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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION ONE

LOUIS A. MARTIN et al.,

Plaintiffs and Appellants,

v.

HAMBRO FOREST PRODUCTS, INC., et
al.,

Defendants and Respondents.

A133084

(Humboldt County
Super. Ct. No. DR100987)

Plaintiffs own a parcel of real property subject to a 96-year lease. The lease contains a provision requiring the lessee to keep the premises free and clear of encumbrances resulting from the lessee's activities. Plaintiffs sued the current lessee, defendants Hambro Forest Products, Inc. and/or Humboldt Flakeboard Panels, Inc., a subsidiary (jointly Hambro), when Hambro executed two deeds transferring its leasehold interest in trust, contending the deeds of trust breached the lease by encumbering the property. The trial court sustained a demurrer without leave to amend, reasoning a transfer of the leasehold interest did not constitute an encumbrance of plaintiffs' interest in the property. We affirm.

I. BACKGROUND

Plaintiffs, six individuals, are the successors in interest to Frank Martin as the owners of real property in Arcata (the property). In May 2010, plaintiffs filed an action for breach of contract and declaratory relief against Hambro and Robert and Katheryn Figas. The complaint alleged Frank Martin executed a 96-year lease of the property in

1950 (the lease). Hambro is the current lessee, while the Figases are subtenants. The lease contains a provision requiring the lessee to “keep said premises free and clear of all liens and encumbrances of every kind and character created or resulting from the Lessee’s acts or operations” In 2009, Hambro caused to be recorded two deeds of trust with respect to its interest in the lease. The complaint contended the recording of these deeds of trust constituted a breach of the lease and sought a declaration to that effect and forfeiture of the lease.

Hambro filed a demurrer, arguing the deeds of trust did not constitute an encumbrance of the “premises” because they reached only Hambro’s interest in the lease. The demurrer was accompanied by a request for judicial notice of the two deeds of trust. Both deeds of trust stated that Hambro “grants, transfers and assigns to Trustee in trust, with power of sale, for the benefit of Lender as Beneficiary, all of Trustor’s right, title, and interest in, to and under the Lease . . . together with all existing or subsequently erected or affixed buildings, improvements and fixtures; all easements, rights of way, and appurtenances; all water, water rights and ditch rights (including stock in utilities with ditch or irrigation rights); and all other rights, royalties, and profits relating to the real property, including without limitation any rights Trustor later acquires in the fee simple title to the land, subject to the Lease, and all minerals, oil, gas, geothermal and similar matters” Opposing the demurrer, plaintiffs contended a lease for a term of years creates an interest in real property and argued the broad terms of the lease should be interpreted to preclude an encumbrance of this real property interest. The trial court took judicial notice of the two deeds of trust and sustained the demurrer with leave to amend, reasoning “the complaint alleges an encumbrance of defendants’ leasehold rights and not an encumbrance of the plaintiffs’ underlying real property ownership.”

Plaintiffs filed a first amended complaint quoting language from the deeds of trust. In opposing a renewed demurrer, plaintiffs argued grant of the deeds of trust breached the lease because the deeds of trust pledged as security various property interests Hambro did not actually own, such as water and mineral rights in the property. The trial court sustained the demurrer without leave to amend, holding: “The Deeds of Trust encumber

only defendants' leasehold interests under the Lease Agreement. By accepting defendants' leasehold interest as collateral, the lender/trustee takes subject to all the terms of the lease.”

II. DISCUSSION

Plaintiffs contend the trial court erred in sustaining the demurrer because execution and recordation of the deeds of trust could constitute a breach of the lease.

“On review from an order sustaining a demurrer, ‘we examine the complaint de novo to determine whether it alleges facts sufficient to state a cause of action under any legal theory, such facts being assumed true for this purpose. [Citations.]’ [Citation.] We may also consider matters that have been judicially noticed.” (*Committee for Green Foothills v. Santa Clara County Bd. of Supervisors* (2010) 48 Cal.4th 32, 42.)

Here, the existence of a cause of action depends on the interpretation of the lease and deeds of trust. “Interpretation of a lease presents a question of law which we independently review using principles of contract law.” (*Principal Mutual Life Ins. Co. v. Vars, Pave, McCord & Freedman* (1998) 65 Cal.App.4th 1469, 1477–1478.) “ ‘The fundamental rule is that interpretation of . . . any contract . . . is governed by the mutual intent of the parties at the time they form the contract. [Citation.] The parties’ intent is found, if possible, solely in the contract’s written provisions. [Citation.] ‘The ‘clear and explicit’ meaning of these provisions, interpreted in their ‘ordinary and popular sense,’ unless ‘used by the parties in a technical sense or a special meaning is given to them by usage’ [citation], controls judicial interpretation.’ ” (*Nelsen v. Legacy Partners Residential, Inc.* (2012) 207 Cal.App.4th 1115, 1129.)

The provision of the lease that is the subject of this dispute is contained within a paragraph stating, in full: “It is further understood and agreed that the Lessee shall pay and keep from becoming delinquent all taxes that may be imposed upon said premises because of the erection thereon of any sawmill or other manufacturing plant or equipment or machinery or ponds by the Lessee and shall pay all such taxes promptly; and *that the Lessee will keep said premises free and clear of all liens and encumbrances of every kind*

and character created or resulting from the Lessee's acts or operations; and that all dikes and ditches that may be constructed on said premises shall be inside the boundary of the above described premises; and that said premises shall not be used by the Lessee for any illegal or unlawful purposes.” (Italics added.) The “premises” referred to in this sentence is not defined in the lease, but the term appears to be used interchangeably with the terms “property” and “land hereinabove described” to refer to the property being leased.¹ In other words, the lease requires the lessee to keep the leased property free of encumbrances resulting from its own activities.

With that understanding, we find no breach of the lease in Hambro’s execution of the deeds of trust. The deeds of trust do not purport to encumber the property itself. Rather, both are a transfer of “all of [Hambro’s] right, title, and interest in, to and under the *Lease*.” A lease for a term of years constitutes an interest in real property, but it is not itself the real property that is the subject of the lease. As the Supreme Court has explained: “A freehold estate is distinguished from other forms of estates in that it is of indeterminate duration [citations] and carries with it title to land [citation]. But an estate for years—in this case, a nonperiodic tenancy under a lease—is not a freehold estate. [Citation.] Indeed, under California law an estate for years is not real property at all but rather a chattel real—a form of personalty—even though the substance of the estate, being land, is real property. [Citations.] [¶] Notwithstanding the fact that a lease is a present possessory interest in land, there is no question that as a nonfreehold estate it is a different species of interest from a freehold estate in fee simple. . . . A leasehold is not an ownership interest, unlike the possession of land in fee simple even when encumbered by a mortgage, for in the latter situation the mortgagor acquires equity over time through periodic payments. It is for that reason that common parlance refers to the ‘owner’ of a

¹ The lease appears to concern raw land, since it anticipates that the lessee “may make, erect and place thereon such buildings, equipment, machinery, roads, spur tracks, [etc.] . . . as the Lessee may desire and that upon the end or other termination of this lease that the Lessee will remove all such buildings” Plaintiffs contend the term “premises” does not refer solely to the real property, but they do not propose an alternative meaning. We see no plausible alternative.

freehold estate, encumbered or unencumbered, but to the ‘holder’ of a lease; the freeholder is seised of land, whereas the leaseholder is not.” (*Pacific Southwest Realty Co. v. County of Los Angeles* (1991) 1 Cal.4th 155, 162–163.)

Consideration of the nature of the encumbrance created by the deed of trust demonstrates that it does not, as a practical matter, encumber plaintiffs’ property. Should Hambro fail to pay the debt for which the lease provides security, the trustee, and thereby the lender, would succeed to ownership of the lease. They would not succeed to ownership of the property, since the deed transfers only Hambro’s interest in the lease. (See *Glendale Fed. Bank v. Hadden* (1999) 73 Cal.App.4th 1150, 1153 [bank that takes lease as collateral takes subject to all the terms of the lease].) Accordingly, the deed of trust is, in effect, a conditional assignment of the lease to the trustee. Because the lease does not limit assignments, this would not constitute a breach. (Civ. Code, §§ 1995.210, subd. (b), 1995.220.) Just as an ordinary assignment of the lease would not impair or otherwise interfere with plaintiffs’ interest in the property, a seizure of the leasehold, which would have the same legal effect as an assignment, would not impair plaintiff’s interest, either.

The context of the clause prohibiting encumbrances suggests its purpose was to ensure that the lessee’s activities did not result in an impairment of the lessor’s ownership interest. The clause follows immediately after a clause requiring the lessee to pay all taxes resulting from its erection of improvements on the property. Unpaid property taxes assessed against improvements constructed by the lessee could, under certain circumstances, become a lien against the real property itself. (See *Simms v. County of Los Angeles* (1950) 35 Cal.2d 303, 312–313; 18 Ops.Cal.Atty.Gen. 26, 27–28 (1951); Rev. & Tax. Code, § 2188.1.) Further, while the lease may have been concerned primarily with tax liens, it is possible to envision other liens impairing the lessor’s ownership interest that might result from the lessee’s activities. Because the parties anticipated the lessee would build on the property and conduct an active business, there was the risk of a mechanic’s lien. (See *Howard S. Wright Construction Co. v. Superior Court* (2003) 106 Cal.App.4th 314, 321 [explaining when a mechanic’s lien filed in

connection with work for a lessee can attach to the underlying property].) A lis pendens growing out of a dispute over the lease was also a possibility. (E.g., *Parker v. Superior Court* (1970) 9 Cal.App.3d 397, 399–400.)

Plaintiffs argue a provision prohibiting the lessee from encumbering the property would be “superfluous” since a lessee would lack the “power or necessary interest [in the property] to create such an encumbrance in favor of a third party.” We recognize Hambro, because it had no ownership interest in the property, could not have mortgaged it or otherwise encumbered the property for its own benefit. As demonstrated above, however, a lien could have been filed against the property by a tax or other creditor of the lessee in certain circumstances. Because of the risk of this type of involuntary encumbrance, the provision was not superfluous.

Plaintiffs also argue the lease “covers every encumbrance regardless of its kind or character,” focusing on the lease language, “all liens and encumbrances of every kind and character.” The immediately preceding language, however, limits the application of this language to encumbrances against the “premises.” For the reasons explained above, a deed of trust to Hambro’s leasehold rights is not an encumbrance of the premises.

Finally, as they did before the trial court, plaintiffs claim the language of the deeds of trust covers certain rights that they retain as owners, thereby encumbering their ownership. The language in question states that Hambro grants “all of Trustor’s right, title, and interest in, to and under the Lease . . . of the following described real property, together with all existing or subsequently erected or affixed buildings, improvements and fixtures; all easements, rights of way, and appurtenances; all water, water rights and ditch rights . . . ; and all other rights, royalties, and profits relating to the real property, including without limitation any rights Trustor later acquires in the fee simple title to the land, subject to the Lease, and all minerals, oil, gas, geothermal and similar matters” Plaintiffs contend the language relating to water rights, royalties and profits, and mineral rights purports to transfer to the trustee their own property rights.

This argument is inconsistent with plaintiffs’ earlier argument that a prohibition of encumbrances of their property would be superfluous because Hambro lacked the “power

or necessary interest” to create such an encumbrance. As that argument correctly recognized, Hambro lacks the legal authority to deed property interests that it does not own. As a result, any clause in the deeds of trust purporting to convey a property interest not actually owned by Hambro would be legally ineffective. In order to avoid such a finding, we construe the phrase “all of Trustor’s right, title, and interest in, to and under the Lease” to apply not only to the possessory interest but also to the other property interests subsequently listed. In other words, the deeds of trust apply to the other rights and interests only if they are possessed by Hambro under the Lease. It would be an absurd construction to hold that the deeds of trust were intended to transfer to the trustee property rights Hambro had no legal right to transfer. (Cf. *Glendale Fed. Bank v. Hadden*, *supra*, 73 Cal.App.4th at p. 1153 [lender succeeds to rights of leaseholder]; *ASP Properties Group, L.P. v. Fard, Inc.* (2005) 133 Cal.App.4th 1257, 1269 [“Interpretation of a contract ‘must be fair and reasonable, not leading to absurd conclusions’ ”].)

Because plaintiffs’ complaint fails to state a claim on the facts pleaded and plaintiffs do not suggest any other facts that could be pleaded to cure the deficiency, the trial court did not abuse its discretion in sustaining the demurrer without leave to amend. (E.g., *Vieira Enterprises, Inc. v. City of East Palo Alto* (2012) 208 Cal.App.4th 584, 594.)

III. DISPOSITION

The judgment of the trial court is affirmed.

Margulies, J.

We concur:

Marchiano, P.J.

Dondero, J.