The Rule against Perpetuities – Tips for the RAP Trap

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Introduction

This is my attempt to make sense of the Rule against Perpetuities, and to give a road map for avoiding one of the infamous traps set by our forebears. How do we see it coming? Does the Uniform Statutory Rule against Perpetuities, or the USRAP, make all of this irrelevant?

Simple Guide to the Rule – Spotting the Issue.

We see a perpetuity coming by simply thinking about anything in a given transaction that one may acquire in the future, resulting from anything in a business transaction, or a will, or a real estate deal, or a trust transferring wealth over the course of generations. For the business lawyer that confronts real estate transactions on a regular or even an infrequent basis, we can set aside wills and trusts – what the perpetuities literature calls "donative transfers." For the business lawyer, think:

- The renewable lease
- An option to purchase – real estate, mineral rights, anything tangible
- The right of first refusal

Each of these <u>can</u> (given the appropriate trap) be rendered void in court if a property right does not vest now, but may (not will) vest (come into title and ownership) in the future, and particularly, more than 21 years in the future.

<u>Examples</u>:

- a 25 year lease; a series of four renewable options exercisable every 10 years;
- a 25 year option;
- a deed from A to B, with A reserving a right to purchase the property on the same terms as may be offered by some willing buyer at some point in the future;
- a deed from A to B, with A reserving the right to repurchase (a) if B does not build ten houses on the land within 10 years (great); (b) if B still owns any land 25 years after acquisition (not so great); or, (c) rather than a right of repurchase, the land reverts to A automatically if the land is not used for a public right of way at any time in the future (great, or at least good).

The latter point in (c) above drives knowledgeable property attorneys nuts, since the great majority of states addressing the issue under the common law rule against perpetuities hold that such a "reversionary interest" is not void because the right to "reenter" or to exercise a "condition" of the original sale is vested at the outset – no

matter when the right of entry or the breach of condition comes to fruition, the reversionary right vests at the outset – the 21 years never starts to "run," to use the trial lawyers language.

So think:

- A fee simple subject to a condition subsequent?
- A fee simple determinable?
- A reversion following a life estate?

Each of these cannot be rendered void in court for violation of the RAP – unless the poor attorney faced with the issue fails to detect the difference between one of these and one of those. This led to the five years of litigation that went up to the Colorado Supreme Court in 2005.[1]

And think – if you draft a deal that could be challenged under the RAP later, one can be negligent and face a liability lawsuit from an upset client simply for missing the issue – for creating the ambiguity, if you will – even if the deal as structured by the lawyer did not violate the Rule.[2]

Skirting the Rule – the fix offered by the Uniform Statutory Rule against Perpetuities, or "USRAP"

The American Law Institute came to the rescue in the late 1980's with the Uniform Rule – the USRAP, for short. This is codified in C.R.S. § 15-11-1101 through 1106, et seq., pertinent portions copied below with liberal annotations. This law came to the rescue of attorneys who might "run afoul" of the RAP by replacing on a go-forward basis the old common law Rule with a new statutory rule, or USRAP. The statute declares (1) that arms-length business transactions – a deal to transfer property that is "nondonative" – are no longer subject to the rule[3] as reformulated in the statute, and that if any pre-1991 deal was later held to violate the rule, any of those lawyers could go to court, proud, to reform the terms of the deal to add a "savings clause" – just as if the attorney had been smart enough to think of this precaution in the first place. Moreover, if the "interest" actually vests within 90 years, you're OK!

Trust not, however, as fate deals a tough hand. Litigation over the Rule against Perpetuities has never been so active, at least in Colorado. The "traps" started surfacing, and it did not take 90 years. Questions arose:

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[1] *Argus Real Estate, Inc. v. E-470 Public Highway Authority*, 109 P.3d 604 (Colo. 2005, discussed in Krendl, 2A COLO. METHODS OF PRACTICE § 72.30 at notes 17, 23 and 30 (6th ed. 2012)

[2] *Temple Hoyne Buell Foundation v. Holland & Hart*, 851 P.2d 192 (Colo. App. 1992).

[3] See C.R.S. §15-11-1102.5, below.

- Why is something that governs business deals immersed in the middle of the Probate Code? See below.
- If one cures the violation of the RAP by filing a "petition" in "a court"; does that mean we go to probate court to fix a contract between two oil companies? If the "petition" results in an order to "reform the disposition" – when did you last refer to your option agreement as a "manifested plan of distribution?

In other words, does this really mean that only "donative" transfers get reformed, because the whole statute sounds like it involves probate matters and procedures? So it does not help the average transaction lawyer, only estate planning lawyers? Does it matter that the public policy of avoiding perpetual wealth, the backbone of RAP, is not met by striking down a 25-year option for the purchase of mineral rights?

Enter the case of *Whiting v. Atlantic Richfield*, 320 P.3d 1179 (Colo. 2014). Whiting, a fairly large, publicly traded outfit, exercised an option to purchase (or repurchase, to be precise) mineral rights and other land in the 25th year after its predecessor sold the rights to ARCO. ARCO says "RAP," Whiting says "USRAP," and off they go for five years and hundreds of thousands in legal fees in court.

More precisely, the facts go like this. ARCO entered into a deal 1968 with a small oil company (Equity, now owned by Whiting, a publicly traded firm) to explore Colorado shale oil development in Garfield county. It gave development money to Equity, and received a partial ownership interest in the mineral rights. Equity was given an option to repurchase Arco's interest within the 25 year term of the deal. In 1983, the agreement (including the option) was extended for another 25 years. The terms are summarized succinctly by the court:

> Pursuant to the 1983 amendment, Equity's right to exercise the option would not expire until 11:59 p.m. on February 1, 2008. Importantly, the parties agreed that "ARCO shall retain the sole and exclusive right to cancel this Option at any time during its term," with the exception that Equity was granted a right of first refusal if ARCO received an offer from another party to buy its interest in the [property].

The trial court says the option violates the RAP and reforms the deal under the USRAP with a savings clause. The court of appeals passes on the first question but affirms the reformation order, since it is "automatic." The Supreme Court jumps in, and after voluminous briefings and at least one amicus brief, decides to revisit the first issue, which was not briefed by the parties. The court declines to rule on the constitutionality of the USRAP's reformation provision, skirting the delightful argument as to whether ARCO had a "vested right" to argue the validity of its own agreement, a right taken unconstitutionally by a retrospective law. Instead, the court says the option does not violate the RAP in the first place.

Technically, the court says, it does violate the rule – Colorado has had several such cases involving options longer than 21 years.[4] But, the court goes on, because the public policy behind the common law rule is not really served by getting in the middle of two fully-lawyered oil companies, it does not. This is the approach taken earlier by the court in a case involving rights of first refusal.[5] This is one way to respect the public policy behind the USRAP when it was adopted by the ALI in the 1980's. The USRAP provisions (set out below) generally "limit the (future) application of the rule against perpetuities to donative transfers of property, thereby freeing commercial transactions from the rule's arcane vesting requirements." [6] This is also consistent with the trend in the common law. [7]

To avoid the RAP Trap? Think:

- Future – if it doesn't happen now, is it a "future interest," and if so, the "wrong" kind? If you cannot remember the right from wrong, just learn to cringe when anything happens after 21 years, or you hear the word "option," or some interest "springs." Add savings clauses. Is your deal truly an arms-length business deal, or does it have a semblance of "donative" intent?
- That's it. The common law is now on your side. Business deals do not violate the Rule (pre-1991) or the USRAP, although they may be so "long" as to violate a common law rule against unreasonable restraints on alienation. If mistaken, it can always be reformed. If you remember to ask in time. (*Argus*). If it is not unconstitutional (reserved for another day, *Whiting*).
- Do what the estate lawyers do – put it in a trust – 1,000 years! See C.R.S. 15-11- 1102, the 2001 Year Rule – a real Space Odyssey!

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[4] Options: *Crossroads Shopping Center v. Montgomery Ward*, 646 P.2d 330 (Colo. 1981); *Perry v. Brundage*, 200 Colo. 229, 614 P.2d 362 (1980); *Rocky Mountain Fuel Co. v. Heflin*, 148 Colo. 415, 366 P.2d 577 (1961); *Matter of Ferguson*, 751 P.2d 1008 (Colo. App. 1987).

[5] Rights of first refusal or preemptive rights: *Cambridge Co. v. East Slope Investment Corp.*, 700 P.2d 537, 542 (Colo. 1985).

[6] *Meadow Homes Dev. Corp. v. Bowens*, 211 P.3d 743, 748 (Colo. App. 2009), *quoting* Krendl, 2A COLO. METHODS OF PRACTICE § 72.27 (5th ed. 2007).

[7] RESTATEMENT THIRD, PROPERTY: DONATIVE TRANSFERS §27.3 (2011) (Rule against Perpetuities does not apply to commercial transactions with eight exceptions taken from the USRAP and set out in C.R.S. § 15-11-1105(1)(a)).

fbs

The Colorado version of the USRAP, annotated liberally.

The USRAP -- two rules that replace or "supersede" the common law RAP:

C.R.S. 15-11-1102.5. Statutory rule against perpetuities

(1) **Year 2001 rule ["the 1000 year rule"]**.

[This rule] **shall apply to interests in trust and powers of appointment . . . which interest or power is created after May 31, 2001**. …

A nonvested property interest is invalid unless it either vests or terminates within one thousand years after its creation.

(2) **Year 1991 rule ["the 90 year rule"]**.

[This rule] shall apply to **interests and powers** [**other than trusts**, which get the 1000 year treatment] created on or after May 31, 1991 . . . .

A nonvested property interest is invalid unless:

(A) When the interest is created, it is certain to vest or terminate no later than twenty-one years after the death of an individual who is then alive; **o**r

(B) The interest either **vests or terminates within ninety years** after its creation.

If your "nonvested" business deal is created after 1991, forget the RAP . . . sort of.

C.R.S. 15-11-1105. Exclusions from statutory rule against perpetuities

(1) **The statutory rule against perpetuities, as set forth in sections 15-11-1102 and 15-11-1102.5, does not apply to invalidate**:

(a) **A nonvested property interest** . . . **arising out of a nondonative transfer [fbs – translate: commercial transaction such as lease, option, or other real estate deal]**, **except** a nonvested property interest or a power of appointment **arising out of**:

(I) A premarital or postmarital agreement;

(II) A separation or divorce settlement;

(III) A spouse's election;

(IV) A similar arrangement arising out of a prospective, existing, or previous marital relationship between the parties;

(V) A contract to make or not to revoke a will or trust;

(VI) A contract to exercise or not to exercise a power of appointment; or

(VII) A transfer in satisfaction of a duty of support. . . .

Translate: Some business deals are sufficiently "close to home" that they really can "run afoul" of the USRAP – they are negotiated but have "donative" qualities, perhaps. These exceptions are adopted in the Restatements' new recitation of the common law rule against perpetuities.

But if your deal was done pre – 1991, here's the fix . . .

C.R.S. 15-11-1106. Prospective application

(1) Except as extended by subsection (2) of this section, **this part 11** [i.e. CRS 15-11-1101 et seq.] **applies to a nonvested property interest or a power of appointment that is created on or after May 31, 1991**. ***

(2) If **a nonvested property interest** or a power of appointment was **created before May 31, 1991**, and **is determined** in a judicial proceeding, commenced on or after May 31, 1991, **to violate this state's rule against perpetuities as that rule existed before May 31, 1991**, a court upon the petition of an interested person **shall reform the disposition** by **inserting a savings clause** that preserves most closely the transferor's manifested plan of distribution and that brings that plan within the limits of the rule against perpetuities applicable when the nonvested property interest or power of appointment was created.

ANNOTATION: Subsection (2) does not allow a party to bring a new action for reformation after a judicial determination that a property interest violated the common law rule against perpetuities. The statute does not authorize a party to file a second lawsuit, because there is no evidence of the general assembly's intent to create an exception to the doctrine of claim preclusion. *Argus Real Estate, Inc. v. E-470 Pub. Hwy. Auth*., 109 P.3d 604 (Colo. 2005)