

1-1963

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Recommended Citation

John M. Rubens, *Right of First Refusal and Waiver of the Right of Judicial Partition*, 14 HASTINGS L.J. 255 (1963).

Available at: https://repository.uchastings.edu/hastings_law_journal/vol14/iss3/5

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Right of First Refusal and Waiver of the Right of Judicial Partition

By JOHN M. RUBENS*

THE usual condominium plan contains extensive management provisions within the Declaration of Covenants to create a centralized administration of the project. The tenant owners agree that a managing authority shall exclusively maintain common areas, provide common services and enter into contracts relating to the efficient operation of the building and its facilities.

Contract Liability

The managing authority is either an individual or individuals, an unincorporated association or a corporation. In either case, the contracts made for the benefit of the individual unit owners are contracts made by an agent for its principal.¹ It can be argued that such contracts, because they benefit all tenant owners, bind them jointly and severally.² However, if not joint and several, the tenant owners' liability would clearly be joint,³ and in California the creditor may elect to proceed against any single tenant owner.⁴ Although the tenant owner who extinguishes the joint obligation may pursue his right of contribution from the co-owners,⁵ the exercise of the right may well be more costly in litigation fees and court costs than the amount of the tenant-creditor's claim.

Tort Liability

Aside from the potential contract liabilities of the tenant owners, each of them must seriously consider his potential tort liability for

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¹ In the case of a corporation, the tenant owners would be liable as undisclosed or partially disclosed principals. See *Shamlian v. Wells*, 197 Cal. 716, 242 Pac. 483 (1925). Or they may be individually liable because they are the alter ego of a corporation whose corporate form will be disregarded by the court. See *Minton v. Cavaney*, 56 Cal. 2d 576, 364 P.2d 473 (1961); *Automotriz Del Golfo v. Resnick*, 47 Cal. 2d 792, 306 P.2d 1 (1957); BALLANTINE, CORPORATIONS § 122, at 292-93 (rev. ed. 1946); LATTIN, CORPORATIONS 66 (1959).

² See CAL. CIV. CODE § 1659; *but see* CAL. CIV. CODE § 1431.

³ See CAL. CIV. CODE § 1431.

⁴ See CAL. CODE CIV. PROC. § 414.

⁵ See CAL. CIV. CODE § 1432.

injuries to third persons caused by unsafe conditions in the common areas or by the acts of common servants. This tort liability would be joint and several, whether it be imputed because of ownership⁶ or *respondeat superior*.⁷

The importance of the area of tort liability is accentuated by the fact that there is no right of contribution among joint tortfeasors until a money judgment is rendered against all of those from whom contribution is sought.⁸ Therefore, a real practical problem exists because not only may the injured plaintiff fail to join all tenant owners in his lawsuit, but also some of the tenant owners may be judgment proof. Insurance may or may not solve the problem depending upon whether or not the injured party's claim exceeds the policy limits. A "hold-harmless" agreement may be helpful to give the tenant owner a right of indemnity from his neighbors and therefore protect the tenant owner to some extent, but the financial responsibility of the co-owners will determine its practical effectiveness.

Harmonious Environment

Aside from purely economic factors there are the environmental factors involved when several owners live in close proximity to one another and share the common services and facilities of the condominium project. Effective rules and safeguards must be provided in order to prevent any disturbance to an environment that is conducive to a successful project.

The joint tort and contractual liability, as well as the necessity for a harmonious environment, requires some sort of provision in the declaration of covenants to control who may become a tenant owner. What type of provision is necessary? It would be desirable to provide that consent of the co-owners be obtained before a tenant owner could transfer his interest. However, the rule against restraints on alienation must be considered by the drafter of the Declarations if he intends to control successive ownership.

Right of First Refusal

Rule Against Restraint Upon Alienation

The rule against the hindrance of free alienability of land is not involved when the condominium interest is a life estate⁹ or an estate for

⁶ *Farrell v. Placer County*, 23 Cal. 2d 624, 145 P.2d 570 (1944).

⁷ *Hiner v. Olson*, 23 Cal. App. 2d 227, 72 P.2d 890 (1937).

⁸ See CAL. CODE CIV. PROC. § 875 (a).

⁹ See RESTATEMENT, PROPERTY §§ 409, 410 (1944).

years.¹⁰ The reason behind this is twofold: the grantor or lessor, the holder of the reversion, has an interest in protecting the property from an undesirable tenant, and also there is no undue interference with the alienability of property.

In a stock cooperative, the right to sell stock is usually subject to a consent requirement. Such restrictions are generally upheld on the theory that a closely held commercial corporation may protect itself against hostile and disinterested persons becoming a part of the management.¹¹ Although the interest in the condominium is an interest in real property rather than a shareholder interest, the condominium is in substance no different from the stock cooperative in this regard. The necessity for socially compatible and financially responsible persons is present in both. However, since there is no indication, absent legislation, that the transfer of the condominium interest will be treated differently by our courts from the transfer of other fee interests in real property, the rule must be considered by the draftsman.

Generally there are three types of restraints:¹² (a) disabling restraints, (b) forfeiture restraints, and (c) promissory restraints. The first type of restraint is one which is an absolute prohibition against alienation; *i.e.*, "the grantee shall not transfer", or "any transfer shall be void." The second type of restraint on alienation is phrased in terms of a fee simple determinable or a fee simple subject to a condition subsequent. The third type is a covenant not to alienate which attempts to make the grantee liable for damages if he does transfer.

Under the general law, and by the express terms of the California Civil Code,¹³ all three types of restraints, with certain exceptions, are illegal and void.¹⁴ A restraint requiring the consent of the grantor to approve every prospective transferee would clearly be void.¹⁵ One exception to the rule against restraints on alienation is the right of first refusal. A provision in the Declaration of Covenants, Conditions and Restrictions that the grantee will not sell the estate without first offering

¹⁰ See *Burns v. McGraw*, 75 Cal. App. 2d 481, 171 P.2d 148 (1946).

¹¹ CAL. CORP. CODE §§ 501(g), 2403(c), 9609; see *Casady v. Modern Metal Spinning & Mfg. Co.*, 188 Cal. App. 2d 728, 10 Cal. Rptr. 790 (1961) (first refusal to corporation and other shareholders); *Vannucci v. Pedrini*, 217 Cal. 138, 17 P.2d 706 (1932) (first refusal right to corporation and other shareholders valid).

¹² See RESTATEMENT, PROPERTY § 404 *et seq.* (1944).

¹³ CAL. CIV. CODE § 711: "A condition restraining alienation, if repugnant to the interest created, is void."

¹⁴ See *Bonnell v. McLaughlin*, 173 Cal. 213, 159 Pac. 590 (1916); *Wharton v. Mollinet*, 103 Cal. App. 2d 710, 229 P.2d 861 (1951). These cases should be distinguished from restraints as to use. See *Los Angeles v. Gary*, 181 Cal. 680, 186 Pac. 596 (1919); *Cornbleth v. Allen*, 80 Cal. App. 459, 251 Pac. 87 (1926).

¹⁵ See *Maynard v. Polhemus*, 74 Cal. 141, 15 Pac. 451 (1887); *Murray v. Green*, 64 Cal. 363, 28 Pac. 118 (1883).

it to the grantor, or some other designated person, would appear to be valid and not a restraint against alienation.¹⁶

However, it should be noted that the appellate court, in the case of *Bay Shore Motors v. Baker*,¹⁷ relied upon section 715 of the California Civil Code to uphold the option therein.¹⁸ Since Civil Code section 715 has been repealed by the legislature,¹⁹ the courts could hold that there is no limitation to Civil Code section 711, and the preemption option, or right of first refusal, would be void. However, there is no real basis for such a holding as long as the right of first refusal is not unreasonable nor, in effect, an indirect preclusion of the right to alienate. The right of first refusal should be held valid if reasonable, for if reasonable it will not inhibit alienation nor be "repugnant to the interest created." A provision in the condominium Declaration that the grantee shall not sell unless the grantor (or managing authority) shall fail to purchase at the offer price of a prospective purchaser and after thirty days' notice so to do, does not deprive the tenant owner of his right to transfer the interest. The unit interest and the undivided interest in the common areas can be sold at no loss of the fair price to the tenant owner. The option is not unreasonable in that it is not an option to purchase exercisable at the will of a holder and, further, it does not restrict the class of persons to whom the tenant owner may sell. When the option is exercised it must be exercised at the price and on the terms that a third party has offered and not at a stipulated price nor upon fixed terms.²⁰ Thus, the owner may decide to sell whenever he wants, and he can do so at the prevailing market price. Although the right of first refusal is usually discussed in the terms stated above, its possible scope should be considered.

If the right of first refusal were to include a separate clause giving the grantor an absolute option to purchase from the personal representative of the tenant owner, such a clause would clearly restrain alienation by devise. Similarly, if the option clause attempted to prevent a gift by the grantor. However, a standard successor-in-interest clause could

¹⁶ See *Bay Shore Motors v. Baker*, 90 Cal. App. 2d Supp. 895, 202 P.2d 865 (1949); RESTATEMENT, PROPERTY § 413 (1944).

¹⁷ *Ibid.*

¹⁸ *Id.* at 896. "In the absence of section 715 of the Civil Code, there might be a basis for this contention of defendant but when section 711 is read with section 715 it becomes at once apparent that section 711 contains no inhibition on time limit restraints on alienation if otherwise lawful, for such time limit restraints on alienation are specifically declared to be valid if they are within the limits prescribed by section 715. . . ."

¹⁹ CAL. CIV. CODE § 715, repealed by CAL. STATS. 1951, c. 1463, p. 3443 § 7; CAL. CIV. CODE § 715.1, repealed by CAL. STATS. 1959, c. 470, p. 2405 § 1.

²⁰ *Maynard v. Polhemus*, 74 Cal. 141, 15 Pac. 451 (1887) (if B "shall ever sell any of the aforesaid property, it shall be sold to (A) at the aforesaid (fixed) price").

be used to bind the donee, devisee or personal representative if he should later attempt to sell to a bona fide purchaser.²¹

Although the right of first refusal would seem to be valid as not being in violation of the rule against restraints on alienation, it is subject to the Rule Against Perpetuities.²²

Rule Against Perpetuities

The right of first refusal gives the holder an election to acquire a property interest at a future time. Therefore, the contingent interest must vest, if at all, within the period of the Rule Against Perpetuities. If there is a possibility that it may vest at any time beyond the period, the option will be void.²³

A properly drafted declaration would not create any problem. The beginning of the period, under this rule, would be the time when the interest is created; *i.e.*, the delivery of the deed which is the subject of the restrictions. The measuring life would be the life of the grantee, the tenant owner. Thus, the interest is bound to vest, by exercise of the option, during the life of the tenant owner when he decides to sell his interest. In the event that the tenant owner dies after the exercise of the option but before the deed is transferred to the optionor, the obligation is binding on the owner's personal representative and can be enforced by the optionee.²⁴

The option to repurchase has been held to be subject to the Rule Against Perpetuities in a number of cases.²⁵ The options to repurchase which have been held to violate the rule were not truly rights of first refusal. They actually gave the optionee the absolute right to repurchase

²¹ See note 27 *infra* with respect to the Rule Against Perpetuities.

²² CAL. CIV. CODE § 715.2: "No interest in real or personal property shall be good unless it must vest if at all, not later than 21 years after some life in being at the creation of the interest and any period of gestation involved in the situation to which the limitation applies. The lives selected to govern the time of vesting must not be so numerous or so situated that evidence of their deaths is likely to be unreasonably difficult to obtain. It is intended by the enactment of this section to make effective in this State the American common-law rule against perpetuities." See *Alamo School Dist. v. Jones*, 182 Cal. App. 2d 180, 6 Cal. Rptr. 272 (1960).

²³ *Haggerty v. City of Oakland*, 161 Cal. App. 2d 407, 326 P.2d 957 (1958); *Dallapi v. Campbell*, 45 Cal. App. 2d 541, 114 P.2d 646 (1941).

²⁴ *Thomson v. Lineer*, 86 Cal. App. 2d 838, 195 P.2d 838 (1948).

²⁵ *Los Angeles Inv. Co. v. Gary*, 181 Cal. 680, 186 Pac. 596 (1919) (covenant that grantee shall not sell, lease or rent to non-caucasian, breach of which caused property to revert to grantor); *Bonnell v. McLaughlin*, 173 Cal. 213, 159 Pac. 590 (1916) (condition that grantee not sell, mortgage, convey or alienate without grantor's consent); *Prey v. Stanley*, 110 Cal. 423, 42 Pac. 908 (1895) (covenant that owner of property shall not sell without consent, breach of which resulted in forfeiture); *Murray v. Green*, 64 Cal. 363, 28 Pac. 118 (1883) (condition that grantee not sell without written consent of grantor).

without any limitations as to time²⁶ or price.²⁷ The solution would be either to provide a saving clause in the declaration stating that the option will in no event last beyond certain lives in being plus 21 years, or simply to provide that the optionor shall not during his lifetime sell, assign or transfer his ownership without first giving the optionee a right of first refusal for a specified time at the bona fide offer price of the desiring third party purchaser.²⁸

What if the tenant owner is a corporation or partnership? A practical problem with respect to the rule exists when the tenant owner is such an entity. In the instance of a corporation, whose is the measuring life? Since a corporation's life is perpetual, is the option void or valid? The right of first refusal would appear to be void as in violation of the rule unless a time limit of 21 years were placed thereon, for it has been held that a corporation cannot constitute a life in being within the rule.²⁹ In the instance of a partnership the problem is not as great. However, the number of partners and their location may make evidence of the death unreasonably difficult to obtain.³⁰ This problem is accentuated under the Corporation Code wherein it is permissible by agreement to continue the partnership beyond the death of a partner.³¹

Remedy of the Grantors

Since California would not allow a destruction of title for failure to comply with the right of first refusal, the holder of the option would be relegated to an action for an injunction, or after sale, damages.³² However, the burden of proof with respect to damages would be extremely hard for the optionee to meet. A liquidated damages clause would to some extent relieve this burden and also tend to insure compliance by the tenant owner, but such a clause may be held to be void.³³

²⁶ *Alamo School Dist. v. Jones*, 182 Cal. App. 2d 180, 6 Cal. Rptr. 272 (1960).

²⁷ *Maynard v. Polhemus*, 74 Cal. 141, 15 Pac. 415 (1887).

²⁸ If a successor in interest clause is used to bind the donee, devisee or personal representative of the tenant owner, a saving clause should be used to prevent a violation of the Rule Against Perpetuities.

²⁹ See *Fitchie v. Brown*, Hawaii, 211 U.S. 321 (1908).

³⁰ CAL. CIV. CODE § 715.2.

³¹ CAL. CORP. CODE § 15031.

³² CAL. CIV. CODE § 3300: "For breach of an obligation arising from contract, the measure of damages, except where otherwise expressly provided by this Code, is the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which, in the ordinary course of things, would be likely to result therefrom."

³³ CAL. CIV. CODE § 1670: "Contract fixing damages void, every contract by which the amount of damages to be paid, or the compensation to be made, for a breach of an obligation, is determined in anticipation thereof, is to that extent void, except as expressly provided in the next Section;" CAL. CIV. CODE § 1671: "Exception. The parties to a contract may agree therein upon an amount which shall be presumed to be the amount of damages

Judicial Partition

The tenant owners are given co-ownership of common areas and facilities within the project to avoid the necessity of entering into cumbersome collateral easement and maintenance arrangements with each individual owner. However, each co-owner has the right to compel partition of common parts through judicial process.³⁴ This could cause either a physical division of the property, each co-tenant receiving a several interest in proportion to the amount of his undivided interest, or a sale with direction to divide the proceeds.³⁵

Although partition in kind is favored by the courts, a sale will still be ordered where necessary to prevent great injustice or prejudice to the owners.³⁶ Because the common areas consist of such facilities as stairwells, elevators and swimming pools, it would seem that it would be a prejudice to the co-tenants not to order a sale. Such a sale would leave the tenant owners without access to the common areas unless the purchaser at the sale is willing to negotiate with each tenant owner for some sort of easement agreement. Even if the purchaser is willing to negotiate it is likely, considering the bargaining positions of the parties, that the agreement reached may be both costly and unfair to the tenant owners.

Absent statutory provision it is necessary that the Declaration of Covenants and Restrictions contain a waiver of the tenant owner's right to a judicial partition. The condominium declaration will usually provide that there shall be no partition by judicial sale until there is a total or partial destruction of the building without a decision to repair or rebuild. When the building is destroyed and there is no decision to rebuild, then there is no longer a need to prohibit partition.

Waiver

It is established that the right to judicial partition may be waived by agreement.³⁷ The rule against restraining alienation is not violated

sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage."

³⁴ CAL. CODE CIV. PROC. § 752; *De Roulet v. Mitchell*, 70 Cal. App. 2d 120, 160 P.2d 574 (1945).

³⁵ CAL. CODE CIV. PROC. §§ 752, 763, 764.

³⁶ See *Formosa Corp. v. Rogers*, 108 Cal. App. 2d 397, 239 P.2d 88 (1951); *Williams v. Wells Fargo Bank*, 56 Cal. App. 2d 645, 133 P.2d 73 (1943).

³⁷ *Teutenberg v. Schiller*, 138 Cal. App. 2d 18, 291 P.2d 53 (1955); *Miranda v. Miranda*, 81 Cal. App. 2d 61, 183 P.2d 61 (1947); *Asels v. Asels*, 43 Cal. App. 574, 185 Pac. 419 (1919); CAL. CIV. CODE § 3513.

by such a waiver.³⁸ It would also seem that a waiver of the right to partition by judicial sale would not be subject to the Rule Against Perpetuities for the grantor is not retaining a contingent future interest.³⁹ Therefore, there appears to be no need to limit the duration of the waiver to lives in being plus 21 years. There is, however, a possibility that a waiver of the right to judicial partition, if not limited to some extent, would be held to be unreasonable by our courts. It can be argued that a waiver which is limited in duration to the life of the building would be reasonable. Although such a waiver may be held to be unreasonable in time, it would clearly seem to be reasonable in purpose. To be absolutely safe, however, it would be wise to avoid the duration problem by limiting the effective period of the waiver clause to the destruction of the building or lives in being plus 21 years, whichever first occurs. If such a time limitation is used by the drafter it would be advisable for him to include in the Declaration provision for easements of ingress and egress. Such easements would give the tenant owners access to the common areas in the event of judicial sale after the period of the rule has lapsed.

Conclusion

It seems apparent that the right of first refusal should be included in the Declaration of Covenants and Restrictions to insure that the tenant owners will be socially compatible and financially responsible persons. The drafter should consider whether he wants the option to bind the tenant owner's successors as well as the tenant owner himself. In this regard the rule against restraint on alienation and the Rule Against Perpetuities should be kept in mind so as to prevent the option from being held void and of no effect.

The Declaration should also contain a clause by which the tenant owner waives his right to judicial partition. The drafter should consider the advisability of limiting the duration of the clause to the period of the Rule Against Perpetuities. He should further consider including easements of ingress and egress for the tenant owners in the event of judicial sale after the period of the rule has elapsed.

A further solution to the problems presented by judicial partition and rules against restraints on alienations and perpetuities would be appropriate legislation dealing specifically with condominiums.

³⁸ The tenant owner maintains his right to convey the undivided interest subject to the Declaration of Covenants and Restrictions. In turn the right to convey is subject to the right of first refusal in the grantor.

³⁹ Prior to the repeal of CAL. CIV. CODE § 715.1, it could have been argued that such a waiver would restrain the absolute power of alienation.