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CONDEMNATION, COMPENSATION AND "NEGATIVE" LEASEHOLDS

The condemnation of private property for public use requires "just compensation."¹ General principles have been devised by the courts in order to determine what is "just compensation"² and to apportion any award³ among those having compensable interests in the property.⁴

1. This requirement is found in the fifth amendment to the United States Constitution. The due process clause of the fourteenth amendment extends this requirement to the states. E.g., *Chicago, B. & Q.R.R. v. Chicago*, 166 U.S. 226, 241 (1897) (state judicial action; one dollar compensation for taking railroad right of way to open street not unjust compensation). In addition, the constitution of every state but North Carolina provides for just, adequate, reasonable or similar specie of compensation. See I. Levey, *Condemnation in U.S.A.* 1467-814 (1969) [hereinafter cited as Levey] for a state-by-state tabulation of the constitutional and statutory authority for taking by eminent domain. The due process clause of the North Carolina constitution [N.C. Const. art. I, § 19] has been construed to require "just compensation." *De Bruhl v. State Highway & Pub. Works Comm'n*, 247 N.C. 671, 675, 102 S.E.2d 229, 232 (1958) ("fundamental right to just compensation . . . so grounded in natural law and justice that it is part of the fundamental law of the State . . ."). In New York "just compensation" is required by its constitution. N.Y. Const. art. I, § 7(a).

2. The question of how "just compensation" is to be measured is basic. In *United States v. Miller*, 317 U.S. 369 (1943), the Court stated: "[Just] compensation means the full and perfect equivalent in money of the property taken. The owner is to be put in as good position pecuniarily as he would have occupied if his property had not been taken.

"It is conceivable that an owner's indemnity should be measured in various ways depending upon the circumstances of each case and that no general formula should be used for the purpose. In an effort, however, to find some practical standard, the courts early adopted, and have retained, the concept of market value. The owner has been said to be entitled to the 'value,' the 'market value,' and the 'fair market value' of what is taken. . . .

" . . . It is usually said that market value is what a willing buyer would pay in cash to a willing seller." *Id.* at 373-74 [footnotes omitted]. See also *United States v. Cors*, 337 U.S. 325, 332 (1949) ("[t]he Court in an endeavor to find working rules . . . has adopted practical standards, including that of market value"); *In re Port Authority Trans-Hudson Corp.*, 20 N.Y.2d 457, 467, 231 N.E.2d 734, 738, 285 N.Y.S.2d 24, 30, motion to amend remittitur granted, 20 N.Y.2d 968, 233 N.E.2d 860, 286 N.Y.S.2d 858 (1967), cert. denied, 390 U.S. 1002 (1968) ("just compensation requires . . . the sum of money [the property owner] could have realized in an uncoerced sale in the open market to a willing buyer"); *In re Board of Water Supply*, 277 N.Y. 452, 456-57, 14 N.E.2d 789, 791 (1938) (just compensation measured as fair market value of the property on the date of taking, or on the closest date when a fair market existed); 4 P. Nichols, *The Law of Eminent Domain* (3d rev. ed. 1974) [hereinafter cited as Nichols]; 1 L. Orgel, *Valuation under the Law of Eminent Domain* §§ 11-46 (2d ed. 1953) [hereinafter cited as Orgel]; Bigham, "Fair Market Value," "Just Compensation," and the Constitution: A Critical View, 24 *Vand. L. Rev.* 63 (1970); Herlihy, *United States v. Fuller: Just Compensation Under Attack*, 1 *Hastings Const. L.Q.* 273 (1974); Kanner, *Condemnation Blight: Just How Just is Just Compensation?*, 48 *Notre Dame Law.* 765 (1973) [hereinafter cited as *Condemnation Blight*]; Note, *The Evolution of the Additive Concept*, 5 *Suffolk U.L. Rev.* 237 (1970).

3. See text accompanying notes 5-38 *infra* for a discussion of apportionment between lessor and lessee.

4. Not all interests in real property are compensable. The general rule is that lessees for a term of years or from year to year have a sufficient property interest in their leasehold to be

A subject of recurring litigation is the amount and apportionment of compensation when real property under lease is totally condemned.⁵ The primary focus of this Note, however, will be on the narrower question of the amount and apportionment of the condemnation award for the taking of real property subject to a "negative" leasehold—a leasehold for which the rent reserved in the lease exceeded the economic rent (fair rental value) of the property at the time of condemnation.⁶ It is the uniform rule that when real property subject to a lease is totally condemned the lease terminates, as does the duty to pay rent.⁷ Lessees for a term of years are considered to be

considered "owners" for purposes of eligibility to share in condemnation awards. See, e.g., *Corrigan v. City of Chicago*, 144 Ill. 537, 543, 33 N.E. 746, 748 (1893). A sublessee of one of these estates is also eligible to share in the awards. See, e.g., *People ex rel. Dep't of Pub. Works v. Rice*, 185 Cal. App. 2d 207, 8 Cal. Rptr. 76 (4th Dist. 1960). However, compensation for the taking of lesser estates such as tenancies from month to month, or tenancies at will, depends upon the right of the tenant in possession to remain in possession against the landlord's will. Thus, the weight of authority is against compensation for the condemnation of tenancies at will. *Rledcl v. Plymouth Redev. Authority*, 354 Mass. 664, 241 N.E.2d 852 (1968) (tenant occupying condemned premises for six years under agreement to enter into lease, characterized as at most a tenant at will and not entitled to damages under statute providing compensation for those having estates in property, or tenants for life or years); *Fort Worth Concrete Co. v. State*, 416 S.W.2d 518 (Tex. Ct. Civ. App. 1967) (tenant who remained and paid rent on monthly basis rather than exercise renewal option held to have no compensable interest in condemned property). *Contra*, *Pensacola Scrap Processors, Inc. v. State Road Dep't*, 188 So. 2d 38 (Fla. Dist. Ct. App. 1966) (tenant at will entitled to recover for injuries caused by condemnation). Options to purchase real estate are often considered to be merely "contract rights," which are not estates in land. Such an option is not compensable if condemnation occurs before its exercise, even when the optionee is in possession of the property under a valid lease at the time of condemnation. *Cornell-Andrews Smelting Co. v. Boston & P.R.R.*, 209 Mass. 298, 95 N.E. 887 (1911); *Phillips Petroleum Co. v. City of Omaha*, 171 Neb. 457, 106 N.W.2d 727 (1960) (option, characterized as unilateral contract, does not create an equitable interest in land). But see *In re Governor Mifflin Joint School Bd. Authority Petition*, 401 Pa. 387, 164 A.2d 221 (1960) (optionee not in possession held entitled to compensation). The only property interests under consideration in this Note are fees, leaseholds, rents, reversions and contracts. For the compensability of various other interests concerning real property see generally 2 Nichols § 5.23; 1 Orgel §§ 121-26. For an overview of the law concerning condemnation of property subject to a lease see Polasky, *The Condemnation of Leasehold Interests*, 48 Va. L. Rev. 477 (1962) [hereinafter cited as Polasky].

5. Total condemnation occurs when the condemning authority takes all the property interests in a parcel. E.g., *Corrigan v. City of Chicago*, 144 Ill. 537, 543, 33 N.E. 746, 747 (1893) (one parcel subject to lease entirely taken to widen street). In contradistinction is partial condemnation, in which event the condemnor takes less than all of the interests in all of the parcel. E.g., *Great Atl. & Pac. Tea Co. v. State*, 22 N.Y.2d 75, 238 N.E.2d 705, 291 N.Y.S.2d 299 (1968) (entire frontage of building and temporary easement taken to widen street). See A. Jahr, *Law of Eminent Domain* § 97 (1953). See also note 7 *infra* and accompanying text for the different treatment accorded the lease and the contractual duty to pay rent depending on whether the property is totally or partially condemned.

6. See text accompanying notes 21 & 35 *infra*.

7. E.g., *United States v. Certain Interests in Property*, 281 F. Supp. 342, 347-48 (E.D. Va. 1968); *Corrigan v. City of Chicago*, 144 Ill. 537, 544-45, 548, 33 N.E. 746, 747-49 (1893); 2 Nichols § 5.23[3], at 98; 1 Orgel § 121, at 521-22; Polasky 493 & n.62. In New York City the result is required by statute. N.Y.C. Admin. Code § B15-37.0(a) (1971); accord, La. Civ. Code

property owners for the purpose of eligibility for compensation when their leaseholds are condemned,⁸ as are sublessees of eligible lessees.⁹ The real property interests of a lessor and lessee eligible for compensation are those identified in *Corrigan v. City of Chicago*:¹⁰ the lessee's interest is the leasehold, subject to the rent,¹¹ and the lessor's interests are the reversion and the rent.¹²

There is little theoretical controversy with respect to the lessee's compensation: in the absence of a condemnation clause¹³ or statutory prohibition,¹⁴ the lessee's award for the taking of the leasehold is determined by the excess, if any, in the value of the unexpired term of the lease over the rent reserved for that remaining period.¹⁵ This award, which represents the "bonus" value of the lease, or the lessee's benefit of the bargain, may be computed in a number of ways,¹⁶ including discounting to present value¹⁷ the aggregate of the

Ann. art. 2697 (1952); W. Va. Code Ann. § 37-6-29 (1966) (unless the parties make express contrary provision in the lease). *Foot v. City of Cincinnati*, 11 Ohio 408, 38 Am. Dec. 737 (1842) appears to be the last case holding that the lessee's duty to pay rent survives total condemnation.

When property subject to a lease is partially condemned and the remaining portion of the property is susceptible of use consonant with the lease, the majority rule is that the duty to pay the unabated rent remains. See, e.g., *Gluck v. Mayor & City Council*, 81 Md. 315, 323, 32 A. 515, 516 (1895) ("nothing short of a surrender, a release, or an eviction will discharge [the tenant] from his covenant" to pay the unabated rent; partial condemnation not an eviction at law). But see *Great Atl. & Pac. Tea Co. v. State*, 22 N.Y.2d 75, 84, 238 N.E.2d 705, 710, 291 N.Y.S.2d 299, 305 (1968) ("lessee . . . entitled to an abatement . . . provided he pleads and demands an abatement in an action against him . . . for the entire rent"). In some jurisdictions abatement of rent is provided for by statute. E.g., La. Civ. Code Ann. art. 2697 (1952); W. Va. Code Ann. § 37-6-29 (1966). See also N.Y.C. Admin. Code § B15-37.0(a) (1971) (duties discharged with respect to taken portion, but remain as to residue). See generally 2 Nichols § 5.23[3]; 1 Orgel § 121.

8. See note 4 supra.

9. See note 4 supra.

10. 144 Ill. 537, 33 N.E. 746 (1893).

11. *Id.* at 545, 33 N.E. at 748.

12. *Id.*, 33 N.E. at 748.

13. The lessor and lessee may agree in advance on their respective interests in the event of condemnation by express provision in the lease. The usual condemnation clause provides that the lessee receive no compensation for the condemnation of a leasehold interest. See, e.g., *United States v. Petty Motor Co.*, 327 U.S. 372, 375-76 & n.4 (1946) (lessee not entitled to share in any condemnation award for partial or total taking); *United States v. 21,815 Square Ft. of Land*, 59 F. Supp. 219, 220 (E.D.N.Y. 1945), *aff'd*, 155 F.2d 898 (2d Cir. 1946). See generally W. Va. Code Ann. § 37-6-29 (1966); 2 M. Friedman, *Friedman on Leases* § 3.6 (1974); 2 Nichols § 5.23[2]; 7 *id.* §§ 11.06-08; 1 Orgel § 121, at 526-28; Note, *Condemnation and the Lease*, 43 Iowa L. Rev. 279, 286-87 (1958).

14. E.g., La. Civ. Code Ann. art. 2697 (1952).

15. E.g., *Gamble v. State*, 289 Ala. 131, 136-37, 266 So. 2d 286, 291 (1972). See generally 4 Nichols § 12.42[3]; 1 Orgel § 126.

16. E.g., *Commonwealth, Dep't of Highways v. Sherrod*, 367 S.W.2d 844, 849-51 (Ky. 1963) (market value of lease is excess of what the property would sell for free of the lease over what it would sell for subject to the lease). See generally 4 Nichols § 12.42[3].

17. The present value of monies due in the future is that amount which, if invested at the

periodic "bonus" rent¹⁸ over the unexpired term of the lease.¹⁹ For example, if property under lease for \$1000 per month²⁰ was totally condemned at a time when the fair rental value of the property was \$1200 per month, and the lease had 25 months left to run, then the "bonus" rent would be \$200 per month, and the "bonus" value of the lease, and the lessee's compensation, would be the present value of \$200 per month for the following 25 months. Assuming a discount rate of one percent per month this would result in an award of \$4448.68 to the lessee.

However, if at the time of condemnation the fair rental value of the property was only \$700 per month, the lessee would own a "negative" leasehold and the termination of the duty to pay rent would be considered sufficient compensation for the taking of the leasehold interest.²¹

Similarly, the lessor's compensation is usually dependent upon whether the property was subject to a "negative" leasehold or a leasehold having a "bonus" value, due to the "undivided fee" rule.²² Under this rule the value of condemned property is based on the supposition that all interests in the property are owned by one party.²³ Nominally the law in most jurisdictions,²⁴

appropriate interest rate, would be sufficient to allow the withdrawal of sums as they become due, leaving a balance of zero after the last payment has been made. See, e.g., *City of Pasadena v. Porter*, 201 Cal. 381, 387, 257 P. 526, 527 (1927). See also 4 Nichols § 12.42[3], at 506-14 & n.55.1.

18. The "bonus" rent is the difference between the economic rent (fair rental value) and the rent reserved in the lease.

19. See, e.g., *Great Atl. & Pac. Tea Co. v. State*, 22 N.Y.2d 75, 84-85, 238 N.E.2d 705, 710, 291 N.Y.S.2d 299, 305-06 (1968) (deduct actual rent from fair rental value and apply appropriate Inwood coefficient to reduce to present value); *In re Pittsburgh Outdoor Advertising Corp.*, 440 Pa. 321, 325, 272 A.2d 163, 165 (1970) (value of condemned leasehold interest is difference in fair rental value and rent reserved, "projected over the life of the lease and discounted to present worth").

20. It is assumed throughout the examples that follow that all leases were made at arms' length, that all leases were reasonable when made and that none contained condemnation clauses.

21. See *In re Pittsburgh Outdoor Advertising Corp.*, 440 Pa. 321, 325-26, 272 A.2d 163, 165 (1970) (rent reserved in lease of billboard space equal to fair rental value at time of condemnation); 1 Orgel § 124; Polasky 492, 499; Comment, *Negative Leaseholds: The Property-Contract Distinction and a Failure of Just Compensation*, 21 Buffalo L. Rev. 174, 176 (1971) [hereinafter cited as *Negative Leaseholds*].

22. See generally 4 Nichols § 12.36.

23. "Where there are different estates in the property, the proper course is to ascertain compensation as though the property belonged to one person, and then apportion this sum among the different parties according to their respective rights." *United States v. 70.39 Acres of Land*, 164 F. Supp. 451, 478 (S.D. Cal. 1958). But see *Korf v. Fleming*, 239 Iowa 501, 526, 38 N.W.2d 85, 98-99 (1948) (damage to fee and damage to leasehold may be separately found). See generally 4 Nichols §§ 12.36, 12.42 & n.4.

24. See 4 Nichols § 12.36[1]. See also Polasky 484-85 & nn.36-41. A strong argument against the unreasoned application of the "undivided fee" rule was advanced by Justice Holmes in a case where the rule would have enhanced the condemnees' damages rather than diminish the total condemnation award, which is the more usual result: "It [the Constitution] does not require a parcel of land to be valued as an unencumbered whole when it is not held as an unencumbered

the basis of this rule is that condemnation proceedings under eminent domain are considered in rem,²⁵ and the money awarded as compensation is for the property taken and not for the values of the (separate) interests condemned.²⁶ The effect of the rule is to limit the condemnor's liability by ensuring that he is not the one to bear the burden of any increase in total value due to the distribution of title to the condemned property among several parties.²⁷

In the majority of jurisdictions, after the "undivided fee" rule has been applied to determine the gross condemnation award, the award is apportioned between lessor and lessee.²⁸ The lessee's award is carved out of the gross condemnation award, and the residue is awarded to the lessor.²⁹

When real property under lease is totally condemned, the gross condemnation award is typically found by capitalizing the fair rental value³⁰ of the whole. It merely requires that an owner of property taken should be paid for what is taken from him. It deals with persons, not with tracts of land. And the question is what has the owner lost, not what has the taker gained." *Boston Chamber of Commerce v. City of Boston*, 217 U.S. 189, 195 (1910); accord, *County of L.A. v. American Sav. & Loan Ass'n*, 26 Cal. App. 3d 7, 11, 102 Cal. Rptr. 439, 442 (2d Dist. 1972) (application of unencumbered fee rule would result in gross overpayment to one of the condemnees). Nonetheless, Justice Holmes's opinion has been relied on to enhance condemnation awards. For example, in *Arkansas State Highway Comm'n v. Fox*, 322 S.W.2d 81, 82-83 (Ark. 1959), the court, in sustaining condemnation awards to a lessor and lessee based on independently made appraisals of their interests, stated: "The appellant, relying upon the axiom that the whole cannot exceed the sum of its parts, insists that the separate interests of the lessor and the lessee should be disregarded, with the physical property being valued as if it were singly owned. We do not consider this axiom to be applicable here, for it is plain that a lease may be so advantageous to both parties that the combined market value of their separate estates exceeds what the land would be worth if the lease had not been made. Thus the 'whole' of single ownership is not necessarily the 'whole' of separate ownerships." For a discussion of the separate valuation theory see 4 Nichols § 12.36[2]. See also notes 70-77 *infra* and accompanying text.

25. See 1 Nichols § 1.142[1]. See also Polasky 485-86; Hershmann, *Compensation—Just and Unjust, A Study in Eminent Domain*, 21 Bus. Law. 285, 299 (1966). For a critical view of the in rem theory see *Condemnation Blight* 778-87.

26. See generally 4 Nichols § 12.36[1]; 1 Orgel § 109. The corollary is that theoretically the condemnor is not interested in the apportionment of the award among those having compensable interests. See generally 4 Nichols § 12.42[2], at 494-96. However, the lessee's rights are not extinguished when the condemnor settles with the lessor without the consent or authority of the lessee. E.g., *Universal Container Corp. v. City of Cambridge*, — Mass. —, —, 278 N.E.2d 727, 729 (1972) (recording of lease is constructive notice of lessee's interest).

27. A typical argument in favor of applying the "undivided fee" rule is: "Undoubtedly, defendant city should only have to pay the value of the land appropriated, even though that value may be less than the aggregate values of the interests in that land." *Hughes v. City of Cincinnati*, 175 Ohio St. 381, 387, 195 N.E.2d 552, 556 (1964).

28. See, e.g., *United States v. 31.07 Acres of Land*, 189 F. Supp. 845, 848 (D. Mont. 1960) (first find gross condemnation award, then distribute between fee owner and lessee according to their interests). *Contra*, Cal. Civ. Pro. § 1248(1) (West 1972); 4 Nichols § 12.36[2] (separate valuation of interests). See generally 4 Nichols § 12.42 and text accompanying notes 70-77 *infra*.

29. E.g., *Arlen of Nanuet, Inc. v. State*, 26 N.Y.2d 346, 355, 258 N.E.2d 890, 893, 310 N.Y.S.2d 465, 470 (1970).

30. The capitalization of the rent is that amount which will indefinitely periodically generate the rent at the applicable interest rate. Capitalization can also be viewed as the present discounted value of the right to indefinitely periodically receive the amount to be capitalized. See

property at the time of condemnation, although many other methods are available and in use.³¹ In the case of the "bonus" value leasehold previously discussed,³² the gross condemnation award would be \$120,000 assuming a capitalization rate of one percent per month. Carving the lessee's award (\$4448.68) out of the gross condemnation award would leave \$115,551.32 for the lessor. This amount represents the present value of \$1000 per month (the contract rent) for the unexpired 25 months of the lease plus the present value of \$1200 per month thereafter, the value of the reversion.³³ The value of the lessor's interest in the rent is exactly what was bargained for: the present value of the *contract rent* for the unexpired term of the lease.

In the "negative" leasehold example,³⁴ capitalizing the fair rental value of \$700 per month would result in a gross condemnation award of \$70,000, all of which goes to the lessor.³⁵ However, the value of the lessor's interest in the rent is now only the present value of the *fair rental value*, not the contract rent, for the unexpired term of the lease. To account for these results, the rule would seem to be that the value of the lessor's rent is the present value of either the contract rent or the fair rental value of the property at the time of condemnation over the unexpired term of the lease, whichever is less. The lessee's award is either zero or the present value of the difference in the fair rental value and the contract rent over the unexpired term of the lease,

note 17 *supra*. See also Polasky 499-514 for an interesting discussion concerning which "rent" should be capitalized to determine the condemnation award, and whether land and building should be capitalized at different rates. In *In re City of N.Y. ex rel. James Madison Houses*, 17 App. Div. 2d 317, 323-24, 234 N.Y.S.2d 799, 806 (1st Dep't 1962), the court stated that: "[T]he largest significance was given to the capitalization of net income. This is not because that is the sole factor of even the weightiest in all cases. It is that . . . it is the 'surest index' of value in the ordinary case of income-producing property, held for income. Assuredly, this is so in the absence of a showing that the income is subject to distortion in reflecting value, or that the land is inadequately improved, or that some other circumstance explains why the rate of income is not indicative of market value based on current appropriate rates of return."

For a critical view of the capitalization method see Sengstock & McAuliffe, *What is the Price of Eminent Domain?*, 44 J. Urban L. 185, 221-22 (1967). See also *Arlen of Nanuet, Inc. v. State*, 26 N.Y.2d 346, 258 N.E.2d 890, 310 N.Y.S.2d 465 (1970) (error to capitalize projected net income under lease when construction not completed); *Levin v. State*, 13 N.Y.2d 87, 192 N.E.2d 155, 242 N.Y.S.2d 193 (1963) (not error to take into account the projected net rental under lease in arriving at value). See generally 4 Nichols § 12.3122; 5 *id.* §§ 19.1-.23; 1 Orgel §§ 177-78; 20 Buffalo L. Rev. 304 (1970).

31. See, e.g., 4 Nichols §§ 12.311 (sales as criterion), 12.312 (income as criterion), 12.3121 (profits as criterion), 12.3122 (rent as criterion), 12.313 (cost as criterion), 12.3141 (use as criterion).

32. See text accompanying note 20 *supra*.

33. This follows from the observation that the capitalization of \$1200 is the same as the present value of \$1200 for the unexpired term of the lease (representing the rental period) plus the present value of the right to receive \$1200 per month thereafter (representing the remainder) and that the former amount is the sum of the present value of \$200 per month and the present value of \$1000 per month over the unexpired term of the lease.

34. See text accompanying note 21 *supra*.

35. See text accompanying note 21 *supra*.

whichever is larger.³⁶ Thus, the impact of the "undivided fee" rule in a "negative" leasehold case is to deprive the lessor of the benefit of the bargain implicit in an advantageous lease,³⁷ while in a "bonus" value leasehold situation the "undivided fee" rule does not impair the lessee's right to the benefit of the bargain.³⁸

The foregoing discussion, concerned only with compensation for real property interests, leaves open the question of whether in a "negative" leasehold case the lessor is entitled to compensation from the condemnor for the loss of the contract right (to "rent" in excess of fair rental value) when the lease is terminated by operation of law. The lessor cannot rely on this contract because the exercise of the power of eminent domain does not result in the impairment of contracts where the subject matter of the contract is condemned or requisitioned: the contract is either appropriated as a result of the condemnation,³⁹ in which case "just compensation" is required for the

36. In the event of a "negative" leasehold the present value of the right to receive the difference in the fair rental value and contract rent over the unexpired term of the lease is negative, so zero is the larger value. If the lease has a "bonus" value, then zero will be the smaller value.

37. In comparison, in jurisdictions applying the majority rule in partial condemnation cases, see note 7 *supra*, the lessor's benefit of the bargain, if there is one, is preserved since the lessee remains liable for the unabated rent. 2 Nichols § 5.23[3], at 96. However, since the lessee is entitled to all of the condemnation award for the period covered by the lease, see 4 *id.* § 12.42[3], at 499, the right to the unabated rent is now secured only by the property remaining after condemnation, which could operate to the prejudice of the lessor in the event the lessee fails financially or otherwise. See 2 *id.* § 5.23[3], at 98-99. Compare *Gluck v. Mayor & City Council*, 81 Md. 315, 324-25, 32 A. 515, 516-17 (1895) (no abatement), discussed at note 80 *infra*, with *Mayor & City v. Latrobe*, 101 Md. 621, 61 A. 203 (1905) (abatement necessary to do justice; 99 year lease with perpetual right to renew; $\frac{3}{4}$ of the property condemned, yet remaining property sufficient to secure the rent).

Mass. Gen. Laws Ann. ch. 79, § 24 (1971) provides for the trusteeship of the condemnation award under such circumstances. The lessor's rent is periodically paid out of the trust and any excess due to earnings is periodically paid to the tenant. The principal is paid over to the lessor at the termination date of the lease. See *Pierson v. H.R. Leonard Furniture Co.*, 268 Mich. 507, 525-27, 256 N.W. 529, 534-35 (1934), where the court fashioned its own version of the Massachusetts trust to protect the lessor.

38. Theoretically, the displaced lessee should be able to find equivalent facilities in the neighborhood at a rental equal to the rent reserved in the terminated lease plus the "bonus" rent, the difference in the fair rental value of the property at the time of condemnation and the rent reserved in the lease. By appropriately investing the portion of the condemnation award for the taking of the leasehold interest, the lessee should be able to periodically withdraw, for the unexpired term of the terminated lease, an amount equal to the "bonus" rent. If the lease has no "bonus" value, then the lessee should be able to find comparable facilities in the neighborhood at a maximum rental equal to that reserved in the terminated lease, since the lessee has contracted to pay above the fair rental value of the property at the time of condemnation. In such event the lessee is not entitled to compensation for the taking of the leasehold interest. See note 21 *supra* and accompanying text. See also 4 Nichols § 12.42[3], at 516.

39. E.g., *Long Island Water Supply Co. v. Brooklyn*, 166 U.S. 685, 691 (1897) (contract condemned pursuant to statute along with tangible and real property).

taking,⁴⁰ or the purpose of the contract is frustrated, performance being rendered impossible,⁴¹ and the contract is considered ended.⁴²

When real property is condemned,⁴³ it is generally considered that the purpose of the lease is frustrated,⁴⁴ and although the contract is property in the constitutional sense,⁴⁵ a taking/consequential damage distinction is made;

40. *Monongahela Nav. Co. v. United States*, 148 U.S. 312, 341, 343 (1893).

41. E.g., *Omnia Commercial Co. v. United States*, 261 U.S. 502, 511 (1923); note 60 *infra*.

42. *Omnia Commercial Co. v. United States*, 261 U.S. 502, 511 (1923). Whether there has been frustration or appropriation depends on whether the contract was coincidentally taken with the subject matter of the condemnation, or whether it was in fact an integral part of the subject matter of the condemnation.

In *Monongahela Nav. Co. v. United States*, 148 U.S. 312 (1893), the Court held that the condemnation of a lock and dam necessarily resulted in the taking of the franchise to exact tolls (along with the tangible property) and that just compensation required payment for the value of the franchise. In particular, the Court said that "before this property can be taken away from its owners, the whole value must be paid; and that value depends largely upon the productiveness of the property, the franchise to take tolls." *Id.* at 329.

Monongahela was distinguished in *Omnia Commercial Co. v. United States*, *supra* at 513. When the United States requisitioned the entire output of a steel plant before any deliveries could be made to *Omnia* under its contract with the steel producer, *Omnia* sued the United States claiming that its "property in the contract" was taken and that it was entitled to compensation under the fifth amendment. The Court rejected the argument that "the contract was so far identified with [the future product of the steel company] that the taking of the [future product], ipso facto, took the [former]." To do otherwise, according to the Court, would be "to confound the contract with its subject-matter." *Id.* at 510 (*italics omitted*).

It seems clear that the particular lease in a "negative" leasehold case is analogous to the contract to purchase steel in *Omnia*. Similarly, it appears accurate to equate the franchise to exact tolls in *Monongahela* with the implicit right to rent property owned in fee. When property is condemned, it would seem that the right to rent the property is so closely identified with the property that to take the former is to take the latter. This, however, would not operate to increase the lessor's award; it is accepted that compensation for the condemnation of real property must be based on the property's highest and best use, which necessarily would require consideration of its value as rental property. For example, in *Olson v. United States*, 292 U.S. 246 (1934), the Court offered the following guideline for determining fair market value. "The sum required to be paid the owner does not depend upon the uses to which he has devoted his land but is to be arrived at upon just consideration of all the uses for which it is suitable. The highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future is to be considered, not necessarily as the measure of value, but to the full extent that the prospect of demand for such use affects the market value while the property is privately held." *Id.* at 255-56 (*citations omitted*). See also note 65 *infra* and accompanying text.

43. Condemnation generally proceeds pursuant to statute, although the power to condemn is independent of any constitutional or statutory provision. See generally *Levey* § 3.02; 1 *Nichols* §§ 3.1[1], 3.2. See *Levey* 1467-814 for a state-by-state tabulation and summary of various statutory provisions. Similarly, statutes usually specify what kind of property is to be condemned, although the power to condemn extends to every classification of property.

44. See 4 *Nichols* § 13.33.

45. *Long Island Water Supply Co. v. United States*, 166 U.S. 685, 690 (1897). See also 4 *Nichols* § 13.33, at 194.

i.e., the loss to the lessor for the termination of the lease by operation of law is of a consequential nature for which "the law affords no remedy."⁴⁶

Although the subject of condemnation of property to a lease has often been discussed, the narrow question of compensation for the taking of property subject to a "negative" leasehold has only been raised in a few cases.⁴⁷ The remainder of this Note will consider the "negative" leasehold situation, in the context of a recent New York case, and alternative treatments for the compensation problems arising from the "negative" leasehold setting are given.⁴⁸ The New York case under discussion, *In re East New York [I] Community Development Plan Section II*,⁴⁹ involved the question of compensation to the lessor for the condemnation of property subject to a "negative" leasehold. Claimant, Willonia Amusement Co., rented its movie theater to Frizler Holding Corp.⁵⁰ in 1949 for a \$39,000 annual base rental, and Frizler in turn leased the theater to Metropolitan Playhouses, Inc., on the same day and for the same rental for a term of 26 years. In 1954 Metropolitan sublet the theater to Randforce Amusement Corp. for the identical rent and for the unexpired term of its lease with Frizler, less one day.⁵¹ In 1959 Randforce sublet most of the theater to Piel Bros., for use as a warehouse, for a term of ten years at a base rental of \$12,000 per year.⁵² Frizler and Metropolitan then

46. *Omnia Commercial Co. v. United States*, 261 U.S. 502, 510 (1923); note 60 *infra*. See generally 4 Nichols § 13.33.

47. See 1 Orgel §§ 123-24. Orgel suggests that the reason may be that "courts and juries are generally ready to assume an excess of rental value over rent reserved. This assumption is probably justified in most cases where the tenant has installed fixtures on the premises which add to their rental value Moreover, the disposition of a tribunal to find a substantial excess in rental value may be due to its recognition that a tenant would otherwise receive no compensation for removal costs and loss of business resulting from the enforced relocation." *Id.* § 124. The general rule is that relocation costs and the value of lost business are noncompensable consequential losses. See 4 Nichols § 13.3; 4A *id.* § 14.2471. Another probable reason for the existence of relatively few "negative" leasehold cases is the general trend for real estate values to increase in the United States. See also *Pierson v. H.R. Leonard Furniture Co.*, 268 Mich. 507, 514-15, 256 N.W. 529, 530-31 (1934) ("collapse of real estate values" in wake of depression); Kanner, *And Now, for a Word from the Sponsor: People v. Lynbar, Inc. Revisited*, 5 U. San Fran. L. Rev. 39, 56-57 (1970) [hereinafter cited as Kanner].

Orgel claimed in 1953 that he could find no cases directly on point on whether the condemnor must indemnify the landlord for the "lost opportunity to continue exacting a rent charge in excess of current rent value." 1 Orgel § 123.

48. See text accompanying notes 85-88 *infra*.

49. 45 App. Div. 2d 1007, 358 N.Y.S.2d 52 (2d Dep't 1974) (*per curiam*).

50. Frizler Holding Corp. was "a 'shell' corporation formed by [six fee owners each of whom owned one theatre] . . . solely for the purpose of acting as a conduit and enabling them to sublease those theatres in one transaction . . ." Brief for Appellant at 4, *In re East N.Y. [I] Community Development Plan Section II*, 45 App. Div. 2d 1007, 358 N.Y.S.2d 52 (2d Dep't 1974) [hereinafter cited as Brief for Appellant].

51. *Id.* at 5. It is, however, not clear why there was a sublease rather than an assignment.

52. There was also some question as to whether all the transactions were made at arms' length since Randforce's treasurer was also Willonia's vice president. Brief for Respondent at 7,

modified their lease and reduced the rent from \$39,000 to \$26,520 per year for part of the unexpired term, and subsequently, in 1962, extended the rent reduction to the remaining term of the lease.⁵³ When condemnation occurred in 1968 Piel Bros. was paying its \$12,000 to Metropolitan, which in turn paid its \$26,520 per year to Willonia. There was no question of the financial integrity of Metropolitan,⁵⁴ and Willonia would have received its contract rent for the unexpired term of the lease,⁵⁵ although there was evidence that "[b]etween 1964 and 1967, Metropolitan's failure to pay at least \$8,840 in rent was excused by the fee owner [Willonia]."⁵⁶

The question presented by the case was whether the condemnor's liability extended to the value of the property as enhanced by Willonia's advantageous lease with Frizler, *i.e.*, the value of the contract, or whether the "undivided fee" rule and the taking/consequential damage distinction limited the condemnor's liability to the value of the unencumbered fee.

The appellate division reversed the trial court,⁵⁷ which had refused to compensate Willonia for the value of lost rents under its prime lease with Metropolitan in excess of the current rental value, simply stating that

Willonia was entitled to recover its property's excess rental value because that sum [\$63,700] represented the value that Willonia would have received from Metropolitan pursuant to its lease with Frizler had condemnation not intervened⁵⁸

In re East N.Y. [I] Community Development Plan Section II, 45 App. Div. 2d 1007, 358 N.Y.S.2d 52 (2d Dep't 1974) [hereinafter cited as Brief for Respondent]. One of the objections to basing condemnation awards in whole or in part on contract rents—in addition to the fact that they may not reflect present rental values—is the danger that the contracts may be sham when not made at arms' length. See *Sifuentes v. United States*, 168 F.2d 264, 266 (1st Cir. 1948) (lease between family members in excess of reasonable rent).

53. "Since the conducting of a motion picture theatre in the area . . . was not economically feasible, Randforce, in an apparent attempt to reduce its rent obligation, subleased the major portion of the theatre premises to Peil [sic] Bros. for warehousing." In re City of N.Y. Acquiring Real Property for East N.Y. [I] PLAN, Index No. 8001/68, at 15 (Sup. Ct., Sept. 2, 1971), modified sub nom. In re East N.Y. [I] Community Development Plan Section II, 45 App. Div. 2d 1007, 358 N.Y.S.2d 52 (2d Dep't 1974) (per curiam).

54. At the time title vested in the condemnor Metropolitan's stock was 95.5% owned by United Artists Theatre Circuit, Inc., which was of undisputed financial integrity. 45 App. Div. 2d at 1007, 358 N.Y.S.2d at 53. Similarly, Randforce had been absorbed by United Artists. Brief for Appellant at 6.

55. 45 App. Div. 2d at 1007, 358 N.Y.S.2d at 53.

56. Brief for Respondent at 7. The respondent condemnor raised this point as well as the incorporate relationship between Randforce and Willonia (see note 52 *supra*) to question "whether (1) the property would have, in fact, been sold in the open market subject to the prime lease, or (2) a prospective purchaser would reasonably have relied on the continued payment of an exorbitant rent." Brief for Respondent at 7.

57. In re City of N.Y. Acquiring Real Property for East N.Y. [I] PLAN, Index No. 8001/68 (Sup. Ct., Sept. 2, 1971), modified sub nom. In re East N.Y. [I] Community Development Plan Section II, 45 App. Div. 2d 1007, 358 N.Y.S.2d 52 (2d Dep't 1974) (per curiam).

58. 45 App. Div. 2d at 1007-08, 358 N.Y.S.2d at 53 (citation omitted). In *In re City of N.Y.* (Midtown Highway), 285 App. Div. 1186 (2d Dep't 1955) (mem.) (3-2 decision) the fee owner was denied compensation for the seven years remaining on a lease for which there was evidence of a

The *Willonia* decision appears to be in direct conflict with the law of New York, which applies the "undivided fee" rule in condemnation cases,⁵⁹ and which recognizes the taking/consequential damage distinction with respect to contracts frustrated by the condemnation.⁶⁰

The phrase "excess rental value" used by the court in *Willonia*⁶¹ in justifying its decision may be defined as that portion of the contract rent that is attributable to the special purpose for which the property is leased and used.⁶² The specific case relied on by the appellate division in its discussion of "excess rental value" involved the condemnation of a large area of land of which one parcel was used as a gasoline station.⁶³ The condemnor claimed that the fair rental value of the property was \$14,000 per year, while the condemnee claimed the value to be \$18,000, which was the lease rent. In affirming an award based on the higher rent the court in this case stated:

[T]he [trial] court gave an additional credit for the value of the lease—admittedly a proper procedure. A lease for a rental in excess of the reasonable rental value may be considered as an item of value when the excess is due to the availability of the property for a particular use by the tenant in occupation Where these factors appear and the continuation of the lease is not threatened by any question of the tenant's responsibility, the present value of the excess for the period of the lease, plus renewals provided for therein, is an additional element of value.⁶⁴

The phrase "excess rental value" as used in New York would seem to connote a policy no different from that reflected in two generally applied rules in condemnation cases: first, that the condemnation award be based on the highest and best use to which the property can be put at the time of condemnation,⁶⁵ and second, that the criterion for valuing property taken is not what the condemnor has gained, but what the condemnee has lost.⁶⁶ This "bonus" rent of more than \$1000 per year. *Id.* (dissenting opinion). Apparently the reason was "that the lessee was not a highly rated financial risk." Brief for Appellant 17.

59. *Great Atl. & Pac. Tea Co. v. State*, 22 N.Y.2d 75, 84, 238 N.E.2d 705, 710, 291 N.Y.S.2d 299, 305 (1968) ("ascertain first the damages to the fee as if it were unencumbered").

60. *James Frazee Milling Co. v. State*, 73 Misc. 529, 131 N.Y.S. 23 (Ct. Cl. 1911) (claimant whose contract was frustrated when state condemned railroad right-of-way not entitled to compensation); cf. *In re Westchester County*, 204 Misc. 1031, 1038, 127 N.Y.S.2d 24, 31 (Sup. Ct. 1953), *aff'd mem.*, 285 App. Div. 1169, 141 N.Y.S.2d 824 (2d Dep't 1955) (loss of mortgage commitment and rights under work and materials contracts not compensable since not interests in realty).

61. See text accompanying note 58 *supra*.

62. See text accompanying notes 64 & 67 *infra*.

63. *In re Lincoln Square Slum Clearance Project*, 15 App. Div. 2d 153, 222 N.Y.S.2d 786 (1st Dep't 1961), *aff'd on other grounds*, 16 N.Y.2d 497, 208 N.E.2d 172, 260 N.Y.S.2d 439 (1965) (condemnation of land for construction of Lincoln Center).

64. *Id.* at 170, 222 N.Y.S.2d at 801 (citation omitted).

65. *St. Agnes Cemetery v. State*, 3 N.Y.2d 37, 41, 143 N.E.2d 377, 380, 163 N.Y.S.2d 655, 659 (1957) (highest and best use of condemned property is as a cemetery). See generally Searles, *Highest and Best Use: The Keystone of Valuation in Eminent Domain*, 45 N.Y.S.B.J. 36 (1973).

66. *Kimball Laundry Co. v. United States*, 338 U.S. 1, 13 (1949) (measure is loss to owner, not the gain to the taker); *Fonda, J. & G.R.R. v. State*, 29 App. Div. 2d 240, 241, 287 N.Y.S.2d 134, 136 (3d Dep't 1968) ("fundamental question is what the owner has lost, not what the taker has gained"). See generally 3 *Nichols* § 8.61.

may be illustrated by the New York Court of Appeals' discussion of the phrase:

[T]he terms "excess rental" and "excess rental value" signify, not that the . . . lease rental . . . was "in excess" of the reasonable rent for the subject parcel used as a gasoline station, but that it was "in excess" of the amount that would be paid for a parcel not available for such gasoline station use. As the evidence establishes, the \$30,000 rental was neither unreasonable nor excessive⁶⁷

However, it is clear that in *Willonia* there was no "excess rental," at least not with respect to use of the property as a movie theater, since the property was no longer "available" for that use within the meaning of the rule,⁶⁸ and the highest and best use for the property at the time of condemnation was as a warehouse—the primary use of the property at the time of condemnation, and the use upon which the trial court based the condemnation award.⁶⁹

The question of the lessor's compensation in a "negative" leasehold situation has been discussed in a few other jurisdictions. In *People ex rel. Department of Public Works v. Lynbar, Inc.*⁷⁰ the California court rejected the theory that the application of the "undivided fee" rule was mandated by a statutory provision requiring that at the option of the condemnor the property first be valued as a whole before apportionment of the award.⁷¹ The court affirmed an award to the lessor made on the basis of the value of the property if sold subject to the existing lease.⁷² This was considerably higher than the value of the property as an unencumbered fee since the lease provided for a rent considerably in excess of the fair rental value of the property at the time of condemnation.⁷³ The court stated that to arrive at value "the property . . . must be valued as the condemnor finds it, including without limitation thereby, the state of its title, and in this case, the . . . leasehold."⁷⁴

Similarly, in a 1964 case⁷⁵ the Pennsylvania Supreme Court rejected the contention that a statute required application of the "unencumbered fee"

67. In re Port of N.Y. Authority (Lincoln Tunnel), 2 N.Y.2d 296, 301, 140 N.E.2d 740, 741, 159 N.Y.S.2d 825, 826-27 (1957) (condemnation of property for widening of Lincoln Tunnel).

68. In re City of N.Y. Acquiring Real Property for East N.Y. [I] PLAN, Index No. 8001/68, at 23-24 (Sup. Ct., Sept. 2, 1971), modified sub nom. In re East N.Y. [I] Community Development Plan Section II, 45 App. Div. 2d 1007, 358 N.Y.S.2d 52 (2d Dep't 1974) (per curiam).

69. Id. at 26-27.

70. 253 Cal. App. 2d 870, 62 Cal. Rptr. 320 (2d Dist. 1967). The issue was one of first impression in California. Horgan & Edgar, Leasehold Valuation Problem in Eminent Domain, 4 U. San Fran. L. Rev. 1, 27 (1969) [hereinafter cited as Horgan & Edgar].

71. 253 Cal. App. 2d at 879, 62 Cal. Rptr. at 327, interpreting Cal. Civ. Pro. § 1246.1 (West 1972). See also id. § 1248(1) (separate valuation of interests); Cal. Evid. Code § 817 (West 1966) ("a witness may take into account . . . the rent reserved . . . [in] any lease which included the property or property interest being valued . . .").

72. 253 Cal. App. 2d at 882-83, 62 Cal. Rptr. at 329.

73. Id. at 874, 62 Cal. Rptr. at 323-24.

74. Id. at 881, 62 Cal. Rptr. at 328. The case is discussed at length in two law review articles: Horgan & Edgar 26-31, and Kanner. The former is highly critical of the case, while the latter was written in response to the Horgan & Edgar article by the lessor's attorney.

75. *Garella v. Redevelopment Authority*, 413 Pa. 181, 196 A.2d 344 (1964).

rule.⁷⁶ The court indicated that if worthless property could be leased for a long term to a financially responsible tenant at a considerable rental, so that applying the "unencumbered fee" rule would result in zero value, it would nonetheless approve an award based on the capitalized value of the contract rent.⁷⁷

However, in *Commonwealth, Department of Highways v. Sherrrod*,⁷⁸ the Court of Appeals of Kentucky considered the effect of condemnation on property subject to a "negative" leasehold and reached a result opposite to that reached by the court in *Lynbar*:

Under the quoted ["undivided fee"] rule we think that if the owner of land has negotiated a lease that is advantageous to him (at a rental higher than the fair rental value), and therefore the property would sell for more than its normal market value, the excess over the normal market value must be considered a *profit* for which he is not entitled to be compensated in condemnation proceedings. He must be restricted in recovery to fair market value of the fee; otherwise he is being allowed to enhance the value of the property by distribution of the title among different persons.⁷⁹

There are difficulties with both the traditional approach reflected in *Sherrrod* and the liberal one taken in *Willonia* and *Lynbar*,⁸⁰ which have been

76. *Id.* at 187-89, 196 A.2d at 347-48.

77. *Id.* at 188, 196 A.2d at 348 (dictum). See also *City of Chicago v. Lord*, 276 Ill. 544, 115 N.E. 8 (1916), in which the court based its award to the lessor on the capitalized value of the average rent reserved under a long term lease to a financially responsible tenant, despite the "evidence that . . . other property in the vicinity was rented for comparatively less," and without discussion or mention of the "undivided fee" rule, or separate valuation. *Id.* at 552-53, 115 N.E. at 11. But in *Sifuentes v. United States*, 168 F.2d 264 (1st Cir. 1948), the First Circuit rejected the argument that "just compensation" required capitalizing the rents according to the custom in Puerto Rico when "the [lease] relied upon to establish rental value, was between members of a family group and the Government's expert witness testified that the rent paid under that lease was too high." *Id.* at 266.

78. 367 S.W.2d 844 (Ky. 1963).

79. *Id.* at 849.

80. Many courts may apply one rule rather than another in a particular condemnation case on a theory that the rules are simply tools to be used as required to reach the goal of "just compensation." See generally *United States v. Commodities Trading Corp.*, 339 U.S. 121, 124-25 (1950) (ceiling price of commodities under price control constituted "just compensation," even though their fair market value in an uncontrolled market would be higher); *United States v. Cors*, 337 U.S. 325, 332 (1949) (fifth amendment contains no fixed standard for determining "just compensation"); *United States v. Miller*, 317 U.S. 369, 373-74 (1943) (no general formula for measuring owner's indemnity).

There are some rules, for example the "undivided fee" rule, which are so basic and substantive that a jurisdiction should commit itself one way or the other. See *Gluck v. Mayor & City Council*, 81 Md. 315, 32 A. 515 (1895), where the court refused to abrogate the rule in partial condemnation cases that the lessee be given all the award attributable to the time period remaining under the lease, even when there was question of the security of the award in the lessee's hands (see note 7 *supra*). The court stated: "Obviously a principle, if sound, ought to be applied wherever it logically leads, without reference to ulterior results. That it may in consequence operate in some instances with apparent or even with real harshness and severity does not indicate that it is inherently erroneous. Its consequences in special cases can never impeach its accuracy." 81 Md. at 325, 32 A. at 517. Certain rules and formulas, such as those for

masked by the simple fact patterns of the litigated cases. These cases dealt with apportionment and compensation in "negative" leasehold situations between lessor and lessee. The courts apparently have not confronted the problem that would arise in a situation involving a sublessee and both a "negative" and "bonus" value leasehold.⁸¹ The effect of compensating the sublessee for the "bonus" value of his lease while not requiring the lessee to make compensation for the negative value of his leasehold, would be to charge the former amount to the lessor in the event the "undivided fee" rule is applied.

Commentators and courts seem only to have considered abandoning the "undivided fee" rule or the taking/consequential damage distinction to prevent the unjust compensation to lessors in "negative" leasehold cases.⁸² However, it may be demonstrated that, even if disposing of the "undivided fee" rule or the taking/consequential damage distinction is equitable to the condemnor in the simple lessor-lessee "negative" leasehold situation, this could lead to condemnor liability in excess of the value of the property as enhanced by a lease advantageous to the fee owner, because the sum of the "bonus" rents of the lessee and sublessees could exceed the fair rental value of the property at the time of condemnation.⁸³

valuing a leasehold, discussed *supra* notes 13-20 and accompanying text, are essentially procedural in nature and likely to lead to the same result when properly applied.

81. Assume that A leased property to B at a monthly rental of \$1000, but B sublet the property to C at a rental of \$300 per month, and that at the time of condemnation the fair rental value of the property had increased to \$700 per month. C as the owner of a leasehold having a "bonus" value, and under the majority law, would be entitled to the present value of the right to receive the excess of the fair rental value over the contract rent, or \$400, for the unexpired term of the lease with B. Under a strictly formal analysis B would be entitled to the present value of the right to receive the contract rent (in the lease with C) for the unexpired term of the lease, but this amount would simply pass to A, because of the lease between A and B. Under existing policy B would not be called on to compensate A for any excess in the contract rent (in the lease with A) over the fair rental value of the property at the time of condemnation. In this situation, however, under the "undivided fee" rule and the taking/consequential damage distinction, A stands to lose not only the benefit of the bargain with B. Unless B is required to be responsible for the value of C's benefit of the bargain with B, A may also be charged with this amount. This, however, raises the question of whether there is any reason to hold lessees responsible for "negative" leaseholds in one situation and not in another.

Even if there is no reason to treat lessee and sublessee differently, it may be argued that the lessor and sublessor should be treated differently in this situation since, presumably, the lessor could have provided either that the lessee not be allowed to sublet or assign, or that sublessees not share in any condemnation award. See generally M. Friedman, *Preparation of Leases* §§ 12, 12.1 (1962); 3A G. Thompson, *Real Property* §§ 1210-14 (1959). One answer to this argument is that the lessee could have made similar provision in the lease with the sublessee. Moreover, the purpose of these rules is to provide default provisions when the parties either failed to agree or did not consider the possibility of condemnation when the lease was made.

82. See, e.g., Kanner 50-88; Polasky 492; *Negative Leaseholds* 187.

83. Suppose A leased property to B for \$1000 per month, B subleased the property to C for \$500 per month and C subsequently subleased to D at \$1200 per month, and the fair rental value of the property at the time of condemnation was \$900 per month. If all the parties were to be compensated for the benefits of their bargains, while not requiring any party to pay for the

One approach to the problems presented is to change the rule respecting sublessees' rights to share in the condemnation award.⁸⁴ However, there seems to be no reason to distinguish their rights from those of original lessees, when such a solution would leave unchanged the rule that lessees enjoy the benefit of the bargain while lessors do not.

There are two solutions which would treat uniformly both lessors and lessees. Under the first, outstanding leases would be terminated along with the duty to pay rent, and all outstanding interests in the property would be merged in the fee owner before transfer to the condemnor.⁸⁵ Under this approach each lease would be treated as if it had a condemnation clause⁸⁶ (unless the parties explicitly manifested a contrary intent), which would have the effect of depriving all parties of the benefit of their bargains.⁸⁷

The second solution would preserve the "undivided fee" rule and the taking/consequential damage distinction and the benefit of the bargain for all parties by requiring that lessees and sublessees holding negative value leaseholds at the time of condemnation pay the difference in the amount they have contracted to pay in rent and the fair rental value of the property at the time of condemnation (or the amount contracted to be received in rent under a sublease).⁸⁸

Under these two solutions the condemnor would not be called on to pay for the value of any contract; he would only be responsible for the fair market value of the property at the time of condemnation, taking the value of the property for rental purposes into account, but disregarding any particular lease of the property, except to the extent that such lease may be probative of the value of the property at the time of condemnation.

Of these two proposed solutions the former is certainly the simpler and more easily administered: the fair market value of the unencumbered fee is found and awarded to the fee owner. No leaseholds or contracts are compensated unless the parties to the lease have agreed among themselves to the

negative value of his leasehold, then B and D would wind up with no compensation, since they have contracted to pay above fair rental value at the time of condemnation, while C would be entitled to the present value of \$300 per month over the unexpired term of the lease with D, and A would be entitled to the present value of the contract rent of \$1000 per month for the unexpired term of the lease with B. Thus, the condemnor would be liable for the present value of \$1300 per month for the unexpired term of C's lease with D, which exceeds even the maximum contract rent in any of the leases, clearly an undesirable result.

84. See text accompanying notes 8-9 *supra*.

85. Under the usual rule all outstanding interests merge in the condemnor when there is no condemnation clause. See *Corrigan v. City of Chicago*, 144 Ill. 537, 544-45, 33 N.E. 746, 747 (1893) (tenant's and landlord's interests pass to state; effect of total condemnation is "eviction by a paramount title, coupled with a conveyance by the owners of their respective rights").

86. See note 13 *supra*.

87. La. Civ. Code Ann. art. 2697 (1952) provides that in the event of condemnation, the lessee has no claim for damages for the termination of the lease.

88. The payment could be on a monthly basis, or in a lump sum, representing the present discounted value of future payments, or any other accommodation the parties may reach. In jurisdictions where the lessee's duty under the lease terminates by operation of law expressed in a statute, see note 7 *supra*, this would require legislative action.

contrary, but in no event is the condemnor concerned. The latter solution is more complicated, but not any more than the situation extant at the time of condemnation; parties must pay to the extent that they hold negative value leaseholds. Lessors and sublessors, lessees and sublessees not only are treated equally, but the benefits of the bargains are preserved. This solution would probably most closely approximate the intent of the parties when they entered into whatever leases and subleases were in existence at the time of condemnation.

Since the majority of jurisdictions already preserve the lessee's benefit of bargain, the statutory⁸⁹ extension of the rule to all interested parties would be more innovative than radical, and most important, disposes of inherent inconsistencies while preserving the expectation of the parties without surcharge to the condemnor.

Stephen Markstein

89. It would be unfair to change the rule by judicial decision and thus expose lessees to liability that was not contemplated at the time of leasing. Any change should be prospective, and should be ineffective with respect to leases entered into before the effective date of the legislation.