

#42

4/2/65

First Supplement to Memorandum 65-14

Subject: Study No. 42 - Good Faith Improver

This supplement presents several additional matters for Commission consideration in connection with this topic.

One unanswered problem that contributed to the previous deferment of this topic concerns the extent of protection that should be provided for persons other than the principal participant in the typical good faith improver situation. For example, unimproved property may be subject to an incumbrance, for divided ownership, or a variety of other equitable interests that complicate considerations relevant to determining ownership. Similarly, persons other than the improver himself may have an equitable interest in an improvement that is at least as meritorious as the improver's interest (and perhaps more so). Thus, the person who grants a construction loan, the contractor, subcontractors, landscapers, and the like, contribute to an improvement in the form of money, labor, and materials, each expecting to have a secured interest. In determining the standards to be applied in defining a good faith improver and an innocent owner, therefore, attention should be directed to the scope of protection to be accorded these additional persons. For example, should a subcontractor be treated as if he were a good faith improver in his own right to the extent of his contribution to the improvement or should he stand in the shoes of the principal improver?

The staff presents the following statements of principles for Commission consideration. Acceptance or rejection of all or a part of these and related principles will afford a framework within which to draft a tentative statutory solution to the good faith improver problem.

1. An innocent owner should be made whole in every case by guaranteeing to him an equity (either in kind or in cash proceeds) equal to the unimproved value of the property.

2. A mortgagee who claims through an owner should be guaranteed a security at least equal to the security he had prior to the improvement.

3. An innocent owner should be entitled to damages for withholding, such damages to be measured by rents, profits, etc.

4. An innocent owner should be entitled to share in any increment in value of the property as improved (such share to be measured, perhaps, by the ratio that the value of the unimproved property bears to the cost of the improvement).

5. A culpable owner (e.g., one who induced or participated in the improvement) should have none of the rights guaranteed an innocent owner other than an equity in the improved property measured by the same ratio mentioned above.

6. An innocent improver should have only secondary rights (i.e., rights subservient to the rights of an innocent owner, persons claiming through an innocent owner, and persons who would otherwise have an equitable interest in the property by reason of their contribution to the improvement). In other words, where the value of the property is not sufficient to satisfy all interests, the improver should suffer.

7. The interests of several different persons who have contributed to an improvement should be rateably apportioned in such amount as the cost of each bears to the cost of the whole.

If each of the forgoing principles were approved, the result would be as follows: (1) An innocent owner of property and all persons claiming an

interest would be valued at \$1,000 and C's interest would be valued at \$2,000 (since A is treated as having contributed \$10,000 and C is treated as having contributed \$20,000). (A's and C's interests are subject to adjustment, however, because of C's liability for withholding.)

The form of relief to be granted is not particularly important at this time so long as the interests to be protected can be defined with some accuracy. Hence, the forgoing is presented in an effort to assist in defining the interests to be protected and determining the proportionate value to be assigned to such interests. Consideration will be given at a later time to suggested procedures to implement enforcement of the rights secured to the various persons defined as needing protection.

Respectfully submitted,

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