

M e m o r a n d u m

To: Mr. Verne Walton

Date: January 23, 1989

From: Eric F. Eisenlauer

Subject: Possessory Interest on Contract Terms

This is in response to your memorandum of December 2, 1989 to Mr. Ken McManigal wherein you request our opinion with respect to the facts provided with your memorandum and set forth below.

In October 1987, the United States of America acting in this matter by the Secretary of the Interior ("Secretary") and Redacted ("Concessioner") entered into a contract which created a taxable possessory interest in Concessioner in land located in Yosemite National Park.

Section 1 of the contract provided that the "contract shall be for the term of twenty (20) years from January 1, 1987 through December 31, 2006. In the event the Concessioner fails to complete the said improvement and building program described in subsection 1(b) hereof within the time allocated thereof in subsection 1(c) [December 31, 1988] then this contract shall be for and during the term of five years (5) from January 1, 1987 through December 31, 1991."

Subsection 1(b) provides that "[t]he Concessioner shall undertake and complete an improvement and building program costing not less than \$300,000"

You have not indicated whether the Concessioner did timely construct the improvements required by the contract. The Assessment Appeals Board ruled that the contract created a five-year term of possession.

You have asked for our opinion as to whether the above quoted language "should be viewed as an option or term of contract." By this we assume your question is whether the contract term is for five years or twenty years.

Treating the quoted language as an option would be to view the contract as a five-year lease with an option to renew for fifteen years which the lessee would exercise by constructing the required improvements by December 31, 1988.

An option is an irrevocable offer which the optionee may accept or reject as he may elect. Palo Alto Town and County Village, Inc. v. BBTC Company (1974) 11 Cal.3d 494. An optionee, however, has no duty unless and until he exercises his option by accepting the irrevocable offer. Palo Alto at page 503. Here, not only does the language in question omit mention of any option to renew by the lessee, but the lessee is contractually obligated to construct improvements ("[t]he Concessioner shall undertake and complete an improvement and building program") (Emphasis added.)

In our opinion, that fact alone precludes treating the quoted language as a five-year lease with an option to renew for fifteen years because an option implies a choice and here the lessee, having a contractual obligation to build, legally has no choice.

In the somewhat similar case of *Kirker v. Shell Oil Co.* (1951) 104 Cal.App.2d 497, the granting clause created an oil lease for twenty years “and for so long thereafter as Lessee shall conduct drilling . . . or producing operations on the leased land. The lease then set forth various obligations and a provision for forfeiture if drilling was not commenced within three years. The Court of Appeal held at page 502 that: “The lease is not a grant for three years . . . and thereafter for 17 years . . . if drilling operation should be begun prior to the expiration of three years. Instead the grant is of a leasehold estate determinable at the end of 20 years with a proviso extending it, if a stated event occurs, at or before the end of the 20 years.” The court observed that the granting and habendum clauses of the lease granted the premises for a term of twenty years and that language subsequent to the granting and habendum clauses may not modify or cut down those clauses unless such clauses incorporate the additional language by express reference.

In our opinion, the quoted language plainly indicates that the Secretary and Concessioner intended to create a twenty-year lease which was to be reduced to five years in the event the lessee did not erect the required improvements by December 31, 1988. Had the parties intended otherwise, it is reasonable to assume they would have used language to carry out that intention, e.g., language such as the following: “This contract shall be for the term of five (5) years from January 1, 1987 through December 31, 1991. In the event the Concessioner completes the said improvement and building program described in subsection 1(b) hereof within the time allocated thereof in subdivision 1(c) [December 31, 1988], then this contract shall be for and during the term of twenty years from January 1, 1987 through December 31, 2006.”

Obviously the parties did not so provide. Accordingly, we are of the opinion that the interest created was a twenty-year lease subject to being reduced to a five-year lease in the event the Concessioner fails to build timely rather than a five-year lease subject to being expanded to a twenty-year lease if the Concessioner does build timely. Such an interest is properly characterized either as a determinable estate for years or an estate for years on condition subsequent. Although both are vested estates subject to possible termination (or reduction) on occurrence of a contingency (e.g., failure to build in this case), the former terminates automatically on the happening of the contingency whereas the latter is terminated only when the power to terminate is exercised by the lessor. See generally 30 Cal.Jur. 3d (Rev.), Estates section 23 and 24.

If we can be of further assistance in this matter, please let us know.

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cc: Mr. Richard H. Ochsner
Mr. Robert H. Gustafson