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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.

CASE NO. 77,477

CERTIFICATION FROM THE UNITED STATES
COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

APPELLANTS' BRIEF

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STATEMENT OF THE CASE AND OF THE FACTS

The appellants, John S. Taylor, III, Mary Taylor Hancock and Jean Taylor Carter (the Taylors), filed this action for declaratory relief in the Circuit Court in Pinellas County, Florida. The two-count complaint sought a declaration as to whether the Taylors had the right to terminate a 99-year lease with the Fusco Management Company (Fusco), and whether Fusco had the right to exercise an option to purchase the Taylors' interest in the real property. (Appendix 1). Fusco removed the case to the United States District Court for the Middle District of Florida pursuant to 28 U.S.C. §1441 et seq.

Fusco filed several counter-claims, all but one of which were voluntarily dismissed without prejudice prior to trial pursuant to Fed. R. Civ. P. 41(a)(1)(i) and 41(c). (Appendix 2). Of the remaining counter-claim, Count IV, only one issue remained at trial. That issue was interpretation of the option contained in paragraph 11 of the parties' ground lease. The parties reached a settlement concerning the issues raised in the Taylors' complaint and the complaint was dismissed with prejudice pursuant to the District Court's order of February 21, 1990. (Appendix 3). At trial, the District Court did not hear any evidence concerning the parties' intent in drafting paragraph 11 of the lease. (Appendix 4).

The facts in this litigation are not in dispute. The Taylors' father, John S. Taylor, Jr., and his wife, Marion, entered into a 99-year lease in 1963 with Leonard L. Farber for 36 acres of real property located in Clearwater, Florida.

(Appendix 5). A shopping center known as the Sunshine Mall was constructed on the property. Fusco acquired the lessee's interest in 1973. The Taylors inherited their parents' interest in the lease. Fusco has indicated it may wish to exercise an option to purchase the property pursuant to paragraph 11 of the lease which requires that three appraisers value the property if Fusco exercises the option. The lease does not specify how the appraisers are to value the Taylors' interest. The Taylors contend that Florida law requires that their interest be valued as if it were not encumbered by the lease. The District Court agreed with Fusco that the appraisers should value the Taylors' interest as if encumbered by the lease, thus substantially reducing the value of their interest should Fusco exercise its option.

The Taylors appealed the District Court's final judgment to the United States Court of Appeals for the Eleventh Circuit. Florida law controls the outcome of this appeal as the District Court's jurisdiction was based upon diversity jurisdiction pursuant to 28 U.S.C. §1332(a)(1). As the Florida Supreme Court had not considered this issue, the Eleventh Circuit certified the following question to this Court pursuant to article V, §3(b)(6) of the Florida Constitution. (Appendix 6).

> 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.

SUMMARY OF ARGUMENT

Florida law requires that a ground lessor's interest be valued as if it is not encumbered by the lease when the lessee exercises an option to purchase the property. All but one of the decisions of the Florida District Courts of Appeal have reached that conclusion.[1] There is only one appellate court which has reached a contrary conclusion.

The only practical construction of paragraph 11 of the lease is to interpret that provision as requiring that the ground lessor's fee be valued as if it were not encumbered by the lease. If a third-party purchases the Taylors' interest, it will receive lease payments from Fusco for the remaining years of the agreement. Thus, it would pay a lower price for the Taylors' interest as it would be purchasing a stream of income. That analysis does not apply if Fusco purchases the Taylors' interest. The leasehold interest and the fee merge as they are held by the same person or entity at the same time, extinguishing the leasehold interest. Permitting Fusco to purchase the Taylors' interest for an amount calculated as if their interest were encumbered by the lease gives Fusco an opportunity to acquire the Taylors' property at an unconscionable price. The Taylors have the right to refuse any offers from third parties to

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[1]The Fourth District Court of Appeal certified a similar question to this Court in Lassiter v. Kaufman, 563 So. 2d 209 (Fla. 4th DCA 1990). This Court heard oral argument in Lassiter, Case No. 76,369, on March 7, 1991.

purchase their interest but paragraph 11 of the lease mandates they accept an offer from Fusco. It defies logic to conclude that the original parties drafted paragraph 11 in the manner that would require the Taylors to sell their interest at a price far below the fair market value.

ARGUMENT AND CITATIONS OF AUTHORITY

I. 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

Three of the District Courts of Appeal in Florida have considered the issue of whether the lessor's interest should be valued as if the property is encumbered by the lease when the lessee exercises an option to purchase the property. The Second and the Fourth District Courts of Appeal have held that the lessor's interest should be valued as if it is not encumbered by the lease. Palm Pavilion of Clearwater v. Thompson, 458 So.2d 893 (Fla. 2d DCA 1984), Lassiter v. Kaufman, 563 So.2d 209 (Fla. 4th DCA 1990) and Simpson v. Fillichio, 560 So.2d 331 (Fla. 4th DCA 1990). Only the Third District has held that the lessor's interest should be valued as if it is encumbered by the lease. Contos v. Lipsky, 433 So.2d 1242 (Fla. 3rd DCA 1983).

In Palm Pavilion, the Court held that when a long term lessee purchases property pursuant to an option, the land should be valued as if it were not encumbered by the lease. The lease provision interpreted by the Palm Pavilion Court is almost identical to paragraph 11 of the lease in this litigation. The applicable provision in the Palm Pavilion lease provided:

> If the Lessee timely elects to exercise this option, the Lessee and the personal representative of the Lessor/Owner's estate shall agree upon a purchase price for said property. If the Lessee and the personal representative cannot agree upon a purchase price, then the lessee shall select a real estate appraiser, the personal representative shall select a real estate appraiser and the two real estate appraisers so selected shall appoint a third real estate appraiser. The three real estate appraisers shall then each determine the fair market value of said property and the average of the three prices or values determined by the appraisers shall be considered the fair market value of the property and said value shall be binding upon all parties in interest. [emphasis added}

458 So.2d at 893. Paragraph 11 of the Taylors' lease provides:

> 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 Seven Hundred Twenty Thousand Dollars ($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 Seven Hundred Twenty Thousand Dollars ($720,000.00) net to Lessors, their heirs or assigns, and Purchaser to assume all unpaid mortgage obligations against said property. [emphasis added]

The lease provision in Palm Pavilion refers to the lessee purchasing "said property" and "the property" while paragraph 11 provides that Fusco may purchase "the premises." The Palm Pavilion Court held that the term "property" in the option provision of the lease was not narrowed by any qualifying

language such as "the landlord's interest in the property" or "the fee as burdened by the lease." Id. at 894. Accordingly, the Palm Pavilion Court held that "to construe the agreement as though it contained such restrictive or narrowed language would amount to a judicial rewriting of the agreement which is not our province to do so." Id.

The Palm Pavilion analysis applies to this litigation. There is no limiting language in paragraph 11 requiring that the term "premises" be limited to the Taylors' interest in the property burdened by the lease. The only substantial difference between the applicable lease provisions is that the option provision in the Taylors' lease refers to the term "premises" while the Palm Pavilion lease refers to the "property." Black's Law Dictionary defines premises as:

> Lands and tenements; an estate, including land and building thereon; the subject-matter of a conveyance. [citation omitted] The area of land surrounding a house, and actually or by legal construction forming one inclosure with it. A distinct and definite locality, and may mean a room, shop, building or other definite area, or a distinct portion of real estate. Land and its appurtenances.

Black's Law Dictionary, 1063 (5th ed. 1979). Even Fusco's expert witness at trial, Gene Dilmore, acknowledged on cross-examination that the words "premises" and "property" are synonyms. (Appendix 4, afternoon session, at p. 21).

An examination of the Taylors' lease supports their theory that the premises referred to in paragraph 11 is not the property encumbered by the lease. Paragraph 12 of the lease grants the

lessee a right of first refusal refers to the "demised premises" while paragraph 11 refers to the "premises." "Demised" means leased. Black's Law Dictionary, supra at 388. The term "demised premises" in paragraph 12 cannot mean the same as "premises" in paragraph 11 unless the Court concludes that the drafters assumed that the word "demised" had no meaning. The Court should construe all terms in the parties' agreement as having meaning. Excelsior Insurance Co. v. Pomona Park Bar & Package, 369 So.2d 938 (Fla. 1979) and American Employers' Insurance Co. v. Taylor, 476 So.2d 281 (Fla. 1st DCA 1985). No word in the contract should be treated as surplusage if the Court can give any meaning which is reasonable and consistent with the remainder of the contract. Peoples Gas System, Inc. v. City Gas Co., 147 So.2d 334 (Fla. 3rd DCA 1962).

Thus, the interest referred to in paragraph 12 of the lease is obviously the Taylors' interest in the property as encumbered by the lease for which they might receive offers to purchase from third parties. Third parties would take the Taylors' interest in the "demised premises" subject to Fusco's lease. Pursuant to paragraph 12, the Taylors have the right to reject any offer from a third party to purchase the "demised premises". Only if they enter into a contract to sell their interest in the "demised premises" do they have to give Fusco a right of first refusal. Accordingly, if the Taylors do not want to sell their interest for an amount equal to the value of their interest encumbered by the lease, they do not have to accept any offers from third parties. If they insist on receiving an amount equal to the fair

market value of their interest unencumbered by the lease, they can refuse any offer from a third party.

Fusco relies upon Contos, supra. The Palm Pavilion decision is factually closer to this litigation than Contos. The lease in Palm Pavilion provides that the lessee had an option to purchase "said property". The parties' lease in Contos provided that the lessee had an option to purchase the "leased premises." The Contos Court concluded that the term "leased premises" meant the property was to be valued as if the lease encumbered the fee. The term "leased premises" is far closer to the term "demised premises" as used in paragraph 12 of the Taylors' lease. Paragraph 11 makes no mention to the premises being either "demised" or "leased."

II. THE MERGER DOCTRINE REQUIRES THE TAYLORS' INTEREST BE VALUED IS IF THE PROPERTY WERE NOT ENCUMBERED BY THE LEASE

The merger doctrine provides that when estates are held by the same person at the same time, they merge. Accordingly, a leasehold interest and a leased fee estate merge into a fee simple when the property is conveyed to the lessee. To argue to the contrary is to engage in a legal fiction.

Fusco relies upon Jackson v. Relf, 26 Fla. 465, 8 So. 184 (1890). The Jackson decision involved the issue of whether a mortgagee's and a mortgagor's interests merge when held by the same person. Accordingly, Jackson is factually dissimilar to this litigation. In addition, the Jackson Court noted that ordinarily estates are merged when held by one person.

> When a mortgage on lands and the equity of redemption in the same lands have become united in the same person, ordinarily the mortgage is merged, -- in other words, ceases to be an incumbrance, -- and the owner will hold the land with the unincumbered title, if there is no other mortgage or lien.

8 So. at 185. Thus, the Jackson Court acknowledged that the general rule is that estates merge when held by one person. To conclude that Fusco's and the Taylors' interest do not merge upon the exercise of the option is to engage in the legal fiction that Fusco would be required to pay itself rent after the purchase and, if a third party bought the shopping center from Fusco, the original lease would still encumber the premises. This Court should not endorse such a charade.

III. THE OPTION IS NOT WORTHLESS IF THE TAYLORS' INTEREST IS NOT ENCUMBERED BY THE LEASE

Fusco may contend that the option to purchase the property from the Taylors is worthless if it has to pay fair market value for the property. That reasoning is incorrect. The option, for which the lessee paid no separate consideration, merely grants to the lessee the right to purchase the property, a right which has considerable value. The Taylors must sell the property to Fusco if Fusco exercises the option. No other entity has the right to purchase the property from the Taylors. Accordingly, the option has significant value. The only issue to be determined is the price. If Fusco believes the fair market value of the property is too high, it need not exercise the option. Fusco must decide whether it makes economic sense to exercise the option, weighing

the fair market value of the property against the cost of seven decades of future lease payments to the Taylors.

IV. THE PRICE PAID BY A THIRD PARTY FOR THE TAYLORS' PROPERTY SHOULD BE LESS THAN THE PRICE PAID BY THE LESSEE

If the Taylors agree to sell their interest to a third party, that person will buy a stream of income over the next six decades. That third party can do nothing but receive the income as the property is burdened by a 99-year lease. It cannot develop the property. It cannot demolish the aging Sunshine Mall and construct a lavish new mall which might generate significantly more income. Accordingly, a third party would pay far less for the Taylors' interest than the lessee. Fusco has complete control over the conditions of the mall. It can let the mall fall into a state of disrepair, decreasing the lessor's income which is based on the tenants' rent, and then exercise its option, claiming that the fair market value of the property encumbered by the lease is low. If the lessee exercises the option, its leasehold interest merges with the leased fee estate to give it fee simple title to the property. The lessee can then do with the property as it wishes. Thus, Fusco should pay the fair market value of the property as it will not be encumbered by the lease when Fusco takes the title.

V. THE LESSEE DOES NOT BUY THE LEASEHOLD ESTATE IF IT EXERCISES THE OPTION

As noted above, if Fusco exercises the option to purchase the property, its leasehold estate will merge with the Taylors' interests. If it exercises the option, it is not buying the

leasehold estate which it already owns; rather, it is paying for the fee simple estate which will allow Fusco to use the property as it will and to stop paying rent. In addition, the appraisers should appraise the property exclusive of the improvements so that the purchase price will not include the value of the mall for which Fusco apparently paid when it acquired the lessee's interest.

VI. EQUITY REQUIRES THAT THE TAYLORS' INTEREST BE VALUED AS IF IT IS NOT ENCUMBERED BY THE LEASE

Both the Taylors and Fusco agree that the Court should look to the parties' intent when the lease was executed. Unfortunately, the trial court had no evidence before it regarding the parties' intent. Nevertheless, it is only logical that the parties intended when they drafted paragraph 11 that the lessors would sell its interest to Fusco at the fair market value. It defies common sense to conclude that the Taylors' father would have entered into this lease had he known that the lessee could exercise the option to purchase, forcing him to sell his interest at a price far below fair market value.

In addition, Fusco has had the benefit of what it acknowledges is a below-market lease and it now wants to use that below-market lease to depress the value of the property to obtain the fee simple estate at an unconscionable price.[2] If Fusco is

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[2]Until the parties reached a settlement of the claims the Taylors raised in their complaint, the lease did not contain an escalator for inflation. The revised lease will not be considered when the appraisers establish the value of the property if Fusco exercises its option.

allowed to do so, it can then sell the property to a third party for fair market value, reaping millions of dollars in windfall profits. Equity requires that Fusco not be allowed to profit at the Taylors' expense. If Fusco does not want to pay fair market value for the property, it need not exercise the option. However, the Taylors are forced to sell the property to Fusco. The Court should not force them to sell it at anything less than fair market value.

CONCLUSION

The fair market value of the Taylors' property if Fusco exercises its option to purchase the land is the value of the fee simple estate unencumbered by the lease. To permit Fusco to purchase that interest for the amount that a third party would pay is to ignore reality. If it exercises the option, Fusco's leasehold interest will merge with the Taylors' interest to give Fusco fee simple title to the property. Pursuant to paragraph 11 of their lease, the Taylors are required to sell the property to Fusco if it exercises the option. This Court should not permit Fusco to obtain the property for the same price that a third party would pay who would receive a steam of income for the next seven decades. If Fusco exercises the option, it can then sell the fee simple estate for an enormous profit. In fact, under Fusco's theory, it can enter into a 99-year lease, pay rent

for a few years and then exercise the option to purchase to obtain the entire fee simple estate for a small fraction of its worth. The Court should not sanction such conduct.

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