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Deeds to Non-Existent Entities and Senate Bill 15-049

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The CBA's Real Estate Law Section Executive Council has proposed amendments to C.R.S. § 38-34-105 which have been supported by the Executive Council of the Business Law Section, and endorsed by the CBA's Legislative Policy Committee. On January 8, 2015, Senator Beth Martinez-Humenik (R-Adams County) and Representative Jon Keyser (R-Jefferson County) introduced S.B. 15-049 — *Concerning the Vesting of Title to Real Estate in a Grantee that is an Entity that has not yet Been Formed Once the Entity has Been Formed*.¹

Existing C.R.S. § 38-34-105 provides a cure for a conveyance of real property to a corporation that was not formed at the date of conveyance. In pertinent part, that section reads as follows:

If at the time of the delivery of a deed describing the grantee as a corporation no incorporation papers have been filed and if thereafter proper incorporation papers are filed, the title to the real property shall vest in the grantee as soon as the grantee is incorporated and no other instrument of conveyance shall be required.²

C.R.S. § 38-34-105 became effective March 28, 1927, long before any of our current entity statutes were adopted and when, in fact, "papers" were filed with the Secretary of State to form a corporation. The contemplated legislation would modernize the language and expand this statute to include limited liability companies, partnerships, and other entities³ in addition to corporations.⁴

Business lawyers know that prior to the formation of an entity, the entity cannot "own" the property granted to it. Colorado law does not recognize the existence of an entity or its power to hold title or take action until such time as the entity has been lawfully formed.⁵ The Colorado

¹ Its fiscal note was issued on January 20, 2015 and noted that there would be "minimal workload impact." On January 28, 2015, with a 9-0 vote, the Senate Committee on Business, Labor & Technology referred S.B. 15-049 "to the Committee of the Whole with favorable recommendation." It was passed on third reading by the Senate and referred to the House of Representatives with no amendments on February 3, 2015.

² Colorado Title Standard 3.4.1 extends this relief to LLCs, partnerships, and other entities. There is no Colorado statute supporting this expansion by the Title Standard.

³ The term "entity" is broadly defined in C.R.S. § 7-90-102(20) by reference to a "domestic entity" (defined broadly in C.R.S. § 7-90-102(13)) and "foreign entity" (C.R.S. § 7-90-102(23)).

⁴ S.B. 15-049, which proposes to amend C.R.S. § 38-34-105, is appended to this paper.

⁵ For the purposes of the entity statutes in Title 7, C.R.S., the term "formed" is defined in C.R.S. § 7-90-102(20) using terms including "incorporated, created, and organized." "Formation" under the

Colorado Business Corporation Act (“CBCA”), the Colorado Nonprofit Corporation Act (“CNPCA”), the Colorado Limited Liability Company Act (“CLLCA”), the Colorado Uniform Limited Partnership Law (“CULPL”), and the Colorado Uniform Limited Partnership Act (“CULPA”) generally requires a filing with the Colorado Secretary of State. While CULPL and CULPA require the filing of a certificate of limited partnership with the Colorado Secretary of State, the two statutes provide that a limited partnership is formed “if there has been substantial compliance with the requirements of this section.” CULPA, § 7-62-304(1); CULPL requires that the substantial compliance be “in good faith.” CULPL, § 7-61-103(1). The statutes in question provide:

CBCA: § 7-102-103(1) – “A corporation is incorporated when the articles of incorporation are filed by the secretary of state [unless a delayed date is stated].”

§ 7-102-104 – “All persons purporting to act as or on behalf of a corporation without authority to do so and without good faith belief that they have such authority shall be jointly and severally liable for all liabilities incurred or arising as a result thereof.”

CNPCA: § 7-122-103(1) – “A nonprofit corporation is incorporated when the articles of incorporation are filed by the secretary of state [unless a delayed date is stated].”

§ 7-122-104 – “All persons purporting to act as or on behalf of a nonprofit corporation without authority to do so and without good-faith belief that they have such authority shall be jointly and severally liable for all liabilities incurred or arising as a result thereof.”

CLLCA: § 7-80-203(1) – “One or more persons may form a limited liability company by delivering articles of organization to the secretary of state for filing.”

§ 7-80-105 – “All persons who assume to act as a limited liability company without authority to do so and without good-faith belief that they have such authority shall be jointly and severally liable for all debts and liabilities incurred by such persons so acting.”

CULPL (1931): § 7-61-103. Formation. (1) Two or more persons desiring to form a limited partnership shall: Sign and swear to a certificate which shall state: [various specified things] (a) File for record the certificate in the office of the county clerk and recorder.

(2) A limited partnership is formed if there has been substantial compliance in good faith with the requirements of this section.

CULPA (1981): § 7-62-201. Certificates - contents - filing with secretary of state. (2) A limited partnership is formed at the time of the filing of the certificate of limited partnership in the office of the secretary of state, or at any later time not more than ninety days after the date of the filing of the certificate, stated in the certificate of limited partnership, if, in either case, there has been substantial compliance with the requirements of this section.

§ 7-62-304(1) Except as provided in subsection (2) of this section, a person who makes a contribution to a business enterprise and erroneously, but in good faith, believes that the person has become a limited partner in the enterprise is not a general partner in the enterprise and is not bound by its obligations by reason of making the contribution, receiving distributions from the enterprise, or exercising any rights of a limited partner, if, on ascertaining the mistake, the person causes an appropriate certificate of limited partnership or a certificate of amendment to be delivered to the secretary of state, for filing pursuant to part 3 of article 90 of this title.

(2) A person who makes a contribution of the kind described in subsection (1) of this section is liable as a general partner to any third party who transacts business with the enterprise before an appropriate certificate is filed in the records of the secretary of state to show that the person

Court of Appeals has confirmed that there can be no *de facto* corporation under Colorado law, and its language supports the same conclusion under other entity laws.⁶ In that case, the Colorado Court of Appeals stated:

In 1958 the General Assembly adopted a new corporation code based on the Model Business Corporation Act. . . . Under that act a corporation comes into existence upon the issuance of the certificate of incorporation. . . .

Further, courts that have directly addressed the issue have concluded that there can be no *de facto* corporate existence prior to the issuance of the certificate of incorporation under statutes similar to ours.⁷

Business lawyers also understand that any person acting on behalf of a non-existing entity (including the lawyers) incur liability. In the context of a limited liability company, C.R.S. § 7-80-105 provides:

All persons who assume to act as a limited liability company without authority to do so and without good faith belief that they have such authority shall be jointly and severally liable for all debts and liabilities incurred by such persons so acting.⁸

Even in the absence of statutory provisions like those cited from CLLCA, CBCA, and CNPCA, a person who acts on behalf of an unformed entity will be liable to the third party under agency law, and the entity once formed will be unable to ratify the contract.⁹ Although the entity once formed may adopt the contract, adoption does not relate back and does not release the person who acted on its behalf from liability on the contract unless the third party agrees to the release.¹⁰ Thus, while title may vest under § 38-34-105 upon formation of the entity (as it currently exists or

is not a general partner, but only if the third party actually believed in good faith that the person was a general partner at the time of the transaction.

The conclusion from the foregoing is that before a filing is made, there is no entity, under any of the statutes that require a filing with the Secretary of State. A general partnership under CUPA (§ 7-64-101 *et seq.*) or (prior to January 1, 1998) CUPL (§ 7-60-101 *et seq.*) does not require a filing with the Secretary of State.

⁶ *Bowers Bldg. Co. v. Altura Glass Co., Inc.*, 694 P.2d 876, 878 (Colo. Ct. App. 1984). See also *Black Canyon Citizens Coal., Inc. v. Bd. of Cnty. Comm'rs of Montrose Cnty.*, 80 P.3d 932, 933 (Colo. Ct. App. 2003) (concluding that *Bowers Building* should also apply to nonprofit corporations).

⁷ *Bowers Bldg. Co. v. Altura Glass Co., Inc.*, 694 P.2d 876, 877-78 (Colo. Ct. App. 1984).

⁸ See similar provisions in C.R.S. § 7-102-104 (CBCA), § 7-122-104 (CNPCA). CULPA, however, contains a provision that indicates that limited partners may be protected from pre-formation actions. See C.R.S. § 7-62-205.

⁹ RESTATEMENT (THIRD) OF AGENCY § 4.04 and comment *c*.

¹⁰ *Id.*

is proposed to be amended), those people who acted on behalf of the unformed entity will retain personal liability for those actions.

The issue of conveyances to non-existent entities is not just a theoretical problem. It appears that title companies, mineral title examiners, and others run into this issue more often than business lawyers would think. In some cases, the conveyance may be decades old; in some cases, the conveyance may be more recent. Title examiners look at this statute as one of several curative measures. Other curative measures include a claim of “color of title” after (among other elements) seven years of “actual residence, occupancy or possession” (C.R.S. § 38-41-106) or through “adverse possession” residency after 18 years (C.R.S. § 38-40-101). Parties who believe they are entitled to title to real property can also bring quiet title actions or seek a curative deed from the grantor to the entity after the entity is formed.

One would think that in 2015 with the ease of examining the Secretary of State’s records, these problems would not exist or be curable. However, when examining title to real property title examiners do not customarily review the Secretary of State’s records. Title examiners generally just rely on information obtained from the county records and only review the Secretary of State’s records when an inconsistency appears in the county records that points to the Secretary of State’s records. For example, if ABC Co. conveyed title to DEF Co., and GHI Co. made the next conveyance of property, the title examiner would likely look to the Secretary of State’s records to see whether DEF Co. merged into GHI Co. If so, that solves the problem. Except for circumstances such as the foregoing, title opinions (and title insurance policies) are usually based only on the instruments recorded in the county records. The existence of entities do not have to be recorded and if not recorded will not form a part of any abstract of title.

Where a conveyance has been made to a non-existent entity, title lawyers like the simplicity of § 38-34-105. Under the current statute, the problem can be cured by forming the grantee corporation under current law; as contemplated to be amended, the curative statute would include non-corporate entities as well.

However, § 38-34-105 (as it exists and as it is proposed to be amended) fails to address a large number of issues relating to title to real property after the purported conveyance but before the entity is actually formed. Consider a closing table where the seller delivers a deed to real property (water, surface, minerals, or all of the above) and receives consideration from two persons (“B” and “C”) claiming to be acting on behalf of an entity (BC Corp., but one not yet formed by B or C). Perhaps the buyers knows that the entity is not yet formed; perhaps the buyers do not know. Who then owns the real property?

- Does the conveyance to a non-existent entity fail since there is no *de facto* corporation or other entity, resulting in the grantor continuing to hold title even though the grantor received consideration and believes himself/herself to be rid of the property?
- Does the grantor hold title in trust for the non-existent entity, thus creating an unexpected fiduciary responsibility through no fault of the grantor?

- Is the owner (in the example above) B and C as a general partnership doing business under the name “BC Corp.”? (Admittedly, this would require filing a tradename affidavit under § 7-71-101, but that would not impact title.¹¹)
- Is title in some state of limbo?
- To the extent activities on the property result in some sort of liability, who is responsible? What effect would a lack of title have on liability insurance policies insuring the owner?
- What is the effect of a lien filed against the property made by a careless lender to the person in possession, who thinks it may have title, but actually does not?

During the interim, it is clear that BC Corp., as an entity, does not own the real property conveyed. Under C.R.S. § 38-34-105, when BC Corp. is formed, title automatically vests. However:

- It does not matter when BC Corp. is formed – minutes later or decades later;
- It does not matter who forms BC Corp. – B, C, or some other unrelated person – continuity of interest is not required;
- It does not matter whether BC Corp. is formed in Colorado or in any other state since (under the Colorado Corporations and Associations Act) an entity does not have to be qualified to do business in Colorado to hold real property in Colorado;¹² and
- If at the time of the conveyance to BC Corp. (not yet formed) there is an existing BC Corp. in another state, arguably title would vest in that entity. (If the deed defines the grantor as “BC Corp., a Colorado corporation, the obligation to look in other states would hopefully be eliminated.)

There is also an issue about interim conveyances. Generally an entity can only convey the title it owns.

- If before title vests in BC Corp., BC Corp. (still an unformed entity) conveys property by a general warranty deed (which conveys “after acquired title”¹³) recorded in the

¹¹ The penalty for failing to file a tradename affidavit is defined in C.R.S. § 7-71-102 and includes an inability to bring suit or a \$500 fine. The statute states specifically that this does “not impair the validity of the acts of the person at any time taken, affect title to any property or interest in property owned by the person, or prevent the person from defending any proceeding in this state at any time.

¹² A foreign entity does not have to be qualified to do business in Colorado to “own[], without more, real or personal property.” C.R.S. § 7-90-801(2)(j).

¹³ See C.R.S. §§ 38-30-104, 107, and 113.

county records, the grantee will receive no title immediately, but title will vest in the grantee under C.R.S. § 38-34-105 when BC Corp. is formed.

- If BC Corp. conveys property by a quitclaim deed, on the other hand, the grantee will receive no title immediately and will not receive “after acquired title” when and if the title vests under C.R.S. § 38-34-105. BC Corp. when formed can then convey the same property to another person for additional consideration. BC Corp., as grantor will not even have breached any warranties since a quitclaim deed conveys no warranty of title.¹⁴ This may ultimately result in two lines of conveyances, each claiming title to the real property in question – and a title examiner’s nightmare.
- Alternatively, if a person acting on behalf of BC Corp. took title under the tradename “BC Corp.,” the subsequent conveyance would transfer the title that BC Corp. received, but then a second “vesting” would arguably occur if BC Corp. was subsequently formed. Depending on the nature of the first deed from BC Corp. to the grantee, this may also create a second chain of title that may perplex title examiners in the future.

These interim title issues are concerns for real estate lawyers, title companies, and those giving water, surface, or mineral title opinions. Where they arise, a curative deed, quiet title actions, adverse possession, and color of title may resolve the situation. With the passage of time, it may be impossible to find the correct person to sign a curative deed.¹⁵ Unfortunately, litigation may put a court in a position of ignoring legal title (that is, BC Corp. as ultimately formed) and trying to determine who owns equitable title to the real property with potentially the resulting mish-mash of judicial decisions. On the other hand, a Westlaw search of Colorado decisions reflect that there has been no case decided based on C.R.S. § 38-34-105 since its 1927 enactment.

From the perspective of a business lawyer, however, it is hard to see how C.R.S. § 38-34-105, even as proposed to be amended, does violence to Colorado’s entity statutes as long as it is recognized that BC Corp., BC LLC, or BC LP, as an entity does not and cannot hold title to the real property before it is formed.

¹⁴ See C.R.S. § 38-30-116.

¹⁵ Other states have taken other approaches to this problem since mineral rights cannot generally be acquired by adverse possession. *See, for example*, Wyo. Stat. § 34-10-103 entitled: “*Effect of unbroken chain of title; marketable record title*” which contemplates a 40 year period: “Any person having the legal capacity to own land in this state, who has an unbroken chain of title of record to any interest in land for forty (40) years or more, shall be deemed to have a marketable record title to such interest subject only to the matters stated in W.S. 34-10-104. A person shall be deemed to have such an unbroken chain of title when the official public records disclose a conveyance or other title transaction of record not less than forty (40) years at the time the marketability is to be determined, which conveyance or other title transaction purports to create the interest, either in the person claiming the interest, or some other person from whom, by one (1) or more conveyances or other title transactions of record, the purported interest has become vested in the person claiming the interest, so long as nothing appears of record, in either case, purporting to divest the claimant of his purported interest.”



SB 15-049

Real Estate Title Vests in Entity Once Formed

- Senator Martinez Humenik & Representative Jon Keyser

Please Support the proposed update to 38-34-105

This new statute updates language from 1927 statute referring only to corporations. At the time of the 1927 statute's adoption, other types of entities* (such as limited liability companies) did not exist. The updated language - now referring to "entities" allows conveyances of real property to any type of entity formed after the date of such conveyance to be effective to convey title to such entity.

SB 15-049:

- * replaces the word "entity" for "corporation" from the old 1927 statute;
- * removes references to what happens as to documents recorded within 1 year after 1927, since moot at this point; and
- * permits cross referencing for definitions of the new terms "entity" and "formed".

SB 15-049 enables all types of entities permitted under current law to receive the benefit of this section of law, rather than just limiting to corporations.

The Colorado Bar Association urges your support of this update, which brings Colorado Law up to date with the realities of modern business transactions.

Thank you!

("Entity" refers to any entity generally, whether foreign or domestic.)

For more information, please contact Jeremy Schupbach 303.229.5434 or Amy Redfern 720.837.5435

First Regular Session
Seventieth General Assembly
STATE OF COLORADO

INTRODUCED

LLS NO. 15-0635.01 Thomas Morris x4218

SENATE BILL 15-049

SENATE SPONSORSHIP

Martinez Humenik,

HOUSE SPONSORSHIP

Keyser,

Senate Committees

Business, Labor, & Technology

House Committees

A BILL FOR AN ACT

101 CONCERNING THE VESTING OF TITLE TO REAL ESTATE IN A GRANTEE
102 THAT IS AN ENTITY THAT HAS NOT YET BEEN FORMED ONCE THE
103 ENTITY HAS BEEN FORMED.

Bill Summary

(Note: This summary applies to this bill as introduced and does not reflect any amendments that may be subsequently adopted. If this bill passes third reading in the house of introduction, a bill summary that applies to the reengrossed version of this bill will be available at <http://www.leg.state.co.us/bills summaries>.)

Current law specifies that when a grantee of a deed is a corporation whose incorporation papers have not yet been filed, title to the real estate vests in the corporation once the papers are filed. The bill expands this law to apply to all entities, specifying that title vests once the entity is formed.

Shading denotes HOUSE amendment. Double underlining denotes SENATE amendment.
Capital letters indicate new material to be added to existing statute.
Dashes through the words indicate deletions from existing statute.

1 *Be it enacted by the General Assembly of the State of Colorado:*

2 **SECTION 1.** In Colorado Revised Statutes, **amend** 38-34-105 as
3 follows:

4 **38-34-105. When deed transferred before formation.** (1) If A
5 GRANTEE DESCRIBED IN A DEED AS AN ENTITY HAS NOT BEEN FORMED at
6 the time of the delivery of a THE deed ~~describing~~ TO the grantee, as a
7 ~~corporation no incorporation papers have been filed and if thereafter~~
8 ~~proper incorporation papers are filed~~, the title to the real property shall
9 vest DESCRIBED IN THE DEED VESTS in the grantee as soon as the grantee
10 is incorporated WHEN THE ENTITY IS FORMED, and no other instrument of
11 conveyance shall be IS required. ~~As to all such conveyances executed~~
12 ~~prior to March 28, 1927, it shall be conclusively presumed that the title~~
13 ~~vested in the incorporators in trust for the grantee and that said~~
14 ~~incorporators properly conveyed the real property to the grantee when the~~
15 ~~grantee was incorporated unless within one year from March 28, 1927,~~
16 ~~there is filed in the office of the proper recorder a written explanation or~~
17 ~~statement of the transaction signed and acknowledged by the proper~~
18 ~~parties.~~

19 (2) AS USED IN THIS SECTION:

20 (a) "ENTITY" HAS THE MEANING SPECIFIED IN SECTION 7-90-102
21 (20), C.R.S.

22 (b) "FORMED" HAS THE MEANING SPECIFIED IN SECTION 7-90-102
23 (29.5), C.R.S.

24 **SECTION 2. Act subject to petition - effective date -**
25 **applicability.** (1) This act takes effect at 12:01 a.m. on the day following
26 the expiration of the ninety-day period after final adjournment of the

1 general assembly (August 5, 2015, if adjournment sine die is on May 6,
2 2015); except that, if a referendum petition is filed pursuant to section 1
3 (3) of article V of the state constitution against this act or an item, section,
4 or part of this act within such period, then the act, item, section, or part
5 will not take effect unless approved by the people at the general election
6 to be held in November 2016 and, in such case, will take effect on the
7 date of the official declaration of the vote thereon by the governor.

8 (2) This act applies to deeds delivered on or after the applicable
9 effective date of this act.