#36.300 4/16/75

Memorandum 75-38

Subject: Study 36.300 - Eminent Domain (AB 11 and Related Bills)

The Commission, at the April 1975 meeting, requested the staff to supply it with further information concerning the following matters involved in the Eminent Domain Law: (1) litigation expenses, (2) compensation for divided interests, (3) termination of a lease in a partial taking, and (4) treatment of unexercised options. This memorandum presents the information requested by the Commission.

Litigation Expenses

Litigation expenses awarded on abandonment include reasonable attorney's fees where such fees were reasonably and necessarily incurred to protect the defendant's interests in the proceeding in preparing for trial, during trial, and in any subsequent judicial proceedings, whether such fees were incurred for services rendered before or after the filing of the complaint. Section 1235.140. This provision is substantially the same as existing law. See Section 1255a(c).

At the April meeting, the Commission directed the staff to investigate whether this provision requires public entities to pay for lobbying fees incurred by the defendant in obtaining an abandonment of the proceeding. Attached (Exhibit I--green) is the case of Excelsior etc. School Dist. v. Lautrup concerning this issue. The staff believes that this case demonstrates that lobbying fees are not recoverable. Both the opinion of the court and the dissent state this rule; the difference between the opinions is one of characterization of the trial court's ruling. The majority opinion takes the position that the trial court did not specifically address the question whether the compensation included lobbying fees, and the public entity did

not raise the issue of whether this was proper until the appeal. The dissent takes the position that the trial court impliedly based the award of attorney's fees in part on the lobbying activities of the defendant.

Regardless which opinion is "correct," the staff believes that the case clearly stands for the proposition that lobbying fees are not legally recoverable. The staff believes that the statutory definition of litigation expenses is clear, and no changes should be made.

Compensation for Divided Interests

The Commission, at the April 1975 meeting, considered Section 1260.220 (procedure where there are divided interests), which permits a two-stage valuation proceeding where there are divided interests in the property:

> (b) The plaintiff may require that the amount of compensation be first determined as between plaintiff and all defendants claiming an interest in the property. Thereafter, in the same proceeding, the trier of fact shall determine the respective rights of the defendants in and to the amount of compensation awarded and shall apportion the award accordingly. Nothing in this subdivision limits the right of a defendant to present during the first stage of the proceeding evidence of the value of, or injury to, his interest in the property; and the right of a defendant to present evidence during the second stage of the proceeding is not affected by his failure to exercise his right to present evidence during the first stage of the proceeding.

It was the underscored language that most concerned the Commission, and the Commission requested background information on this language.

A copy of old Memorandum 73-9 is attached hereto. This was the initial memorandum considered by the Commission which presented the basic divided interest problem and reproduced the Lynbar case. The memorandum points out that, where there is a lease on property that is above market rate, the fair market value of the encumbered property will exceed the fair market value of the undivided fee; on the other hand, where there is a lease on property that is below market rate, the fair market value of the encumbered property will be less than the fair market value of the undivided fee.

To use the undivided fee value of the property as the basis for compensation will be fair in the case where the lease is at or below market rate but will not yield an adequate amount to compensate the landlord where the lease is above market rate. For this reason, a bare undivided fee rule is inadequate and, if adopted, must be tempered by cases such as Lynbar or by statutory exceptions.

Likewise, to use the encumbered fee value of the property as the basis for compensation will be fair in the case where the lease is at or above market rate but will not yield an adequate amount to compensate both landlord and tenant where the lease is below market rate. For this reason, a bare encumbered fee rule is inadequate if unmodified. For this reason, the Uniform Code provision is inadequate:

> 1012. The amount of compensation for the taking of property in which divided interests exist is based upon the fair market value of the property considered as a whole, giving appropriate consideration to the effect upon market value of the terms and circumstances under which the separate interests are held.

The solution originally proposed by the staff in Memorandum 73-9 was a section to require a two-stage proceeding in every case; the valuation stage was to utilize the undivided fee rule except that, where the aggregate value of all the interests in the property exceeded the undivided fee value, the amount of compensation would include an amount sufficient to compensate all the interests in the property. The Commission, at the March 1973 meeting, adopted this approach but permitted the condemnor a choice of one- or two-stage proceedings. This basically codified existing California law.

Subsequently, at the September 1973 meeting, the Commission determined to delete the sections codifying the foregoing rules and to simply indicate in a Comment to the two-stage proceeding section (Section 1260.220) that the Lynbar rule remains unimpaired. At that time, Section 1260.220(b) read:

(b) The plaintiff may require that the amount of compensation be first determined as between plaintiff and all defendants claiming an interest in the property. Thereafter, in the same proceeding, the trier of fact shall determine the respective rights of the defendants in and to the amount of compensation awarded and shall apportion the award accordingly.

The relevant portion of the Comment was revised to read:

Subdivision (b) retains the procedure formerly provided by the first sentence of Section 1246.1. It is intended as procedural only. It does not, for example, affect the rule that, where the plaintiff elects the two-stage proceeding, the value of the property includes any enhanced value created by the existence of a favorable lease on the property. See People v. Lynbar, Inc., 253 Cal. App.2d 870, 62 Cal. Rptr. 320 (1967). See also Section 1263.310 (compensation for property taken).

This is the form in which the section stands today with the exception of the last sentence. The last sentence was added by the Commission in October 1973 at the suggestion of the State Bar Committee. The relevant portion of old Memorandum 73-89 containing the State Bar's suggestion is set out below.

Section 1260.220. The State Bar suggests that the statute provide that, where the plaintiff elects a two-stage proceeding and where a defendant can show that it would be a burden upon him to have to present evidence as to the value of the entire property sought to be taken, the court by order can permit such defendant to present evidence as to the value of his interest alone. This suggestion was prompted by a case where property was taken which was being put to an integrated business use--as we recall, a service station, car wash, and perhaps some other related business. The car wash was separately owned and the owner (after some opposition) was finally permitted to put on evidence as to the value of his separate interests alone, e.g., improvements under a leasehold. In the situation described, the staff believes that the court's ruling was proper and that in the future the courts would permit such testimony whether or not the statute specifically so provides.

The State Bar also considered whether a defendant has to participate in the first stage of a two-stage proceeding as a prerequisite to participating in the second stage. Our notes as to whether any action was taken in regard to this point are in conflict. However, we believe that no such prerequisite exists under present law, and our statute would not change this result. We do not believe that any revisions are necessary.

There may, however, be some room for argument concerning the above issues, and the Commission may wish to deal with them by adding the following sentence at the end of subdivision (b):

> Nothing in this subdivision limits the right of a defendant to present during the first stage of the proceeding evidence of the value of, or injury to, his interest in the property; and the right of a defendant to present evidence during the second stage of the proceeding of the value of, or injury to, his interest in the property is not affected by whether or not he avails himself of the right to present evidence during the first stage of the proceeding.

The staff does not feel strongly about this sentence one way or another. The staff believes that the sentence is useful and should be left in, but that its removal will cause no great problems. The staff suggests that, if the Commission decides to remove the sentence, the Commission give consideration to retaining the last portion of the sentence which simply makes clear that the failure of a party to participate in the valuation stage of the proceeding does not prejudice his right to participate in the apportionment stage.

Termination of Lease in Partial Taking

At the April meeting, the County of Los Angeles expressed concern over the situation where there is a partial taking of property subject to a lease, and the lease is terminated pursuant to Section 1265.130. In such a situation, the lessee would be entitled to compensation for the taking of his entire leasehold interest (or, if the lease has a bonus value, the landlord would be entitled to compensation for the destruction of the bonus value of the lease).

The concern of the County of Los Angeles is that, if the fact of termination is shown in the first stage of the proceeding, the award will exceed the undivided fee value of the property taken. The staff agrees that this is what would happen; however, the award should exceed the undivided fee

value, since the landlord and lessor are really being awarded severance damages for the injury to the remainder rendering it unsuitable for the existing lease. The staff believes that no change is needed in this section.

Unexercised Options

Section 1265.310 provides that, where property subject to an unexercised option to purchase is taken by eminent domain, the option terminates as to the property taken, and the option holder is entitled to compensation for his interest. At the April meeting, the question arose as to the treatment of the remainder in a partial taking case.

It is clear that, in the case of a partial taking, the option as to the remainder does not and should not terminate; the taking may be a very small portion of the whole. However, there should be some sort of abatement of option price as to the remainder. How this abatement is to be accomplished is a problem. The staff does not believe that it is wise to permit the court to rewrite a new option agreement for the parties. The case of Cinmark Investment Co. v. Reichard, (Exhibit II--yellow) holds that the amount of compensation awarded to the property owner should be offset against the purchase price of the option.

While the staff believes that the Cinmark approach is a good one in the ordinary situation, problems will arise where only part of the whole property is subject to the option. Then there will be difficulties in allocating damages and benefits to the part subject to the option and the part not subject to the option; the mechanical simplicity of Cinmark disappears. For this reason, the staff does not believe it is wise to cite Cinmark with approval in the Comment.

Can we provide a rule to govern the partial taking situation where only part of the larger parcel is subject to the option? There are several possibilities that occur to the staff, none of which it believes are good:

(1) Use the Cinmark rule for its simplicity, knowing that in some cases it will be grossly unfair to the property owner.

(2) Have the jury at the apportionment stage allocate damages and benefits to the property under option and the property not under option.

(3) Permit the court to rewrite the option terms at the apportionment stage.

(4) Terminate the option as to the remainder as well as to the part taken.

(5) Repeal the section and throw the whole problem in the lap of the courts.

(6) Do nothing.

Of these alternatives, the staff prefers the last. The court will then have to do what is equitable when the hard case arises.

A final possibility that the staff believes is good, but that has been previously rejected by the Commission is the staff's original recommendation for dealing with options--permit the property owner, after commencement of the proceeding, to require the option holder to either exercise the option or have it terminated. The problem with this approach is that it may work a hardship on the option holder; however, we could provide that the option holder is compensated for the loss he sustains by termination of the option.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary