THE SUPREME COURT OF FLORIDA

JOHN S. TAYLOR, III,
MARY TAYLOR HANCOCK, and
JEAN TAYLOR CARTER,

Plaintiffs/Appellants,

vs.

THE FUSCO MANAGEMENT COMPANY,
f/k/a THE FUSCO CORPORATION,
a Connecticut corporation,

Defendant/Appellee.

Original

ANSWER BRIEF OF APPELLEE

ON CERTIFICATION FROM THE
UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT
CASE NO. 90-3288

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INTRODUCTORY STATEMENT

The question certified by the Eleventh Circuit is too broad, if it seeks one answer which would apply to every landlord-tenant option to purchase. Narrowing of the question will be proposed in this brief.

Consistent with the preference of members of this Court that the points in the Answer Brief correspond to those in the Appellants' Brief, Appellants' points, although not focusing on the Certified Question, will be answered seriatim. Additional points will then be stated, followed by a suggested rephrasing of the Certified Question.

As in Appellants' Brief, the Plaintiffs/Appellants will be generally referred to as "the Taylors" or "Lessors." When appropriate, the Taylors and their father or their father and mother will be cumulatively referred to as the same. Defendant/Appellee will be generally referred to as "Fusco" or "Lessee." When appropriate, it and its predecessor lessees will be cumulatively referred to as the same.

Page references to Appendix (App.) 1 to 6 are to the Appendix accompanying Appellants' Brief. Page references to Appendix (App.) 7 and Appendix (App.) 8 are to the Appendix accompanying this Answer Brief. The trial judge's MEMORANDUM opinion is App. 7 and the per curiam majority and the dissenting opinion of the District Court of Appeal in Lassiter v. Kaufman, now pending review in this Court, are App. 8.

Record references are to the volume, document and page in the Eleventh Circuit record transmitted to this Court. Page reference to arguments or statements of the Taylors are, unless otherwise indicated, to their Appellants' Brief in this Court. All emphasis is supplied unless otherwise indicated.

STATEMENT OF THE CASE AND OF THE FACTS[1/]

The Nature of The Case

This is a declaratory proceeding to establish whether, in setting the price to be paid by a Lessee seeking to purchase the Lessors' interest under an option to purchase contained in the parties' lease, appraisers should determine the value of the fee simple as encumbered by the lease, or, instead, as unencumbered by the lease.

The Course of the Proceeding

The Taylors commenced this case in the Circuit Court for Pinellas County, Florida, seeking to terminate the parties' 99-year lease. Fusco removed the action to the United States District Court for the Middle District of Florida and filed an answer with counterclaims, including Counterclaim Count IV which sought a declaration as to the proper interpretation of the parties' option-to-purchase clause. The Taylors in their Answer and Defenses joined issue on Counterclaim Count IV.

All other issues between the parties were settled and dropped, and a one-day nonjury trial on Count IV ensued. Both sides were afforded an opportunity to submit evidence. Fusco submitted expert testimony. Taylors declined to submit any evidence. Both sides

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1/ Because Appellants' Statement of the Case and of the Fact does not follow the format of Florida Rules of Appellate Procedure 9.210(b), and because it either misstates or omits certain important facts, Appellee submits this Statement of the Case and of the Facts.

orally argued the matter, submitting briefs and proposed findings of fact and conclusions of law.

Disposition in the Lower Tribunal

The trial judge entered a comprehensive Memorandum opinion [R 3-71, App.7], containing findings of fact and conclusions of law, and addressing and rejecting the arguments presented by the Taylors. The trial court found the parties' intention to be that, upon exercise of the Lessee's option to purchase, the Lessee would purchase the Lessors' encumbered leased fee estate and, therefore, the price to be paid would be the appraised valuation of the Taylors' interest, subject to and burdened by Fusco's 99-year lease. [App. 7, p.14; R3-71-14]. Final Judgment was entered in favor of Fusco and against the Taylors, [App. 3; R 3-71-15], concluding:

> IT IS DECLARED that, upon Lessee's exercise of the option to purchase as set forth in Paragraph 11 of the Lease Agreement, Lessors' interest in the property is to be appraised as encumbered by the Lease Agreement and shall be so appraised.

The Federal Appellate Proceedings

The Taylors appealed to the Eleventh Circuit Court of Appeals. Briefs were submitted by both parties. The case was advanced on the calendar and was orally argued before an Eleventh Circuit panel. Before rendering a decision, the Eleventh Circuit certified the following question of Florida law to this Court [App. 6, p.4]:

> WHETHER THE FAIR MARKET VALUE OF LEASED PROPERTY AT THE TIME A LESSEE EXERCISES AN OPTION TO PURCHASE THE PROPERTY IS THE VALUE OF THE FEE SIMPLE ESTATE UNENCUMBERED BY

THE LEASE OR THE VALUE OF THE FEE ESTATE ENCUMBERED BY THE LEASE.

In so certifying its question, the Eleventh Circuit added [App. 6, p.4]:

> We do not intend the particular phrasing of this question to limit the Supreme Court of Florida in its consideration of the issue posed by the case.

The Facts

The Taylor family has long owned acreage in Clearwater, Florida, upon which there was once an orange grove, later destroyed by a freeze, part of which was and is low-lying. [R2-26-10]. At least as early as March of 1962, the Taylors' father ("Taylor"), acting on behalf of the family, commenced negotiations to lease the land to a New Yorker, Leonard L. Farber, who was a shopping center developer and broker. During the ensuing negotiations, which extended over a period of approximately one and one-half years, Taylor consulted with the family's lawyer and certified public accountant.[2/] [R2-26-11].

After negotiating at arms length, Taylor as Lessor and Farber as Lessee in 1963 entered into a 99-year Lease Agreement (the "Lease Agreement" or the "Lease") of the undeveloped property. [R1-1-10; R2-26-11]. The Lease required the Lessee to make substantial improvements, including construction of a shopping center, at the Lessee's

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2/ Taylor was experienced and expert in business and real estate, and was also a bank officer-director (Deposition of John S. Taylor, III, page 17, [R1-1-13, No. 1]; he was a knowledgeable businessman and banker (Deposition of Mary Taylor Hancock, page 5, [R1-1-13, No. 2]; and he admittedly explored all avenues and studied all points, which he discussed fully with his lawyer and accountant (Deposition of Richard A. Leandri, pp. 15, 17, 23, 27 and 30, [R1-1-13, No. 6]. The Taylors cannot, and do not deny, that he chose a percentage of tenant rents to adjust future rental income instead of a periodic reappraisal or a cost-of-living adjustment.

expense. [R1-1-11]. The Lease further contained the following option provision whereby the Lessee could "purchase the premises" based on an appraisal, at a minimum net price of $720,000 [part of App. 5, p.11; R1-120]:

> 11. The Lessee shall have the option to purchase the premises from Lessors at any time within three (3) years from the date of commencement of rent under the lease, at a sum of not less than $720,000.00 net to Lessors and the Lessee shall have the further option to purchase at any time thereafter during the term of the lease, upon an appraisal made by three competent local MIA Appraisers, one of whom shall be appointed by Lessors, one appointed by Lessee, each of whom shall mutually select a third such appraiser, but in no event shall the sum be less than $720,000.00 net to Lessors, their heirs or assigns, and Purchaser to assume all unpaid mortgage obligations against said property.

No definition of "the premises" was provided by the Lease, and no specific guidelines were given for the methodology to be followed in appraising "the premises" upon exercise of the option by the Lessee. Paragraph 11 is silent as to whether "the premises" are, or are not, to be valued subject to the Lease encumbrance.

The next clause (Paragraph 12) of the Lease provides a first refusal in favor of the Lessee, as follows [part of App. 5, pp. 11-12; R1-1-11 to 12]:

> 12. The Lessors further agree that they will not sell the demised premises during the first three years after the commencement of rental payments and that thereafter, during the entire term of this lease, if Lessors receive a bona fide offer to purchase the demised premises, any contract which may be entered into between the Lessors and such bona fide purchaser shall provide that such contract shall be subject to the Lessee's right of first refusal hereinafter set forth. And in event of any sale to anyone other than the Lessee herein, the sale shall be subject to the lease and affirmed by the purchasers. The Lessee shall have the option, to be exercised within thirty (30) days after receipt by Lessee of written notice of the general terms of such offer, to enter into a contract with the Lessors on the same terms and conditions as said offer to purchase the demised premises in accordance therewith.***

Once the property was rezoned for the uses provided in the Lease, the Lessee's interest was assigned to Gambest Corp., which erected the first phase of improvements known as the Sunshine Mall, a then "state-of-the-art" enclosed Mall, with a grand opening in September of 1968. [R2-26-11]. In 1972, the Taylors, as Lessor, entered into a Fourth Modification of Lease [R1-1-52] with Gambest Corp., as Lessee, contemplating the acquisition by Fusco of Gambest's leasehold interest in the Mall and the addition by Fusco of a second phase to the Mall. [R2-26-12].

As so modified, there was no prohibition against further assignment. On the contrary, under the Fourth Modification, the Lease is freely assignable, without the Lessors' consent, to any business entity which is owned or controlled by the Fusco Group, or to immediate members of their respective families [part of App. 5, 3rd page; R1-1-54, amended paragraph 25]. Further, the lease, as modified, does not prohibit separate assignment of the option to purchase, without any assignment of the balance of the Lessee's leasehold interest.

After Fusco thus acquired the Lessee's interest, including the options provided in the Lease, it added approximately 60,000 square feet of improvements, resulting in an aggregate of approximately one half million square feet of shopping mall. [R2-26-12]. The investments by Gambest and by Fusco in improvements upon the property, as required by the lease, reached many millions of dollars.

Fusco has not yet exercised its option to purchase. Currently, the contract rentals payable under the Lease, which were set before the improvements were made, are below prevailing market rentals. [R2-26-23; App. 4, Morning, pp.39-40; R6-68-39 to 40; App. 7, Afternoon, p.3 at n.2; R3-71-3 at n.2]. Accordingly, exercise of its option at a price

measured by the value of the property unburdened by the lease would be to Fusco's great financial disadvantage. For Fusco, "the most beneficial effect" will be to value it as burdened by the Lease.

In appraisal terminology, "property", which constitutes a bundle of rights, is, when leased, a combination of the leased fee estate owned by the Lessor and the leasehold interest owned by the Lessee. The value of a leased fee estate, when burdened by a below-market lease, is the value of the unencumbered fee less the value of the leasehold estate, namely the value of the present right to receive the contract rent from the Lessee plus the present value of the revision. [App. 4, Afternoon, pp.9-10,14, 22; R7-6-9 to 10, 14, 22].

SUMMARY OF ARGUMENT

The provision for appraisal, upon exercise of the Lessee's option "to purchase the premises", ambiguously failed to define the word "premises". Also, the Lease did not direct whether or not the appraisers should value the Lessors' interest subject to the burden of the Lessee's leasehold interest. Accordingly, the parties' intent must be determined by examining the rest of their Lease and the surrounding circumstances.

Their Lease contains a further provision, which gives the Lessee a first-refusal, clearly calling for a sale subject to the burden of the Lessee's leasehold. This supports rather than opposes similar construction of the parties' option provision.

The Lessors assert that under the common law of Florida, upon exercise of the Lessee's option, its leasehold would automatically merge into the fee. Thus, they say the "premises" to be appraised would be unburdened by the leasehold. This position ignores Florida's time-honored equity decisions which in the absence of a clear intent to the contrary, presume no such merger if it would result in economic disadvantage to the party in whom the greater and the lesser property interest combine. This presumption unquestionably supports the Lessee's position that valuation here should consider the burden of the below-market Lease.

Besides the language of the Lease in the two relevant provisions, the Lessee's position is strongly supported by the surrounding circumstances when the Lease was executed, the existing law at the time, and existing custom, usage and practice.

Several Florida District Court of Appeals opinions cited by the Lessors [Palm Pavilion of Clearwater v. Thompson, 458 So.2d 893 (Fla. 2d DCA 1984), rev. den. 464 So.2d 555 (Fla.

1985); Lassiter v. Kaufman, ___ So.2d ___, 1990 Fla.App. Lexis 880, and formerly 15 Fla. L. Week. 419 and 1990 WL 11118, on rehearing 563 So.2d 209, now pending review in Florida Supreme Court; and Simpson v. Fillichio, 560 So.2d 331 (Fla. 4th DCA 1990), in contrast with Contos v. Lipsky, 433 So.2d 1242 (Fla. 3d DCA 1983) are distinguishable from this case both on the law and the facts. None of them supports the Lessors' contention, based on merger or otherwise, that the parties' intent was for an appraisal unencumbered by the Lease.

Adapted to the present case, the question certified by the Eleventh Circuit should be answered that valuation is of the fee estate encumbered by the Lease.

ARGUMENT

First Point: THE VALUE OF THE LESSORS' INTEREST IN LEASED PREMISES AT THE TIME THE LESSEE EXERCISES ITS OPTION TO PURCHASE THE PREMISES IS, UNDER THE CIRCUMSTANCES, THE VALUE OF THE FEE SIMPLE ESTATE ENCUMBERED BY THE LEASE

In their Point I the Taylors begin their argument (page 4), as they have done at earlier stages of this case, by urging that three out of four reported decisions of Florida's District Courts of Appeal have, in valuation controversies between landlords and tenants under lease-options, decided in favor of the landlord and against the tenant. The three decisions have indeed held, under the particular lease-option provisions and facts of each

case, that valuators should not deduct the burden of a below-market lease.[3/] Here, however the trial court properly refused to rule in a vacuum and instead looked to the parties' intent as ascertained from the terms of their Lease and the surrounding circumstances. It was on that basis that the trial court rejected the inflexible merger rule urged by the Lessors and instead construed the parties' Lease in accordance with the court's finding as to their intent.

Dealing specifically with the Taylor-Fusco Lease, the Taylors argue (page 6) that the word "premises," contained in paragraph 11 of the Lease, means on its face the unencumbered real estate described in the Lease. They rely simplistically, as they did before the trial court, upon a dictionary definition of the word "premises." At trial, they had represented to the trial judge in their Proposed Findings of Fact and Conclusions of Law (at R3-67-5) that:

> Black's Law Dictionary defines "premises" as the "lands and tenements; an estate, including land and buildings thereon." Black's Law Dictionary, 1063 (5th Ed. 1979).

[Note the period!] Using this partial quotation they argued that "premises," when used in isolation, means the "lands and tenements" or, in other words, the unencumbered absolute fee simple title to the total property unburdened by any lease.

After a mild rebuke by the trial judge for not completing the sentence (App. 7, pp.6-7; R3-71-6 to 7), and thus erroneously citing only a portion of the dictionary definition,

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3/ Each of the four reported cases [as cited in the Summary of Argument, pp.8-9] is analyzed at pages 26 et seq.

they now (at page 6) correctly, except for omitting a relevant citation, complete the sentence by changing the period to a semi-colon and adding the following:

> "the subject matter of a conveyance. [citation omitted.]"

The omitted citation is F.F. Proctor Troy Properties Co., Inc. v. Dugan Stores, Inc., 191 App.Div. 685, 181 N.Y.S. 786, 788 (1920). The Troy court, after referring to the elasticity of the word "premises," concluded that "premises" could "be held to mean only the right, title or interest conveyed; . . ." Quoting from Merchants' Bldg. Imp. Co. v. Chicago Exch. Bldg. Co., 210 Ill. 26, 71 N.E. 22, 27 (1904), which involved a leasehold rather than a fee simple title, the Troy court declared that:

> The term "premises" may or may not include land, but may be held to mean only the right, title, or interest conveyed; and its exact meaning, when found in contracts and conveyances, must be determined according to the intention of the parties as ascertained from the contract and the facts and circumstances attending its making.

Standing alone, the word "premises", as used in Paragraph 11 of the Lease, could mean either the entire unencumbered fee simple or only the leased fee estate of the Taylors. Hence, the trial court found that this ambiguity required construction of the parties' agreement and resort to traditional tools of construction: (i) analysis of the language used in the option clause and the rest of the Lease, (ii) existing law when the Lease was made regarding Fusco's intent if the option was exercised, and (iii) other surrounding

circumstances when the Lease was executed.[4/] The very dictionary authority so cited by the Taylors, and the precedents upon which it relies, confirm the correctness of the trial court's decision to determine the parties' intent "as ascertained from the contract and the facts and circumstances attending its making."

The Taylors do proceed (pages 6-8) to look beyond Paragraph 11 (the option clause) to Paragraph 12 (the first-refusal clause) of the parties' Lease. While they admit that a purchase under the first-refusal clause would be subject to the burden of the Lease, they say that a difference in meaning is justified, because paragraph 12 refers to "the demised premises," while Paragraph 11 refers only to "the premises". The trial judge readily rejected this unsupportable argument that these nearby terms in the Lease could have referred to two different "premises." The Taylors have not demonstrated any error in the trial court's reasoned conclusion that the word "premises" has the same meaning and effect under both clauses [App. 7, pp.7-8; R3-71-7 to 8]:

> Pursuant to ¶12, any third-party who purchased the "demised premises" would take subject to the remaining term of the lease. Therefore, by purchasing the "premises" under ¶12, the third-party purchaser would purchase the Lessors' leased fee estate. Basic canons of

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4/ "When interpreting contracts, the court must attempt to discern the intention of the parties at the time the contract was formed. If the parties' intent is not expressly set forth on the face of the document, the court must rely on other evidence to ascertain the contract's meaning. Such evidence may include a reasonable interpretation of the disputed contractual provisions' language, the circumstances surrounding the creation of the contract, the purpose of the transaction, and, of course, applicable court precedents addressing the particular category of contractual question." [App. 7, p.4 n.3; R3-71-4, n.3].

> construction caution that, absent evidence to the contrary, a term found in a contract, such as the term "premises", is presumed to have a common meaning in all contractual provisions wherein that term is used. Nothing in either paragraphs 11 and 12 themselves or in other provisions of the Lease Agreement indicate that the term "premises" in ¶11 means "fee simple" while the identical term as used in ¶12 means "leased fee estate." Because "premises" under ¶12 can mean nothing but "leased fee estate," it should be accorded that same meaning when used in other portions of the Lease Agreement including ¶11.

Nothing in the history of the transaction or within the four corners of the Lease or in logic or in common sense suggests that the parties intended two different meanings of the term "premises" as used in the two related paragraphs.

Second Point: THE MERGER DOCTRINE DOES NOT REQUIRE THAT THE TAYLORS' INTEREST BE VALUED AS IF THE PROPERTY WERE NOT ENCUMBERED BY THE LEASE

In their Point II (pages 8-9), the Taylors persist in their major legal argument, which has permeated their entire case from the beginning, that upon exercise by Fusco of the option its leasehold would automatically merge into the Lessors' fee and no longer be a burden on the fee for valuation purposes. They do not cite, nor can they cite, any Florida decision approving such an automatic rule.

Surprisingly, especially since they did not even mention it in their Appellants' Brief to the Eleventh Circuit, the Lessors now cite this Court's seminal opinion in Jackson v. Relf, 26 Fla. 465, 8 So. 184 (1890), for the old common law doctrine that merger would

automatically take place when a greater estate and a lesser estate in the same property coincide in the same person without any intermediate estate. "To argue to the contrary [say the Taylors at page 8] is to engage in a legal fiction", whereby Fusco would be required to pay itself rent after the purchase. "This Court [they say] should not endorse such a charade" (at page 9).[5/]

Perhaps in their reply brief the Taylors will confess that this Court's actual holding in Jackson rejects automatic merger. The strict common law doctrine of automatic merger has given way to principles of equity. As pointed out by the trial judge (App. 7, p.9; R3-71-9), Jackson in 1890 (8 So. at 185) joined an already uniform holding that under equitable principles the intention of the party in whom the interests combine should control:

> that whether a merger of property interests takes place, . . . depends upon the intention of the person in whom the interests are united . . . . Although now in its centennial year, the passing decades have only fortified the endurance of the rule expressed in Jackson. See, e.g., Walter J. Dolan Properties, Inc. v. Vonnegut, 133 Fla. 854, 184 So. 757 (1938); Contos v. Lipsky, 433 So.2d 1242, 1245 (Fla. 3d DCA 1983); Gourley v. Wollam, 348 So.2d 1218, 1220 (Fla. 4th DCA 1977); Friedman v. Pohnl, 143 So.2d 690, 691 (Fla. 3d DCA 1962) (per curiam)[6/].

5/ If there is a "charade" in this case, it is the Taylors' attempt to sell and be paid for more than they now own.

6/ More recently the same presumption, in a mortgage-judgment lien situation, was upheld by the Second District Court of Appeal. Ennis v. Finanz Und Kommerz-Union Etabl., 565 So.2d 374 (Fla. 2d DCA 1990). The opinion was authored by Judge Lehan, who had six years previously authored Palm Pavilion of Clearwater, Inc.
(continued...)

The trial court further (pages 9-10) pointed to the Jackson holding that, absent evidence of that party's intention, there is a presumption he intended the result most beneficial to him:

> In an oft quoted passage, the Jackson decision delineated specific procedures, applicable herein, to determine the acquiring party's intent to merge acquired interests in given realty. The supreme court reasoned: . . . that intention is to be determined by [the acquiring party's] declarations at the time, or, in the absence of these, by his interest, as shown in the condition of things then existing, or by the attending circumstances. When there is no evidence of the intention of the owner in uniting the legal and equitable estates in himself, it is proper to presume that he intended that effect which is the most beneficial to him. Id. at 8 So. at 185; accord., e.g., Contos v. Lipsky, supra, 433 So.2d at 1244-45.

It is historically interesting that this Court's Jackson opinion in turn had relied (at page 185) on the decision in Factors' and Traders' Ins. Co. v. Murphy, 111 U.S. 738, 4 S. Ct. 679 (1884). At that even earlier date the highest court in the United States (at page 681-682) stated that in equity "it has been uniformly held that where an incumbrancer, by mortgage or otherwise, becomes the owner of the legal title or of the equity of redemption, the merger will not be held to take place if it be apparent that it was not the intention of the owner, or if in the absence of any intention said merger was against his manifest interest

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[6]/(...continued)
v. Thompson, 458 So. 2d 893, upon which the Taylors rely.

. . . 'The question is always upon the intentions, actual or presumed, of the person in whom the interests are united.'"

Besides the long line of anti-merger cases involving mortgagors and mortgagees, there is seasoned precedent to the same effect in the landlord-tenant relationship. In William P. Rae Co. v. Courtney, 250 N.Y. 271, 165 N.E. 289 (1929), a case practically on all fours with this case, Chief Judge Cardozo and his distinguished colleagues followed exactly the same anti-merger rule. In the landlord-tenant decision of Contos v. Lipsky, 433 So.2d 1242 (Fla. 3d DCA 1983), which the trial judge in the present case accepted as good Florida law, the court relied appropriately on the Rae case.

In none of these cases, spanning more than a century, was it considered "legal fiction" or a "charade" to hold against merger because the unmerged mortgagor might be expected to make mortgage payments to itself as mortgagee or the unmerged tenant might be expected to pay rent to itself as landlord. The trial judge, in response to this desperate argument of the Taylors, said that it would not be any of the Taylors' business what Fusco might do after exercising its option. [App. 4, Morning, p.35; R6-68-35]

Another scenario exemplifying "the irrationality of the lessors' position" has been suggested (1) by Judge Downey, the dissenting judge in Lassiter v. Kaufman, Fla. App. Lexis 880, 15 Fla. L. Week. 419 (Fla. 4th DCA, Feb. 14, 1990 (App. 8, 3rd page), review pending in this Court, (2) by the trial judge in this case [App. 4, Morning, pp. 31 et seq.; R6-68-31 et seq.], and (3) by discussion at the oral argument before this Court in its pending review of the Lassiter case. Under their approach, instead of exercising the option itself, the Lessee could first assign the option to a third person, whose interest would not, upon exercise of

the option, combine the leasehold with the fee. City of New York v. Pymm Thermometer Corp., 135 Misc. 2d 565, 515 N.Y.S.2d 949, 952 (N.Y. City Civ. Ct. 1987). There being no prohibition in the Taylor Lease against assignment to selected assignees, and no prohibition against assignment of the option separate from the leasehold interest, the Lessee's option to purchase contained in the Lease may be separately assigned. Spaulding v. Yovino-Young, 30 Cal. 2d 138, 180 P.2d 691 (1947); Holmes v. Harris, 33 N.J. Super. 395, 110 A.2d 329 (1954); and Meyers v. Epstein, 31 Leh. L.J. 311 (Pa. Com. Pl. 1963). This scenario would enable a Lessee, such as Fusco or its assignee, to avoid any technical merger of the fee and the leasehold upon exercise of the option and consummation of the purchase.

Lest this Court, irrespective of merger considerations, sympathize with the Taylors because of their unsupported and unargued claim of unfairness, the following language, quoted in Contos v. Lipsky, 433 So.2d 1242, 1246 (Fla. 3d DCA 1983), from William P. Rae Co. v. Courtney, 250 N.Y. 271, 165 N.E. 289, 290-291 (1929), is repeated here:

> To permit a merger of the plaintiff's leasehold estate would result in a loss to it of $30,000, the value of the unexpired term of the lease of sixteen years. To permit a merger under such circumstances would be contrary to justice and equity. It would require the plaintiff to lose the value of its lease and pay as much for the premises as a third party would have to pay. Its option would be worthless and the improvements which it had made in reliance thereon would be lost.

The Contos court, before quoting from Rae, had also put it a little differently (at 1245):

> A merger of the leasehold estate would result in a loss to the lessee of the value of her profitable annual fair return for the length of the unexpired term. Were merger to be permitted, the lessee would have to pay as much for the premises as any stranger to the lease transaction and lose the value of her lease and the improvements made in reliance on the lease. On the other hand, the owners would receive for their property in 1981 that which they would be entitled to receive only after the lease expired.

The same unfairness, multiplied into millions of dollars and some seventy years of unexpired lease term, would result in this case if Fusco were required to pay the Taylors for the unencumbered fee.

Third Point: THE OPTION IS WORTHLESS OR SUBSTANTIALLY REDUCED IN VALUE IF THE TAYLORS' INTEREST IS NOT VALUED AS ENCUMBERED BY THE LEASE

In the Taylors' Point III (page 9) they speculated that Fusco would argue, undoubtedly based on the above quoted language from the Rae and Contos cases, that its option would be worthless if Fusco were required to pay the value of the Taylors' fee as if it were unencumbered by Fusco's lease. They emphasize that the Lessee paid no separate consideration for the option to purchase, although they do not deny that the Lessee bargained for it in negotiating with their father.

Nor could they deny that Lessee improvements greatly increased the value of the property. If the option price were for the property unencumbered by the Lease, Fusco

would indeed lose the benefit of the option for which the Lessee had bargained and would instead be required to pay the greatly enhanced value that resulted from the very substantial improvements made by the Lessee to the property at its sole expense.

The Taylors' "concession" (at page 9), that Fusco has a valuable option even if it could only compel the Taylors to sell out for market value unburdened by the Lease, is hardly meaningful. It certainly is not what the Lessee bargained for or why the Lessee made such a large investment in the property.

Fourth Point: THE PRICE PAID BY A THIRD PARTY SHOULD NOT BE LESS THAN THE PRICE PAID BY THE LESSEE

The convoluted reasoning in the Taylors' one-paragraph Point IV (page 10), again citing no supporting authority, seems to argue that Fusco should be willing to pay more for the Taylors' interest in the property than a third person would pay. Clearly, Fusco has no reason to pay more, in light of the Lessee's arms-length bargain of its option. If anything, it should hope to pay less, in light of its investment and risk over the years, although the Taylors would always be entitled to the $720,000 minimum for which their father had bargained.

The concluding three sentences in point IV merely repeat the Taylors' discredited merger argument.

Fifth Point: IF THE LESSEE WERE TO PAY A PRICE FOR THE FEE UNBURDENED BY THE LEASE IT WOULD BE PAYING AGAIN FOR ITS LEASEHOLD ESTATE

In their Point V the Taylors' premise is again that a merger will result if Fusco exercises its option (page 10). It follows, they say (pages 10-11), that Fusco will not be buying the leasehold estate which it already owns. This is entirely illogical.

They further say (page 10) that the appraisers should not include the value of the Mall improvements made by the Lessee. Indeed, this is a remarkable concession. It has not been heretofore suggested in any pleading or any prior brief or argument in this case. No precedent is cited for any such approach. It is, of course, complete acknowledgment that the "premises" do not constitute the land and tenements unencumbered by the Lease. The Taylors' earlier analysis of the meaning of the "premises" as being synonymous with the "property" is utterly inconsistent with a division of the improvements from the real estate. At the end of the lease term those improvements would revert to the Taylors. In contrast, no such inconsistency arises if the Taylors' interest is valued by reference to the stream of income from the rents and the reversion in the land and buildings. This concession by the Taylors recognizes that the Certified Question cannot be answered without reference to the applicable underlying lease. More importantly, it recognizes that equitable considerations should apply.

Sixth Point: EQUITY REQUIRES THAT THE TAYLORS' INTEREST BE VALUED AS ENCUMBERED BY THE LEASE

The Taylors finally reach the equity issue in their last point, Point VI (pages 11-12). They say Fusco should not be allowed to profit at their expense, for an (unestablished) "unconscionable price" because it is "only logical" that the Lessors would sell their interest to Fusco at the fair market value. This again begs the question. What was the optioned interest of the Lessors?

The Taylors do now recognize that the "subject-matter" of Fusco's option, which is to be sold, bought and valued, is the Taylors' "interest."[7/] Their interest, all they have had to sell, either to Fusco or to a third party, is their leased fee estate, encumbered by the lease.

All equity arguments favor Fusco. The very foundation of the presumption against merger is that equity interposed the presumption to prevent inequitable consequences of merger.

The most significant equitable consideration is the improvement of the property, made at Lessee's great expense, as contemplated and mandated by the Lease. This equitable consideration was stressed in both Rae and Contos. It is significant that the Palm Pavilion court specifically distinguished Contos, not only because there was ambiguity in the Contos lease, but because there were "equitable considerations in Contos which do not exist here." 458 So.2d at 894. This can only be a reference to the significant improvements made

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7/ Four times at page 2, five times on page 3, five on page 4, several on page 7, once on page 8, and finally on page 11.

by the Contos lessee. How could it be equitable to require a lessee, on exercise of the option, to "pay for the buildings twice," which would be exactly what would happen if the option price were to be at the improved fee simple value unburdened by the lease.

Fusco should not be required to pay an excessive price for Taylors' interest in the property. To pretend that the Taylors had an unencumbered fee simple interest in the property would produce a most inequitable result, especially adverse to Fusco's economic interests. As observed by the trial judge [R3-71-3, FN. 2], "[i]t is beyond doubt that the value of the property appraised as a fee simple is significantly greater than the worth calculated by subtracting from the fee the burden of the over seventy years remaining under a lease which generates below-market value rents."

Seventh Point: THE PRESUMPTION, UNREBUTTED BUT ACTUALLY SUPPORTED BY THE RECORD, IS THAT THE TAYLORS' INTEREST SHOULD BE VALUED AS ENCUMBERED BY THE LEASE

The Taylors have not borne their burden, in the face of an unquestionably ambiguous use in Paragraph 11 of the isolated word "premises", to rebut the presumption favoring Fusco. Their reliance, to resolve the ambiguity, upon the contrasting use of the word "leased" before the word "premises" in their Lease's paragraph 12 first-refusal provision, is insufficient to rebut the presumption against merger and in turn against valuation of the Lessors' interest as if it were unencumbered. So is their unfounded unconscionability argument.

In addition to the facts presented in the Pre-Trial Stipulation, the trial court ruled that it would receive expert testimony which might bear on the contracting parties' intent.

[App. 4, Morning, pp.59,67,70; R6-68-59, 67, 70]. The Court subsequently heard expert testimony from Fusco's expert on the prevailing custom and practice in appraisal methodology for valuing leased property. [App. 4, Afternoon, pp.9-11, 13 et seq; R7-69-9 to 11, 13 et seq.]. The Taylors offered no evidence at all.

The presumption sustaining Fusco's intent to buy and pay for only the encumbered fee, instead of being rebutted by the Taylors, has been sustained by reviewing the entire Lease and the surrounding circumstances, as follows:

(i) **The Language of the Lease**

As argued above, the language of the Lease, combining Paragraphs 11 and 12, supports the presumption.

(ii) **The Surrounding Circumstances When the Lease Was Executed**

The Taylors started with burned-out orange grove acreage, partially low lying. Their father, quite knowledgeable and well advised, chose a percentage rent type of escalator clause instead of a periodic reappraisal or cost-of-living formula to control future rentals in the event of inflation (note 2, supra, page 5). Irrespective of future rental income, a minimum net option price was set at $720,000, protecting the Taylors against deflation. The Lessee was required to build an expensive Mall on the land entirely at its own expense.

(iii) **The Existing Law at the Time of Contracting**

The next, and perhaps most significant, consideration in determining the parties' contractual intent is the then prevailing law on the issue of merger of title upon the exercise of a lease option to purchase. The applicable law at the time of contracting is a vital circumstance to be considered. As stated in Saint Paul-Mercury Indemnity Co. v. Rutland,

225 F.2d 689, 692 (5th Cir. 1955), when dealing with possible ambiguities of an insurance contract:

> Of course, the existing law, including judicial precedents, must be read into all contracts; and we must now consider the present [contract] in the light of prior cases.

Citing Florida decisions to the same effect, the trial judge expressly found [R3-71-10]:

> In the absence of contrary evidence, I find that an appropriate inference is that the original contracting parties intended the Lease Agreement to conform within the scope of Florida's controlling and applicable legal principles. Cf. Southern Crane Rentals, Inc., v. City of Gainesville, 429 So.2d 771, 773 (Fla. 1st DCA 1983); Wilcox v. Atkins, 213 So.2d 879, 881-82 (Fla. 2d DCA 1968). [R3-71-10].

The Taylors cannot, and do not, dispute that the law of merger, as it existed at the time of contracting, was incorporated in the parties' intention when they agreed upon their option provision. Then, as now, it was and has remained the controlling Florida law that there would be no automatic merger in a case such as this, because the law presumes that the acquiring party would not intend such a result if it would adversely affect his interests. The same was clearly true under the law of New York, where Farber resided and where the Rae case, similarly involving the word "premises," had been previously decided.

(iv) **Existing Custom, Usage and Practice**

In addition to the then existing law of merger, the contracting parties must also have contemplated relevant custom, usage and business practice. Where knowledgeable parties have not otherwise clearly expressed themselves, the custom in the applicable trade

is a circumstance to consider in determining their intent and is by implication incorporated into their contract. Fred S. Conrad Construction Co. v. Exchange Bank of St. Augustine, 178 So.2d 217, 221 (Fla. 1st DCA 1965); Eustis Packing Co. v. Martin, 122 F.2d 648 (5th Cir. 1941); Edward E. Morgan Co. v. United States, 230 F.2d 896, 902 (5th Cir.), cert. den., 351 U.S. 965 (1956); Fifteenth Avenue Christian Church v. Moline Heating & Construction Co., 131 Ill. App. 2d 766, 265 N.E.2d 405, 508 (Ill. App. 2d 1970) (professional engineering custom and usage).

While not specifically relied upon in the trial Judge's opinion [App. 7; R3-71], he did hear the testimony of Fusco's expert on appraisal methodology. The expert testified as to the prevailing custom and usage, which is followed in making appraisals, except when specifically directed otherwise by the parties -- upon the division of property interests by a lease, to value the unencumbered fee and deduct from it the value of the Lessee's leasehold interest, leaving as a balance the value of the Lessor's estate, now known as a leased fee estate, which would thus be appraised at the value of the present right to receive the contract rent from the Lessee plus the present value of the reversion. [App. 4, Afternoon, pp.9-10,14,22; R7-69-9 to 10, 14, 22]. He testified further that the use of the "income approach", the preferred approach in appraising income property such as shopping centers,[8/] would bring approximately the same result. [App. 4, Afternoon, pp.15-16; R7-69-15 to 16]. This uncontradicted testimony on custom and usage of appraisers further

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8/ Schultz v. TM Florida-Ohio Realty Ltd., 553 So.2d 1203, 1207-1210 (Fla. 2d DCA 1989), quashed and remanded on other grounds, ____ So.2d ____, 1991 WL 41504 (Fla. Sup. Ct. March 28, 1991).

supports the trial judge's finding that these parties intended for their appraisers to consider the burden of the Lease when valuing the premises.

Eighth Point: FLORIDA PRECEDENTS ARE NOT CONTRARY TO THE TRIAL COURT'S DECISION

Rather than directly addressing the trial court's finding with respect to intent, the Taylors argue that because some Florida courts have ruled, based on the particular facts presented to them, that a below-market lease should not be considered in valuing a Lessee's option to purchase, the trial court was compelled so to hold in this case. No Florida or other cited case has adopted such a rigid approach. Rather, each case has turned on the language used in the parties' agreement and the particular facts before the court. Considering each of the landlord-tenant option cases cited by both parties, there is no reason to accept the Taylors' argument.

The closest precedent is New York's Rae case where, as here, the parties used the word "premises" in their option clause, the lessee made substantial improvements as required by the lease, and there were years left of unexpired below-market rentals.

Contos, which relies on both Jackson and Rae, is very much the same. The Contos lease used the words "the leased premises." The lessee had leased a restaurant and related real estate under a long-term lease. During the lease term, the lessee made significant improvements to the property (although they were minuscule in comparison to the value of improvements made by Fusco and its predecessor Lessee), allowing the lessee to sublet the premises for a significantly greater rent than it was required to pay to the landowner. Given the absence of expressed intent concerning merger in the lease

documents or any evidence in the record from which an intent to merge could be implied, the Contos court applied the Jackson and Rae presumption that the lessee would act in its own best interest, thereby negating any merger and requiring that the below-market lease be taken into account in appraising the property.

The Taylors' effort to make this case the same as Palm Pavilion, by asserting that "premises" must mean "said property," as used in Palm Pavilion, and thus be resolved in the same manner as Palm Pavilion, is without merit. Indeed, the Palm Pavilion court stated that the use of "premises" in Contos was one of the very reasons for the different outcome in those cases. The Palm Pavilion court specifically found no ambiguity in their lease, and also expressly distinguished Contos because of "equitable considerations in Contos which do not exist here [in Palm Pavilion]." 458 So.2d 894. The opinion makes no reference to lessee improvements on the property. For that reason, the Palm Pavilion court found no need to consider "whether, in the absence of any manifestation of intent, a merger of the leasehold interest and the fee would occur upon consummation of the purchase." Id. The same court more recently subscribed to the long-standing presumption against merger. Supra, note 5 on page 13.

The majority decision of the District Court of Appeal in the Lassiter case, currently under review by this Court, would not require a decision unfavorable to Fusco. The per curiam affirmance contains no discussion whatever of intent or merger, much less any explicit holding on those issues. Rather, the court simply affirmed on the basis of Palm Pavilion and, noting a "possible conflict" with Contos, identified a question to be certified to this Court that makes no reference to merger or to intent. The Lassiter clause is different,

in that it refers to "the fee title to the above described premises", although somewhat modified by other language in the lease. Accordingly, if this Court were not to reverse Lassiter, it should still be distinguished here.

On the other hand, if this Court were to reverse the per curiam affirmance of Lassiter, accepting instead the anti-merger reasoning of Judge Downey's dissent, it would then quite logically follow that the Eleventh Circuit's question in this case should be answered favorably to Fusco.

The Taylors also cite Simpson v. Fillichio, 560 So.2d 331 (Fla. 4th DCA 1990), reported during the pendency of Taylors' appeal, which deals with the apportionment of a condemnation award between lessors and long-term lessees. The language of the condemnation clause in the particular lease was held to be controlling there, and the court in no way dealt with the merger issue.

CONCLUSION

All the Taylors now own and can sell is a leased fee estate, their fee encumbered by the Lease. That was the premises -- "the subject matter of [the] conveyance" which would result from the exercise of the option -- which the parties intended to be appraised. The Lessors could not sell a greater estate than they owned. [App. 7, p.6 n.4; R3-71-6, n.4]. The long standing "merger" precedents support, rather than detract, from this conclusion. There is no Florida law to the contrary. Florida lease-option decisions in favor of landlords are completely distinguishable from the present case based on the lease language and surrounding circumstances in each case.

For all of the above reasons, the question certified by the Eleventh Circuit should be modified by this Court and so answered that the judgment of the District Court will be affirmed. One suggested rephrasing would be to add the words:

> "if the parties have not in the option clause sufficiently expressed their intent and if it would be financially disadvantageous to the lessee to value it as if it were unencumbered."

The question would then read:

> WHETHER THE FAIR MARKET VALUE OF LEASED PROPERTY AT THE TIME A LESSEE EXERCISES AN OPTION TO PURCHASE THE PROPERTY IS THE VALUE OF THE FEE SIMPLE ESTATE UNENCUMBERED BY THE LEASE OR THE VALUE OF THE FEE ESTATE ENCUMBERED BY THE LEASE IF THE PARTIES HAVE NOT IN THE OPTION CLAUSE SUFFICIENTLY EXPRESSED THEIR INTENT AND IF IT WOULD BE FINANCIALLY DISADVANTAGEOUS TO THE LESSEE TO VALUE IT AS IF IT WERE UNENCUMBERED.

The answer by this Court should be, and is requested to be: ENCUMBERED.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing has, along with Appendix 7 and 8, been furnished by mail this 8th day of April, 1991, to F. Wallace Pope, Jr., Esquire, and Marion Hale, Esquire, both of Johnson, Blakely, Pope, Bokor, Ruppel & Burns, P.A.

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