

Subject: Study 36 - Condemnation (Divided Interests)

This memorandum reviews the comments of the State Bar Committee on Governmental Liability and Condemnation relating to the divided interest chapter of the Eminent Domain Law. A copy of this chapter (Chapter 10) is attached. This chapter should be approved for printing at the September meeting. While we have not yet received the official minutes of the Bar Committee, we have attended the meeting at which the comments were made. This memorandum is based on our interpretation of the committee proceedings. We will send the minutes when they are received.

The Bar Committee did not complete its review of the divided interest chapter, considering only Sections 1265.010 to 1265.230. It is possible that the committee will have some objections to the remainder of the chapter concerning compensation for options and future interests.

Of the sections considered, the Bar Committee recommended only one change, revision of Section 1265.230 to refer to "a mortgage or other lien" rather than to a mortgage or deed of trust, to conform with the language of other sections in the same article. While the staff recognizes that consistency is frequently a virtue, we note that mortgages and deeds of trust are the types of liens in which prepayment penalties are normally encountered and that the reference to a mortgage or deed of trust simply continues the language of existing Code of Civil Procedure Section 1246.2.

Respectfully submitted,

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CHAPTER 10. DIVIDED INTERESTS

Article 1. Amount of Compensation for Divided Interests

§ 1265.010. Undivided fee rule; exception

1265.010. Where the plaintiff requires that the amount of compensation be first determined as between plaintiff and all defendants claiming an interest in the property:

(a) The amount of compensation shall be based on the value of the property as if it were owned by a single person in an undivided state.

(b) Where the amount of compensation provided in subdivision (a) is not sufficient to compensate all the interests in the property, the amount of compensation shall include an amount sufficient to compensate all the interests in the property.

Comment. Section 1265.010 provides the general rules for the amount of compensation to be determined in the first stage where the plaintiff elects a two-stage proceeding. See Section 1260.220(b).

Subdivision (a) states the undivided fee rule, long a feature of California law. See, e.g., People v. S. & E. Homebuilders, Inc., 142 Cal. App.2d 105, 107, 298 P.2d 53, (1956); El Monte School Dist. v. Wilkins, 177 Cal. App.2d 47, 54-55, 1 Cal. Rptr. 715, (1960); Costa Mesa Union School Dist. v. Security First Nat'l Bank, 254 Cal. App.2d 4, 11, 62 Cal. Rptr. 113, (1967).

Subdivision (b) provides for compensation of amounts in excess of the undivided fee value provided in subdivision (a). Prior law allowed such amounts

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in excess of the undivided fee in cases where the value of the fee was enhanced by the existence of a leasehold. See People v. Lynbar, Inc., 253 Cal. App.2d 870, 62 Cal. Rptr. 320 (1967); see also People v. Dunn, 46 Cal.2d 539, 297 P.2d 964 (1956). Subdivision (b) makes clear that the amount of compensation awarded must be sufficient to permit compensation for all interests in the property. This rule applies in any case in which the value of all interests if valued separately would amount to a sum in excess of the undivided fee value. For the rule governing costs of apportionment where divided interests, see Section 1268.710(b).

Article 2. Leases

§ 1265.110. Rights under lease not affected

1265.110. Nothing in this article affects or impairs the rights and obligations of the parties to a lease to the extent that the lease provides for such rights and obligations in the event of the acquisition of all or a portion of the property for public use.

Comment. While this article provides rules that govern the rights of parties to a lease of property taken by eminent domain, Section 1265.110 makes clear that these rules apply only absent a provision in the lease covering the situation.

§ 1265.120. Termination of lease in whole taking

1265.120. Where all the property subject to a lease is acquired for public use, the lease terminates.

Comment. Section 1265.120 codifies the rule that the taking of the entire demised premises for public use by eminent domain or agreement operates to release the tenant from liability for subsequently accruing rent. See, e.g., City of Pasadena v. Porter, 201 Cal. 381, 387, 257 P. 526, (1927); Carlstrom v. Lyon Van & Storage Co., 152 Cal. App.2d 625, 313 P.2d 645 (1957). This rule does not apply if there is a provision to the contrary in the lease. See Section 1265.110.

§ 1265.130. Partial cancellation of lease in partial taking

1265.130. Except as provided in Section 1265.140, where part of the property subject to a lease is acquired for public use, the lease is cancelled as to the part taken and remains in force as to the remainder, and the rent reserved in the lease that is allocable to the part taken is extinguished.

Comment. Section 1265.130 abrogates the rule in City of Pasadena v. Porter, 201 Cal. 381, 257 P. 526 (1927), and numerous cases following it that required continuation of the lessee's full rental obligation for the duration of the lease in cases of a partial taking of property subject to a lease. Section 1265.130 requires a pro rata abatement of the rental obligation. For a comparable provision, see W. Va. Code § 37-6-29 (19\_\_). The requirements of Section 1265.130 do not apply where there is a provision to the contrary in the lease. See Section 1265.110.

§ 1265.140. Termination of lease in partial taking

1265.140. Where part of the property subject to a lease is acquired for public use, the court may, upon petition of any party to the lease, terminate the lease if the court determines that an essential part of the property subject to the lease is taken or that the remainder of the property subject to the lease is no longer suitable for the purposes of the lease. Upon such termination, compensation shall be determined as if there were a taking of the entire leasehold.

Comment. Section 1265.140 is new to California law. It provides for termination of a lease in a partial taking case where the taking in effect destroys the value or utility of the lease for either of the parties and requires compensation by the condemnor accordingly. Section 1265.140 is not applicable in cases where there is a provision in the lease covering the situation. See Section 1265.110.

§ 1265.150. Time of termination or partial cancellation

1265.150. The termination or partial cancellation of a lease pursuant to this article shall be at the earlier of the following times:

(a) The time title to the property is taken by the person who will put it to the public use.

(b) The time the plaintiff is authorized to take possession of the property as stated in an order for possession.

Comment. Section 1265.150 makes clear the time of partial cancellation (Section 1265.130) or termination (Section 1265.140) of a lease.



§ 1265.160. Remedies of parties not affected

1265.160. Nothing in this article affects or impairs any right a lessee may have to compensation for the taking of his lease in whole or in part or for the taking of any other property in which he has an interest.

Comment. Section 1265.160 is added to assure that partial cancellation or termination of a lease pursuant to this article does not preclude a lessee's recovery of compensation for the value of his leasehold interest, if any, and any of his property taken in the eminent domain proceeding. See Sections 1263.010 (right of owner of property to compensation) and 1263.210 (improvements pertaining to realty).

Article 3. Encumbrances

§ 1265.210. Acquisition of property subject to encumbrances

1265.210. Where property acquired by eminent domain is encumbered by a mortgage or other lien, and the indebtedness secured thereby is not due at the time of the entry of judgment, the amount of such indebtedness may be, at the option of the plaintiff, deducted from the judgment and the lien of the mortgage or other lien shall be continued until such indebtedness is paid; but the amount for which, as between the plaintiff and the defendant, the plaintiff is liable under Article 5 (commencing with Section 1268.410) of Chapter 11 may not be deducted from the judgment.

Comment. Section 1265.210 is the same in substance as former Section 1248(8).

Note: The Commission intends to give this provision further scrutiny on receipt of additional information relating to acceleration clauses.

§ 1265.220. Allocation of award among encumbrancers in partial taking

1265.220. (a) As used in this section:

(1) "Lien" means a mortgage or other lien.

(2) "Impairment of security" means the security of the lienholder remaining after the taking, if any, is of less value in proportion to the remaining indebtedness than the value of the security before the taking was in proportion to the indebtedness secured thereby.

(b) This section applies only if there is a partial taking of property encumbered by a lien and the part taken or some portion of it is also encumbered by a junior lien that extends to only a portion of the property encumbered by the senior lien.

(c) The total amount of the award that will be available for payment to the senior and junior lienholders shall be allocated first to the senior lien up to the full amount of the indebtedness secured thereby and the remainder, if any, to the junior lien.

(d) If the allocation under subdivision (c) is sufficient to pay in full both senior and junior liens, or if such allocation would not cause an impairment of the junior lienholder's security, such shall be the allocation.

(e) If the allocation under subdivision (c) would cause an impairment of the junior lienholder's security, the junior lien shall be allocated an amount sufficient to preserve the junior lienholder's security to the extent that the remaining amount allocated to the senior lien, if paid to the senior lienholder, would not cause an impairment of the senior lienholder's security.

(f) The amounts allocated to the senior and junior liens by this section are the amounts of indebtedness owing to such senior and junior lienholders which are secured by their respective liens on the property taken, and any other indebtedness owing to the senior or junior lienholders shall not be considered as secured by the property taken. If the plaintiff makes the election provided in Section 1265.210, the indebtedness that is deducted from the judgment is the indebtedness so determined, and the lien shall continue until that amount of indebtedness is paid.

Comment. Section 1265.220 continues the substance of former Section 1248(9), designed to meet the problems that arise when a parcel is encumbered with a first trust deed, or other senior lien, and a portion is encumbered with a subordinate lien as well. In this situation, condemnation of all or part of the smaller portion may result in an award inadequate to satisfy both liens. Section 1265.220 prescribes a procedure for allocating eminent domain awards between senior and junior lienholders of condemned property.

Both senior and junior lienors may be entitled to assignment of any condemnation award in accordance with contract terms. Under terms providing for automatic assignment of a condemnation award, the award may be appropriated to pay the entire remaining indebtedness of the first lien, with the remainder going to the beneficiary of the second. After condemnation, the security of

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the junior lien creditor may have become nearly or totally inadequate to cover the outstanding indebtedness. If the debt secured by the junior lien is a purchase money obligation, for which there is no personal recourse under anti-deficiency judgment legislation (Code Civ. Proc. § 580b), the debtor may default with impunity. Under former law, default of the debtor may leave the purchase money lienholder without remedy, despite the fact the condemnation award would have been ample to satisfy both his claim in full and a part of the senior lien proportional to the reduction of the senior lienor's security. The debtor's remaining interest in the parcel condemned may be of far less value than the outstanding debt the parcel formerly secured.

The allocation procedure of Section 1265.220 is designed to allow adjustment of the condemnation award so that both the senior and junior lienholders will retain security interests proportionate to those existing before the taking. When the award is sufficient, both will be paid in full. If the award is not sufficient, it will be tentatively allocated to pay the full amount of the senior lien with any balance to the junior. At that time, the court will determine the adequacy of the remaining property to secure the junior lien. If it determines that the junior lienholder's security is disproportionately low, the court may make adjustments to the tentative allocation to place the junior in the same relative position as before the taking. The adjustment, made by reducing the allocation to the senior and adding to that of the junior, is permissible only if it preserves the proportional security of the senior lienholder.

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Section 1265.220 is not intended to affect any rules precluding recovery by an encumbrancer of any part of the award where there is no impairment of security. See, e.g., Sacramento etc. Drainage Dist. v. Truslow, 125 Cal. App.2d 478, 270 P.2d 928 (1954).

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§ 1265.230. Prepayment penalty under mortgage or trust deed

1265.230. Where the property acquired for public use is encumbered by a mortgage or deed of trust, the amount payable to the mortgagee or beneficiary under the deed of trust shall not include any penalty for prepayment.

Comment. Section 1265.230 is the same as former Section 1246.2.

Article 4. Options

§ 1265.310. Unexercised options

1265.310. Unless the option expressly provides otherwise, an unexercised option to acquire an interest in property taken by eminent domain is terminated as to that property, and the option holder is entitled to compensation therefor as of the time of the filing of the complaint in the eminent domain proceeding.

Comment. Section 1265.310 reverses prior case law that the holder of an unexercised option to purchase property has no right to share in the award when that property has been condemned. People v. Ocean Shore R.R., 90 Cal. App.2d 464, 203 P.2d 579 (1949); East Bay Mun. Util. Dist. v. Kieffer, 99 Cal. App. 240, 278 P. 476 (1929). This is consistent with the general rule that unexercised options to purchase or to lease property must be considered in determining the value of a lease. State v. Whitlow, 243 Cal. App.2d 490, 52 Cal. Rptr. 336 (1966); Nicholson v. Weaver, 194 F.2d 804 (9th Cir. 1952). The measure of compensation for the loss of the option is the fair market value of the option. See Section 1263.310.



Article 5. Future Interests

§ 1265.410. Contingent future interests

1265.410. (a) Where property acquired for public use is subject to a use restriction in the form of a contingent future interest and the use restriction is violated by such acquisition but violation of the use restriction was otherwise reasonably imminent, the contingent future interest shall be compensated as a present interest.

(b) Where property acquired for public use is subject to a use restriction in the form of a contingent future interest and the use restriction is violated by such acquisition but violation of the use restriction was not otherwise reasonably imminent:

(1) If the benefit of the use restriction is appurtenant to other property, the contingent future interest shall be compensated to the extent violation of the use restriction damages the dominant premises to which the restriction was appurtenant, but in no event shall such compensation exceed the value the contingent future interest would have as a present interest.

(2) If the benefit of the use restriction is not appurtenant to other property and if the use restriction is that the property be devoted to a particular charitable or public use, the compensation for the property shall be devoted to the same or similar use subject to the same contingent future interest.

Comment. Section 1265.410 makes clear that, where there are contingent future interests in property acquired by eminent domain, such interests may

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be entitled to compensation despite any implications to the contrary in such cases as Romero v. Department of Public Works, 17 Cal.2d 189, 109 P.2d 662 (1941); People v. City of Fresno, 210 Cal. App.2d 500, 26 Cal. Rptr. 853 (1962); People v. City of Los Angeles, 179 Cal. App.2d 558, 4 Cal. Rptr. 531 (1960); City of Santa Monica v. Jones, 104 Cal. App.2d 463, 232 P.2d 55 (1951).

The test stated in subdivision (a)--"reasonably imminent"--is derived from 1 Restatement of Property § 53 (c) (1936). The reference to "public use" in subdivision (b)(2) is intended to include all uses for which the power of eminent domain might be exercised, including public utility purposes. See Section 1240.010 (public use limitation).

§ 1265.420. Property subject to life tenancy

1265.420. Where property acquired for public use is subject to a life tenancy, upon petition of the life tenant or any other person having an interest in the property, the court may order any of the following:

- (a) An apportionment and distribution of the award based on the value of the interest of life tenant and remainderman.
- (b) The compensation to be used to purchase comparable property to be held subject to the life tenancy.
- (c) The compensation to be held in trust and invested and the income (and, to the extent the instrument that created the life tenancy permits, principal) to be distributed to the life tenant for the remainder of the tenancy.
- (d) Such other arrangement as will be equitable under the circumstances.

Comment. Section 1265.420 provides the court express statutory authority to devise an equitable solution where property subject to a life tenancy is taken and an outright division of the award would not result to substantial justice under the circumstances of the particular case. See Estate of Giacomelos, 192 Cal. App.2d 244, 13 Cal. Rptr. 245 (1961)(trust imposed on proceeds).