#36.300 6/18/75

Memorandum 75-49

Subject: Study 36.300 - Eminent Domain (AB 11--Options)

Attached is a letter and article by Theodore B. Hannon concerning compensation for options. He takes the position that the section included in Assembly Bill 11 (Section 1265.310) should be retained in the bill.

The staff believes that Mr. Hannon's analysis is incorrect in several ways. Moreover, it fails to deal with the partial taking problems that caused the Commission to determine to delete its option provision from AB 11. Nonetheless, you may find Mr. Hannon's article to be of interest.

Although Mr. Hannon is a state employee, the views expressed are his personal views and not those of the agency by which he is employed.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

Memorandum 75-49

EXHIBIT I

June 13

Dear Mr. DeMoully,

I would very much like to know if you decide to alter AB 11 or not - especially as regards the compensation for optometrics.

You can either drop me a note, or call -
Home: 415-841-8780
Office: 916-445-3637

I hope you decide to leave it as is, you've done a good job.

Jed Harmon

ADDRESS:
O. P. R.
1400 10th St.
Sac. CA 95814

San Diego v. Miller:

Compensation At The Law's Expense

Theodore B. Hannon

June 10, 1975

Introduction

After sixty years of settled law and deference to the legislature,[1] the California Supreme Court, in San Diego v. Miller,[2] broke with precedent and unanimously ruled that holders of unexercised options on real property subject to eminent domain proceedings be compensated for their loss to the extent the total award exceeds the option price of the property.[3] Although similar policy decisions have been criticized in the past as properly made only by the legislature,[4] the trend in the courts is towards active judicial determination of eminent domain policy.[5] In light of this trend, this article will not address itself to the question of the Court's authority to alter compensation policy, but will focus instead upon (a) the Court's treatment of authority other than that directly overruled, (b) the method the Court has chosen to implement its policy decision, and finally, (c) the precedential implications of San Diego v. Miller.

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[1] "It is quite within the power of the legislature to declare that a damage to that form of property known as business shall be compensated for, but unless the constitution or the legislature has so declared, it is the universal rule of construction that an injury is damnum absque injuria, and does not form an element of the compensating damages to be awarded." City of Oakland v. Pacific Coast Lumber and Mill Co., 171 Cal 392, 398 (1915).

[2] 13 Cal 3d 684 (1975).

[3] Id., at 693.

[4] e.g., Southern California Edison Co. v. Bourgerie, 9 Cal 3d 169, 178 (1973) (dissenting opinion).

[5] see, e.g., Community Redevelopment Agency of Los Angeles v. Abrams, 116 Cal Rptr 308, 313 (1974).

A. The Court's Use of Existing Authority

It is difficult, if not impossible to reconcile San Diego v. Miller with the Constitution of California, the statutes regulating eminent domain, and much of the common law of the state. Miller's area of greatest inconsistency with existing law lies in the operation of the formula adopted by the Court for determining the amount of compensation to be awarded option holders.[6] Significantly, the difficulties arising from the formula were not anticipated in the Court's opinion.

A glaring example of the Miller Court's dereliction of its duty to conform its decision to existing law in its use of a compensation formula which automatically deprives condemnees of their constitutional[7] and statutory[8] rights to ascertainment and apportionment of damages by a jury. The Miller formula provides that when there is an option price and a set market value only one inference can be drawn, i.e., the value of the option is the difference between the two figures. Thus, ascertainment and apportionment of damages becomes a question of law,[9] and is no longer a question of fact for the jury. The formula is therefore incapable of being reconciled with the constitutional guarantee of a jury trial. Such abridgment of legal rights is surprising, to say

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[6] n. 3, supra.

[7] Cal. Const. Art I, sec. 14 (Deering 1974): "...which compensation shall be ascertained by a jury, unless a jury be waived...."

[8] Code Civil Pro. sec. 1246.1 (Deering 1974); construed, Redevelopment Agency of Fresno v. Penzner, 8 Cal. App. 3d 417, 425 (1970).

[9] see, e.g., State v. Witlow, 243 Cal. App. 2d 490, 496 (1966).

the least, when perpetrated by a Court otherwise zealous in the pursuit of "fairness and public policy."[10]

An equally serious problem with the Miller formula lies in the fact that by state law an option price is inadmissible as evidence and is a legally improper basis for evaluation of condemned property.[11] Furthermore, the law requires that value be shown only by opinion testimony of witnesses qualified to express such opinions, and the owner of the property interest being valued.[12] Thus, Miller is in direct conflict with the statutory provisions of the eminent domain law, for it (1) requires the option price be used in determining the amount of compensation, and (2) bases evaluation of the option upon a mathematical formula rather than upon opinion testimony.

Just as Miller runs afoul of constitutional and statutory authority, it encounters grave obstacles in the relevant case law. A clear instance is the Miller Court's concern for compensating the optionee for loss of anticipated profits,[13] which appears directly contrary to the long settled rule that "the damage allowed is not [for] a failure to realize a profit...but [for] the loss actually suffered...."[14] This concern for lost profits could be explained as

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[10]Miller, n.2, supra, at 691.

[11]Code Evid. sec. 822 (Deering 1974).

[12]Code Evid. sec. 813 (Deering 1974).

[13]Miller, n. 2, supra, at 692.

[14]Muller v. Southern Pacific R. Ry. Co., 83 Cal 240, 244 (1890); accord, People v. Ricciardi, 23 Cal.2d 390, 395 (1944); see also, 20 Hast. L.J. 675, 676.

derivable from the primary policy decision: the failure to realize a profit is an aspect of the injustice the Court seeks to remedy by granting compensation to the optionee. If such is indeed the intention of the Court, this obstacle could be surmounted by a simple addition to the list of cases disapproved. In any event, clarification is needed.

A less easily explained discrepancy is found, however, in the Court's unprecedented and unjustified abandonment of the 'market value' method of determining just compensation.[15] Once again, the Court failed to acknowledge the problem. It can only be hoped that when this inconsistency with established procedure is settled, the Court will take into consideration the flexibility of market value measurements, and the leeway it allows the courts in molding justice to the facts of the particular case:[16] the certainty and simplicity of the Miller formula may be adopted only at the expense of the discretion necessary for the realization of "substantial justice."[17]

Such lack of thoroughness and the resulting conflicts with existing law can be best explained by observing that policy considerations were the overriding concern in Miller. The compensation formula was adopted because it gave the result desired -- the manner of its operation was seemingly of little interest.

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[15] see, Code Evid. sec. 814 (Deering 1974).

[16] see, e.g., Westchester County Park Comm. v. United States, 143 F. 2d 688 (2d Cir. 1944).

[17] Miller, n. 2, supra, at 692.

B. The Miller Formula in Operation

Although the Miller Court goes to great lengths to justify compensating optionees for their loss, the Miller formula betrays this intention by only compensating optionees when the option price is below the market value of the property.[18] Option holders who would have paid the market value, or more, are granted no relief, despite the Court's sympathetic language and considerations of fairness and public policy.[19] Miller does not protect the optionee as much as it denies the optionor what the Court labeled "unequitable and unjustifiable windfall,"[20] for the compensability of the optionee's "property interest"[21] is totally contingent upon the option price being below the market price, and not upon the existence of the option itself. This, if the Court is to be believed, is substantial justice.

Such arbitrarily conditional compensation for a property right suggests that fairness and justice were not foremost in the Court's mind when it adopted this peculiar formula. The Court was apparently more concerned with cost, for "no increase in the total condemnation award will result from allocating compensation to the optionee"[22] under the Miller formula.

Clearly, it is one thing to recognize a new property interest in an

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[18] n. 3, supra.

[19] n. 10, supra.

[20] Miller, n. 2, supra, at 692.

[21] Miller, n. 2, supra, at 693.

[22] Miller, n. 2, supra, at 691.

unexercised option to purchase real property, and quite another to require the state to pay for its taking.[23] Here again, the Court has failed to deal with the difficulty facing it: If an option is indeed a property interest, what doctrine justifies its confiscation without compensation? If the Court is reluctant to order compensation regardless of cost, perhaps option contracts should not be made property interests, or perhaps the decision should have been left up to the legislature. In short, many alternatives were available, yet the Court seems to have chosen the worst: it assumed the authority to change the law while not satisfactorily justifying its decision or recognizing its consequences.

C. The Precedential Implications of San Diego v. Miller

After Miller, the so-called "property interest-contractual right test"[24] is no longer conclusive, depending upon "considerations of fairness and public policy."[25] The opinion, however, is of no real help in identifying operative considerations of fairness or policy aside from cost, as has been discussed. Such considerations, then, remain largely undefined. This raises severe precedential problems, for these considerations led the Court to hold

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[23]The Argument that such recognition of a new property right would significantly raise the cost of condemnation "may be considered where we approach a contention that by private contract an estate in land unknown to the common law or the law of this state is created." Friesen v. City of Glendale, 209 Cal 524, 530 (1931); see also, Abrams, n. 5, supra, at 316 (dissenting opinion).

[24]Miller, n. 2, supra, at 690.

[25]n. 10, supra.

that an option is a property interest, contrary to the technically correct[26] reasoning of East Bay Municipal Utility District v. Kiefer.[27] In addition, these considerations must be at least partially determinative of similar cases in the future. Thus, Miller's vagueness aggravates the confusion engendered by the policy change that labels an option contract a property interest, and leaves the lower courts without adequate direction in this fluctuating area of the law.

Due to the difficulties examined in the preceding sections, it is unlikely the Miller compensation formula will remain intact for long. Assuming the Court will modify its method of compensating option holders, bringing it into conformity with existing law, one alternative is readily available, i.e., compensate the optionee for the value of his option, if any.[28] This method is desirable for a number of reasons, chief among them is its consistency with established authority,[29] especially insofar as procedure is concerned.[30]

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[26]Miller, n. 2, supra, at 691.

[27]99 Cal.App. 240 (1929).

[28]"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 for its value, if any, as of the time of the filing of the complaint in the eminent domain proceeding." A.B. 11, California Legislature, 1975-1976 Regular Session, sec. 1265.310.

[29]"The condemnation caused the loss of his right to elect to purchase. Surely, this must have possessed some value -- it took a $9,000 down payment to secure it!" In re Gov. Mifflin Joint School Authority Petition, 164 A.2d 221, 225.

[30]see, e.g., People ex rel Department of Public Works v. Fresno, 210 Cal. App. 2d 500 (1962).

Another advantage is the flexibility it allows the courts in determining the amount of compensation to be awarded: compensation would be ascertained by a jury, and would vary as to loss, not as to the option contract.[31] Although compensation for value will probably increase the cost of condemnation, this objection has not been persuasive in the courts[32] or the legislature[33] in recent years.

Miller, therefore, will most likely suffer from the flux it has created in the law of eminent domain, and undergo substantial alterations in the future. Whatever happens, the Court will no doubt find that it must take the advice of one of its own cited authorities and "adopt working rules in order to do substantial justice in eminent domain proceedings."[34]

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[31] see, e.g., Muller, n. 14, supra.

[32] n. 5, supra.

[33] The California Legislature has never statutorily overruled any decision of the California Supreme Court that has extended compensability under the law of eminent domain. see, Parking Authority of Sacramento v. Nicovich, 32 Cal.App. 3d 420; cf., Government Code sec. 7262 (Deering 1974).

[34] United States v. Miller, 317 U.S. 369, 375 (1943).

Conclusion

Totally apart from questions of authority, San Diego v. Miller is a prime example of what can happen when a court becomes more concerned with policy than with the letter and application of the law. The Court's failure to conform its opinion to the laws of California, and the parallel failure to anticipate the inequities in the operation of its formula, is an inexcusable dereliction of the Court's duty as the highest tribunal of the state.

Fortunately for the Court, its policy decision can be saved and compensation for option holders can be upheld by discarding the Miller formula in favor of the compensation-for-value method.[35] If this can be done before the legislature gets around to it, the Court may be able to save itself some embarrassment.

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[35] n. 28, supra.