

## First Supplement to Memorandum 73-86

Subject: Study 36.400 - Condemnation (Comprehensive Statute: Chapter 10--Divided Interests)

The State Bar Committee on Governmental Liability and Condemnation at its September 28-29 meeting (for which we have not yet received minutes) completed consideration of the divided interests chapter of the Eminent Domain Law. Recommendations made by the committee with regard to the balance of this chapter are indicated below.

§ 1265.220. Allocation of award among encumbrancers in partial taking.

The committee was concerned that this section appears to set up a rule that all the proceeds of a partial taking must go to allocation between junior and senior lienholders despite case law indicating that proceeds of condemnation may go to a lienholder only if his security is impaired.

The staff believes that the committee's concern is justified, and it is for this reason that the paragraph at the end of the Comment was added to indicate that the case law relating to compensation where there is no impairment of security is not affected by the section. However, the State Bar Committee's concern is an indication that the statement in the Comment is not adequate. Consequently, the staff proposes amendment of the section as indicated in Exhibit I.

The Bar Committee would go further to codify the rule that a lienholder is entitled to compensation in a partial taking only to the extent of the impairment of his security; to this, the committee would add that only amounts remaining after reimbursement of the costs of defense of the action would be available to lienholders. While the staff has no quarrel with either of these proposals, we note that, when the topic of compensation for lienholders has been raised in the past, the Commission has refrained from codification of measures of compensation, leaving the matter to case law development.

§ 1265.230. Prepayment penalty under lien. The Bar Committee noted an apparent conflict in language between this section invalidating prepayment penalties and Streets and Highways Code Sections 6447 and 6464 which provide a prepayment penalty for early payment of bonds issued under the Improvement Act of 1911. (At the September 1973 meeting, Section 1265.230--which originally applied only to mortgages and deeds of trust (as does the existing

statute)--was expanded to apply to any lien.) The staff believes that it is now the policy of Section 1265.230 to invalidate prepayment penalties where property is taken by eminent domain whether the "penalties" are imposed by contract as in a mortgage or by statute for improvement bonds. Hence, the staff proposes addition of the following language to the Comment to Section 1265.230:

Section 1265.230 is intended to apply to penalties for prepayment of liens of all kinds (see Section 1265.200 defining lien) including but not limited to prepayment penalties under mortgages and deeds of trust and redemption premiums under Streets and Highways Code Sections 6447 and 6464.

§ 1265.310. Unexercised options. The Bar Committee recommends addition of the following sentence:

For the purposes of this section, an unexercised option is deemed to be an interest in real property.

The staff recommends against addition of this sentence. It is obvious that an option is an interest in property for any purpose, and the definition of property in Section 1235.170 is sufficiently broad to cover options. The purpose of Section 1265.310 is to compensate a property interest that the courts have previously refused to compensate. To state that an option is a property interest is merely to cast doubt on the classification of other interests in property not specifically mentioned.

§ 1265.410. Contingent future interests. The State Bar Committee would substitute for this section the following provision:

§ 1265.410. Where property acquired for public use is subject to a use restriction enforced by a contingent future interest and the use restriction is violated by such acquisition, the owner of said interest is entitled to be paid the fair market value, if any, of the interest.

The reason for substitution of this provision is that the factor of imminence of reversion spelled out in the Commission's draft would be an evidentiary matter in a determination of the market value of the interest in any case.

While the staff would not be opposed to adoption of the State Bar proposal, we note that to do so would lose some of the policies previously determined to be important by the Commission. The Bar proposal would in effect deny compensation to a person who donated property subject to a use restriction where the violation of the restriction was not imminent even though

the real consideration for the donation was that appurtenant property owned by the donor would be benefited by the use as restricted.

In addition, the Bar proposal would delete the provision to subject the proceeds of property donated for charitable and public uses to continued charitable and public uses. Of course, it is arguable that a public or charitable user will most likely devote the proceeds to a similar public or charitable use in any case.

Respectfully submitted,

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EXHIBIT I

§ 1265.220. Allocation of award among encumbrancers in partial taking

1265.220. (a) This section applies only where 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. This section provides only for allocation of the portion of the award, if any, that will be available for payment to the junior and senior lienholders and does not provide for determination of the amount of such portion.

(b) As used in this section, "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.

(c) The ~~total~~ amount of the portion 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 allocation to the junior lien shall be ~~allocated an amount sufficient to~~ adjusted so as 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 that 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.