

#36.150

5/21/73

Memorandum 73-50

Subject: Study 36.150 - Condemnation (Compensation for Divided Interests)

Attached to this memorandum are the draft provisions relating to compensation for divided interests revised in accordance with the Commission's directions at the May 1973 meeting and two copies of the preliminary portion of the recommendation relating to this subject. Please mark your editorial revisions on one copy and return it to the staff at the June 1973 meeting. We hope to work out any substantive problems with the draft statute and recommendation at the meeting with the view to sending both to the State Bar for comment following the meeting.

Respectfully submitted,

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## PRELIMINARY PORTION OF RECOMMENDATION

### Apportionment of the Award Among Divided Interests

At the time property acquired by eminent domain is taken, it is not normally held by a single owner in fee simple; there are frequently coowners, liens and encumbrances, deed restrictions, leases, and the like. The Commission has reviewed the statutes and case law relating to compensating and apportioning the award among divided interests and recommends the following changes in existing law.

Accrual of right to compensation. Code of Civil Procedure Section 1249 provides that, for the purpose of assessing compensation and damages, the right thereto accrues as of the date of issuance of summons. This date is an arbitrary one; the date the complaint is filed is more appropriate since that is the date the court acquires jurisdiction over the property.

Undivided fee rule. Section 1246.1 of the Code of Civil Procedure permits the plaintiff in an eminent domain proceeding to have compensation determined in a lump sum as against all defendants with a subsequent second-stage apportionment rather than to have compensation determined as against each defendant individually. While the Commission recommends continuance of this plaintiff's option, provision should be made to assure that all defendants are adequately compensated under the two-phase proceeding.

Under existing law, where the plaintiff elects to have compensation determined in a lump sum, compensation is measured by the undivided fee value of the property except where the value of the fee is enhanced by the existence of a leasehold. See People v. Lynbar, Inc., 253 Cal. App.2d 870, 62 Cal. Rptr. 320 (1967). The rule of Lynbar should be extended so that, in any case where

the undivided fee value of the property is not adequate to compensate all the interests in the property, the undivided fee value will be augmented to include an amount sufficient to compensate all such interests.

Leaseholds. Under City of Pasadena v. Porter, 201 Cal. 381, 257 P. 526 (1927), where property subject to a lease is partially taken, the lessee's obligation to pay rent under the terms of the lease for the property taken continues unabated, and the lessor's compensation for the property is given in part to the lessee to be paid back to the lessor as a part of the rental installments. This rule, which in effect makes the lessee a trustee for the lessor's compensation, has been widely criticized. The Commission believes that the lessor should be given compensation for the property taken outright, and the lessee should not be required to make payments on property no longer subject to the lease. Absent an express provision in the lease, a partial taking of property subject to a leasehold should work a pro rata reduction of the rental obligation; and, if the taking is sufficiently great that it operates as a frustration of the whole lease, the court should, on motion of any party, terminate the lease.

Options. Existing law denies compensation to the holder of an option to acquire property. See, e.g., People v. Ocean Shore R.R., 90 Cal. App.2d 464, 203 P.2d 579 (1949). An option may be a quite valuable interest in property for which substantial consideration was given. An option holder should receive compensation for the fair market value of the option.

Future interests. When property subject to a life tenancy is taken by eminent domain, the life tenant's portion of the award may be inadequate for investment to provide the life tenant with the same income or comparable living conditions as the original life tenancy. In this situation, the court should have authority to defer distribution of the eminent domain award pending

termination of the life tenancy and meanwhile to permit investment of the funds or their devotion to such purposes as would be equitable under the circumstances. Such authority would make express the holding of Estate of Giacomelos, 192 Cal. App.2d 244, 13 Cal. Rptr. 245 (1961).

Contingent future interests in property such as rights of reentry and possibilities of reverter are denied compensation under existing law. See, e.g., Romero v. Dep't of Public Works, 17 Cal.2d 189, 109 P.2d 662 (1941). Such future interests may be of real market value particularly where the reentry or reverter is imminent at the time of the taking. The Commission recommends that, if the transformation of the future interest to a present interest was imminent at the time of the eminent domain proceeding, the future interest be compensated as a present interest. Where the occurrence was not imminent but the future interest was appurtenant to some property that is damaged by the acquisition, the owner should be compensated for that damage. Where the occurrence was not imminent but the future interest was a limitation on use to public or charitable purposes, the award should be devoted to the same purposes subject to the continued future interest.

## EMINENT DOMAIN LAW

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CHAPTER 6. COMPENSATION FOR DIVIDED INTERESTS

Article 1. General Provisions

§ 1250.010. Procedure for compensating divided interests

1250.010. (a) Except as provided in subdivision (b), where there are divided interests in property acquired by eminent domain, the value of each interest and the injury, if any, to the remainder of such interest shall be separately assessed and compensation awarded therefor.

(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.

Comment. Section 1250.010 retains the existing California scheme of permitting a plaintiff the option of having the interests in property valued separately or as a whole. Subdivision (a) retains the procedure formerly provided by Section 1248(1)-(2). Subdivision (b) retains the procedure formerly provided by the first sentence of Section 1246.1. It is intended as procedural only. Cf. People v. Lynbar, Inc., 253 Cal. App.2d 870, 62 Cal. Rptr. 320 (1967). For the rules governing the amount of compensation where the plaintiff elects a two-stage proceeding, see Section 1250.020.

§ 1250.020. Amount of compensation for divided interests

1250.020. 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 1250.020 provides the general rules for the amount of compensation to be determined in the first stage where the plaintiff elects a two-stage proceeding.

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 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

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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 total to an amount in excess of the undivided fee value.



§ 1250.030. Costs of apportionment among divided interests

1250.030. Where the plaintiff requires that the amount of compensation be first determined as between plaintiff and all defendants claiming an interest in the property, the costs of determining the apportionment of the award shall be allowed to the defendants and taxed against the plaintiff except that the costs of determining any issue as to title between two or more defendants shall be borne by the defendants in such proportion as the court may direct.

Comment. Section 1250.030 is the same in substance as the second sentence of former Section 1246.1.

§ 1250.040. Accrual of right to compensation

1250.040. Except as otherwise provided by law, for the purpose of assessing compensation, the right thereto shall be deemed to have accrued at the date of filing the complaint.

Comment. Section 1250.040 continues the substance of a portion of former Section 1249, but the date of filing the complaint rather than the date of issuance of summons is used to determine the accrual of the right to compensation since the filing of the complaint is the factor that establishes the jurisdiction of the court over the property. See Comment to Section 1245.120 (date of valuation is date of filing the complaint).

The rule stated in Section 1250.040 is subject to several exceptions created by both statute and case law. Thus, for example, if an interest in existence at the time of filing the complaint is extinguished before entry of judgment, the right of the owner of the interest to compensation does not accrue. See, e.g., People v. Hartley, 214 Cal. App.2d 378, 29 Cal. Rptr. 502 (1963). The right of the owner of an interest may accrue even if a complaint is never filed. See, e.g., Concrete Service Co. v. State, 274 Cal. App.2d 142, 78 Cal. Rptr. 923 (1969). Where a complaint is filed but a lis pendens is not filed, the right of a subsequent owner of an interest who has no notice of the eminent domain proceeding is not affected. Section \_\_\_\_\_. The right to compensation may depend on legal incidents other than the filing of the complaint. See, e.g., Civil Code § 1662 (Uniform Vendor and Purchaser Risk Act).

Article 2. Leases

§ 1250.110. Rights under lease not affected

1250.110. Nothing in this article affects or impairs the rights and obligations of the parties to a lease to the extent that such rights and obligations in the event of the acquisition of the property for public use are expressly provided in the lease.

Comment. While this article provides rules that govern the rights of parties to a lease of property taken by eminent domain, Section 1250.110 makes clear that these rules apply only absent an express provision in the lease covering the situation.

§ 1250.120. Termination of lease in whole taking

1250..120. Where all the property subject to a lease is acquired for public use, the lease terminates.

Comment. Section 1250..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 an express provision to the contrary in the lease. See Section 1250.110.

§ 1250.130. Partial cancellation of lease in partial taking

1250.130. Except as provided in Section 1255.140, 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 1250.130 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 1250.130 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 1250.130 do not apply where there is an express provision to the contrary in the lease. See Section 1250.110.

§ 1250.140. Termination of lease in partial taking

1250.140. 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 1250.140 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 1250.140 is not applicable in cases where there is an express provision in the lease covering the situation. See Section 1250.110.

§ 1250.150. Time of termination or partial cancellation

1250.150. 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 1250.150 makes clear the time of partial cancellation (Section 1250.130) or termination (Section 1250.140) of a lease.

§ 1250.160. Remedies of parties not affected

1250.160. 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 1250.160 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 1245.010 (right of owner of property to compensation) and 1245.210 (improvements pertaining to realty).



Article 3. Encumbrances

§ 1250.210. Acquisition of property subject to encumbrances

1250.210. 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 8<sup>7</sup> (commencing with Section 1245.710) of Chapter 5 may not be deducted from the judgment.

Comment. Section 1250.210 is the same in substance as former Section 1248(8).

§ 1250.220. Allocation of award among encumbrancers in partial taking

1250.220. (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 1250.210, 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 1250.220 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, and condemnation of all or part of the smaller portion results in an award inadequate to satisfy both liens. Section 1250.220 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

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 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 1250.220 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 1250.220 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 absent a contractual provision to the contrary. See, e.g., Sacramento etc. Drainage Dist. v. Truslow, 125 Cal. App.2d 478, 270 P.2d 928 (1954).

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§ 1250.230. Prepayment penalty under mortgage or trust deed

1250.230. 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 1250.230 is the same as former Section 1246.2.

Article 4. Options

§ 1250.310. Unexercised options

1250.310. 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 1250.310 reverses prior case law that the holder of an unexercised option to purchase property 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 1245.310.

Article 5. Future Interests

§ 1250.410. Contingent future interests

1250.410. (a) Where property acquired for public use is subject to a contingent future interest and the contingency is violated by such acquisition but violation of the contingency 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 contingent future interest and the contingency is violated by such acquisition but violation of the contingency was not otherwise reasonably imminent:

(1) If the contingency is that the property be devoted to a particular public or charitable use, the compensation for the property shall be devoted to the same or similar use subject to the same contingency.

(2) If the contingency is other than one described in paragraph (1) and is appurtenant to property owned by the owner of the contingent future interest, the contingent future interest shall be compensated to the extent violation of the contingency damages the property appurtenant thereto. but in no event shall such compensation exceed the value the contingent future interest would have as a present interest.

Comment. Section 1250.410 makes clear that, where there are contingent future interests in property acquired by eminent domain, such interests may 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).



§ 1250.420. Property subject to life tenancy

1250.420. 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, rather than an apportionment and distribution of the award based on the value of the interest of life tenant and remainderman, any of the following:

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

Comment. Section 1250.420 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).