the buyer to occupy the property when the residence violates the CC&Rs listed in the Schedule B exceptions in the policy or existing zoning.

The premium for an ALTA-R policy is priced lower than the premium for an ALTA owner's policy. This is due to the fact that the ALTA-R policy is usually issued only on parcels in an existing subdivision or CID which has no known problems with easements, encroachments or legal access.

## The ALTA homeowner's policy

A **homeowner's policy** exists to provide more coverage than the ALTA owner's or the ALTA-R policies.

Before an *ALTA homeowner's policy* is issued by a title insurer, two requirements need to be met:

- the property needs to be *improved* with a one-to-four unit family residence; and
- the buyer needs to be a natural person, not an entity such as a corporation, limited liability company (LLC) or partnership.

In addition to the risks covered by the ALTA owner's and ALTA-R policies, the homeowner's policy covers several risks to ownership which may arise *after closing*, including:

- the *forging* of the buyer's signature on a deed in an attempt to sell or encumber the buyer's property;
- the construction on an adjoining parcel of a structure which *encroaches* onto the buyer's property, excluding a boundary wall or fence;
- the *recording of a document* which prevents the buyer from obtaining a secured mortgage or selling the property;
- claims of *adverse possession* or *easement by prescription* against the buyer's property; and

- claims by others of a right in the buyer's property arising out of a lease, contract or option *unrecorded and unknown* to the buyer at the time of closing.

The ALTA homeowner's policy also covers losses arising out of a lack of vehicular and pedestrian access to and from the property. Other owner's policies only cover losses resulting from the lack of a legal right to access, not a practical means of access which is covered by the ALTA homeowner's policy.

Also covered by the ALTA homeowner's policy are losses incurred due to many other risks which may exist at the time of closing, including:

## Other risks

- the correction of any pre-existing violation of a CC&R;
- the inability to obtain a building permit or to sell, lease or use the property as security for a mortgage due to a pre-existing violation of a subdivision law or regulation;
- the removal or remedy of any existing structure on the property when it was built without obtaining a building permit, excluding a boundary wall or fence;
- damage to existing structures due to the exercise of a right to maintain or use an easement;
- damage to improvements due to mineral or water extraction;
- the enforcement of a discriminatory CC&R;
- the assessment of a supplemental real estate tax due to construction or a change of ownership or use occurring before closing;
- an incorrect property address stated in the policy; and
- the map attached to the policy showing the incorrect location of the property.

Encumbrances relating to the insured title and known to the title company are itemized in the ALTA policy Schedule B as additional *exceptions* which limit coverage. The exceptions are reviewed by the buyer and buyer's agent in a prelim before closing and issuance of a policy.

The ALTA homeowner's policy contains the same exclusions from coverage stated in the ALTA-R policy, plus an exclusion for any *building code violations*, unless notice of the violation was recorded with the county recorder.

Many title insurance companies use the ALTA homeowner's policy as their default policy which is used when a specific title policy is not requested by escrow. The premium for the policy is approximately 10% more than the CLTA owner's policy.

## The CLTA standard joint protection policy

### joint protection (JP) policy

A title insurance policy which enables one or more individuals or entities to be named as insured, usually the buyer and the new mortgage holder.

A lender or carryback seller has options when calling for title insurance.

The lender or carryback seller may either:

- be named as an additional insured on a CLTA standard **joint protection (JP)** title insurance policy with the buyer; or
- request a separate ALTA mortgage policy as the only named insured.

The *JP policy* enables one or more individuals or entities to be named as insured. Thus, in addition to the owner's standard CLTA title coverage, the JP policy provides coverage for a trust deed held by a lender or carryback seller.

The JP policy indemnifies the lender and carryback seller against losses arising from risks such as:

- the invalidity or unenforceability of the insured creditor's trust deed lien;
- the priority of a lien or other encumbrance which was not listed in the policy exceptions; and
- the invalidity or unenforceability of an assignment of the insured trust deed when the assignment is listed in the exceptions as affecting the trust deed.

When a loss covered by a JP policy occurs, the named insureds who suffer from the loss share in any recovery up to the dollar limit of the policy. The recovery is subject to disbursements based on their priority or pro rata interest between them in title. Thus, recovery by both the owner and the secured creditor under the JP is not cumulative.

Accordingly, no windfall occurs since title policies only indemnify an insured against the insured's actual monetary loss. If there is no loss of value, there is no basis for recovery.

Most policy limits are established based on the value of the property, and as part of that value is the mortgage amount. Thus, the owner and the lender are fully protected under a JP policy since the aggregate value of their interests (debt plus equity) does not exceed the policy limits on closing.

Thus, once a policy loss has been paid to an insured owner, lender or carryback seller, the amount of coverage under the policy is reduced.

However, the JP policy is only available under a CLTA standard policy. When either the buyer or lender in a cash-to-new-loan transaction requests ALTA coverage, a separate ALTA mortgage policy is issued to each for total premiums of approximately double the CLTA-JP cost.

## The ALTA mortgage policy increases costs

An **institutional lender** usually requires its trust deed lien on a parcel of real estate to be insured under an ALTA mortgage policy.

The ALTA mortgage policy insures against monetary losses incurred by lenders and carryback sellers due to the loss of priority of the insured trust deed lien, unless listed in the exceptions, to encumbrances such as:



- a mechanic's lien, if the work was *commenced prior to* recording the trust deed (which is the same date and time as the date of the policy) and the trust deed did not secure a mortgage to pay for the construction;
- a mechanic's lien arising out of *work financed by proceeds* from the construction mortgage secured by the insured trust deed, if no part of the construction work was commenced before the trust deed was recorded; and
- assessments such as Mello-Roos for street improvements under construction or completed prior to recording the trust deed.

Thus, the ALTA policy does not cover losses resulting from lack of priority of the insured trust deed to a mechanic's lien if:

- the secured mortgage was not a construction mortgage designed to finance construction; and
- no part of the construction work which led to the mechanic's lien commenced before the trust deed was recorded.

*ALTA exclusions* in lender policies eliminate coverage for claims arising out of a mortgage transaction due to the operation of federal bankruptcy law, state insolvency or similar creditors' rights laws, when the claims are based on:

- a *fraudulent conveyance* to the vested owner to conceal assets;
- the *equitable subrogation* (a court ordered assignment) of the insured lender's lien; or
- the insured lender's trust deed being deemed a *preferential transfer* by a bankruptcy court due to the recording of the trust deed within 90 days before a bankruptcy filing.

Those insured under the CLTA standard policy, ALTA owner's policy or ALTA-R policy include the name of the insured in *Schedule A*. They also include the name of those who succeed to the interest of the named insured by *operation of law*, not by purchase, including:

- heirs;
- distributees;
- devisees;
- joint tenancy or community property survivors;
- personal representatives;
- next of kin by intestate succession; and
- corporate or fiduciary successors.

When title is to be transferred to another vesting, concurrently or within a few months, the title company needs to be asked to include that vesting as a named insured by endorsement.

However, the ALTA homeowner's policy requires the insured and any covered successor to be an individual or the trustee of an *inter vivos* (living)

**Who is  
insured?**



trust, not an entity, such as an LLC. A transfer of title by an insured to their revocable inter vivos trust is covered by the ALTA homeowner's policy without endorsement. This is not the case for other policies.

A policy covering an owner does not cover a buyer who purchases the insured property from the owner. A new policy needs to be obtained, unless the seller holds a *binder* and uses it to request the title insurer issue a policy naming the buyer as the insured.

Those insured under a lender's ALTA title insurance policy include:

- the lenders described in the policy;
- future purchasers of the insured trust deed, except assignees who acquire the trust deed as a result of an indemnity, guaranty, other policy of insurance or bond held by the insured lender; and
- any government agency which insures or guarantees the loan secured by the insured trust deed.

## Settling a claim

To begin the claims process on becoming aware of an encumbrance covered as a loss by the policy of title insurance, the insured promptly gives the title insurance company written **notice of claim**.

Upon being notified of the claim, the title company has 15 days to:

- acknowledge receipt of the claim or pay the claim;
- provide the insured with all forms, instructions, assistance and information necessary to prove the claim; and
- begin any investigation of the claim.<sup>7</sup>

Further, the insured needs to provide the title company with a **proof-of-loss statement** within 90 days after incurring the loss. The statement sets forth:

- the encumbrance discovered;
- the amount of the loss; and
- the basis for calculating the loss.

The title company may also require the insured party to make available records, checks, letters, contracts, insurance policies and other papers related to the claim.

After receipt of the 90-day *proof-of-loss statement*, the title insurance company has 40 days to **accept or reject** the claim, in whole or in part.<sup>8</sup>

On accepting a claim, the title company may:

- *pay policy limits*, plus any authorized costs, attorney fees and expenses incurred by the insured;
- *pay the loss* incurred by the insured, plus costs, attorney fees and expenses;

### proof-of-loss statement

A statement submitted to the title insurance company by the insured referencing the encumbrance discovered after they were issued the policy, the amount of the loss and the basis for calculating the loss.

<sup>7</sup> 10 Calif. Code of Regulations §2695.5(e)(1-3)

<sup>8</sup> 10 CCR §2695.7(b)

- negotiate a *settlement*;
- bring or defend a *legal action* on the claim; or
- for an insured lender, *purchase the mortgage* from the lender for the amount owed by the borrower, plus any authorized costs, attorney fees and expenses incurred by the insured lender.

The **conditions section** of a title insurance policy limits the amount the title company is required to pay to settle a claim made by an insured.

For owners, the title company may *settle a claim* by paying the lesser of:

- the full dollar amount of the policy; or
- the reduction in value of the insured's ownership interest caused by the title defect or encumbrance missed by the title company and not listed in the policy exceptions.

For lenders, the title company may settle a claim by paying the lesser of:

- the full dollar amount of the policy;
- the impairment or reduction in value of the security interest due to the title defect or encumbrance not listed in the policy exceptions; or
- the amounts due on the unpaid mortgage at the time of the loss caused by a defect or encumbrance not listed in the policy exceptions.

The title company will not pay a claim:

- when the title company is able to remove the encumbrance from title;
- until any litigation over the encumbrance has become final; or
- when the owner or lender settles the claim without written permission of the title company.

All claim payments made by the title insurance company, except payments made for costs, attorney fees and expenses, reduce the dollar amount of coverage remaining under the title policy.

In addition to the limitations on the title company's obligation to pay under a policy, the ALTA owner's policy contains **underinsurance** and **apportionment** provisions. These provisions further limit payout by the title company by shifting a percentage of the loss to the insured. *Underinsurance* and *apportionment* provisions are not contained in policies other than ALTA owner's policies since other policies are not issued on large projects.

The *underinsurance provision* of the ALTA owner's policy is triggered when a claim is made, if:

- the amount of the policy limits is less than 80% of the value of the insured real estate or security interest on the date the policy was issued, which arises when the policy is for less than the price paid for the property; or

## Extent and limitation of liability

## Underinsured and apportioned losses

- an improvement has been erected on the real estate after issuance of the policy which increases the value of the property by at least 20% over the policy limits.

Thus, the underinsurance provision subjects the recovery on any partial loss to the following:

- payment by the title company of a pro rata amount based on the percentage the policy limit is of the property value at the time the policy was issued, when improvements have not been made; or
- when improvements have been made, payment by the title company of a pro rata amount based on the percentage that 120% of the policy limits represents of the total of the policy limits (usually the price paid for the property) and the cost of the improvement.

The underinsurance provision does not apply to costs, attorney fees or expenses which the title company pays under the ALTA owner's policy. Further, the underinsurance provision only applies to that portion of any loss which exceeds 10% of the policy limits.

For example, an owner of a property valued at \$2,000,000 on the date of the policy receives an ALTA owner's title policy with a policy limit of \$1,400,000. The owner erects no improvements on their property. An undisclosed encumbrance on title results in a loss of \$600,000. The owner of the property seeks recovery from the title company.

According to the underinsurance provision in the ALTA owner's policy, the owner is not indemnified for the entire loss. Only \$140,000 will be paid, being 10% of the policy limit, plus a percentage of the remaining loss based on a policy-limits-to-property-value ratio.

The amount of the loss which exceeds 10% of the policy limit is \$460,000 (\$600,000 - \$140,000 = \$460,000). The percentage the policy limit represents of the property value on the date of the policy is 70% (\$1,400,000 / \$2,000,000 = 70%).

Accordingly, the title company pays \$140,000 (10% of the policy limit) and \$322,000 (70% of the \$460,000 remaining loss) for a total settlement of \$462,000 on the \$600,000 loss.

The ALTA owner's policy *apportionment provision* further limits the title company's payout. The apportionment provision is triggered when the insured property consists of two or more parcels which have not been combined for use as a single site. When a loss affects less than all of the parcels, the loss is settled based on each lot's value when the policy was issued as a pro rata share of the policy limit. Improvements made after the date of the policy are excluded.

On payment of a claim or elimination of the defect or encumbrance, called *settlement*, all rights the owner may have against any person or property causing the paid loss are assigned to the title company under a *subrogation provision* in the policy.

Further, the title company has the right on settlement to sue, compromise or settle in the name of the insured to enforce the rights assigned to the title company.

When the title company recovers any money by enforcing the rights assigned to them by the owner, the title company pays any loss sustained by the owner which was not covered or already paid under the policy. The title company retains any recovery remaining after paying the owner's loss.

## Transfer of rights on settlement

A title insurance policy is the contract issued by a title insurance company agreeing to reimburse or hold harmless an insured person who acquires an interest in real estate against a monetary loss caused by an encumbrance on title that:

- is not listed in the title insurance policy as an exception to coverage; and
- the insured policy holder was unaware of when the policy was issued.

Depending on the type of transaction, a buyer's agent advises their client to include in the purchase agreement title coverage in the form of either:

- a California Land Title Association (CLTA) policy;
- an American Land Title Association (ALTA) policy; or
- a title insurance binder.

The buyer's choice of a title policy is initially stated in the purchase agreement, including whether the buyer or seller pays the title insurance premium. The CLTA standard policy insures against all encumbrances affecting title which may be discovered by a search of public records prior to issuance of the policy.

A variety of endorsements may be added to title insurance policies to provide coverage for title conditions and use or economic conditions not covered by the basic policies.

The conditions section of a title insurance policy limits the amount the title company is required to pay to settle a claim made by an insured.

## Chapter 22 Summary

## **Chapter 22**

### **Key Terms**

<b>abstract of title.....</b>	<b>pg. 218</b>
<b>binder.....</b>	<b>pg. 216</b>
<b>encumbrance .....</b>	<b>pg. 217</b>
<b>exception .....</b>	<b>pg. 219</b>
<b>exclusion.....</b>	<b>pg. 219</b>
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**Quiz 9 Covering Chapters 21-23 is located on page 449.**



# Real estate can be stolen

## Chapter 23

After reading this chapter, you will be able to:

- understand what constitutes a taking of real estate by adverse possession;
- differentiate adverse possession from trespassing, easements and encroachments;
- list the requirements for perfecting a claim of adverse possession; and
- identify whether adverse possession is taken by color of title or claim of right.

**actual notice**

**adverse possession**

**claim of right**

**color of title**

**constructive notice**

## Learning Objectives

## Key Terms

While real estate is not an item a thief may pick up and carry off, the ownership or rights in ownership to real estate is capable of being stolen — if the thief is not first caught **trespassing** and ejected. The means by which the law justifies a private taking of another's ownership is known as **adverse possession**.

*Adverse possession* is the only means by which the law will take 100% of an individual's legal or equitable ownership interest in a parcel of real estate and give it to another individual without compensation.

The doctrine of adverse possession is based on a social and economic rationale suggesting real estate is not to lie idle. An individual who puts another's land to use without interference or compensation and pays taxes imposed on the property — *ad valorem* — is allowed in time to enjoy the benefits of continued long-term possession, namely **ownership**.

## Adverse possession becomes ownership

### **adverse possession**

A method of acquiring title to real estate owned by another by openly maintaining exclusive possession of the property for a period of five years and paying all property taxes.

The “use it or lose it” rationale has remained unchanged since its inception, when the doctrine of adverse possession was established to dispossess medieval lords of their stranglehold on fertile farmland in England.

Adverse possession is often confused with and needs to be distinguished from other legal principles establishing control over another’s land, such as:

- boundary disputes;
- encroachments;
- easements by necessity; and
- prescriptive easements.

Possession under a lease or rental agreement is the antithesis of adverse possession. A lease or rental agreement involves the owner’s consent by conveyance of the right to possession and the occupant’s agreement to pay rent. An individual claiming adverse possession will have their claim barred when they occupy the property as a tenant under a lease or rental agreement at any time during their five-year claim.

## Boundary disputes distinguished

Adverse possession is not connected with an individual’s possession of another’s property under the doctrine of *title by agreed boundaries*. [See Chapter 9]

The **agreed-boundary** doctrine applies when uncertainty exists between neighbors concerning the exact location of the legally described boundary between the properties. For example, an individual occupies land by agreement with his neighbor. The individual believes the land to be their own, but it is located beyond their legally described lot line on their neighbor’s adjacent property.

Conversely, adverse possession is the *private taking* of another’s land and the payment of taxes, knowing it belongs to someone else and without permission from the owner.

## Encroachments distinguished

Encroachments are similar to boundary disputes. The distinguishing factor between the two is that an encroachment is a dispute between owners of adjoining property which results not from a simple misplaced fence or boundary line, but from the location of *improvements* by one property owner which improperly cross over the common boundary line and intrude into a neighbor’s property.

The owner of the encroaching improvements is able to retain the improvements when the encroachment is relatively minor and resulted from the honest mistake of the owner or builder. [See Chapter 10]



An **easement by necessity** also differs from adverse possession. Easements are based on the *concurrent use* by a non-owner of another's property. By contrast, adverse possession has as one of its elements the *exclusive use* of another's property.

Usually, an easement by necessity is granted across a property when a neighboring property is unintentionally landlocked from access to a public right-of-way.

The distinguishing feature of an easement by necessity is that it is granted by court order when no prior use of the easement existed. Conversely, adverse possession results from an individual's exclusive use of a property maintained by continuous and uninterrupted possession.

Most easily confused with adverse possession is a **prescriptive easement**. Like adverse possession, a prescriptive easement over another's property is an uncompensated *private taking* of a right to use without the owner's consent.

However, a prescriptive easement only involves the non-exclusive (concurrent) and limited *right to use* another's real estate without any obligation to pay property taxes. On the contrary, adverse possession is concerned with acquiring the ownership of real estate with its right to **exclusive possession** and obligation to **pay taxes**.<sup>1</sup> [See Chapter 13]

Any person claiming title to property through adverse possession needs to satisfy specific criteria to *perfect their claim* of ownership. If the adverse possessor fails to meet any criterion, their claim to ownership fails as it has not been perfected.

The criteria for **perfecting ownership** by an adverse possession claim are:

- a color of title or claim of right to title;
- actual, notorious and open possession;
- hostile, adverse and exclusive use;
- continuous and uninterrupted possession for five years; and
- payment of current and delinquent real estate taxes and assessments.<sup>2</sup>

Two distinct types of adverse possession claims exist:

- a claim of ownership based on a written instrument, called a **color of title** claim<sup>3</sup>; or
- a claim of ownership made without any documentation, except possession and payment of taxes, called a **claim of right**.<sup>4</sup>

## Easement by necessity and prescription

## Adverse possession criteria

## Color of title or claim of right

<sup>1</sup> **Silacci v. Abramson** (1996) 45 CA4th 558

<sup>2</sup> **Gilardi v. Hallam** (1981) 30 C3d 317

<sup>3</sup> Calif. Code of Civil Procedure §322

<sup>4</sup> CCP §324

**color of title**

Title that has the appearance of validity but has a fatal defect and is ineffective.

The *color of title* claim is used to defend the claim of ownership held by the individual in possession of the property. This defense is used against the person who holds recorded title and seeks to:

- wrest possession of the property from the occupant, called an **adverse possessor**; and
- clear title of the cloud created by the document which supports the adverse possessor's color of title claim.

To perfect a color of title claim, the adverse possessor presents written documentation demonstrating they are the owner of the property. This documentation need not be valid to support a color of title claim. Typically, title held by the adverse possessor is defective and unenforceable. However, the adverse possessor only needs to show they have a good faith belief they are the owner of the property to fulfill this criteria for adverse possession.

For example, real estate is conveyed by a recorded grant deed to an individual on the distribution of a deceased relative's estate. The individual takes possession of the property and exercises the rights and responsibilities of ownership.

Later, it is discovered the deceased relative in fact was only a *lessee*, not the record owner of the property, and had no legal title to convey. However, the individual has an adverse possession claim to the property based on the color of title since they had a good faith belief the deed they received was valid.<sup>5</sup>

## Under a claim of right

**claim of right**

A claim of ownership made without any documentation, except possession and payment of taxes.

Conversely, adverse possession by *claim of right* attacks the title held by the recorded owner and takes possession of the property with the intent to interfere with that title.

A person whose adverse possession is based on a claim of right is merely a *trespasser* or *intruder* who has taken possession of a property without any belief they are the owner.

Consider an adverse possessor who takes possession of an unoccupied residential property to establish a claim of right, then rents the property to a tenant.

The absentee owner of the property seeks to terminate the adverse possessor's occupancy within five years of the adverse possessor taking possession. The owner claims the adverse possessor is a criminal trespasser since they entered the property with the intent of interfering with the owner's property rights. The adverse possessor claims they are not a trespasser since the renting out of the property conferred on them a title by occupancy.

In this example, the adverse possessor is acting as a trespasser. The adverse possessor did not adversely occupy the property (and pay property taxes and any liens arising out of unpaid property taxes) for the five-year period required for their (or their tenant's) possession to ripen into ownership with the right to obtain marketable title.<sup>6</sup>

<sup>5</sup> *Helvey v. Lillis* (1934) 136 CA 644

<sup>6</sup> *People v. Lapcheske* (1999) 73 CA4th 571

Additionally, an individual who has a mistaken but good faith belief they have an ownership interest in a property, but no documents to validate their ownership, establishes their adverse possession claim against the owner under a claim of right.<sup>7</sup>

An adverse possessor's claim to ownership is based upon their willingness and ability to defend their possession of the property against others who may claim title, including the owner of record.<sup>8</sup>

Proving ownership by adverse possession based on a claim of right is more difficult than by color of title which relies on title documentation. Evidence of five years of continuous adverse and hostile possession and use by the adverse possessor and the payment of property taxes is required to prove ownership under a claim of right.<sup>9</sup>

An adverse possessor needs to show they have been in *actual possession* of the property they claim they own.<sup>10</sup>

Actual possession is occupancy by the adverse possessor or by a tenant who rents the property from the adverse possessor.<sup>11</sup>

When the adverse possession claim is made under a *claim of right*, the adverse possessor needs to demonstrate their actual possession of the property by either:

- surrounding the property with a substantial, protective enclosure;
- cultivating the property; or
- improving the property.<sup>12</sup>

A **substantial enclosure** needs to completely surround the claimed property and restrict access to the property by others, including the legal owner of record.<sup>13</sup>

The enclosure may be a fence, a natural barrier (such as a body of water), or a combination of each as long as the enclosure restricts access to the property.<sup>14</sup>

Further, the enclosure needs to be properly maintained during the period the adverse possessor occupies the property. A fence which has deteriorated over time and is not in repair is an insufficient enclosure to put the legal owner of record on notice that another person is occupying the property.<sup>15</sup>

An adverse possessor occupying property under *color of title* may show possession through one of the claim of right methods, or they may show they used the land similarly to the usage of like properties in the area.<sup>16</sup>

**Actual,  
notorious  
and open  
possession**

7 **California Maryland Funding, Inc. v. Lowe** (1995) 37 CA4th 1798

8 **Brown v. Berman** (1962) 203 CA2d 327

9 **Thomson v. Dypvik** (1985) 174 CA3d 329

10 **Howell v. Slauson** (1890) 83 C 539

11 **Palin v. Sweitzer** (1937) 8 C2d 329

12 CCP §325

13 **Jones v. Hodges** (1905) 146 C 160

14 *Palin, supra*

15 **Ross v. Burkhard Inv. Co.** (1928) 90 CA 201

16 CCP §323

For example, an occupant of a property under color of title believes they are the true owner of the property based on a conveyance they received. However, the occupant has only cultivated a portion of the property described in the conveyance, leaving the remainder untouched.

Since the document of conveyance, which the occupier believes in good faith gave them title, describes the entire property, the occupier will be deemed to have actual possession of the entire property, even though they only use a portion of it.<sup>17</sup>

#### actual notice

Express or implied knowledge of conditions which exist on a property.

Conversely, a claim of right possessor cultivating land in a situation similar to the preceding color of title example is only able to claim that portion of the entire parcel they cultivated, not the portion of the parcel they left untouched.<sup>18</sup>

#### constructive notice

A legal fiction charging persons who own or acquire an interest in real estate with knowledge of recorded documents affecting title and conditions observable on the property.

Additionally, the owner of the property against which an adverse possession claim is made needs to be *on notice* of the possessor's adverse activity regarding the property. This notice may be either **actual** or **constructive**.

*Actual notice* means the owner is personally aware of the occupancy or the adverse possessor's claim against the owner's land.

However, the owner has *constructive notice* when, upon viewing the property, a reasonable person understands the adverse possessor appears to hold some interest in the property due to their occupancy.<sup>19</sup>

## Hostile and adverse use

When an individual claims ownership under color of title — the existence of a document which purports to vest title in the individual in conflict with the true ownership — satisfies the *hostile and adverse possession* requirements.

For possession under a claim of right to qualify as *hostile and adverse* the possession needs to be without any permission or consent from the legal owner of record and without regard to any rights of the true owner.

Consider a married individual who holds title and occupies a single family residence, paying all mortgage installments, taxes and maintenance costs. The couple divorces and the individual's spouse is awarded the residence.

Title is never vested in the spouse, nor does the spouse ask the title holder to move out or pay rent. The title holder continues to make mortgage payments, pays property taxes and remodels the residence.

More than five years after the divorce is final, the title holder lists the property for sale. The spouse files an action to have title vested in their name.

The title holder claims they are the owner of the property by adverse possession.

<sup>17</sup> CCP §322

<sup>18</sup> CCP §324

<sup>19</sup> *Myran v. Smith* (1931) 117 CA 355

However, the title holder is not an adverse possessor since their possession of the property was not hostile and adverse. The spouse allowed the title holder to use the property as long as they paid all the obligations of ownership.<sup>20</sup>

Now consider a married individual who owns their residence as separate property. Unknown to their spouse, the individual deeds the property into the individual's name and the name of a child from a previous marriage, as joint tenants.

Later, the individual dies and the child asks the spouse to vacate the residence.

The spouse refuses to vacate the residence, claiming the residence is community property and the spouse is now the owner due to the individual's death. The spouse makes mortgage payments, pays property taxes and remodels the house. When the child lists the property for sale, the spouse interferes with the "For Sale" signs.

More than five years after the individual's death, a buyer purchases the residence taking title from the child and seeks to eject the spouse as a trespasser.

The spouse claims they are entitled to ownership of the property under adverse possession. The buyer claims the spouse's possession was permitted by the surviving child and is thus not hostile or adverse.

Is the spouse's possession hostile and adverse?

Yes! The spouse's possession is hostile and adverse since the spouse's actions are consistent with the belief they are the owner of the property and not the child.<sup>21</sup>

Consider another buyer who constructs a home on a newly subdivided lot and pays all the property taxes. More than five years later, the buyer discovers their home is actually located on land legally described as their neighbor's property.

The buyer's *use and improvement* of the property are sufficiently hostile and adverse to establish their claim of ownership of the property they occupy, regardless of the true legal ownership.<sup>22</sup>

A possessor's *exclusive use* of a property is required to perfect any adverse possession claim, whether based on color of title or claim of right. When another person concurrently or intermittently uses the property without consent from the adverse possessor, the possessor's claim is defeated.

## Exclusive use

For example, an adverse possessor who has occupied and used a parcel of real estate seeks to perfect their ownership interest by adverse possession. However, without permission from the adverse possessor, a neighboring

<sup>20</sup> *Buic v. Buic* (1992) 5 CA4th 1600

<sup>21</sup> California Maryland Funding, Inc., *supra*

<sup>22</sup> *Kunza v. Gaskell* (1979) 91 CA3d 201

property owner used the same property for storage and grazing during the period of the adverse possessor's occupancy. Accordingly, the adverse possessor's claim to ownership is denied for lack of exclusive use.<sup>23</sup>

However, the occasional use of the property by the public (e.g., for recreational activities, as a right-of-way, etc.) does not affect an adverse possession claim.<sup>24</sup>

## Continuous and uninterrupted use

An adverse possessor needs to have occupied a property for at least **five years** before they are able to acquire title through adverse possession.<sup>25</sup>

Any interruption in the adverse possessor's possession of the property, such as use by another not authorized by the possessor, negates the continuity of the five-year period, barring an adverse possession claim.<sup>26</sup>

However, the adverse possessor need not be in **continuous possession** of the property to satisfy the *continuous possession* requirement. Exceptions to the continuous possession requirement include:

- vacancies between tenants of rental property;<sup>27</sup>
- vacancies of homes built on subdivided property and not immediately sold;<sup>28</sup> and
- off-season vacancies of property used for agriculture or grazing.<sup>29</sup>

Continuous possession by an adverse possessor acting under a claim of right needs to encompass a constant, definable portion of the property. The claim-of-right possessor's use of different portions of a property at different times for a total of five years does not satisfy the continuity requirement.

For example, an adverse possessor relying on a claim of right who uses part of a property for two years, then uses a different part of the property for three years, has not satisfied the five-year requirement.<sup>30</sup>

## Payment of taxes

An adverse possessor needs to provide a certified record of tax payments from the county tax collector to prove they have paid the property taxes during each year of their five-year qualifying occupation.<sup>31</sup>

Additionally, the adverse possessor needs to pay any **back taxes** owed on the property at the time they took possession.<sup>32</sup>

<sup>23</sup> Myran, *supra*

<sup>24</sup> **Webber v. Clarke** (1887) 74 C 11

<sup>25</sup> CCP §325

<sup>26</sup> **Laubisch v. Roberdo** (1954) 43 C2d 702

<sup>27</sup> **Montgomery & Mullen Lumber Co. v. Quimby** (1912) 164 C 250

<sup>28</sup> **Blume v. MacGregor** (1944) 64 CA2d 244

<sup>29</sup> **Park v. Powers** (1935) 2 C2d 590

<sup>30</sup> **Zimmer v. Dykstra** (1974) 39 CA3d 422

<sup>31</sup> CCP §325

<sup>32</sup> **City of Los Angeles v. Coffey** (1966) 243 CA2d 121

In a situation where the taxes are assessed to both the true owner and the adverse possessor, the requirement will be satisfied when the adverse possessor pays the taxes which are assessed in their name, without regard to the payment of taxes by the true owner also.<sup>33</sup>

When the taxes are assessed only to the owner, the adverse possessor needs to pay the taxes before the owner pays them. Paying taxes after they are paid by the owner does not satisfy the payment of taxes requirement, and the possessor will not be able to obtain legal title through adverse possession.<sup>34</sup>

<sup>33</sup> **Cummings v. Laughlin** (1916) 173 C 561

<sup>34</sup> **Carpenter v. Lewis** (1897) 119 C 18

Adverse possession is the private taking of another's land and the payment of taxes, knowing it belongs to someone else and without permission from the true owner.

The criteria for perfecting ownership by an adverse possession claim are:

- a color of title or claim of right to title;
- actual, notorious and open possession;
- hostile, adverse and exclusive use;
- continuous and uninterrupted possession for five years; and
- payment of current and delinquent real estate taxes and assessments.

Under color of title, the adverse possessor presents written documentation demonstrating they have a good faith belief they are the true owner of the property.

A person whose adverse possession is based on a claim of right is merely a trespasser or intruder who has taken possession of a property without any belief they are the true owner. Evidence of five years of continuous adverse and hostile possession and use by the adverse possessor and the payment of property taxes is required to prove ownership under a claim of right.

When the adverse possession claim is made under a claim of right, the adverse possessor needs to demonstrate their actual possession of the property by one of the following:

- surrounding the property with a substantial, protective enclosure;
- cultivating the property; or

## Chapter 23 Summary



- improving the property.

A possessor's exclusive use of a property is required to perfect any adverse possession claim, whether based on color of title or claim of right. When another person concurrently or intermittently uses the property without consent from the adverse possessor, the possessor's claim is defeated.

**Chapter 23**  
**Key Terms**

<b>actual notice .....</b>	<b>pg. 238</b>
<b>adverse possession .....</b>	<b>pg. 233</b>
<b>claim of right.....</b>	<b>pg. 236</b>
<b>color of title .....</b>	<b>pg. 236</b>
<b>constructive notice .....</b>	<b>pg. 238</b>

**Quiz 9 Covering Chapters 21-23 is located on page 449.**



# Community property rights

## Chapter 24

After reading this chapter, you will be able to:

- understand the role of a seller's broker in the conveyance of property rights by a married individual or couple;
- know how property rights may be transferred between spouses by transmutation; and
- understand when a transfer of property rights requires consent by both spouses.

### transmutation

### Learning Objectives

### Key Term

A broker who represents a married individual in a sale, purchase, lease or financing of community real estate needs to know whether the performance of the married individual under a listing (paying the fee), a purchase agreement (closing escrow) or a lease agreement may be negated by community property defenses held by the other spouse. When the broker is unaware, a married individual can inflict a loss on the broker.

For example, a broker obtains an *exclusive right-to-sell listing* signed only by one spouse who manages the couple's real estate. The real estate listed is community property, vested in the name of the married couple as joint tenants.

During the listing period, the couple sells the property themselves without providing for payment of a fee to the seller's broker. The **exclusive listing** agreement entitles the broker to a fee when the property is sold by anyone, including the couple, during the listing period. [See **RPI** Form 102 §3.1]

### Brokers have a role to play

The broker claims both spouses are liable for the brokerage fee since the property is a community asset and was sold during the listing period.

The spouse who signed the agreement claims the listing is unenforceable without the other spouse's signature since the property listed may not be sold and conveyed without their written consent.

Is the broker entitled to a fee?

Yes! While the spouse who did not sign the listing agreement is not personally liable for the brokerage fee, the spouse who did sign is liable for the fee. The spouse signed the exclusive listing agreement employing the broker to render professional services to market the property and locate a buyer.

Here, the broker's enforcement of their fee agreement under the listing is an action for money due on an employment agreement, not an action for specific performance to deliver title under a real estate purchase agreement — which does require both spouses' signatures.<sup>1</sup>

## Judgment against one spouse

The broker records an *abstract of judgment* in the name of the spouse who signed the listing agreement and is liable for the brokerage fee. The recorded judgment becomes a lien on the separate property of the named spouse and any **community real estate** owned by the couple. However, the other spouse's separate property is not lienied and is unaffected by the abstract against the named spouse.

Now consider a married individual who encumbers community property with a trust deed, executed by the individual alone without the consent of the spouse, to secure a debt evidenced by a note.

Later, the trust deed held by the lender is set aside in an action by the spouse, clearing title of the trust deed the spouse did not consent to – the encumbrance (financing) of the community property.

The individual defaults on the now unsecured mortgage, the trust deed being void for lack of spousal consent. The lender obtains a money judgment against the individual and records an abstract of judgment naming the individual as the judgment debtor.

The abstract now recorded attaches as a lien to all community real estate in the name of the couple, including the same community property previously encumbered by the voided trust deed.

Later, the couple's marriage is dissolved and the individual's spouse is awarded sole ownership of the community property previously cleared of the trust deed lien.

The non-consenting spouse claims the money judgment lien cannot attach to the property since the debt which merged into the money judgment had been secured by the same property under a trust deed the court declared void.

<sup>1</sup> *Tamimi v. Bettencourt* (1966) 243 CA2d 377

However, when the abstract of judgment against the individual was recorded, the abstract created a valid lien on all of their community property, including the property now solely owned by the spouse. The judgment attached to the property while it was still community property, before dissolution of the marriage.<sup>2</sup>

A married couple divides their community assets between themselves so they may conveniently pass the assets on to their children from previous marriages.

## Transfer by transmutation

The couple does not provide for the division of the funds one spouse receives as a pension payment. Here, the money from the pension fund is community property, even though the pension is vested only in the spouse's name.

The spouse places the **pension funds** into an individual retirement account (IRA) vested in the name of the spouse's revocable inter vivos (living) trust. The spouse obtains the other spouse's consent to the deposits, acknowledging they are not to be named as a beneficiary on the IRA account.

Years later, the consenting spouse asserts an interest in the IRA, claiming the funds are community property.

The spouse with the IRA claims the other spouse *transmuted* their community property interest into the first spouse's separate property when they signed the consent form for the change in vesting.

Does the other spouse have a community property interest in the first spouse's IRA?

Yes! For a written declaration to express intent to **transmute property** from a community asset to a separate asset of one spouse, the declaration signed needs to contain an **explicit statement** confirming the spouse *conveys and terminates* their community property interest held in the property.

The use of the word "transmutation" is not required in a **transfer document** to transmute property. A transmutation takes place when the consent agreement contains the provision, "I give to the account holder any interest I have in the funds deposited in this account."<sup>3</sup>

Consider a married couple who buy property with money each spouse earned during their marriage. Escrow is instructed to vest title to the property in the one individual as their sole and separate property.

Concurrent with the recording of the grant deed to the individual, the spouse signs a quitclaim deed clearing title of any interest they may have in the property.

<sup>2</sup> *Lezine v. Security Pacific Financial Services, Inc.* (1996) 14 C4th 56

<sup>3</sup> *In re Estate of MacDonald* (1990) 51 C3d 262

Later, the property is sold and the individual's conveyance is insured by a title company as a transfer of the entire fee ownership of the property. The spouse does not sign and record another quitclaim deed, or join in the individual's conveyance.

The title insurance company considers the spouse's deed on the individual's acquisition of title to the property to be the only conveyance required since the quitclaim deed was recorded.

Within one year after recording the individual's conveyance, the spouse seeks to set aside the sale as voidable. The spouse claims the original quitclaim deed was not a *transmutation* of their community property into the separate property of the individual since they only intended to vest the property so the spouse's name did not appear of record.

Is the quitclaim deed a written declaration which changed the characteristics of the property from community to separate ownership by the individual?

Yes! The spouse's *execution* (signature and delivery) of the *quitclaim deed* transferred their interest in the community property interest to the individual as the individual's separate property since the deed released all interest the spouse held in the property. Thus, the spouse's quitclaim deed transmuted the community property into the separate property of the other spouse.<sup>4</sup>

#### **transmutation**

The transfer of property between separate property and community property or between the separate property interests owned by spouses.

A **transmutation** occurs when a married individual or couple transfers personal or real property from:

- community property to a separate property interest of one spouse;
- a separate property interest of one spouse to community property; or
- a separate property interest of one spouse to the separate property interest of the other.<sup>5</sup>

## Unrecorded transmutations

A transmutation needs to be *written and recorded* to be effective against persons relying on the record title. The recording requirement gives **notice** to others who rely on the recorded title (such as title insurance companies, buyers, tenants or lenders) and whose rights may be affected by a transmutation (such as family members).<sup>6</sup>

For example, an individual acquires property as their sole and separate property.

Later, the individual marries. The individual transmutes their separate property to community property by handing their spouse a signed deed granting the property jointly to them and their spouse, as a married couple. However, the deed which transmuted the property is never recorded.

<sup>4</sup> **In re Marriage of Broderick** (1989) 209 CA3d 489

<sup>5</sup> Calif. Family Code §850

<sup>6</sup> Fam C §852

Later, the individual sells and conveys the property. Within one year after the sales transaction closes, the spouse seeks to set aside the sale, claiming they did not consent to the sale of the community real estate as evidenced by the unrecorded deed.

The buyer claims they (and their title insurer) may rely on the record title which showed the property to be vested only in the individual as their sole and separate property.

May the sale of the community property be set aside by the spouse?

No! The transmutation of the individual's separate property to community property was not recorded to give notice to others. Thus, the buyer (and the title insurer) may rely upon the record title.<sup>7</sup>

*Editor's note — This situation is unlikely to occur unless the broker representing the buyer knows the transmutation rules and presses the title company to issue a policy. Title insurance companies do not readily insure the conveyance by a spouse who is the sole vested owner until the off-record spouse delivers a quitclaim deed or joins in the conveyance.*

*However, no reported case or statute suggests a community interest accrues which may be adjudicated and enforced against a buyer or a lender. Title companies insuring conveyances on property acquired post-1984 or acquired prior to a post-1984 marriage may and ought to rely on the record title.*

Both spouses need to consent to a *sale, lease* for more than one year or *encumbrance* of community real estate.<sup>8</sup>

When one spouse, without the consent of the other, sells, leases for more than one year or encumbers community real estate, the nonconsenting spouse may either *ratify* the transaction or have it *set aside*. The nonconsenting spouse has **one year** from the recording of the transaction to file an action to set it aside. When a third party to the transaction — a buyer, tenant or lender — has no notice of the marriage, the transaction may not be set aside.<sup>9</sup>

Consider a **buyer's broker** who has knowledge the seller of real estate is married and was married when, in their own name, they acquired the property being sold. The broker does not inform the buyer (or the title company) of the seller's marital status. The property is vested of record in the name of the seller only, with no recorded reference to their married status.

Later, and within one year, the nonconsenting spouse learns of the sale and files suit to void the transaction claiming a community property interest in the real estate. The buyer claims they are a bona fide purchaser (BFP), unaware of the marital relationship at the time of the sale.

**Community  
status  
imputed to  
buyer**

<sup>7</sup> Fam C §852(b)

<sup>8</sup> Fam C §1102

<sup>9</sup> Fam C §1102

Here, the **knowledge** of the buyer's broker is *imputed* to the buyer since the broker is the buyer's agent. Thus, the nonconsenting spouse is able to set aside the sale of the property, even though the buyer was personally unaware of the marriage.<sup>10</sup>

## LLC as a vesting

To circumvent the need to obtain quitclaim deeds or determine whether a transmutation has occurred, real estate may be vested in a limited liability company (LLC) solely owned by one spouse, or owned by both spouses with only one spouse as the manager of the LLC.

For example, a married individual may transfer their separate property to an LLC, and manage and control the property as the manager of the LLC. While the LLC owns the real estate, the individual owns the LLC as its sole member.

As manager, the individual is able to sell, encumber or lease the property in the name of the LLC — without their spouse's consent.<sup>11</sup>

Other instruments and entities which may be used to authorize one spouse to manage and control community property include:

- a power of attorney;
- a revocable trust in which one spouse is the named trustee<sup>12</sup>; or
- a limited partnership.<sup>13</sup>

<sup>10</sup> **Waldeck v. Hedden** (1928) 89 CA 485

<sup>11</sup> Calif. Corporations Code §§17052(f), 17157

<sup>12</sup> Fam C §761(c)

<sup>13</sup> Corp C §§15900 et seq.



## Chapter 24 Summary

A broker who represents a married individual in a sale, purchase, lease or financing of community real estate needs to know whether the performance of the married individual under a listing (paying the fee), or purchase agreement (closing escrow) or a lease agreement may be negated by community property defenses held by the other spouse. When the broker is unaware, the individual can inflict a loss on the broker.

A transmutation occurs when a married individual or couple transfers personal or real property from:

- community property to a separate property interest of one spouse;
- a separate property interest of one spouse to community property; or
- a separate property interest of one spouse to the separate property interest of the other.

A transmutation needs to be written and recorded to be effective against persons relying on the record title. For a written declaration to express intent to transmute property from a community asset to a separate asset of one spouse, the declaration signed needs to contain an explicit statement confirming the spouse conveys and terminates the community property interest held in the property.

The use of the word “transmutation” is not required in a transfer document to transmute property.

Both spouses need to consent to a sale, lease for more than one year or encumbrance of community real estate.

To circumvent the need to obtain quitclaim deeds or determine whether a transmutation has occurred, real estate may be vested in a limited liability company (LLC) solely owned by one spouse, or owned by both spouses with only one spouse as the manager of the LLC.

**transmutation ..... pg. 246**

## Chapter 24 Key Term

**Quiz 10 Covering Chapters 24-26 is located on page 450.**

*Notes:*



# The revocable title holding trust

## Chapter 25

After reading this chapter, you will be able to:

- understand the use of an inter vivos (living) trust vesting to avoid probate supervision of a deceased owner's real estate; and
- distinguish a inter vivos (living) trust from other trust arrangements.

**beneficiary**

**business trust**

**inter vivos (living) trust**

**real estate investment trust (REIT)**

**trustee**

### Learning Objectives

### Key Terms

A broker, on behalf of a prospective buyer, locates real estate the buyer decides to make an offer to purchase.

To obtain information for title provisions before preparing a purchase agreement for the buyer to sign, the broker asks the buyer:

- How are you going to *take title* to the property?; and
- How are you going to fund the good faith deposit?

The buyer informs the broker they want to take title in the name of their *family trust*, legally titled a *revocable inter vivos (living) trust*. The deposit for the down payment of the purchase price will be made using funds on deposit in a bank account held in the buyer's name as **trustee** for their inter vivos (living) trust.

Due to the buyer's trust vesting requirement, the broker tells the buyer they need to provide a copy of the trust agreement (or at least the first page) on the opening of escrow. Escrow needs a copy of the trust agreement to confirm the correct name and spelling of both the trustee and the inter vivos (living) trust for use when preparing escrow instructions and the grant deed transferring title to the inter vivos (living) trust.

### A review of vestings

#### **trustee**

One who holds title to real estate in trust for another.

The broker, also aware the buyer will fund a portion of the purchase price from the net proceeds of a purchase-assist mortgage, is concerned about the vesting the lender will demand to fund and record the mortgage.

Since the broker knows lenders will require the buyer to take title in their own name, the broker inquires into or confirms the buyer's legal status, asking:

- Are you single, married, unmarried or widowed?; and
- On acquisition, will the property be solely-owned separate property, community property or a property jointly owned with others?

The buyer informs the broker they are married and the property acquired will be community property.

To avoid vesting complications on closing, the broker informs the buyer that the lender (and the title company) will require **both spouses** to individually execute the mortgage documents, including the trust deed to be recorded and insured. Lenders will not accept a inter vivos (living) trust as a borrower since a inter vivos (living) trust is not an individual or an entity.

Thus, the buyer and their spouse will be required to take title to the property in both their names as joint tenants, as community property or as community property with the right of survivorship. [See Chapter 24]

Accordingly, the broker enters the names of both the buyer and their spouse as the buyers on the purchase agreement, not naming the inter vivos (living) trust as the buyer.

The buyer is advised that after the spouses take title and the lender's trust deed is recorded, a grant deed further conveying the property from the spouses into the inter vivos (living) trust vesting will be recorded.

The escrow officer will be instructed to prepare two grant deeds:

- one from the seller to the buyers; and
- one from the buyers to their inter vivos (living) trust, to be recorded after the lender's trust deed is recorded.

This "double deed" instruction is to be part of the mutual escrow instructions signed by the seller and buyer. The lender, on receiving a copy of the escrow instructions, will have notice (as required by federal due-on mortgage law) of the additional transfer into the inter vivos (living) trust vesting.<sup>1</sup>

Additionally, escrow will be advised the policy of **title insurance** is to be issued in the name of the buyer and their spouse as the vested owners. However, only the American Land Title Association (ALTA) homeowner's policy of title insurance automatically provides coverage for a later transfer into the revocable inter vivos (living) trust vesting, even though the two spouses are named as the insureds, not the trust. All other title insurance policies require an endorsement to insure a later transfer to the inter vivos (living) trust vesting. [See Chapter 22]

<sup>1</sup> 12 Code of Federal Regulations §591.5(b)(1)(vi)

An individual owner of property, real or personal, creates a *revocable inter vivos (living) trust* to hold title to their property for multiple reasons, primarily:

- to accommodate the **distribution** of the owner's estate which remains at the time of the owner's death, without resorting to probate proceedings under a will; and
- to retain the **interim ability** to sell, encumber, lease or remove the property from the trust vesting without the debilities imposed by other estate planning vestings, such as joint tenancy or community property vestings.

Alternatively, spouses who want to best accomplish the passing of their community property to the surviving spouse are best served by using a right of survivorship vesting, such as a joint tenancy or community property with right of survivorship vesting. These survivorship vestings eliminate the need for a conveyance from the successor trustee under the inter vivos (living) trust on the death of a spouse.

Additionally, under these vestings, the **right of survivorship** may be individually *severed* — eliminated — by either spouse. To sever the right of survivorship, either spouse may deed their interest to themselves with a declaration stating they are terminating the joint tenancy or community property with right of survivorship vesting. [See Chapter 27]

The deed to oneself of a fractional ownership interest alters the vesting but does not alter the underlying nature of the ownership, whether it is a community asset or a separate asset. What remains after a spouse **severs** a right of survivorship vesting is a simple community property vesting.

A popular misconception maintains that owners may use revocable inter vivos (living) trust vestings to avoid their creditors. This is completely unfounded — the trust vesting is not a debt shield or an *asset preservation vesting*. Creditors can reach property vested in the owner's revocable inter vivos (living) trust, both during the owner's lifetime and after their death.

A revocable inter vivos (living) trust is *not* a legal entity separate or different from the owner, such as a partnership, limited liability company (LLC) or corporate form of ownership.<sup>2</sup>

The singular advantage of a revocable inter vivos (living) trust is its ability to perform the same functions as a will while avoiding probate procedures. Given the onerous nature of California probate proceedings, the advantage of the alternative trust vesting is substantial, both in conveyance time and handling costs.

A trust agreement is nothing more than escrow instructions to the successor trustee to deed properties to named beneficiaries on the death of the owner. Probate is **litigation**, service of process on heirs, attorneys and courtroom action which span over a long period of time, not just a few weeks.

## Reasons for a trust vesting

## Personal judgments attach to trust vestings

<sup>2</sup> Calif. Probate Code §18200

Inter vivos  
(living) trust  
considerations

**PROPERTY TAX REASSESSMENT:** Transfers of title to real estate by individuals into their revocable inter vivos (living) trusts are exempt from reassessment. [Calif. Revenue and Taxation Code §62(d)]

*Editor's note – In an environment of financially strapped counties and trigger-happy assessors, the owner needs to get prior written approval from the assessor before conveying the property into a inter vivos (living) trust vesting.*

**DUE-ON-SALE:** A conveyance of real estate into any trust vesting triggers the due-on clause, requiring written pre-conveyance consent by lenders with due-on clauses in their trust deeds. [12 Code of Federal Regulations §591.5 (b)(1)(vi)]

*Editor's note – Federal regulations requiring lender approval on owner-occupied, one-to-four residential units contradict federal codes, which exempt transfers to revocable inter vivos (living) trusts from due-on-sale enforcement. However, until the 2010s, the discrepancy was a moot issue with brokers since due-on-sale interference by lenders is primarily an economic issue, not just a legal issue.*

*When pressure on interest rates subsides, old mortgages will usually have a higher rate of interest than new mortgages, creating no incentive for lenders to call mortgages due or recast them on transfer of title to a inter vivos (living) trust. However, the decades following 2012 will see lender interference with transfers as interest rates rise. [12 United States Code§ 1701j-3(d)(8)]*

**PROBATE AVOIDANCE:** Trust provisions limiting the right of a successor trustee or beneficiary to petition the probate court to resolve disputes are unenforceable. [*In re Estate of Parrette* (1985) 165 CA3d 157]

**TAX ASPECTS:** All tax consequences remain with the beneficial owner of the property, unaltered by the trust vesting – including income and expenses, interest, depreciation, profit and loss, §1031 and §1040 reporting, the \$250,000 per person residential §121 profit exclusion, rental operating losses, etc. However, the appointment of a trustee other than the owner to operate the property establishes the trust as a separate taxable activity (but not a separate entity), and the owner will lose the personal tax benefits from the real estate. A property manager is not a trustee.

**FAMILY PARTNERSHIP:** Community assets vested in the name of a limited partnership or limited liability company (LLC), with the husband and wife solely owning the partnership as partners or the LLC as members, allow their capital ownership interests in the entity to be vested in name of the inter vivos (living) trust. The same vesting holds for stock in a corporation, trust certificates, bonds, and notes and trust deeds owned by the husband and wife.

**SURVIVING SPOUSE:** A qualified terminable interest in property (QTIP) conveys to the surviving spouse a life estate in the deceased spouse's property, without the ability by the surviving spouse to amend or revoke the deceased's distribution of the fee simple to, for example, their children. The surviving spouse needs to file a declaration with the Internal Revenue Service (IRS) stating the life estate is a QTIP to exempt the property from the deceased spouse's estate taxes under the marital deduction. However, the property will be included in the surviving spouse's taxable estate on death. [26 USC §2056(b)]

Consider a creditor who records an **abstract of judgment** which attaches as a lien to all real estate owned in the county by a judgment debtor. A parcel of real estate owned by the debtor is vested in their revocable inter vivos (living) trust. The parcel is subject to a first mortgage.

A second mortgage is later recorded on the real estate vested in the revocable inter vivos (living) trust.

Ultimately, the first mortgage holder forecloses. The property is sold at a trustee's sale for a price in excess of the amount due on the first mortgage. The judgment creditor demands the excess sales proceeds, claiming their judgment lien naming the debtor attached to the real estate vested in the debtor's revocable inter vivos (living) trust and is second in priority to the first trust deed, ahead of the claims of the second trust deed holder.

The second trust deed holder claims they are entitled to the excess funds since they were a good faith encumbrancer of the "trust asset," unaware of the judgment recorded against the debtor, who was the owner of the property vested in the name of the trust.

Is the second trust deed holder entitled to the excess proceeds?

No! The judgment creditor is entitled to the excess proceeds. The second trust deed holder has **constructive notice** of the recorded judgment against the debtor, who is the owner (beneficiary) of the real estate vested in the revocable inter vivos (living) trust. A review of the trust agreement controlling the trustee who holds title reveals the owner's identity.<sup>3</sup>

Any trust created for the purpose of holding title to real estate for another person is only valid if the trust relationship with the trustee is declared in writing.<sup>4</sup>

However, to establish a viable inter vivos (living) trust only a minimal writing is required, called a *Declaration of Trust* or *trust agreement*.

The elements necessary to enter into a statutory inter vivos (living) trust agreement include:

- the owner's declaration to establish a trust as the *trustor* (sometimes called the *settlor*);<sup>5</sup>
- the identification of a *trustee* (usually the owner) to manage title to properties vested in the trustee as instructed by the trust agreement;<sup>6</sup>
- an actual conveyance — vesting — of property (called the *corpus* or *trust property*) to the trustee;<sup>7</sup> and
- the successor(s), called **beneficiaries**, to receive the trust property on the death of the owner.<sup>8</sup>

Thus, the inter vivos (living) trust agreement becomes a **title holding arrangement** which is not operative and has no legal, financial or tax consequences until death. [See Form 463 accompanying this chapter]

## Establishing the trust

### beneficiary

One entitled to the benefits of properties held in a trust or estate, with title vested in a trustee or executor.

<sup>3</sup> *Bank One Texas, N.A. v. Pollack* (1994) 24 CA4th 973

<sup>4</sup> Prob C §15206

<sup>5</sup> Prob C §15201

<sup>6</sup> Prob C §15200

<sup>7</sup> Prob C §15202

<sup>8</sup> Prob C §15205



### Community property, separate trusts

*A married couple needs to consider establishing separate trusts for each of their half interests in their community property. Each trust agreement names the other spouse as successor trustee.*

*Although spouses may jointly deed their community property into one trust, the joint trust is substantially more complex and replete with distribution and trust management complications after the first death.*

*The complexities involved with spouses deeding into the same trust are comparable to the folly of attempting to use one set of escrow instructions to handle the sale/exchange of two properties owned by each of two separate sellers (who are also separate buyers). Here, two escrows need to be created in an actual exchange of properties.*

*Placing each spouse's community property interest into separate trusts incurs no financial, legal or tax disadvantages, and in no way alters the character of community property. The trust vesting is just another way to vest community property. [Calif. Family Code §761]*

The only activity remaining to complete after entering into the trust agreement is to convey title to the property into the trust vesting, called *funding the trust*. Thus, the trust has become vested with property.

The owner has to sign and record grant deeds conveying their real estate into the trust vesting. Otherwise, the property will remain vested in the owner on death, and the trust will be useless since it was not funded and has nothing to further convey.

The property vested in the name of the trustee is listed in a property distribution schedule attached to the trust declaration, usually called **Schedule A**. [See Form 463]

In addition to identifying the trust real estate, *Schedule A* specifies the successors of the owner as *beneficiaries* to whom property will be distributed by grant deed.

Trust agreements do not need to be recorded. However, it is prudent to have the trust agreement notarized. That way, when the title company asks for it before issuing an insurance policy or any further conveyances, they can verify the owner(s) signed the document.

### Amending Schedule A for further vestings

An owner is able to add properties to Schedule A attached to the trust agreement at any time. To do so, the owner conveys properties to the trustee vesting and then adds a description of the properties to the list in Schedule A, naming the successors who are to receive the properties on their death.

Conversely, an owner deeding out properties from the trust and deleting them from Schedule A, or changing successors to a property, needs to redraft Schedule A in its entirety and attach the new draft to the original trust agreement after removing and destroying the old Schedule A.

## - PAGE 1 OF 2 — FORM 463

10 Prob C §1514

## Form 463

Declaration of  
Revocable Living  
Trust

Page 2 of 2

----- PAGE 2 OF 2 — FORM 463 -----

**"Schedule A"  
for the****Family Trust**

Property	Name of Beneficiary(ies)	Percentage of interest to each beneficiary
1. _____	a) _____	_____
	b) _____	_____
2. _____	a) _____	_____
	b) _____	_____
3. _____	a) _____	_____
	b) _____	_____
4. _____	a) _____	_____
	b) _____	_____
5. _____	a) _____	_____
	b) _____	_____
6. _____	a) _____	_____
	b) _____	_____
7. _____	a) _____	_____
	b) _____	_____
8. _____	a) _____	_____
	b) _____	_____
9. _____	a) _____	_____
	b) _____	_____
10. _____	a) _____	_____
	b) _____	_____

Initials: \_\_\_\_\_ Date: \_\_\_\_ / \_\_\_\_ / \_\_\_\_

**FORM 463**

03-11

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To prevent the underage *successor* from being subjected to a court-appointed guardian to administer the property received, the owner may simply require the trustee (or someone else) to retain title under the trust agreement and manage or provide for management of the property until the successor reaches the age of 18.

Of course, an owner may not want the property to wind up in the possession of an 18-year-old either. Some owners prefer to prevent distribution of property to their children until the children reach a more mature age, for fear a younger, less experienced successor will waste or misuse the property.

Critical to the distribution of properties on the death of an owner is:

- the naming of *successor trustees* in the declaration of trust agreement; and
- the preparation of an exhibit (attached to the trust agreement) listing the properties vested in the name of the trustee, followed by the name(s) of the individual(s) who are to receive the properties on the owner's death.

## Successor trustees to carry on

Variations on the distribution of the owner's property exist, such as:

- having a list of beneficiaries who will "share and share alike" all the properties vested in the name of the trustee; or
- selling all the assets vested in the trustee and distributing the net proceeds of the sale to the named beneficiaries based on the percentage given each of them in the trust agreement, etc.

The variations are limited only by the simplicity or complexity sought by the owner. This includes the establishment by a provision in the inter vivos (living) trust agreement for a management trust to own and operate the properties and distribute the income for a period of time after the owner's death.

A transfer of community assets, such as the disbursement of cash savings and borrowing funds to purchase a property or vest the property in the "[name of the trustee] for The [\_\_\_\_\_] Living Trust," does not alter the **community asset nature** of the property.

The trust vesting, like a joint tenancy vesting, has no effect on the nature of the property, whether the property is transferred into the trust or transferred out of the trust. It remains community property at all times since it was acquired or transmuted to community property during the marriage.<sup>11</sup>

Additionally, the vesting of community property in a revocable inter vivos (living) trust avoids any conflicting attempts at distribution under a will or by intestate succession when a will does not exist. The trust agreement provisions control the distribution of properties vested in the name of the trustee on the death of the owner.<sup>12</sup>

A inter vivos (living) trust offers no ability to obtain greater or lesser **tax results** than can be attained under a will. Thus, the revocable inter vivos (living) trust is a complete substitute for a will for those assets vested in the trust at the time of the owner's death. A will controls the distribution of assets remaining vested in the name of the owner at the time of their death.

Additionally, when the spouse of the deceased is the successor, and the property is a community property asset, the surviving spouse receives the entire property with a fully stepped up **cost basis** to the property's market value on the death of the spouse.

<sup>11</sup> Fam C §761

<sup>12</sup> Prob C §13504

The surviving spouse receives a fully stepped up cost basis whether the property is vested in a inter vivos (living) trust, as joint tenants or under either community property vesting.<sup>13</sup>

## Trust entities and trust relationships

Relationships in real estate transactions frequently include an agency relationship which rises to the level of a **trust relationship**. A trust relationship imposes a duty on the person who holds title for the owner, or who is to deliver the property *held in trust* to others. The named person is required to follow instructions given to them by the principal who owns the property.

Real estate brokers, escrow companies, title companies, banks operating a trust business and attorneys are commonly employed by principals to act as their agents holding title to their property. They are subject to the duties of a trust relationship, which is imposed while the agent holds title to or manages property owned by the principal.

A **trust company** is any corporation or bank which is authorized to engage in the activities of a trust. A **trust business** is a business which acts as an executor, administrator, guardian or conservator of estates, or as assignee, receiver, depositary or trustee by the appointment of the court or for any purpose permitted by law.<sup>14</sup>

A *trust business* in California has a distinctly different relationship with the public than the relationship established by the activities of an out-of-state **business trust**.

### business trust

A type of business entity which is not recognized in California; out-of-state business trusts are required to first qualify as a corporate entity with the Department of Financial Protection and Innovation (DFPI) before doing business in California.

Business trusts, frequently called *Massachusetts trusts*, are engaged in general business, not in the trust business. The relationships created under a business trust arrangement do not include the trust relationship between a principal (beneficiary) and their agent (trustee).

A business trust is a type of entity which cannot be established under California law. A scheme does not exist for the creation of a business trust in California. Thus, a business trust can only be established in states with a scheme for creating a business trust entity.

When a business trust is created in another state, it cannot operate as such in California. However, it can buy, sell, lease or operate real estate located in California on behalf of the entity or anyone else when it first qualifies as a corporation under the California Corporate Securities Act. Business trusts are considered *foreign corporations*.<sup>15</sup>

As foreign corporations, business trusts need to register with the Department of Financial Protection and Innovation (DFPI) and file corporate income tax returns with the Franchise Tax Board (FTB) when they conduct business within the state of California by owning and operating real estate assets.<sup>16</sup>

<sup>13</sup> 26 United States Code §1014(b)(6); Revenue Ruling 87-98

<sup>14</sup> Calif. Financial Code §115

<sup>15</sup> Calif. Corporations Code §§170, 171

<sup>16</sup> Corp C §191; Calif. Revenue and Taxation Code §23038(b)(2)(B)

Thus, a business trust, as a foreign corporation in California, needs to qualify with a state agency before:

- conducting any business in California;<sup>17</sup> or
- accepting money from investors in exchange for share ownership in the trust entity.

The trustee of a business trust holds title to real estate in their name (as trustee for the named business trust), and **controls the operation** of the property. The trustee is also a principal, and is personally liable for all debts/obligations incurred by the business trust, as though they were a general partner in a limited partnership.<sup>18</sup>

Further, the business trust itself is liable for obligations incurred on its behalf in the management of the real estate vested in the trustee. Also, the assets of the business trust are directly liable for any *torts* of the trustee, such as failure to properly maintain the security of tenants or the condition of the property which causes injury to others.<sup>19</sup>

If the beneficiaries are authorized to exercise ultimate control over the trustee's ability to buy, sell, refinance, own or operate the property, including the trustee's selection of successor trustees, the beneficiaries will be personally liable for the debts incurred by the trustee.

Accordingly, the trustee is then not personally liable since they have been reduced in their powers to a mere **agent** acting on behalf of the beneficiaries. Thus, the association between the trustee and the beneficiaries is not that of a business trust at all. It is a principal-agent relationship under a management contract.<sup>20</sup>

One trust entity, called a **real estate investment trust (REIT)**, is authorized to be created under California law only if it has been:

- formed as a REIT under the Internal Revenue Code and does business under the code; and
- qualified by the Division of Corporations.<sup>21</sup>

The beneficiaries who invest in this real estate ownership entity are called **shareowners**. The shareowners hold transferable shares which are sold publicly. As individuals, the shareowners are not liable for the debts/obligations of the REIT. The REIT is managed by officers called *trustees* who also are not liable for the debts and obligations of the REIT.

## Real estate investment trusts

### real estate investment trust (REIT)

An entity issuing securities held by investors and traded on the stock market, holding title to income-generating property, trust deeds and treasury bonds.

<sup>17</sup> Fin C §117

<sup>18</sup> *Goldwater v. Oltman* (1930) 210 C 408

<sup>19</sup> *Alphonzo E. Bell Corporation v. Bell View Oil Syndicate* (1941) 46 CA2d 684

<sup>20</sup> *Bernesen v. Fish* (1933) 135 CA 588

<sup>21</sup> Corp C §23000

## Chapter 25

### Summary

An individual owner of property, real or personal, creates a revocable inter vivos (living) trust to hold title to their property for multiple reasons, primarily:

- to accommodate the distribution of the owner's estate which remains at the time of the owner's death, without resorting to probate proceedings under a will; and
- to retain the interim ability to sell, encumber, lease or remove the property from the trust vesting without the debilities imposed by other estate planning vestings, such as joint tenancy or community property vestings.

Alternatively, spouses who want to best accomplish the passing of their community property to the surviving spouse are best served by using a right of survivorship vesting, which eliminates the need for a conveyance from the successor trustee under the inter vivos (living) trust on the death of a spouse. Additionally, under these vestings, the right of survivorship may be individually severed by either spouse.

A revocable inter vivos (living) trust is not a vesting or legal entity separate or different from the owner, such as a partnership, limited liability company (LLC) or corporate form of ownership.

The singular advantage of a revocable inter vivos (living) trust is its ability to perform the same functions as a will while avoiding probate procedures.

Any trust created for the purpose of holding title to real estate for another person is only valid if the trust relationship with the trustee is declared in writing.

The elements necessary to enter into a statutory inter vivos (living) trust agreement include:

- the owner's declaration to establish a trust as the trustor (sometimes called the settlor);
- identification of a trustee (usually the owner) to manage title to properties vested in the trustee as instructed by the trust agreement;
- actual conveyance of property (called the corpus or trust property) to the trustee; and
- successor(s), called beneficiaries, to receive the trust property on the death of the owner.

The owner has to sign and record grant deeds conveying their real estate into the trust vesting.

Real estate brokers, escrow companies, title companies, banks operating a trust business and attorneys are commonly employed by principals to



act as their agents. They are subject to the duties of a trust relationship, which is imposed while the agent holds title to or manages property owned by the principal.

<b>beneficiary .....</b>	<b>pg. 255</b>
<b>business trust .....</b>	<b>pg. 260</b>
<b>inter vivos (living) trust.....</b>	<b>pg. 251</b>
<b>real estate investment trust (REIT) .....</b>	<b>pg. 261</b>
<b>trustee .....</b>	<b>pg. 251</b>

## Chapter 25 Key Terms

**Quiz 10 Covering Chapters 24-26 is located on page 450.**

*Notes:*



## Chapter 26

# Tenants in common as a vesting

After reading this chapter, you will be able to:

- distinguish between the co-ownership of real estate and having a co-ownership interest in an entity that owns real estate;
- identify the differences between California partnership law and federal tax law regarding co-ownership and management of real estate; and
- understand the advantages of using a limited liability company (LLC) or limited partnership (LP) to hold title to fractional ownership interest instead of as a tenant in common (TIC) with all other co-owners.

**alienation**

**partition action**

**partnership**

**tenants in common (TIC)**

**vesting**

## Learning Objectives

## Key Terms

When a group of investors purchases real estate, the **vestings** available to properly structure their common ownership interests include taking title in the name of:

- each of the investors, or their trustees, as **tenants in common (TIC)**;
- a **limited liability company (LLC)** owned by the group; or
- a **partnership** (general or limited) comprised of the group.

A corporate ownership and *vesting* of real estate is infrequently used by investors in real estate held for rental income or profits due to adverse tax consequences, whether reporting as a C or S corporation.

## Vesting choices

### **tenants in common (TIC)**

Co-ownership of real estate by two or more persons who each hold equal or unequal undivided interest, without the right of survivorship.

**vesting**

A method of holding title to real estate, including tenancy in common, joint tenancy, community property and community property with the right of survivorship.

While the steps for forming an LLC or a partnership are clearly defined, the annual franchise fee to the state of California is an inhibition interfering with the selection and use of an LLC or limited partnership entity.

Instead, many groups still take title to investment property in the name of all the investors — each investor to an undivided equal or unequal percentage of title as a *tenant in common*.

Although vested as a *TIC*, the group will be governed by partnership law. No individual will have the rights of a tenant in common since the property requires centralized management to oversee:

- the collection of any income;
- payment of expense and debt obligations; and
- maintenance of insurance and the condition of the property.

Management responsibilities exist even when the co-owned land is unused and unimproved.

## Co-ownership by TIC in California

Consider a group of investors who acquire income-producing property located in California. Title is taken as a *TIC*, naming each investor and stating their percentage or fractional share of **undivided ownership** in the property.

Tenants occupy the property under periodic rental agreements and short-term lease agreements that provide for the landlord to care for and maintain the premises.

The co-owner investors orally agree to:

- divide annual operating income (or losses) and resale profits on a pro rata basis in accordance with their percentage of ownership;
- grant each other a *right of first refusal* on a resale of their fractional TIC interests; and
- grant the syndicator the option to purchase the property at its **fair market value (FMV)**.

The broker who organized the group is also designated to manage the property with authority to:

- locate tenants;
- enter into short-term lease and rental agreements;
- collect rents;
- contract for the repair, maintenance, utilities and security to be provided by the landlord under the lease agreements;
- pay operating expenses and mortgage payments; and
- distribute spendable income to the co-owners quarterly.

Are the co-owners conducting themselves as partners under California partnership law despite the TIC vesting placing each co-owner on title and property management?

Yes! Co-owners of California real estate vested as TICs, when engaged in the business of *jointly operating* the property on terms calling for them to **share income and profits**, are conducting themselves as partners. Thus, they are considered *agents of one another*, charged as fiduciaries with the duty to cooperate in the ownership of the property.<sup>1</sup>

A TIC vesting does not control the **possessory rights** of the co-owners when the co-ownership conduct in fact constitutes a California **partnership**. For example, a partner may use or possess partnership property only on behalf of the *partnership*, while a common-law TIC co-owner (as viewed by the Internal Revenue Service (IRS)) may use, possess or lease the property themselves, without regard to any other co-owner.<sup>2</sup>

Although title to an income-producing property held by co-owner investors for profit is vested in the names of all the co-owners, each co-owner actually *holds title as a trustee* on behalf of all the TIC co-owners, collectively called a partnership.<sup>3</sup>

As co-owners and operators of a rental property, they have formed a partnership, holding title in the TIC, the most troublesome of all California co-ownership vestings.

Thus, the conveyance of a co-owner's TIC interest to another person conveys nothing more than the co-owner's interest in the partnership's **equitable ownership** of the property. The partnership's title to the property is *held in trust*, in the name of each co-owner for the benefit of all co-owners.

Prior to California's 1949 enactment creating **tenancies in partnership**, TIC **co-owners** who owned rental property requiring centralized management did not constitute a partnership. Before 1949, no agency relationship existed between TIC co-owners to protect the common interests of the co-owners to share profits. The federal tax law defining TIC interests remains the same today as the prior California law controlling TICs.<sup>4</sup>

Since 1949, a California partnership exists when two or more investors join together to carry on a business for income and profit in California. A California business includes every trade, occupation or profession.<sup>5</sup>

While a landlord's property management activities are not classified as a trade or business activity for federal income tax purposes (since the property is a passive rental operation or a portfolio asset), landlord and property management by a syndicated group is an *occupation* under California partnership law. A co-ownership is a California partnership when the co-owners are involved in **sharing earnings and profits** from rental operations, refinancing and resale of the property they own.<sup>6</sup>

**Trustees for one another, by law**

**The defining acts of partners**

**partnership**

A voluntary association of two or more persons to carry on a business or venture on terms of mutual participation in profits and losses.

<sup>1</sup> Calif. Corporations Code §§16202(a), 16202(c)(3)

<sup>2</sup> Corp C §16401(g)

<sup>3</sup> Calif. Civil Code §682; Corp C §16404(b)(1)

<sup>4</sup> **Johnston v. Kitchin** (1928) 203 C 766

<sup>5</sup> Corp C §16101(1)

<sup>6</sup> Corp C §§16202(a), 16202(c)(3)

Also, the receipt of income (from operations) and profits (from a sale) by co-owners from their joint investment is considered evidence of a California partnership, unless the earnings are received by a co-owner in payment:

- of an installment note, including one given in consideration for the sale of goodwill or property;
- for wages or rent due the co-owner;
- on an annuity to a surviving spouse or representative of a deceased co-owner; or
- as interest on a loan.<sup>7</sup>

## The TIC partnership

With a TIC vesting, the sharing of income and profits earned by each co-owner's separate use of the property — such as occurs with the extraction of minerals from the property by each co-owner for their own separate use — does not in itself create a California partnership. It takes more than the sharing of use and possession by co-owners to constitute conduct on the level of a partnership.<sup>8</sup>

It is the **interaction and coordinated conduct** of the co-owners while directly or indirectly managing or operating the investment that determines whether a state law partnership relationship exists between them. Once the conduct of co-owners in a coordinated ongoing operation of the property constitutes a joint and mutually beneficial activity, an agency relationship exists between the co-owners.

With the agency relationship comes fiduciary duties owed to partners, which obligate each prospective or actual co-owner to act in the best interest of the group.<sup>9</sup>

## Interaction and coordinated conduct among co-owners

Thus, TIC co-owners of rental property who act collectively to manage the property, or authorize a property manager to operate the property on their behalf, hold ownership to the real estate under a *tenancy in partnership*. Each co-owner is a tenant in partnership with all other co-owner investors.

By the sharing of income among co-owners who are vested as **TICs**, a tenancy in partnership is established.

Each co-owner is subjected to the rights and obligations of a partner, such as:

- the duty to *hold title* to the real estate as a trustee for the benefit of the partnership;<sup>10</sup>
- the right of each co-owner to *use and possess* the real estate — but only for group purposes;<sup>11</sup>

<sup>7</sup> Corp C §16202(c)(3)

<sup>8</sup> Corp C §16202(c)(1)

<sup>9</sup> Corp C §16404; **Leff v. Gunter** (1983) 33 C3d 508

<sup>10</sup> Corp C §16404(b)(1)

<sup>11</sup> Corp C §16401(g)

- the nontransferable right to use and possess the real estate unless all co-owners *collectively transfer* the partnership's right to possession of the property;<sup>12</sup> and
- the protection of the co-owned property as not being *subject to attachment or execution on a judgment* against an individual co-owner, only on claims against the partnership.<sup>13</sup>

Even when co-owners do not characterize their mutual working relationship in a profit-sharing investment as a partnership, they are still obligated to act on behalf of the group as though they were partners in a partnership.<sup>14</sup>

Under state law, TIC co-owners hold no interest in the real estate they co-own that they may legally transfer, voluntarily or involuntarily, independent of the rights of the resulting California partnership.<sup>15</sup>

However, federal tax law for determining the tax partner status of TICs disregards state law to the contrary.<sup>16</sup>

The **coordinated conduct** of co-owners in the exercise of ownership rights to operate the investment real estate they co-own is viewed differently under federal income tax law than under California partnership law.

When co-owners of property located in California share the income — profit and losses generated by a joint investment in real estate — and operate under an unincorporated ownership arrangement such as a TIC, California partnership law classifies the profit-sharing group as a partnership.

Thus, California imposes agency obligations on each co-owner to act in concert for *the mutual benefit* of the group. These agency obligations arise the first moment discussions about a syndicated investment occur. As a result, anarchy within the group of co-owners is legally avoided as public policy in California.

Conversely, federal tax law as a contrivance places emphasis on common law TIC rules to establish co-owner rights, but solely for the purposes of tax reporting. TIC ownership does not rise to tax partner status unless the co-owners are operating as:

- a declared partnership (general or limited);
- an LLC which has not elected to report as a corporation; or
- a cooperative TIC.

To avoid federal tax partnership status, each co-owner vested as a TIC needs to have the unrestricted common law right by agreement to independently *alienate* their fractional interest without the prior consent of the other co-

## A tax partnership vs. a California partnership

## Avoidance of federal tax partnership status

<sup>12</sup> Corp C §§16203, 16501

<sup>13</sup> Corp C §§16201, 16501

<sup>14</sup> Corp C §16202(a)

<sup>15</sup> Corp C §16502

<sup>16</sup> Revenue Procedure 2002-22



**alienation**

The sale, further encumbrance or lease (for a period exceeding one year) of a property.

owners. Further, each co-owner also needs to have the unrestricted right to independently block any **alienation** of the entire property co-owned by the group.

*Alienation* of the entire property refers to its sale, further encumbrance or lease for a period exceeding one year.

The ownership of a TIC interest that retains its common law right of alienation in real estate is viewed by the IRS as the §1031 ownership of a fractional interest in the real estate itself, rather than merely the ownership of an interest in a partnership which controls ownership activities. Thus, California state law is not considered by the IRS for tax reporting purposes, since California will treat the same TIC as a California partnership when a dispute arises.

## Cooperation among co- owners

Further, §1031 TIC co-ownership arrangements may provide for **cooperation** among the co-owners in the ongoing management and operation of the property. Operating the property by centralized management does not violate the IRS requirement of unanimous approval for sale, encumbrance or leasing of the entire property by the group.

Thus, the IRS distinguishes the alienation of rights inherent in ownership from the day-to-day managerial operations of the property. This separate distinction of rights in ownership and management is not the case under California treatment of TIC ownerships of real estate.

An understanding of the distinctions between federal tax law (which defines §1031 property investments as excluding fractional interests held by tax partners) and California's partnership law (which controls joint ventures and profit sharing ownerships that are not entities) is critical to individuals involved in investment groups.

These individuals include:

- **syndicators** structuring the ownership for acquisition of property by an investment group they are forming;
- **investors** acquiring or disposing of a fractional interest in a syndicated real estate investment; and
- **brokers** (or other advisors) representing a person who is buying into or withdrawing from a real estate syndicated investment.

Knowing the parameters for activities that establish a partner under California partnership law versus activities that establish a tax partnership for federal income tax reporting avoids unintended and unexpected results under either set of laws, or worse, the loss of a transaction because of insufficient knowledge.

The penalty for a TIC co-owner who is federally classified as a tax partner in the ownership of either the property sold or the property acquired in a § 1031 *reinvestment plan*, is the loss of the entire **§1031 tax exemption** for profit taken on the property sold.<sup>17</sup>

Thus, the arrangements or activities a co-owner, other co-owners, a property manager, a syndicator or a lender agree to among themselves and make a co-owner a tax partner, may become of great concern to investors in syndicated real estate investments programs.

When a co-owner of investment real estate is classified by the IRS as a partner, the real estate is considered to be owned by a **tax partnership**. Classified as a partner, the co-owner's ownership interest is that of a share in a partnership and does not qualify as §1031 property.

Thus, an investor with after-tax cash they have accumulated or §1031 money to reinvest, who makes a capital contribution to a group being formed to jointly own and operate an income-producing parcel of real estate, needs to be certain no co-owner is sharing in any income from tenants other than rent.

Co-owners establish tax partner status when they:

- occasionally provide tenants with business or professional services (such as linen service, maid service, meals, etc.) for a fee separate from rent; or
- share in the income received by others providing services to tenants that go beyond the customary services required under a lease.

Consider an investment group of five people, including the syndicator/broker. The group invests in (residential or commercial) rental property. The management responsibilities are undertaken by the syndicator/broker.

The syndicator will share in the income and profits based on a one-fifth co-ownership interest they receive for packaging the acquisition of property.

The group erroneously takes title to the property as a TIC, as opposed to vesting it in the name of an LLC or a partnership formally created by the group. Each individual holds title to an undivided one-fifth interest in the property.

Even though vested as a TIC, the rights of the individual partners are not those of tenants in common. The group is presumed to be governed by partnership law.<sup>18</sup>

However, due to the vesting, any number of disastrous situations may occur which will cloud title to the property and put the investment at risk.

For example, one of the co-owners files a **bankruptcy petition**. The bankrupt co-owner's one-fifth interest in the title to the property is then placed in the

## A tax partner's profits disqualified

## Hazards of investors on title

<sup>17</sup> 26 United States Code §1031

<sup>18</sup> Corp C §§16202(a), 16204(c)

hands of a trustee before the bankruptcy court. Title to the whole property is clouded by the bankruptcy filing of a vested co-owner since the court is able to sell the entire property.

Yet, when the group enters into a co-owner *buy-out agreement*, the bankruptcy filing allows the other co-owners to purchase the bankrupt co-owner's interest and eliminate the adverse effect on title. The bankrupt partner is usually reimbursed for their capital contribution, less any sums received. However, the uncertainties and complications associated with court proceedings still exist.

A formal LLC operating agreement or partnership agreement and an LLC or a partnership vesting avoids interference with title by a co-owner and their creditors. The property is owned and operated by an entity, independent of the co-owner's problems.

Consider the co-owner who is in debt for reasons having nothing to do with the investment property. The co-owner's creditor attaches or liens their vested TIC interest in the property, clouding the title.

Due to the TIC vesting, a creditor's only concern is that the co-owner owns a recorded interest in the property which is attached by the creditor's recorded **abstract of judgment**.

When title to the real estate is vested in the name of an LLC or partnership, the creditor of the indebted co-owner may not lien the real estate itself, but only attach the co-owner's interest in the LLC or partnership by way of a court-issued charging order.<sup>19</sup>

Consider next the owner and co-owner of a vacation home who enter into a TIC agreement, which includes a right of first refusal provision. A dispute arises when the co-owner refuses to pay for the necessary repairs, landscaping and cleaning for the vacation property. The owner decides to sell their half interest in the property.

Upon finding a buyer, the owner, in accordance with the right of first refusal provision, offers to sell their interest to the co-owner first. The co-owner rejects the offer. When the buyer discovers the co-owner's unwillingness to contribute to the maintenance of the property, they withdraw their offer to purchase the owner's interest.

Deciding no buyer will enter into an agreement with the co-owner when they continue to refuse to contribute to the maintenance of the property, the owner seeks to force the sale of the property through a judicial sale, called a **partition action**.

Does the owner have the right to force the sale of the property by partition when they agreed to the right of first refusal provision in the TIC agreement?

**partition action**

Court proceedings by which co-owners seek to sever their joint ownership and parcel or sell the property.

<sup>19</sup> *North Coast Business Park v. Superior Court* (1984) 158 CA3d 858

Yes! The co-owner of real estate has the right to a judicial sale via a *partition action* since the owner fully performed their duties under the right of first refusal provision in the TIC agreement, which is not a waiver of the right to a partition action.<sup>20</sup>

The partition action and legal scuffle between two owners is avoided when the real estate is vested in the name of an LLC or partnership. A properly provisioned LLC (or partnership) operating agreement enables the owner to buy out the non-performing co-owner without resulting in a judicial sale of the property.

Suppose one of the co-owners vested as a tenant in common dies. The right of survivorship does not exist among tenants in common. Thus, the remaining co-owners need to look to the will of the deceased co-owner (or inter vivos trust, if vested) to determine who takes title to the co-owner's interest. The transfer is accomplished by court approval in probate naming a successor to the co-tenancy interest, or by a trustee under an inter vivos (living) trust when the deceased's interest was vested in the trustee.

## Further complications

Any successor to the interest of the deceased co-owner will be a non-voting partner until they are accepted by the group as a member. The successor will not possess any rights as a partner other than the right to a pro rata share of any income/profit distributed on the investment — even though the successor holds title as a tenant in common.<sup>21</sup>

Consider the co-owner vested as a tenant in common who refuses to convey their one-fifth interest when the other co-owners decide to sell, encumber or lease the property. Under the TIC vesting, all the co-owners need to sign the grant deed or trust deed in order to convey or encumber the entire property.<sup>22</sup>

One co-owner's refusal to convey gives them the potential for establishing anarchy within the group and blackmailing the co-owners by demanding more than their fair share of the proceeds for their voluntary cooperation. The TIC vesting has given each co-owner veto power over the majority, resulting in the loss of control over the investment — even when a TIC agreement for voting and buy out exists.

Situations like these are eliminated by keeping investors off title and organized in an LLC or a partnership form of business entity.

As an LLC or formal partnership, the co-owners are not vested with any ownership interest in the real estate. Their ownership interest is a percentage interest as a co-owner of the LLC or partnership. Each co-owner's interest in the LLC or partnership is personal property under state law, comparable to a stockholder's interest in a corporation.<sup>23</sup>

<sup>20</sup> *LEG Investments v. Boxler* (2010) 183 CA4th 484

<sup>21</sup> Corp C §16503

<sup>22</sup> Corp C §16302(a)(3)

<sup>23</sup> Corp C §16502

A creditor may only attach, via a charging order issued by a court, a co-owner's ownership interest in the LLC or partnership, and never the real estate owned by the LLC or partnership unless the LLC or partnership also owes the money.<sup>24</sup>

<sup>24</sup> Corp C §16504; **Wardley Development Inc. v. Superior Court** (1989) 213 CA3d 391

## Chapter 26 Summary

When a group of investors purchases real estate, the vestings available to properly structure their common ownership interests include taking title in the name of:

- each of the investors, or their trustees, as tenants in common (TIC);
- a limited liability company (LLC) owned by the group; or
- a partnership (general or limited) comprised of the group.

Co-owners of California real estate vested as TICs, when engaged in the business of jointly operating the property on terms calling for them to share income and profits, are conducting themselves as partners. Each co-owner actually holds title as a trustee on behalf of all the TIC co-owners, collectively called a partnership.

By the sharing of income among co-owners who are vested as TICs, a tenancy in partnership is established.

A TIC vesting does not control the possessory rights of the co-owners when the co-ownership conduct in fact constitutes a California partnership. For example, a partner may use or possess partnership property only on behalf of the partnership, while a common-law TIC co-owner (as viewed by the Internal Revenue Service (IRS)) may use, possess or lease the property themselves, without regard to any other co-owner.

The conveyance of a co-owner's TIC interest to another person conveys nothing more than the co-owner's interest in the partnership's equitable ownership of the property.

TIC ownership does not rise to tax partner status unless the co-owners are operating as:

- a declared partnership (general or limited);
- an LLC which has not elected to report as a corporation; or
- a cooperative TIC.

To avoid federal tax partnership status, each co-owner vested as a TIC needs to have the unrestricted common law right by agreement to independently alienate their fractional interest without the prior consent of the other co-owners.

The penalty for a TIC co-owner who is federally classified as a tax partner in the ownership of either the property sold or the property acquired in a §1031 reinvestment plan, is the loss of the entire §1031 tax exemption for profit taken on the property sold.

A formal LLC operating agreement or partnership agreement and an LLC or a partnership vesting avoids interference with title by a co-owner and their creditors. A creditor may only attach, via a charging order issued by a court, a co-owner’s ownership interest in the LLC or partnership, and never the real estate owned by the LLC or partnership unless the LLC or partnership also owes the money.

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**partition action ..... pg. 272**  
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**tenants in common (TIC) ..... pg. 265**  
**vesting ..... pg. 266**

**Chapter 26**  
**Key Terms**

**Quiz 10 Covering Chapters 24-26 is located on page 450.**

*Notes:*





# The right of survivorship among co-owners

## Chapter 27

After reading this chapter, you will be able to:

- apply the community property presumption when title to property is vested jointly in the names of a married couple;
- create a joint tenancy vesting based on the four unities in title;
- explain the right of survivorship and how it is severed;
- advise on how to clear title of a deceased joint tenant's ownership by an affidavit; and
- discuss the tax aspects of a joint tenancy vesting.

**community property**

**fully stepped-up cost basis**

**joint tenancy**

**ratify**

**right of survivorship**

**set aside**

**vesting**

## Learning Objectives

## Key Terms

Consider a married couple who, with the assistance of their agent, locates real estate they intend to purchase. They will use monies accumulated during their marriage and a new purchase-assist mortgage to pay the purchase price.

The agent, as part of their *due diligence* on any property acquisition, asks the couple how they want to take title on the close of escrow. The couple wants the property to be vested in both of their names, as a married couple, with the **right of survivorship**.

On the death of a spouse, the couple wants the *surviving spouse* to automatically become the sole owner of the property, avoiding probate procedures.

## Vesting reflects estate planning

### **right of survivorship**

The right of surviving joint tenants or a spouse to succeed to the entire interest of the deceased co-owner.

**community property**

All property acquired by spouses during a marriage when not acquired as the separate property of either spouse.

**vesting**

A method of holding title to real estate, including tenancy in common, joint tenancy, community property and community property with the right of survivorship.

Recognizing the **community property** aspect of their funds accumulated during marriage, the agent advises the couple they need to take title as:

- “a married couple as community property with **right of survivorship**”; or
- “a married couple as joint tenants.”

The agent explains the two **vestings** are identical for future conveyancing since:

- both vestings may be *severed* before death by either spouse to provide for an alternative distribution of each spouse’s ownership interest to others by will, an inter vivos (living) trust agreement, or another vesting of their interest; and
- on death the title is cleared of the deceased spouse’s interest by the surviving spouse recording an *affidavit* declaring the death of the deceased spouse and attaching a certificate of death.<sup>1</sup> [See Form 460 accompanying this chapter; see Form 461 accompanying this chapter]

However, mindful of the *tax consequences* for the surviving spouse, the agent recommends the couple vest title to the property as community property with right of survivorship. Like the tax consequences of a joint tenancy vesting by spouses, the surviving spouse is assured a fully **stepped-up cost basis** for the community property.

In this example, the agent’s advice to vest the property as “community property with right of survivorship” satisfies the couple’s estate planning needs for holding title to the property. Likewise, since the property was acquired during the marriage, it is considered *community property* even when the couple vested the property in their names as joint tenants.

Additionally, the couple intends to avoid probate procedures on the death of a spouse. Both right of survivorship vestings avoid enforcement of any contrary provisions in the will of the deceased since no interest remains under either vesting to be transferred by will or otherwise after death.

Thus, for the surviving spouse, a **community property** vesting with right of survivorship is superior to a simple community property vesting. This is the case even though a simple community property vesting without the right of survivorship also transfers the property to the surviving spouse when the deceased dies *intestate* (with no will) or *testate* (with a will) stating the surviving spouse takes the property.

On a simple community property vesting, when no one contests the surviving spouse’s right to become the sole owner of the deceased spouse’s interest in the property, the surviving spouse needs to wait 40 days following the death before the property may be sold, leased or encumbered.

After 40 days, an **affidavit** by the surviving spouse is recorded to clear title by declaring the death and attaching a death certificate.<sup>2</sup> [See Form 461]

<sup>1</sup> Calif. Civil Code §682.1(a); Calif. Probate Code §210

<sup>2</sup> Prob C §13540

**Joint tenancy:** John Doe and Jane Doe, married couple as joint tenants.

**Community property:** John Doe and Jane Doe, married couple as community property with right of survivorship.

**Community property:** John Doe and Jane Doe, married couple as community property.

**Tenants in common:** John Doe, a married man as to an undivided one-half interest, and Jane Doe, a married woman as to an undivided one-half interest, as tenants in common.

**Separate property of one spouse:** John Doe, a married man as his separate property.

Married couple:  
wording the  
grant deed  
vesting

A joint tenancy recommendation by the agent produces the same transferability and tax results as does the community property vesting with right of survivorship. They function identically before and after death.

However, joint tenancy provides spouses with more flexibility by allowing for avoidance of some *community debts* during the marriage and on death. This avoidance of debts incurred solely by one spouse is not available under either community property vesting.<sup>3</sup>

Although most **joint tenancies** are created by a married couple, a joint tenancy can exist between non-married persons. Conversely, community property vestings are only available to married couples or registered domestic partners.<sup>4</sup>

*Editor's note — In California, individuals who are in a same-sex registered domestic partnership (RDP) may take title to property under the "community property" or the "community property with right of survivorship" vesting. RDPs have the same rights and responsibilities under those vestings as do married couples under California law. Thus, our discussion of community property rights in California pertains to RDPs as well as married individuals.*

*Same-sex couples who were married in jurisdictions which legally recognize their marriages are treated as married couples for federal tax purposes. Same-sex marriages are legal in the state of California.<sup>5</sup>*

*However, favorable federal taxation policies available to legally married couples do not currently apply to RDPs.*

Additionally, the number of joint tenants is not limited to two, as is a married couple's ownership of community property interests. Using one deed, any number of co-owners may take title to real estate as joint tenants. The ownership conditions are that the joint tenants take **equal ownership interests** in the property and do so by the same document.

## Creating a joint tenancy

### joint tenancy

An ownership interest in property concurrently received by two or more individuals who share equally and have the right of survivorship.

<sup>3</sup> CC §682.1

<sup>4</sup> Calif. Family Code §297.5

<sup>5</sup> Fam C §301

Traditionally, the creation of a **joint tenancy** requires the conveyance of **four unities**:

- **unity of title**, meaning the joint tenants take title to the real estate through the *same instrument*, such as a single grant deed or court order;
- **unity of time**, meaning the joint tenants receive their interest in title at the *same time*;
- **unity of interest**, meaning the joint tenants own *equal shares* in the ownership of the property; and
- **unity of possession**, meaning each joint tenant has the *right to possess* the entire property.<sup>6</sup>

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6 **Swartzbaugh v. Sampson** (1936) 11 CA2d 451

Today, a joint tenancy vesting is loosely based on these four unities. For example, a joint tenancy is currently defined as ownership by two or more persons **in equal shares**. Thus, the joint tenancy co-ownership incorporates the *unity of interest* into its statutory definition.<sup>7</sup>

Similarly, a joint tenancy needs to be created by a **single transfer** to all the co-owners who are to become joint tenants. Thus, the historic *unity of title* (same deed) and *unity of time* (simultaneous transfers) required under common law have been retained in one event. Usually, this is accomplished by the recording of a conveyance transferring title to all the joint tenants.

A joint tenancy ownership in real estate is created by any of the following transfers when the conveyance following all named grantees states they take title “as joint tenants”:

- a transfer by grant deed, quitclaim deed or assignment, from an owner of the fee, leasehold or life estate, to themselves and others;
- a transfer from co-owners vested as tenants-in-common to themselves; or
- a transfer from a married couple holding title as community property, tenants-in-common or separately, to themselves.<sup>8</sup>

For the small percentage of joint tenants who are not a married couple, typically family members or life-long friends, a valid joint tenancy is created when all co-owners take title under the same deed “as joint tenants,” without stating their **fractional ownership interest** in the property.

Their actual fraction of ownership, when severed or transferred to others, is a function of the number of individuals who took title as joint tenants. For example, five co-owners as joint tenants each hold a one-fifth or 20% fractional ownership interest.

A community property with right of survivorship vesting is created on the *acceptance* by a married couple of the deed vesting their acquisition of property. For a couple to convert a vesting to community property with the right of survivorship, they merely deed out of their present vesting (as **grantors**) and deed the property back to themselves as “a married couple as community property with right of survivorship” (as **grantees**). [See **RPI Form 404**]

No requirement exists calling for consent to the vesting beyond mere **delivery** of the deed.<sup>9</sup>

## A conveyance naming the joint tenants

<sup>7</sup> CC §683

<sup>8</sup> CC §683

<sup>9</sup> CC §682.1(a)

Form 461

Affidavit for  
Surviving  
Spouse

Page 1 of 2

<p>RECORDING REQUESTED BY</p> <p>AND WHEN RECORDED MAIL TO</p> <p>┌</p> <p>Name</p> <p>Street</p> <p>Address</p> <p>City &amp;</p> <p>State</p> <p>└</p>	
SPACE ABOVE THIS LINE FOR RECORDER'S USE	
<p><b>AFFIDAVIT FOR SURVIVING SPOUSE</b></p> <p>(California Probate Code §13540)</p>	
<p><b>NOTE:</b> This form is used by a surviving spouse or their agent when during the ownership of community property a spouse dies and the surviving spouse is the successor to the decedent's interest in the property, to clear title of the deceased spouse's interest and establish the surviving spouse as the sole owner of the property.</p>	
<p><b>DATE:</b> _____, 20____, at _____, California.</p> <p><i>Items left blank or unchecked are not applicable.</i></p>	
<p><b>FACTS:</b></p> <p>1. _____,</p> <p style="padding-left: 40px;">is the decedent named in the attached certified copy of the Certificate of Death.</p> <p>2. _____,</p> <p style="padding-left: 40px;">is the surviving spouse of the decedent, being married to the decedent at the time of decedent's death.</p> <p>3. More than 40 days have passed since the decedent's death.</p> <p>4. The decedent and the surviving spouse treated as community property the following real property situated in the County of _____, State of California, referred to as:</p>	
<p>----- PAGE 1 OF 2 — FORM 461 -----</p>	

## A joint tenant's right of survivorship

A joint tenancy vesting adds nothing to the legal aspects of the ownership interest held in real estate by each co-owner beyond the right of survivorship. Whether the interests held by the co-owners are separate property or community property, a joint tenancy vesting neither enlarges nor reduces the nature of the ownership interest.

However, the **necessary incident** of a joint tenancy vesting is the **right of survivorship**, legally referred to as *jus accrescendi*. The right of survivorship is a case law doctrine which is triggered by the death of one joint tenant.

Thus, the joint tenancy vesting, by the incident of its right of survivorship, becomes operative only on the death of a joint tenant. On death, the right of

----- PAGE 2 OF 2 — FORM 461 -----

APN#: \_\_\_\_\_

5. No election has been or will be made in any probate proceedings to administer the decedent's or the surviving spouse's interest in the described property.
6. The surviving spouse is the successor to the decedent's interest in the described property since no other person has acquired any right to the property by testate or intestate succession.
7. The surviving spouse has full power to dispose of, lease, or encumber the described property as provided in Calif. Probate Code §13540.
8. I, the undersigned, declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Date: \_\_\_\_\_, 20\_\_\_\_ Signature: ☒ Surviving spouse  
 Of the: ☐ Personal representative of surviving spouse  
☐ Guardian of the estate of the surviving spouse  
☐ Conservator of the estate of the surviving spouse

A notary public or other officer completing this certificate verifies only the identity of the individual who signed the document to which this certificate is attached, and not the truthfulness, accuracy, or validity of that document.

STATE OF CALIFORNIA  
 COUNTY OF \_\_\_\_\_  
 SUBSCRIBED and SWORN to (or affirmed) before me on this \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_,  
 by \_\_\_\_\_,  
 proved to me on the basis of satisfactory evidence to be the person(s) who appeared before me.

Signature: \_\_\_\_\_  
(Signature of notary public)

(This area for official notarial seal)

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Form 461

Affidavit for  
Surviving  
Spouse

Page 2 of 2

survivorship **extinguishes the deceased's interest in the property**. The remaining joint tenant(s) then share equally the entire ownership interest initially held by the original joint tenants.

Ultimately, on the death of all other joint tenants, the last survivor becomes the sole owner of the interest in the property originally owned by all the joint tenants.

Further, the right of survivorship is a mere **expectancy** held by each co-owner and is not a property right. Thus, it can be terminated at will.



## Vesting alone does not transmute community property

On a *dissolution* of the marriage, all property acquired jointly by a married couple during the marriage, no matter how vested, is **presumed** to be community property for purposes of division.<sup>10</sup>

Further, the community property co-ownership presumption for married couples does not only come into play when a couple divorces. All property acquired by a couple or by either spouse during marriage is considered **community property**, unless the couple clearly states their contrary intention to own their individual interests in the real estate as separate property.<sup>11</sup>

## The overlay of community property rights

Joint tenancy and community property rights held by married couples **overlap** in California law when community property is placed in a joint tenancy vesting. This overlap is a by-product of California legal history.

**Joint tenancy**, with its inherent right of survivorship, arises out of the English common law, and is called a **common law estate**.

**Community property**, with its implicit partnership aspect, is a creation of Spanish civil law, dating from the time when California was a Spanish colony operating under the Law of the Indies. [See Chapter 1]

Today, a joint tenancy vesting is used by co-owners solely to avoid probate on the death of a joint tenant. The joint tenancy vesting provides no other advantage to co-owners. The underlying community or separate property character of the real estate is not altered when a married couple vests their co-ownership as joint tenants. Both ownership characteristics operate concurrently to produce *mutually exclusive* results.

For example, a married couple who takes title as joint tenants do not by the vesting **transmute** their community property into separate property owned 50:50 by the couple. It remains community property.

However, a joint tenancy vesting allows a married couple, one of whom has a problem with a creditor, to **renounce** the community property aspect since it is a presumption. This allows them to claim they intended the joint tenancy vesting to establish separate property interests for each spouse in the real estate. Thus, either spouse may *rebut* the community property presumption. Also, a married couple vested as joint tenants occasionally exercise the rebuttal to deter creditors of solely one spouse.<sup>12</sup>

A similar result altering community property rights occurs in federal **bankruptcy** proceedings when a married couple holds title as joint tenants. The interest of each spouse vested as a joint tenant is treated in bankruptcy proceedings as separate property in order to attain the objective of federal bankruptcy law to free individuals of onerous debt. Thus, a spouse's one-half

<sup>10</sup> Fam C §2581

<sup>11</sup> Fam C §760

<sup>12</sup> *Abbett Electric Corporation v. Storek* (1994) 22 CA4th 1460

interest in community property vested as joint tenants is not liable under bankruptcy for debts which were incurred solely by the other spouse and not on behalf of the community.<sup>13</sup>

When the couple does not intend by the joint tenancy vesting to transmute their community property into separate property, but to take title to their community assets as joint tenants for the sole purpose of avoiding probate (which is the reason for most joint tenancy vestings), the property is **presumed** to be a community asset without concern for the joint tenancy vesting.

Thus, the nature of the underlying ownership of property held by a married couple as joint tenants — separate or community — may be challenged by a third party, such as a creditor of one of the spouses seeking to reach community assets.

However, title companies always apply the community property presumption when real estate is vested in a married couple. A title company will not insure the conveyance of an interest in the couple's property (such as a trust deed encumbrance) executed by only one spouse, since the signatures of both spouses are required to convey interests or impose liens on community property.<sup>14</sup>

As community real estate, both spouses need to consent to the *sale, lease for more than one year or encumbrance* regardless of how the couple's interest is vested.<sup>15</sup>

When one spouse, without the consent of the other, sells, leases for more than one year or encumbers community real estate, the nonconsenting spouse may either **ratify** the transaction or have it **set aside**.

The nonconsenting spouse has **one year** from the recording of the transaction to file an action to *set aside* the transaction.

However, when the other participant to the transaction has no notice of the marriage, actual or constructive, the nonconsenting spouse who failed to make the community interest known cannot have the transaction set aside. This includes any knowledge of the agent representing the buyer, tenant or lender about the owner's marital status.<sup>16</sup>

When real estate held in a joint tenancy vesting is **separate property** (i.e., the joint tenants are not a married couple or are married and in writing agree their interests are separate property), each joint tenant may sell or encumber their interest in the real estate without the consent of the other joint tenant(s).

## Conveying community property

### set aside

To annul by court order a document transferring an interest in real estate.

### ratify

The later adoption or approval of an act performed on behalf of a person when the act was not previously authorized.

## Encumbering and leasing joint tenancy property

<sup>13</sup> *In re Pavich* (1996) 191 BR 838

<sup>14</sup> Fam C §1102

<sup>15</sup> Fam C §1102

<sup>16</sup> Fam C §1102(c)

Additionally, when the joint tenancy interest in real estate represents *separate property*, a joint tenant may lease out the entire property since a lease is a transfer of possession. Each joint tenant has the right to exclusively possess the entire property.<sup>17</sup>

However, consider a married couple who owns **community property real estate** as joint tenants. One spouse enters into an agreement to lease the property for a term over one year, which the other spouse does not sign.

Under the joint tenancy rule, either joint tenant alone may lease the property. However, under the community property rule (which applies to property acquired during marriage), **both spouses** need to execute a long-term lease agreement with a term greater than one year.

This one-spouse leasing scenario is an example of the misunderstanding created by the overlay of community property rights when community property is placed in a joint tenancy vesting.

Although no case or statute addresses this set of leasing facts, existing case law suggests the joint tenancy vesting needs to be viewed as controlling. This treatment allows the joint-tenant spouse to lease the property without the other spouse's consent. Also, the doctrine of ratification will influence the result in favor of the tenant when the nonconsenting spouse knowingly enjoys the benefits of the lease.<sup>18</sup>

## Severing right-of- survivorship vestings

A married couple owns a parcel of real estate which is community property. The vesting provides for the right of survivorship under either a community property with right of survivorship vesting or a joint tenancy vesting.

However, every co-owner vested as a joint tenant or as community property with the right of survivorship has the right to **unilaterally sever** the right of survivorship. The severance by a co-owner **terminates** the right of survivorship held by the other owner in that co-owner's severed interest.

The separate or community property nature of the co-owner's interest in the property is unaffected by the severance — termination — of the right of survivorship from the co-owner's interest.

A co-owner *unilaterally severing* their right of survivorship is not required to first give notice or seek consent from the other co-owner(s) who loses the right.<sup>19</sup>

Severance is a vesting issue. To sever the right of survival, the co-owner prepares and signs a deed as the grantor from themselves "as a joint tenant" or "as community property with right of survivorship" back to themselves as the grantee. On recording the deed revesting of the owner's interest, the right of survivorship is severed. The deed revesting the co-owner's title is to include a statement noting the transfer is intended to sever the prior vesting.<sup>20</sup>

<sup>17</sup> Swartzbaugh, *supra*

<sup>18</sup> CC §2310

<sup>19</sup> *Riddle v. Harmon* (1980) 102 CA3d 524

<sup>20</sup> CC §683.2(a)

Alternatively, the co-owner may transfer title to themselves as **trustee** under the co-owner's revocable inter vivos (living) trust agreement. The conveyance into the trust vesting also severs the right of survivorship. By the conveyance, the trust vesting avoids the probate process while gaining control over succession of the co-owner's interest on death. Again, community property remains community property even though one spouse's interest is now vested in their separate inter vivos (living) trust.

Further, any transfer of a joint tenant's interest in the joint tenancy property to a third party, such as from a joint tenant parent to a child, *automatically severs* the joint tenancy.

When co-ownership of property is vested as a joint tenancy, the death of a joint tenant *automatically extinguishes* the deceased joint tenant's interest in the real estate. This leaves the surviving joint tenant(s) as the **sole owner(s)**.

However, the deceased joint tenant's interest in the property needs to be cleared from the title before the surviving joint tenant(s) will be able to sell, lease or encumber the property as the *sole owner*.

The new ownership interest of the surviving joint tenant(s) is documented by simply recording an **affidavit**, signed by anyone, declaring the death of a joint tenant who was a co-owner of the described real estate.<sup>21</sup>

The interest in the property held by the deceased spouse as community property with right of survivorship is extinguished by the same **affidavit** procedure used to eliminate the interest of a joint tenant, except the surviving spouse or their representative is the only one *authorized* to make the declaration. [See Form 461]

The affidavit made under the penalty of perjury includes:

- the name of the deceased joint tenant;
- a copy of the deceased joint tenant's death certificate;
- a description of the real estate affected by the joint tenant's death; and
- a statement the deceased is the person vested in title to the described property as a joint tenant. [See Form 460]

Once the affidavit is **notarized, recorded and indexed**, anyone conducting a title search on the property will have notice of the joint tenant's death since the deceased joint tenant is indexed as a grantor. Thus, the surviving joint tenant becomes the sole owner of the property due to the right of survivorship.

A trust deed lien or a creditor's judgment lien secured solely by a joint tenant's interest in real estate is extinguished on the death of the joint tenant. By the right of survivorship held by the surviving joint tenant(s), the ownership interest of the deceased joint tenant is **extinguished**, leaving nothing for the lien to encumber.

**On death,  
clear title by  
affidavit**

**Lien or lease  
extinguished  
on death**

<sup>21</sup> Prob C §210(a)

These rules of nonliability for surviving joint tenant(s) do not apply to the debts of a deceased spouse under the community property vestings, with or without the right of survivorship.<sup>22</sup>

Consider an unmarried couple who hold title to a parcel of real estate as joint tenants.

A judgment creditor of one of the joint tenants seeks to execute on the judgment by foreclosing on the joint tenant's interest in the real estate.

A notice of levy is recorded and a date is set for the *execution sale*. However, before the date of the sale, the joint tenant who is the judgment debtor dies.

The surviving joint tenant seeks to bar (or set aside) the judgment creditor's execution sale, claiming the judgment lien only attached to the deceased joint tenant's **separate property interest** in the real estate which was extinguished on the joint tenant's death due to the right of survivorship.

The judgment creditor claims the joint tenancy was **severed** by the recording of the levy on the deceased joint tenant's interest, terminating the right of survivorship and preserving the judgment lien.

However, until the execution sale takes place, the judgment creditor only has a lien on the debtor joint tenant's interest in the property. Since a lien does not sever a joint tenancy and the joint tenant's interest ceases to exist on his death, the judgment creditor's lien disappears on the death of the joint tenant as well.<sup>23</sup>

Similarly, a lease entered into by only one joint tenant is extinguished on the death of the joint tenant who alone executed the lease.<sup>24</sup>

## Death during divorce

The coexistence of joint tenancy and community property can lead to unintended results. The following unintended result will occur whether a joint tenancy vesting or a community property with right of survivorship vesting is used.

Consider a married couple who owns a residence as joint tenants. One spouse seeks a divorce, but takes no action to **sever** the joint tenancy. Before the marriage is ordered dissolved by the court, the spouse seeking divorce dies. The surviving spouse claims the property is now theirs under the joint tenancy right of survivorship and sells it to a bona fide purchaser (BFP).

The executor of the deceased spouse's estate seeks to obtain one-half of the proceeds of the sale. The executor claims the joint tenancy was severed when the deceased spouse filed the action to dissolve the marriage, and all property acquired by a couple during the marriage is to be divided under community property principles on dissolution of the marriage, without consideration for the joint tenancy vesting.<sup>25</sup>

<sup>22</sup> CC §682.1

<sup>23</sup> *Grothe v. Cortlandt Corporation* (1992) 11 CA4th 1313

<sup>24</sup> *Tenhet v. Boswell* (1976) 18 C3d 150

<sup>25</sup> Fam C §2581

However, the marriage was never dissolved. Without a dissolution, the joint tenancy was never severed by the court. Until the **marriage is dissolved** and the joint tenancy is **severed**, the residence remains vested in the married couple as joint tenants. Thus, the spouse's right of survivorship to the property was not terminated and they retain all the proceeds from the property's sale.

The spouse seeking divorce clearly did not intend for their interest in the property to pass to the other spouse on their death. However, the deceased spouse did not act on their intentions — as their attorney ought to have advised them — to immediately sever the joint tenancy by revesting their interest. Thus, the spouse's right of survivorship was not terminated by a deed revesting title or dissolution of the marriage before death, and may be enforced whether the deceased's interest in the real estate was separate or community property.<sup>26</sup>

The best remedy for a spouse involved in a divorce is to promptly and unilaterally sever vestings of property held in joint tenancy or community property with right of survivorship.

A spouse may unilaterally sever the joint tenancy and community property with right of survivorship vestings by:

- executing and delivering a deed that conveys legal title to a third party;
- executing a deed to themselves;
- executing a written severance of joint tenancy; or
- executing a written instrument that evidences an intent to sever.<sup>27</sup>

Consider a married couple who own a residence as joint tenants. A dissolution proceeding is filed, creating a court-ordered preliminary injunction which prohibits both spouses from transferring or disposing of any property. One spouse executes and records a declaration of severance of joint tenancy, deeding the property to themselves. The spouse then dies while the dissolution proceeding is pending.

The surviving spouse claims the severance is ineffective since it violates the court-ordered preliminary injunction. The administrator of the deceased spouse's estate claims the severance is effective since it did not constitute a transfer or disposition of the property.

Was the declaration of severance of joint tenancy executed by the deceased spouse prior to their death valid?

Yes! Revesting the property by deeding it to themselves did not violate the preliminary injunction against transferring or disposing of the property.<sup>28</sup>

## Controlling the vesting of one-half

<sup>26</sup> *Estate of Blair* (1988) 199 CA3d 161

<sup>27</sup> CC §683.2(a)

<sup>28</sup> *Estate of Mitchell* (1999) 76 CA4th 1378; Fam C §2040(b)(3)



Additionally, the community property interest of a spouse who executes a deed to themselves to sever the title and eliminate the right of survivorship remains community property. Community property cannot be transmuted to separate property without the consent of both spouses or a court order.

A **severance deed** to oneself which terminates the right of survivorship is not sufficient, without further documents, to avoid passing the community property to the surviving spouse on death, whether vested as community property with right of survivorship or in joint tenancy.

A *will* needs to also be prepared or a inter vivos (living) trust established and title vested in the trustee, the trust naming the person intended to receive the spouse's community property interest on death.

Otherwise, since it is community property, the property will pass by intestate succession to the surviving spouse as though the severance of the vesting had never occurred.<sup>29</sup>

Consider a spouse who dies after the marriage is dissolved but before the property is taken out of the joint tenancy vesting. The surviving spouse claims they are entitled to the couple's residence due to the joint tenancy right of survivorship.

However, community real estate vested in the name of the married couple as joint tenants becomes separate property of each on the dissolution of the marriage since the community ownership of the property no longer exists. Thus, the order dissolving the marriage severs the joint tenancy vesting and terminates the remaining spouse's right of survivorship to the deceased spouse's interest in the property.<sup>30</sup>

Accordingly, the deceased ex-spouse's (now) separate property interest will be distributed under the terms of the deceased's will (**testate**), or in the absence of a will by **intestate succession** to their heirs.

## Joint tenancy tax aspects

### fully stepped-up cost basis

The tax basis of community property a surviving spouse receives on the death of a spouse is stepped up to the property's fair market value (FMV) on the date of death.

Taxwise, the main question raised for a married couple when the surviving spouse becomes the sole owner of what was community property is: What is the surviving spouse's **cost basis** in the property as the sole owner after the death of the other spouse?

The surviving spouse who becomes the sole owner of community real estate receives a **fully stepped-up cost basis** to the property's **fair market value (FMV)** on the date of the death which terminated the community property vesting.

Thus, the surviving spouse is entitled to a *fully stepped-up cost basis* in the real estate previously owned by the community without concern for whether the property was vested as community property (with or without the right of survivorship), as joint tenants or in a revocable inter vivos (living) trust.

<sup>29</sup> Prob C §13500

<sup>30</sup> *In re Marriage of Hilke* (1992) 4 C4th 215



State law controls how marital property is characterized for federal tax purposes. Federal law is unconcerned with the form in which title is taken to community property.<sup>31</sup>

Thus, the real estate owned by a married couple (unless vested as tenants in common) is considered *community property* for federal income tax purposes. Accordingly, a surviving spouse entitled to the property receives a fully stepped-up cost basis to the property's FMV on the date of the other spouse's death.

However, consider a married individual who becomes the sole owner of a trust deed note on the death of their spouse since they held the note and trust deed as joint tenants, in an inter vivos (living) trust or in one of the community property vestings. The trust deed note is a carryback from a sale years earlier. The note amount contains profit on the sale which the couple is reporting on the installment method for tax purposes.

At the time of the spouse's death, profit on the unpaid principal in the note had not yet been taxed since calculation and payment of the **tax was deferred** until principal was received on the note.

For income tax purposes, the surviving spouse seeks a fully stepped-up cost basis on the entire note to its FMV on the date of the spouse's death since the survivor became the sole owner of the note which was community property.

The Internal Revenue Service (IRS) claims the note does not qualify for a fully stepped-up cost basis. The note contains profit from a **nonexempt sale** which is taxed as principal is received, but has not been entirely taxed prior to the spouse's death.

The individual claims the note qualifies for a stepped-up cost basis since the note is a community property asset they received on the spouse's death.

Does the note qualify for a fully stepped-up cost basis?

No! The carryback note held by the community and received by the individual on their spouse's death does not qualify for a fully stepped-up cost basis. The note at the time of death contained profit from a sale which was reportable (recognized) and had not yet been taxed. Thus, the tax may not be avoided by a stepped-up cost basis on death.<sup>32</sup>

<sup>31</sup> IRS Revenue Ruling 87-98

<sup>32</sup> **Holt v. United States** (1997) 39 Fed Cl. 525

## Chapter 27

### Summary

Although most joint tenancies are created by married couples, a joint tenancy can exist between non-married persons and is not limited to two individuals. Traditionally, the creation of a joint tenancy requires the conveyance of four unities of title, time, interest and possession.

Community property vestings are only available to a married couple or registered domestic partners (RDPs). All property acquired jointly by a married couple during marriage, no matter how vested, is presumed to be community property, unless the couple clearly states their intention to own their individual interests as separate property.

Both spouses need to consent to the sale, lease for more than one year or encumbrance of community real estate regardless of how it is vested. When real estate held in a joint tenancy vesting is separate property (i.e., the joint tenants are not a married couple or are married and in writing agree their interests are separate property), each joint tenant may sell or encumber their interest in the real estate without the consent of the other joint tenant(s).

The right of survivorship is provided under both a community property with right of survivorship vesting and a joint tenancy vesting. The death of a joint tenant automatically extinguishes the deceased joint tenant's interest in the real estate. However, the deceased joint tenant's interest in the property needs to be cleared from the title before the surviving joint tenant(s) will be able to sell, lease or encumber the property as the sole owner(s). The new ownership interest of the surviving joint tenant is documented by recording an affidavit declaring the death of the joint tenant.

Every co-owner vested as a joint tenant or as community property with the right of survivorship has the right to unilaterally sever the right of survivorship. Recording is necessary to terminate a joint tenant's right of survivorship. A surviving spouse is entitled to a fully stepped-up cost basis in the real estate previously owned by the community without concern for whether the property was vested as community property, as joint tenants or in a revocable inter vivos (living) trust.

## Chapter 27

### Key Terms

<b>community property</b> .....	<b>pg. 278</b>
<b>fully stepped-up cost basis</b> .....	<b>pg. 290</b>
<b>joint tenancy</b> .....	<b>pg. 279</b>
<b>ratify</b> .....	<b>pg. 285</b>
<b>right of survivorship</b> .....	<b>pg. 277</b>
<b>set aside</b> .....	<b>pg. 285</b>
<b>vesting</b> .....	<b>pg. 278</b>

**Quiz 11 Covering Chapters 27-28 is located on page 451.**



# The statutory purchaser's lien

After reading this chapter, you will be able to:

- understand a buyer's use of a purchase lien when a seller breaches a purchase agreement; and
- identify when a buyer may and may not use a purchase lien to recover monies paid toward the purchase price of real estate.

**lien**

**lis pendens**

**rescission**

**restoration**

A real estate broker employed by a seller as their agent misrepresents to a prospective buyer the construction costs incurred by the seller for a building located on a parcel of real estate. The misrepresentations result in the buyer and seller entering into a purchase agreement. The buyer makes the agreed down payment on the purchase price and escrow closes.

After the close of escrow, the buyer constructs further improvements on the property and pays property taxes and insurance premiums. Later, the buyer learns the broker misrepresented the costs incurred by the seller to construct the improvements.

The buyer demands that the seller return all monies paid on the purchase price, the cost of the additional improvements and the property taxes and insurance premiums, an action called **rescission**. The buyer reconveys the real estate to the seller, an activity called **restoration**.

Does the buyer have a remedy against the seller to recover the payments made toward the purchase price and the expenses related to the property?

## Chapter 28

### Learning Objectives

### Key Terms

### Foreclosing on the seller's property

#### **rescission**

The termination of an agreement or transaction from its inception by mutual consent of the participants to the agreement or transaction, or by one participant based on fraud or misrepresentation of another participant.

**restoration**

The return of funds and documents on a rescission of a purchase agreement or transaction sufficient to place all the parties in the position they held before entering into the agreement or closing the transaction.

**lien**

An encumbrance on a property securing the payment of a debt or performance of an obligation.

## The buyer's right to a lien

## Foreclosing the purchaser's lien

**lis pendens**

A notice recorded for the purpose of warning all persons that the title or right to possession of the described real property is in litigation.

Yes! The buyer is entitled to a **purchaser's lien** which they may foreclose on the property they reconvey to the seller as part of the recovery process called *rescission and restoration*. The *purchaser's lien* is for the amount of payments made on the purchase price, plus expenditures made to improve the property and pay property taxes and insurance premiums.<sup>1</sup>

From the moment a buyer enters into a purchase agreement with a seller to acquire property, they have an interest in the seller's property, called an *equitable ownership*. This property interest entitles the buyer to a statutory lien against the property for **amounts paid** on the purchase price when the seller fails to deliver as agreed.<sup>2</sup>

The amount of the purchaser's lien is *offset* by any rent the buyer receives or the implicit rental value of the buyer's use of the property while they are in possession.<sup>3</sup>

The buyer's right to a purchaser's lien for monies paid includes situations where the seller:

- fails to deliver the property as agreed;
- interferes with the buyer's right to possession;
- fails to sign and deliver agreements or documents;
- induces the buyer to enter into the purchase agreement by misrepresentation; or
- attempts to avoid their performance on the purchase agreement.

Additionally, a buyer is not entitled to a purchaser's lien when a seller's nonperformance is excused due to a **breach** by the buyer.<sup>4</sup>

The buyer's right to a purchaser's lien allows the buyer to record a **lis pendens** on the property while seeking a court ordered foreclosure of the property to satisfy the purchaser's lien. The seller's property under a purchase agreement with the buyer is considered security for repayment of the money the seller owes the buyer. Any deficiency in the property's value after the foreclosure sale becomes a money judgment against the seller.

For example, a buyer and seller enter into a purchase agreement. The purchase agreement calls for the buyer to make a down payment on the purchase price. The seller agrees to carry back a note and trust deed for the dollar amount remaining to be paid on the purchase price.

The buyer tenders the down payment and signs and delivers the note and trust deed to the seller. The buyer is given possession of the property. The seller's grant deed and the trust deed are not recorded.

<sup>1</sup> **Montgomery v. Meyerstein** (1921) 186 C 459

<sup>2</sup> Calif. Civil Code §3050

<sup>3</sup> *Montgomery, supra*

<sup>4</sup> *Montgomery, supra*

The seller later refuses to record the grant deed and convey title to the buyer as agreed. Due to the seller's breach of their purchase agreement, the buyer decides not to complete their purchase, but to restore the property to the seller. The buyer then commences an action to establish and foreclose on a purchaser's lien for the amount paid towards the purchase price.

The seller claims the buyer is not entitled to a purchaser's lien since the buyer failed to first give the seller a notice of rescission or demand a return of the money paid.

However, by seeking a purchaser's lien on the property, service of the complaint in the action is notice of the buyer's rescission of the purchase agreement. Further, the seller breached the purchase agreement by failing to convey the property, called a *material breach*. Thus, the buyer is entitled to treat the purchase agreement as terminated and seek recovery of the money previously paid on the purchase price without prior notice.

In addition to being entitled to the purchaser's lien by statute, the buyer is also allowed to **judicially foreclose** and sell the real estate under the purchaser's lien.<sup>5</sup>

The seller is entitled to receive an offset from the amount they owe the buyer for the rental value of the property for the period the buyer occupied the property.

The **priority** of a purchaser's lien on title is set as of the date the buyer takes possession under the purchase agreement, called the *relation back theory*.

A purchaser's lien gives a buyer who takes possession of a property priority over all later buyers or lenders who acquire an interest in the property without the buyer's consent. Due to the buyer's possession of the property, future buyers and lenders have constructive knowledge of the original buyer's interest in the property, which includes the statutory right to a purchaser's lien.

Later buyers or lenders are considered to be aware of an original buyer's interest in a property when:

- the record title to the property, such as a recorded land sales contract, *lis pendens* or other document, gives notice of the original buyer's interest;
- the later buyer or lender has knowledge of the purchase agreement; or
- the original buyer's possession of the property is inconsistent with the record title.

Consider a buyer and seller who enter into an oral land sales contract. The property is encumbered by an existing first trust deed.

## Purchaser's lien priority

<sup>5</sup> *Lockie v. Co-Operative Land Co.* (1929) 207 C 624

Before the buyer is given possession of the property, the trust deed lender advances additional funds to the seller under the **future advances clause** in the trust deed.

The buyer later takes possession of the property and makes all payments on the land sales contract directly to the trust deed lender. The trust deed lender accepts the buyer's payments with full knowledge of the land sales contract between the buyer and the seller.

Later, the trust deed lender advances additional funds to the seller, again under the future advances clause in the trust deed.

Meanwhile, the buyer pays the lender all amounts owed on the first trust deed note at the time the buyer took possession of the property. However, payments do not also pay the amount advanced to the seller by the lender after the buyer took possession. The buyer makes a demand on the lender to release the trust deed lien on the property, called a *reconveyance*.

The lender refuses to reconvey the trust deed unless all advances are repaid, an amount greater than the amount due to the seller on the land sales contract.

Due to the fact that the seller is unable to clear title to the property as agreed to under the oral land sales contract, the buyer seeks to enforce a purchaser's lien on the property for all the payments they advanced toward the purchase price. Further, the buyer claims their purchaser's lien has priority over the lender's unpaid advances since their purchaser's lien relates back in time to the date the buyer took possession of the property under the unrecorded land sales contract.

In this example, the purchaser's lien has priority over all advances made by the trust deed lender after the date the buyer took possession of the property under the land sales contract. Advances made to the seller by the lender prior to the buyer's possession are senior to the purchaser's lien.

Alternatively, the buyer may **quiet title** to the property and extinguish the trust deed of record. The trust deed lender was paid all amounts owed under the first trust deed on the date the buyer took possession of the property under the land sales contract.<sup>6</sup>

## Buyer in default

A purchaser's lien only arises if a buyer's failure to perform as agreed in the purchase agreement is **excused** due to wrongful actions by the seller.

For example, a buyer makes a good faith deposit with their offer to purchase a property. The good faith deposit is placed in escrow to be applied to the purchase price on the close of escrow. The seller hands their grant deed to escrow for delivery to the buyer on closing.

<sup>6</sup> *Garcia v. Atmajian* (1980) 113 CA3d 516



The buyer fails to place the entire amount of the down payment in escrow when escrow calls for funds, and thus escrow does not close. The seller refuses to release the buyer's good faith deposit from escrow by returning it to the buyer.

The buyer seeks to establish a purchaser's lien on the seller's property for the amount of the good faith deposit in escrow, claiming the seller may not cause a forfeiture of the buyer's deposit.

Is the buyer entitled to a purchaser's lien when it is the buyer who is in default under the purchase agreement?

No! A purchaser's lien will not exist in favor of the buyer who defaults. Thus, the buyer who breached the purchase agreement by refusing to perform according to its terms is not entitled to a purchaser's lien to secure any amount.<sup>7</sup>

However, the seller is not automatically entitled to retain the buyer's deposit in escrow on the buyer's default. A seller is not allowed to forfeit the buyer's funds even if the buyer's breach is deliberate.<sup>8</sup>

Instead, the seller is entitled to an offset against the buyer's deposit for any recoverable money losses incurred by the seller due to the buyer's breach.<sup>9</sup>

A purchaser's lien covers all monies paid out by a buyer for expenses and improvements on a property.<sup>10</sup>

However, for a buyer to recover their expenditures on a property, the breach may not be caused by the buyer.

For example, a buyer agrees in a purchase agreement to buy a parcel of real estate on which a water pumping plant is located. As a condition of the purchase, the buyer agrees to lay water mains on adjacent property retained by the seller of the parcel. The buyer will also provide irrigation service to the adjacent property. These promises to perform are not secured by a performance trust deed on the property purchased. [See **RPI** Form 451]

The seller performs as agreed under the purchase agreement by conveying the parcel with the water pumping plant to the buyer. The buyer takes possession of the parcel on which the water pumping plant is located and completes some of the promised improvements on the seller's adjacent property.

However, the buyer fails to complete all of the improvements as agreed, reconveys the property to the seller and makes a demand on the seller for the cost of the improvements the buyer made.

## Recovering the value of improvements

<sup>7</sup> *Merrill v. Merrill* (1894) 103 C 287

<sup>8</sup> CC §1057.3

<sup>9</sup> *Allen v. Enomoto* (1964) 228 CA2d 798

<sup>10</sup> *Montgomery, supra*



The buyer claims they are entitled to a purchaser's lien on the property reconveyed to the seller for the value of the completed improvements on the adjacent property, with priority to any interest of the seller.

However, the default in the purchase agreement was due to the buyer's failure to complete the agreed upon improvements. Thus, the buyer is not entitled to a purchaser's lien on the property for the cost of the improvements they completed.<sup>11</sup>

### Quiet title action by breaching seller

Consider a buyer and seller who enter into a purchase agreement.

The buyer makes a good faith deposit which is deposited into escrow. Before closing, the buyer discovers a defect in the title to the property being purchased and makes a demand on the seller to clear title and close escrow.

The seller cannot convey a marketable title since a title company will not insure their conveyance as agreed to in the purchase agreement.

The buyer refuses to complete the transaction and demands a return of their deposit since the seller failed to deliver marketable title as agreed. However, the seller refuses to release the buyer's deposit from escrow.

The buyer files an action to impose and foreclose a purchaser's lien on the property to recover the deposit which the seller will not release. The seller counters with a quiet title action to clear title of the buyer's purchaser's lien.

Is the seller entitled to prevail on their quiet title action?

No! The seller may not quiet title and extinguish the purchaser's lien held by the buyer until the seller returns to the buyer all monies paid toward the purchase price by the buyer.<sup>12</sup>

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<sup>11</sup> **Wilson v. Smith** (1924) 69 CA 211

<sup>12</sup> **Benson v. Shotwell** (1890) 87 C 49

## Chapter 28 Summary

From the moment a buyer enters into a purchase agreement with a seller to acquire property, they have an interest in the seller's property which entitles the buyer to a statutory lien against the property for amounts paid on the purchase price when the seller fails to deliver as agreed.

The purchaser's lien is for the amount of payments made on the purchase price, plus expenditures made to improve the property and pay property taxes and insurance premiums.

The right to a purchaser's lien for monies paid includes situations where the seller:

- fails to deliver the property as agreed;
- interferes with the buyer's right to possession;
- fails to sign and deliver agreements or documents;
- induces the buyer to enter into the purchase agreement by misrepresentation; or
- attempts to avoid their performance on the purchase agreement.

Additionally, a buyer is not entitled to a purchaser's lien when a seller's nonperformance is excused due to a breach by the buyer.

The buyer is entitled to a purchaser's lien which they may foreclose on the property they reconvey to the seller as part of the recovery process called rescission and restoration.

The right to a purchaser's lien permits a buyer to record a *lis pendens* on the property purchased while seeking a court ordered foreclosure of the property to satisfy the purchaser's lien. The seller's property under contract with the buyer is considered security for repayment of the money the seller owes the buyer. Any deficiency in the property's value after the foreclosure sale becomes a money judgment against the seller.

The priority of a purchaser's lien on title is set as of the date the buyer takes possession under the purchase agreement, called the relation back theory.

<b>lien.....</b>	<b>pg. 294</b>
<b>lis pendens.....</b>	<b>pg. 294</b>
<b>rescission .....</b>	<b>pg. 293</b>
<b>restoration .....</b>	<b>pg. 294</b>

## Chapter 28 Key Terms

**Quiz 11 Covering Chapters 27-28 is located on page 451.**

*Notes:*



# Mechanic's liens and foreclosures



## Chapter 29

After reading this chapter, you will be able to:

- understand construction loans as a source of financing available to owners who pay for labor and materials to improve property;
- discuss a contractor or subcontractor's right to record a mechanic's lien on title to the owner's job site; and
- identify the notices required for a contractor to perfect and foreclose on a mechanic's lien.

**20-day preliminary notice**  
**construction lender**

**mechanic's lien**  
**notice of nonresponsibility**

## Learning Objectives

## Key Terms

An owner enters into a master lease with a tenant who will sublet space to occupants, called **subtenants**. The master lease contains a provision authorizing the subtenants to make improvements to their premises without the owner's prior consent.

A general contractor is hired by a subtenant to make improvements to their property. In turn, the general contractor hires a subcontractor who commences work to improve the space. The owner is not aware of the construction and the subcontractor does not serve the owner with a 20-day preliminary notice of the subcontractor's lien rights.

Upon completion of the improvements, the subcontractor is not paid. The subcontractor records a mechanic's lien against the owner's fee interest in the property within 30 days after completion of the work. A lawsuit is filed to foreclose the subcontractor's mechanic's lien on the owner's interest within 90 days after recording the mechanic's lien.

## Obligation to pay for work performed

The owner claims the mechanic's lien is unenforceable since the subcontractor failed to serve the owner with a 20-day preliminary notice identifying the subcontractor as a supplier of labor and materials to the job site.

The subcontractor claims the mechanic's lien is enforceable without the 20-day preliminary notice based on the owner's *constructive knowledge* of the construction, since the master lease authorized subtenants to make improvements, authorization which imposes a duty on the owner to conduct periodic inquiries to discover any construction.

Is the subcontractor's mechanic's lien enforceable?

No! Without service of the 20-day preliminary notice on the owner, the subcontractor's mechanic's lien is unenforceable. The owner, while authorizing future improvements without the need for their prior consent, did not have *actual knowledge* of the construction.<sup>1</sup>

## Perfecting claims for labor and materials

### mechanic's lien

A lien entitling a contractor or subcontractor to foreclose on a job site property to recover the amount due and unpaid for labor and materials they provided.

Contractors and subcontractors may file a **mechanic's lien** against title to a property they have improved when they are not paid for labor and materials as agreed.<sup>2</sup>

A *mechanic's lien* entitles the contractor or subcontractor to foreclose on the job site property to recover the amount due and unpaid for labor and materials.<sup>3</sup>

However, the mechanic's lien remedy is only available to contractors and subcontractors who have **perfected** their right to foreclose on the property to collect sums due for labor and materials.

Subcontractors typically do not enter into contracts directly with a property owner, but have a contract with the owner's or tenant's general contractor. Thus, subcontractors **perfect** their right to payment differently from general contractors who do contract with the property owner.

Before a subcontractor employed by a contractor may record a mechanic's lien against real estate and enforce it by foreclosure, they perfect their lien rights by serving a **20-day preliminary notice** on:

- the owner;
- the general contractor; and
- the construction lender.<sup>4</sup>

The *20-day preliminary notice* informs the recipients the subcontractor is working on the site and has the right to record and foreclose a mechanic's lien against property when the subcontractor is not paid for their labor and materials.

### 20-day preliminary notice

Notification of a subcontractor's right to record and foreclose a mechanic's lien against property when they are not paid.

<sup>1</sup> **Kim v. JF Enterprises** (1996) 42 CA4th 849

<sup>2</sup> California Constitution, Article XIV §3

<sup>3</sup> Calif. Civil Code §8400

<sup>4</sup> CC §8200

The 20-day preliminary notice is not a notice of nonpayment or for payment. Rather, it is a notice which informs the relevant parties that the subcontractor has been or is supplying labor and materials to the property.<sup>5</sup>

In contrast to subcontractors, an owner's general contractor's right to a mechanic's lien is **perfected** automatically. The lien is perfected when the contractor and property owner enter into an agreement calling for the general contractor to deliver labor or furnish materials to the job site, directly or through subcontractors.

However, for the contractor to be able to enforce collection from mortgage funds held by the construction lender, they need to provide a 20-day preliminary notice to the construction lender, when one exists.<sup>6</sup>

The 20-day preliminary notice for private work includes:

- a description of the equipment, materials, services or work performed;
- an estimate of the price for the labor and materials;
- the name and address of the person giving the notice, the general contractor, the owner of the property and the construction lender (if any);
- a description of the job site location; and
- a statement of a contractor's lien rights.<sup>7</sup>

The preliminary notice is served within **20 days** after the general contractor or subcontractor first furnishes labor or materials to the job site.<sup>8</sup>

The general contractor or subcontractor may only make a claim under a mechanic's lien for nonpayment of labor and materials furnished beginning 20 days prior to service of the preliminary notice.<sup>9</sup>

Further, when a general contractor or subcontractor fails to serve the 20-day preliminary notice prior to recording their mechanic's lien, the mechanic's lien is invalid. A subcontractor is subject to disciplinary action by the **Registrar of Contractors** for filing a mechanic's lien without first giving the 20-day preliminary notice when the subcontract exceeds \$400.<sup>10</sup>

A general contractor or subcontractor checks the *public record* to identify any **construction lenders** to be served with a 20-day preliminary notice needed to perfect any claim they may make on construction funds.

Identification of the construction lender in the **public record** is accomplished by checking the county recorder's office. The contractor or subcontractor will check the public record for any construction mortgages recorded on the job

## Preliminary notices

## Locating the construction lender

**construction lender**  
A lender that originates a mortgage which funds the construction or development of real estate.

<sup>5</sup> CC §8202

<sup>6</sup> CC §8200(e)(2)

<sup>7</sup> CC §8202

<sup>8</sup> CC §8204

<sup>9</sup> CC §8204(a)

<sup>10</sup> CC §8200(c); 8216

site. They will also review the county zoning office, the City Department of Building and Safety or any other agency which makes building permit information available for public inspection.

Agencies authorized to issue building permits provide space on their building permit application forms for entry of the construction lender's name and address.<sup>11</sup>

When the construction lender is unknown at the time the general contractor applies for the permit, that needs to be noted in the space provided in the building permit application.<sup>12</sup>

Consider a subcontractor who checks the public record on the day they begin on-site work to identify and serve the construction lender with a 20-day preliminary notice. A construction loan has not been recorded with the county recorder's office. Further, no lender is noted on the building department records.

The subcontractor serves a 20-day preliminary notice on the owner and the general contractor within 20 days of commencing on-site work. The project owner then records a trust deed for a construction loan during the 20-day period after the subcontractor began work. The subcontractor is unaware of the construction loan and does not serve a notice on the construction lender.

The subcontractor is not paid when the work is completed. The subcontractor records a mechanic's lien for the amount unpaid and makes a demand on the construction lender to be paid.

The construction lender seeks to invalidate the mechanic's lien, claiming the subcontractor has a duty to continue checking the public records for a recorded construction mortgage until the 20-day limitation for service of a preliminary notice expires. When they discover the existence of a construction loan, they need to serve the notice on the lender.

Does the subcontractor have a duty to check the public records again on the 20th day after commencing work to locate the existence of a construction lender?

No! A subcontractor does not have a duty to recheck the public records to establish a construction lender's identity. A subcontractor only needs to check the public records once, whether on the first day of work or at any other time during the 20-day preliminary notice period.

Since no record of the construction loan existed at the time the subcontractor checked the public record, the subcontractor does not have *constructive notice* of the construction lender's identity. Thus, the subcontractor is not required to send the lender a 20-day preliminary notice before exercising their mechanic's lien rights.

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<sup>11</sup> CC §8172(a)

<sup>12</sup> CC §8172(b)



Constructive notice of the construction lender's identity exists when the lender's name appears on the public record, either by way of a recorded construction mortgage or on a building permit, on the day the subcontractor checks the records within 20 days after they begin onsite work.<sup>13</sup>

However, the failure of the public record to list a construction lender's name does not relieve a general contractor or subcontractor from the obligation to serve the lender with a 20-day preliminary notice when they have *actual knowledge* of the lender's identity due to information supplied by the owner (or in the case of the subcontractor, the general contractor).<sup>14</sup>

A trust deed securing a loan arranged to fund the construction of improvements on real estate needs to:

- be entitled "Construction Trust Deed";
- state the name and address of the owner (trustor) and the lender (beneficiary); and
- include a legal description of the property.<sup>15</sup>

However, the failure of the lender originating the construction trust deed loan to provide all of the required construction information does not relieve the general contractor or the subcontractor of the obligation to serve the lender with the preliminary notice when the construction trust deed is recorded and indexed on or before the first day they begin work.<sup>16</sup>

General contractors are also responsible for providing subcontractors with the name and address of the owner and construction lender.<sup>17</sup>

If known, the construction lender's name and address need to be disclosed in the original written agreement entered into by the owner and the general contractor.<sup>18</sup>

In turn, the general contractor entering into contracts with subcontractors needs to include the names and addresses of the owner and the construction lender in the subcontract.<sup>19</sup>

When a construction loan is obtained after construction has commenced, the owner, on receipt of a 20-day preliminary notice from the subcontractor, is to provide the subcontractor with the name(s) and address(es) of any construction lender(s).<sup>20</sup>

## Construction trust deeds

## Contractor's and owner's duty to inform

<sup>13</sup> **Kodiak Industries, Inc. v. Ellis** (1986) 185 CA3d 75

<sup>14</sup> CC §8172(c)

<sup>15</sup> CC §8174

<sup>16</sup> CC §8174

<sup>17</sup> CC §8208

<sup>18</sup> CC §8170(a)(2)

<sup>19</sup> CC §8170(b)

<sup>20</sup> CC §8210

The 20-day preliminary notice statutes do not dictate what is required of a contractor when an owner provides a construction lender's name and address after construction has begun and the 20-day preliminary notice has been served.

However, prudent general contractors and subcontractors need to serve the construction lender with a copy of the 20-day preliminary notice upon receipt of the name and address of the lender after construction has begun, even when the 20-day period has lapsed. Thus, the construction lender is notified at the earliest possible moment that the general contractor and subcontractor have provided labor and materials to the job site.

This lender identification process does not apply to home improvement or swimming pool contracts.<sup>21</sup>

### **An enforceable mechanic's lien**

A mechanic's lien is a form statement signed by the general contractor or subcontractor and recorded. The statement does not need to be notarized.

To be enforceable, a mechanic's lien is served by mail to the owner of the property on which the labor was performed. This service is evidenced by a certificate of mailing.

A mechanic's lien contains:

- the dollar amount of the general contractor's (or subcontractor's) unpaid demand for labor and materials;
- a description of the labor involved;
- an identification of the property on which the labor was performed;
- the name of the property owner, if known;
- the name of the general contractor, when the mechanic's lien is filed by a subcontractor;
- the address of the general contractor (or subcontractor) recording the lien;
- a completed proof of service affidavit with the date, place, manner of service and recipient of service, signed by the person serving the copy of the mechanic's lien; and
- the statutory "Notice of Mechanic's Lien" statement, printed in at least ten-point boldface type with the last sentence in uppercase type.<sup>22</sup>

Further, a mechanic's lien is invalid if:

- the lien was created with the intent to defraud; or
- an innocent third party takes possession of the property and is not made aware of the lien due to the lien being deceptively deficient.

All rights under a mechanic's lien will be forfeited if the contractor or subcontractor willfully includes any labor or materials not provided for the property described.<sup>23</sup>

<sup>21</sup> CC §8170(a)(2)

<sup>22</sup> CC §8416

<sup>23</sup> CC §8422

A mechanic's lien may be recorded after the general contractor or subcontractor has made a demand for payment on the owner or the general contractor and payment has not been tendered.

**Time limitations** exist for recording a mechanic's lien after **completion or cessation** of construction on the job site. Notices of completion or cessation are recorded by the owner of the property being improved to commence the running of the period during which the mechanic's lien needs to be recorded to be enforceable by foreclosure.

Thus, **recording a notice** of completion or cessation of labor is financially important to the owner. Recording commences the time period which cuts off any further claims. To reduce the period in which an enforceable mechanic's lien may be recorded, the owner:

- records the notices of completion and/or cessation; and
- serves a copy of the notice via mail within ten days of the date of the recording to the contractor and any subcontractor who delivered a preliminary notice.<sup>24</sup>

Owner-occupants of one-to-four unit residential properties are exempt from having to serve a copy of the notice. However, they are still subject to the recording requirement.<sup>25</sup>

A *notice of completion* is recorded by the owner in the county where the property is located within 15 days after completion of construction.<sup>26</sup>

When two or more general contractors are performing work on the property, the owner may record a partial notice of completion for each general contractor's portion of labor.<sup>27</sup>

When the project is not completed, a *notice of cessation* is recorded by the owner in the county where the property is located 30 days after cessation of all onsite labor.<sup>28</sup>

If a **notice of cessation** is not recorded, a cessation of labor for a continuous period of 60 days constitutes **completion** of the construction project. This commences the limitation period for recording a mechanic's lien.<sup>29</sup>

Mechanic's liens are to be recorded within one of two periods of time:

- when a notice of completion or cessation of labor is recorded, the mechanic's lien of a general contractor is **recorded** within 60 days (30 days for a subcontractor) of the date the notice of completion or cessation is recorded;<sup>30</sup> or

## Mechanic's lien recording period

<sup>24</sup> CC §8190

<sup>25</sup> CC §8190(d)(2)

<sup>26</sup> CC §8182(a)

<sup>27</sup> CC §8186

<sup>28</sup> CC §8188(a)

<sup>29</sup> CC §8180(a)(3)

<sup>30</sup> CC §58412(b); 8414(b)(2)

- when a notice of completion or cessation of labor is **not recorded**, all mechanic's liens are to be recorded within 90 days of the date the project is completed or considered completed.<sup>31</sup>

Consider a subcontractor who delivers materials to a site to be used in the construction of a building. The subcontractor is not paid for the materials.

More than 90 days after the project is completed, the subcontractor records a mechanic's lien.

After the mechanic's lien is recorded, a notice of completion is recorded which states an incorrect completion date. The completion date is erroneously stated as being within 30 days prior to the date the mechanic's lien was recorded.

To avoid the subcontractor's mechanic's lien, the owner and general contractor claim the mechanic's lien is unenforceable since it was not recorded within 90 days after the actual completion date of the building.

The subcontractor claims the mechanic's lien is enforceable since it was recorded within 30 days of the completion date stated in the notice of completion.

Is the mechanic's lien enforceable?

No! When a notice of completion is not recorded within 15 days after the actual completion date, a mechanic's lien needs to be recorded within 90 days after the actual completion date of construction to be enforceable.

While no statute requires the owner to record a notice of completion, the notice benefits the owner by shortening the period in which a mechanic's lien may be recorded and foreclosed upon.<sup>32</sup>

## Foreclosing the mechanic's lien

When a mechanic's lien is timely recorded, it is enforced by filing an action to **judicially foreclose** the lien on the property. The action is to be filed within 90 days after the mechanic's lien is recorded.<sup>33</sup>

On failure to timely file the **foreclosure action**, the mechanic's lien becomes *void*. It thus no longer encumbers the property.<sup>34</sup>

However, an exception to this 90-day rule exists when the general contractor or subcontractor agrees with the owner to extend the time for payment of the mechanic's lien. The general contractor or subcontractor is to record the fact and terms of this extension within 90 days of the recording date of the mechanic's lien.

To enforce the mechanic's lien after an extension, the general contractor or subcontractor files a foreclosure action within the lesser of:

- 90 days after the expiration of the extension to enforce the mechanic's lien; or

<sup>31</sup> CC §58412(a); 8414(b)(1)

<sup>32</sup> *Fontana Paving, Inc. v. Hedley Brothers, Inc.* (1995) 38 CA4th 146

<sup>33</sup> CC §8460(a)

<sup>34</sup> CC §8460(a)

RECORDING REQUESTED BY  AND WHEN RECORDED MAIL TO <input type="checkbox"/> <input type="checkbox"/> Name _____ Street Address _____ City & State _____ L _____ J _____	SPACE ABOVE THIS LINE FOR RECORDER'S USE
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**NOTICE OF NONRESPONSIBILITY**  
From Landlord (California Civil Code §8444)

**NOTE:** This form is used by a property manager or income property owner when a tenant commences construction of improvements on premises leased from the owner, to declare the property owner is not responsible for any claim arising out of the tenant improvements being constructed on the property.

**DATE:** \_\_\_\_\_, 20\_\_\_\_, at \_\_\_\_\_, California.

**NOTICE IS HEREBY GIVEN:**

1. \_\_\_\_\_ is the vested and legal owner of real property located in the County of \_\_\_\_\_, State of California, identified as

1.1 Common address \_\_\_\_\_

1.2 Legal description \_\_\_\_\_

2. \_\_\_\_\_ is:

2.1 ☐ The Buyer of the property under a purchase agreement, option or land sales contract, or

2.2 ☐ The Tenant under a lease of the property.

3. Within 10 days before the posting and recording of this notice, the undersigned Owner or Agent of Owner obtained knowledge that a work of improvement has commenced on the site of the property involving ☐ construction, ☐ alteration, or ☐ repair.

4. Owner will not be responsible for any claim arising out of this work of improvement.

5. I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Date: \_\_\_\_\_, 20\_\_\_\_ Name: \_\_\_\_\_

Signature: \_\_\_\_\_

☐ Owner, or ☐ Agent of Owner

A notary public or other officer completing this certificate verifies only the identity of the individual who signed the document to which this certificate is attached, and not the truthfulness, accuracy, or validity of that document.

STATE OF CALIFORNIA  
COUNTY OF \_\_\_\_\_  
On \_\_\_\_\_ before me, \_\_\_\_\_  
(Name and title of officer)

personally appeared \_\_\_\_\_  
who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.  
 WITNESS my hand and official seal.

Signature: \_\_\_\_\_  
(Signature of notary public)

(This area for official notarial seal)

FORM 597
09-16
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Form 597

## Notice of Nonresponsibility

- one year after the completion of the labor and materials in dispute.<sup>35</sup>

Consider a tenant who is authorized by the owner to make improvements on the leased premises.

The tenant contracts for improvements to the property with a contractor and fails to pay. A mechanic's lien recorded by the unpaid contractor attaches to the tenant's leasehold interest in the property.<sup>36</sup>

## Notice of nonresponsibility

<sup>35</sup> CC §8460(b)

<sup>36</sup> CC §8442(a)

**notice of nonresponsibility**

A notice used by a landlord to declare that they are not responsible for any claim arising out of improvements the tenant is constructing on their property. [See RPI Form 597]

Further, when the owner or their property manager has *actual knowledge* of the construction, the mechanic's lien will also attach to the owner's fee interest in the property. However, the owner may prevent the attachment by recording and posting a **notice of nonresponsibility** within ten days after they become aware of the tenant-contracted improvements.<sup>37</sup> [See Form 597 accompanying this chapter]

The notice of nonresponsibility is posted at a conspicuous place on the property and **recorded** with the recorder's office in the county where the property is located.<sup>38</sup>

## Enforcement of rights

Consider a subcontractor who is employed by a general contractor to supply labor and materials for the improvement of a property.

The subcontractor is hired under a subcontract agreement with the general contractor which contains a *pay-when-paid provision*. The pay-when-paid provision states the general contractor needs to receive payment from the owner of the property before the general contractor is obligated to pay the subcontractor, called a *condition precedent* (to payment), or *contingency*.

The general contractor obtains a *payment bond* from a corporate surety to protect the owner from mechanic's lien claims arising due to the general contractor's failure to pay for labor and materials.

Later, the owner stops making payments to the general contractor. In turn, the general contractor stops making payments to the subcontractor since they owe the subcontractor nothing under the subcontract until they are paid by the owner.

The subcontractor records a mechanic's lien against the property and seeks recovery from the surety under the payment bond the general contractor provided to the owner.

The surety claims the subcontractor is not entitled to payment under the bond since the pay-when-paid provision ended the general contractor's obligation to pay when the owner ceased making payments.

Is the subcontractor entitled to payment under the surety bond issued to the owner to cover mechanic's lien claims?

Yes! The surety is liable to the subcontractor for amounts remaining unpaid since the pay-when-paid provision in the subcontract is void.

The provision constitutes an unenforceable attempt by the general contractor to cause the subcontractor to waive their (constitutionally protected) mechanic's lien rights against the property since the subcontractor, by their agreement with the general contractor, is not entitled to compensation for unpaid work when the owner does not pay.<sup>39</sup>

<sup>37</sup> CC §8442(b)

<sup>38</sup> CC §8444

<sup>39</sup> *Wm. R. Clarke Corporation v. Safeco Insurance Company of America* (1997) 15 C4th 882

The waiver of a general contractor or subcontractor's mechanic's lien rights is unenforceable unless the waiver is a **waiver and release** signed by the general contractor (or subcontractor) making the claim in exchange for partial or full payment of the amount due under the mechanic's lien. Evidence of payment is required for a waiver and release to be enforceable against the general contractor or subcontractor making the claim.<sup>40</sup>

Additionally, a waiver and release of mechanic lien rights needs to be substantially similar to the statutory waiver and release form, depending on whether the waiver and release is:

- conditional or unconditional; and
- based on progress payments or final payments of amounts due under the lien.<sup>41</sup>

The owner of a property, or a general contractor affected by a recorded mechanic's lien, who contests the validity of the mechanic's lien may obtain a release of the property from the mechanic's lien by recording a **lien release bond**.<sup>42</sup>

The lien release bond needs to be:

- conditioned on the payment of judgment and costs recovered on the mechanic's lien; and
- for an amount equal to 125% of mechanic's lien amount.<sup>43</sup>

A lien release bond is recorded before a foreclosure action has commenced to enforce the mechanic's lien.<sup>44</sup>

Notice of the recording of the lien release bond is given to the general contractor or subcontractor who recorded the mechanic's lien. The general contractor or subcontractor has six months from the date of the notice of the lien release bond recording to commence a foreclosure action on the mechanic's lien.

**Bonding  
releases a  
mechanic's  
lien from title**

<sup>40</sup> CC §§8124, 8126

<sup>41</sup> CC §§8128-8138

<sup>42</sup> CC §8424(a)

<sup>43</sup> CC §8424(b)

<sup>44</sup> CC §8424(c)



## Chapter 29

### Summary

When contractors and subcontractors are not paid for labor and materials, they have a constitutionally protected right to file a mechanic's lien against the property they improved. A mechanic's lien enables the contractor or subcontractor to foreclose on the property to recover the amount due and unpaid under the contract.

Before a subcontractor may record a mechanic's lien against property, they need to serve a 20-day preliminary notice on the owner, general contractor and the construction lender of their right. A general contractor's right to a mechanic's lien is perfected automatically.

The general contractor or subcontractor may only assert a claim under a mechanic's lien for nonpayment of labor and materials furnished beginning 20 days prior to service of the preliminary notice.

A subcontractor does not have a duty to recheck the public records to establish a construction lender's identity. A subcontractor only needs to check the public records once, whether on the first day of work or at any other time during the 20-day preliminary notice period.

The subcontractor is not required to send the lender a 20-day preliminary notice before exercising their mechanic's lien rights if they do not have constructive notice of the lender's identity.

An owner may prevent the attachment of a mechanic's lien for improvements contracted for by a tenant by recording and posting a notice of nonresponsibility.

The waiver of a general contractor or subcontractor's mechanic's lien rights is unenforceable unless the waiver is a waiver and release signed by the general contractor (or subcontractor) making the claim in exchange for partial or full payment of the amount due under the mechanic's lien.

The owner of a property, or a general contractor affected by a recorded mechanic's lien, who contests the validity of the mechanic's lien may obtain a release of the property from the mechanic's lien by recording a lien release bond.

## Chapter 29

### Key Terms

<b>20-day preliminary notice .....</b>	<b>pg. 302</b>
<b>construction lender .....</b>	<b>pg. 303</b>
<b>mechanic's lien .....</b>	<b>pg. 302</b>
<b>notice of nonresponsibility .....</b>	<b>pg. 310</b>

**Quiz 12 Covering Chapters 29-31 is located on page 452.**



# Clearing a lien-clouded title

## Chapter 30

After reading this chapter, you will be able to:

- negotiate the release of a lien from title to a seller-in-foreclosure's residence;
- understand the process a judgment creditor uses to create a valid lien on real estate owned by a debtor; and
- advise a homeowner how to preserve their equity on a sale under the California homestead exemptions.

**abstract of judgment**

**declaration of homestead**

**federal tax lien**

**homestead**

**judgment lien**

## Learning Objectives

## Key Terms

An equity purchase (EP) investor enters into an EP agreement prepared and negotiated by their agent to buy a seller-occupied residence in foreclosure, called an **EP transaction**. [See **RPI** Form 156]

After expiration of the seller-in-foreclosure's five-business-day cancellation period, the agent opens escrow. A **preliminary title report** is ordered. On reviewing it, the buyer's agent discovers a recorded abstract for a money judgment awarded to a creditor against the seller. The abstract, called a **judgment lien**, clouds title to the seller's residence. The seller did not record a **declaration of homestead** prior to the creditor recording the abstract.

The *judgment lien* was not specifically mentioned in the EP agreement since neither the seller nor the title profile the buyer's agent pulled advised the agent it existed. The judgment lien is listed in the General Index, which is not searched for title profile purposes.

## Negotiate a release to create equity

### **judgment lien**

A money judgment against a person recorded as an abstract and attaching to the title of real estate they own.

**declaration of homestead**

A document signed by a homeowner and filed with the county recorder's office to shield the owner-occupant's homestead equity from seizure by creditors. [See **RPI** Form 465]

However, provisions in the EP agreement call for:

- the down payment to be reduced by the amount of any unreferenced lien; **and**
  - the responsibility for satisfying and releasing the lien is shifted to the EP investor to be negotiated prior to closing; **or**
  - the EP investor may take title subject to the judgment lien and negotiate its satisfaction and release after closing. [See **RPI** Form 156 §13.3]

Further, the title insurance company, as a requisite to issuing a title insurance policy, requires either a *partial* or *full release* be recorded. The release clears title of the lien, a necessary step before they will eliminate the judgment lien as a listed exception to the prelim. The EP investor chooses to have the lien released before closing, rather than offset the down payment and leave the lien on title to be dealt with after closing.

However, the seller is uninformed about debt management and has no understanding about **lien avoidance**. Needing to clear title of the judgment lien before escrow can close, the buyer's agent obtains written authority from the seller to contact the judgment lienholder, directly or through escrow, to negotiate a partial or full release of the lien. These negotiations are equivalent to negotiating a short payoff of a mortgage.

When contacted, the lienholder initially demands full payment of the debt since it is secured by the property, the very reason the lienholder recorded the abstract.

However, the EP investor has superior economic leverage over the creditor in negotiations for a release of the judgment lien. Here, the mortgage on the property is in foreclosure, greatly increasing the creditor's risk of losing their lien on the property. More importantly, the seller qualifies for an **automatic homestead exemption** depriving the creditor of any ability to collect on the judgment by processing a judicial foreclosure enforcing their abstract.

Both the mortgage and the homestead claims on title are *senior interests* in title to the abstract. Being senior claims, they have priority over the creditor's right to recover the amount of their judgment from the property's value.

For example, a trustee's foreclosure sale on the mortgage, if it takes place, wipes out the judgment lien. Unless excess funds flow from the trustee's sale to be distributed to junior lien holders, the judgment creditor receives nothing.

California homeowners qualify for a net equity homestead protection of up to \$300,000 or the median sale price for a single family residence (SFR) in their county in the calendar year prior to the year in which the exemption is claimed, not to exceed \$600,000. This dollar threshold is adjusted annually for inflation.<sup>1</sup>

<sup>1</sup> Calif. Code of Civil Procedure §704.730

Thus, the owner's equity exemption frees the homestead amount from collection by the creditor on their judgment.<sup>2</sup>

Usually, a good bargaining tactic with the judgment creditor for obtaining a **release of a lien** from a seller's residence is a combination of:

- a "gentle reminder" the lien is on the verge of being *wiped out by foreclosure* of the senior mortgage without the likelihood of an overbid to provide funds for anyone, including the creditor;
- a review of the homeowner's *homestead exemption* rights as having a claim on equity with priority to the creditor's lien, leaving no ability for the creditor to collect by forcing a judicial sale under their abstract [See Chapter 33];
- an *offer to pay* a lesser amount in full satisfaction of the debt owed to the lienholder; and
- a partial (or full) satisfaction and the execution of a partial (or full) release, allowing the abstract of judgment to remain of record (unless fully released) while *releasing the residence* from its lien so escrow may close.

The objective of the EP investor's agent's negotiations is to give the lienholder sufficient incentive to cooperate. The objective is a release of the property from the lien without the homeowner filing a bankruptcy petition to remove the creditor's lien from title and approve the sale to the EP investor. The EP investor (or the seller's agent) is in a better position to deal with the lienholder in an aggressive manner than the seller-in-foreclosure, who long ago exhausted their goodwill with the judgment creditor.

A financially advantageous situation is created for all parties when:

- the **lienholder** collects a portion of the money owed, which is not available via a sale of the residence when a foreclosure under the mortgage wipes out the judgment lien, or a recorded or automatic homestead exemption exists with the seller;
- the **seller** closes the sale of their residence, avoiding the loss of their equity to the lender's foreclosure, and receives the amount of proceeds protected by their homestead exemption; and
- the **EP investor** keeps their purchase agreement alive by negotiating a release of the lien in exchange for a partial payoff of the lienholder's judgment out of the seller's proceeds from the sale.

Often a judgment lienholder agrees to release a residence from their lien. To document the release, a signed and notarized **release of recorded instrument** is obtained from the lienholder and recorded. All aspects of the paperwork are handled through escrow after negotiations have been completed. [See Form 409 accompanying this chapter]

**The abstract  
lien about to  
be wiped out**

**Mutually  
beneficial  
situation**

<sup>2</sup> CCP §704.730

The release contains all the information necessary to clear the judgment lien from the record title to the property.

When the release is notarized and recorded, the judgment lien attached to the residence is removed from record and a policy of title insurance is issued covering title free of the lien.

## The abstract of judgment lien

### abstract of judgment

A condensed written summary of the essential holdings of a court judgment.

A judgment creditor creates a valid lien on real estate owned by the debtor by recording an **abstract of judgment** issued by a state court.<sup>3</sup>

A judgment lien continues in effect for ten years from the date it is recorded, unless the money judgment is either satisfied or released.<sup>4</sup>

Further, the recording of a certified copy of a judgment awarded by a federal court attaches without the need to obtain and record an *abstract of judgment*.

For example, a judgment creditor obtains a federal district court money judgment against an individual. A **certified copy** of the judgment is recorded in the county where the individual is the vested owner of real estate. Title to the property at the time of recording is subject to a first mortgage.

The owner later records a second trust deed on the property to secure a loan. A dispute arises between the lender and the judgment creditor over who has priority and is entitled to funds remaining on a sale after a payoff of the first mortgage.

The second trust deed lender claims the recorded federal judgment is not a valid lien since it is not documented by a recorded abstract of judgment to give the lien priority to the lender's trust deed.

Does the judgment creditor hold a valid lien senior to the lender's trust deed?

Yes! The judgment creditor holds a valid lien senior to the second trust deed. A federal judgment creditor creates a lien on real estate owned by the judgment debtor on recording a certified copy of the federal judgment.<sup>5</sup>

A money judgment from a court of the United States becomes a valid lien on real estate on the recording of:

- an abstract of judgment; or
- a certified copy of the money judgment.<sup>6</sup>

## California's FTB as a judgment creditor

A *personal income tax lien* on a residence recorded by the California Franchise Tax Board (FTB) is enforced under the same procedure as any creditor's judgment lien. The FTB issues and records a **warrant** for the amount claimed due by the state. The *warrant* has the same force and effect as an abstract of judgment issued by a court.<sup>7</sup>

<sup>3</sup> CCP §697.310(a)

<sup>4</sup> CCP §697.310(b)

<sup>5</sup> *In re McDonell* (9th Cir. BAP 1996) 204 BR 976

<sup>6</sup> CCP §697.060

<sup>7</sup> CCP §688.020

**Facts:** A creditor is awarded a money judgment and records an abstract of the judgment which attaches to title of a property subject to an existing mortgage. Later, another judgment creditor records an abstract of judgment attaching to title to the property. In a partition action, the original creditor's lien is established as priority. However, the creditor allows the judgment lien to expire. Later, the owner sells the property, and the sales proceeds are distributed to the lienholders. None of the sales proceeds are distributed to the creditor under their judgment as their judgment lien had expired before the property was sold.

**Claim:** The judgment creditor seeks to be paid from the proceeds on the property's sale to satisfy their lien, claiming their lien was still enforceable and they did not need to renew their judgment since the partition action established them as priority over other creditors.

**Counterclaim:** The other creditor claims the original judgment creditor is not entitled to any of the excess sales proceeds from the property since their judgment expired prior to the sale.

**Holding:** A California appeals court holds the original judgment creditor is not entitled to any of the excess proceeds from the owner's property sale since they lost their lienholder interest in the property when they failed to renew their judgment within the statutory 10-year period. [*Starcevic v. Pentech Financial Service, Inc.*, (2021) 66 CA5th 365]

*Editor's note—Judgment liens must be renewed to remain as a lienholder on title to a property. When a judgment is not renewed, a judgment creditor loses their security interest in a property.*

### Case in Point

Is a judgment creditor entitled to proceeds from a property sale occurring after their lien expired?

The FTB lien created by recording the warrant attaches to real estate owned by the taxpayer in the same priority as a judgment lien. More importantly, the taxpayer, who is a homeowner and head of the household, has a homestead exemption senior to the FTB lien. The exemption shields \$300,000 or the median sale price for a single-family home in your county in the calendar year prior to the year in which you claim exemption, not to exceed \$600,000 (adjusted annually for inflation) of the seller's equity from seizure by the FTB.<sup>8</sup>

No statutory or regulatory authority exists for the FTB to negotiate a partial payment of the tax bill in exchange for releasing the residence from the tax lien.

However, California's **Taxpayer Bill of Rights** provides some relief. Under it, the FTB is obligated to release its lien from the residence when the proceeds from the sale do not result in a reasonable reduction of the seller-in-foreclosure's debt to the FTB. Again, negotiations are an all or nothing analysis for a release of the FTB lien on a short sale of the property.<sup>9</sup>

Nevertheless, no case law exists testing whether the statute presents an offensive weapon the seller may use to quiet title to real estate and eliminate the cloud of a state income tax lien when a *declaration of homestead* was recorded prior to recording the FTB warrant.

<sup>8</sup> CCP §688.030; Calif. Government Code §§7170 et seq.

<sup>9</sup> Calif. Revenue and Taxation Code §21016(a)(3)



## Releasing an IRS lien

### **federal tax lien**

A lien recorded attaching to the title of real estate owned by a taxpayer who owes the Internal Revenue Service (IRS) unpaid taxes.

Consider an EP investor's agent whose preliminary title report reveals the existence of a **federal tax lien** junior to a mortgage in foreclosure.

When property is sold at a trustee's sale and a timely recorded junior *federal tax lien* exists, the Internal Revenue Service (IRS) may later purchase (redeem) the property from the successful bidder at the trustee's sale. The IRS pays the successful bidder the amount of their bid within 120 days, plus interest and foreclosure costs.

Thus, the equity the owner lost may be acquired by the IRS after the trustee's foreclosure sale to satisfy unpaid income taxes owed by the owner. The IRS later holds its own auction and resells the residence, having bought the property for the price bid and paid by the successful bidder.

When a second trust deed or judgment lien exists on the residence, the IRS usually waits until the first trust deed lender completes its foreclosure, wiping out the junior lienholder and **creating an equity** where none existed before the trustee's sale. The IRS then steps in within 120 days after the trustee's sale and acquires the residence from the buyer at the trustee's sale.

On a regular sale of property, the IRS has the authority to negotiate with the seller/taxpayer, their authorized agent or the EP investor to accept partial or no payment in exchange for a **certificate of discharge** from the income tax lien. Unlike rules controlling the FTB, the discharge by the IRS is authorized when the IRS's recovery under its lien and redemption and resale rights are economically unfeasible beyond the amount available to the IRS from a sale of the property at current value.<sup>10</sup>

## EP investor's agent negotiates the discharge

The EP investor's agent may negotiate the discharge of the IRS tax lien from title on behalf of the taxpayer. The agent uses the same persuasive facts used to negotiate a release of a judgment lien with a creditor, or a short payoff with a lender using a **hardship letter**.

To release the tax lien from title when the property is in foreclosure, the seller submits a written request to the district director of the IRS for a discharge of the residence from the federal tax lien. The required **Form 4422: Application for Certificate of Discharge of Property from Federal Tax Lien**, is available in IRS Publication 783 at [www.irs.gov](http://www.irs.gov).<sup>11</sup>

General information the IRS wants with Form 4422 is:

- a preliminary title report;
- proposed closing statement, e.g. a HUD-1 settlement statement or Closing Disclosure;
- two opinions of value documented in an appraisal report; and
- a declaration and signature of the payer under penalty of perjury.

<sup>10</sup> 26 United States Code §6325(b)(2)

<sup>11</sup> 26 Code of Federal Regulations §301.6325-1(b)



Attached to the application is a statement from the taxpayer providing the reasons why they are requesting a discharge of the tax lien. The statement needs to be honest and to the point, with good, solid reasons. Hardships necessitating the discharge may include:

- reduced income;
- job loss;
- an illness, medical emergency or death in the family;
- a job transfer (voluntary or involuntary);
- a divorce or separation;
- an exotic mortgage (e.g., adjustable-rate mortgage);
- incarceration; and
- increased expenses and excessive debt.

If relevant, have the taxpayer use concrete numbers to explain loss of income or negative cash flow. Taxpayers need to be advised to limit this part of the statement to what has occurred, and not what they fear or expect from the future.

Current IRS policy dictates the IRS, not the seller, is to receive all of the proceeds from any equity remaining in the residence up to the amount of the lien.

Additionally, the EP investor is to consider whether it is more advantageous to take the residence subject to the IRS tax lien, especially when the property is a “fixer-upper.” Often little or no equity exists beyond the encumbrances senior to the IRS lien. Here, the agent acting on behalf of the EP investor who is the new owner may negotiate with the IRS for the release of the lien. The investor offers a small cash payment in exchange for the release — often an amount less than the IRS was normally willing to accept from the seller prior to the EP investor becoming the owner.

However, taking the residence subject to the IRS lien entails a risk of loss for the EP investor. The IRS may decide to leave its lien intact on the property if the investor takes the property out of foreclosure. Thus, IRS is able to participate in the future property value added by:

- inflation;
- appreciation; or
- the efforts of the EP investor.<sup>12</sup>

**Take title  
subject to  
the lien when  
little or no  
equity exists**

<sup>12</sup> *Han v. United States of America* (9th Cir. 1991) 944 F2d 526

## The homestead exemption coup

### homestead

The dollar amount of equity in a homeowner's principal dwelling the homeowner qualifies to shield as exempt from creditor seizure. [See RPI Form 465]

California homeowners qualify for a net equity homestead protection of up to \$300,000 or the median sale price for a single family residence (SFR) in their county in the calendar year prior to the year in which the exemption is claimed, not to exceed \$600,000. This dollar threshold is adjusted annually for inflation.<sup>13</sup>

Two types of *homestead* procedures are available to California homeowners:

- the declaration of homestead, which is recorded;<sup>14</sup> and
- the **automatic homestead**, also called a *statutory homestead exemption*, which is not recorded.<sup>15</sup>

The homestead protection is automatic when the judgment lienholder or the FTB attempts to enforce its money judgment by a sheriff's sale of the homeowner's residence. The residence may not be sold by the lienholder when the net proceeds of the sale will be less than the homestead exemption amount.

However, the automatic homestead exemption only applies to:

- execution sales ordered by a court to satisfy money judgments against the homeowner; and
- any sale of the home in a bankruptcy proceeding.

While limited as a defensive tool for the homeowner, the automatic homestead exemption becomes a powerful offensive tool in a bankruptcy proceeding. Through bankruptcy proceedings, the homeowner is able to clear their title of judgment and state tax liens impairing the value of their homestead equity in the property.<sup>16</sup>

However, the automatic homestead exemption is not enforceable against an IRS tax lien in bankruptcy.<sup>17</sup>

Alternatively, the homeowner may have recorded their declaration of homestead prior to the date a judgment or FTB lien was recorded. The owner may quiet title to the property and eliminate the effect of the judgment or FTB tax lien on their home when:

- the recorded homestead is senior to the judgment creditor's or FTB's lien; and
- the net proceeds of a voluntary sale entered into by the owner of the residence will be less than the homestead amount.

However, like the automatic homestead exemption, the recorded homestead has no priority over an IRS tax lien. Thus, the IRS may still force the sale of the residence under its tax lien when a certificate of discharge is not arranged.<sup>18</sup>

<sup>13</sup> CCP §704.730

<sup>14</sup> CCP §704.920

<sup>15</sup> CCP §704.720

<sup>16</sup> *In re Herman* (9th Cir. BAP 1990) 120 BR 127; 11 USC §522(f)

<sup>17</sup> *U.S. v. Heffron* (9th Cir. 1947) 158 F2d 657; 11 USC §545

<sup>18</sup> *U.S. v. Rodgers* (1983) 461 US 677

In practice, the release of an IRS lien under a certificate of discharge from title is always negotiated based on whether it has recorded priority over voluntary encumbrances and judgment liens on the residence. The homestead has no effect on the **lien rights** of the IRS.

Whether it is by an automatic exemption or recorded declaration, the homestead is leverage to be used to induce judgment lienholders and the FTB to voluntarily release their lien from the title to the residence. The effects of foreclosure, a bankruptcy or quiet title action to enforce the homestead exemption and clear title gives lienholders an incentive to negotiate the release.

The lienholder unilaterally executes the release by **signing** it and **dating** their signature. When more than two signature lines are required, check the box to indicate a signature page addendum is attached. [See **RPI** Form 251]

**Notarize** the release for recording. Record the release to clear the seller's title of the lien.<sup>19</sup>

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<sup>19</sup> Gov C §27287

The agent of an equity purchaser (EP) investor negotiates the release of a recorded lien to create equity. Good bargaining tactics for obtaining a release of a lien from a seller's residence include:

- a reminder to the creditor that the lien is on the verge of being wiped out by foreclosure of the first trust deed without the likelihood of an overbid to provide funds for the creditor;
- a review of the homeowner's homestead exemption rights as having a claim on equity senior to the creditor's lien, leaving no ability for the creditor to collect by forcing a judicial sale;
- an offer to pay a lesser amount in full satisfaction of the debt owed to the lienholder; and
- a partial (or full) satisfaction and the execution of a partial (or full) release, allowing the abstract of judgment to remain of record (unless fully released) while releasing the residence from its lien so escrow may close.

A judgment creditor creates a valid lien on real estate owned by the debtor by recording an abstract of judgment issued by a state court. Similarly, a money judgment from a court of the United States becomes a valid lien on real estate on the recording of an abstract of judgment or a certified copy of the money judgment.

## Chapter 30 Summary

A personal income tax lien on a residence recorded by the Franchise Tax Board (FTB) is enforced under the same procedure as any creditor's judgment lien.

Under the California's Taxpayer Bill of Rights, the FTB is obligated to release its lien from the residence when the proceeds from the sale do not result in a reasonable reduction of the seller-in-foreclosure's debt to the FTB.

When property is sold at a trustee's sale and a timely recorded, and a junior federal tax lien exists, the Internal Revenue Service (IRS) may later purchase the property from the successful bidder at the trustee's sale. The IRS pays the successful bidder the amount of the bid within 120 days, plus interest and foreclosure costs.

Through bankruptcy proceedings, the homeowner is able to clear their title of judgment and state tax liens impairing the value of their homestead equity in the property under California homestead exemption laws. However, the automatic homestead exemption is not enforceable against an IRS tax lien in bankruptcy.

**Chapter 30**  
**Key Terms**

<b>abstract of judgment .....</b>	<b>pg. 316</b>
<b>declaration of homestead .....</b>	<b>pg. 314</b>
<b>federal tax lien .....</b>	<b>pg. 318</b>
<b>homestead .....</b>	<b>pg. 319</b>
<b>judgment lien .....</b>	<b>pg. 313</b>

**Quiz 12 Covering Chapters 29-31 is located on page 452.**



# The lis pendens

## Chapter 31

After reading this chapter, you will be able to:

- recognize the nexus between a recorded lis pendens describing a parcel of real estate and the litigation it references for a claim to an interest in title or right to possession of the real estate;
- understand the interference a recorded lis pendens has on the owner's ability to convey clear title; and
- explain an expungement of a lis pendens as the remedy for clearing title of the litigation so the property can be conveyed and title insurance issued.

**absolutely privileged publication**

**bond**

**constructive trust**

**expungement**

**lis pendens**

**specific performance action**

### Learning Objectives

### Key Terms

**Lis pendens** is Latin for *pending litigation*. More commonly, a *lis pendens* is called a **Notice of Pending Action**. In practice, a recorded lis pendens puts all persons on *constructive notice* that the title or right to the possession of real estate is in litigation.

The purpose of recording a lis pendens is to preserve a person's rights to the real estate until the dispute with the owner is resolved. Thus, buyers who acquire an ownership interest in real estate after a lis pendens describing the property has been recorded take their interest in the property subject to someone else's (the claimant's) rights.

### Clouding the title with a notice

#### **lis pendens**

A notice recorded for the purpose of warning all persons that the title or right to possession of the described real property is in litigation.

Claiming an interest in title or the right to possession without a recorded *lis pendens* or physical possession of the real estate is risky. The owner may encumber or convey the property to another buyer, lender or tenant who, for lack of notice, is unaware someone else holds an interest in the property.

Consider a seller now several days into a sales escrow who discovers the sales price set by the purchase agreement they entered into with the buyer is 20% below the property's current market value.

Prior to closing, the seller receives a backup offer substantially above the sales price they are under contract to receive from the existing buyer. The seller enters into a purchase agreement with their back-up buyer, contingent on the cancellation of the purchase agreement and sales escrow with the existing buyer.

To frustrate the closing of the existing escrow and induce cancellation, the seller refuses to cooperate or perform any of the conditions required to close. However, the existing buyer on deciding to pursue closing the acquisition performs all the obligations necessary to close as scheduled.

The seller has no contingency provision or other justifiable excuse to cancel the purchase agreement and escrow instructions they entered into with the existing buyer. Nevertheless, the seller sends a **Notice of Cancellation** to escrow. Further, mutual cancellation instructions are prepared by escrow and forwarded to the buyer for signatures.

The buyer refuses to sign the cancellation instructions and demands the seller convey the real estate under the terms of their purchase agreement and escrow instructions. The seller refuses.

The buyer is concerned the seller will convey the real estate to the backup buyer, who might acquire an interest in the property superior to their prior right to buy it.

Does a legal mechanism exist for the buyer to notify all future buyers, lenders and tenants of the buyer's claim to ownership of the real estate before the seller conveys an interest in the property to them?

Yes! A *lis pendens* or *Notice of Pending Action*, when recorded, is notice from the buyer warning all prospective buyers, lessees or encumbrancers who might acquire an interest in the property that **title or possession** of the real estate described in the *lis pendens* is in dispute.<sup>1</sup>

In this example, the pending action noticed by the recorded *lis pendens* is the buyer's lawsuit for the specific performance of the purchase agreement they entered into with the seller.

Occasionally, another buyer or a lender acquires possession or a lien on the real estate before they become aware or are on notice of a dispute between

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<sup>1</sup> Calif. Code of Civil Procedure §405.2

the property owner and a prior buyer over title or possession. If so, the prior buyer loses their rights to acquire the property, to the extent the interest was conveyed to the other buyer or lender.

A lawsuit needs to *affect title or the right to possession of real estate* to support the recording of a *lis pendens*.<sup>2</sup>

## Title or possession to real estate

Lawsuits affecting title or possession of real estate include:

- *specific performance* of an unclosed transaction or rescission of a closed transaction;<sup>3</sup>
- *judicial foreclosure* of a trust deed lien by a lender;<sup>4</sup>
- foreclosure of a *mechanic's lien* by a construction contractor;<sup>5</sup>
- *cancellation of a grant deed* or other conveyance by a prior owner;
- *fraudulent conveyance* to be set aside as voidable by creditors;<sup>6</sup>
- *evictions* and suits concerning *unexpired leaseholds* brought by tenants or leasehold lenders;
- termination or establishment of an *easement* between neighboring property owners;<sup>7</sup>
- *government declaration* that a building is uninhabitable;
- *ejection* of an unlawful occupant other than a tenant from real estate by an owner;
- partition or sale of the real estate by a *co-owner*;
- *quiet title*;
- *eminent domain* actions;<sup>8</sup> and
- *divorce proceedings* involving real estate.

A *lis pendens* is also permitted in the following real estate actions:

- actions by *adverse possessors* to determine claims to title;<sup>9</sup>
- actions to re-establish *lost land records*;<sup>10</sup>
- actions to determine adverse interests in any liens or clouds on real estate arising out of *public improvement assessments*;<sup>11</sup>
- actions by purchasers or the state to *quiet title* to tax-deeded property;<sup>12</sup>
- actions by *innocent improvers* of real estate against owners or lenders of record;<sup>13</sup>

<sup>2</sup> CCP §405.20

<sup>3</sup> *Wilkins v. Oken* (1958) 157 CA2d 603

<sup>4</sup> *Bolton v. Logan* (1938) 30 CA2d 30

<sup>5</sup> Calif. Civil Code §8461

<sup>6</sup> *Hunting World, Incorporated v. Superior Court* (1994) 22 CA4th 67

<sup>7</sup> *Kendall-Brief Company v. Superior Court of Orange County* (1976) 60 CA3d 462

<sup>8</sup> CCP §1250.150

<sup>9</sup> CC §1007

<sup>10</sup> CCP §751.13

<sup>11</sup> CCP §801.5

<sup>12</sup> Calif. Revenue and Taxation Code §3956

<sup>13</sup> CC §1013.5(b)



### Lis pendens and out-of-state actions

*A buyer enters into a purchase agreement with a seller to acquire property located in California. Before the buyer completes the purchase, the seller hands them a notice of cancellation of the agreement. The buyer sues in an out-of-state court to require the seller to perform on the purchase agreement. A lis pendens is recorded in California giving public notice that the out-of-state action concerned the buyer's claim to an interest in the real estate.*

*The seller files an action to quiet title, claiming the lis pendens is void since a lis pendens cannot be recorded to give notice of a lawsuit filed in another state.*

*The buyer claims the lis pendens is valid since a lis pendens on litigation from another state is not prohibited by California law.*

*Here, the lis pendens is void. The right to record a lis pendens does not extend to lawsuits filed in other states since the action is not within the control of a California court. [The Formula Inc. v. Superior Court of Mono County (2008) 168 CA4th 1455]*

- actions on an *improvement bond*;<sup>14</sup> and
- actions *terminating or establishing an easement*, except for a public utility easement.<sup>15</sup>

### Improper use of a lis pendens

It is improper to record a lis pendens on:

- suits affecting title to *personal property* located on real estate;
- foreclosure on real estate by a *trustee's sale*;
- actions to *impress a trust* on personal property being recovered;
- actions to recover *attorney fees*;
- actions for *breach of a real estate contract* when only money losses are sought;
- actions for recovery of a *brokerage fee* on the sale or lease of property; and
- actions against a partner, member or stockholder co-owning real estate as a partnership, limited liability company (LLC) or a corporation.

For example, a creditor of an individual who is a member of an LLC sues the member personally, not the LLC. The creditor records a lis pendens describing the real estate vested in the name of the LLC. The member used the funds lent to them to fund their contribution to the LLC. However, the creditor's only claim is one for money owed by the member with no claim against the LLC itself.

Is the lis pendens properly recorded on the LLC's property?

No! The member holds no personal interest in the real estate the creditor can look to as security. The member's only relationship to the real estate is as a member of the LLC, a separate entity which holds title to the real estate. Further, the membership interest held by the member is personal property.<sup>16</sup>

<sup>14</sup> Calif. Streets and Highways Code §6619

<sup>15</sup> CCP §405.4(b)

<sup>16</sup> **North Coast Business Park v. Superior Court** (1984) 158 CA3d 858

Additionally, a creditor's suit against a corporate shareholder does not entitle the creditor to place a *lis pendens* on a corporation's real estate. A claim against the corporation does not exist even if the funds obtained by the shareholder's wrongful conduct can be traced to their contribution to the corporation.

The shareholder's interest is ownership of the stock they hold in the corporation, again, personal property. The real estate is owned exclusively by the corporation, an entity separate from its individual stockholders. Like the ownership interest of a member in an LLC or partnership, the interest of the shareholder in the corporation is personal property.<sup>17</sup>

Consider a county which repeals an ordinance designed to control the resale and possession of real estate for low-income buyers, affecting a large number of parcels. An individual files an action to invalidate the repeal and re-impose the county controls on these low-income designated parcels.

The individual also records a *lis pendens* describing all the properties in the county which might be affected by the possible outcome of the action even though none of the owners are named in the lawsuit.

Is the *lis pendens* proper notice to owners and buyers of a suit seeking to re-enact the county ordinance affecting an owner's right to sell their property?

No! The fact the action might affect title to the properties described in the *lis pendens* sometime in the future if the individual prevails on their invalidation claim is an insufficient basis for a *lis pendens*. The suit names none of the property owners as parties.<sup>18</sup>

When an individual fraudulently acquires funds from another person and the funds can be directly traced to the acquisition of their title to real estate, a *lis pendens* may be recorded in an action by the defrauded person to impose a **constructive trust** on real estate.

A *constructive trust* is an involuntary, court-created trust imposed on the ownership of property held by an owner who acquired it through:

- fraud (force, duress, undue influence, deceit or mistake);
- accident;
- the violation of a trust or agency relationship; or
- some other wrongful act.<sup>19</sup>

A constructive trust is imposed on the named title holder as a judicial remedy. The remedy establishes that a wrongdoer who holds title to property they did not properly acquire and are not entitled to own, now holds title to the property as an *involuntary trustee* for the benefit of the person entitled to the property.<sup>20</sup>

## Constructive trust on improperly acting vestee

### constructive trust

An involuntary, court-created trust imposed on the ownership of real estate held by an owner who acquired it through fraud or other wrongful action.

<sup>17</sup> *Wardley Development, Inc. v. Superior Court* (1989) 213 CA3d 391

<sup>18</sup> *Moseley v. Superior Court* (1986) 177 CA3d 672

<sup>19</sup> CC §2224

<sup>20</sup> CC §2224

However, a constructive trust is not created when real estate is merely **improved**, not purchased with fraudulently acquired money. The transfer of property by a court-imposed constructive trust on the vested owner in favor of an injured party is not appropriate. The owner fraudulently acquired funds to make improvements to the real estate, not to buy it, and the improvements are less than the overall value of the property.

An action seeking to impose a constructive trust on property improved by wrongfully acquired funds is essentially a creditor's action for the recovery of money. It is not sustainable unless it is a claim to ownership of real estate (title) acquired by those funds.<sup>21</sup>

## No trust for an unsecured loan

Consider an unsecured lender who seeks to impose a constructive trust on real estate the owner acquired with funds advanced by the lender.

The lender files a lawsuit and records a *lis pendens* against the property to recover the money owed, claiming the owner purchased the real estate by using the lender's funds.

The owner claims the *lis pendens* is invalid since the underlying dispute does not concern the lender's enforcement of an unrecorded interest they presently hold in the real estate, but only the recovery of funds legally acquired and used to purchase the real estate.

The lender claims the *lis pendens* is valid since the funds are directly traceable to the real estate, and the lender needs a constructive trust imposed on the property to avoid loss of the source of repayment.

Is the unsecured lender's *lis pendens* valid?

No! None of the claims the lender made against the owner of the real estate state are a claim to possession or an interest in title to the real estate. The lender sought a constructive trust on the property to have it sold and the sales proceeds used as a source of funds to repay the lender.<sup>22</sup>

In this example, the unsecured lender needed to seek and obtain a court ordered *attachment* of the property to properly enforce the collection of their claim. Better yet, the lender initially needed to obtain the owner's promise to secure the debt by the real estate they were buying, and then perfect the promise to secure the loan by receiving and recording a trust deed as a voluntary lien on the property.

## The lis pendens process

Before a *lis pendens* may be recorded, a copy of the notice needs to be mailed to:

- the known address of all persons adversely impacted by the action; and

<sup>21</sup> *Burger v. Superior Court of Santa Clara County* (1984) 151 CA3d 1013

<sup>22</sup> *Lewis v. Superior Court* (1994) 30 CA4th 1850

- the property owner's address, as shown in the county assessor's records.<sup>23</sup>

Proof of service needs to be provided when filing the lis pendens. Failure to properly serve notice can void a lis pendens.<sup>24</sup>

To record a lis pendens, the lis pendens needs to:

- **identify** the parties to the lawsuit; and
- give an adequate **description** of the real estate.<sup>25</sup>

The object of the lawsuit and its effect on title or possession of real estate does not need to be stated in the lis pendens. However, the objective of the lawsuit needs to be stated in the lis pendens for it to be considered an **absolutely privileged publication** and avoid slander of title and libel claims.<sup>26</sup>

*Editor's note — An absolute privilege covers any publication during a judicial proceeding which is authorized by law, including a lis pendens. A publication made under absolute privilege bars a slander of title action against the person wrongfully claiming an interest in the property.*

**absolutely  
privileged  
publication**

Any statement made as part of a legislative, judicial or other official proceeding authorized by law, barring a slander of title action.

A technical legal description of the property subject to litigation is not required as long as the property can be sufficiently identified.

For example, when a lis pendens is recorded describing a property as bounded by specific landmarks, such as a road, river, fence or surveyed line, but erroneously states the property's location within a parcel of land, the lis pendens is still valid.

Even though the lis pendens contains an error, the location of the property can be ascertained by the boundary description alone.<sup>27</sup>

However, the property's legal description based on metes and bounds, such as exists for a numbered lot in a recorded subdivision map, needs to be used to clarify the location of the property.

A lis pendens is recorded when it is **filed and indexed** in the county recorder's office of the county where the property is located.<sup>28</sup>

A county recorder's filing and indexing of a lis pendens constitutes constructive notice to all persons about the existence of a dispute over title or possession of a property. Any later conveyance of an interest in the property to a buyer, lender or tenant binds them to abide by the final resolution of the dispute.

Consider a buyer who enters into a purchase agreement and escrow instructions to acquire real estate from a seller. The seller then enters into a

## Notice by recording and indexing

<sup>23</sup> CCP §405.22

<sup>24</sup> *Carr v. Rosien* (2015) 238 CA4th 845

<sup>25</sup> CCP §405.20

<sup>26</sup> CC §47(b)(4)

<sup>27</sup> *McLean v. Baldwin* (1902) 136 C 565

<sup>28</sup> CCP §405.20

backup purchase agreement to sell the property to another buyer, contingent on the cancellation of the pre-existing purchase agreement and escrow instructions.

The seller unilaterally cancels the pre-existing purchase agreement and escrow instructions. The buyer files a lawsuit to enforce the purchase agreement and files a lis pendens describing the property. The lis pendens, while filed, is not immediately indexed by the recorder. Prior to indexing the lis pendens, the seller conveys the property to their new buyer.

The original buyer then seeks to enforce their purchase agreement with the seller against the new buyer, claiming the new buyer had constructive notice of the lis pendens when the new buyer acquired title since it was previously filed with the county recorder.

Does filing a document, such as a lis pendens, provide constructive notice to the new buyer of the lis pendens prior to it being indexed by the recorder?

No! The original buyer may not enforce the seller's purchase agreement against the new buyer of the property (who is a bona fide purchaser (BFP)) since a lis pendens, while it was filed, had not yet been indexed and thus does not constitute constructive notice to the new buyer.<sup>29</sup>

Until a county recorder indexes a document filed with their office, it cannot be found by a **title search**. Thus, it is unfair to impose constructive notice on a buyer who cannot be expected to locate the document.

## Title insurers and specific performance actions

### specific performance action

Litigation to compel  
performance of an  
agreement.

Title companies usually refuse to insure title when a lis pendens is recorded which involves a **specific performance action**. Without title insurance, buyers will not buy, lenders will not lend and tenants will not occupy the property.

However, a lis pendens in a buyer's *specific performance action* does not interfere with a title company insuring a lender's trust deed, which secures a debt in an amount less than the price the buyer will be paying for the property.<sup>30</sup>

As a result, property subject to specific performance actions by buyers is often rendered unmarketable while the lis pendens remains in effect.

The tremendous value of the lis pendens to litigating buyers is its ability to preserve the buyer's right to purchase the property. The recording of a lis pendens often persuades a breaching seller to perform.

Accordingly, the potential for *abuse* of the lis pendens procedure to cloud title of an owner's property is readily apparent.

<sup>29</sup> **Dyer v. Martinez** (2007) 147 CA4th 1240

<sup>30</sup> **Behniwal v. Mix** (2007) 147 CA4th 621

Further aggravating to an owner's hostility to the buyer is the rule that a recorded *lis pendens* identifying a court action which actually concerns title or right of possession to real estate is an absolutely privileged communication.<sup>31</sup>

A *lis pendens* is sometimes improperly used to tie up title to real estate when the claim is against the individual, not against an interest in their real estate.

Procedurally and for the initial cost of an attorney, a wrongfully recorded *lis pendens* can be removed quite quickly.<sup>32</sup>

Any time after a *lis pendens* has been recorded, anyone with an interest in the property affected may file a motion asking the court to remove the *lis pendens* from the record, called **expungement**.

An order *expunging* a *lis pendens* removes from title any restrictions sought to be imposed by the lawsuit on the transfer of the property.<sup>33</sup>

Once a *lis pendens* has been successfully expunged, the same person may not record another *lis pendens* against the property without the permission of the court.<sup>34</sup>

When the owner or any other person with an interest in the property contests a *lis pendens*, the opposing person who recorded the *lis pendens* and seeks to retain it needs to prove:

- the action affects title or the right of possession to the property described in the notice; and
- a valid claim exists on which they will *likely prevail* at trial.<sup>35</sup>

When these two requirements are not established, the *lis pendens* will be expunged and no longer affect title.

Banks and insurance companies frequently issue a **bond** which acts as a source of payment for a liability which may arise as the debt of another in the future. A *bond* for removing a *lis pendens* is a guarantee which assures payment of a debt the owner may become responsible to pay.

However, an owner seeking to expunge a *lis pendens* does not have to post a bond with the court as a requirement for the removal of a *lis pendens* when a valid claim to the real estate does not exist.<sup>36</sup>

Conversely, the person who recorded the *lis pendens* may be required to post a bond for the amount of money they claim they are due as a condition of maintaining the *lis pendens*.<sup>37</sup>

## Expungement of a *lis pendens*

### expungement

A court order removing from title to real estate the effect of a recorded *lis pendens* regarding litigation asserting a claim to title or possession of the property.

## Bonds in lieu of the real estate

### bond

Written evidence issued by an insurer or guarantor of its obligation to pay the debt of another on a default in a promised performance.

<sup>31</sup> CC §47(b)(4)

<sup>32</sup> CCP §§405.30 et seq.

<sup>33</sup> CCP §405.61

<sup>34</sup> CCP §405.36

<sup>35</sup> *Hunting World, Incorporated, supra*

<sup>36</sup> CCP §405.32

<sup>37</sup> CCP §405.34

## Case in Point

May a buyer record a second lis pendens after the original lis pendens has been expunged?

**Facts:** A buyer and seller enter into a purchase agreement for commercial property. A dispute arises over the buyer's obligation to deposit earnest money. The buyer and seller enter into arbitration and closing is postponed. The buyer petitions the court to enter judgment on the arbitration award and records a lis pendens clouding title to the property. The lis pendens is expunged and the buyer abandons the litigation. The buyer sues the seller in a separate lawsuit seeking to compel the seller to perform the purchase agreement, and records a second lis pendens. The seller seeks to invalidate the second lis pendens.

**Claim:** The seller claims the second lis pendens is improperly recorded and void since the first lis pendens was expunged and the second was filed by the same buyer on the same property without court authorization.

**Counterclaim:** The buyer claims the second lis pendens was properly recorded since the lis pendens only needs court authorization when the successive lis pendens is filed in the same litigation.

**Holding:** A California court of appeals holds the buyer improperly recorded a second lis pendens since the first lis pendens was expunged and the second, regardless of whether it was filed in the same litigation, was filed on the same property without court authorization. [*De Martini v. Superior Court* (2024) 98 CA5th 1269]

## Attorney fees with expungement

An owner who successfully defends their title by prevailing on a motion to expunge a claimant's lis pendens from the record is entitled to recover their attorney fees from the claimant, unless the claimant acted with justification.<sup>38</sup>

When a lis pendens is ordered expunged on a motion by the owner, the owner is considered the prevailing party for the purpose of recovering their attorney fees.

<sup>38</sup> CCP §405.38



## Chapter 31 Summary

The purpose of recording a lis pendens is to preserve a person's rights in a parcel of real estate until the dispute with the owner is resolved. A lawsuit needs to affect title or the right to possession of real estate to support the recording of a lis pendens.

The lis pendens needs to identify the parties to the lawsuit and give an adequate description of the real estate. Further, the objective of the lawsuit needs to be stated in the lis pendens for it to be considered an absolutely privileged publication and avoid slander of title and libel claims. The privilege bars a slander of title action against the person wrongfully claiming an interest in the property.

Before a lis pendens may be recorded, a copy of the notice needs to be mailed to:

- the known address of all persons adversely impacted by the action; and
- the property owner's address, as shown in the county assessor's records.

A lis pendens is considered recorded when it is both filed and indexed in the county recorder's office of the county where the real estate is located. The recording constitutes constructive notice to all persons about the existence of a dispute over title or possession of a property.

Title insurers usually refuse to insure title when a lis pendens is recorded involving a specific performance action. However, a lis pendens in a buyer's specific performance action does not interfere with a title company insuring a lender's trust deed.

After a lis pendens has been recorded, anyone with an interest in the property affected may file a motion asking the court to expunge the lis pendens. Expungement removes from title any restrictions sought to be imposed on title or to possession by the lawsuit.

<b>absolutely privileged publication.....</b>	<b>pg. 329</b>
<b>bond.....</b>	<b>pg. 331</b>
<b>constructive trust .....</b>	<b>pg. 327</b>
<b>expungement.....</b>	<b>pg. 331</b>
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## Chapter 31 Key Terms

**Quiz 12 Covering Chapters 29-31 is located on page 452.**

*Notes:*

# Chapter 32



## Liens against individuals

After reading this chapter, you will be able to:

- use a limited liability company (LLC) as a shield to allow real estate vested in the LLC to remain undisturbed by creditors of a member; and
- understand what the creditor of an individual LLC member achieves when they enforce a money judgment against the debtor member's ownership interest in the LLC.

**buyout provision**

**charging order**

**fraudulent conveyance**

**money judgment**

### Learning Objectives

### Key Terms

Consider a broker/owner of a high volume real estate office. The broker, acting as the designated officer for their brokerage corporation, employs several sales agents and has continuous awareness of real estate entering the market for sale. The broker manages the office and sales agents, and periodically meets with clients handled by agents. The broker occasionally acquires property as a principal for their own account.

Due to the business activities of the sales agents employed by the broker, the broker has some liability exposure for the professional errors and misconduct of the broker's agents. Even though the broker has incorporated their real estate brokerage and has **errors and omissions (E&O)** insurance coverage, their role as the *designated officer* exposes the broker to liability. The broker bears responsibility for the constant supervision of the sales agents employed by their corporation and as manager meeting with some of the clients.

The broker is cognizant of the need to personally maintain a low financial profile to avoid the appearance of a "deep pocket," which might itself trigger

### Vesting to shield assets from others

litigation. As a result, the broker vests all the real estate they personally acquire in **limited liability companies (LLCs)** the broker creates by filing an LLC-1 form with the Secretary of State.

The broker's *conflicting ownership interest* between their brokerage office and any acquisitions or sales handled in the office on behalf of the broker's LLC vestings is fully disclosed to any seller or buyer with whom the broker or their sales agents have contact. [See **RPI** Form 527]

Later, one of the broker's sales agents commits an error. The broker is faced with a potentially dangerous lawsuit arising out of the sales agent's misconduct while acting on behalf of the brokerage corporation, unrelated to any of the broker's conduct or personal real estate acquisitions.

#### money judgment

An award for money issued by a court resulting from a lawsuit for payment of a claim.

The broker needs assurance the pending litigation, which seeks a **money judgment** against the broker personally, will not interfere with the ability to manage, sell or lease the real estate vested in the broker's LLC.

Will a *money judgment* or recorded abstract of judgment against an individual member who is an owner of an LLC interfere with the real estate vested in the LLC?

No! Only the broker's ownership interest in the LLC can eventually be affected.

Further, their broker's interest as owner of the LLC is **personal property**. Thus, any liens or judgments against the broker do not affect the real estate vested in the LLC.<sup>1</sup>

## Interest in the LLC

An individual who is a member of an LLC has no interest in the real estate owned by the LLC. A member's ownership interest in the LLC is thus classified as *personal property*.<sup>2</sup>

While a member has no interest in any LLC property, the member is entitled to their share of the LLC's:

- operating income;
- sales proceeds; and
- assets in the event the LLC is dissolved.<sup>3</sup>

## Creditors, judgments and liens

A member in an LLC may have an *outstanding debt* they owe due to:

- a money judgment (e.g., lawsuit liability); or
- a local, state or federal tax lien.

<sup>1</sup> Calif. Corporations Code §17705.01

<sup>2</sup> Corp C §17300

<sup>3</sup> Corp C § 17707.05

Once recorded, these money judgments and tax liens automatically attach to any real estate **interests vested** in the individual's name or the name of a trust they have established to hold title. Remember, a trust is not an entity and is not separate from the beneficiary who retains the rights of ownership.

However, a money judgment against an LLC member which does not also name the LLC entity as a judgment debtor can only be satisfied by foreclosing on the member's *ownership interest* in the LLC, not the real estate owned by the LLC.<sup>4</sup>

Thus, an LLC entity remains unaffected by a lawsuit against an individual member. The LLC, as a separate entity, carries on its normal business activities without interference from a member's creditor seeking to enforce its collection rights under a judgment.

Through a money judgment against a member in an LLC, a creditor may attach the member's fractional **ownership interest** in the LLC to satisfy the judgment. The attachment procedure involves the use of a judicial device called a **charging order**.<sup>5</sup>

To process a *charging order*, the creditor needs to first locate the LLC interests held by the judgment debtor. The creditor generally obtains this knowledge by discovery activities overseen by the court. When assets are located, the creditor applies to the court for an order to charge (place a lien on) the ownership interest in the LLC held by the individual member for payment of the judgment.<sup>6</sup>

Notice of the hearing on the charging order is given to the debtor member and all other members of the LLC.<sup>7</sup>

A creditor of an individual member has two options when enforcing a money judgment:

- have a **receiver** appointed to collect the debtor member's share of the income and profits generated by operations of the property vested in the name of the LLC; or
- **foreclose** under the charging order lien and have the member's interest in the LLC sold.<sup>8</sup>

Under a charging order lien, the appointment of a receiver is limited to their accepting the benefit of the individual member's interest in the LLC. The creditor acquires no greater rights than the debtor member had under the LLC *Articles of Organization* or the LLC *operating agreement*.<sup>9</sup> [See **RPI** Form 372]

A creditor with a judgment has the judicial means only to go after the **economic interest** of the debtor member. However, the reality of obtaining

## Charging orders to attach a share

### charging order

An attachment device used by a creditor to place a lien on the ownership interest in a limited liability company (LLC) held by the individual member for the payment of a money judgment, and either appoint a receiver to hold the debtor member's share or foreclose on the member's interest in the LLC.

<sup>4</sup> Calif. Code of Civil Procedure §708.310

<sup>5</sup> CCP §708.310

<sup>6</sup> Corp C §17302

<sup>7</sup> CCP §708.320

<sup>8</sup> Corp C §17302

<sup>9</sup> Corp C §17705.02

an individual member's interest is often more of a hassle than it is worth. The interest the creditor obtains on acquiring the debtor member's ownership is a nonvoting interest. The creditor is prohibited from any interference with LLC activities requiring a vote. Thus, the creditor assumes no duty or liability owed to the LLC or its other members.

Further, the LLC operating agreement typically provides for removal of the debtor member from the LLC when a charging order against the debtor member's interest and the member does not have it removed immediately. [See **RPI** Form 372 §6.2(d)]

## Buyout provisions triggered

### buyout provision

A provision in a limited liability company (LLC) operating agreement which, on termination of a member's interest, grants the remaining members the right to buy out the terminated member's interest in the LLC or dissolve the LLC. [See **RPI** Form 372 §7]

One or all of the members in an LLC may terminate a debtor member's interest in the LLC on the notice of a charging order without causing the LLC to be dissolved and the property sold. This right is granted in the LLC operating agreement on terms of the **buyout provisions**. [See **RPI** Form 372 §7]

On termination of a member's interest by a triggering event such as a charging order, the remaining members may buy the terminated member's entire interest in the LLC. Where more than one member exercises their option, those exercising will purchase their pro rata share based on their aggregate ownership interest. [See **RPI** Form 372 §7.1(b)]

*Buyout provisions* in an LLC agreement between members are the most common method used for the elimination of a debtor member and their judgment creditor. Additionally, the terms of buyout provisions are usually advantageous to the remaining members. [See **RPI** Form 372 §7]

## Fraudulent conveyances by debtors

### fraudulent conveyance

A property transfer made for the purpose of avoiding creditors without receiving fair value on the transfer which is voidable.

The transfer of property by an owner of real estate to *evade a creditor* is considered fraudulent when:

- the owner **intends to defraud** their creditors;<sup>10</sup> and
- a reasonably **equivalent value** is not received by the owner in exchange for the property transferred, and the owner is or will be insolvent (i.e., debts exceed assets) on the transfer.<sup>11</sup>

The **fraudulent conveyance** of a property may be invalidated.<sup>12</sup>

However, when the full value or a reasonably equivalent value is received by an owner for a transfer, the transaction cannot be invalidated. The creditor is then left to chase down and attach the proceeds received by the owner (debtor).

## Fraudulent conveyance without fair value

Consider an LLC consisting of three members. Later, a judgment is obtained by a creditor against two of the members of the LLC.

A creditor obtains a *charging order* against the members' individual interests in the LLC. All three members receive notice of the proceedings.

<sup>10</sup> Calif. Civil Code §3439.04(a)(1)

<sup>11</sup> CC §3439.05

<sup>12</sup> CC §§3439 et seq.

Prior to the enforcement of the charging order, the members dissolve the LLC. The two debtor members each transfer their ownership interest for a minimal sum to the third member, who is unnamed in the judgment.

Here, the transfer is fraudulent since the third member was on notice of the charging order and did not pay a fair value for the transfer. When a transfer by an owner of an interest is made without a fair exchange of value to a “buyer” who knows the transfer diminishes the creditor’s claim, the “buyer” becomes liable for the creditor’s losses.<sup>13</sup>

Thus, the fraudulent conveyance of a debtor’s “wealth” beyond the reach of a creditor is subject to disciplinary action from the court.

The use of an LLC to hold real estate assets was neither designed nor intended to be employed as a place to hide an individual’s personal wealth from creditors. Rather, use of an LLC is a means to allow real estate vested in the LLC to remain *undisturbed* in the face of an individual member’s financial adversity, and vice versa.

## The LLC asset shield

Consider an owner of real estate who transfers title to the property into an LLC they created. The owner receives a percentage or all of the ownership interests in the LLC as a member for the conveyance — fair value for the transfer since they became an owner/member of the LLC which now owns the real estate.

In this instance, the conveyance is not fraudulent. The owner has merely exchanged their interest in the real estate for an interest in the LLC of equal value. Full value is received and no tax liability is incurred on this tax-free exchange.<sup>14</sup>

In essence, the owner has substituted their real estate vesting for a position in the LLC. The owner still owns a value equal to the equity in the real estate they transferred, only in a different form. Thus, the value of the owner’s interest was not diminished; they received an equivalent value for the property. The nature of the owner’s ownership interest merely changes from one of *real property* to one of *personal property*.

However, this simple change in vesting inherently makes it more difficult for creditors to locate and attach the debtor’s assets. The individual owner (debtor) on a recorded abstract of judgment is not the vested owner of any real estate.

Further, the change in vesting makes the real estate, now the asset of an LLC, much more difficult for the creditor to reach due to:

- the charging order process;
- nonvoting status if they do foreclose; and
- the subject of buyout provisions in the LLC operating agreement.

<sup>13</sup> *Taylor v. S & M Lamp Co.* (1961) 190 CA2d 700

<sup>14</sup> 26 United States Code §721



As the creditor attempts to locate and attach the debtor's assets, the LLC is able to continue its business of renting, selling or encumbering the property. On attaching the member's interest via a charging order or appointment of a receiver, the LLC distributes income proceeds to the judgment debtor. On foreclosure, the debtor becomes a nonvoting member in the LLC.

## Chapter 32 Summary

The use of a limited liability company (LLC) to hold real estate assets was neither designed nor intended to be employed as a place to hide an individual's personal wealth from creditors. Rather, use of an LLC is a means to allow real estate vested in the LLC to remain undisturbed in the face of an individual member's financial adversity, and vice versa.

A member in an LLC may have an outstanding debt they owe due to a money judgment or a local, state, or federal tax lien. Through a money judgment against a member in an LLC, a creditor may attach the member's fractional ownership interest in the LLC to satisfy the judgment.

The attachment procedure involves the use of a judicial device called a charging order. Once recorded, these money judgments and tax liens automatically attach to any real estate interests vested in the individual's name or the name of a trust they have established to hold title.

A money judgment against an LLC member which does not also name the LLC entity as a judgment debtor can only be satisfied by foreclosing on the member's ownership interest in the LLC, not the real estate owned by the LLC. Thus, an LLC entity remains unaffected by a lawsuit against an individual member.

A creditor of an individual member has two options when enforcing a money judgment:

- have a receiver appointed to collect the debtor member's share of the income and profits generated by operations of the property vested in the name of the LLC; or
- foreclose under the charging order lien and have the member's interest in the LLC sold.

A creditor with a judgment has the judicial means only to go after a member's economic interest of the debtor member. The interest the creditor obtains from the debtor member is a nonvoting interest, which prohibits interference with the LLC activities requiring a vote.

One or all of the members in an LLC may terminate a debtor member's interest in the LLC on the notice of a charging order without causing the LLC to be dissolved and the property sold. Upon the termination of

a member's interest, the remaining members may buy the terminated member's entire interest in the LLC. Buyout provisions in a LLC agreement between members

<b>buyout provision .....</b>	<b>pg. 338</b>
<b>charging order .....</b>	<b>pg. 337</b>
<b>fraudulent conveyance .....</b>	<b>pg. 338</b>
<b>money judgment .....</b>	<b>pg. 336</b>

## Chapter 32 Key Terms

**Quiz 13 Covering Chapters 32-34 is located on page 453.**

*Notes:*



# Automatic and declared homesteads



## Chapter 33

After reading this chapter, you will be able to:

- advise a homeowner whether they qualify to voluntarily sell and protect the equity in their residence from creditor seizure;
- differentiate between an automatic homestead and a recorded declaration of homestead and the protections afforded under each;
- determine the specified dollar amounts of net equity homestead protection available; and
- understand the components of a recorded homestead declaration.

**abstract of judgment**

**automatic homestead**

**declaration of homestead**

**quiet title**

### Learning Objectives

### Key Terms

A homeowner is sued by a creditor for money owed on an unsecured debt. A money judgment is awarded to the creditor who becomes a *judgment creditor*. The homeowner becomes a *judgment debtor*.

An **abstract of judgment** is recorded by the judgment creditor in the county where the homeowner's residence is located.

Can the homeowner prevent the recorded abstract from attaching as a lien against the title to their home?

No! However, the type of homestead the homeowner claims and the amount of the homestead exemption they qualify for determine the homeowner's ability to:

- **voluntarily sell** the home and buy another home with the homestead amount they have in equity; or

### Homestead by type and amount

#### **abstract of judgment**

A condensed written summary of the essential holdings of a court judgment.

- bar the judgment creditor from **forcing a sale** of the home to satisfy the judgment.

## Protected equity

### declaration of homestead

A document signed by a homeowner and filed with the county recorder's office to shield the owner-occupant's homestead equity from seizure by creditors. [See **RPI** Form 465]

### automatic homestead

The dollar amount of equity in a homeowner's principal dwelling the homeowner is automatically qualified to exempt from creditor seizure. Also known as a statutory homestead exemption.

A homestead is the dollar amount of equity in a homeowner's dwelling the homeowner qualifies to exempt from creditor seizure. The dollar amount of the homestead held by the homeowner in the equity in their home has priority on title over most judgment liens and state government liens.

Two types of *homestead* procedures are available to California homeowners:

- the **declaration of homestead**, which is recorded;<sup>1</sup> and
- the **automatic homestead**, also called a *statutory homestead exemption*, which is not recorded.<sup>2</sup>

Both homestead procedures provide Californians with the same dollar amount of home-equity protection. However, a homeowner needs to record a declaration of homestead to receive all the benefits available under the homestead laws. These benefits allow homeowners the right to sell their home, receive the net sales proceeds up to the dollar amount of the homestead and reinvest the funds in another home. [See Form 465 accompanying this chapter]

Neither the declared nor the automatic homestead interferes with:

- **voluntary liens** previously or later placed on title to the property by the homeowner, such as trust deeds;
- **involuntary liens** given priority to the homestead exemption under public policy legislation; or
- the homeowner's credit ratings or title conditions.

Some *involuntary liens* and encumbrances are given priority to the amount of the homestead exemption by statute. Liens with priority are enforced as senior, including:

- mechanic's (contractor's) and vendor's (seller's) liens;
- homeowners' association (HOA) assessments;
- judgments for alimony or child support;
- real estate property taxes; and
- Internal Revenue Service (IRS) liens.

Involuntary liens subordinate and junior to the homestead amount include:

- Franchise Tax Board (FTB) personal income tax liens;
- Medi-Cal liens; and
- judgment creditor's liens.

<sup>1</sup> Calif. Code of Civil Procedure §704.920

<sup>2</sup> CCP §704.720

An *automatic homestead* is always available on the principal dwelling occupied by the homeowner or their spouse when:

- a judgment creditor's abstract is recorded against the homeowner and attaches as a lien on the property; and
- the occupancy by the homeowner continues until a court determines the dwelling is a homestead.<sup>3</sup>

The *automatic homestead exemption* applies to the equity in:

- a real estate dwelling (and its outbuildings);
- a mobilehome;
- a condominium;
- a planned development;
- a stock cooperative;
- a community apartment project together with the land it rests on; or
- a houseboat or other waterborne vessel used as a dwelling.<sup>4</sup>

Conversely, a *recorded declaration of homestead* applies only to real estate dwellings. Thus, mobilehomes not established as real estate on the property tax records and houseboats are protected only by the automatic homestead, not a recorded declaration of homestead since it applies to real estate.

As long as the homeowner claiming the exemption uses the homesteaded property as the **principal residence** for themselves and their family, the type of real estate qualifying for a homestead includes such properties as:

- two five-room flats;<sup>5</sup>
- an 18-unit apartment building where the owner occupies only one unit;<sup>6</sup> and
- 523 acres of rural land with a house and water rights for the land.<sup>7</sup>

Consider a creditor who obtains a money judgment and records an abstract which places a lien on title to the judgment debtor's residence. The debtor vacates the residence and leases the property to a tenant. The debtor files a petition for bankruptcy protection claiming an automatic homestead exemption. A month following their petition, the tenant vacates and the debtor moves back into the residence.

Can a debtor claim an automatic homestead exemption when they are not occupying the property as their principal residence when they file the bankruptcy petition?

No! The debtor's equity in the residential property is not protected by an automatic homestead exemption since the debtor's absence was not temporary as the debtor showed no intent to move back before the date of the bankruptcy petition.<sup>8</sup>

## Automatic and declared homesteads

## Real estate to be homesteaded

<sup>3</sup> CCP §704.710(c)

<sup>4</sup> CCP §704.710(a)

<sup>5</sup> *Viotti v. Giomi* (1964) 230 CA2d 730

<sup>6</sup> *Phelps v. Loop* (1944) 64 CA2d 332

<sup>7</sup> *Payne v. Cummings* (1905) 146 C 426

<sup>8</sup> *In re: Bhangoo* (9th Cir. BAP 2021) 634 BR 80

## Case in Point

May an individual in bankruptcy claim an automatic homestead exemption on real estate they occupy when title is vested in an LLC co-owned by the individual and their spouse?

**Facts:** A creditor obtains a money judgment against an individual. The individual occupies real estate as their personal residence which property is vested in a limited liability company (LLC) co-owned by the individual and their spouse as their alter-ego. The individual files a petition for bankruptcy protection and claims an automatic homestead exemption to protect their interest in the residential property vested in the LLC.

**Claim:** The individual claims they are entitled to an automatic homestead exemption since they occupy the property as their personal residence and the LLC which owns the property is their alter ego.

**Counterclaim:** The creditor claims the individual is not entitled to an automatic homestead exemption since the LLC owned the property and the individual's interest in the LLC is personal property which cannot be a homestead.

**Holding:** A United States bankruptcy appeals court holds the individual as a debtor under a bankruptcy petition may not claim an automatic homestead exemption since the individual's ownership interest in the LLC is personal property and cannot be the subject of a homestead exemption. [*In re Schaefer*s (9th Cir. BAP 2020) 623 BR 777]

## Amount of equity protected

The dollar amount of home equity protection a homeowner qualifies to preserve is the same under either the automatic homestead or a recorded declaration of homestead.

Homeowners qualify for a net equity homestead protection of a minimum of \$300,000 or the median sale price for a single-family home in your county in the calendar year prior to the year in which you claim exemption, not to exceed \$600,000 (adjusted annually for inflation).

Both spouses of a married couple may be the declared homestead owners in the same homestead declaration when both spouses own an interest in the property.<sup>9</sup>

However, a couple's combined homestead exemption may not exceed the exemption limit for a head of household.

When spouses separate but one continues to live in the homesteaded real estate, the other spouse not living in the homestead continues to be shielded from credit seizure under the homestead exemption, until the community property is legally divided.<sup>10</sup>

## Abstract avoids increased homestead amounts

The dollar amount of homestead exemptions is periodically increased to keep up with consumer price inflation (not property price inflation). A homeowner who has recorded a declaration of homestead does not need to record a new declaration to avail themselves to the increased amounts. The increased homestead exemption amounts apply to the old declaration.

<sup>9</sup> CCP §704.930(a)(1)

<sup>10</sup> CCP §704.720(d)



The **recorded homestead declaration** includes:

- the name of the homeowner declaring the homestead;
- a description of the property homesteaded; and
- a statement that the declared homestead is the principal dwelling in which the homeowner resides on the date the homestead is recorded. [Calif. Code of Civil Procedure §704.930(a); see Form 465 accompanying this chapter]

The declaration needs to be signed, notarized, and recorded to take effect. [CCP §704.930]

The homestead declaration may be **signed and recorded** by any one of several individuals, including:

- the owner of the homestead;
- the owner's spouse; or
- the guardian, conservator, or a person otherwise authorized to act for the owner or the owner's spouse, such as an attorney-in-fact. [CCP §704.930(b)]

An individual's personal residence vested in the name of a revocable inter vivos (living) trust, or other type of title holding arrangement established for the benefit of the homeowner, may also be declared a homestead by anyone who has an interest in the property and resides there. [*Fisch, Spiegler, Ginsburg & Ladner v. Appel* (1992) 10 CA4th 1810]

Additionally, a declaration of homestead in no way restricts the homeowner's ability to voluntarily sell, convey or encumber their homesteaded residence. [CCP §704.940]

A recorded homestead declaration does not appear in credit reports or impact the homeowner's credit reputation or ability to borrow funds. Title companies disregard recorded homestead declarations, except in litigation guarantee policies.

Declaring a  
homestead  
as asset  
preservation

Similarly, when an involuntary lien is recorded prior to an increase in the exemption amount, the amount of equity protected from the attachment is the increased homestead amount available. This applies whether the homeowner is claiming an automatic or declared homestead.<sup>11</sup>

Thus, inflation or appreciation in the value of the residence may eventually create a home equity large enough to exceed the homestead amount and provide some recovery for a judgment creditor.<sup>12</sup>

A judgment creditor with a recorded abstract of judgment lien who wants to foreclose always needs to petition a court for authorization to sell a homesteaded property and collect on a money judgment. The court then determines whether the owner's *net sales equity* in their home is a dollar amount greater than the amount of the owner's homestead exemption. If it is, the creditor may proceed to judicial foreclosure on their judgment lien by an **execution sale**.<sup>13</sup>

**Combating  
a creditor's  
attempt to  
sell the home**

<sup>11</sup> *Barclay v. Boskoski* (9th Cir. 2022) 52 F4d 1172

<sup>12</sup> *Berhanu v. Metzger* (1992) 12 CA4th 445

<sup>13</sup> CCP §704.740(a)

## Case in Point

May a co-owner of a home in bankruptcy claim an automatic homestead exemption when they are not occupying the property?

**Facts:** An unmarried couple purchases a home and vest title as co-owners. They later separate. One co-owner vacates the property and contributes nothing to the maintenance, insurance and property taxes while using a new address for driver's license and voting records. The non-occupying co-owner, experiencing financial difficulties, files for bankruptcy protection and seeks an automatic homestead exemption for the co-ownership interest, stating they intend to move back into the home once the other co-owner vacates. The bankruptcy trustee objects to the homestead exemption filing.

**Claim:** The non-occupying co-owner claims they qualify for the automatic homestead exemption since they intend to move back into the home when the occupying co-owner vacates.

**Counterclaim:** The bankruptcy trustee claims the co-owner does not qualify for the homestead exemption since they offer no evidence they intend to retake possession of the property.

**Holding:** A federal appeals court for the 9th district covering California holds the non-occupying co-owner does not qualify for automatic homestead exemption in bankruptcy since no evidence exists supporting the non-occupying co-owner's intent to re-occupy the property. [*In re Mckee* (9th Cir. 2024) 90 F4d 1244]

For example, the head of a household owes \$325,000 on trust deed loans encumbering their home. An unsecured creditor is awarded a money judgment against the homeowner and an abstract is recorded, attaching as a lien on title to the property.

Before the creditor can begin judicial proceedings against the equity in the home to collect on the judgment from the net proceeds of its sale, the home needs a **net value** in excess of \$425,000 — the \$325,000 owed on the existing trust deeds plus the homestead exemption.

A home with a net equity less than the homestead amount (after transactional costs of a sale) leaves nothing for the creditor to sell and apply to the debt owed under the judgment.

## Forced sale by court order only

A creditor may force the sale of a homesteaded dwelling when a net equity exists beyond the amount of the homestead the homeowner holds in the property. To force the sale of a homeowner's dwelling, the creditor needs to first **file an application** for a judicially ordered sale, called an *execution sale*, stating under oath:

- a description of the property;
- whether a declared homestead has been recorded on the property;
- the names of the person or persons who claim the homestead;
- the amount of the homestead; and
- the dollar amounts of all liens and encumbrances recorded on the property and the names and addresses of the lienholders.<sup>14</sup>

<sup>14</sup> CCP §704.760

When a creditor challenges the validity of a recorded declaration of homestead, it is the creditor who needs to prove the property does not qualify for a homestead.

However, when the homeowner has not recorded a declaration of homestead on the property, they need to prove their residency in the dwelling qualifies the property for the automatic homestead exemption.<sup>15</sup>

When the court orders an execution sale of the property and the bids received at the sale are insufficient to satisfy the senior liens, the homestead amount and the sales costs, the dwelling will not be ordered sold.<sup>16</sup>

Additionally, a winning bid needs to exceed 90% of the **fair market value (FMV)** of the property as set by the court.<sup>17</sup>

A real estate appraiser is often appointed by the court as a *reference* to assist in determining the FMV of the dwelling. Compensation for the appraiser may not exceed comparable fees for similar services in the community.<sup>18</sup>

When the dwelling is jointly owned by the judgment debtor and another person as joint tenants or tenants in common, only the judgment debtor's interest in the property is sold.<sup>19</sup>

The proceeds from an execution sale of the dwelling are disbursed in the following order:

- pay all senior liens and encumbrances on the property;
- disburse the amount of the homestead equity to the homeowner;
- cover the costs of the sale;
- pay the judgment creditor's court costs; and
- pay the amount due to the creditor from the judgment.<sup>20</sup>

Any remaining proceeds from an execution sale go to the homeowner.

Consider a homeowner who records a declaration of homestead on their principal residence encumbered by a trust deed. A creditor is later awarded a money judgment against the homeowner and records an abstract of judgment.

The homeowner then records a second trust deed on the residence to secure another loan for an amount less than the dollar amount of their homestead exemption.

The homeowner defaults on the first trust deed loan and the first trust deed holder forecloses on the residence. The residence is sold at a trustee's sale on a bid in excess of the amount owed to the first trust deed holder.

**“Drawing  
down” the  
homestead  
amount**

<sup>15</sup> CCP §704.780(a)(1)

<sup>16</sup> CCP §704.800(a)

<sup>17</sup> CCP §704.800(b)

<sup>18</sup> CCP §704.780(d)

<sup>19</sup> CCP §704.820(a)

<sup>20</sup> CCP §704.850

## Form 465

## Declaration of Homestead

Page 1 of 2

<p style="text-align: center;">RECORDING REQUESTED BY</p>  <p style="text-align: center;">AND WHEN RECORDED MAIL TO</p> <p style="text-align: center;">┌                      ┐</p> <p>Name _____</p> <p>Street _____</p> <p>Address _____</p> <p>City &amp; State _____</p> <p style="text-align: center;">└                      ┘</p>	<p style="text-align: right;"><i>SPACE ABOVE THIS LINE FOR RECORDER'S USE</i></p>
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### DECLARATION OF HOMESTEAD

**NOTE:** This form is used by a homeowner when as the owner of their principal residence they seek protection of the equity in the property from creditors, to declare and record their monetary homestead interest in the property.

**DATE:** \_\_\_\_\_, 20\_\_\_\_\_, at \_\_\_\_\_, California.  
*Items left blank or unchecked are not applicable.*

1. The name of the owner or owners of the real estate subject to this declared homestead  
 \_\_\_\_\_  
(Enter the name of the individual entitled to the Homestead Exemption)
  
2. The declared homestead regards real estate situated in the City of \_\_\_\_\_,  
 County of \_\_\_\_\_, California, referred to as:

- 2.1 The property is more commonly referred to as:  
 \_\_\_\_\_  
(Enter the street address and the city)

The judgment lien creditor claims they are entitled to the excess funds since the judgment lien is prior in time to the later recorded second trust deed.

The second trust deed holder claims they are entitled to the remaining funds since the second trust deed lien is a voluntary encumbrance on the homeowner's equity protected by the homestead exemption, which entitles them to be paid from funds due the homeowner under the recorded declaration of homestead exemption.

Is the second trust deed holder entitled to the excess funds?

Yes! The second trust deed holder is entitled to payment from the funds remaining after satisfaction of the first trust deed debt since:

----- PAGE 2 OF 2 — FORM 465 -----

3. The declared homestead is the principal dwelling and is now resided in as the residence of:

- ☐ A declared owner of the homestead;
- ☐ The declared owners of the homestead; or
- ☐ The spouse of the declared owner of the homestead.

4. I execute this declaration of homestead as:

- ☐ a declared homestead owner.
- ☐ the spouse of the declared homestead owner.
- ☐ the guardian or conservator of the person or estate of the:
  - ☐ declared homestead owner; or
  - ☐ spouse of the declared homestead owner.
- ☐ an attorney in fact for the:
  - ☐ declared homestead owner; or
  - ☐ spouse of the declared homestead owner.

4.1 As a guardian, conservator or attorney in fact acting on behalf of the declared homestead owner or the spouse of the declared homestead owner, I am authorized to execute this declaration under the authority vested in me by \_\_\_\_\_.

(Enter identification of the source of your authority)

5. The facts stated above are known to me to be true as of my own personal knowledge.

Date: \_\_\_\_\_, 20\_\_\_\_.

(Print name) (Signature)

Date: \_\_\_\_\_, 20\_\_\_\_.

(Print name) (Signature)

A notary public or other officer completing this certificate verifies only the identity of the individual who signed the document to which this certificate is attached, and not the truthfulness, accuracy, or validity of that document.

STATE OF CALIFORNIA  
COUNTY OF \_\_\_\_\_

On \_\_\_\_\_ before me, \_\_\_\_\_

(Name and title of officer)

personally appeared \_\_\_\_\_

who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

(This area for official notarial seal)

Signature: \_\_\_\_\_

(Signature of notary public)

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Form 465

Declaration of  
Homestead

Page 2 of 2

- the dollar amount of the homestead exemption held by the owner and created by their recorded declaration was **voluntarily encumbered** by the second trust deed lien; and
- the judgment creditor's lien is subordinate to the recorded declaration of homestead exemption.<sup>21</sup>

A creditor may be permitted by the court to force the sale of the debtor's home. If so, the dollar amount of the homestead received by the homeowner on the sale is protected from the creditor's attachment during a **six-month reinvestment period** following the sale.

<sup>21</sup> *Smith v. James A. Merrill, Inc.* (1998) 64 CA4th 94

**Automatic  
homestead is  
a shield**

Further, an automatic homestead exemption is provided on the replacement residence to protect the reinvested funds.<sup>22</sup>

However, when the replacement home acquired is in the same county where the judgment lien is recorded, the lien attaches to the new residence (subject to the owner's homestead exemption) the instant title is transferred into the homeowner's name.

Further, a homeowner who decides to *voluntarily sell* their residence when title is subject to a creditor's lien may not use the automatic homestead exemption to protect the sales proceeds from being taken by the judgment creditor.

In contrast, a *declaration of homestead* recorded prior to the recording of the judgment lien allows the homeowner to voluntarily sell their home and first withdraw their homestead amount from the net sales proceeds before the judgment creditor receives any funds.

Unlike a declared homestead, the homeowner claiming only an automatic homestead exemption may not use a *quiet title* action to remove the lien and sell the home. When an insufficient net equity exists barring the judgment creditor from forcing a sale of the home, the homeowner is unable to sell without dealing with the judgment creditor, as though in a short sale.

## The exemption in bankruptcy sales

For an individual who files a bankruptcy petition, any sale of the individual's home during the bankruptcy, whether voluntary or court ordered, is considered a **forced sale**. Thus, a bankruptcy petitioner who voluntarily sells their home (even if the sale is against the bankruptcy court's order) is entitled to an automatic homestead exemption on the proceeds of the sale.<sup>23</sup>

Consider a homeowner whose home is in foreclosure under a lender's first trust deed. A judgment creditor holds a recorded judgment lien junior to the trust deed lien. The homeowner did not record a declaration of homestead prior to the recording of the judgment lien.

At the trustee's sale, a bid in excess of the loan leaves funds to be disbursed to junior lienholders or the homeowner.

Here, the automatic homestead exemption does not protect the homeowner's equity which exists above the trust deed foreclosed lien. A foreclosure under a power-of-sale provision in a trust deed is a **voluntary sale** agreed to by the owner, not a forced sale by a judgment creditor.

The homeowner whose home is lost to foreclosure exposes any excess proceeds from the trustee's sale to the creditor's lien, unless the homeowner records a declaration of homestead prior to the creditor recording their abstract of judgment.<sup>24</sup>

<sup>22</sup> CCP §704.720(b)

<sup>23</sup> *In re Reed* (9th Cir. 1991) 940 F2d 1317

<sup>24</sup> *Spencer v. Lowery* (1991) 235 CA3d 1636

*Editor's note — A homeowner in foreclosure will receive their automatic homestead exemption if they file a bankruptcy petition before the foreclosure is completed. In a bankruptcy proceeding, all sales are considered forced sales. Through bankruptcy, the dollar amount of the equity covered by the automatic homestead exemption is protected from the claims of involuntary creditors.*<sup>25</sup>

Additionally, the creditor holding a judgment lien (a recorded abstract of judgment) simply waits until the equity in the home increases due to inflation, appreciation or loan reduction. Once the value of the home exceeds the amount of the homestead exemption, the creditor may then begin a forced sale.

Thus, the homeowner who relies solely on the automatic homestead exemption to protect their equity is imprisoned in their own home unless they file a bankruptcy petition, since they cannot voluntarily sell and avoid the judgment lien.

In contrast to an automatic homestead exemption, a *recorded declaration of homestead* coupled with a quiet title action allows the homeowner to remove **judgment liens** attached to their title.

Also, judgment liens do not attach to the exempt homestead amount in the equity under a declared homestead when the homestead declaration is recorded prior to the recording of the creditor's abstract of judgment.<sup>26</sup>

Judgment liens do, however, attach to any equity exceeding the amount of the declared homestead exemption and all liens and encumbrances on the property at the time the abstract of judgment is recorded.<sup>27</sup>

It takes a creditor several months of litigation to obtain and record an abstract of judgment. In contrast, a declaration of homestead may be prepared and recorded by the homeowner on readily available forms in a matter of hours. Thus, the issue of priority of the recorded declaration over a later recorded judgment creditor lien is accomplished by the prudent homeowner. [See Form 465]

Once recorded, a declaration of homestead lasts until:

- the homestead owner records a declaration of **abandonment** of the homestead; or
- the homestead owner records a **new declaration** of homestead on another residence.<sup>28</sup>

When a homeowner decides to sell their home which is subject to a declared homestead when title to their home has become clouded with a creditor's lien, the homeowner may either:

**Declared  
homestead  
allows the  
owner to sell**

<sup>25</sup> In re Reed, *supra*

<sup>26</sup> CCP §704.950(a)

<sup>27</sup> CCP §704.950(c)

<sup>28</sup> CCP §§704.980, 704.990



- negotiate a release of the lien with the creditor [See Chapter 30]; or
- clear title to the home through a quiet title action based on the priority of their declaration of homestead. [See Chapter 36]

## Clearing title of a lien

### quiet title

A court action to remove a cloud and establish title to a property.

A **quiet title** action determines the priorities of the creditor's lien and the recorded homestead on title. When the homeowner demonstrates the homestead declaration is valid and was recorded prior to the creditor's lien, the title will be cleared of the lien, provided the equity in the property does not exceed the homestead amount.<sup>29</sup>

Judgment creditors junior to a declared homestead where no excess equity exists soon realize their futility in litigation. Thus, they are generally receptive to a negotiated release. Consequently, the homeowner can usually "buy" a partial (or full) release from the creditor — typically for less than the costs of a *quiet title* action. [See **RPI** Form 409]

After title is cleared and the homeowner sells their property, they have *six months* to reinvest the homestead proceeds in another home. When the proceeds are reinvested in a new residence within six months, the new residence may then be declared a homestead by recording a new homestead declaration.

When the homeowner records a new homestead declaration on their replacement residence, the recording *relates back* to the time the prior homestead was recorded. This leaves no gap for the creditor's lien to gain priority over the homestead declaration on the new residence.<sup>30</sup>

However, when the homeowner does not invest the proceeds of the sale in a new homestead within six months, and the proceeds are still in the State of California, the exempt proceeds from the sale may be attached by the judgment creditor.

An alternative to vesting title in the judgment debtor's name is to use a title holding arrangement, such as a corporation or limited liability company (LLC) created by the homeowner to hold title. Thus, the abstract of judgment against the homeowner will not automatically attach to the title held by these entities.

## The homestead exemption and CIDs

Consider a prospective buyer of residential unit in a common interest development (CID). When entering into the purchase agreement, the buyer agrees to the CID association's covenants, conditions and restrictions (CC&Rs). The CC&Rs include a clause limiting the owner's ability to claim a homestead exemption senior to any judgment obtained by the association.

The buyer, now an owner, fails to pay the association's assessment fees, and the association obtains a money judgment against the owner for the unpaid assessment. The association claims the CC&Rs bar the homestead exemption from taking a senior position ahead of the association's judgment.

<sup>29</sup> Viotti, *supra*

<sup>30</sup> CCP §704.960

Is the waiver of the homestead exemption enforceable?

No! As a matter of long-standing public policy, a waiver of a homestead is unenforceable. Since the CID's money judgment is an **involuntary lien**, it does not have priority over the homestead exemption.

However, a *foreclosure by a trustee's sale* on an assessment lien for delinquent assessments recorded by the association in lieu of the alternative money judgment is considered a **voluntary lien**, agreed to in the CC&Rs and always senior to the owner's homestead exemption.<sup>31</sup>

<sup>31</sup> CCP §703.010(b)

A homestead is the dollar amount of equity in a homeowner's dwelling the homeowner qualifies to exempt from creditor seizure. Two types of homestead procedures are available to California homeowners: the automatic homestead and the declaration of homestead.

Homeowners qualify for a net equity homestead protection of \$300,000 or the median sale price for a single-family home in your county in the calendar year prior to the year in which you claim exemption, not to exceed \$600,000 (adjusted annually for inflation) with either type of homestead.

The dollar amount of the homestead held by the homeowner has priority on title over most judgment liens and state government liens.

A creditor may be permitted by the court to force the sale of the debtor's home. If so, the dollar amount of the homestead received by the homeowner on the sale is protected from the creditor's attachment during a six-month reinvestment period following the sale.

However, a homeowner needs to record a declaration of homestead to receive all the benefits available under the homestead laws. In contrast to an automatic homestead exemption, a recorded declaration of homestead coupled with a quiet title action allows the homeowner to remove judgment liens attached to their title. A declaration of homestead allows homeowners to voluntarily sell their home, receive the net sales proceeds up to the dollar amount of the homestead and reinvest the funds in another home.

Once recorded, a declaration of homestead lasts until the homestead owner records a declaration of abandonment of the homestead or the homestead owner records a new declaration of homestead on another residence.

## Chapter 33 Summary

## Chapter 33

### Key Terms

abstract of judgment .....	pg. 343
automatic homestead.....	pg. 344
declaration of homestead .....	pg. 344
quiet title .....	pg. 354

**Quiz 13 Covering Chapters 32-34 is located on page 453.**



# Slander of title

## Chapter 34

After reading this chapter, you will be able to:

- identify statements and conduct which constitute slander of title against a person's interest in real estate; and
- determine whether a statement bars a slander of title action due to conditional or absolute privilege.

**absolutely privileged publication**

**conditionally privileged publication**  
**slander of title**

### Learning Objectives

### Key Terms

**Slander of title** refers to both **slander** and **libel**. Any interest in real estate can be harmed or damaged by:

- false oral statements, called *slander*; or
- false written statements, called *libel*.<sup>1</sup>

For a person to be liable for *slander of title* based on their comments about another person's interest in a parcel of real estate, the oral or written statement needs to:

- be published;
- be untrue and disparaging to the owner's property interest;
- be made without privilege; and
- cause money losses.<sup>2</sup>

A real estate interest is *slandered* when a person:

- makes an unprivileged false statement about a real estate interest;

### False statements, oral or written

#### **slander of title**

False and malicious statements disparaging an owner's title to property resulting in money losses to the owner.

<sup>1</sup> Restatement of the Law Second, Torts §624

<sup>2</sup> Rest.2d Torts §624

- the statement brings into question the right or title to the interest, called *disparagement*; and
- the statement causes the owner of the real estate interest to lose money.

A false statement consists of writings, words or conduct communicated to another — the *publication* — which adversely affects the desirability of a **marketable interest** in real estate.

## Harmed by slander

For example, a business owner places their business on the market for sale. The lease on the premises occupied by the business owner is assignable without prohibition or restriction.

The lease contains an option to renew or extend the lease. The option needs to be exercised to assure potential buyers the business may remain in possession of the premises since the location contributes to the goodwill value of the business.

However, the landlord informs the business owner they expect the business owner to vacate the property when the original term of the lease expires. Regardless, the business owner timely exercises the option to renew/extend the lease.

A buyer for the business is located and escrow is opened. The landlord contacts the buyer and orally advises them that the business owner's attempt to exercise the renewal option was ineffective. The landlord threatens to sue and physically retake possession of the premises when the buyer accepts an assignment of the lease and occupies the premises.

The landlord's oral statements cause the buyer to cancel the purchase agreement and escrow. Thus, the business owner lost the monies from the sale. Further, the landlord continues to interfere with the business owner's marketing of the business, making a sale of the business virtually impossible by causing the value of the leasehold interest to be uncertain.

Has the landlord slandered title to the business owner's leasehold interest in the real estate occupied by the business?

Yes! The landlord's *oral misrepresentations* about the validity of the exercise of the renewal option are a publication made to a buyer who acted on the information to the financial detriment of the business owner. Thus, the landlord is liable to the business owner for the loss in the value of the leasehold caused by the disparaging remarks made to the prospective buyer.<sup>3</sup>

Examples of written publications constituting slander of title include:

- forging a trust deed which is recorded as a lien on real estate;<sup>4</sup> and
- conveying real estate by a deed without holding a claim to title.<sup>5</sup>

<sup>3</sup> **Baker v. Kale** (1947) 83 CA2d 89

<sup>4</sup> **Forte v. Nolfi** (1972) 25 CA3d 656

<sup>5</sup> **Cavin Memorial Corporation v. Requa** (1970) 5 CA3d 345

## Real estate interests open to slander

Slander of title applies to any *marketable interest* in real estate which is assignable, transferable or capable of being sold. A real estate interest includes the fee simple, a leasehold, an easement and covenants, conditions and restrictions (CC&Rs) — not just the vested title.<sup>6</sup>

For example, an owner and their neighbor own adjacent parcels of real estate.

While negotiating the sale to the owner and the neighbor, the previous owner of the two adjacent parcels set a common western boundary line for each of the parcels, agreed to by the owner and the neighbor.

However, the western boundary lines set in the deeds conveying ownership to the owner and neighbor are several dozen feet short of the common western boundary line set by the previous owner and agreed to by the owner and the neighbor. The portion of the property outside the previously agreed-to boundary is effectively excepted from the conveyance.

The owner constructs a residence on their parcel, encroaching on the portion excepted from the parcel they acquired.

The neighbor has also openly used their parcel and the excepted portion for over five years, paying all property taxes on the exception from the parcel they own.

However, the neighbor does not file a judicial action to establish record title to the excepted portion of their parcel.

The owner whose residence encroaches on the excepted portion from their parcel lists their parcel for sale.

The owner's broker contacts the neighbor who claims they own the exception to their parcel by adverse possession.

The broker contacts the prior owner who holds title to the exceptions and arranges for the sale of the exceptions. The broker locates a buyer who acquires the owner's parcel and both exceptions.

After closing, the neighbor seeks money losses from the broker for slander of title regarding ownership of the excepted portion they have been occupying. Further, the neighbor files an adverse possession action against the buyer to quiet title to the excepted portion.

The broker claims they did not slander the neighbor's title since a claim of adverse possession is not a property interest which can be slandered.

Can the broker slander title which is to be perfected by adverse possession?

No! The broker cannot be held liable for slander of title since they arranged the sale of the property as reflected by its recorded title. The neighbor did not hold legal title to the exception from title to their parcel at the time of the broker's actions. The neighbor needs to first file and complete a judicial proceeding to **establish record title** by adverse possession before they hold an interest to be slandered.

<sup>6</sup> Rest.2d Torts §624

An owner may bring a slander of title action to protect the **marketability** of their title for a potential sale of property. Title not yet perfected by an adverse possession action is not marketable until judicial proceedings establish title against the record owner.

The broker did not interfere with the neighbor's ability to sell the excepted portion they claim to own since the neighbor did not have marketable title to the property when the broker sold it.<sup>7</sup>

## Privileged statements are not slander

### conditionally privileged publication

Documents relating to a lawsuit or dispute over a right or interest in real estate made in good faith and without malice, barring a slander of title action.

### absolutely privileged publication

Any statement made as part of a legislative, judicial or other official proceeding authorized by law, barring a slander of title action.

A statement made about a real estate interest as part of a *privileged publication* does not subject the person making the statements to liability for slander of title.

Two types of privileges exist:

- **conditional privilege**; and
- **absolute privilege**.

A *conditional privilege* is a defense used by the person to defeat an owner's claim that they made a statement which slandered the owner's title. A statement made to another person about an owner's interest is a communication legally called a *publication*.

To be a privileged publication and thus avoid liability, the statement about an owner's interest in a parcel of real estate needs to be made without malice toward the owner of the interest.<sup>8</sup>

A conditionally privileged communication includes the content of a lawsuit filed in good faith, or a dispute over a right or interest in real estate, such as a claim of ownership by way of a prescriptive easement.

The malice required to impose liability as a breach of good faith when making a statement about an ownership interest can be:

- *actual*; or
- *implied*.

**Actual malice**, also called *malice in fact*, exists when a statement adverse to an owner's interest is made solely for the purpose of causing harm to the owner.

While the existence of malice is essential for the owner to overcome the defense of a conditional privilege, the elevated level of *actual malice* is not required for the owner to prove their title has been slandered. The lower level of **implied malice** will suffice.

*Implied malice*, also called *malice in law*, is determined by the conduct of the person making a disparaging statement as evidence they are not acting in good faith. Here, malice is inferred from the actions of an individual who is attempting to establish an invalid claim against an owner's title.

<sup>7</sup> **Howard v. Schaniel** (1980) 113 CA3d 256

<sup>8</sup> Calif. Civil Code §47(c)



Thus, when the individual who slanders title is able to show their statement was made in good faith and they honestly believed their **claim of title** to be valid, then the individual cannot be held liable for slander of title when they fail to prove their claim and do not prevail.

For example, an owner executes a note in favor of a private lender secured by a trust deed on the owner's real estate. Later, a bank makes the owner a loan secured by a trust deed on the same property. The title insurance company erroneously insures the priority of the bank's trust deed as senior to the private lender's trust deed.

Later, the private lender attempts to foreclose as the senior lienholder. A dispute in priority between the private lender and the bank ensues. The private lender's trust deed is held to be senior to the bank's trust deed.

The private lender initiates a slander of title action against the title company. The private lender seeks to collect their out-of-pocket money losses for the delay in foreclosure and decline in value of the secured property caused by the uncertainty of their trust deed's priority resulting from the erroneous priorities stated in the title insurance policy issued to the bank.

The private lender is unable to show the title company acted maliciously towards the private lender when they issued the title policy.

Is the title insurance company liable to the private lender for slander of title?

No! The title insurance company's policy issued to the bank is *conditionally privileged*. The private lender cannot prove malice toward them exists on the part of the title company based on the erroneous priority of trust deeds in the policy of title insurance.

Additionally, a title insurance policy does not constitute a publication. A title insurance policy is not an **abstract of title** and does not warrant that conditions or defects in title do not exist. Under a title insurance policy, the title company only assumes the risk of the insured mortgage lender's money losses due to an undisclosed defect in title or error – the prior trust deed.<sup>9</sup>

A publication classified as an *absolute privilege* bars a slander of title action, even when an individual makes the publication with actual malice.

A communication protected as an absolute privilege is any statement made as part of a legislative, judicial or other *official proceeding* authorized by law.<sup>10</sup>

For example, an unsecured lender brings an action to impose a lien on property to recover money owed by the owner. The lender records a **lis pendens** referencing the action which clouds title to the owner's property.

## Absolute privilege

<sup>9</sup> *Smith v. Commonwealth Land Title Insurance Company* (1986) 177 CA3d 625

<sup>10</sup> CC §47(b)

The lender does not prevail in the action and the owner's title is cleared of the lis pendens. The owner then files a slander of title action seeking to recover money losses they incurred due to the lender's recording of the lis pendens.

The lender claims the recordation of the lis pendens is absolutely privileged, barring the owner from any recovery in a slander of title action.

The owner claims the lis pendens is not absolutely privileged since it was not made in a **judicial proceeding**, such as pleadings and communications of the judge, parties, witnesses, etc.

Is the recording of the lis pendens absolutely privileged?

Yes! A recorded lis pendens which identifies a court action concerning adverse claims — against title or right of possession to the owner's real estate — is an absolutely privileged publication.<sup>11</sup>

To be a properly recorded lis pendens, the recorded statement needs to identify all parties to the lawsuit and give an adequate description of the real estate. The object of the lawsuit, whether for title or possession, does not need to be stated in the lis pendens.<sup>12</sup> [See Chapter 31]

Absolute privilege applies to any publication required by law in the course of a judicial proceeding to achieve the objectives of a final judgment in the litigation. This includes publications made outside the courtroom, such as a lis pendens.<sup>13</sup>

Additionally, papers filed during court proceedings are absolutely privileged from a slander of title action. Absolute privilege applies to the recording of a lis pendens since its use is authorized to give constructive notice of a claim against property asserted in pending litigation.<sup>14</sup>

## Loss of privilege for lis pendens

However, a lis pendens loses its status as absolutely privileged when the litigation referenced fails to state a **claim to title or possession** of the real estate described in the lis pendens.

For example, a buyer bids and acquires a property at a sheriff's sale in a judicial foreclosure on a money judgment awarded to an unsecured creditor in a debt collection action. The buyer intends to renovate and sell the property at a profit.

The prior owner who was wiped out by the sheriff's sale appeals the money judgment and records a lis pendens against the property. The lis pendens references the debt collection lawsuit which resulted in the sheriff's sale. The lis pendens prevents the buyer from selling the property for three years, during which time it drops in value.

<sup>11</sup> CC §47(b)(4)

<sup>12</sup> Calif. Code of Civil Procedure §405.20

<sup>13</sup> CC §47(b)

<sup>14</sup> **Albertson v. Raboff** (1956) 46 Cal2d 375

The buyer seeks to recover their loss of value from the prior owner, claiming they were prevented from selling the property since the lis pendens slandered title to the property. The prior owner claims a slander of title did not occur since the recording of the lis pendens was absolutely privileged.

Is the recording of the lis pendens absolutely privileged when the money judgment is on appeal?

No! Here the buyer is able to recover their money losses caused by the recorded lis pendens. The lis pendens referenced an action for the collection of an unsecured debt, a lawsuit with no claim against the *title or possession* of the property, only to the creditor's entitlement to a money judgment for a debt owed. Thus, the lis pendens was improper and lost its status as absolutely privileged.<sup>15</sup>

*Editor's note — The remedy for an improperly recorded lis pendens is to have the lis pendens expunged as lacking a real estate claim or evidence to support a real estate claim, collect damages caused by the recording of the lis pendens or proceed with a malicious prosecution action.*<sup>16</sup>

Consider a creditor who is awarded a judgment against an individual, called a judgment debtor. Later, the judgment debtor marries an individual who is the vested owner of real estate.

After the marriage, the creditor records a **writ of execution** issued by the court as a levy on all real estate vested in the owner's name, even though it is not vested in the debtor's name. The levy attaches as a lien on the owner's separate property.

The owner locates a ready, willing and able buyer who enters into an agreement to purchase the property. However, the buyer refuses to complete the transaction when they (and their title insurer) learn of the creditor's levy. The property's marketability and equity value drops as a result of the creditor's levy.

The property owner demands the creditor's levy under the writ of execution be removed, informing the creditor:

- the judgment debtor, who is the owner's spouse, does not have an interest in the property; and
- the property owner is not a party to the action creating the judgment.

The creditor refuses to remove the lien, claiming married individuals are responsible for each other's debts.

The property owner sues the creditor for slander of title to collect their money losses caused by the creditor's levy, claiming the lien was improperly placed on their real estate.

## Wrongful levy issued by a court

<sup>15</sup> *Palmer v. Zaklana* (2003) 109 CA4th 1367

<sup>16</sup> CCP §405.30; Calif. Penal Code §1447

The creditor claims the recording of the writ of execution (the levy) is an absolutely privileged publication, performed as part of a judicial proceeding.

Is the court ordered levy a privileged publication?

No! The levy on the property under the writ of execution was not obtained in good faith by the creditor. The creditor held no honest belief the judgment debtor had an interest in the property of the owner. Thus, the creditor is liable for the owner's out-of-pocket money losses caused by their slander of the owner's title resulting from the recording of a levy in the name of the owner, a person against whom the creditor had no judgment.<sup>17</sup>

### Money losses due to slander of title

To impose liability, an individual's slanderous statements about title or possession do not need to be made for the purpose of directly influencing another person's conduct.

The individual making a disparaging statement is liable for an owner's losses when it is *reasonably foreseeable* others will act in reliance on their statement and cause the owner to suffer out-of-pocket money losses.<sup>18</sup>

However, when the owner does not suffer out-of-pocket money losses due to the disparaging remarks, no basis exists for a claim of slander of title since the owner lost nothing to be recovered.

For example, a buyer and seller enter into a purchase agreement and open escrow. A neighboring owner the buyer contacts makes statements to the buyer concerning a possible defect in the property's soil condition.

The seller assures the buyer the neighbor's statements are untrue, and the buyer closes escrow. The seller incurs no money losses as a result of the neighbor's statements, only aggravation and lost time.

Later, the seller claims the neighbor's statements slandered their title.

However, the seller has no claim against the neighbor for slander of title. The neighbor's statements, while erroneous, did not prevent the sale of the property at its full market value and the seller did not suffer any out-of-pocket money losses.<sup>19</sup>

However, it is possible for an individual's statements to cause an owner to lose money, even when a sale is not involved.

For example, the money losses recoverable by an owner or tenant for slander of title include:

- money losses which are a direct result of another person's statement, including any decrease in the market value of the real estate caused by the slanderous statement;<sup>20</sup> and

<sup>17</sup> **Gudger v. Manton** (1943) 21 C2d 537

<sup>18</sup> Rest.2d Torts §623A, Comment b

<sup>19</sup> **Burkett v. Griffith** (1891) 90 C 532

<sup>20</sup> Rest.2d Torts §633(1)(a)

- expenses incurred by the owner to remove any doubt caused by the slanderous statement, including the costs of litigation.<sup>21</sup>

When an owner is able to show an individual made the slanderous statement with actual malice, the owner may recover **punitive** amounts of money from the individual slandering the owner's title.<sup>22</sup>

For example, to improve their residence, an owner intends to remove an existing privacy fence constructed by the prior owner and relocate it on the boundary line, which is located six feet into what the neighbor now uses as part of their backyard. Both the owner and the neighbor are aware the fence is for privacy purposes and was not built to establish an agreed-to boundary.

Further, an existing utility pole needs to be relocated to the boundary line which is also the center of an **easement** held by the utility company. The owner takes out their building permits to relocate the fence and the utility company is requested to move the pole.

The neighbor is notified of the owner's construction plans to relocate:

- the privacy fence to the boundary line; and
- the utility pole to the center of the utility easement.

The neighbor does not want the fence or the utility pole to be moved and intends to prevent the construction by asserting a boundary line dispute. The neighbor notifies the owner and the utility company in writing that they consider the privacy fence to be the property's agreed-to boundary line — a statement the neighbor knows is false.

The utility company refuses to proceed with the relocation of the utility pole until the dispute with the neighbor over the boundary line is resolved. As a result of the neighbor's actions, construction is delayed and the owner's construction costs to improve their residence increase.

The owner sues the neighbor to establish the fence as a privacy fence and not an agreed-to boundary fence. The owner also makes a demand on the neighbor for payment of increased construction costs, claiming they are the result of the neighbor slandering their title and delaying the construction of the improvements.

Has the neighbor slandered the owner's real estate title?

Yes! The neighbor made statements about the owner's real estate which the neighbor knew to be false, causing the owner to lose money and **incur expenses**. The neighbor knew the privacy fence was not the agreed-to boundary yet tried to enforce it as the boundary line by interfering with the construction. Thus, the neighbor is liable for:

- the owner's increased construction costs; and

## Punitive amounts for known falsehoods

<sup>21</sup> Rest.2d Torts §633(1)(b)

<sup>22</sup> CC §3294

- punitive amounts of money for slandering the owner's title.<sup>23</sup>

*Editor's note — When the neighbor files an action to dispute the boundary line instead of making the comments to the owner and the utility company, the neighbor still slanders the title. Any lawsuit the neighbor initiates is not absolutely privileged since it is not brought in good faith to protect their interest in another's property.*

<sup>23</sup> **Appel v. Burman** (1984) 159 CA3d 1209

## Chapter 34 Summary

Any interest in real estate can be harmed or damaged by false oral statements, called slander, or false written statements, called libel. For a person to be liable for slander of title based on their comments about another person's interest in a parcel of real estate, the oral or written statement needs to:

- be published;
- be untrue and disparaging to the owner's property interest;
- be made without privilege; and
- cause money losses.

A real estate interest is slandered when a person:

- makes an unprivileged false statement about a real estate interest;
- the statement brings into question the right or title to the interest, called disparagement; and
- the statement causes the owner of the real estate interest to lose money.

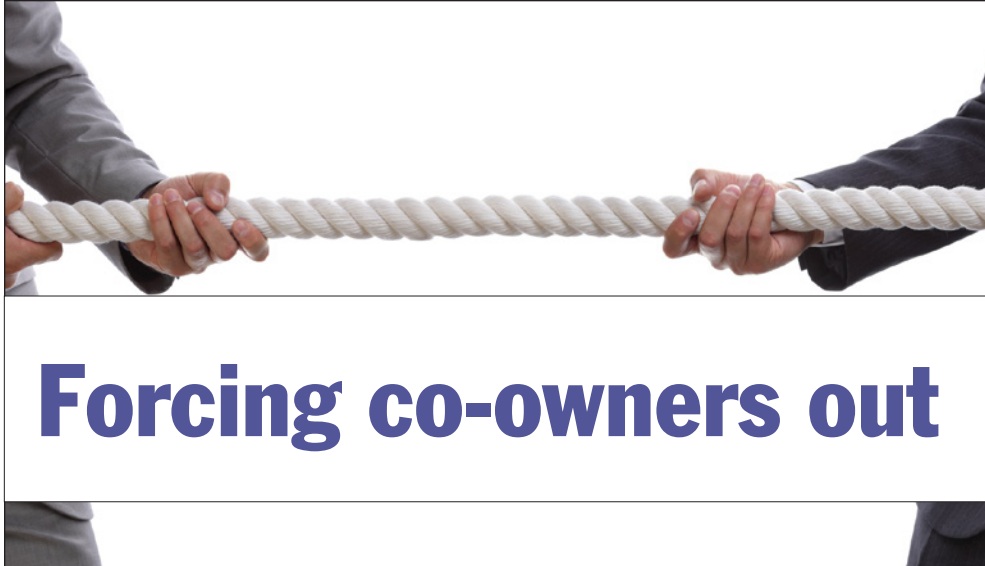
A false statement consists of writings, words or conduct communicated to another — the publication — which adversely affects the desirability of a marketable interest in real estate. Slander of title applies to any marketable interest in real estate which is assignable, transferable or capable of being sold.

A statement made about a real estate interest as part of a privileged publication does not subject the person making the statements to liability for slander of title.

## Chapter 34 Key Terms

<b>absolutely privileged publication.....</b>	<b>pg. 360</b>
<b>conditionally privileged publication .....</b>	<b>pg. 360</b>
<b>slander of title .....</b>	<b>pg. 357</b>

**Quiz 13 Covering Chapters 32-34 is located on page 453.**



## Chapter 35

# Forcing co-owners out

After reading this chapter, you will be able to:

- discuss the use of a partition action to resolve disputes between co-owners of real estate;
- determine whether a sale or division of real estate is the most practical outcome in a partition action; and
- better understand the need for a limited liability company (LLC) vesting for co-owners other than spouses, to keep disputes from affecting title and operations of a property.

**distribution in kind**  
**partition action**

**referee**

## Learning Objectives

## Key Terms

On the death of both parents, the surviving children receive real estate vested in their names as co-owners. One child is selected to manage the property on behalf of all the children.

Soon, the children disagree on the ownership and management of the inherited property. One child, concerned about their personal liability exposure from ownership, wants the property to be sold and the proceeds distributed based on each child's percentage of co-ownership.

Another child wants to subdivide the real estate and eliminate the co-ownership by conveying the separate parcels to one another. Each child is then the sole owner and manager of their separately divided ownership of their parcel.

Yet another child is willing to cash out the other family members and acquire ownership of the entire property themselves.

## Divide, sell or buy out



Thus, no arrangement meets the individual goals of each child vested as a co-owner.

Can any one of the co-owners force a termination of the co-ownership since they no longer agree on the ownership and management of their real estate?

#### partition action

Court proceedings by which co-owners seek to sever their joint ownership and parcel or sell a property.

Yes! A **partition action** severs co-ownership of real estate by either:

- dividing the property into parcels and *distributing it in kind* among the co-owners, when feasible;<sup>1</sup> or
- *selling the property and distributing* the net sales proceeds to the co-owners according to their percentage of ownership.<sup>2</sup>

By filing a *partition action*, the co-owner wanting to be cashed out directly achieves their goal by a sale of the property now or on a division of the properties by a later sale of the parcel they receive. Also, the co-owner wanting to buy out the other co-owners achieves their goal by bidding on the property at the court ordered sale, unless the property is partitioned. When partitioned, the third co-owner directly obtains their ownership goal.

## The quieting of quarreling co-owners

A partition action is a lawsuit to **sever** or **sell** real estate which is co-owned.<sup>3</sup>

The need for a partition action arises when co-owners cannot agree on the management, division or sale of the real estate they jointly own. Co-owners may mutually agree to divide the real estate in a **voluntary partition** or sell it under voting provisions in written co-ownership agreements.

Conversely, a partition action will force an **involuntary division or sale** of the real estate.

## Who can file a partition action

A partition action is an *equitable* remedy which has its roots in English common law, called **chancery**. The court of equity — chancery — has great discretion in deciding what is the best resolution for feuding co-owners.

While partition and distribution of the property is the preferred equitable result, not all forms of co-ownership or types of property allow for a partition to terminate a co-ownership.

**Unmarried co-owners** vested as joint tenants or tenants in common have an absolute right to partition (or sell) the real estate owned.<sup>4</sup>

A partition action is available to unmarried joint tenants or tenants in common who hold title in their individual names. They may have acquired title by mutual decision among themselves or by *operation of law*, such as a distribution under a will or trust.

<sup>1</sup> Calif. Code of Civil Procedure §§873.210 et seq.

<sup>2</sup> CCP §§873.510 et seq.

<sup>3</sup> CCP §872.020

<sup>4</sup> **Lazzarevich v. Lazzarevich** (1952) 39 C2d 48

For example, a lender originates a mortgage secured by the fractional interest of a co-owner in real estate. The co-owner defaults on the mortgage. The lender forecloses and becomes a tenant in common with the other co-owner of the property. Here, the lender acquires a fractional ownership interest in the real estate, not the entire ownership.

May the lender, as a fractional owner, sue the co-owner for partition or sale of the real estate simply to liquidate and recover their original investment in the loan?

Yes! The lender, now owning an **undivided fractional interest** in the real estate, may sue for partition or sale to complete the liquidation of their initial security interest in the property.<sup>5</sup>

Spouses owning property with title vested as community property are not entitled to sue for partition of the real estate as it is a community asset.<sup>6</sup>

Further, real estate acquired as joint tenants during the marriage is presumed to be community property.<sup>7</sup>

However, real estate vested in a joint tenancy by a married couple might be separate property, when they rebut the community property presumption by either:

- a statement in the deed noting the real estate is not community property; or
- a separate written agreement stating the real estate is not community property.<sup>8</sup>

Disputes between spouses to sever community property interests in real estate are handled as part of divorce proceedings, called a **dissolution**. Consequently, the termination of a co-ownership of community real estate is subject to offsets and payment of monies to equal out the distribution of all assets of the community on *dissolution*.

Consider a couple who acquires real estate in a joint tenancy vesting as single or unmarried individuals before they are married.

The couple marries but does not alter the joint tenancy vesting nor enter into a written agreement transmuting the ownership into community property. Later, the couple divorces and cannot agree on the division or sale of the real estate.

Is the real estate community property?

## Spousal co-ownerships

<sup>5</sup> **Kane v. Huntley Financial** (1983) 146 CA3d 1092

<sup>6</sup> CCP §872.210(b)

<sup>7</sup> Calif. Family Code §2581

<sup>8</sup> Fam C §2581

No! Their ownership of the property is vested as joint tenants without a reference to their status as spouses. They were not married when they acquired title, and they did not later alter the vesting by a writing (deed) to transmute their separate interests to community property.<sup>9</sup>

Are the joint tenancy interests acquired before marriage severed by a partition action rather than by divorce proceedings?

Yes! Spouses who vest title as joint tenants are entitled to a partition action when their co-ownership is held in a joint tenancy (or tenancy in common) vesting and they rebut the presumption of community property by showing their interests are separate property.<sup>10</sup>

## Co-owners as partners

Consider co-owners who acquire real estate and vest title in the name of a **limited liability company (LLC)**, each owning a fractional interest in the LLC as members. The LLC holds title to ownership of the real estate, not the individual members.

When the members agree to end their co-ownership, they mutually terminate their relationship by dissolving the LLC and an accounting of the LLC's assets.

Generally, the accounting provides for the LLC's **assets** to be sold, not partitioned and distributed to members. Thus, the sale proceeds are distributed to the members. However, members may agree in the LLC operating agreement to a distribution of the LLC property to the individual members as a manner of returning their capital contributions. The distribution is called a **distribution in kind**.

### distribution in kind

Distribution of a limited liability company's (LLC's) real estate on dissolution to members as a return of their capital contributions.

In another example, several members in an LLC sign an operating agreement to own and operate several parcels of land as a farm. Under the agreement, a member may resign and call for a conveyance of separate parcels to each individual member, which one member does.

Another member claims an LLC may not distribute property it owns to the members *in kind*, but needs to sell the properties and distribute the proceeds pro rata, based on the percentage of ownership each member has in the LLC.

May dissolution of an LLC be completed by the division of the LLC real estate between the members as opposed to only a cash distribution?

Yes! While the general rule requires the sale of LLC assets and the net sales proceeds to be distributed, the members may enforce an agreement to divide or partition the real estate.<sup>11</sup>

Additionally, a court may dissolve an LLC and distribute its assets in kind whenever the distribution is fair and does not impair the payment of LLC debts.<sup>12</sup>

<sup>9</sup> *In re Marriage of Leversee* (1984) 156 CA3d 891

<sup>10</sup> CCP §872.210(b)

<sup>11</sup> *Logoluso v. Logoluso* (1965) 233 CA2d 523

<sup>12</sup> CCP §872.730

For example, four investors enter into an LLC operating agreement to buy and operate a hotel. Title to the hotel is vested in the name of the LLC. The LLC agreement does not reference the division of the property on a dissolution of the LLC.

One of the members resigns and the LLC is dissolved. The remaining members demand the LLC's real estate be partitioned and distributed in kind.

Is a partition of the LLC assets proper in this case?

No! In this instance, there is only one LLC asset (the hotel) which is impractical to subdivide unless a condominium conversion is practical.<sup>13</sup>

The ability of a member in an LLC to demand a partition of LLC property is controlled by the buyout and dissolution provisions in the operating agreement.

Without an agreement, no member has the right during the life of the LLC to receive any LLC asset other than money.<sup>14</sup>

On *dissolution and winding up* of the LLC's affairs, the distribution to members is made from the **net proceeds** from a sale of the assets.

The real estate interests which are subject to a partition suit include:

- *fee estates*;
- *life estates*; and
- *leasehold estates*.<sup>15</sup>

Other real estate interests, such as *easements* or *profits a prendre*, cannot be separately sold or partitioned.<sup>16</sup>

Two siblings own two adjacent parcels of unimproved land, which they use for personal and recreational hunting and fishing. Title to the real estate is vested as tenants in common (TIC), each co-owner holding an undivided one-half interest. Both parcels are of equal value.

One parcel contains the actual hunting and fishing areas while the other provides access. Both co-owners use the property frequently.

One sibling dies and passes their interest in the real estate to a hunting and fishing group that wishes to open the real estate to the public. The hunting and fishing group offers to buy out the surviving co-owner's interest, but the surviving co-owner refuses, filing a partition action to divide the property and become the sole owner of one of the parcels.

## Distribution of an LLC's assets

## What real estate is partitionable?

## Physical division preferred

<sup>13</sup> **Jacoby v. Feldman** (1978) 81 CA3d 432

<sup>14</sup> Calif. Corporations Code §17704.04(c)

<sup>15</sup> CCP §872.210(a)(2)

<sup>16</sup> **Porto v. Vosti** (1955) 136 CA2d 395

The group wants to buy out the co-owner on a sale of the property to permit members of the group to have exclusive access to the recreational areas, claiming the real estate cannot be severed due to topographical problems.

The surviving sibling, as co-owner, claims they have a right to retain physical possession of a portion of the land, since the land can be divided into separate parcels and the division will not reduce the economic value of the separate parcels.

Is a co-owner entitled to retain possession of a portion of the real estate when the property can be as a practical matter divided among the co-owners?

Yes! A division of the real estate is required of tenants in common unless it is impractical to divide and distribute or a sale of the entire real estate is fairer to all involved.<sup>17</sup>

## Impractical division

Consider two co-owners who inherited an inside lot in the middle of a densely populated area of a major city.

The lot is small (one-eighth of an acre) and is improved with residential structures — one facing the street, the other facing a back alley. The positions of the buildings on the lot do not permit a division (parceling) of the real estate or the construction of a partition wall.

Additionally, local **zoning restrictions** do not permit the further subdivision of the lot.

Is a sale of the real estate the best solution?

Yes! The further division of the lot is highly impractical and legally impossible without great **loss of value** to the co-owners.<sup>18</sup>

Similarly, consider the co-owners of real estate who operate a large, diverse enterprise on the property (e.g., a movie studio). The co-owners by agreement coordinate the use of the buildings, sets and lots for their own separate ventures.

Eventually, the co-owners no longer agree on how to use the property. Due to the location of the buildings on the parcel, a division of the property by partition is highly impractical. In this scenario, a sale of the property is the most practical remedy.<sup>19</sup>

## The partition action and lis pendens

To initiate a partition action, a co-owner needs to file an action stating their **interest** in the real estate and the facts which establish their right to maintain a partition suit.

Specifically, a partition action needs to include:

- a description of the real estate;

<sup>17</sup> *Butte Creek Island Ranch v. Crim* (1982) 136 CA3d 360

<sup>18</sup> *Priddel v. Shankie* (1945) 69 CA2d 319

<sup>19</sup> *Formosa Corp v. Rogers* (1951) 108 CA2d 397

- the interest of the co-owner;
- all other recorded real estate interests or unrecorded interests actually known or reasonably discoverable;
- the real estate interest sought to be partitioned (fee, leasehold, minerals, etc.); and
- any facts justifying the sale of the real estate.<sup>20</sup>

Once the partition action is filed, the co-owner seeking partition needs to record a **lis pendens** with the county recorder identifying the parties and the real estate involved.<sup>21</sup>

The *lis pendens* is notice to all future buyers, lenders or tenants that a dispute exists regarding title or possession to the real estate. Through the recorded *lis pendens*, any person later acquiring an interest in or encumbering the real estate does so subject to the pending partition action.

The first procedure in a partition action is to establish each co-owner's interest in a parcel of real estate.<sup>22</sup>

The condition of the real estate's title is determined next, primarily by use of a title company's **litigation guarantee**, an insurance policy issued based on their search of the record title.<sup>23</sup>

The priority of all liens on the property is then set. Provisions are made for the liens to be paid or assumed before the partition action can be completed or the sale proceeds distributed.<sup>24</sup>

Usually, a real estate broker or attorney experienced in real estate matters is appointed as a **referee** to wade through the facts presented by the co-owners. The *referee* is an advisor to the court on the feasibility of the partition or sale.<sup>25</sup>

An appointed referee's activities are subject to judicial review and approval. The referee's job is to balance the competing interests and arrive at a *reasonable division* of the property between the co-owners.<sup>26</sup>

The referee needs to consider:

- improvements made to the property;<sup>27</sup>
- the size and number of lots owned;<sup>28</sup> and
- any liens on the real estate.<sup>29</sup>

## Determining real estate interests

### referee

An advisor to the court on the feasibility of the division or sale of co-owned real estate.

## Cutting up the real estate

<sup>20</sup> CCP §872.230

<sup>21</sup> CCP §872.250(a)

<sup>22</sup> CCP §872.610

<sup>23</sup> CCP §872.620

<sup>24</sup> CCP §872.630(a)

<sup>25</sup> CCP §872.630(b)

<sup>26</sup> CCP §873.210

<sup>27</sup> CCP §873.220

<sup>28</sup> CCP §873.240

<sup>29</sup> CCP §873.260

The referee determines how the property is to be divided and prepares a report for the court's review and approval.<sup>30</sup>

The report may be contested by the owners.<sup>31</sup>

## Division of the real estate

The objective in a partition action is to **physically divide** ownership and possession of the real estate between the co-owners in a practical way. The real estate may be divided in a number of ways:

- by separate lots or parcels;<sup>32</sup> or
- by allocating any improved real estate to the co-owner who constructed the improvements.<sup>33</sup>

When the real estate cannot be divided equally, one co-owner may be ordered to pay money to the other to even up the division. The money paid to even the distribution is legally called *owelty*.<sup>34</sup>

Any division of the real estate needs to comply with all environmental, zoning and other ordinances affecting the use of the real estate.

## Sale of the real estate

The sale of real estate may be held at a public auction or by a privately negotiated sale, depending on:

- which is likely to bring more money for the co-owners;<sup>35</sup> or
- a prior agreement between the co-owners.<sup>36</sup>

A court-appointed referee, such as a listing broker, is given great latitude to conduct sales. For example, real estate consisting of more than one parcel may be sold collectively or individually.<sup>37</sup>

## Notice of sale

The public or private sale of real estate needs to be conducted under the same rules for an execution sale on a money judgment.<sup>38</sup>

For example, the **notice of sale** needs to be given to all parties named in the partition action at least 20 days before the sale date.<sup>39</sup>

Additionally, the notice of sale needs to be published in a local newspaper of general circulation once a week for three weeks before the sale, similar to a trustee's sale under a power-of-sale provision.<sup>40</sup>

<sup>30</sup> CCP §873.280

<sup>31</sup> CCP §873.290

<sup>32</sup> CCP §873.240

<sup>33</sup> CCP §873.220

<sup>34</sup> CCP §873.250

<sup>35</sup> CCP §873.520

<sup>36</sup> CCP §873.600

<sup>37</sup> CCP §873.620

<sup>38</sup> CCP §873.640(a)

<sup>39</sup> CCP §701.540(b)

<sup>40</sup> CCP §701.540(g)



At a public or private sale, the real estate is sold to the highest bidder.<sup>41</sup>

The only persons prohibited from bidding at the sale are:

- the referee;
- an **attorney** for the persons in the partition suit; and
- a **guardian** of a person to the suit, unless it is on behalf of and for the benefit of their ward.<sup>42</sup>

These prohibitions are not in place at a trustee's sale where anyone may bid, including the trustee holding the private sale (but restrictions exist on a mortgage broker bidding when they arranged the mortgage). In a partition action, when one of the co-owners wants to own the entire property, they may acquire it by making the highest bid.

After the highest bid is accepted, the sale is confirmed in a hearing which permits an **overbid** to be accepted at the hearing.<sup>43</sup>

The proceeds of the sale are distributed as follows:

- to the expenses of the sale;
- to the costs of the partition action;
- to the payment of the liens; and
- to the co-owners.<sup>44</sup>

Judgment is entered and is binding on all persons with claims known or unknown in the real estate.<sup>45</sup>

A co-owner may avoid the unnecessary costs of a partition action at the outset of a dispute between co-owners by:

- selecting the correct form of ownership; and
- including in the co-ownership agreement a provision for disposition of the property on termination of the co-ownership.

The least problematic and thus the best form of co-ownership of real estate is an LLC. In the LLC operating agreement, the co-owners agree in advance what will happen when one of the members wants to withdraw or is expelled from the group.

A member holds no interest in the real estate vested in the LLC, only a vote and entitlement to an accounting of the LLC's activities.<sup>46</sup>

## Bidding at the sale

## Confirmation and distribution

## Avoiding a partition action

<sup>41</sup> CCP §§873.670, 873.680

<sup>42</sup> CCP §873.690(a)

<sup>43</sup> CCP § 873.740(a)(2)

<sup>44</sup> CCP §873.820

<sup>45</sup> CCP §874.210

<sup>46</sup> Corp C §§17701.02(r), 17705.01

On dissolution of the LLC, the member is only entitled to their **percentage share** in interest of the net proceeds of a sale, unless an agreement exists calling for a distribution of the real estate in kind.<sup>47</sup>

When a member’s ownership interest in an LLC is assigned, whether voluntarily (to a buyer) or involuntarily (to a creditor), the assignee becomes a nonvoting member of the group. The assignee has no voice in the LLC’s business affairs, unless accepted as a member by all the existing members, or the operating agreement calls for a different procedure.<sup>48</sup>

The operating agreement may also indicate events which terminate a member’s interest. This allows others to buy out that member’s interest (e.g., bankruptcy, failure to remove a charging order, death, assignment, etc.) at a prearranged price or valuation arrangement.

<sup>47</sup> Corp C §17707.05(a)  
<sup>48</sup> Corp C §§17705.02(a)(3), 17704.01(c)(3)

Chapter 35  
Summary

A partition action is a lawsuit to sever or sell real estate which is co-owned. A partition action severs co-ownership of real estate by either:

- dividing the property into parcels and distributing it in kind among the co-owners, when feasible; or
- selling and distributing the net sales proceeds to the co-owners according to their percentage of ownership.

Co-owners may mutually agree to divide the real estate in a voluntary partition or sell it under voting provisions in written co-ownership agreements. Conversely, a partition action will force an involuntary division or sale of the real estate.

Not all forms of co-ownership or types of property allow for a partition to terminate a co-ownership. The real estate interests which are subject to a partition suit include:

- fee estates;
- life estates; and
- leasehold estates.

Any division of the real estate needs to comply with all environmental, zoning and other ordinances affecting the use of the real estate.

Chapter 35  
Key Terms

**distribution in kind ..... pg. 370**  
**partition action ..... pg. 368**  
**referee ..... pg. 373**



## Chapter 36

# Quiet title to clear title

After reading this chapter, you will be able to:

- determine when a quiet title action may be used to clear title to real estate;
- identify who may file a quiet title action; and
- list the factors required for a person to prove their right to quiet title to their interest in real estate.

**bona fide purchaser (BFP)**

**cause of action**

**cloud on title**

**equitable owner**

**forfeiture**

**quiet title action**

**redemption**

**restitution**

**restoration**

## Learning Objectives

## Key Terms

On receiving a preliminary title report after opening escrow, brokers are occasionally confronted with unexpected **title conditions** which interfere with the closing of the sale when not eliminated.

Also, **off-record claims** occasionally arise before or after closing when the broker or buyer receives information about unrecorded documents granting rights which affect title, such as mortgages, easements or license agreements.

These claims, encumbrances and conditions are collectively called **clouds on title**. Since *clouds on title* interfere with a transaction, brokers need to consider effective ways to eliminate them and close the transaction — the original goal of the buyer, seller and agents.

Presented here, in numerous title-related scenarios, is a common involuntary resolution called a **quiet title action**. While the filing of a *quiet title action*

## The cloud of adverse claims removed

### cloud on title

A claim, encumbrance or condition which impairs the title, not possession, to real estate until eliminated by a release of recorded document, quitclaim deed or a quiet title action.

necessarily involves the services of an attorney, the availability of quiet title relief to owners of property is first raised by the brokers in an effort to negotiate an alternative resolution for owners confronted with a cloud on title.

## Quiet title: an overview

A quiet title action is a judicial procedure employed to determine claims to **nonpossessory rights** in disputes over title to real estate.<sup>1</sup>

Title disputes over real estate interests which are resolved by a quiet title action include:

- a buyer or their successor against the holder of an easement which was unrecorded and unknown on the date the buyer acquired ownership;
- an owner or a buyer against the holder of an expired lien;
- an owner against another who claims to be the owner;
- a buyer in possession of property under a land sales contract, lease-option sale or a similar security device against a lienholder other than the seller; or
- an adverse possessor against the holder of title.

Other title-clearing remedies also awarded as part of a quiet title action include a cancellation of instruments, removal of a cloud on title, declaratory relief and a partition action. Nonjudicial voluntary resolutions (which are privately negotiated by principals and their agents) include a release of the recorded instrument and quitclaim deed. [See **RPI** Form 409 and 405]

### cause of action

Facts which are the basis for a claim in a court action.

Conversely, an owner's **possessory remedies**, such as *ejectment* or *removal of improvements*, are separate **causes of action**. However, they may be included with a quiet title action when possession of the property is also in question. Ejectment and encroachment actions address possession, not title, and are unrelated to quiet title actions.

Besides possession, other disputed rights to real estate interests not resolved by a quiet title action include:

- a lienholder against the owner; or
- a buyer against the carryback seller to enforce a security device such as an unexecuted purchase agreement, a land sales contract or a lease-option sales agreement.

## Record owner clears title

The record owner of a parcel of real estate judicially eliminates unenforceable claims or other clouds on title, recorded or unrecorded, which are adverse to their ownership of the fee title by *quieting title* of the claim by a court order.

Unenforceable claims adverse to a fee owner's real estate interest which may be cleared from title by a quiet title action include:

- easements, right of ways and covenants, conditions and restrictions (CC&Rs);

<sup>1</sup> Calif. Code of Civil Procedure §760.020

- adverse possession;
- options; and
- mortgages and other liens held by creditors.

An owner who is, or is a successor to, a **bona fide purchaser (BFP)** may eliminate claims against their interest in the property arising out of an unknown and unrecorded interest — such as a conveyance, lease, lien or use restriction — by commencing a quiet title action against the holder of the unrecorded interest.

A *BFP* is a buyer of property for value and in good faith who acquired their ownership in a property unaware of the existence of clouds on title which were:

- unrecorded;
- unobservable by a reasonable inspection of the property; and
- unknown to the buyer.

A buyer who purchases property from a BFP is called a **successor-in-interest**. A *successor-in-interest* to a BFP's interest is also a BFP, even though the successor is fully informed about the cloud on title at the time of their acquisition.

Consider a real estate buyer whose seller does not inform them of an unrecorded easement to a utility company for the maintenance of underground utility lines on the property. The buried utility lines prevent the building of any structures within the easement.

The easement is not recorded and the lines are not apparent on a visual inspection of the property.

After acquiring the property, the buyer discovers the existence of the buried utility lines and demands their removal. Further, the buyer seeks to quiet title against the utility company's claim to an easement on the property.

The utility company claims the buyer may not quiet title since public interest requires the company to maintain the lines through the property.

May the buyer demand the removal of the utility lines and clear the cloud of the easement from the title to their property?

Yes! The buyer is a BFP who was unaware of the unrecorded and unobservable easement held by the utility when they purchased the property. As a BFP, the buyer has the right to quiet title of the easement and remove the utility lines.

However, when the utility company can show public interest necessitates the continued maintenance of the utility lines on the property, the buyer as a BFP is entitled to compensation in a separate action for their lost use of the land, called **inverse condemnation**.<sup>2</sup>

**bona fide purchaser (BFP)**

A buyer who purchases a property for valuable consideration in good faith without notice or knowledge of pre-existing encumbrances or conditions affecting their right to full ownership.

<sup>2</sup> *Pettis v. General Telephone Company of California* (1967) 66 Cal 2d 503

Further, when the buyer (or their agent) knows of the unrecorded and unobservable utility easement, their title to the property is subject to the easement. If known, the buyer is not entitled to the removal of the lines or compensation for inverse condemnation. The buyer's prior knowledge of the easement's existence disqualifies them as a BFP.

### Buyer in escrow quiets title

An agent on behalf of a buyer locates a parcel of real estate their buyer wants to acquire. During the agent's due diligence search into property and title conditions to affirm the property is what the buyer believes it to be, a cloud on title is discovered. A remote prior owner of the property entered into a **restriction agreement** prohibiting construction on the property without a neighbor's prior approval.

Also, the agent discovers the prior-approval agreement was not recorded or brought to the seller's attention until after the seller acquired title to the property, making the seller a BFP as against the prior-approval agreement.

The buyer and seller enter into a purchase agreement contingent on the neighbor's approval of the buyer's construction plans. However, the neighbor does not approve the buyer's construction plans.

The buyer then seeks to clear title of the cloud by a court ordered cancellation of the prior-approval agreement in a quiet title action. When a court cancels the restriction and it is declared unenforceable, the buyer intends to close escrow on the property and proceed with construction.

The neighbor claims the buyer cannot cancel the agreement since the buyer is not the owner of record holding title to the property.

However, the buyer did acquire an interest in the ownership of the property when they entered into a binding purchase agreement with the seller. Thus, the buyer may obtain a cancellation of the prior-approval agreement in a quiet title action since it is a cloud on title.

Here, the buyer is an **equitable owner** of the property. They hold the contractual right to purchase the property. As an equitable owner of the property, the buyer may quiet title against unenforceable claims adverse to their pre-closing ownership interest in the property.

A pivotal factor in this case allowing the buyer with full knowledge of the cloud on title is the fact the seller was unaware of the unrecorded agreement entered into by a prior owner when the seller acquired the property.

Here, it is the seller who qualifies as a BFP. Before the seller acquired title, the agreement was not recorded or brought to their attention or the attention of their agent. The seller's BFP status shields both the seller as the current owner, and the buyer as the *successor-in-interest* to the seller, from the neighbor's enforcement of the restriction agreement.<sup>3</sup>

<sup>3</sup> **Reiner v. Danial** (1989) 211 CA3d 682

A quiet title action may be joined with other **causes of action** related to the property. [Calif. Code of Civil Procedure §760.030]

For example, a quiet title action to eliminate an adverse possessor's claim to title may be joined by an **ejectment** action to oust the adverse possessor from possession of the property. [*Tobin v. Stevens* (1988) 204 CA3d 945]

Other claims used to clear title, which need not be stated as additional causes of action in a quiet title action, include:

- cancellation of instruments (removal of a cloud on title);
- declaratory relief (declaration of rights under an agreement or law); and
- partition (acknowledgment of co-ownership). [CCP §760.030]

In a quiet title action, a court may grant any equitable relief deemed necessary to quiet an owner's title. Thus, the lack of an additional title-clearing cause of action in the quiet title complaint does not deny the owner the relief necessary to resolve the title dispute. [CCP §760.040]

An all-inclusive  
remedy

Consider real estate encumbered with a recorded *security device*, a lien on title voluntarily entered into by the owner securing a debt they owe. The security device does not contain a **power-of-sale provision** authorizing a nonjudicial foreclosure on the property by trustee's sale.

**Non-BFP  
buyers clear  
title**

Security devices without a power-of-sale provision include:

- a mortgage-in-fact grant deed given to a private lender;
- a two-party mortgage held by a lender (used in other states); and
- a land sales contract or lease-option sales agreement entered into to acquire the property.

The owner defaults on the debt owed under one of these types of security device and the creditor (lender or seller) does not enforce collection.

More than four years after default on all scheduled and balloon payments, the owner conveys their interest in the property to a buyer without satisfying or clearing title of the creditor's lien. The buyer acquires ownership, legal or equitable, subject to the recorded security device.

Now as the owner of the property, the buyer files a **quiet title action** seeking to eliminate the security device, claiming the security device:

- secures an uncollectible debt due to the running of the four-year *statute of limitations* barring judicial enforcement of written obligations, sometimes called an *outlawed debt*; and
- is an encumbrance without a power of sale provision which secured an *extinguished debt* now unenforceable in a court of law.

The creditor claims the buyer is barred from eliminating the security device as a lien on the property since the buyer purchased the property with

**quiet title action**  
A court action to  
remove a cloud and  
establish title to a  
property.



full knowledge of the lien and thus is not a BFP. In essence, the creditor's argument is that the lien remains valid even though the debt is uncollectible in a court of law due to the passage of time.

Can the buyer quiet title in their name and eliminate the lien from title to the property?

Yes! Status as a BFP is not required to clear title of an **extinguishable lien** securing a debt which has not been paid in full. The only outdated lien which cannot be extinguished by a non-BFP buyer in a quiet title action is a *public improvement lien*.<sup>4</sup>

A money obligation evidenced by a written agreement, a security device — usually a note and trust deed or installment sales contract — becomes *judicially unenforceable* after a period of time due to the **statute of limitations**. The power-of-sale by trustee's foreclosure is an entirely different matter, as discussed below.

Scheduled principal and interest payments in default for more than four years cannot be enforced against the owner through a court action, such as a judicial foreclosure, even when title is vested in the name of the creditor as security for payment of the debt. This situation arises with a land sales contract, a lease-option sale or a mortgage-in-fact grant deed when they do not contain a power-of-sale provision.<sup>5</sup>

Conversely, a trustee's power-of-sale provision allows nonjudicial private enforcement of a note by a trustee's sale for ten years after the note's final due date.<sup>6</sup>

A trust deed expires and is automatically *extinguished* from the record:

- ten years after the entire debt becomes due; or
- 60 years after the trust deed is recorded when the due date cannot be ascertained by the written records of the transaction.<sup>7</sup>

*Editor's note — Under prior law, an owner was not able to quiet title of a lender's trust deed which was the owner's personal obligation. It was reasoned that to allow the owner to clear title of the lender's trust deed while the debt remained unpaid was tantamount to the court aiding them in avoiding their debt.*<sup>8</sup>

*Now, all trust deeds automatically expire, clearing title without the need for a quiet title action after the ten-year or 60-year period.*<sup>9</sup>

<sup>4</sup> *Mix v. Sodd* (1981) 126 CA3d 386

<sup>5</sup> CCP §337

<sup>6</sup> Calif. Civil Code §882.020

<sup>7</sup> CC §882.020

<sup>8</sup> *Mix, supra*

<sup>9</sup> CC §882.030

When a lender secured by real estate actually repossesses the real estate by a quiet title action as an alternative method to foreclosure on a default, called *strict foreclosure*, the quiet title action deprives the owner of their **right of redemption**. Thus, they are not allowed to pay off the debt and clear title of the lien.

A lender's completion of a quiet title action in lieu of foreclosure results in the owner's **forfeiture** of the property to the lender, since the right of redemption is lost. Here, the property is not sold by a judicially ordered auction followed by a *redemption* period for final payoff and the owner's retention of title.

Due to the lender working a *forfeiture* of the property through a quiet title action, the loss of the right of redemption triggers:

- an evaluation of the fair market value of each the lender's security interest and the owner's equity interest in title; and
- an accounting of the debt as of the date of cancellation.

Accordingly, a lender secured by an interest in real estate needs to always first foreclose by way of a judicial or nonjudicial (trustee's) foreclosure procedure. These foreclosure procedures provide a notice and opportunity for the borrower to redeem (keep) the property by paying off the debt. Thus, no forfeiture of the property on a default occurs as with a quiet title action.

*Editor's note—CalVet loan contracts permit the forfeiture of a residence on a default, leaving no right of redemption, and are an exception to California's mortgage law right-of-redemption policy. CalVet financing arrangements place veterans funding the purchase of their home at a distinctly greater risk of losing their property than non-veterans who have any type of mortgage.*

For example, when a buyer defaults on a land sales contract, the seller as a creditor of the buyer has three remedies:

- **rescind** the land sales contract by cancellation as though it never existed, take title and restore the buyer to their pre-contractual position;
- **enforce** the seller's lien on the property by a judicial foreclosure, or by a nonjudicial trustee's foreclosure if the sales contract contains a power-of-sale provision [See **RPI** Form 168]; or
- **terminate** all rights under the contract by a quiet title action.

When rescinding a land sales contract (or lease-option sale) without declaring a default and foreclosing, the seller on recovering the property (voluntarily or by eviction) is required to account for and restore to the buyer all the money the seller received under the rescinded land sales contract, subject to permitted monetary offsets against the buyer. Thus, rescission returns everyone to their prior position as though the transaction had never taken place, called **restoration**.

## Foreclose, don't quiet title – it's a mortgage

### redemption

A property owner or junior lienholder's right to clear title to property of a mortgage lien prior to the completion of a trustee's sale or following a judicial foreclosure sale by paying all amounts due on the mortgage debt, including foreclosure charges.

### forfeiture

Loss of money, rights or anything of value due to failure to perform, a remedy abhorred by the courts.

### restoration

The return of funds and documents on a rescission of a purchase agreement or transaction sufficient to place all the parties in the position they held before entering into the agreement or closing the transaction.

The seller is entitled to **offsets** through an accounting for the rental value of the property during the buyer's entire period of occupancy. In turn, the buyer receives credit for all payments made toward the down payment, principal and interest under the land sales contract.

Conversely, there is no restoration when the seller erroneously sues to quiet title in lieu of foreclosing. Thus, the seller and buyer do not restore each other to their pre-contractual positions. By quieting title, the seller affirms and enforces the land sales agreement — from inception to default. With a quiet title action, the seller remedies the default not by foreclosing as needed to respect everyone's rights, but by terminating the contract and forfeiting the buyer's equity in the property. Forfeitures are abhorred by the courts in civil actions.

#### **restitution**

A refund to the buyer by the seller on a rescission of a transaction in exchange for the restoration of the property to the seller.

Additionally, when the seller carries back an installment sales contract and on a breach quiets title to terminate all the buyer's contract rights to acquire the property, the buyer is entitled to **restitution**, not just *restoration*, as though the transaction had never occurred. Restitution includes lost equity in the property in excess of principal amounts owed the seller on the date of default.

## **Restitution**

*Restitution* is an accounting between the buyer and seller which results in a refund to the buyer in exchange for the return of the property to the seller. However, when the property value has dropped:

- the seller owes no credits to the buyer for lost equity since the property value is less than the principal remaining owed on the land sales contract; and
- the seller is barred from collecting any deficiency in their recovery of amounts owed by the buyer as a result of the drop in property value below the balance owed on the land sales contract due to anti-deficiency rules.<sup>10</sup>

For example, a buyer purchases real estate under a land sales contract for the price of \$400,000. A down payment is made. To pay the balance of the purchase price, the buyer agrees to take over payments on a mortgage. The buyer will pay mortgage installment amounts directly to the lender or indirectly through the seller. Installments are also due the seller for payments on the balance of their equity in the land sales contract.

The buyer takes possession of the property and makes principal and interest installments to the seller, as well as payments on the mortgage.

Later, the buyer defaults on their payments, resulting in a **material breach** of the land sales contract. The seller terminates the contract by a notice of cancellation believing it to be a purchase agreement, not a security device. The fair market value (FMV) of the property on the date of cancellation is \$300,000.

<sup>10</sup> CCP §580b

The buyer refuses to surrender possession of the property but continues to make principal and interest payments on the underlying mortgage.

The seller files a quiet title action to clear title of the buyer's land sales contract. The court appoints a receiver on request of the seller to operate and maintain the property until trial.

At trial, the seller regains possession of the property. The court calls for an accounting of activities under the canceled land sales contract.

The court-ordered accounting calls for the seller to determine their losses. However, the seller is unable to obtain a money judgment against the buyer for any loss due to a deficiency in the property value to fully satisfy the remaining principal due on the land sales contract under anti-deficiency laws controlling recovery of *purchase-money debts*.

Instead, the accounting of the seller's losses provides the court with a means of determining how much restitution may be owed a buyer. The only restitution available to a seller is recovery of the property.

For the accounting, the seller's **losses** include:

- the *benefit of their bargain* under the land sales contract;
- out-of-pocket expenses caused by the breach; and
- other expenditures which naturally flow from the breach, called *consequential damages*.

The seller's benefit of the bargain for restoration under the cancelled land sales contract is calculated as the sales price, less the current value of the property as of the date of breach (when less than the agreed price).

In this example, the seller's lost benefit of the bargain under the land sales contract is \$100,000 — the sales price of \$400,000 less the property's lower current market value of \$300,000.

Further, the seller is entitled to **out-of-pocket expenses** for the buyer's wrongful retention of the property after the date of the breach. After the date of the breach, the buyer's continued possession of the property is treated as though they were renting it, not as an owner owing interest to the seller. The notice of cancellation terminated the buyer's land sales contract and ownership.

Thus, the seller is owed the fair rental value of the property from the date of the cancellation to the eviction of the buyer. Rent compensates the seller for the seller's lost use of the property during the buyer's wrongful (holdover) possession.<sup>11</sup>

**First, the seller accounts for their losses**

<sup>11</sup> CC §3307

The repossessing seller is entitled to retain any interest which accrued on the debt owed the seller before termination of the land sales contract. They also receive credit for any expenses that are the **natural consequence** of the buyer's breach, including:

- payment of delinquent real estate taxes prior to termination of the contract;
- payment of any assessment bonds or association fees until termination of the contract;
- payment of penalties or fees for reinstating the mortgage;
- receivership costs;
- resale costs when the property is resold; and
- the cost to repair/replace any damage to the physical property over normal wear and tear.

### The buyer's accounting on the forfeiture

The buyer, having permitted the seller's forfeiture of all their rights to the property due to their breach and the seller's cancellation, gets credit for:

- the down payment;
- installments of principal paid to the seller on the land sales contract, excluding interest earned by the seller on amounts owed;
- principal reduction on the mortgage paid by the buyer in installments prior to termination of the land sales contract, excluding interest;
- principal and interest payments paid by the buyer after the breach which caused the seller to terminate the land sales contract (the buyer's holdover in possession of the property); and
- any expenses paid by the buyer after the breach which the seller was obligated to pay as the new owner by forfeiture, such as care and maintenance of the property during the buyer's holdover as a tenant.

The buyer's payments of interest to the seller under the land sales contract are not an offset. Interest payments are properly retained by the seller as earnings for the buyer's use of the principal remaining unpaid on the land sales contract prior to breach. The interest paid to the mortgage lender **prior to termination** of the land sales contract is also not an offset. Interest is part of the buyer's burden of ownership under the land sales contract.

Importantly, owners holding equitable or legal ownership do not owe rent for their possession of property. They own it with the right to occupy (or to let).

However, interest the buyer paid on the mortgage **after termination** of the land sales contract is a credit due to the buyer (part payment of rent due the seller). On the seller's termination of the land sales contract and commencement of the buyer's wrongful possession, the buyer only owes rent to the seller. Thus, rental value payments, which may be more or less

than the interest portion of the installment payments on the land sales contract, replace interest payments on the principal balance remaining on the terminated land sales contract.

After the accounting is complete, if the amount the buyer is entitled to receive is greater than the credit the seller is to receive for their losses, the buyer is entitled to a refund of the difference, called *restitution*. Restitution is the excess of the buyer's payments over the money losses incurred by the seller due to the buyer's breach of the contract and holdover possession of the property. The buyer is entitled to a money judgment for the amount of restitution.<sup>12</sup>

When the lost value is stripped out of the amount the seller is owed, the amount remaining will set any dollar amount of judgment the seller is entitled to. In conclusion, the negotiation and execution of a deed-in-lieu of foreclosure on the land sales contract or lease-option sale avoids any type of litigation and accomplishes a mutually acceptable result — recovery of the property and a settlement. [See **RPI** Form 406]

An **equitable owner** of real estate is a person who purchased the property and has not yet received a grant deed conveying legal ownership into their name. As an *equitable owner*, a buyer may quiet title of adverse claims which threaten their ownership interest in the property.

Equitable owners include:

- beneficiaries of an irrevocable trust, but not of a revocable inter vivos (living) trust or simple revocable transfer on death deed (RTDD);
- buyers in possession of property under a contract for deed, land sales contract or lease-option sale;
- buyers in escrow under purchase agreements; and
- owners in possession of property who have been defrauded of their legal title.

For example, four individuals buy a parcel of real estate as co-owners. An **irrevocable trust agreement** is entered into by the co-owners as beneficiaries.

One of the beneficiaries holds legal title to the property in their individual name, as trustee under the trust agreement. As trustee, they annually pay the real estate taxes from funds contributed by all beneficiaries — co-owners.

The beneficiaries further agree that each is to possess a separate portion of the real estate which they are to exclusively occupy, called *divided interests*.

One of the beneficiaries conveys their divided interest in the real estate to their child by an assignment of their beneficial rights under the trust. The child takes and remains in exclusive possession to a portion of the real estate for more than five years.

## Equitable ownership versus the trustee

### equitable owner

A person who purchased a property and has not yet received legal ownership placing title in their name, such as occurs under a purchase agreement, land sales contract or lease-option sales agreement.

<sup>12</sup> **Kudokas v. Balkus** (1972) 26 CA3d 744



The child then seeks to quiet title in their name to the portion of the property they exclusively possess as against the other beneficiaries and the trustee, claiming they acquired title to their portion of the property through **adverse possession**.

Can the child quiet title against the other beneficiaries and the trustee through adverse possession?

Yes and no! Yes, the child can quiet title against any claims the *other beneficiaries* may have in the portion of the real estate the child exclusively occupies. However, the child cannot quiet title in their name as against the trustee. The trustee holds legal title and pays the taxes. Thus, title remains in the name of the trustee.

Unlike a limited partnership or limited liability company (LLC) vesting which is a separate entity typically created to hold title to property as the owner, a trustee is a person who merely holds title as a trustee for the benefit of all who are **beneficiaries** of the trust agreement.

As a successor-in-interest to one of the beneficiaries, the child is a beneficiary of the trust. Thus, they hold an equitable ownership interest to the portion of the real estate exclusively occupied by their predecessor. No entity holds title for its members as the owner of property, even when a portion of which the property occupied by a member.

To take title from the trustee to the portion exclusively possessed by the beneficiary in this example, the child as a beneficiary is limited to *enforcement* of the trust agreement, a contract law remedy, not a real estate law remedy (such as a quiet title action).<sup>13</sup>

### Equitable owners by purchase agreement

Similarly, a buyer under a purchase agreement which is yet to be performed by closing escrow, or an optionee holding a purchase option, is an equitable owner. However, these buyers under contract may not use a quiet title action to resolve their claims to fee title against the owner of record who has yet to fully perform under a purchase agreement or option to sell the property.

The buyer's or optionee's remedy against the owner is **specific performance** of the purchase agreement or the option. Yet-to-be-performed real estate agreements which are enforced by specific performance include purchase agreements and escrow instructions, mortgages, leases and options.

*Editor's note — Quieting title and partitioning real estate against the other co-owners also gives rise to compliance with **subdivision** issues.*

*An agreement granting undivided interests in title to each co-owner and also giving each co-owner exclusive occupancy to a portion of the real estate, unless recorded in a grant deed or lease, does not violate subdivision law. Such an agreement does not partition the property into separate units.<sup>14</sup>*

<sup>13</sup> **Tuffree v. Polhemus** (1895) 108 C 670

<sup>14</sup> **Bakanauskas v. Urdan** (1988) 206 CA3d 621



*Further, the purchase of rental or investment property by five or more co-owners vested as tenants in common creates a subdivision and requires clearance from the California Department of Real Estate (DRE), except in cases where the undivided interests are:*

- *held by people related by blood or marriage;*
- *created as a result of a foreclosure sale;*
- *created by a valid court order;*
- *offered and sold by permission of the Commissioner of Corporations according to the Corporate Securities Law of 1968; or*
- *in real estate offered for sale is an authorized time share project.<sup>15</sup>*

*Additionally, a subdivision is not created when the undivided interests are purchased by fewer than ten people who each give a signed statement to the Real Estate Commissioner acknowledging they are:*

- *fully informed about the ownership risks;*
- *purchasing the interest for themselves without present intention to resell the interest; and*
- *waiving any protections afforded under a subdivision.<sup>16</sup>*

Consider a buyer of real estate under a land sales contract. The seller retains legal title to the property as **security** for the buyer's payment of the balance remaining unpaid on the purchase price.

The buyer then enters into a construction and co-ownership agreement with a contractor to improve the property. The contractor is to build four houses on the property and pay in full the balance remaining due on the purchase price under the land sales contract.

In exchange, the contractor is to receive a 75% ownership interest in the property, as a co-owner with the buyer. The buyer is given the rights to exclusively occupy one of the units.

As agreed, the contractor pays off the balance due on the land sales contract to the seller. However, the seller conveys title to the contractor, not the buyer named in the land sales contract. The buyer occupies one of the residences on the property.

The contractor then **encumbers** the property with a mortgage without the consent of the buyer whose 25% co-ownership interest is not recorded.

Neither the lender holding the mortgage nor the title company insuring the mortgage inspect the property for occupants, much less inquire into interest held in the property by those in possession. Thus, the lender is actually unaware the co-owner of a 25% undivided interest exists or occupies the property.

## Unrecorded owner in possession

<sup>15</sup> Calif. Business and Professions Code §11000.1

<sup>16</sup> Bus & P C §11000.1(b)(2)

Later, the buyer learns of the lender's mortgage encumbrance and seeks to quiet title against the lender's lien on the buyer's unrecorded 25% ownership interest in the entire property.

The lender claims the buyer cannot quiet title of its security interest since the contractor holds title and thus the buyer is not the owner of record.

However, when originating a mortgage, the lender has a duty to inspect the property, as well as the record title, for any off-record claims to title before making a loan secured by the real estate. The buyer's **actual possession** of the property places the lender on *constructive notice* of the buyer's ownership interest.

Thus, the contractor's mortgage never attached to the buyer's unrecorded ownership interest and the quiet title action *extinguishes* the mortgage from the buyer's 25% undivided ownership interest in the property.<sup>17</sup>

## Protecting non-fee title interests

The holder of an interest in real estate other than the fee title, such as an easement, right of way, lien, lease, option or by adverse possession, may also use a quiet title action to eliminate claims which challenge the interest they hold in the real estate.

**Non-fee interests**, such as possession held by tenants under the leasehold interest they own, may be protected by the use of a quiet title action. However, the tenant's interest is not based on ownership of the fee interest in the real estate and title cannot be quieted in the name of the tenant.<sup>18</sup>

Only an occupant who can establish a **claim of title** to property, such as by adverse possession, equitable ownership or strict foreclosure and forfeiture by a lender, may quiet title to the property in their name and become the owner of record. [See Chapter 23]

For example, a couple dissolves their marriage. One spouse is awarded the community residence; the other is ordered to hand over possession of the residence to the title-holding spouse.

Accordingly, the spouse awarded the residence asks the occupying spouse to vacate the property. However, the spouse refuses to vacate and remains in possession of the property for more than five years, during which they pay the taxes and other costs for maintaining and carrying the property. The title-holding spouse takes no legal action to evict.

Claiming title by adverse possession, the occupying spouse files a quiet title action to eliminate the recorded ownership interest held in the property under the court order. The title-holding spouse claims the occupying spouse cannot quiet title since their possession is in violation of the court order awarding them the property.

<sup>17</sup> **Dement v. Pierce** (1932) 122 CA 254

<sup>18</sup> Tuffree, *supra*

*When an action to quiet title is brought, a lis pendens describing the real estate needs to be recorded with the county recorder's office where the property is located. The recorded lis pendens puts potential lenders and buyers of the property on notice of the pending quiet title action. [Calif. Code of Civil Procedure §§405.24; 761.010]*

*Title to the property may still be conveyed subject to the recorded lis pendens and the risks of the litigation's outcome.*

*When a buyer purchases the property from a seller whose ownership interest is later eliminated by a quiet title action when a lis pendens was of record prior to closing, the seller's conveyance to the buyer will be voided as part of the quiet title action. [CCP §405.24; see Chapter 31]*

## Lis pendens

Can the occupying spouse quiet title even though their possession is wrongful?

Yes! The occupying spouse has acquired title by adverse possession. Their possession is hostile since they did not vacate when asked and paid the taxes for a period of five years or more.

An individual claiming ownership by adverse possession needs to have hostile possession of a property without the legal owner's stated or implied permission. They need also to pay taxes and all encumbrances on the property and wait the required five-year period in possession of the property (without being evicted) to obtain legal title.<sup>19</sup>

Consider an owner of record to real estate who has not occupied their property for over five years.

A **trespasser** has possession of the property and claims to be the true owner, but has not paid property taxes. The owner seeks to quiet title of the trespasser's claim to ownership and remove them from the property by ejectment.

The trespasser claims the owner is barred from recovering the property and ejecting them since the owner has not been in physical possession of the property within the last five years.

Can the owner quiet title of the trespasser's claim and remove them from possession of the property?

Yes! The trespasser is unable to establish a right to title by adverse possession. They did not pay the taxes on the property. Also, the owner of record at all times has the right to **immediate possession** of the property by ejectment of anyone not legally in possession or who cannot prove an adverse possession claim. Thus, the owner is able to quiet title against the trespasser's claims.<sup>20</sup>

## Squatter's rights and nonresident owner

<sup>19</sup> **Buic v. Buic** (1992) 5 CA4th 1600

<sup>20</sup> **Tobin v. Stevens** (1988) 204 CA3d 945

## Five years to perfect title

A creditor records an **abstract of judgment**. The abstract of judgment attaches as a lien on title to a parcel of real estate which is vested of record in the name of the judgment debtor.

The judgment debtor later sells and conveys the property to a buyer.

The creditor obtains a writ of execution to foreclose the judgment lien. At the sheriff's sale, the creditor is the highest bidder. The creditor receives a certificate of sale entitling them to a sheriff's deed and immediate possession of the property. However, the creditor does not immediately obtain the sheriff's deed since the interest acquired in the property has no present value to the creditor due to the amount of the encumbrances with priority.

The buyer remains in possession, paying all the costs of ownership.

The creditor waits more than five years after the sheriff's sale, when the value of the property has increased, to obtain and record the sheriff's deed. The creditor files a quiet title action against the buyer, claiming the sheriff's deed gives the creditor legal title and the right to possession.

The buyer claims the creditor has no right to quiet title to the property in the creditor's name since the creditor did not **possess or hold title** to the property within five years after the sheriff's sale.

Is the creditor entitled to ownership of the property?

No! The creditor is barred from asserting a claim to ownership of the property. The creditor's right to record the sheriff's deed, take possession of the property and eject the occupant first arose on the date it purchased the property at the sheriff's sale. A five-year *statute of limitations* begins to run on the creditor's right to recover the property from the date of the sheriff's sale.

Due to the five-year delay in recording the sheriff's deed, the creditor lost their right to recover the property from the buyer. An **injunction** against the creditor's claim to ownership clears the buyer's title of the creditor's unenforceable sheriff's deed.<sup>21</sup>

Only when the creditor records the sheriff's deed and files their quiet title action within five years after the sheriff's sale are they entitled to possession. When recorded by the creditor within five years of the sheriff's sale, a claim to title as an adverse possessor by their payment of taxes and possession for five years is defeated.

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<sup>21</sup> **Lawrence v. Maloof** (1967) 256 CA2d 600

## Chapter 36 Summary

The record owner of a parcel of real estate judicially eliminates unenforceable claims or other clouds on title, recorded or unrecorded, which are adverse to their ownership of the fee title by quieting title of the claim by a court order.

A quiet title action is a judicial procedure employed to determine claims to nonpossessory rights in disputes over title to real estate. Title disputes over real estate interests which are resolved by a quiet title action include:

- a buyer or their successor against the holder of an easement which was unrecorded and unknown on the date the buyer acquired ownership;
- an owner or a buyer against the holder of an expired lien;
- an owner against another who claims to be the owner;
- a buyer in possession of property under a land sales contract, lease-option sale or a similar security device against a lienholder other than the seller; or
- an adverse possessor against the holder of title.

A buyer who is an equitable owner may quiet title of adverse claims which threaten their ownership interest in the property. The holder of an interest in real estate other than the fee title, such as an easement, right of way, lien, lease, option or by adverse possession, may also use a quiet title action to eliminate claims which challenge the interest they hold in the real estate.

Only an occupant who can establish a claim of title to property, such as by adverse possession, equitable ownership or strict foreclosure and forfeiture by a lender, may quiet title to the property in their name and become the owner of record.

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<b>cause of action</b> .....	<b>pg. 378</b>
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## Chapter 36 Key Terms

**Quiz 14 Covering Chapters 35-37 is located on page 454.**

*Notes:*



## Declaratory relief prevents more costly litigation

After reading this chapter, you will be able to:

- understand the use of a declaratory relief action by a client to resolve a dispute between real estate owners, tenants or others with an interest in the real estate.

**anticipatory breach**

**declaratory relief**

## Chapter 37

### Learning Objective

### Key Terms

A buyer is interested in purchasing an unimproved parcel of real estate to build a residence on it as allowed by zoning.

The buyer and seller enter into a purchase agreement. Before escrow closes, a neighbor informs the seller's listing agent a written agreement between the prior owners of the neighbor's property and the seller's property prohibits the construction of any improvements on the seller's property.

However, the agreement is not recorded and the seller was previously unaware of the existence of the use restriction. The agent believes the agreement is not binding. The use restriction was not recorded and the seller acquired the property without actual knowledge it existed.

The buyer is promptly advised of the agreement and requests the neighbor's permission to build improvements on the property.

The neighbor refuses to grant the buyer permission, claiming the agreement is a covenant running with the land and is binding on all subsequent owners, including the buyer. No one wants escrow to close due to the uncertainty the property can be used as all involved expected.

### Disputes resolved before closing



**declaratory relief**

An action seeking a judicial declaration of the rights and obligations of parties to a disputed situation.

To resolve the dispute over the use restriction agreement, the buyer and seller join together and file an action against the neighbor for **declaratory relief**.

The buyer and seller do not seek to recover any money losses or property from the neighbor. They only seek a **declaration of their rights and obligations** under the use restriction agreement entered into between the prior owners of the contiguous properties.

Also, the buyer and seller agree with the agent to an extension of their escrow period with closing contingent on a favorable result in the *declaratory relief* action they filed.

The neighbor claims the buyer is barred from pursuing declaratory relief since they are merely a prospective buyer with no ownership interest in the property.

However, an **actual controversy** exists. The use restriction might force the buyer into further litigation after acquiring the property. If the buyer were to purchase the real estate and begin constructing improvements as allowed by zoning, but in violation of the unrecorded agreement, they expose themselves to an expensive and time-consuming lawsuit with the neighbor and possibly need to remove the improvements.

Thus, the buyer is entitled to a declaration of their rights to resolve the uncertainty before buying the property and constructing improvements. Here, the buyer has standing to sue. They hold an *equitable ownership interest* in the property created on entering into their purchase agreement with the seller.

Likewise, the seller is entitled to a declaratory judgment. They will also be directly affected by the outcome — the closing of the sale is contingent on the buyer's ability to make improvements.<sup>1</sup>

With a declaratory judgment, the agent is able to keep alive an otherwise dead transaction.

## Preventative justice for a certain future

When one person sues another, they are usually seeking to recover something tangible — money, property or a right such as an easement.

However, controversies over the *nature of rights* or the *interpretation of agreements* frequently arise long before they produce any claims for the recovery of money or property. A prudent individual often wants to know what their rights and duties are before they undertake irreversible actions which may result in costly litigation.

The declaratory relief statutes allow a person to obtain a **declaration of rights** and obligations before an actual claim arises for the recovery of money or property, or a breach of an obligation.<sup>2</sup>

<sup>1</sup> *Reiner v. Danial* (1989) 211 CA3d 682

<sup>2</sup> Calif. Code of Civil Procedure §1060

To expedite the resolution of controversies which might result in a future loss and litigation, actions for declaratory relief are given priority over the court scheduling of other kinds of actions.<sup>3</sup>

When a claim for declaratory relief arises due to a performance already in process, such as construction or foreclosure, the court will postpone the contested activity, called a **stay**, until the declaratory relief action is resolved.

The differing parties in a declaratory relief action often enter into a **reservation of rights agreement** allowing them to preserve their respective claims so they may later pursue them after a court declares their rights. The purpose of the stay with reservation of rights is to maintain the status quo, such as the acceptance of installment payments on a mortgage in dispute, until the uncertainty is resolved by a declaratory judgment.<sup>4</sup>

Thus, declaratory relief functions as a kind of preventive justice, settling controversies before they result in litigation to recover money, convey property, rescind a transaction, reconvey property lost to foreclosure or reoccupy a premise after an eviction.

Declaratory relief is based on an individual's right to know where they stand in relation to the adverse claims made by another person which might affect their position. When an individual is contemplating activity they or others feel may be prohibited by law or contract, they are entitled to know whether the activity is permitted before undertaking it.

**No breach  
required for  
clarification**

For instance, consider an owner who believes their property is no longer subject to **deed restrictions** against construction recorded many years earlier.

To know for certain whether the deed restrictions are enforceable and apply to them, the owner can either:

- undertake construction activities in violation of the restrictions (but not zoning ordinances) and run the risk of a potentially expensive lawsuit; or
- obtain a declaration from the court stating whether the restrictions are still binding before they proceed with construction.

The owner is not required to breach their obligations before they seek a judicial determination of their rights. Thus, the owner is entitled to a declaratory judgment clarifying their rights which will either allow them to proceed safely with their desired construction activities, or notify them the restrictions are still in effect.<sup>5</sup>

<sup>3</sup> CCP §1062.3

<sup>4</sup> **Wellenkamp v. Bank of America** (1978) 21 C3d 943 (Disclosure: the legal editor of this publication was the attorney of record for the buyer in this case.)

<sup>5</sup> **Ross v. Harootunian** (1967) 257 CA2d 292

Resolve your  
disputes, then  
act

*Real estate activities giving rise to a declaratory relief action include:*

- **trust deed *foreclosures*** the owner claims cast doubt on the lender's or carryback seller's right to foreclose, such as claims of misrepresentation, unenforceability or demands for offsets;
- **rental or lease agreements** involving such issues as the renewability of a lease or the landlord's demands for rent;
- **lease-option** sales with their frequently misunderstood legal status as security devices which raise questions as to the ownership rights of the seller/landlord and buyer/tenant;
- **right of first refusal** agreements which raise questions about whether a particular activity or event has triggered the first refusal right to acquire the property;
- **cancellation** of purchase agreements or **rescission** of closed transactions;
- claims of **usury** on private lender loans;
- **priority** of liens and **validity** of subordination agreements;
- **prepayment penalty** enforcement [*Sacramento Savings and Loan Association v. Superior Court County of Sacramento* (1982) 137 CA3d 142 (Disclosure: the legal editor of this publication was the attorney of record for Sacramento Savings and Loan Association in this case.)];
- enforceability of **trust deed provisions** [*Wellenkamp v. Bank of America* (1978) 21 C3d 943 (Disclosure: the legal editor of this publication was the attorney of record for the buyer in this case.)]; and
- **due dates** for the final payoff of a loan or performance dates for any other obligation.

## Predetermining legal results

Proceeding with activities under dubious authority without first obtaining a declaratory judgment can produce disastrous financial results.

For example, a buyer of real estate seeks to rescind their recently closed acquisition of property after grading it.

Without first seeking a court declaration of their rights, the buyer deeds the property back to the seller, called **rescission**. The buyer then makes a demand on the seller to recover the purchase price and the costs of carrying the property during their ownership, called **restoration**.

The seller accepts the deed to the property but refuses to return any money to the buyer. The seller claims the buyer physically damaged the property when they graded it in preparation for construction.

Ultimately, the buyer is unable to recover any money through restoration since they inflicted damage on the property by grading it. Thus, the buyer now has neither the property nor the money.<sup>6</sup>

A declaratory judgment will have clarified whether the buyer was entitled to recover the purchase price by rescinding the transaction, and if so, the

<sup>6</sup> *Grill v. Hunt* (1992) 6 CA4th 73

basis for valuation of the property on its return. Thus, the buyer is able to decide whether to proceed with the rescission, which will have “restored” the property to the seller and the money to the buyer, or keep the property.

Declaratory relief may also take the place of a buyer’s or seller’s claim the conduct of the other party is an **anticipatory breach** of their purchase agreement, lease agreement or note and trust deed.

An *anticipatory breach* occurs when a buyer or seller in some way acts to repudiate the purchase agreement before the time for closing arrives — manifesting through words or conduct their intent not to further perform on their agreements.<sup>7</sup>

However, proving an anticipatory breach can be difficult. The claim is about one’s nonperformance before the time of performance by closing escrow has arrived.

Thus, rather than attempting to prove a buyer or seller does not intend to perform on their agreement or close a transaction, a better remedy might be a declaratory relief action to determine whether the other party’s activities constitute a breach of the agreement.

With a declaration of their rights in hand, the injured party may then pursue a specific performance action or recover their money losses for a breach when escrow does not close.

Declaratory relief may be sought to interpret nearly any kind of right or obligation.

For instance, a property owner may seek a declaratory judgment testing the validity of a city zoning ordinance.<sup>8</sup>

Additionally, an owner may seek declaratory relief before entering into a transaction which may result in a **tax liability** to determine what their liability may be if they undertake the activity. Since any tax liability will not accrue and be payable before the transaction is completed, a declaratory judgment does not illegally prevent the collection of a tax.<sup>9</sup>

However, once a tax is levied, owners involved in tax disputes with state government agencies have no recourse to declaratory relief. Courts may not prevent the collection of taxes now payable to state agencies. The owner’s remedy is to pay the taxes and pursue an action for a **refund** of excess taxes paid.<sup>10</sup>

## Anticipating a breach before closing?

### anticipatory breach

When a buyer or seller repudiates the purchase agreement by their words or conduct before closing.

## Interpreting government agency rights

<sup>7</sup> Calif. Commercial Code §2610

<sup>8</sup> **Viso v. State** (1979) 92 CA3d 15

<sup>9</sup> **Honeywell, Inc. v. State Board of Equalization** (1975) 48 CA3d 907

<sup>10</sup> Calif. Revenue and Taxation Code §§6931, 6932

## Interference with future events

Consider a tenant operating a barber shop who subleases a portion of the premises to a subtenant who sets up a smoke shop. The sublease grants the subtenant an **option to extend** the sublease contingent on the tenant extending their master lease, granted the tenant in an option.

The tenant arranges for their child to lease the property from the landlord at the end of the current lease term rather than extend it themselves. The tenant then informs the subtenant they will not be extending the master lease, and thus the sublease will be terminated at the end of the current term.

The subtenant claims the leasing of the property by the tenant's child is merely a ploy to terminate the sublease.

No cause of action yet exists for money losses or breach of the option to extend. The sublease is still in effect and no one is seeking to evict the subtenant.

However, due to the words and conduct of the tenant, a controversy exists as to whether the subtenant is entitled to extend their sublease. The subtenant seeks a declaration of their **right to extend** their sublease.

The court awards a declaratory judgment in favor of the subtenant, stating the leasing of the property by a member of the tenant's family constitutes an extension of the master lease. With their rights established by a court order, the subtenant is able to enforce the exercise of their option to extend the sublease when the time to exercise the option arrives.<sup>11</sup>

## Useful purpose of ending litigation

The requirements for obtaining a declaratory judgment are:

- an actual controversy exists as to a person's rights or duties; and
- the controversy will likely result in future litigation if not resolved.

Thus, a declaratory judgment is only granted when the judgment serves a **useful purpose**. The court may deny declaratory relief when no declaration is necessary or proper.<sup>12</sup>

For example, a buyer and seller sign a purchase agreement. Later, a third party records an option to purchase the property.

The seller informs the buyer they will be unable to deliver title to the property due to the option. The buyer's deposit is refunded and the property is sold to the optionee.

The buyer now claims the seller breached the purchase agreement and seeks a declaration of their rights. However, the buyer does not seek any other form of relief, such as the recovery of money losses or specific performance of the purchase agreement.

Thus, the buyer's claim for declaratory relief amounts to asking the court to declare the seller breached the purchase agreement when they conveyed the property to the optionee.

<sup>11</sup> *Jones v. Feichtmeir* (1949) 95 CA2d 341

<sup>12</sup> CCP §1061

This is a useless declaration. It has no effect on the future rights or claims between the parties. The relationship between the buyer and seller was already terminated and the seller no longer owns the property.

Thus, any claims of the buyer against the seller can only be for money losses incurred by the termination of the agreement, for which a declaration is unnecessary.<sup>13</sup>

*Editor's note — An important distinction needs to be made between a court's refusal to award declaratory relief and a declaratory judgment **negative** or **adverse** to the individual seeking it.*

*When an actual controversy exists, a person is entitled to declaratory relief even if the judgment is against them. They are entitled to have their uncertainty resolved.*

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<sup>13</sup> **Travers v. Loudon** (1967) 254 CA2d 926

**Chapter 37**  
**Summary**

To resolve disputes over the use of real estate, a person may file for declaratory relief. The declaratory relief statutes allow a person to obtain a declaration of rights and obligations before an actual claim arises for the recovery of money or property, or a breach of an obligation. The requirements for obtaining a declaratory judgment are:

- an actual controversy exists as to a person’s rights or duties; and
- the controversy will likely result in future litigation if not resolved.

Actions for declaratory relief are given priority over the court scheduling of other kinds of actions. When a claim for declaratory relief arises due to a performance already in process, the court will postpone the contested activity, called a stay, until the declaratory relief action is resolved.

The differing parties in a declaratory relief action often enter into a Reservation of Rights Agreement allowing them to preserve their respective claims so they may later pursue them after a court declares their rights.

A person is not required to breach their obligations before they can seek a judicial determination of their rights.

Declaratory relief may also take the place of a buyer’s or seller’s claim the conduct of the other party is an anticipatory breach of their purchase agreement, lease agreement or note and trust deed.

Declaratory relief may be sought to interpret nearly any kind of right or obligation.

**Chapter 37**  
**Key Terms**

<b>anticipatory breach .....</b>	<b>pg. 399</b>
<b>declaratory relief .....</b>	<b>pg. 396</b>

<p><b>Quiz 14 Covering Chapters 35-37 is located on page 454.</b></p>
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# Rent skimming by investors

## Chapter 38

After reading this chapter, you will be able to:

- recognize the criteria necessary for an investor in residential property to be found guilty of rent skimming under state and federal laws; and
- explain the consequences of initial multiple acts and additional single acts of rent skimming.

**parcel**

**rent skimming**

### Learning Objectives

### Key Terms

**Rent skimming** with civil monetary liability occurs when an investor:

- receives rents from a **parcel** of residential rental real estate during their first year of ownership; and
- does not apply the rents (or an equivalent amount) to the payments due on all mortgages on the property.<sup>1</sup>

A *parcel* is a three-dimensional space of real estate identified by a legal description. Parcels may contain one or more residential units within the boundaries of the parcel.

Further, an investor exposes themselves to state criminal prosecution as well as civil penalties for **multiple acts** of rent skimming when they *skim rents* from five or more parcels of residential real estate they took title to during any two-year period.

### Civil and criminal consequences of skimming

#### **rent skimming**

When an investor receives rents from a parcel of residential rental property during their first year of ownership and does not apply the rents (or an equivalent amount) to the payments due on all mortgages secured by the property.

<sup>1</sup> Calif. Civil Code §890(a)

Thus, to incur penalties, civil and criminal, an investor under California law needs to be involved in multiple act of rent skimming meeting the following criteria:

- rents are skimmed from five or more parcels of residential rental property during the investor's first year of ownership of each parcel; and
- all the properties the investor rent skimmed from were acquired within the same two-year period.

Thus, a criminal count of multiple acts of rent skimming is only applicable on properties the investor acquired during any two-year period.<sup>2</sup>

## The act of rent skimming

### parcel

A three-dimensional space of real estate identified by a legal description circumscribed on the face of the earth by a surveyor.

Consider an investor who locates a fully rented residential complex situated on one parcel of real estate they deem suitable to own. The investor and the seller negotiate terms for purchase which include:

- the assumption or origination of a first mortgage; and
- the execution of a note and trust deed in favor of the seller.

The amount of the carryback note is for the difference between the down payment amount and the amount of the existing mortgage.

The property's rental income is enough to carry its verifiable operating expenses and mortgage payments with a 10% annual vacancy factor.

The investor's savings and liquid assets are entirely consumed by the down payment and closing costs. With this bet, the investor is left with no cash reserves to cover operating expenses if the property experiences more than the pro forma 10% vacancy at present rental rates.

Soon after acquisition, the investor experiences a substantial drop in rental income due to the loss of a tenant. Worse, the investor is unable to locate a new tenant willing to pay the same rent amount the prior tenant paid.

Shortly thereafter, the investor is laid off by their employer. Starved for cash, the investor makes no further payments on the mortgages and immediately attempts to resell the units. The investor receives no offers.

After two months of mortgage delinquencies, the investor locates a tenant at a lower rental rate and enters into a one-year lease. The investor collects rents and uses the monies to cover living expenses, not mortgage payments.

The property eventually sells at a foreclosure sale on the first mortgage, exhausting the security for the seller's carryback note.

At the foreclosure sale, the lender acquires ownership and the property becomes a **real estate owned property (REO)**. The lender requests the property be vacated and gives the tenants the required 90-day Notice to Quit Due to Foreclosure. [See **RPI** Form 573]

<sup>2</sup> CC §890(b)

The tenant on a one-year lease with several months remaining vacates immediately on receipt of the notice to vacate. The tenant relocates to a comparable residential unit incurring moving costs and an increase in monthly rent. The other tenants, on month-to-month rental agreements, vacate within the 90 days provided by the lender's notice.

The tenants and the carryback seller now make demands on the investor for their money losses, claiming the investor engaged in rent skimming activities. The investor claims they did not maliciously engage in rent skimming and are not liable for the tenants' and seller's losses due to the concurrence of several adverse economic conditions.

May the tenants and seller recover their losses from the investor based on their claim the investor was engaged in the act of rent skimming on a single parcel?

Yes! The tenants and the seller have separate, enforceable claims for money against the investor. Each may collect their money losses caused by the investor's collecting rent and failing to apply the rent toward mortgage payments during the investor's first year of ownership, the investor's single act of rent skimming on one parcel of residential rental real estate.<sup>3</sup>

A tenant of residential property subject to rent skimming may recover their actual out-of-pocket **money losses** from the investor in a civil action when:

- the property is sold at a foreclosure sale while the tenant is in possession; and
- the tenant is given notice to vacate or otherwise forced to vacate.<sup>4</sup>

The *tenant's recovery* from the owner who rent skims includes:

- the security deposit lost;
- moving expenses;
- attorney fees; and
- court costs.

When a rent-skimming investor breaches a lease agreement held by a tenant who is forced to move before the lease term expires due to the foreclosure sale, the tenant's initial recovery is the **difference** between:

- the rent due for the months remaining until expiration of the breached lease; and
- any higher rent they pay on a comparable replacement residence for the remaining term of the breached lease.

Further, the tenant holding an unexpired lease agreement at the time of the foreclosure sale may qualify to receive an additional award of punitive sums

## The tenant's recovery of money

<sup>3</sup> CC §5890(a), 891(a), (d)

<sup>4</sup> CC §891(d)

of money from the rent-skimming investor. The additional punitive sums may be up to three times the amount of the tenant's out-of-pocket losses. However, an award of punitive sums of money is only available when:

- payments on the underlying mortgage were at least two months delinquent at the time the tenant entered into the lease agreement; or
- the property is one in which the investor was engaged in multiple acts of rent skimming.<sup>5</sup>

### Seller recovery of money

A **carryback seller** is entitled to their actual money losses caused by an investor's act of rent skimming. For recovery, the property need not be one of the parcels involved in multiple acts of rent skimming. The seller's recovery includes the amount owed under a carryback note, land sales contract or lease-option, unless fully satisfied by the high bid at the foreclosure sale — a loss collectible despite anti-deficiency, nonrecourse law barring recovery of money.

Additionally, the carryback seller is entitled to collect other money losses caused by the rent skimming investor's activities, such as waste.<sup>6</sup>

The carryback seller is further entitled to **punitive losses** of no less than three times their out-of-pocket losses when the investor participated in multiple acts of rent skimming, one being the seller's property.<sup>7</sup>

When the seller forecloses and recovers ownership as the highest bidder, they need to underbid by the amount of their out-of-pocket losses so they sustain an actual money loss on foreclosure.

### Deed-in-lieu protection

A carryback seller who reacquires the property by a deed-in-lieu of foreclosure from a rent-skimming investor is entitled to a court order clearing title of any judgment liens brought about by the investor.

The alternative to a *deed-in-lieu* is to foreclose on the carryback mortgage and eliminate the junior liens by a trustee's sale.

A carryback seller who reacquires clouded title under a deed-in-lieu gives the lienholders at least 30 days advance written notice of the seller's intention to remove the liens by court order before filing an action.<sup>8</sup>

### Lender recovery is limited

An investor engaged in multiple acts of rent skimming is also **liable** to mortgage holders for money losses incurred on mortgages secured by one of the properties involved in the multiple acts of rent skimming. However, lender recovery is limited to the rents collected on the property, whether or not the investor obtained or assumed the mortgage.<sup>9</sup>

<sup>5</sup> CC §891(d)

<sup>6</sup> CC §891(a), (g)

<sup>7</sup> CC §891(a)

<sup>8</sup> CC §891(b)

<sup>9</sup> CC §891(c)

Like the carryback seller, the mortgage holder needs to underbid at the trustee's sale (if they acquire title) by the amount of rents the lender anticipates collecting from the rent-skimming investor. The recovery of rents is for losses remaining after applying the lender's credit bid at the foreclosure sale to the mortgage debt when the lender acquires the property.

The lender may not recover more than the money owed them on their mortgage, a debt fully satisfied when they make a full credit bid. Here, due to rent skimming, anti-deficiency law does not prevent the lender from recovering the rents up to the amount of the loss established by the lender's underbid.<sup>10</sup>

In addition, a lender secured by one of the properties in a criminal count for multiple acts of rent skimming may receive an award for punitive sums of money, an amount solely within the discretion of the court.<sup>11</sup>

An investor engaged in multiple acts of rent skimming also exposes themselves to a separate **criminal prosecution**, not only civil liability for money losses they inflict on tenants, sellers and mortgage lenders.

## Rent skimming prosecution

The multiple acts of rent skimming during the first year of ownership on five or more parcels containing residential rentals which are acquired during any two-year period is a crime. Further, prosecution for the multiple acts of rent skimming needs to be filed within **three years** after the last parcel was acquired during the two-year period set for multiple acts of rent skimming.<sup>12</sup>

For example, an investor skims the rents off more than five parcels. All the properties were encumbered by mortgages and the investor acquired them during a two-year period.

The state files criminal charges on:

- the **initial act** of multiple rent skimming (rent skimming on five parcels acquired in a two-year period); and
- **additional acts** of rent skimming for each parcel beyond the five parcels comprising the initial act of multiple rent skimming.

The state files the charges within three years after the investor's acquisition of the last of the five parcels included in the initial charge of multiple acts of rent skimming. However, while the parcels involved in the additional charges were acquired earlier during the same two-year period, the additional parcels were not acquired within the three-year statute of limitations period for rent skimming which ran before filing the criminal complaint.

The investor claims the criminal charges cannot be brought for the additional acts of rent skimming since:

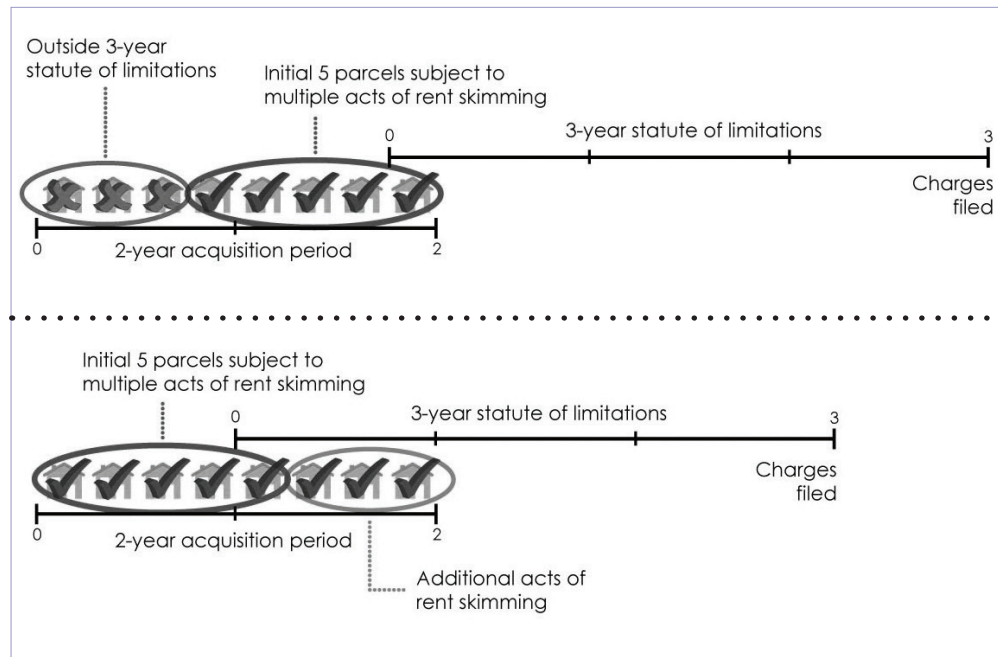
- these parcels were not included in the initial charge of multiple acts of rent skimming; and

<sup>10</sup> CC §891(g)

<sup>11</sup> CC §891(c)

<sup>12</sup> CC §892(c)

Figures 1 and 2  
Rent Skimming



- the investor acquired those additional parcels more than three years before the state brought the action.

Thus, the investor claims they are shielded from prosecution on the additional single acts of rent skimming since the parcels were not acquired within the three year statute of limitations.

The state claims the prosecution of each additional violation is proper since all the charges were brought within three years after the last acquisition of a parcel subject to rent skimming, and the additional acquisitions occurred within the two-year period ending on acquisition of the last parcel.

Is the investor subject to criminal charges for the additional acts of rent skimming for properties acquired prior to three years before the additional charges were filed?

No! The state's action for each additional rent skimming violation after the first violation comprised of five separate acts of rent skimming within two years is time-barred by the three year *statute of limitations*. The acquisition of each additional parcel which is the subject of each **additional violation** did not occur within three years prior to filing the action.<sup>13</sup> [See Figure 1]

Here, properly, all the parcels listed in the multiple acts of rent skimming accusation were acquired within a two-year period. Also properly, five of the parcels are the basis for conviction on the initial charge of multiple acts of rent skimming.

However, some of the parcels listed as multiple acts of rent skimming were acquired outside the three-year statute of limitations (but within the two-

<sup>13</sup> *People v. Bell* (1996) 45 CA4th 1030

year acquisition period). For the initial five parcels listed in the charges, only the acquisition of one parcel need occur within the three-year period to prosecute the initial criminal count for multiple acts of rent skimming.<sup>14</sup>

All additionally listed parcels subject to rent skimming beyond the initial five parcels may not be prosecuted when the three-year statute has run. They were acquired prior to three years before the criminal complaint was filed. [See Figure 2]

To be subjected to penalties for *additional acts* listed, along with the initial five parcels needed to prove multiple acts of rent skimming for a conviction, the additional listed parcels need to both be acquired within:

- the two-year period for all listed parcels; and
- the three year period for the criminal filing.

An investor guilty of an initial five acts of rent skimming under a multiple rent skimming charge is subject to criminal penalties of:

- imprisonment for one year;
- a fine of no more than \$10,000; or
- both imprisonment and a fine.<sup>15</sup>

For each *additional* act of multiple rent skimming the investor is found guilty of beyond the initial five acts, additional penalties include:

- an additional one-year imprisonment;
- a \$10,000 fine; or
- both imprisonment and the fine.<sup>16</sup>

When an investor has been previously convicted of multiple acts of rent skimming, later convictions for further rent skimming impose the same penalties as additional acts of rent skimming for each new single act.<sup>17</sup>

The crime of multiple acts of rent skimming is considered a **misdemeanor** unless the court in its discretion sentences the rent skimmer to state prison.<sup>18</sup>

An adverse possessor often acts as a landlord, renting out properties and receiving rents from residential tenants without the property owner's consent. Typically, they claim the right to possession through a false claim of title and trespass (a requisite to becoming the owner after five years in possession and all property taxes are paid).

An adverse possessor who does not first use the rents to make payments on mortgages encumbering the property is engaging in rent skimming.<sup>19</sup>

## Adverse possession

<sup>14</sup> CC §892(c)

<sup>15</sup> CC §892(a)

<sup>16</sup> CC §892(a)

<sup>17</sup> CC §892(b)

<sup>18</sup> Calif. Penal Code §17

<sup>19</sup> CC §890(a)(2)



Consider an adverse possessor who, within a 24-month period, takes possession of five or more parcels of unoccupied residential property. Each parcel is encumbered by a mortgage.

During the first year after taking possession of each property, the adverse possessor rents the properties to tenants under their claim of ownership. The adverse possessor collects rents which are not applied toward payments due on mortgages encumbering the properties.

The state prosecutes the adverse possessor for engaging in multiple acts of rent skimming. The adverse possessor has no justification (such as maintaining the habitability of the property or correcting code violations) for not forwarding the rents to the lender, up to the amount of the delinquent and current month's payments.

The adverse possessor claims they are not engaged in rent skimming since they rented the unoccupied properties as their initial step toward acquiring title.

Is the adverse possessor guilty of multiple acts of rent skimming?

Yes! The adverse possessor is **criminally liable** for multiple acts of rent skimming. Here, they collected rents during the first year of possession on five properties taken over during a two year period and did not use the rents to pay the mortgages.

However, the adverse possessor, like any property investor, is initially entitled to take the rents since they are in physical possession of the parcels. Thus, an adverse possessor does not commit the felony of *grand theft* since their taking of the rents is not a crime. Nevertheless, they are criminally liable for multiple acts of rent skimming for failing to apply the rents to mortgage payments.<sup>20</sup>

## The investor's defenses to rent skimming

A rent-skimming investor avoids both criminal and civil rent skimming liabilities when:

- the rents were used to pay their medical expenses, or licensed contractors and material suppliers to correct any building violations relating to the habitability of the property;
- the expenses were paid within 30 days of receiving the rental revenue; and
- no other source of funds existed from which to pay the expenses.<sup>21</sup>

To avoid rent skimming charges, an investor who becomes delinquent submits to the lender the entire monthly rent they receive from tenants, limited to the delinquent and current monthly payments due. Usually, the lender will imprudently return the funds to the investor, refusing to accept the rents when the amount is insufficient to fully reinstate the mortgage.

<sup>20</sup> *People v. Lapcheske* (1999) 73 CA4th 571

<sup>21</sup> CC §893

To be assured the lender receives the rents, the investor needs to pursue a deposit of some other nature with the lender.

An investor does not shield themselves from rent skimming claims by obtaining an agreement from a tenant waiving the tenant's rights against rent skimmers. Any waiver of rent skimming law is **void** as contrary to public policy.<sup>22</sup>

## Investor attempts to limit liability

Similarly, an investor cannot shield themselves from rent skimming penalties by purchasing their properties through a limited liability company (LLC), partnership or corporation. The investor operating under any type of business entity or title-holding arrangement will still be held liable as a rent skimmer. They are the individuals in control of the rental properties and mortgage payments.<sup>23</sup>

In distinction, a **property manager** is not liable for rent skimming. A property manager is an employee of the owner and is not in the position of control over the property. Their work is as an agent of the owner, the individual who controls the use of rents and payments on the mortgages.<sup>24</sup>

Likewise, rent skimming law does not hold a tenant liable who:

- sublets their unit;
- collects rental payments; and
- fails to make rental payments to the owner of the property.<sup>25</sup>

Many investors seek out desperate owners who are in default on mortgages insured by the **Federal Housing Administration (FHA)** or guaranteed by the **U.S. Department of Veterans Affairs (VA)**. In these situations, the investor acquires the property with little or no money down, and then converts it to a rental unit.

## The federal scheme

For example, an investor acquires two or more homes in default which are encumbered by FHA or VA mortgages. The investor rents the properties to tenants but applies none of the rents received to the underlying mortgages.

The investor is prosecuted for rent skimming by the federal government.

The investor claims the government may not prosecute them unless it can show they had the intent to defraud the government.

Here, the investor need not even be aware the properties are FHA-insured or VA-guaranteed to be convicted of rent skimming when the investor:

- acquires a single residential property;
- rents the property;
- collects rents; and

<sup>22</sup> CC §891(a)

<sup>23</sup> CC §890(c)

<sup>24</sup> CC §890(c)

<sup>25</sup> CC §890(a)(2)

- fails to make payments on the mortgages.<sup>26</sup>

An investor is guilty of rent skimming under **federal law** when they:

- acquire two or more one-to-four unit residential properties encumbered by FHA-insured or VA-guaranteed mortgages;
- default on the mortgages within one year after acquisition, or the mortgages are in default at the time of acquisition;
- intentionally fail to make payments on the mortgages when due; and
- use the rental income for their own purposes.<sup>27</sup>

The federal rent skimming statute does not apply to an investor who skims rent on only one property subject to an FHA/VA mortgage. An investor found guilty of rent skimming will be subject to:

- a fine no greater than \$250,000;
- imprisonment for no more than five years; or
- both imprisonment and the fine.<sup>28</sup>

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<sup>26</sup> **United States v. Laykin** (9th Cir. 1989) 886 F2d 1534

<sup>27</sup> 12 United States Code §1709-2

<sup>28</sup> 12 USC §1709-2

Rent skimming occurs when an investor receives rents from a parcel of residential rental property during their first year of ownership and does not apply the rents (or an equivalent amount) to the payments due on all mortgages secured by the property.

An investor exposes themselves to state criminal prosecution as well as civil penalties for multiple acts of rent skimming when they skim rents from five or more parcels of residential real estate they took title to during any two-year period.

An investor who engages in multiple acts of rent skimming is liable to the mortgage lenders for money losses incurred on mortgages secured by one of the properties involved in rent skimming. However, lender recovery is limited to the rents collected on the property, whether or not the investor obtained or assumed the mortgage.

An investor engaged in multiple acts of rent skimming also exposes themselves to a separate criminal prosecution, not only civil liability for money losses they inflict on tenants, sellers and mortgage lenders.

The investor operating under any type of business entity or title holding arrangement will still be held liable as a rent skimmer. They are the individuals in control of the rental properties and mortgage payments. In distinction, a property manager is not liable for rent skimming.

Any waiver of rent skimming law is void as contrary to public policy.

**parcel..... pg. 404**  
**rent skimming ..... pg. 403**

**Chapter 38  
Summary**

**Chapter 38  
Key Terms**

**Quiz 15 Covering Chapters 38-40 is located on page 455.**

*Notes:*



# Attorney fees reimbursed

## Chapter 39

After reading this chapter, you will be able to:

- determine when an agreement containing an attorney fees provision entitles a person in a lawsuit to attorney fees;
- distinguish between claims on contract and tort actions and the collection of attorney fees under differently worded provisions; and
- discuss risk reduction concerns with attorney fees provisions in differing contractual arrangements.

**attorney fees provision**

**class action**

## Learning Objectives

## Key Terms

Consider an owner of real estate who signs a promissory note in favor of a private lender to evidence a debt. The debt is secured by a trust deed on the owner's property.

The note provides for the owner to pay attorney fees incurred by the lender on an *action to enforce the note*. Thus, the **attorney fees provision** by its wording:

- limits recovery to actions on the contract, not negligence of other tort actions; and
- is one-sided in its application — enforceable by the lender only.

The lender making the loan is not licensed as a real estate broker. Also, a real estate broker is not consulted to arrange the loan. Thus, the loan is controlled by the **usury ceiling** on the annual yield received by the lender over the life of the loan, such as interest, discounts and bonuses.<sup>1</sup>

## By agreement, by statute or by both

### **attorney fees provision**

A provision in an agreement permitting the prevailing party to a dispute to receive attorney fees when litigation arises due to the agreement. [See RPI Form 552 §23.2]

<sup>1</sup> Calif. Constitution, Article XV §1

However, the interest yield agreed to by the property owner exceeds the usury ceiling (the Federal Reserve Board of San Francisco discount rate, plus 5% with a 10% floor). Thus, the loan is usurious and only the principal amount advanced may be collected by the lender.

The owner discovers the loan is usurious and tenders only the amount the lender is legally able to collect — the remaining principal, less all interest and discounts paid.

The lender rejects tender of the adjusted principal and statutory reconveyance costs and initiates foreclosure to enforce the note. To protect against the loss of their property, the owner files a lawsuit claiming usury as a defense to the lender's attempts to foreclose on their property.

The loan is held to be usurious. The owner, having prevailed, demands payment of their attorney fees from the defeated lender under the attorney fees provision in the note.

The lender claims they owe no attorney fees since they never agreed in the *attorney fees provision* to pay the owner's attorney fees. Under the provision, only the owner agreed to pay the lender's attorney fees.

Is the lender liable for the owner's attorney fees?

Yes! The existence in the note of an attorney fees provision for enforcement of the note entitles the **prevailing party** to a money award for their attorney fees against the lender who lost, even when the provision is written to protect only the lender.<sup>2</sup>

Conversely, had the private lender successfully enforced collection of their loan by defeating the owner's usury defense, the lender is entitled to reimbursement of their attorney fees from the owner.

## Paying the attorney

Each party to a lawsuit bears the burden of their own attorney fees unless a **statute**, or the **agreement** out of which the dispute arose, calls for an award of attorney fees to the prevailing party.<sup>3</sup>

Additionally, a claim by an individual for **indemnity** requiring another person to hold the individual harmless in litigation initiated by a third person is another basis for collecting attorney fees.

Paying your own attorney fees is a tradition in American law. Conversely, the English common law entitles the winning party to be paid their attorney fees by the loser.<sup>4</sup>

<sup>2</sup> Calif. Civil Code §1717; **Winnett v. Roberts** (1986) 179 CA3d 909 (Disclosure: The legal editor of this publication was the attorney of record for the property owner in this case.)

<sup>3</sup> Calif. Code of Civil Procedure §1021

<sup>4</sup> **Reynolds Metals Company v. Alperson** (1979) 25 C3d 124



With attorney rates per hour far exceeding the average daily pay received by the average household, and contingency fee arrangements exceeding one-third of the money/value recovered, the cost of litigation is an **economic factor** which weighs on the resolution of any dispute.

Accordingly, it is financially essential a broker confronted with a claim understand when and how attorney fees may be collected (or paid), either by themselves or by others.

Real estate agreements which may contain an attorney fees provision include:

- listings;
- purchase and exchange agreements;
- escrow instructions;
- leases and rental agreements; and
- promissory notes and trust deeds.

Persons most likely to sue and prevail on an attorney fees provision include landlords in lease agreements, lenders in promissory notes and brokers in listing agreements.

Additionally, these classes of litigants are likely to want the attorney fees provisions worded to limit recovery of attorney fees to actions for **enforcement** of the lease, note or listing. Thus, they get attorney fees if they win, or the person sued gets attorney fees for defending.

However, the persons sued on a contract with an attorney fee provision limiting recovery of enforcement cannot collect their attorney fees on any action they pursue on a tort theory which **arises out of the contract**. For example, misrepresentation or breach of agency duties claims arising out of a contract are often raised by those defending against a lawsuit.

Purchase agreements entered into by buyers and sellers exist in a dispute-prone environment. As a result, brokers need to consider excluding attorney fees provisions from some agreements as a **risk reduction strategy** to limit the incentive of others to litigate disputes in transactions they have negotiated.

For example, the California Association of Realtors' purchase agreement form contains an attorney fees provision (as well as the publicly unacceptable compulsory arbitration agreement).

Conversely, neither an attorney fees provision nor an arbitration agreement is included in any of the purchase agreement forms published by **RPI (Realty Publications, Inc.)**.

The difference is significant.

## Real estate practices for attorney fees

## To use or not to use

## Mediation first

*The inclusion of a mediation provision in all real estate agreements mitigates the risk of costly judicial actions and incorrect arbitration results.*

**Mediation** is an informal, confidential, non-binding legal process. By design, mediation helps the parties reach an accord and put disputes to rest without litigation, while still allowing for judicial intervention when a resolution is not found.

Unlike arbitration, which requires parties to an agreement to actively sign or initial away their rights to a fair and reviewable judicial determination, mediation passively allows for a mutually acceptable termination of a dispute.

In the process, a neutral third-party — the mediator — acts as an avuncular facilitator. The mediator encourages the disputing parties to arrive at their own decision. They do this by fostering an environment of discussion, asking questions while listening for a commonality of thoughts needed for settlement and resolution. Mediators are trained to help craft a conclusion and end disputes.

While a mediation provision requires participation, either party can withdraw during the process. In addition to these benefits, the use of mediation also provides a solution to a dispute without adding and falling subject to the backlog of cases burdening the legal system.

Most importantly, mediation works. The Los Angeles superior court system reports that 63% of cases ordered into mediation are resolved. Nationwide, the mediation success rate ranges between 60%-90%. [Final Report of Colorado Governor's Task Force on Civil Justice Reform, Exhibit 7]

For buyers and sellers, attorney fees provisions tend to encourage and promote litigation of disputes rather than inhibit disputes. When buyers and sellers sue one another over a transaction, brokers are uniformly named as defendants who are at least claimed to owe a duty to indemnify.

The absence of an attorney fees provision in purchase agreements appropriately focuses the dispute on the **monetary recovery** available, an amount limited to actual money losses on a transaction. Financially, any money award recovered is reduced by the attorney fees paid to pursue the recovery.

As a result, a dispute between a buyer and a seller will not proceed to litigation when the recovery of the money losses will be **economically infeasible** to pursue unless there exists the ability to additionally recover attorney fees, an unintended but real consequence of the provision. Thus, the risk of a broker's entanglement in litigation between buyers and sellers is reduced by eliminating the attorney fees provisions from purchase agreement forms.

Without an attorney fees provision, the buyer or seller needs to be fully convinced they will prevail against the other, and willing to pay and bear the ultimate cost of their own attorney fees from any recovery. Their attorney will advise them of this result on reviewing the purchase agreement.

## Case-in-Point

The case for a limited attorney fees provision

*Attorney fee provisions in transaction agreements carry financial implications for real estate brokers and landlords. Brokers occasionally end up entangled in litigation between buyers and sellers, landlords and tenants or lenders and borrowers. The primary culprit is the existence and enhanced encouragement provided by an attorney fees provision which induces someone to file suit rather than settle.*

*Consider a tenant who enters into a lease agreement. The lease agreement contains an attorney fees provision stating the prevailing party in any “**action arising out of the tenancy granted**” by the agreement is entitled to attorney fees. The tenant sustains physical injury in a common area of the property due to the landlord’s negligent maintenance. The tenant sues and is awarded a money judgment against the landlord to recover money losses incurred due to the injury.*

*The tenant seeks to recover the attorney fees they incurred in pursuing their claim to judgment, claiming their injury, and thus their judgment award, were the result of their tenancy in the property and costs of the litigation are governed by the attorney fee provision in the lease agreement.*

*The landlord rejects the tenant’s claim for attorney fees, arguing the tenant’s injuries were not a result of the landlord’s breach of the lease agreement contract since it is a tort claim arising out of the landlord’s conduct and thus not governed by the contract’s attorney fee provision.*

*However, the tenant is entitled to their attorney fees. The tenant’s injury arose out of their tenancy and the attorney fees provision as worded referenced that claim without limiting recovery of attorney fees to actions on the lease agreement contract. [**Hemphill v. Wright Family, LLC** (2015) 234 CA4th 911]*

*First, the Hemphill action was a **tort claim** — not a contract claim — against the landlord. The tenant sought to recover losses incurred due to physical injuries sustained due to improper maintenance by the landlord. Thus, the tenant’s injury did not occur due to the landlord’s breach of the lease agreement.*

*Second, the attorney fee provision in the lease agreement referenced claims arising out of the tenancy — not just claims for breach of the leasing contract. The provision, in part, stated:*

*“[in]any action aris[ing] out of the Homeowner’s tenancy, this Agreement, or the provisions of the Mobilehome Residency Law, the prevailing party or parties shall be entitled to recover reasonable expenses, including without limitation attorney fees and costs.”*

*Editor’s note — In Hemphill, the tenant owned a mobilehome and leased ground space on which to park and occupy it.*

*Lease agreement forms published by **RPI** have always contained the following limited attorney fees provision:*

*In any action to enforce this agreement, the prevailing party will receive attorney fees. [See **RPI** Form 550 §7.5]*

*Aside from engineered brevity and clarity of purpose, the key difference between this attorney fees provision and the Hemphill provision lies in its limitation to actions to **enforce this agreement**. This automatically limits an award of attorney fees to claims filed to enforce aspects of the lease agreement itself (payments and other agreed performances). Thus, the wording discourages the litigation of disputes secondary to the agreement such as the tort claim for physical injury suffered by the tenant.*

## Who benefits by ability to recover fees

At first glance, attorney fees provisions inserted in purchase agreements appear to only benefit the attorneys who represent the parties.

However, real estate attorneys do not take cases involving real estate disputes on contingency fee arrangements. Rather, they are paid based on an hourly rate. On retaining an attorney, the client is required to sign an attorney fee agreement, which itself contains an attorney fees provision.

The deposit of an upfront retainer, against which the attorney bills their time, is almost always demanded by the attorney.

Clients who do not pay their attorney by either depositing a minimum balance with them or paying billings on time, will find their attorney successfully requesting the court for a withdrawal from the case.<sup>5</sup>

Accordingly, experienced attorneys retained on real estate matters assure themselves from the outset of a transaction they will be paid for their services by their client.

Thus, attorney fees provisions do not benefit attorneys, other than by inducing them to advise their client to litigate based on their expectation of winning.

On the contrary, attorney fees provisions are designed to **reimburse the winner** — as the beneficiary of the provision — on successful completion of litigation by trial. When the litigation is terminated by a timely voluntary dismissal or settlement, no one collects attorney fees.

The presence (or absence) of an attorney fees provision in a contract plays a significant role in the eagerness with which individuals pursue, defend or avoid legal disputes.

## Agreed-to attorney fees

Any agreement containing an attorney fees provision entitles the prevailing party to reimbursement of attorney fees they incurred enforcing the contract, regardless of how the provision is worded.<sup>6</sup>

This **reciprocal fee statute** applies to actions on the contract only, not tort actions such as misrepresentation, deceit or breach of agency duties.

An attorney fees provision in an agreement is read to apply reciprocally for all parties to the agreement to collect attorney fees when they prevail on any action based on the contract.

Simply, when an attorney fees provision exists, the prevailing party at trial receives their attorney fees in contract disputes. The fees are limited only by reasonableness, the wording of the fee provision and the application of the reciprocal fee statute.<sup>7</sup>

<sup>5</sup> **People v. Prince** (1968) 268 CA2d 398

<sup>6</sup> CC §1717(a)

<sup>7</sup> **Smith v. Krueger** (1983) 150 CA3d 752

The losing party does not necessarily pay *all* of the prevailing party's attorney fees under an attorney fees provision — only the fees which the court deems **reasonable**.

## Only reasonable fees

Courts have a great deal of discretion in deciding what is reasonable and may consider:

- the complexity of the litigation;
- attorney rates for similar cases in the area;
- the prevailing attorney's experience, knowledge and skill;
- the time properly consumed by the case; and
- the amount of the final judgment.<sup>8</sup>

Many agreements include the word "reasonable" in the language of the attorney fees provision.

Even when the attorney fees provision does not state "reasonable attorney fees," reasonable fees are **implied**.

Attorney fees are assessed and collectable only after a judgment becomes final and ends the litigation. The prevailing party needs to ask the court for the fees or submit the attorney fees as part of the court costs to be recovered.<sup>9</sup>

Either way, a copy of all billings for legal services is submitted to the court as evidence of the prevailing party's attorney fees. The losing party will likely object to the costs, calling them "unreasonable."

When the prevailing party's actual attorney fees exceed what the court deems reasonable, they are not reimbursed for the excessive fees paid or demanded by their attorney. Fees paid in excess of a reasonable amount are borne by the prevailing party.

The **prevailing party**, determined when the court enters its final judgment in the case, is the individual who:

- receives the greater money damages award;<sup>10</sup>
- receives the requested equitable relief (a non-money remedy, such as specific performance); or
- successfully defends against the plaintiff's claim and the plaintiff obtains no relief.<sup>11</sup>

## Who is the prevailing party?

For example, a group of tenants sue their landlord for a breach of their leases. The leases contain an attorney fees provision.

When the tenants withhold rent payments, the landlord files an unlawful detainer (UD) action to evict the tenants. The tenants' action and the landlord's UD action are consolidated into one lawsuit.

<sup>8</sup> **Berry v Chaplin (1946)** 74 CA2d 669

<sup>9</sup> CCP §1021

<sup>10</sup> CC §1717(b)(1)

<sup>11</sup> CCP §1032(a)(4)

The tenants prevail on their claim the landlord breached their lease agreements and are awarded a money judgment. However, the landlord is also awarded a money judgment against the same tenants for the delinquent rent. A **setoff** then occurs between the greater and the lesser amounts of the two opposing money awards.

The money judgment awarded to the tenants is greater than the amount of the landlord's judgment. Both the landlord and the tenants claim their attorney fees are owed since each prevailed on their respective claims.

Who is the prevailing party: the landlord, the tenants or both?

In this instance, the tenants prevail for purposes of recovering attorney fees under the lease since the tenants received a higher dollar amount of recovery than the landlord.<sup>12</sup>

However, a court has the discretion to decide neither party prevailed. When the money recovery by both parties is comparable or so small that neither party is the winner, the court may deny the payment of attorney fees.<sup>13</sup>

Additionally, when a case is **voluntarily dismissed** in a timely fashion or dismissed **pursuant to a settlement**, neither party prevails for attorney fees purposes.<sup>14</sup>

## On the contract or arising from it

A client's attorney pursues recovery based on numerous theories and causes of action, some in contract to enforce an agreement, some in tort to recover for bad conduct.

For example, a buyer sues their seller. The buyer alleges intentional misrepresentation, negligence, breach of contract and agency duties, indemnity and even emotional distress in an effort to recover their money loss on the purchase and litigation.

Each legal theory for recovery is a separately stated claim for recovery, some to enforce the contract, and some based on the seller's conduct, called **torts**. The buyer's attorney spends billable time researching, investigating and establishing proof for each the contract and tort claims the buyer is making.

The purchase agreement the buyer used to document the transaction contains an attorney fees provision covering all litigation **arising out of the subject** of the agreement, wording not limited to litigation enforcing the contract.

In this instance, the prevailing party may recover attorney fees for the billable time spent on *every claim* they prevail on which arises out of the **subject matter** of the agreement — not just for the fees incurred on claims seeking to enforce the purchase agreement, such as specific performance.

Claims other than for enforcement or the recovery of money losses under a breached purchase agreement (specific performance or lost value) arise due

<sup>12</sup> **Haire v. Stevenson** (1987) 196 CA3d 1249

<sup>13</sup> CC §1717(b)(1)

<sup>14</sup> CC §1717(b)(2)



to a person's improper conduct. These claims are personal under *tort theories*, including breach of fiduciary duties, breach of covenants for good faith and fair dealing, and fraudulent representation, deceit or concealment.<sup>15</sup>

Consider the recovery of attorney fees incurred by a client who pursues a *fraud or negligence* action against a broker arising out of their employment under a listing agreement. The recovery of the attorney fees by either party depends on the type of attorney fees provision contained in the listing agreement.

For example, a broker employed by a buyer under a listing agreement fails to include key terms from a purchase agreement in the escrow instructions. The attorney fees provision is all-inclusive; it calls for reimbursement of attorney fees in **any action arising out of the listing agreement**.

The buyer sues the broker for both neglect and breach of the listing agreement.

The buyer wins a money judgment against the broker for their negligent conduct as an agent of the buyer and demands their attorney fees under the attorney fees provision in the listing agreement.

The broker claims they owe no attorney fees since their negligence while acting as an agent was the basis for the client's recovery, not a dispute regarding a breach or performance of the listing agreement.

Is the buyer entitled to receive attorney fees?

Yes! The attorney fees provision in the listing agreement was not limited to recovery based solely on enforcement of the listing agreement. The broker's negligence as an agent arose out of their employment agreed to in the listing agreement, which is an action covered by the "all-inclusive" attorney fees provision.

The broker's negligent acts as an agent while handling the sale of the listed property are not separate and distinctly different activity from the employment undertaken in the listing agreement to locate a buyer for the property. The neglect occurred as a result of the employment.<sup>16</sup>

However, the broker is not liable for attorney fees for their negligent conduct when the attorney fees provision limits recovery to enforcement of the listing agreement.

Now consider a buyer and seller who enter into a purchase agreement on a form which separates the seller's agreement to pay a brokerage fee from the purchase agreement signed by the buyer. The separate brokerage fee agreement is signed by the seller, but not the buyer. Thus, the brokerage fee is not provided for within the terms of the purchase agreement.

## The listing and attorney fees provisions

## Buyer's broker and no attorney fee provision

<sup>15</sup> *3250 Wilshire Boulevard Building v. W.R. Grace & Company* (9th Cir. 1993) 990 F2d 487

<sup>16</sup> *Perry v. Robertson* (1988) 201 CA3d 333



However, the buyer's purchase agreement includes an attorney fees provision covering any dispute between the parties to the purchase agreement.

Later, the buyer sues the broker for misrepresentation. The broker retains an attorney and prevails against the buyer.

The broker claims they are entitled to recover their attorney fees from the buyer since they received a fee on the sales transaction which was documented by a purchase agreement "containing" an attorney fees provision.

In this example, the broker is not entitled to recover their attorney fees. The broker's only right to a brokerage fee is derived from the separate brokerage fee agreement entered into by the seller, which the buyer never signed.

Thus, the broker cannot benefit from the attorney fees provision in the purchase agreement since the provision for payment of a brokerage fee was not agreed to by the buyer. The attorney fees provision was part of the seller's separate brokerage fee agreement, not the buyer's purchase agreement entered into by the buyer.<sup>17</sup>

## Unenforceable agreements

A buyer and seller enter into a real estate purchase agreement containing an attorney fees provision. The buyer and seller become embroiled in a dispute over a contingency and the seller cancels the transaction.

The buyer sues the seller for specific performance of the purchase agreement. However, the buyer loses since the terms of the purchase agreement are too ambiguous for the court to determine what the parties agreed to or how to enforce the agreement.

As the prevailing party, the seller makes a demand on the buyer for payment of their attorney fees. The buyer claims attorney fees are not owed since the agreement is **unenforceable**.

Is the seller entitled to recover their attorney fees from the buyer?

Yes! An attorney fees provision acts separately from the agreement it is in to permit an award of attorney fees to the person who prevails in the action even when the underlying agreement is unenforceable.<sup>18</sup>

Now consider a buyer and seller who enter into a purchase agreement.

Before closing, the seller's broker obtains a **backup offer** from another buyer to purchase the same property if the prior transaction with the first buyer is terminated.

The purchase agreements in both transactions contain attorney fees provisions.

<sup>17</sup> *Super 7 Motel Associates v. Wang* (1993) 16 CA4th 541

<sup>18</sup> *Manier v. Anaheim Business Center Company* (1984) 161 CA3d 503

The seller and the buyer in the first transaction *renegotiate* and totally restructure the agreement, setting different terms and conditions. The prior transaction with the first buyer, as renegotiated, closes.

The backup buyer claims the renegotiated transaction the seller closed with the first buyer is a new and later agreement, not the prior agreement on which their backup transaction was contingent. Thus, the backup buyer claims the contingency no longer exists and the backup agreement now has priority and is enforceable.

The backup buyer sues the seller and the first buyer to enforce their backup purchase agreement and acquire ownership of the property.

Here, the first buyer prevails. As a result, the first buyer claims the backup buyer owes the amount of the attorney fees they incurred defending against an attempt to enforce the backup buyer's purchase agreement.

The backup buyer claims they do not owe attorney fees to the original buyer since the first buyer was not a party to the backup purchase agreement which was litigated.

Does the original buyer, who was not a party to the unenforceable backup purchase agreement, receive their attorney fees?

Yes! The backup buyer sued the original buyer **to enforce an agreement** containing an attorney fees provision. The original buyer, now the owner, successfully defended their ownership of the property against the claim to ownership made under the backup contract.<sup>19</sup>

A buyer takes title to real estate subject to an existing first trust deed. The lender, aware of the transfer, **calls** the loan and accepts installments without first entering into a loan assumption agreement with the buyer. Much later, the lender initiates foreclosure due to the tandem effect of the call under the due-on-sale and acceleration clauses in the trust deed.

Both the note and the trust deed contain an attorney fees provision. The buyer sues the lender to stop enforcement of the call under the due-on-sale and acceleration clause and prevails on the claim the lender waived its right to foreclose by accepting payments after the call.

The buyer then makes a demand on the lender for attorney fees incurred to enforce their rights under the lender's note and trust deed.

The lender claims the buyer may not collect attorney fees since they did not sign or formally assume the note and trust deed. Thus, the buyer is **not a party** to the trust deed contract being litigated.

May the buyer collect their attorney fees even though they never signed or formally assumed the existing loan?

## Attorney fees on an assumed loan

<sup>19</sup> **Meadows v. Lee** (1985) 175 CA3d 475

Yes! Attorney fees are payable to the prevailing party, in this example the buyer, in a dispute enforcing an agreement containing an attorney fees provision. An agreement containing an attorney fees provision *does not need to be signed* by either party for the prevailing party to collect attorney fees.<sup>20</sup>

### By statute or by court order

The prevailing party in some real estate disputes is entitled to recover their attorney fees under a statute or by a court-created right.

For example, a water district maintains a canal system to collect excess water from one basin and divert it into a neighboring water basin.

The diverted water floods an owner's property. The property owner sues the water district to recover the fair market value (FMV) of their property under their federal constitutional right to just compensation for a *taking* by a government agency, legally called **inverse condemnation**.

The owner claims the water district has taken their property by physically occupying it with flood water, as though the water district has formally condemned the property through inverse condemnation for its own use to store excess water.

The water district claims the physical occupation of the owner's property by its flood waters is not a taking and only inflicts flood damage to the property. The owner wins their inverse condemnation action, forcing the water district to pay the full cash value of the flooded property.

The owner demands reimbursement of their attorney fees spent pursuing their claim against the water district.

The water district claims the owner has no right to reimbursement of attorney fees since the United States Constitution makes no mention of attorney fees as a part of recovery under the just compensation clause.

However, the owner claims the attorney fees are collectable under California **statutory** recovery of attorney fees in inverse condemnation actions.<sup>21</sup>

Is the owner of the flooded property entitled to reimbursement of their attorney fees spent on their inverse condemnation action?

Yes! The California Legislature created the right to collect attorney fees in *taking actions*, even though the federal constitutional right to recover the property's value contains no mention of the payment of attorney fees.<sup>22</sup>

However, when the flooding only damages the property and is not a taking of the real estate, no attorney fees are owed since no statute exists for the reimbursement of attorney fees in real estate damage cases.

**Eminent domain** actions are often initiated by government agencies to take property from an owner and in turn compensate them for their

<sup>20</sup> *Saucedo v. Mercury Savings and Loan Association* (1980) 111 CA3d 309 (Disclosure: The legal editor of this publication was the attorney of record for the property owner in this case.)

<sup>21</sup> CCP §1036

<sup>22</sup> *Salton Bay Marina, Inc. v. Imperial Irrigation District* (1985) 172 CA3d 914

property's value. When a property owner challenges the eminent domain action based on its legitimacy or the price the government agency offers to pay, the property owner is entitled to reimbursement of their attorney fees – if they prevail.<sup>23</sup>

However, consider a government agency which seeks a pre-trial settlement conference to negotiate the amount of compensation owed to a property owner in an eminent domain action.

The owner refuses to negotiate the compensation amount and demands a trial despite the government agency's willingness to compromise.

The owner prevails at trial but is not entitled to attorney fees since the trial was *frivolous and unnecessary*. The owner was able to settle the issue with the government agency in a pre-trial conference.<sup>24</sup>

In another example, mobilehome park rent increases and termination of lease/rental agreements are controlled by the **Mobilehome Residency Law**. Any action about a violation of the landlord/tenant law controlling mobilehomes entitles the prevailing party to attorney fees, whether the prevailing party is the landlord or the tenant.<sup>25</sup>

Similarly, real estate owners who have had their civil rights violated may collect their attorney fees by statute.

## Civil rights violations

For example, an owner of an adult theater is forced to shut down their business due to the city's excessively restrictive zoning ordinances.

The owner sues the city and wins since the ordinances violate federal First Amendment rights to free speech under the United States Constitution.

The owner is entitled to collect their attorney fees from the city, even though the First Amendment does not contain any mention of attorney fees.

Additionally, a federal code permits the collection of attorney fees for violation of civil rights.<sup>26</sup>

Consider attorney fees expended in disputes between vested co-owners of real estate to partition or sell the real estate. The co-owners cannot mutually agree on its management or disposal and have no partnership or tenants-in-common agreement providing for resolution by a vote among the co-owners.

## Partition actions

One of the co-owners incurs attorney fees in the judicial sale or parceling of the property. Are these **attorney fees** recoverable pro rata from the other co-owners?<sup>27</sup>

<sup>23</sup> CCP §1250.410

<sup>24</sup> **Glendale Redevelopment Agency v. Parks** (1993) 18 CA4th 1409

<sup>25</sup> CC §798.85

<sup>26</sup> 42 United States Code §1983

<sup>27</sup> CCP §5874.010 et seq.

Yes, all the co-owners benefitted from the litigation. Thus, the contributions by all co-owners for attorney fees in *proportion* to each owner's percentage of ownership interest in the real estate are proper.<sup>28</sup>

### Another's wrong — indemnity for fees

Even without a statute or contract provision addressing attorney fees, an individual prevailing in real estate litigation may have a **court-created right** to recover their attorney fees.

Consider a buyer who makes an offer to purchase an improved lot on which they will build a home. The seller's broker erroneously advises the buyer their offer has been accepted by the seller and the transaction will close within 30 days.

As a result, the buyer spends money in reliance on the broker's erroneous representation regarding the existence of a binding purchase agreement.

After the buyer is advised they have no enforceable deal, they sue the seller for specific performance and the broker for negligent misrepresentation.

The buyer loses their specific performance action against the seller, but prevails against the broker for misrepresenting the seller had accepted the purchase offer.

The buyer makes a demand on the broker for their attorney fees incurred in the action against the seller, claiming they only sued the seller since the broker improperly advised them on whether a binding agreement existed.

Is the broker liable for the buyer's attorney fees for the action against the seller?

Yes! Attorney fees may be recovered from an individual when the individual's wrongful conduct forces someone to bring or defend a lawsuit against another person (in this example the seller), called indemnity.<sup>29</sup>

Further, the seller also may collect attorney fees from the broker under either the attorney fees provision in the seller's listing agreement they entered into with the broker or the indemnity theory.

### Benefits offset an award of fees

A broker negotiates the sale of an apartment building they have managed for a long time. The broker is aware of **property defects**, but fails to disclose these defects to the buyer.

As a result, the buyer pays the seller more for the apartment building than its present value. Thus, the seller who employed the broker receives a higher sales price than market value considering the property's condition.

<sup>28</sup> *Stutz v. Davis* (1981) 122 CA3d 1

<sup>29</sup> *Gray v. Don Miller & Associates, Inc.* (1984) 35 C3d 498

The buyer, on discovering the property defects, sues the seller and the broker to recover the excess price paid for the property. The buyer obtains a money judgment against the broker, not the seller, for the amount they paid in excess of the property's FMV.

Further, the seller also demands the broker reimburse them for their attorney fees incurred in their successful defense of the buyer's lawsuit, claiming the broker's failure to disclose the property's condition caused the litigation and therefore entitles them to indemnity from the broker.

The broker admits they owe attorney fees to the seller but claims they are entitled to an **offset** against the seller's attorney fees for benefits conferred on the seller by the broker's actions. The dollar offset is the portion of the sales price received by the seller that exceeds the property's FMV.

Since the excess in the sales price is greater than the amount of the seller's attorney fees, the broker claims no reimbursement is due to the seller.

Does the broker owe the seller their attorney fees in spite of the benefits received and retained by the seller due to the broker's wrongful conduct?

Yes and no! The broker is liable for the seller's attorney fees since the broker caused the seller to have to defend against a lawsuit filed by the buyer.

However, the amount owed in attorney fees is reduced — offset — by the excess financial benefit the seller received and retained due to the broker's wrongful conduct. The right to reimbursement for attorney fees incurred due to the wrongful conduct of a broker is subject to a full offset for any **excess benefit** derived by the client from the client/broker relationship. Thus, due to the offset, the broker owes nothing to the seller.<sup>30</sup>

Attorney fees may also be recovered as part of an action or actions against an individual or entity involving all similarly situated claimants, called a **class action**, by such individuals as tenants, borrowers, insureds, buyers, clients, etc.

Legal theories to collect attorney fees in *class action* cases include:

- **common fund** recovery for numerous injured parties;
- **substantial benefit** conferred on a group; and
- benefits conferred on a broad class of people involving a matter of strong **public policy**.

Under the *common fund* theory, the person initiating an action needs to obtain a judgment which benefits a group of persons, such as multiple tenants of a landlord.

In the interest of fairness, the tenant suing and obtaining a money judgment on behalf of themselves and all other tenants is entitled to have their attorney fees paid out of the "fund" of monies received from the landlord.<sup>31</sup>

<sup>30</sup> *Heckert v. MacDonald* (1989) 208 CA3d 832

<sup>31</sup> *Quinn v. State* (1975) 15 C3d 162

## Other court-created rights to attorney fees

### class action

An action against a person brought by or on behalf of all similarly situated claimants.

Consider a city which establishes an assessment district to improve streets. A citizen's group sues the city to prepare an environmental impact report (EIR) before the work may be started.

The citizen's group prevails since an EIR is required as the project substantially affects the environment.

Is the citizen's group entitled to attorney fees from the city?

Yes! The EIR *substantially benefitted* a large group of people and is an important interpretation of environmental law.<sup>32</sup>

Finally, when a person sues and obtains a judgment which affects a large group of people involving a matter of strong **public policy**, the person suing recovers their attorney fees.

For example, a citizen's group enters a shopping center to obtain signatures on a statewide political issue. The owner of the shopping center prohibits the citizen's group from entering the premises.

The citizen's group sues the owner, claiming there was a violation of their First Amendment rights to free speech under the California Constitution. The citizen's group prevails and demands their attorney fees.

The shopping center owner claims no contract or statute entitles the citizen's group to be paid their attorney fees.

The citizen's group claims the case is of such importance to the whole of society that it is a matter of public policy and their attorney fees are to be paid.<sup>33</sup>

Is the citizen's group entitled to have their attorney fees paid by the shopping center owner?

Yes! The citizen's group's case sets strong *public policy* since it benefitted the public as a whole, as though the Attorney General for the State of California had brought the suit on behalf of the people. Thus, the citizen's group is entitled to recover their attorney fees.<sup>34</sup>

A private citizen who is awarded attorney fees in a public policy case is called a **private attorney general**.<sup>35</sup>

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<sup>32</sup> *Friends of "B" Street v. City of Hayward* (1980) 106 CA3d 988

<sup>33</sup> CCP §1021.5

<sup>34</sup> *Press v. Lucky Stores, Inc.* (1983) 34 C3d 311

<sup>35</sup> *Serrano v. Priest* (1977) 20 C3d 25



## Chapter 39 Summary

Attorney fees provisions are designed to reimburse the beneficiary of the provision on successful completion of litigation by trial. When the litigation is terminated by a voluntary dismissal or settlement, no one collects attorney fees.

Each party to a lawsuit has to bear the burden of their own attorney fees unless a statute or the agreement out of which the dispute arose calls for an award of attorney fees to the prevailing party.

The prevailing party, determined when the court enters its final judgment in the case, is the individual who:

- receives the greater money damages award;
- receives the requested equitable relief (a non-money remedy, such as specific performance); or
- successfully defends against the plaintiff's claim and the plaintiff obtains no relief.

Real estate agreements which usually contain an attorney fees provision include:

- listings;
- purchase and exchange agreements;
- escrow instructions;
- leases and rental agreements; and
- promissory notes and trust deeds.

Any agreement containing an attorney fees provision entitles the prevailing party to reimbursement of attorney fees they incurred enforcing the contract, regardless of how the provision is worded and even when the underlying agreement is unenforceable. An agreement containing an attorney fees provision does not need to be signed by either party for the prevailing party to collect attorney fees.

However, the persons sued on a contract with an attorney fee provision limiting recovery of enforcement cannot collect their attorney fees on any action they pursue on a tort theory which arises out of the contract.

A dispute will not proceed to litigation when the recovery of the money losses will be economically infeasible to pursue except for the additional recovery of attorney fees, an unintended but real consequence of the provision. Thus, the risk of a broker's entanglement in litigation between buyers and sellers is reduced by eliminating the attorney fees provisions from purchase agreement forms.

The inclusion of a mediation provision in all real estate agreements mitigates the risk of costly judicial actions and incorrect arbitration results.

The prevailing party in some real estate disputes is entitled to recover their attorney fees under a statute or by a court-created right.

**Chapter 39**  
**Key Terms**

**attorney fees provision ..... pg. 415**  
**class action ..... pg. 429**

**Quiz 15 Covering Chapters 38-40 is located on page 455.**



# Retaining a real estate attorney

## Chapter 40

After reading this chapter, you will be able to:

- locate, interview and retain an attorney to advise and render services in real estate disputes; and
- anticipate what to expect when retaining a competent attorney.

**initial conference**

**retainer agreement**

### Learning Objectives

### Key Terms

Oftentimes, it is necessary or advisable for a licensee in a real estate transaction to seek the legal counsel of an **attorney**.

Consider a licensee who has never sought out the professional advice of an attorney and does not know how to locate or select a qualified one. The licensee needs to determine:

- what steps to take to select a competent attorney to provide legal services;
- what law office attributes and procedures to observe when first meeting with an attorney; and
- what the licensee may rationally expect to encounter when retaining a competent attorney.

To initiate the attorney *selection process*, you first need to talk to several experienced real estate brokers in the area where the subject real estate is located. Ask the solicited brokers for the names of three or four real estate attorneys they have worked with or feel confident referring someone to for advice on real estate and agency matters similar to those confronting you.

### Choosing the right one

### Selecting an attorney

You also need to inquire into the:

- different areas of real estate law each referenced attorney is engaged in;
- types of cases the attorneys handle; and
- competence demonstrated by the attorneys as observed by the solicited brokers.

The recurrence of the name of one attorney who is *consistently recommended* by the brokers contacted is usually a reliable indication of a more experienced, if not more qualified attorney.

While **attorney referral services** and **media advertising** may be helpful in the initial selection stage, it is difficult to obtain objective recommendations or criticism from these biased sources.

It may even be necessary to locate an out-of-area attorney who specializes in the particular type of legal situation confronting you due to the sensitivity of local attorneys. Regardless of locale, at least two or more attorneys are to be selected, with phone or office conferences arranged with each.

Before and after selecting an attorney, it is prudent to contact yet another attorney and hold telephone conferences as “brainstorming sessions.” This provides a second opinion — and an additional or alternative advisor if you determine the first attorney selected is unsuitable. The cost of conferring with another attorney becomes the *premium* paid for the assurance you and the attorney ultimately selected are on the right track, an activity called **risk reduction**.

## A broker's expectations

When meeting with an attorney, you will consider many aspects of the attorney's law office and practice, including:

- the compatibility of the attorney's personality with yours;
- the efficiency and professionalism of the attorney's work habits;
- the law office's appearance and whether it appears to be well organized and adequately equipped;
- the attorney's conversational skills;
- the courtesy, productivity and helpfulness of the office staff;
- how quickly and thoroughly the attorney or staff return phone calls and emails from you; and
- the competency of the attorney's law clerks or legal assistants to follow up and advise on fact investigation, legal research, calendaring of events and related details.

## The initial conference

During the **initial conference** with the selected attorney, discuss your real estate dispute and interview the attorney to determine their qualifications. This contact is the first step toward deciding whether you feel this attorney is the best attorney for you to retain – comparative shopping.

The **first tuesday Real Estate Attorney Database** is a community-generated list of California attorneys who specialize in real estate law. Use the Real Estate Attorney Database to recommend an attorney or use the database to find a real estate attorney in your area by going to:

<http://journal.firsttuesday.us/real-estate-attorney-database/>

Attorneys listed on the Real Estate Database are recommended by **first tuesday Journal** readers and are displayed based on:

- firm/attorney name;
- city and county of practice;
- website, phone number and email address; and
- area of specialization.

**first tuesday** does not endorse or investigate any of the attorneys on this list.

The **California State Bar's Attorney Lookup** tool can be found at the address below:

<http://members.calbar.ca.gov/fal/MemberSearch/QuickSearch>

## Real Estate Attorney Database

Relevant topics to be discussed during the *initial conference* include:

- the attorney's professional background and the types of legal disputes which make up their practice;
- the attorney's previous experience with cases similar to yours;
- whether the attorney's practice regularly calls for their appearance in the court which will hear your case;
- the attorney's initial grasp and assessment of the facts and laws controlling the case;
- whether or not, and why, the attorney believes they can obtain a favorable result for you;
- the different procedural stages, including negotiations, filing, discovery, trial and possible appeal;
- whether the dispute is covered by any insurance policies you hold;
- the potential liability exposure or other negative consequences on an adverse result of the litigation;
- whether the prevailing party may collect their attorney fees from the other party;
- the attorney's hourly fee and required retainer deposit (and the policies surrounding its refund on the termination of their representation);
- whether the attorney has a conflict of interest based on their other cases and clients;
- the estimated cost of handling the various stages in the resolution of the dispute;
- their attitude toward mediation or other settlement of a case; and
- the tax reporting permitted for the payment of the attorney fees.

### initial conference

The first meeting between a licensee and prospective attorney conducted prior to entering into a retainer agreement where the licensee discusses their real estate dispute and interviews the attorney to determine their professional background, qualifications and compatibility.

When you are interviewing the attorney, the attorney will also be deciding whether or not they want to represent you. Attorneys will not, unlike some listing agents, take on any individual as a client.

You also need to determine whether the attorney will handle the case themselves or delegate the analysis and decision-making process to a **subordinate** or **partner**. If the case is to be delegated, you need to determine how closely the attorney will supervise the handling of the case.

You also need to interview the associate attorney who will work on or actually handle the case. Prudence suggests you include any associate attorney in the conference to avoid *double billing* for repeating the same discussion.

You will likely be billed for this initial consultation on a per hour basis. Ask before you have the meeting. Attorneys' hourly rates range from \$150 to \$600 per hour, depending on their location and expertise. Any time spent counseling with the attorney or their staff will cost you money. Be efficient and save yourself money by fully preparing with notes before calling or meeting with an attorney.

An attorney has the basic duty to respond promptly to any status inquiries you ask for. Further, the attorney is required to keep you reasonably well informed, at least monthly, on matters relating to the case.<sup>1</sup>

When an attorney you interview is not retained to represent you, the attorney still has the duty to maintain **confidentiality** of the information exchanged during the initial conference.<sup>2</sup>

## Retainer agreements

### retainer agreement

A contract entered into between an attorney and licensee specifying the respective responsibilities of each, and the hourly rate, deposit and other fees the attorney charges for legal services.

Once you choose an attorney who is willing to represent you, you will be asked to enter into a **retainer agreement** employing the attorney. The attorney has a statutory right to collect a fee for their legal services.<sup>3</sup>

The attorney needs to fully explain the amount of fees or basis for their computation before you sign a fee agreement. To be enforceable, fee agreements for attorney services are required to be in writing when it is known the attorney fees will exceed \$1,000.<sup>4</sup>

Thus, written *retainer agreements* need to contain:

- the hourly rate, deposit and other rates, fees and applicable charges;
- the nature of the services to be provided; and
- the respective responsibilities of the attorney and you in performance of the retainer agreement.<sup>5</sup>

All billings for services are itemized, stating the:

- name of the activity performed;

<sup>1</sup> Calif. Business and Professions Code §6068(m)

<sup>2</sup> Bus & P C §6068(e)

<sup>3</sup> Calif. Code of Civil Procedure §1021

<sup>4</sup> Bus & P C §6148(a)

<sup>5</sup> Bus & P C §6148(a)(1-3)

- amount due; and
- the hourly rate or basis of calculation used to determine the fees.<sup>6</sup>

When a **retainer fee** is negotiated, the agreement needs to be in writing and contain:

- a statement of the *retainer fee* rate;
- a statement addressing how disbursements and costs incurred in connection with prosecuting or settling the case will affect the amount of the retainer fee and your recovery;
- a statement addressing what extent, if any, you are required to pay attorney fees for related matters not covered by the retainer fee; and
- a statement the fee is negotiable and not set by law.<sup>7</sup>

A duplicate copy of the retainer fee agreement you and the attorney signed needs to be handed to you. Failure to provide this information renders the retainer fee agreement voidable at your option.<sup>8</sup>

Later, when you have grounds and choose to void the retainer fee agreement, the attorney is entitled to collect a reasonable fee from you based on their time spent on your case.<sup>9</sup>

The retainer agreement may also be signed by and given to your representative, such as your office manager when you are the broker.<sup>10</sup>

Written fee agreements are confidential contracts between the attorney and their client — in this example, you.<sup>11</sup>

Deductibility of legal fees for tax reporting is determined by the nature of the activity causing the expense. When not deductible, the legal fees are either:

- **personal losses**; or
- a **capital investment** added to the cost basis of the property or ownership interest involved.

## Deductibility of legal fees

Legal fees fall into one of four federal tax reporting categories:

- personal expenses;
- business expenses;
- real estate rental (passive) expenses; or
- investment portfolio expenses.

Legal fees incurred for consultation on a broker's business-related matter are fully deductible as an expense of earning brokerage fees — a business category activity.

<sup>6</sup> Bus & P C §6148(b)

<sup>7</sup> Bus & P C §6147(a)(1-5)

<sup>8</sup> Bus & P C §6147(b)

<sup>9</sup> Bus & P C §6147(b), 6148(c)

<sup>10</sup> Bus & P C §6147(a)

<sup>11</sup> Bus & P C §6149



Legal fees incurred in the management, conservation or maintenance of **income-producing real estate** — rentals — or for the production or collection of rents, are an expense deductible from rental income, a passive income category activity.<sup>12</sup>

However, some legal fees are capitalized, not expensed, including fees incurred by property owners and buyers in connection with:

- zoning battles;
- title defenses;
- condemnation; or
- acquisition.

These expenditures are added to the property's basis as they are classified as **capital expenditures**, not operating costs.<sup>13</sup>

Legal expenses incurred to preserve ownership or defend title to an owner's personal residence are *nondeductible* personal expenses.

It is prudent to ask the attorney when retaining them for their advice on the tax deductibility of their fees and, in contingency cases, the reporting of the attorney's share of any recovery.

## Itemized billings

Prior to entering into a retainer agreement, it is prudent for you to ask for and review a sample **billing statement** used by the attorney.

The *billing statement* is usually itemized, describing:

- each legal activity or service provided by the attorney or their staff;
- the date the service was performed;
- the time spent rendering the service;
- the fee charged or the cost of each item;
- the amount due; and
- the hourly rate or other basis for calculating the fees.<sup>14</sup>

The attorney is to provide you with a billing within **ten days** following your request.<sup>15</sup>

You are also entitled to receive invoices at intervals of no less than 30 days following your initial request for a billing statement.<sup>16</sup>

The attorney's failure to meet these requirements will render the fee agreement voidable at your option. However, if you elect to void the retainer agreement, the attorney will be entitled to collect a reasonable fee for unpaid services.<sup>17</sup>

<sup>12</sup> 26 United States Code §212

<sup>13</sup> **Soelling v. Commissioner** 70 TC 1052

<sup>14</sup> Bus & P C §6148(b)

<sup>15</sup> Bus & P C §6148(b)

<sup>16</sup> Bus & P C §6148(b)

<sup>17</sup> Bus & P C §6148(c)

Additional factors you wisely consider before selecting an attorney include:

- the attorney's familiarity with real estate law and how up-to-date they are on any statutory, case law and regulatory changes;
- whether the attorney will review the file on a monthly or other periodic basis;
- whether the attorney will automatically provide you with copies of all correspondence, documents and papers related to the case, and at what cost;
- whether the attorney will consult with you on any substantial issues which may arise before making a decision or taking action; and
- whether the attorney will review insurance policies to determine if legal fees are covered, such as homeowner's policies, business insurance or errors and omissions (E&O) insurance.

When your dispute is covered by insurance, the insurance carrier may reserve its right to choose your attorney.

However, in some circumstances when the insurance company issues a *reservation of rights*, you are allowed to select your own attorney in addition to the attorney selected by the insurance carrier.

## Other factors influencing selection

## Covered by insurance

**Chapter 40**  
**Summary**

Oftentimes it is necessary or advisable for a licensee in a real estate transaction to seek the legal counsel of an attorney. To initiate the attorney selection process, you first need to talk to several experienced real estate brokers in the area where the subject real estate is located.

When meeting with an attorney, you will consider many aspects of the attorney's law office and practice, including:

- the compatibility of the attorney's personality with yours;
- the efficiency and professionalism of the attorney's work habits;
- the law office's appearance and whether it appears to be well organized and adequately equipped;
- the attorney's conversational skills;
- the courtesy, productivity and helpfulness of the office staff;
- how quickly and thoroughly the attorney or staff return phone calls and emails from you; and
- the competency of the attorney's law clerks or legal assistants to follow up and advise on fact investigation, legal research, calendaring of events and related details.

During the initial conference with the selected attorney, discuss your real estate dispute and interview the attorney to determine their qualifications. This contact is the first step toward deciding whether you feel this attorney is the best attorney for you to retain — comparative shopping. When you are interviewing the attorney, the attorney will also be deciding whether or not they want to represent you.

Once you choose an attorney who is willing to represent you, you will be asked to enter into a retainer agreement employing the attorney.

The attorney is to provide you with a billing within ten days following your request. You are also entitled to receive invoices at intervals of no less than 30 days following your initial request for a billing statement.

**Chapter 40**  
**Key Terms**

<b>initial conference .....</b>	<b>pg. 435</b>
<b>retainer agreement .....</b>	<b>pg. 436</b>

**Quiz 15 Covering Chapters 38-40 is located on page 455.**

## Legal Aspects of Real Estate, Sixth Edition Quizzes

Instructions: Quizzes are open book. All answers are Multiple Choice.  
The answer key is located on Page 457.

### Quiz 1 — Chapters 1-2, Pages 1-20

- \_\_\_\_ 1. Under \_\_\_\_\_, legal disputes were settled on a case-by-case basis before a judge.
  - a. the English common law
  - b. the Spanish legal system
  - c. the Mexican civil law
  - d. None of the above.
- \_\_\_\_ 2. Under \_\_\_\_\_, legal disputes were settled by pre-established statutes.
  - a. the English common law
  - b. the Spanish civil law
  - c. the Mexican judiciary
  - d. None of the above.
- \_\_\_\_ 3. The federal and state governments are divided into these branches:
  - a. executive, statutory and legislative.
  - b. judicial, constitutional and executive.
  - c. legislative, executive and judicial.
  - d. constitutional, statutory and regulatory.
- \_\_\_\_ 4. \_\_\_\_\_ is the power of the state or local government to protect the public well-being.
  - a. Eminent domain
  - b. Police power
  - c. The power to tax
  - d. None of the above.
- \_\_\_\_ 5. \_\_\_\_\_ is the right of the government to take private property for public use.
  - a. Judicial authority
  - b. Police power
  - c. The power to tax
  - d. Eminent domain
- \_\_\_\_ 6. \_\_\_\_\_ is the power of the state or local government to generate revenue and fund state and local governmental functions under their police power.
  - a. The power to tax
  - b. The commerce clause
  - c. The right to vote
  - d. The Spanish common law
- \_\_\_\_ 7. Covenants, conditions and restrictions (CC&Rs) which limit subdivision sales to nonminorities violate:
  - a. federal commerce clauses.
  - b. equal protection laws.
  - c. rent control ordinances.
  - d. All of the above.
- \_\_\_\_ 8. California has a three-tiered court system consisting of:
  - a. trial courts, superior courts and appellate courts.
  - b. superior courts, night courts and trial courts.
  - c. supra courts, the Supreme Court and night courts.
  - d. trial courts, appellate courts and the Supreme Court.
- \_\_\_\_ 9. \_\_\_\_\_ determines the proper physical location of the court which will hear a case.
  - a. Jurisdiction
  - b. Appellate
  - c. Venue
  - d. Police power

- \_\_\_\_ 10. A \_\_\_\_\_ clause determines in advance which state's law applies in a dispute.
- |                  |                             |
|------------------|-----------------------------|
| a. due process   | c. diversity of citizenship |
| b. choice-of-law | d. small claims             |

**Quiz 2 — Chapters 3-4, Pages 21-40**

- \_\_\_\_ 1. The right to possess and use property includes the right to:
- |                         |                        |
|-------------------------|------------------------|
| a. occupy the property. | c. lease the property. |
| b. sell the property.   | d. All of the above.   |
- \_\_\_\_ 2. Real estate is characterized as:
- |               |                       |
|---------------|-----------------------|
| a. movable.   | c. personalty.        |
| b. immovable. | d. None of the above. |
- \_\_\_\_ 3. The first component of real estate is land, which includes:
- |           |   |
|-----------|---|
| a. soil.  | c. reasonable airspace above the earth. |
| b. rocks. | d. All of the above.                    |
- \_\_\_\_ 4. A fixture is:
- |  |
|--|
| a. personal property which has become permanently attached to real estate. |
| b. real estate which has been condemned.                                   |
| c. personal property which is no longer associated with real estate.       |
| d. real estate which has been abandoned.                                   |
- \_\_\_\_ 5. The ownership interests in real estate include:
- |                  |                       |
|------------------|-----------------------|
| a. fee estates.  | c. leasehold estates. |
| b. life estates. | d. All of the above.  |
- \_\_\_\_ 6. A person who holds a \_\_\_\_\_ interest in real estate has the right to possess and control their property indefinitely.
- |                |                     |
|----------------|---------------------|
| a. leasehold   | c. fee estate       |
| b. life estate | d. profit a prendre |
- \_\_\_\_ 7. A(n) \_\_\_\_\_ is an interest in a parcel of real estate lasting the lifetime of a named individual, called a controlling life.
- |                     |                        |
|---------------------|------------------------|
| a. periodic tenancy | c. controlled interest |
| b. drilling right   | d. life estate         |
- \_\_\_\_ 8. A leasehold estate conveys to a tenant the right to \_\_\_\_\_ a fee owner's real estate.
- |            |                      |
|------------|----------------------|
| a. possess | c. destroy           |
| b. sell    | d. All of the above. |
- \_\_\_\_ 9. In a \_\_\_\_\_, a landlord and tenant agree to successive rental periods of the same length, such as in a month-to-month tenancy.
- |                     |                          |
|---------------------|--------------------------|
| a. periodic tenancy | c. tenancy-at-sufferance |
| b. tenancy-at-will  | d. life tenancy.         |
- \_\_\_\_ 10. A(n) \_\_\_\_\_ grants its holder a nonexclusive personal privilege to use property.
- |             |              |
|-------------|--------------|
| a. easement | c. covenant  |
| b. license  | d. partition |

**Quiz 3 — Chapters 5-6, Pages 41-66**

- \_\_\_\_ 1. \_\_\_\_\_ are improvements made to leased property to meet the needs of the occupying tenant.
  - a. Mechanic's liens
  - b. Tenant improvements
  - c. Lease agreements
  - d. Encroachments
- \_\_\_\_ 2. An improvement which a tenant is required to make in exchange for a reduction in rent is an example of a:
  - a. mandatory encroachment.
  - b. mandatory improvement.
  - c. permissive improvement.
  - d. permissive fixture.
- \_\_\_\_ 3. An improvement which is authorized but not required by the landlord is called a:
  - a. mandatory encroachment.
  - b. mandatory improvement.
  - c. permissive improvement.
  - d. permissive fixture.
- \_\_\_\_ 4. On expiration of a lease, the passage of real estate fixtures from the tenant to landlord is a conveyance called:
  - a. forfeiture.
  - b. tariff.
  - c. sacrifice.
  - d. reversion.
- \_\_\_\_ 5. \_\_\_\_\_ are improvements unique to the tenant's business which may be removed by the tenant upon expiration of a lease or rental agreement.
  - a. Trade fixtures
  - b. Fugacious matter
  - c. Airspace
  - d. Walls
- \_\_\_\_ 6. A \_\_\_\_\_ sets the terms of a fixed-term tenancy.
  - a. rental agreement
  - b. guest occupancy agreement
  - c. lease agreement
  - d. listing agreement
- \_\_\_\_ 7. A rental agreement sets the terms of a:
  - a. periodic tenancy
  - b. fixed-term tenancy
  - c. tenancy at sufferance
  - d. tenancy at will
- \_\_\_\_ 8. On expiration of a lease, a tenant who remains in possession of a property without an agreement or acceptance of rent by the landlord for the extended occupancy becomes a(n):
  - a. holdover tenant.
  - b. life tenant.
  - c. transient occupant.
  - d. fee owner.
- \_\_\_\_ 9. A tenancy relationship may be changed by:
  - a. notice.
  - b. expiration of a lease.
  - c. Both a. and b.
  - d. None of the above.
- \_\_\_\_ 10. An occupant of a vacation property, motel or hotel for less than 30 days is classified as a:
  - a. lien holder.
  - b. transient occupant.
  - c. residential property owner.
  - d. commercial property owner.

## Quiz 4 — Chapters 7-9, Pages 67-98

1. An instrument conveying a possessory interest in real estate which allows the tenant to exclusively occupy the premises in exchange for rent is called a:
  - a. license.
  - b. lease.
  - c. servient tenement.
  - d. grant.
2. When an individual makes substantial expenditures to improve their use of another person's property in reliance on the oral consent of the property owner, the license becomes:
  - a. irrevocable.
  - b. revocable.
  - c. invalid.
  - d. unenforceable.
3. \_\_\_\_\_ refer to a landowner's incidental property right to withdraw water from an adjacent river for beneficial use on their riparian land.
  - a. Appropriation rights
  - b. Prescriptive rights
  - c. Riparian rights
  - d. Overlying rights
4. The right to use riparian water is a(n) \_\_\_\_\_ and incidental right attached to the ownership of real estate.
  - a. appurtenant
  - b. unreasonable
  - c. percolatory
  - d. correlative
5. Similar to appropriation rights, prescriptive rights may be lost by abandonment after \_\_\_\_\_ years.
  - a. two
  - b. three
  - c. four
  - d. five
6. An agreed boundary which remains in place for more than \_\_\_\_\_ years is binding on subsequent owners even if the recorded legal description is different.
  - a. two
  - b. three
  - c. four
  - d. five
7. Written or oral agreements on a boundary's location are called \_\_\_\_\_ since they are not implied.
  - a. implied agreements
  - b. express agreements
  - c. uncertain agreements
  - d. probable agreements
8. The agreed-boundary doctrine can be used to:
  - a. convey property.
  - b. establish an agreed-to boundary when the true boundary line is uncertain.
  - c. steal property.
  - d. All of the above.
9. An owner who plans to construct, replace or maintain a boundary fence needs to provide a \_\_\_\_\_ written notice to the affected adjoining property owners.
  - a. 3-day
  - b. 1-year
  - c. 30-day
  - d. 24-hour
10. Shrubbery or trees whose trunks stand partly on the land of two adjacent property owners are called:
  - a. line trees.
  - b. common boundary trees.
  - c. appurtenances.
  - d. Both a. and b.



**Quiz 5 — Chapters 10-12, Pages 99-124**

- \_\_\_\_ 1. An improvement on real estate which extends onto property belonging to another person without that person's consent is a(n):
- a. trespass.
  - b. encroachment.
  - c. nuisance.
  - d. lease.
- \_\_\_\_ 2. Once an encroachment has been determined, the remedies available to the owner include:
- a. self-help by forcefully removing the encroachment.
  - b. an injunction ordering the removal of the encroachment.
  - c. calling the police to have the encroachment removed.
  - d. None of the above.
- \_\_\_\_ 3. When the continuance of an encroachment on an owner's property is permitted, the encroaching neighbor is granted \_\_\_\_\_ to maintain the improvement on the owner's property.
- a. a sublease
  - b. an equitable easement
  - c. an injunction
  - d. rent
- \_\_\_\_ 4. An owner seeking to terminate an encroachment or recover their money losses is generally subject to a \_\_\_\_\_ statute of limitations running from the commencement of the encroachment.
- a. two-year
  - b. three-year
  - c. five-year
  - d. ten-year
- \_\_\_\_ 5. A(n) \_\_\_\_\_ is a wrongful and unauthorized entry onto another's real estate.
- a. trespass
  - b. statute of limitations
  - c. easement
  - d. prescription
- \_\_\_\_ 6. Examples of trespass resulting from indirect entry include:
- a. depositing dirt or debris on another's property.
  - b. diverting a river or surface waters across another's property.
  - c. leaving toxic waste on another's property.
  - d. All of the above.
- \_\_\_\_ 7. A trespasser who does not leave when requested commits a:
- a. federal offense.
  - b. felony.
  - c. misdemeanor.
  - d. nonpunishable offense.
- \_\_\_\_ 8. A nuisance is anything which:
- a. is injurious to health.
  - b. is offensive to the senses.
  - c. obstructs the use of property.
  - d. All of the above.
- \_\_\_\_ 9. A \_\_\_\_\_ is a nuisance which affects an entire segment of the population.
- a. private nuisance
  - b. continuing nuisance
  - c. public nuisance
  - d. temporary nuisance
- \_\_\_\_ 10. A nuisance which may be reduced or terminated at any time at a reasonable expense is a(n):
- a. permissive nuisance.
  - b. equitable nuisance.
  - c. permanent nuisance.
  - d. continuing nuisance.

**Quiz 6 — Chapters 13-14, Pages 125-144**

- \_\_\_\_ 1. A(n) \_\_\_\_\_ is the right of one property owner to use the property of another.
  - a. easement
  - b. reversion
  - c. unlawful detainer (UD)
  - d. ejectment
- \_\_\_\_ 2. The property which benefits from an easement is referred to as the:
  - a. servient tenement.
  - b. diminutive tenement.
  - c. dominant tenement.
  - d. All of the above.
- \_\_\_\_ 3. A(n) \_\_\_\_\_ belongs to an individual and is their personal right.
  - a. easement in gross
  - b. appurtenant easement
  - c. easement running with the land
  - d. encroachment
- \_\_\_\_ 4. \_\_\_\_\_ easements restrict an owner's ability to maintain or construct any improvements which interfere with a neighbor's solar energy system.
  - a. Light
  - b. Air
  - c. View
  - d. Solar
- \_\_\_\_ 5. A(n) \_\_\_\_\_ is a voluntary conveyance of the right to keep land in its natural or historic condition.
  - a. solar easement
  - b. conservation easement
  - c. costal easement
  - d. air easement
- \_\_\_\_ 6. A(n) \_\_\_\_\_ has been created when an owner conveys a parcel of property but reserves the right to continue using a portion of the conveyed property.
  - a. exception
  - b. easement by reservation
  - c. trespass
  - d. omission
- \_\_\_\_ 7. An easement created by conduct without any prior agreement between the owner and the easement user is called a(n):
  - a. inverse condemnation.
  - b. reversive easement.
  - c. encroaching easement.
  - d. implied easement.
- \_\_\_\_ 8. To establish an implied easement, the use by the prior owner needs to be:
  - a. known or obvious to both the prior owner and the buyer.
  - b. regularly used during the prior owner's ownership.
  - c. intended to be permanent.
  - d. All of the above.
- \_\_\_\_ 9. If a property is landlocked, the owner of the property may be able to acquire a(n):
  - a. easement by necessity.
  - b. partial easement.
  - c. easement by grant.
  - d. prescriptive easement.
- \_\_\_\_ 10. A(n) \_\_\_\_\_ is established by the adverse use of another's property for a period over five years.
  - a. easement by necessity
  - b. implied easement
  - c. easement by grant
  - d. prescriptive easement

**Quiz 7 — Chapters 15-17, Pages 145-166**

- \_\_\_\_ 1. Limitations on an easement's use are set by:
  - a. its historic use.
  - b. its established purpose.
  - c. Both a. and b.
  - d. None of the above.

- \_\_\_\_ 2. A(n) \_\_\_\_\_ is accomplished by the use of a quitclaim or grant deed in favor of the owner of the burdened property, signed by the easement user.
- a. release
  - b. merger
  - c. destruction
  - d. foreclosure
- \_\_\_\_ 3. A \_\_\_\_\_ occurs when the same person acquires fee title to both the benefitting and burdened properties.
- a. release
  - b. merger
  - c. destruction
  - d. foreclosure
- \_\_\_\_ 4. An easement is terminated by \_\_\_\_\_ if the easement holder places an excessive burden on the property encumbered by the easement.
- a. abandonment
  - b. merger
  - c. forfeiture
  - d. prescription
- \_\_\_\_ 5. An easement is terminated by \_\_\_\_\_ when the burdened property owner permanently interferes with the neighbor's use of the easement.
- a. forfeiture
  - b. merger
  - c. prescription
  - d. circumspection
- \_\_\_\_ 6. \_\_\_\_\_ of an easement demonstrates a clear intent to permanently abandon all future use of the easement.
- a. Nonuse
  - b. Frequent use
  - c. Improvement
  - d. None of the above.
- \_\_\_\_ 7. Restrictive covenants on how parcels of property may be used are contained in a document called the:
- a. Bill of Rights.
  - b. covenants, conditions and restrictions (CC&Rs).
  - c. mechanic's lien.
  - d. trade fixtures.
- \_\_\_\_ 8. A recorded restriction limiting the use of a property to a specific purpose is classified as a(n):
- a. affirmative covenant.
  - b. negative covenant.
  - c. unenforceable covenant.
  - d. covenant-of-will.
- \_\_\_\_ 9. A restriction which \_\_\_\_\_ is unenforceable.
- a. unreasonably restricts the marketability of a property
  - b. prohibits ownership by a certain race
  - c. is not uniformly observed and enforced against all prior violators
  - d. All of the above.
- \_\_\_\_ 10. When a written maintenance agreement does not exist between the owners of a burdened and benefitting property, maintenance costs are:
- a. paid solely by the burdened property owner.
  - b. paid solely by the benefitting property owner.
  - c. shared in proportion to each property owner's use of the easement.
  - d. paid by the local government.

**Quiz 8 — Chapters 18-20, Pages 167-210**

- \_\_\_\_ 1. A valid deed must:
  - a. be in writing and identify the grantor and the grantee.
  - b. contain a granting clause and describe the real estate involved.
  - c. be signed by the grantor and accepted by the grantee.
  - d. All of the above.
- \_\_\_\_ 2. An executed oral agreement for the transfer of real estate ownership will be enforced under the doctrine of:
  - a. specific performance.
  - b. estoppel.
  - c. Both a. and b.
  - d. None of the above.
- \_\_\_\_ 3. At the time of signing the deed, a capable grantor must:
  - a. possess their civil rights.
  - b. be of sound mind.
  - c. be an adult at least 18 years of age.
  - d. All of the above.
- \_\_\_\_ 4. A deed with a misnamed grantee is:
  - a. automatically void.
  - b. still a valid conveyance of the real estate.
  - c. unenforceable.
  - d. unlawful.
- \_\_\_\_ 5. A(n) \_\_\_\_\_ may acquire title to California real estate.
  - a. individual
  - b. California limited liability company (LLC)
  - c. California corporation
  - d. All of the above.
- \_\_\_\_ 6. A \_\_\_\_\_ is used to pass an ownership interest in real estate from the grantor to another individual, with implied covenants against prior conveyances and undisclosed encumbrances.
  - a. grant deed
  - b. notice of nonresponsibility
  - c. lease agreement
  - d. warranty deed
- \_\_\_\_ 7. A \_\_\_\_\_ is intended to convey whatever interest the grantor may hold in real estate, without warranty that any interest exists.
  - a. grant deed
  - b. quitclaim deed
  - c. guaranty agreement
  - d. public nuisance
- \_\_\_\_ 8. Implied covenants are for the personal benefit of the:
  - a. seller only.
  - b. buyer only.
  - c. all future owners of the property.
  - d. All of the above.
- \_\_\_\_ 9. For delivery of a deed to occur, the grantor must \_\_\_\_\_ and the grantee must \_\_\_\_\_.
  - a. intend to convey title; accept the deed as immediately effective
  - b. physically hand the deed to the grantee; record the deed with the county
  - c. place the deed in the mail; plan to accept the deed on certain conditions
  - d. intend to convey partial title; record the deed with the county

- \_\_\_\_ 10. A \_\_\_\_\_ deed is unenforceable at all times and never conveys an interest in real estate.
- |             |              |
|-------------|--------------|
| a. void     | c. grant     |
| b. voidable | d. quitclaim |

**Quiz 9 — Chapters 21-23, Pages 211-242**

- \_\_\_\_ 1. A(n) \_\_\_\_\_ is a written statement which presents an accurate, factual representation of title to the property being acquired, encumbered or leased.
- |                             |                       |
|-----------------------------|-----------------------|
| a. preliminary title report | c. abstract of title  |
| b. property profile         | d. None of the above. |
- \_\_\_\_ 2. Title insurance is the means by which a title insurance company \_\_\_\_\_ a person who acquires an interest in real estate against a monetary loss caused by an encumbrance on title.
- |                   |                      |
|-------------------|----------------------|
| a. holds harmless | c. indemnifies       |
| b. reimburses     | d. All of the above. |
- \_\_\_\_ 3. A title insurance policy will cover monetary losses stemming from:
- encumbrances listed as excluded or excepted from coverage.
  - encumbrances known to exist when the policy was issued.
  - encumbrances not listed as excluded or excepted from coverage, and unknown to the insured individual.
  - All of the above.
- \_\_\_\_ 4. \_\_\_\_\_ of a title insurance policy identifies the insured, the property, the vesting, the dollar amount of coverage, the premium paid and the recording.
- |               |                        |
|---------------|------------------------|
| a. Schedule A | c. Schedule C          |
| b. Schedule B | d. The insuring clause |
- \_\_\_\_ 5. \_\_\_\_\_ are provisions added to title insurance policies to cover losses due to conditions, covenants and restrictions (CC&Rs) violations, mechanic's liens, and the effects of inflation.
- |                                    |                           |
|------------------------------------|---------------------------|
| a. Endorsements                    | c. Right of way easements |
| b. Equitable subordination clauses | d. Exceptions             |
- \_\_\_\_ 6. A(n) \_\_\_\_\_ owner's title insurance policy insures only against recorded encumbrances and contains a list of pre-printed policy exceptions.
- California Land Title Association (CLTA)
  - American Land Title Association (ALTA) owner's extended coverage policy
  - ALTA residential policy
  - Standard Title Association (STA)
- \_\_\_\_ 7. A(n) \_\_\_\_\_ title insurance policy insures against recorded encumbrances and off-record matters.
- California Land Title Association (CLTA)
  - American Land Title Association (ALTA)
  - Standard Title Association (STA)
  - All of the above.

- \_\_\_\_ 8. The criteria for perfecting ownership by an adverse possession includes:
- possession for at least two years within the last five years.
  - payment of mortgage principal and interest for at least three years.
  - payment of rent.
  - actual, notorious and open possession.
- \_\_\_\_ 9. \_\_\_\_\_ is an adverse possession claim of ownership based on a written instrument and is held by the individual in possession of the property.
- Color of title
  - Claim of right
  - Easement by possession
  - Both a. and b.
- \_\_\_\_ 10. An adverse possessor must have occupied a property for at least \_\_\_\_\_ before they will be able to acquire title through adverse possession.
- one year
  - two years
  - five years
  - six years

**Quiz 10 — Chapters 24-26, Pages 243-276**

- \_\_\_\_ 1. A transmutation must be \_\_\_\_\_ to be effective against persons relying on the record title.
- written and recorded
  - oral
  - published in a newspaper
  - All of the above.
- \_\_\_\_ 2. \_\_\_\_\_ may be used to authorize one spouse to manage and control community property.
- A revocable trust in which one spouse is the named trustee
  - A power of attorney
  - A limited partnership
  - All of the above.
- \_\_\_\_ 3. A revocable inter vivos (living) trust benefits real estate owners by:
- distributing the owner's estate without resorting to probate proceedings.
  - allowing the owners to avoid their creditors.
  - providing more favorable tax results than a will.
  - All of the above.
- \_\_\_\_ 4. A(n) \_\_\_\_\_ is required to establish a viable inter vivos (living) trust.
- oral agreement
  - Declaration of Trust
  - Declaration of Consent
  - writing signed by the beneficiary only
- \_\_\_\_ 5. A \_\_\_\_\_ is a business which acts as an executor, administrator, guardian or conservator of estates, or as assignee, receiver, depository or trustee by the appointment of the court or for any purpose permitted by law.
- trust business
  - business trust
  - Franchise Tax Board
  - homeowners' association (HOA)
- \_\_\_\_ 6. Adverse tax consequences make \_\_\_\_\_ ownership and vesting of rental real estate infrequent.
- tenants in common (TIC)
  - limited liability company (LLC)
  - corporate
  - partnership

- \_\_\_ 7. The conveyance of a co-owner's TIC interest to another person conveys:
- full fee ownership of the property.
  - equitable ownership of the property.
  - all the income and profits flowing from the property.
  - All of the above.
- \_\_\_ 8. The \_\_\_\_\_ of co-owners while managing the investment determines whether a state law partnership relationship exists.
- sharing of income and profits
  - interaction and coordinated conduct
  - tax bracket
  - All of the above.
- \_\_\_ 9. The alienation of property refers to its:
- sale.
  - further encumbrance.
  - lease for a period exceeding one year.
  - All of the above.
- \_\_\_ 10. When a co-owner of investment real estate is classified by the Internal Revenue Service (IRS) as a partner, the real estate is considered to be owned by:
- the co-owner only.
  - a tax partnership.
  - a non-taxable trust.
  - None of the above.

**Quiz 11 — Chapters 27-28, Pages 277-300**

- \_\_\_ 1. \_\_\_\_\_ is the right of surviving joint tenants or a spouse to succeed to the entire interest of the deceased co-owner.
- Ratification
  - Prescription
  - The right of survivorship
  - Accession right
- \_\_\_ 2. A surviving spouse with an uncontested claim to sole ownership needs to wait \_\_\_\_\_ before they may clear title in their name and sell, lease or encumber the property.
- 30 days
  - 3 days
  - 60 days
  - 40 days
- \_\_\_ 3. The creation of a joint tenancy traditionally requires the conveyance of the four unities of:
- title, interest, time and manner.
  - possession, method, time and title.
  - interest, title, time and possession.
  - time, method, manner and title.
- \_\_\_ 4. All property acquired by a couple or by either spouse during marriage is automatically considered \_\_\_\_\_, unless otherwise specified.
- personal property
  - community property
  - separate property
  - an easement
- \_\_\_ 5. Both spouses need to consent to the \_\_\_\_\_ of community property.
- sale
  - lease for more than one year
  - encumbrance
  - All of the above.
- \_\_\_ 6. If a spouse sells, leases or encumbers real estate without the consent of the other spouse, the nonconsenting spouse has \_\_\_\_\_ from the recording to set aside the transaction.
- one year
  - five years
  - six months
  - 24 hours



- \_\_\_\_ 7. A purchaser's lien may include:
  - a. the amount of payments made on the purchase price.
  - b. punitive damages for grief and suffering.
  - c. Both a. and b.
  - d. None of the above.
- \_\_\_\_ 8. The moment a buyer enters into a purchase agreement with a seller to acquire property, the buyer has \_\_\_\_\_ the seller's property.
  - a. an easement on
  - b. a lien against
  - c. a riparian right to
  - d. an equitable ownership interest in
- \_\_\_\_ 9. The priority of a purchaser's lien on title is set as of the date the buyer is given possession under the purchase agreement, called the:
  - a. relation back theory.
  - b. flash back theory.
  - c. valuation date.
  - d. signing date.
- \_\_\_\_ 10. A buyer who defaults on a purchase agreement may only obtain a purchaser's lien if:
  - a. they have paid at least \$1,000 to the seller.
  - b. their breach is excused due to wrongful actions by the seller.
  - c. their breach is the result of market conditions.
  - d. All of the above.

**Quiz 12 — Chapters 29-31, Pages 301-334**

- \_\_\_\_ 1. A subcontractor needs to serve a \_\_\_\_\_ on the appropriate parties to perfect their right to file a mechanic's lien.
  - a. ten-day notice of lien rights
  - b. 20-day preliminary notice
  - c. 30-day preliminary notice
  - d. 90-day notice to quit
- \_\_\_\_ 2. A mechanic's lien becomes void if a foreclosure action is not filed within \_\_\_\_\_ after the mechanic's lien is recorded.
  - a. 15 days
  - b. 30 days
  - c. 60 days
  - d. 90 days
- \_\_\_\_ 3. An owner may prevent a mechanic's lien from attaching to their fee interest in the property by recording and posting a \_\_\_\_\_ within ten days after they become aware of tenant-contracted improvements.
  - a. notice of nonresponsibility
  - b. preliminary notice
  - c. pay-when-paid provision
  - d. notice of cessation
- \_\_\_\_ 4. The waiver of a subcontractor's mechanic's lien rights is:
  - a. always enforceable.
  - b. never enforceable.
  - c. only enforceable if it is a waiver and release signed by the contractor in exchange for partial or full payment of the amounts due.
  - d. only enforceable if obtained by force.
- \_\_\_\_ 5. A signed and notarized \_\_\_\_\_ is used to document a judgment lienholder's release of a lien against a residence.
  - a. certificate of discharge
  - b. release of recorded instrument
  - c. automatic homestead
  - d. abstract of judgment

- \_\_\_ 6. Lis pendens means:
- a. pending litigation.
  - b. pending cancellation.
  - c. condemned.
  - d. eminent domain.
- \_\_\_ 7. Recording a lis pendens is permitted in lawsuits which:
- a. affect title to personal property.
  - b. seek recovery of only money losses.
  - c. seek recovery of only attorney fees.
  - d. affect title or the right to possession of real estate.
- \_\_\_ 8. A(n) \_\_\_\_\_ is an involuntary, court-created trust imposed on the ownership of property held by an owner who acquired it through a wrongful act.
- a. ordinance
  - b. statutory lien
  - c. constructive trust
  - d. inter vivos (living) trust
- \_\_\_ 9. To record a lis pendens, the lis pendens needs to:
- a. identify the parties to the lawsuit.
  - b. give an adequate description of the real estate.
  - c. Both a. and b.
  - d. None of the above.
- \_\_\_ 10. An order \_\_\_\_\_ a lis pendens removes any restrictions sought to be imposed on title to a property.
- a. hypothecating
  - b. imposing
  - c. exempting
  - d. expunging

### **Quiz 13 — Chapters 32-34, Pages 335-366**

- \_\_\_ 1. Membership in a limited liability company (LLC) is:
- a. real estate.
  - b. personal property.
  - c. livestock.
  - d. unlawful in California.
- \_\_\_ 2. A money judgment against a member of a limited liability company (LLC) which does not also name the LLC as a judgment debtor can be satisfied by:
- a. foreclosing on the member's ownership interest in the LLC.
  - b. foreclosing on any property owned by the LLC.
  - c. incarcerating the LLC member judgment debtor.
  - d. All of the above.
- \_\_\_ 3. A creditor uses a \_\_\_\_\_ to place lien on a limited liability company (LLC) member's ownership interest in the LLC to satisfy a judgment.
- a. grant deed
  - b. vesting
  - c. charging order.
  - d. asset statement
- \_\_\_ 4. A \_\_\_\_\_ is recorded.
- a. declared homestead
  - b. automatic homestead
  - c. Both a. and b.
  - d. None of the above.
- \_\_\_ 5. Liens with priority over the homestead exemptions include:
- a. trust deeds
  - b. mechanic's liens
  - c. Internal Revenue Service (IRS) tax liens
  - d. All of the above.

- \_\_\_\_ 6. A \_\_\_\_\_, coupled with a quiet title action, allows a homeowner to remove judgment liens attached to their title.
- |                        |                       |
|------------------------|-----------------------|
| a. automatic homestead | c. Both a. and b.     |
| b. declared homestead  | d. None of the above. |
- \_\_\_\_ 7. A recorded declaration of homestead lasts:
- |  |  |
|--|--|
| a. 10 years.   |  |
| b. until the homeowner abandons their home or records a new declaration of homestead on another residence. |  |
| c. until the homeowner dies.   |  |
| d. perpetually.  |  |
- \_\_\_\_ 8. To constitute slander of title, the oral or written statement must cause money losses and:
- |  |  |
|--|--|
| a. be published.   |  |
| b. be untrue and disparaging to the owner's property interest. |  |
| c. be made without privilege.                                  |  |
| d. All of the above.   |  |
- \_\_\_\_ 9. A statement made about a real estate interest as part of a(n) \_\_\_\_\_ does not subject the person making the statements to liability for slander of title.
- |                             |                          |
|-----------------------------|--------------------------|
| a. unprivileged publication | c. published publication |
| b. privileged publication   | d. None of the above.    |
- \_\_\_\_ 10. An owner can recover \_\_\_\_\_ if they can show slanderous statements were made about their property with actual malice.
- |                                      |                      |
|--------------------------------------|----------------------|
| a. punitive damages                  | c. a tax credit      |
| b. double any award of attorney fees | d. All of the above. |

**Quiz 14 — Chapters 35-37, Pages 367-402**

- \_\_\_\_ 1. A \_\_\_\_\_ is a lawsuit to sever or sell real estate which is co-owned.
- |                       |                       |
|-----------------------|-----------------------|
| a. dissolution action | c. partition action   |
| b. divorce action     | d. subdivision action |
- \_\_\_\_ 2. A(n) \_\_\_\_\_ is a real estate interest which is subject to a partition suit.
- |                     |                      |
|---------------------|----------------------|
| a. fee estate       | c. life estate       |
| b. leasehold estate | d. All of the above. |
- \_\_\_\_ 3. When real estate cannot be divided equally in a partition action, \_\_\_\_\_ is the money paid to even the distribution.
- |                |                       |
|----------------|-----------------------|
| a. retribution | c. good-faith deposit |
| b. owelty      | d. None of the above. |
- \_\_\_\_ 4. A notice of sale must be given to all parties named in a partition action at least \_\_\_\_\_ days before the sale date.
- |       |       |
|-------|-------|
| a. 15 | c. 25 |
| b. 20 | d. 30 |
- \_\_\_\_ 5. A judicial procedure employed to determine claims to nonpossessory rights in disputes over title to real estate is called:
- |                        |                          |
|------------------------|--------------------------|
| a. a lis pendens.      | c. declaratory relief.   |
| b. a summary judgment. | d. a quiet title action. |

- \_\_\_\_ 6. \_\_\_\_\_ is an accounting between a buyer and seller which results in a refund to the buyer in exchange for the return of the property to the seller.
- |                |            |
|----------------|------------|
| a. Restitution | c. Renewal |
| b. Reformation | d. Breach  |
- \_\_\_\_ 7. A(n) \_\_\_\_\_ is an action seeking a judicial declaration of the rights and obligations of parties to a disputed transaction.
- |                              |                   |
|------------------------------|-------------------|
| a. declaratory relief action | c. money judgment |
| b. quiet title action        | d. foreclosure    |
- \_\_\_\_ 8. A(n) \_\_\_\_\_ allows opposing parties in a declaratory relief action to preserve their respective claims so they may later pursue them.
- |                                  |                                    |
|----------------------------------|------------------------------------|
| a. right of survivorship vesting | c. reservation of rights agreement |
| b. proof-of-loss statement       | d. party wall                      |
- \_\_\_\_ 9. A(n) \_\_\_\_\_ occurs when a buyer or seller somehow acts to repudiate the purchase agreement before the time for closing arrives.
- |                        |                       |
|------------------------|-----------------------|
| a. abandonment         | c. usufructuary right |
| b. anticipatory breach | d. tenancy-at-will    |
- \_\_\_\_ 10. A declaratory judgment will only be granted if:
- |  |
|--|
| a. an actual controversy exists.   |
| b. future litigation is likely to result if the dispute is not resolved. |
| c. Both a. and b.  |
| d. None of the above.  |

**Quiz 15 — Chapters 38-40, Pages 403-440**

- \_\_\_\_ 1. An investor who rent skims from \_\_\_\_\_ parcels they took title to during any two-year period may be held liable for multiple acts of rent skimming.
- |                   |                 |
|-------------------|-----------------|
| a. one or more    | c. five or more |
| b. three or fewer | d. two or fewer |
- \_\_\_\_ 2. A tenant's recovery from an investor who engages in rent skimming includes:
- |                          |                      |
|--------------------------|----------------------|
| a. the security deposit. | c. attorney fees.    |
| b. moving expenses.      | d. All of the above. |
- \_\_\_\_ 3. An investor is subject to \_\_\_\_\_ for one charge of multiple rent skimming.
- |                          |                       |
|--------------------------|-----------------------|
| a. one-year imprisonment | c. Both a. and b.     |
| b. a fine of \$30,000    | d. None of the above. |
- \_\_\_\_ 4. A rent-skimming investor avoids both criminal and civil rent skimming when they:
- |  |
|--|
| a. use the money to pay for a new investment property.   |
| b. use the money to pay medical expenses within 30 days of collecting the rent, and no other funds were available to pay the expenses. |
| c. they obtain a waiver of rent skimming liability from the tenant.  |
| d. All of the above.   |
- \_\_\_\_ 5. A(n) \_\_\_\_\_ is a provision in an agreement permitting the prevailing party in a dispute to receive attorney fees when litigation arises due to the agreement.
- |                                   |                            |
|-----------------------------------|----------------------------|
| a. choice-of-law clause           | c. litigation fund clause  |
| b. further-improvements provision | d. attorney fees provision |

- \_\_\_\_ 6. The reciprocal fee statute applies to actions regarding:
  - a. contracts.
  - b. deceit
  - c. breach of agency duties.
  - d. misrepresentation.
- \_\_\_\_ 7. When the court enters its final judgment in a case, the prevailing party is the individual who:
  - a. receives the greater money damages award.
  - b. receives the requested equitable relief.
  - c. successfully defends against the plaintiff's claim and the plaintiff obtains no relief.
  - d. Any of the above.
- \_\_\_\_ 8. The amount of attorney fees the non-prevailing party owes to the prevailing party is offset by:
  - a. any excess financial benefit received by the prevailing party from the non-prevailing party.
  - b. court costs paid by the prevailing party.
  - c. \$1,000 for each action.
  - d. All of the above.
- \_\_\_\_ 9. Fee agreements for attorney services must be in writing when it is known the fees will exceed:
  - a. \$500.
  - b. \$1,000.
  - c. \$1,500.
  - d. \$2,000.
- \_\_\_\_ 10. An attorney must provide an itemized billing within \_\_\_\_\_ days following a broker's request for the billing statement.
  - a. five
  - b. ten
  - c. 15
  - d. 30

## Answer References

The following are the answers to the quizzes for *Legal Aspects of Real Estate, Sixth Edition* and the page numbers in the printed material where they are located.

Quiz 1	Quiz 2	Quiz 3	Quiz 4	Quiz 5
1. a 2	1. d 21	1. b 41	1. b 69	1. b 100
2. b 2	2. b 22	2. b 43	2. a 73	2. b 101
3. c 2	3. d 24	3. c 46	3. c 78	3. b 104
4. b 3	4. a 28	4. d 48	4. a 79	4. b 104
5. d 3	5. d 31	5. a 49	5. d 84	5. a 107
6. a 5	6. c 32	6. c 57	6. d 92	6. d 108
7. b 8	7. d 33	7. a 59	7. b 92	7. c 110
8. d 12	8. a 34	8. a 62	8. b 94	8. d 115
9. c 13	9. a 35	9. c 63	9. c 95	9. c 118
10. b 16	10. b 36	10. b 64	10. d 96	10. d 121
Quiz 6	Quiz 7	Quiz 8	Quiz 9	Quiz 10
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2. c 126	2. a 149	2. c 169	2. d 215	2. d 248
3. a 126	3. b 149	3. d 172	3. c 218	3. a 253
4. d 128	4. c 149	4. b 175	4. a 219	4. b 255
5. b 129	5. c 150	5. d 176	5. a 220	5. a 260
6. b 134	6. d 150	6. a 182	6. a 221	6. c 265
7. d 136	7. b 154	7. b 183	7. b 223	7. b 267
8. d 137	8. a 155	8. b 187	8. d 235	8. b 268
9. a 139	9. d 156	9. a 197	9. a 235	9. d 270
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1. c 277	1. b 302	1. b 336	1. c 368	1. c 403
2. d 278	2. d 308	2. a 337	2. d 371	2. d 405
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5. d 285	5. b 315	5. d 344	5. d 378	5. d 415
6. a 285	6. a 323	6. b 353	6. a 384	6. a 420
7. a 294	7. d 325	7. b 353	7. a 396	7. d 421
8. d 294	8. c 327	8. d 357	8. c 397	8. a 429
9. a 295	9. c 329	9. b 360	9. b 399	9. b 436
10. b 296	10. d 331	10. a 365	10. c 400	10. b 438

# Glossary

## #

### **20-day preliminary notice .....302**

Notification of a subcontractor's right to record and foreclose a mechanic's lien against property when they are not paid.

## A

### **abandonment .....150**

The termination of an easement when the easement holder's actions demonstrate a clear intent to permanently abandon all future use of the easement.

### **absolutely privileged publication .....329, 358**

Any statement made as part of a legislative, judicial or other official proceeding authorized by law, barring a slander of title action.

### **abstract of judgment .....316, 343**

A condensed written summary of the essential holdings of a court judgment.

### **abstract of title .....213, 218**

A representation issued by a title company as a guarantee to the named person, not an insurance policy, listing all recorded conveyances and encumbrances affecting title to the described real estate.

### **actual money losses .....108**

Monetary losses recovered for injury to the real estate, lost use of the property, personal injury or injury to the occupant's personal property, also called damages.

### **actual notice .....238**

Express or implied knowledge of conditions which exist on a property.

### **administrative agencies .....9**

A government entity created by the state or federal legislature and local governing bodies to oversee specialized matters. Most have legislative, executive and judicial authority.

### **adverse possession .....113, 171, 233**

A method of acquiring title to real estate owned by another by openly maintaining exclusive possession of the property for a period of five years and paying all property taxes.

### **affirmative covenant .....155**

A recorded restriction limiting the use of a property to a specific purpose.

### **agreed-boundary doctrine .....90**

When owners of adjacent properties uncertain over the true boundary agree to establish the location of their common lot line and acquiesce to the boundary line for at least five years.

### **alienation .....270**

The sale, further encumbrance or lease (for a period exceeding one year) of a property.



**amanuensis .....178**

An individual who has the oral authority of the grantor to sign a grant deed by their own hand on behalf of the grantor.

**amendment clause .....158**

A clause contained in covenants, conditions and restrictions (CC&Rs) establishing a procedure for modifying the CC&Rs.

**anticipatory breach .....399**

When a buyer or seller repudiates the purchase agreement by their words or conduct before closing.

**appellate courts ..... 12**

Courts which review trial court decisions to determine whether the proper rules of law were correctly applied.

**appropriation right ..... 26, 83**

The right to divert water from a river or watercourse to real estate for reasonable use.

**appurtenant easement .....126**

A type of easement which is incidental to the ownership and belongs to the property which benefits from its use.

**appurtenant rights .....29**

Incidental property rights which are not located on a parcel of real estate nor reflected on its title, including the right of ingress and egress across adjoining properties.

**arbitrator .....164**

A neutral third-party who is appointed to hear a dispute, and authorized to make a decision as an award in favor of one of the parties.

**attorney fees provision .....415**

A provision in an agreement permitting the prevailing party to a dispute to receive attorney fees when litigation arises due to the agreement. [See RPI Form 552 §23.2]

**automatic homestead .....344**

The dollar amount of equity in a homeowner's principal dwelling the homeowner is automatically qualified to exempt from creditor seizure. Also known as a statutory homestead exemption.

**B****balancing hardships .....101**

The awarding of money to an owner to compensate for lost use of their property burdened with an encroachment.

**balancing of the rights .....116**

A determination of whether a nuisance exists when an activity is not classified as a nuisance per se.

**beneficiary .....255**

One entitled to the benefits of properties held in a trust or estate, with title vested in a trustee or executor.

**binder .....216**

A written commitment of a title insurer to issue a title insurance policy in the future, usually acquired by a buyer intending to resell the described property.

**bona fide purchaser (BFP).....139, 379**

A buyer who purchases a property for valuable consideration in good faith without notice or knowledge of pre-existing encumbrances or conditions affecting their right to full ownership.

**bond.....331**

Written evidence issued by an insurer or guarantor of its obligation to pay the debt of another on a default in a promised performance.

**business trust.....260**

A type of business entity which is not recognized in California; out-of-state business trusts are required to first qualify as a corporate entity with the Department of Financial Protection and Innovation (DFPI) before doing business in California.

**buyout provision.....338**

A provision in a limited liability company (LLC) operating agreement which, on termination of a member's interest, grants the remaining members the right to buy out the terminated member's interest in the LLC or dissolve the LLC. [See **RPI** Form 372 §7]

## C

**cause of action .....378**

Facts which are the basis for a claim in a court action.

**charging order.....337**

An attachment device used by a creditor to place a lien on the ownership interest in a limited liability company (LLC) held by the individual member for the payment of a money judgment, and either appoint a receiver to hold the debtor member's share or foreclose on the member's interest in the LLC.

**choice-of-law clause .....16**

A clause which sets the state law applicable in the event of a dispute.

**civil law .....2**

A Spanish legal system in which an elaborate system of statutes address permissible conduct of the people in advance of disputes.

**claim of right.....236**

A claim of ownership made without any documentation, except possession and payment of taxes.

**class action .....429**

An action against a person brought by or on behalf of all similarly situated claimants.

**cloud on title .....377**

A claim, encumbrance or condition which impairs the title, not possession, to real estate until eliminated by a release of recorded document, quitclaim deed or a quiet title action.

**color of title .....236**

Title that has the appearance of validity but has a fatal defect and is ineffective.

**common boundary improvement .....94**

An improvement which acts as a demarcation of the property line.

**common boundary trees .....96**

Shrubbery or trees with trunks which stand partly on the land of two adjacent properties belonging to the adjacent owners.

<b>common description</b> .....	<b>177</b>
Description of real estate by its street address. Also known as a common address.	
<b>common interest development (CID)</b> .....	<b>23</b>
Condominium projects, cooperatives or single family residences in a planned unit development.	
<b>common law</b> .....	<b>2</b>
An English legal system in which disputes are decided on a case-by-case basis before a judge applying codes and prior cases.	
<b>community property</b> .....	<b>278</b>
All property acquired by spouses during a marriage when not acquired as the separate property of either spouse.	
<b>conditionally privileged publication</b> .....	<b>360</b>
Documents relating to a lawsuit or dispute over a right or interest in real estate made in good faith and without malice, barring a slander of title action.	
<b>conservation easement</b> .....	<b>129</b>
A voluntary conveyance of the right to keep land in its natural or historical condition to a conservation organization or government agency.	
<b>construction lender</b> .....	<b>303</b>
A lender that originates a mortgage which funds the construction or development of real estate.	
<b>constructive delivery</b> .....	<b>198</b>
Delivery of a deed occurring when the deed is understood by the grantor and grantee to be delivered by agreement, or when the deed is accepted by a third-party for the benefit of the grantee.	
<b>constructive notice</b> .....	<b>238</b>
A legal fiction charging persons who own or acquire an interest in real estate with knowledge of recorded documents affecting title and conditions observable on the property.	
<b>constructive trust</b> .....	<b>327</b>
An involuntary, court-created trust imposed on the ownership of real estate held by an owner who acquired it through fraud or other wrongful action.	
<b>continuing nuisance</b> .....	<b>100, 121</b>
An ongoing nuisance that can be entirely eliminated by those adversely affected by the activity or condition.	
<b>correlative right</b> .....	<b>80</b>
The sharing of water between riparian land owners based on a tiered variety of priority and subordinate uses across the entire group of riparian owners.	
<b>covenants, conditions and restrictions (CC&amp;Rs)</b> .....	<b>37, 154</b>
Recorded restrictions against the title to real estate prohibiting or limiting specified uses of the property.	

## D

<b>date-down search</b> .....	<b>212</b>
A further search of the public records performed by a title insurer after preparing a preliminary title report and immediately prior to issuance of a policy of title insurance.	

**declaration of homestead . . . . . 314, 344**

A document signed by a homeowner and filed with the county recorder's office to shield the owner-occupant's homestead equity from seizure by creditors. [See **RPI** Form 465]

**declaratory relief . . . . . 396**

An action seeking a judicial declaration of the rights and obligations of parties to a disputed situation.

**distribution in kind . . . . . 370**

Distribution of a limited liability company's (LLC's) real estate on dissolution to members as a return of their capital contributions.

**documentary transfer tax . . . . . 206**

A tax imposed on a recorded document when real estate is transferred.

**dominant tenement . . . . . 67, 126**

The property benefitting from an easement on a servient tenement.

**due process . . . . . 7**

A constitutional guarantee of fair dealings between the government and property owners.

**E**

**easement . . . . . 36, 125**

The right to use another's property for a specific purpose.

**easement by necessity . . . . . 139**

An easement providing access to a landlocked property.

**easement for ingress and egress . . . . . 125**

A type of easement granting one property owner the right to traverse a portion of another's land to access the property.

**easement in gross . . . . . 126**

An easement which belongs to an individual and is not appurtenant to a property.

**ejectment . . . . . 111**

A civil action to recover possession or title to land from someone wrongfully in possession.

**eminent domain . . . . . 3**

The right of the government to take private property for public use on payment to the owner of the property's fair market value.

**encroachment . . . . . 99**

An improvement on one parcel of real estate which extends onto real estate owned by another.

**encumbrance . . . . . 184, 212, 217**

A claim or lien on title to a parcel of real estate, such as property taxes, assessment bonds, trust deeds, easements and covenants, conditions and restrictions (CC&Rs).

**equal protection . . . . . 8**

A constitutional guarantee that similarly-situated persons be treated similarly under the law.

**equitable easement . . . . . 104**

An easement granted to a neighbor allowing them to maintain an improvement encroaching on another owner's property.

**equitable owner.....387**

A person who purchased a property and has not yet received legal ownership placing title in their name, such as occurs under a purchase agreement, land sales contract or lease-option sales agreement.

**equitable remedies.....12**

Non-money remedies based on issues of fairness.

**estate.....32**

The ownership interest a person may hold in real estate.**exception.....219**

Any encumbrances affecting title and any observable on-site activities which are listed as risks assumed by the insured and not covered by a policy of title insurance under Schedule B.

**exclusion.....219**

Risks of loss not covered under a policy of title insurance, comprised of encumbrances arising after the transfer or known to or brought about by the insured.

**executive branch.....3**

The branch of government which polices the law and establishes regulations to carry out the administration of government as established by the legislature.

**expungement.....331**

A court order removing from title to real estate the effect of a recorded lis pendens regarding litigation asserting a claim to title or possession of the property.

**F****federal tax lien.....317**

A lien recorded attaching to the title of real estate owned by a taxpayer who owes the Internal Revenue Service (IRS) unpaid taxes.

**federalism.....2**

A form of government in which individual states share powers with a national or central government.

**fee estate.....32, 168**

An indefinite, exclusive and absolute legal ownership interest in a parcel of real estate.

**fixed-term tenancy.....34, 57**

A leasehold interest which lasts for the specific lease period set forth in a lease agreement. A fixed-term tenancy automatically terminates at the end of the lease period. [See **RPI** Form 550 and 552]

**fixture.....27, 42**

Personal property permanently attached to real estate and conveyed with it.

**forfeiture.....149, 383**

- 1) The termination of an easement when the easement holder exceeds their authorized use of the easement by placing an excessive burden on the property encumbered by the easement.
- 2) Loss of money, rights or anything of value due to failure to perform, a remedy abhorred by the courts.

**fraudulent conveyance.....338**

A property transfer made for the purpose of avoiding creditors without receiving fair value on the transfer which is voidable.

**fully stepped-up cost basis .....290**

The tax basis of community property a surviving spouse receives on the death of a spouse is stepped up to the property’s fair market value (FMV) on the date of death.

**further-improvements provision ..... 42**

A commercial lease provision which allows a landlord to retain tenant improvements or require the restoration of the property to its original condition upon expiration of the lease. [See **RPI** Form 552 §11.3]

**G**

**good faith .....103**

Acting innocently and without knowledge of negative effects to someone else.

**grant.....167**

The transfer of an interest in title to real estate.

**grant deed .....175, 182**

A document used to pass a fee simple interest in real estate from the grantor to another individual, unless a lesser interest is stated.

**grantee .....175**

An individual acquiring an interest in title to real estate.

**grantor .....173**

A individual capable of conveying an interest in real estate.

**ground lease.....35**

A leasehold interest for which rent is based on the rental value of the land, whether the parcel is improved or unimproved.

**guest occupancy agreement ..... 64**

The written document which sets the terms of a transient occupancy. [See **RPI** Form 593]

**H**

**holdover rent.....62**

Rent owed by a holdover tenant for the tenant’s unlawful detainer of the rented premises as a tenant-at-sufferance. [See **RPI** Form 550 §3.4]

**holdover tenant.....62**

A tenant who retains possession of the rented premises after their right of possession has been terminated, called a tenant-at-sufferance.

**homestead.....319**

The dollar amount of equity in a homeowner’s principal dwelling the homeowner qualifies to shield as exempt from creditor seizure. [See **RPI** Form 465]

**I**

**implied covenant .....182**

An implied warrant the grantor has not previously conveyed or encumbered their interest in the real estate.

**implied easement .....136**

An easement created by the conduct of parties without prior agreement.

**initial conference .....436**

The first meeting between a licensee and prospective attorney conducted prior to entering into a retainer agreement where the licensee discusses their real estate dispute and interviews the attorney to determine their professional background, qualifications and compatibility.

**inter vivos (living) trust .....251**

One entitled to the benefits of properties held in a trust or estate, with title vested in a trustee or executor.

**interstate commerce ..... 5**

The flow of goods and services between and within states.

**inverse condemnation ..... 4**

A government taking of privately held real estate interests which does not constitute eminent domain and for which the property owner seeks compensation.

**irrevocable license .....74**

The right to enter and use property when the specific activity granted by the license is maintained by the licensee's on-going expenditure of money or equivalent labor, and remains feasible.

**J****joint protection (JP) policy .....226**

A title insurance policy which enables one or more individuals or entities to be named as insured, usually the buyer and the new mortgage holder.

**joint tenancy .....279**

An ownership interest in property concurrently received by two or more individuals who share equally and have the right of survivorship.

**judgment lien .....313**

A money judgment against a person recorded as an abstract and attaching to the title of real estate they own.

**judicial branch ..... 3**

The branch of government which settles disputes and issues case opinions regarding the application of the codes, cases and regulations.

**jurisdiction.....11**

The power of a court to hear a dispute and rule on a legal issue.

**L****laches.....105**

An unreasonable delay which bars pursuit of a claim.

**lease agreement .....57**

The written document which sets the terms of a fixed-term tenancy. [See **RPI** Form 550 and 552—552-4]

**leasehold estate .....35**

The right to possess a parcel of real estate, conveyed by a fee owner (landlord) to a tenant.



<b>legal description</b> .....	<b>178</b>
Description of real estate in a deed by its parcel or lot number, or containing the property's metes and bounds description.	
<b>legislative branch</b> .....	<b>2</b>
The branch of government which enacts the codes and statutes which regulate most aspects of real estate interests.	
<b>license</b> .....	<b>36, 68</b>
The personal, unassignable right held by an individual to the non-exclusive use of property owned by another.	
<b>lien</b> .....	<b>22, 294</b>
Interests in real estate which secure payment or performance of a debt or other monetary obligation.	
<b>life estate</b> .....	<b>33</b>
An interest in a parcel of real estate lasting the lifetime of the life tenant.	
<b>lis pendens</b> .....	<b>294, 323</b>
A notice recorded for the purpose of warning all persons that the title or right to possession of the described real property is in litigation.	
<b>lot line adjustment</b> .....	<b>94</b>
When adjacent property owners move an existing property line.	

## **M**

<b>mandatory improvement</b> .....	<b>43</b>
An improvement required to be made by the tenant under the terms of the rental or lease agreement.	
<b>master lease</b> .....	<b>36</b>
A leasehold interest granted to a master tenant with the right to sublease the property in exchange for rent paid to the fee owner.	
<b>mechanic's lien</b> .....	<b>49, 302</b>
A lien entitling a contractor or subcontractor to foreclose on a job site property to recover the amount due and unpaid for labor and materials they provided.	
<b>merger</b> .....	<b>149</b>
The termination of an easement when one owner acquires fee title to both the property benefitting from and the property burdened by an easement.	
<b>misdemeanor</b> .....	<b>110</b>
A lesser crime punishable by a fine and/or county jail sentence.	
<b>money judgment</b> .....	<b>336</b>
An award for money issued by a court resulting from a lawsuit for payment of a claim.	

## **N**

<b>negative covenant</b> .....	<b>155</b>
A recorded restriction prohibiting identified uses of a property.	

**nominal money losses .....108**

Monetary recovery when no injury has occurred.

**notice of nonresponsibility ..... 50, 310**

A notice used by a landlord to declare that they are not responsible for any claim arising out of improvements the tenant is constructing on their property. [See **RPI** Form 597]

**nuisance.....96, 115**

An action which is injurious to health, offensive to the senses, or obstructs the use and enjoyment of surrounding property.

**nuisance per se .....116**

Any activity specifically declared by statute to be a nuisance, such as construction of fences of excessive height or the illegal sale of controlled substances.

**O****overlying right .....78**

The right of a real estate owner to take the ground water below the surface of their land.

**P****parcel.....404**

A three-dimensional space of real estate identified by a legal description circumscribed on the face of the earth by a surveyor.

**partition action .....272, 368**

Court proceedings by which co-owners seek to sever their joint ownership and parcel or sell the property.

**partnership.....267**

A voluntary association of two or more persons to carry on a business or venture on terms of mutual participation in profits and losses.

**party wall .....94**

A common boundary improvement located on a property line between adjacent properties, such as a wall, fence or building co-owned by the adjacent property owners.

**periodic tenancy ..... 35, 59**

A leasehold interest which lasts for automatic successive rental periods of the same length of time, terminating upon notice from either party. [See **RPI** Form 551 and 552-5]

**permanent nuisance .....100, 121**

A nuisance which cannot be abated at a reasonable cost and by reasonable means.

**permissive improvement .....46**

A nonmandatory improvement the tenant is authorized to complete without further landlord consent.

**personal property .....22**

Moveable property not classified as part of real estate, such as trade fixtures.

**police power ..... 3**

The constitutional source of the state or local government's authority to act.

**preliminary title report (prelim) .....211, 218**

A report constituting a revocable offer by a title insurer to issue a policy of title insurance, used by a buyer and escrow for an initial review of the vesting and encumbrances recorded and affecting title to a property.

**prescription .....112**

A process for acquiring property rights to use another's property, such as an easement, through adverse use hostile to the rights of the owner.

**prescriptive easement .....141**

The right to use another's property established by the adverse use of the property for a period in excess of five years without a claim of ownership.

**prescriptive right..... 27, 84**

The right to use water established by appropriating nonsurplus water openly and adversely for an uninterrupted period of five years without documentation of a legal right.

**profit a prendre..... 25, 32**

The right to remove minerals from another's real estate.

**proof-of-loss statement.....228**

A statement submitted to the title insurance company by the insured referencing the encumbrance discovered after they were issued the policy, the amount of the loss and the basis for calculating the loss.

**public nuisance .....118**

A nuisance affecting an entire segment of the public.

**Q**

**quiet title action .....353, 381**

A court action to remove a cloud and establish title to a property.

**quitclaim deed .....177, 193**

A document used to convey whatever interest, if any, the grantor may hold in the real estate.

**R**

**ratify .....285**

The later adoption or approval of an act performed on behalf of a person when the act was not previously authorized.

**real estate ..... 22**

Land and anything permanently affixed or appurtenant to it.

**real estate investment trust (REIT).....261**

An entity issuing securities held by investors and traded on the stock market, holding title to income-generating property, trust deeds and treasury bonds.

**redemption.....383**

A property owner or junior lienholder's right to clear title to property of a mortgage lien prior to the completion of a trustee's sale or following a judicial foreclosure sale by paying all amounts due on the mortgage debt, including foreclosure charges.

**referee .....373**

An advisor to the court on the feasibility of the division or sale of co-owned real estate.

<b>reformation</b> .....	<b>191</b>
A legal process to correct an omission or error in a grant deed by court action.	
<b>remote grantee</b> .....	<b>187</b>
A future owner of real estate who later takes title to a property, also known as a successor.	
<b>rent skimming</b> .....	<b>403</b>
When an investor receives rents from a parcel of residential rental property during their first year of ownership and does not apply the rents (or an equivalent amount) to the payments due on all mortgages secured by the property.	
<b>rental agreement</b> .....	<b>59</b>
The written document which sets the terms and conditions of a periodic tenancy. [See <b>RPI</b> Form 551 and 552-5]	
<b>rescission</b> .....	<b>293</b>
The termination of an agreement or transaction from its inception by mutual consent of the participants to the agreement or transaction, or by one participant based on fraud or misrepresentation of another participant.	
<b>restitution</b> .....	<b>384</b>
A refund to the buyer by the seller on a rescission of a transaction in exchange for the restoration of the property to the seller.	
<b>restoration</b> .....	<b>294, 383</b>
The return of funds and documents on a rescission of a purchase agreement or transaction sufficient to place all the parties in the position they held before entering into the agreement or closing the transaction.	
<b>retainer agreement</b> .....	<b>436</b>
A contract entered into between an attorney and licensee specifying the respective responsibilities of each, and the hourly rate, deposit and other fees the attorney charges for legal services.	
<b>reversion</b> .....	<b>48</b>
The conveyance of fixtures from a tenant to landlord on expiration of a lease.	
<b>revocable transfer on death deed (RTDD)</b> .....	<b>200</b>
Any document created to transfer real estate without covenant or warranty of title to a beneficiary upon the owner's death. [See <b>RPI</b> Form 411]	
<b>right of survivorship</b> .....	<b>277</b>
The right of surviving joint tenants or a spouse to succeed to the entire interest of the deceased co-owner.	
<b>right-of-way</b> .....	<b>162</b>
A privilege under an easement granted by the owner of property giving the owner of another property the right to pass over their property.	
<b>riparian land</b> .....	<b>78</b>
A parcel of real estate located next to a water source with surface water and within the watershed of the surface water.	
<b>riparian right</b> .....	<b>26, 77</b>
The right of a real estate owner to take surface water from a running water source contiguous to their land.	

## S

### **Schedule A .....220**

Identification of the property interest insured, the legal description of the insured property, the date and time coverage began, the premium paid for the policy and the total dollar amount to be paid for all claims settled.

### **Schedule B.....220**

Exceptions from coverage, both standard and itemized, by the title insurance policy.

### **secondary easement .....164**

An easement on a property which abuts a primary easement and allows the user of that easement to further enter upon the property for purposes of maintaining the primary easement.

### **security.....200**

Collateral for a debt in the form of a lien imposed on property.

### **servient tenement.....67, 126**

A property burdened by a license or easement.

### **set aside .....285**

To annul by court order a document transferring an interest in real estate.

### **slander of title.....357**

False and malicious statements disparaging an owner's title to property resulting in money losses to the owner.

### **small claims .....12**

An informal court proceeding for disputes over amounts of \$5,000 or less, or \$10,000 or less for individuals.

### **solar easement .....128**

An easement restricting an owner's ability to maintain improvements interfering with a neighbor's solar energy system.

### **specific performance action .....329**

Litigation to compel performance of an agreement.

### **State Water Resources Control Board .....81**

Government entity established to ensure the proper allocation and efficient use of state water resources.

### **statute of limitations.....92**

A period of time establishing the deadline for filing a lawsuit to resolve a dispute.

### **sublease .....36**

A leasehold interest subject to the terms of a master lease.

### **subrogation .....189**

The replacement of one person with another in regard to a legal right or obligation.

### **superior court system ..... 12**

California's trial court system.

### **Supreme Court ..... 12**

The final court for appeals in both the state and federal court systems.

**T****tenancy-at-sufferance.....35**

A leasehold condition created when a tenant retains possession of the rented premises after the tenancy has terminated. [See **RPI** Form 550 §3.4]

**tenancy-at-will.....35**

A leasehold interest granted to a tenant, with no fixed duration or rent owed. A tenancy-at-will can be terminated at any time by an advance notice from either party.

**tenant improvements.....41**

Improvements made to leased property to meet the needs of the occupying tenant. [See **RPI** Form 552 §11]

**tenants in common (TIC) .....265**

Co-ownership of real estate by two or more persons who each hold equal or unequal undivided interest, without the right of survivorship.

**title insurance.....216**

A form of indemnity insurance issued by a title insurance company which holds harmless the named insureds against monetary loss caused by an encumbrance not listed in Schedule B of the policy and not known by the insured when the policy was issued.

**trade fixtures ..... 28, 49**

Fixtures used to render services or make products in the trade or business of a tenant.

**transient occupancy .....64**

The occupancy of a vacation property, hotel, motel, inn, boarding house, lodging house, tourist home or similar sleeping accommodation for a period of 30 days or less. [See **RPI** Form 593]

**transmutation.....246**

The transfer of property between separate property and community property or between the separate property interests owned by spouses.

**trespass.....100, 107**

Any wrongful and unauthorized entry onto real estate in the possession of another.

**trespasser.....56**

A person who occupies a property without the owner's transfer of the right to occupy.

**trial courts.....12**

Courts which hear and decide the facts of a case and apply the proper rules of law to resolve the dispute.

**trustee.....251**

One who holds title to real estate in trust for another.

**U****unlawful detainer.....56**

The unlawful possession of a property. [See **RPI** Form 575-578]

**usufructuary right .....80**

The right to reasonable use of water subject to changing circumstances controlling the use of water.

**V**

<b>venue</b> .....	<b>13</b>
The physical location of the court which has jurisdiction and the correct forum to hear a dispute.	
<b>vesting</b> .....	<b>266, 278</b>
A method of holding title to real estate, including tenancy in common, joint tenancy, community property and community property with the right of survivorship.	
<b>void deed</b> .....	<b>207</b>
A deed that is unenforceable and conveys no interest in real estate.	
<b>voidable deed</b> .....	<b>208</b>
A deed that is valid and enforceable until it is challenged due to a defect and declared invalid by a court order.	