IN THE SUPREME COURT, STATE OF FLORIDA

HOULIHAN'S RESTAURANTS, INC., D/B/A DARRYL'S,

Petitioner,

v.

CASE NO. SC05-1964
CASE NO. 1D03-4755

APAC-FLORIDA, INC., A DELAWARE CORP., ET AL.,

Respondent.
_____/

PETITIONER'S INITIAL BRIEF

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PRELIMINARY STATEMENT

The Petitioner, Houlihan's Restaurants, Inc., will be referred to as "Petitioner" or "Houlihans". The Respondent, CNL-APF Partners, Inc., will be referred to as "Respondent" or "CNL".

The following symbols will be utilized:

The letter "R" will refer to the Record on Appeal. Reference will be made to the record volume and appropriate page number. Example: R V: 355 refers to record volume 5, page 355.

The letter "A" will refer to the numbered tab items in Petitioner's Appendix accompanying this Brief.

STATEMENT OF THE CASE

By Order dated April 6, 2006, this Court accepted jurisdiction to review the decision of the First District Court of Appeal, styled Houlihan's Restaurant, Inc. d/b/a Darryl's v. APAC-Florida, Inc., 911 So. 2d 816 (Fla. 1st DCA 2005). A-1, A-2. The First District's decision, by 2-1 vote, affirmed the "Final Judgment Regarding Apportionment of Condemnation Proceeds", entered by the Circuit Court for Escambia County. RV: 695; A-3.

The Final Judgment apportioned a $1.1 million condemnation settlement award paid by the Florida Department of Transportation as full compensation upon taking of a portion of property owned by CNL, upon which Houlihan's, as a long-term lessee, operated a Darryl's restaurant. R I: 57-68; R V: 696. The judgment apportioned $932,381 of the proceeds to CNL, and $167,619 to Houlihan's to compensate for their respective ownership interests in the property. RV: 699.

The Order accepting jurisdiction directed that the merits briefing shall include, but not be limited to, the issue of whether the alleged reversionary interest was considered and utilized in the calculation of the condemnation judgment. A-1.

This case presents excellent opportunity to establish controlling law for apportionment of condemnation proceeds between a long-term lessee and the fee owner upon a taking of the property that results in termination of the lease.

STATEMENT OF THE FACTS

The Darryl's restaurant property was owned and operated by Houlihan's from 1982 until 1997, when Houlihan's sold the property to CNL for half of its appraised value, then leased the property back from CNL for twenty years at about half the market rent. R IV:476-77, 542-43, 695-96; A-4. By selling the property to CNL at half its market value, Houlihan's essentially invested over $1 million (the other half of the market value) to pay down the rent in advance. R IV:556.

The lease warranted that Houlihan's would enjoy "full, quiet and peaceful possession of the premises . . . during the term hereof and any renewals or extensions." R V 648; A-6. In addition to the 20-year initial term, Houlihan's had two 5-year options to renew. *Id.*

By late 2001, when the Department condemned a portion of the property, Houlihan's was only 4.5 years into the lease; some 186 months (over 15 years) remained on the initial term. R IV:696. As a result of the taking, the restaurant could no longer function, and Houlihan's terminated the lease as permitted under paragraph 6(a) of the "Condemnation" section. R IV:696; R V:645; A-5. Since Houlihan's had more than 20% of its parking taken by the condemnation, Houlihan's was entitled to terminate the lease as a result of the taking. R IV:481.

"The lease provided that, in the event of a complete or partial eminent domain taking, Houlihan's had the option to terminate the lease." A-2; 911 So. 2d at 817. The DOT "obtained a partial taking of an area of the real property used for restaurant parking. Houlihan's then exercised its option to terminate the lease." *Id.* at 818.

The Condemnation section of the lease, paragraph 6(d), provided how condemnation proceeds would be shared if the lease were terminated:

> "If this lease is terminated by reason of a taking, all damages awarded as sums paid in respect to the taking will become the property of the landlord (CNL) and tenant (Houlihan's) respectively, as their interests appears ***immediately prior to the time of such taking***." R V:645; A-5.

A mediated settlement was reached whereby DOT paid $1.1 million for the property taken. R I:76-78; R V:699. In addition, upon early termination of Houlihan's lease, CNL gained possession of the after-taking remainder of the property with the restaurant structure intact, but requiring substantial reconfiguration of the parking lot to resolve traffic flow issues. R V:697.

The after-taking value of the remainder property in the hands of CNL was $625,000 in the opinion of CNL's appraiser. R IV:475, 515. The Circuit Court mistakenly characterized the value of the after-taking remainder as CNL's "reversionary interest." In actuality, CNL's "reversionary interest" was the future value of the property at the end of the lease term. This value was $311,548, as determined by Houlihan's appraiser, using the same growth rate and discount rate

that CNL's appraiser used. R IV:548-51. "Both experts agreed to the same appreciation rate and discount rate." R V:698.

CNL's appraiser, Steve Matonis, testified that the value of Houlihan's lease interest was the $12.50 "spread" between the market rent of $25 per square foot and the contract rent. R IV:476-77. However, Mr. Matonis opined that this spread had no value unless Houlihan's was able to sublease the premises. R IV:477-78.

Pursuant to paragraph 17(b) of the lease, if Houlihan's subleased the premises, it would have to pay CNL 25% of the increase in the sublease rent above rent due under the lease. R V:651; A-7. In other words, Houlihan's would only realize 75% of the "spread" upon subleasing. R IV:479-80. In addition, Mr. Matonis believed that $400,000 would have to be spent to convert the premises to find a new tenant to realize market rent. R IV:479, 485, 489-90. Mr. Matonis also believed that six months would be needed to find a new tenant during which there would be no sublease rent. R IV:484.

Using these assumptions, Mr. Matonis formulated his Analysis I, deducting $400,000 from the supposed sublease income spread, reducing that income by 25%, eliminating 6 months of that income, and then discounting the total to present value. R V:669; A-8. This produced a hypothetical sublease value of $240,000. *Id*. This amount was calculated to be 10.81% of the $2.2 million appraised value of the entire property before the taking. Applying this 10.81% to the $1.1 million

in condemnation proceeds yielded $119,790 as the amount that should be apportioned to compensate Houlihan's interest. R IV:490-91.

On cross-examination, Mr. Matonis admitted that if there were no taking, CNL as lessor/fee owner would be entitled to the contract rent income stream and the reversion value of the property at the end of the lease. R IV:508, 511, 519. He also admitted that the bonus value of Houlihan's lease would help the bottom line of its operations, and that leasehold value exists if there is so-called bonus value, i.e., economic rental is in excess of the reserved rental. R IV:512,525. However, Mr. Matonis believed that to qualify for compensation, a lessee would have to sublease or assign its leasehold interest. R IV:529.

Houlihan's appraiser, Professor Barry Diskin, agreed that CNL's only interest was the value of the contract rent and the reversionary interest. R IV:595. Using the same discount and market rental rates as Mr. Matonis, he determined $903,737 to be the present value of CNL's contract rent. R IV:547, 549. He also determined, using Mr. Matonis' numbers, that $311,548 was the value of CNL's reversionary interest at the end of the lease. R IV:548. Diskin testified that the total of these two elements, i.e. $1,215,285, was the value of CNL's fee interest if its position had not been interrupted by the taking. R IV:550-51. He also testified that the value of Houlihan's lease interest was $891,848 (the present value difference of market and contract rent), and that the total of all the interests equaled

just over $2.1 million, which was the value of the entire property before the taking. R IV:553. This was very close to Mr. Matonis' before-taking appraisal of the property at $2.2 million. R IV:563. The $1.1 million settlement with DOT, combined with $625,000 value of the remainder, left a shortage against the before-taking value that Diskin prorated to reduce the value of each interest proportionately. *Id.*

Diskin thus determined that the apportionable value of CNL's fee interest was $994,891 and from this amount, he subtracted the $625,000 after-taking value of the property retained by CNL. This left $369,891 for CNL's uncompensated fee interest, and $730,109 to be apportioned from the $1.1 million compensation proceeds to compensate Houlihan's leasehold interest. R IV:554-55.

Diskin testified that Houlihan's should enjoy the full bonus value of its lease, without any reduction for a supposed sublease. Houlihan's prepaid half of its rent by discounting the sale price of the property to CNL by 50%; and Houlihan's thus controlled the premises for half the market rent. R IV:555, 580.

The Final Judgment recognized that "Houlihan's rent was approximately 50% of fair rental value for use of the property as a restaurant," but then recited incorrectly that the lease "required Houlihan's to sublease only to a substantial,

national restaurant chain,[1] and that "Houlihan's would be allowed to keep 75% of any increased rent differential above the amount set out in the lease, while CNL would receive 25% of that differential." R V:697.

The Judgment recited this formula "was structured to accommodate Houlihan's subleasing the property". R V:697. "Because of Houlihan's decision . . . to terminate the lease, the obligation to obtain another tenant befalls CNL". . . . "Any new tenant will need to substantially remodel the building . . . CNL's expert conservatively estimated the cost of renovating . . . of any new tenant at $400,000." R V:697. The Judgment then concluded that "Houlihan's should be entitled "to the future stream of income based upon the fair rental value ***as if Houlihan's had subleased the properties***." R V:698 (*e.s.*).

The Judgment adopted the Matonis Analysis I to establish the value of Houlihan's lease. R V:698. However, Houlihan's percentage interest was increased to 15.24% by excluding the after-taking value of the property held by CNL (mistakenly called the "reversionary interest") from the before-taking value used as a denominator by Mr. Matonis. This resulted in $167,619 as the amount apportioned for Houlihan's lease interest, and the remaining $932,381 of the $1.1 million as the amount apportioned to CNL. R V:698-99.

[1] Under paragraph 17(a) of the Lease, a national restaurant chain was one type of company that Houlihan's could sublease to without CNL's consent (which in no case could be unreasonably withheld). A-7.

The above numerical conclusions are summarized as follows:

Rent Reserved Under the Lease			$903,737
CNL's Reversionary Interest at End of Lease			$311,548
Market Bonus Value of Leasehold Interest			$891,848
Value of Entire Property Before Taking			$2.1 to $2.2 million
Settlement Proceeds to be Apportioned			$1.1 million
After Taking Value of Remainder Property			$625,000
CNL's Apportionment	$369,891 Diskin	$980,210 Matonis	$932,381 Judgment
Houlihan's Apportionment	$730,109 Diskin	$119,790 Matonis	$167,619 Judgment

On appeal, the First District majority opinion acknowledged that the trial court accepted the analysis of CNL's expert but "excluded any consideration of CNL's reversionary interest in the property because the reversionary interest was not considered in reaching the condemnation award of $1.1 million." 911 So. 2d at 818, n.2. The reference to "reversionary interest" is apparently to the remainder property valued at $625,000 which CNL gained upon early termination of the lease.

The First District opinion agreed that the Final Judgment "assign(ed) a value to Houlihan's right to sublease the property," even though "no sublease was ever granted by Houlihan's," but held that Mr. Matonis' testimony, accepted by the trial court, supported assignment of value to the sublease right to value Houlihan's leasehold interest. 911 So. 2d at 818.

The First District's opinion concluded that "the lease does not provide any guidance as to how the value of a sublease right is to be considered in making an apportionment of eminent domain damages." 911 So. 2d at 819. Therefore, "consideration of the value of a sublease by the trial court is not contrary to the plain meaning of the condemnation clause of the lease," even though section 6(d) of the lease provided for division between landlord and tenant "as their interests appear immediately prior to the time of such taking." *Id*.

Judge Benton dissented, stating:

> The trial court's analysis adopted a methodology that required speculation about the costs that the tenant would incur if it subleased <u>after</u> <u>the</u> <u>taking</u>. The fundamental difficulty with this approach was its failure to honor the governing provision of the lease. *Id*.

SUMMARY OF THE ARGUMENT

The issues here concern apportionment of condemnation proceeds between a long-term lessee and the property fee-owner upon termination of the lease as a result of a taking. Both lessee and lessor are property owners entitled to full compensation upon a taking of the property.

The decision below misapplied the controlling provision of the lease agreement. The subject lease allowed Houlihan's to terminate its lease upon partial taking of a material portion of the leased premises, and provided that if a taking did result in such termination of the lease, the respective ownership interests should be valued as they existed *immediately prior* to the taking.

As tenant in possession with 50% below-market rent and at least 15 years remaining on the contract lease term, Houlihan's was entitled to valuation of its leasehold as a possessory owner just before the taking. The value of the lease was the value of the substantial rent savings to Houlihan's over the lease term.

As stated by the dissent, the decision below contravened the lease controlling lease requirement by approving valuation as if Houlihan's subleased the premises to a new tenant and incurred conversion costs after the taking. Houlihan's leasehold must be valued as a possessory interest, not as a sublessor interest. Other Florida decisions require that a lease provision for sharing of condemnation proceeds be given full effect. See e.g., Elmore v. Broward County,

507 So. 2d 1220, 1222 (Fla. 4th DCA 1987) (lessee compensated for its interest before the lease is cancelled as a result of the condemnation); K-Mart Corp. v. Dept. of Transp., 636 So. 2d 131, 133 (Fla. 2d DCA 1994) (J. Lazarra concurring) ("the parties have a right to provide in their lease agreement the specific manner in which a condemnation award is to be apportioned between them", citing Elmore).

The decision below also apportioned the lessee/lessor interests in this case contrary to the requirements of law, specifically approving valuation that excluded consideration of the lessor's reversionary interest. See Parks Building, Inc. v. Palm Beach County, 144 So. 2d 830, 833 (Fla. 2d DCA 1962) ("Compensation is due the lessor for damage to his reversionary interest and to the lessee for damage to his leasehold"); Trump Enterprises, Inc. v. Publix Supermarkets, Inc., 682 So. 2d 168 -70) (Fla. 4th DCA 1996) (If property is encumbered by a lease, court must determine the value of any reverter interest of the lessor at termination of the lease. The estate of the lessor during the lease "is limited to his reversionary interest which ripens into perfect title at the expiration of the lease.")

As owner of the fee estate encumbered by a long-term lease, CNL should be apportioned the present value of the rent due under the lease, plus its reversionary interest at the end of the lease. This sum should be reduced by the value of the remainder property after the taking and the prorata shortage in the settlement. Given that experts for both sides agreed on the value of the property, and on

appreciation, capitalization and discount rates to be used, the correct apportionment for CNL should have been $369,891. The remainder of the $1.1 million in condemnation proceeds, i.e. $730,109, should have been awarded to Houlihan's to compensate its favorable (50% below-market) leasehold interest.

Instead, the decision under review approved an improper apportionment analysis that: a) did not consider the value of CNL's reversionary interest or the rent due under the lease; b) did not use the summation method to value the respective interests; c) did not determine the bonus value of the lease to the lessee in possession prior to the taking; and d) assumed that Houlihan's possessory interest could only have value as a future sublease.

Although the value of the entire property before the taking was essentially split 50-50 between lessee and lessor, Houlihan's was inequitably apportioned only a small percentage of that value as a result of the erroneous analysis approved by the decision below.

ARGUMENT

THE DECISION BELOW DID NOT PROPERLY APPORTION CONDEMNATION PROCEEDS BETWEEN LESSEE AND LESSOR TO COMPENSATE THEIR RESPECTIVE INTERESTS AS THEY EXISTED IMMEDIATELY PRIOR TO THE TAKING THAT RESULTED IN TERMINATION OF THE LEASE

As long recognized in eminent domain, a lessee of property is a "full owner" and is entitled to full compensation for the loss of its leasehold. Carter v. State Road Department, 189 So. 2d 793 (Fla. 1966); Bolduc v. Glendale Federal Bank, 631 So. 2d 1127, 1128-29 (Fla. 1994).

"During the life of the lease, the lessee holds an outstanding leasehold estate in the premises, which for all practical purposes is equivalent to absolute ownership. The estate of the lessor during such time is limited to his reversionary interest, which ripens into perfect title at the expiration of the lease." Trump Enterprises, Inc. v. Publix Supermarkets, Inc., 682 So. 2d 168, 169 (Fla. 4th DCA 1996). "In apportioning condemnation proceeds the court should divide the sum equitably between the parties to reflect the respective values of the encumbered fee and the leasehold interest." *Id.* at 170. See also Dama v. Record Bar, Inc., 512 So. 2d 206, 208 (Fla. 1st DCA 1987).

In this case, over 15 years remained on the term of the lease at the time of the taking (with possible extensions for 10 more years). During this lengthy time, for all practical purposes, Houlihan's would have maintained "absolute ownership" over the property. Trump, 682 So. 2d at 169.

Prior to the taking, CNL conceded that the value of the property was virtually a 50-50 split between Houlihan's as lessee and CNL as fee owner. Houlihan's essentially controlled half the value of the property as a result of a sale/leaseback transaction whereby half of the market rent was effectively paid in advance. Houlihan's occupied the enviable position as a business tenant in possession for a lengthy term of years, paying rent that was equal to one-half of that being paid in the market for similar property.

Yet by the decision below, Houlihan's gets $167,619 for its interest, while CNL gets $932,381, plus $625,000 for the after-taking remainder property, for a total of $1,537,381. Although a 50% pre-taking owner, Houlihan's ends up with less than 10% of the recovered value of the property and less than 8% of its pre-taking value. This inequity is due to the failure to apply the controlling lease provision and controlling law for apportionment when a taking results in termination of the long-term lease of a tenant in possession.

A. Apportionment did not Comply with the Lease Condemnation Provision

Where, as in this case, the lease contains a condemnation clause, the law of eminent domain recognizes that its terms will govern apportionment between lessee and lessor, regardless of whether its application seems fair under the circumstances, or results in what appears in retrospect, as a bad bargain. See Simpson v. Fillichio, 560 So. 2d 331 (Fla. 4th DCA 1990) rev. dism. 574 So. 2d 140 (Fla. 1990); K-Mart Corp. v. Dept. of Transp., 636 So. 2d 131 (Fla. 2d DCA 1994); Mullis v. Department of Transp., 390 So. 2d 473 (Fla. 5th DCA 1980); Elmore v. Broward County, 507 So. 2d 1220 (Fla. 4th DCA 1987). The decision below, in approving the hypothetical post-taking sublease analysis proposed by CNL's expert, ignored this well-founded rule.

Section 6 of the subject lease between Houlihan's and CNL contains the "CONDEMNATION" clause of the agreement. Section 6(a) provides that in the event a material portion of the land is taken during the term of the lease, with the result that the premises cannot continue to be operated for the restaurant, Houlihan's could terminate the lease.

Section 6(b) of the lease addresses a "taking which does not give rise to an option to terminate or the Tenant does not elect to terminate." The provision defined the award for such a taking as excluding "the value of the Landlord's reversionary interest," and provided for restoration and repair of the premises and

improvements, after which the rent is reduced in proportion to the reduced rental value. Thus, the focus of the condemnation clause is on the post-taking situation when the taking does not result in termination of the lease. This necessarily includes the reduced rent to the landlord and the restoration and repair costs to refit the premises for the continued occupancy.

In contrast, section 6(d) provides that if the lease is terminated by reason of the taking, all sums paid for the taking become "the property of the Landlord and Tenant respectively, as **their interests appear immediately prior to the time of such taking**." The clause treats a partial taking that results in termination of the lease the same as a complete taking for purposes of valuing the respective interests for apportionment.[2] Upon such a taking, as occurred in this case, the focus is on the pre-taking situation and the value lost from that perspective. This necessarily includes the value of rent due lessor under the lease, the future reversionary interest of the lessor at the end of the lease, and the market rent advantage of the lease to the lessee. The value of the respective interests are frozen at a point immediately prior to the time of taking. This precludes any speculative assumption that the lease would be amended or its status changed after the taking.

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[2] Where a partial taking results in termination of the existing lease, there is no continuing obligation to pay rent, and where no such obligation exists, a partial condemnation of a leasehold interest may be treated as a total condemnation. See Dept. of Public Works v. Blackberry Union Cemetery, 335 N.E.2d 577, 580 (Ill. App. 2d Dist. 1975).

The decision below, in affirming the Final Judgment, contravened the Condemnation clause of the lease. The Final Judgment adopted Mr. Matonis' analysis, valuing the leasehold as if the premises were renovated and subleased to a new tenant six months after the taking. A $400,000 cost to renovate for a hypothetical new tenant was deducted from the value of Houlihan's interest. The $12.50 per square foot market rent advantage enjoyed by Houlihan's was reduced by 25% as if Houlihan's were receiving excess rental income from subleasing at the time of the taking. And six months of this supposed income was eliminated entirely as if the premises were unrented while being refit for the hypothetical new tenant.

This analysis, presented over objection (R IV:485), drastically reduced the compensation for Houlihan's lease interest and drastically increased the compensation for CNL's fee interest that was encumbered by the lease at the time of taking. In fact, CNL is compensated far in excess of the maximum value of its encumbered fee interest as if there were no taking at all (i.e. the lease ran its course and CNL collected its rent, plus its reversionary interest).

The Matonis' analysis was grounded on the faulty premise that Houlihan's below-market lease had no value unless Houlihan's subleased the property. The trial court agreed, ruling that value of the lease was based on fair rental as if the

property were subleased. The decision below approved this ruling and thereby failed to give operative effect to the explicit direction of the Condemnation clause.

At the time of the taking, Houlihan's was a tenant in possession, admittedly enjoying a substantial below-market lease advantage as a result of the discounted sale to CNL that effectively paid half of the rent in advance upon the 20 year leaseback. There was no sublease or agreement to sublease in existence or shown to be contemplated prior to the taking. The valuation and apportionment of Houlihan's interest could not be premised on a hypothetical renovation cost for a non-existent sublease to commence six months after the taking.

Mr. Matonis did not even suggest that Houlihan's needed to sublease, or should have undertaken to sublease. He simply rested his analysis on the false premise that the value of any lease could only be realized through sublease or sale. In reliance on this analysis, the Final Judgment recognized that the lease was properly terminated because of the material affect of the taking on the use of the premises for a restaurant,[3] but ruled that "Houlihan's should be entitled to the

[3] As part of its introduction, the Judgment states that "approximately one (1) month after the partial taking, Houlihan's filed bankruptcy." R V:696. Houlihan's corporate parent owned a chain of restaurants around the country, and sought Chapter 11 reorganization (by which its business could continue). R V:439-40. However, there was no evidence about the Chapter 11 filing in the apportionment hearing. The Circuit Court only learned about it upon hearing argument and ruling on a motion by CNL just before the apportionment hearing. The Court denied CNL's motion, ruling that the reorganization plan did not preclude Houlihan's from recovering apportionment proceeds to compensate its leasehold interest. R IV:467.

future stream of income based on the fair rental value as if Houlihan's had subleased the properties." R IV:698.

Since Houlihan's was operating on the premises prior to the taking (as it had for the past 20 years), the only material issue was the value to Houlihan's of its leasehold possessory interest at the point in time just prior to the taking, not its future sublease value. The First District sidestepped the issue by saying that section 17 of the lease did not address how the right to sublease should be considered in apportioning eminent domain damages. 911 So. 2d at 819. But obviously, since there was never any sublease, section 17 did not come into play. There was no reason to assume that the sublease right under section 17 was the value of the lease to Houlihan's unless that section were actually in effect. The First District's opinion confirms that section 17 did not direct any other result.

Ultimately, the First District held that valuation of Houlihan's leasehold as a hypothetical sublease, reduced by remodeling costs for a new tenant and sharing of 25% of excess income pursuant to paragraph 17(b), was not contrary to the plain meaning of the Condemnation clause. This was wrong under the facts of this case. As the dissent observed: "The trial court's analysis adopted a methodology that required speculation about costs the tenant would incur if it subleased after the taking. The fundamental difficulty with this approach was its failure to honor the governing provision of the lease." 911 So. 2d at 819.

To value the leasehold as it existed immediately prior to the taking required valuation of Houlihan's possessory interest to it as an operating tenant in possession. This necessarily meant valuation of Houlihan's right to use and enjoy the improved premises for the term of the lease at half the market rent, having already effectively paid half of the rent in advance. As stated by Jacksonville Expressway Auth. v. Henry G. Du Pree Co., 108 So. 2d 289, 291 (Fla. 1959):

> The lessee is entitled to just and adequate compensation for his property; that is, the value of the property to him . . . (Emphasis supplied).

Citing this authority, Orange State Oil Co. v. Jacksonville Expressway Auth., 110 So. 2d 687, 690 (Fla. 1st DCA 1959), cert. den.114 So. 2d 4 (Fla. 1959), held the "actual value or value to the owner is usually the best, if not the only adequate test of [full] compensation" for a leasehold interest, and that the value to the lessee of the "right to undisturbed possession of the leased property" is the proper measure of compensation:

> As a general rule the greatest value to a lessee is the right to remain in undisturbed possession of the leased property to the end of the term, and the value of this right, of which he is to be deprived, constitutes a proper measure of the compensation to be paid.

In their law review article, An Economic Appraisal of Leasehold Valuation in Condemnation Proceedings, 17 U. Miami L. Rev. 245 (1963), Professors Boyer and Wilcox discuss the proper compensation for a lessee when the leasehold estate is terminated as a result of the taking:

> Legal and economic concepts are in general agreement on this point. The measure of damages suffered… under the law of eminent domain is the difference in value between market value of the leasehold and this amount (contract rent) which the lessee is obligated to pay. *Id.*
>
> This is explained to typically mean:
>
> … the difference between value of the use and occupancy of the leasehold for the remainder of the tenant's term… less the agreed rent which the tenant would pay for such use and occupancy.

Id. at 265. See also, Dept. of Public Works v. Blackberry Union Cemetery, 355 N.E.2d 577, 580 (Ill. App. 2d Dist. 1975) ("the advantage lessee enjoys by paying less rent than others would pay, is the amount lessee should be awarded for his loss"); and Land Clearance for Redevelopment Auth. v. W. F. Coen & Co., 773 S.W.2d 465, 471-72 (Ct. App. Mo. 1989) ("Where the market rent is higher than the contract rent, the lessee will enjoy a rent savings…" and "is entitled to apportionment of any bonus value the lessee has under the lease").

The premise for the Matonis analysis – that Houlihan's leasehold interest only had value to the extent it could be subleased – was contrary to both the lease and the law. The measure of the value of Houlihan's interest before the taking was the value of its undisturbed possession reflected in the rent savings for years to come at below-market rental.

The lease value to be measured was the value of the possessory interest to Houlihan's as tenant in possession at the point of the taking, not as possible sublessor at some later point. See e.g., In the Matter of the City of New York, 19

A.D.2d 44, 241 N.Y.S. 2d 44, 50 (1st Dept. 1963): "(T)he tenant on condemnation of his interest is entitled to receive the reasonable value thereof at the precise time of the taking." The City of New York case also observed that: "Rent prepaid, as already received by the landlord, has figuratively speaking, been placed in his pockets." *Id.* at 49. Hence, the rent savings to a tenant in possession measures value of the lease to it. Houlihan's effectively prepaid half the rent in advance, and would pay substantially less rent over the term of the lease. Correspondingly, CNL would have "pocketed" the effective rent prepayment, and receive rent payments far below market, greatly diminishing the market value of its encumbered fee at the time of taking.

The mandate of the Condemnation clause of the lease under these facts is to compensate the value of CNL's encumbered fee interest subject to the lease actually in place. The Condemnation clause likewise preserves the bonus value of the lease to Houlihan's for not having to pay market rent for occupancy. The presumption of a sublease at some later point in time, and the cost to achieve that status, do not measure either the value of the lease to the lessee in possession, or the value of the fee as encumbered by the lease "immediately before the taking."

Valuation based on Mr. Matonis' false assumption that the premises had to be subleased in the future to have value is inconsistent with established law, and thus could not be sanctioned by the requirement of the Condemnation clause.

Apportioned compensation must be based on the parties' interests as they existed immediately before the taking.

The decision below could not acknowledge on the one hand that the lease was properly terminated as a result of the taking, yet on the other hand, assume that Houlihan's would have to sublease and pay for new tenant renovations in order to realize the value of the terminated lease. Granting Houlihan's apportionment valuation on Matonis' false premise and related assumptions was totally contrary to the admitted facts that Houlihan's was paying half of the market rent and not subleasing, and further contravened the Condemnation clause, section 6(d), of the lease. Houlihan's was entitled to be compensated for its established positive or bonus value, and CNL could only be compensated for its encumbered fee interest subject to the lease as it existed. The Condemnation clause requires that compensation as between the parties be determined based on a snapshot of their positions "immediately prior to the taking."

The First District's decision thus violated the constitutional requirement that the lessee, as the "full owner" during the term of the lease, be made whole, and denied Houlihan's the value of its possessory leasehold interest as it existed "immediately prior to the taking."

B. **Apportionment did not Comply with Law**

The law required that the parties' respective interests at the time of the taking be valued and apportioned as proposed by Professor Diskin.

When a fee is encumbered by a long-term lease that is terminated by the taking, the respective interests of lessor and lessee should be apportioned using value of rent under the lease and the reversionary interest at the end of the lease. The rest of the value of the property is the value of the lessee's interest. Any shortage of the sum of these values and the total recovery for the property is shared in proportion to the value of the respective interests. See 17 U. Miami L. Rev. at 261:

> Most courts, in applying the unencumbered fee rule, consider that the award is substituted for the land, and that the various claimants should share in proportion to the damage suffered by them. *** Insofar as the award is more or less than the total of the interests, it would appear that the overage or shortage should be shared by the respective owners in proportion to the value of their respective interests.

Where the property taken is encumbered by a leasehold, "the first issue to be determined . . . is the value of the fee interest and the value of the leasehold interest. . . . (T)he parties next proceed to an apportionment hearing at which time the court determines their respective rights in amount awarded." Trump Enterprises v. Publix Supermarkets, 682 So. 2d 168, 169 (Fla. 4th DCA 1996). The Trump decision emphasizes that:

> During the life of a lease, the lessee holds an outstanding leasehold estate in the premises, which for all practical purposes is equivalent to absolute ownership. The estate of the lessor during such time is limited to his reversionary interest, which ripens into perfect title at the expiration of the lease. (*e.s.)*

The lessor's interest in the property cannot exceed the rent reserved under the lease and the reversionary interest at the end of the lease. "Compensation is due the lessor for damage to his reversionary interest and to the lessee for damage to his leasehold." Parks Building, Inc. v. Palm Beach County, 144 So. 2d 830, 833 (Fla. 2d DCA 1962); quoting from Nichols on Eminent Domain.

In Orange State Oil Co. v. Jacksonville Expressway Auth., 110 So. 2d 687 (Fla. 1st DCA 1959), the court approved the summation method for apportionment. The sum of the reserved rent payable during the lease and the reversionary interest, reduced to present value, is deducted from the value of the entire property, with the remainder representing the value of the leasehold. *Id.* at 689. The court explained that "the summation method of evaluating leaseholds accorded with the accepted practice of those engaged in the business of appraisals . . . . *Id.* at 690-91. Because of the infrequency with which leases are sold on the open market and other market factors, "it is virtually impossible" to rely exclusively upon a market test for value and at the same time secure just compensation for the lease. *Id.* at 690.

Professors Boyer and Wilcox explain that apportionment valuation of the lessor and lessee interests should be determined by the widely accepted summation

method. "The value of the lessor's interest is thus (1) the present value of the net rents that he is to receive in addition to (2) the present worth of the value of the property to be repossessed at the time of termination of the lease." 17 U. Miami L. Rev. at 267-68. "(T)he estimation of the value of the lessor's interest is relatively simple when compared with the problem of estimating the lessee's interest. . . . Because of this many appraisers first value the property as a freehold, then estimate the lessor's interest and, by subtraction, reach an opinion of the value of the lessee's interest." *Id.* at 267. Given the difficulty in obtaining sales data for property subject to particular leases, this is the simplest and most appropriate method to value the respective interests. *Id.*

While the bonus value method of valuing a lease can be used in the case of a short-term lease where continuation of the excess rental value can be confidently predicted for the remainder of the term, the summation method should be used in the case of a long-term lease. See Land Clearance for Redevelopment Auth. v. W. F. Cohen, 773 S.W.2d at 472: "Thus, the distinction in method is premised on the theory that the longer the lease, the closer it approximates fee ownership and the more speculative becomes the reversion value to the owner."

Houlihan's had more than 15 years remaining on its lease, plus two renewal options for an additional 10 years. This can certainly be considered a long-term lease. See Barber v. Hatch, 380 So. 2d 536, 537 (Fla. 5th DCA 1980) (lease of 20

years was a long-term lease). To minimize error in apportionment of the respective interests, the summation method should have been used.

Under the summation method, the record establishes that the present value of CNL's reserved rents was $903,737, and the present value of its reversionary interest was $311,548. The total value of CNL's interest as lessor (fee owner), therefore, was no more than $1,215.285. Subtracting this amount from the value of the entire property before the taking establishes a value of $984,715 for Houlihan's interest. After prorating for the shortage in the settlement, and deducting the remainder value of the property from the prorated value of CNL's interest, the Court should have apportioned about a third of the condemnation proceeds to CNL ($370,000), and about two-thirds to Houlihan's ($730,000), to compensate their unpaid interests.

The record also establishes that results would have been comparable if the bonus value method were properly applied, free of the false premise that the lease could nave no value unless the premises were subleased.

C. **Improper Apportionment Produced Inequitable Results**

Under the decision below, Houlihan's was awarded only about 15% of the condemnation proceeds, which was about 9% of the total recovered and retained for the property (the condemnation proceeds and remainder property). This is plainly inequitable in view of: a) Houlihan's highly advantageous lease with over 15 years remaining; b) the acknowledged 50-50 split in ownership value prior to the taking; and c) Houlihan's effective prepayment of $1 million in advance rental that was substantially unused at the time of the taking.

Mr. Matonis' analysis, accepted below, produced this egregiously inequitable result by departing from the controlling law in two respects:

First, pursuant to the Condemnation section of the lease, Houlihan's was entitled to receive the reasonable value of its leasehold interest as it existed "immediately before the taking." There was no provision for the lessee to reimburse costs that might have to be expended to find or re-lease to a new tenant as a result of termination. The Judgment's improper concern for CNL bearing this burden is manifested by the statements in paragraphs 8, 10 and 11 that substantial reconfiguration will be necessary to resolve traffic flow issues created by the partial taking, that the obligation to obtain another tenant befalls CNL because of Houlihan's termination of the lease, and that $400,000 would need to be spent to comply with the specifications of any new tenant. R IV:697.

These considerations do not justify passing the burden of securing a new tenant to Houlihan's. CNL got its property back at least 15 years earlier than expected and could sell the property for $625,000 without any renovation cost. This is what it bargained for, and it can be entitled to no more.

While Mr. Matonis and the courts below may prefer to impose the cost of renovating the remainder property on Houlihan's, this was not sanctioned by the lease. If condemnation resulted in termination of the lease, CNL knew it would have to find a new tenant and perhaps incur renovation costs to do so. As part of the lease agreement, CNL could have provided for a reduction of Houlihan's interest in the amount of such potential costs, but did not do so.

The bonus value of the lease is not dependent on the ability to sublease, but on the use and enjoyment of the premises by the tenant at a substantially reduced rate. The courts are not free to change the lease Condemnation clause or to contort valuation of a possessory leasehold interest to improve CNL's bargain. Houlihan's possessory interest, not its sublease interest, should have been valued. Likewise, CNL's fee interest subject to Houlihan's lease, not a hypothetical sublease, should have been valued.

Second, the decision below did not follow the summation approach recognized in Florida for a lengthy lease. This approach assures fairness by simplifying the calculation of the limits of the lessor's interest, i.e. the value of the

rent reserved under the lease and the reversionary interest. The remainder of the value of the property before taking would belong to the lessee.

In this instance, the summation value coincides with the value of the lease to Houlihan's, as tenant in possession, to enjoy use of the premises for the duration of the lease at half the market rate. That bonus value, of course, is established without regard to the faulty premise that Houlihan's lease had no value unless the premises were subleased.

The summation value is the appropriate method by which to apportion the taking award under Florida law and the parties' lease. The lower court's failure to recognize this produced an unjust windfall to CNL at Houlihan's expense.

CONCLUSION

The decision below should be quashed with direction to remand this matter for entry of a revised apportionment judgment consistent with the Court's opinion. The Court should also grant Petitioner's Motion for Attorney's Fees in connection with proceedings necessitated by the condemnation.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the Initial Brief and Appendix to same have been furnished via U.S. mail to John T. Wettach, Esq., attorney for Respondent, CNL, APF Partners, L.P., 215 North Eola Drive, Orlando, Fl. 32802, this _____ day of May, 2006.

CERTIFICATE OF COMPLIANCE WITH FONT SIZE

I HEREBY CERTIFY that this Initial Brief complies with the font requirements of Rule 9.210 (a) (2), *Florida Rules of Appellate Procedure.*

_____

M. STEPHEN TURNER.