

CONDEMNATION CLAUSES IN COMMERCIAL LEASES

Charles N. Pursley, Jr., Esquire
Pursley Lowery Meeks LLP
Atlanta, Georgia

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CONDEMNATION CLAUSES IN COMMERCIAL LEASES

Introduction

The condemnation clause in a commercial lease is the most important consideration in determining the respective rights of the landlord and tenant when there is a condemnation of the property that is the subject of the lease. Yet the condemnation clause often is one of the most overlooked provisions in the lease.

When faced with the reality that all or part of a commercial property will be involved in a condemnation action, a tenant's first question is "What am I entitled to recover in this case?" The landlord's questions usually are slightly different, "What can I recover in this case, and do I have to share any of that recovery with my tenant?" The answer to the question of each is the same, "It depends on the condemnation clause in the lease." The response back from the tenant or the landlord usually is the same, "Oh, it's just a standard condemnation clause."

From my observations and experience, there is no such thing as a "standard condemnation clause." Condemnation clauses are as varied as the lawyers or real estate professionals who draft them. A real problem, however, is that all too often the parties consider condemnation as something that is not likely to happen and they fail to consider all the possible contingencies and issues that might arise in a condemnation case.

The Georgia courts have developed a substantial body of law regarding the various elements of just and adequate compensation in general and relating specifically to compensation for the owner/landlord and for the tenant/lessee. But the law also provides that "[a]bsent a public policy interest, contracting parties are free to contract to

waive numerous and substantial rights Thus, a lessee may in the lease assign away or waive its right to just and adequate compensation in any type of condemnation proceedings, which assignment or waiver we will enforce.” McGregor v. Board of Regents of the University System of Georgia, 249 Ga.App. 612, 548 S.E. 2d 116 (2001). In determining the validity and extent of any assignment or waiver, the courts have stated that “as a general rule, the provisions of a contract will be construed against the draftsman, and those of the lease will be construed against the lessor. Department of Transportation v. Calfee Co. of Dalton, Inc., 202 Ga.App. 299, 414 S.E. 2d 268 (1991) (cert. denied 1992).

The purpose of this presentation is to identify issues that may arise in the drafting or implementation of a condemnation clause.

1. Applicability of a Condemnation Clause.

The Condemnation clause should apply in the event of an acquisition of all or part of the lease premises under circumstances that would require the payment of just and adequate compensation for that acquisition. The Condemnation clause should apply to the acquisition of the property for any public or quasi public purpose or use under any statute; to the right of eminent domain under any statute; or to the purchase by any governmental authority or public authority in lieu of the exercise of the right of eminent domain.

2. Lease Termination Issues.

a. Acquisition of Part of the Leased Property.

1. The parties must decide the circumstances under which the lease can be terminated if only part of the property is taken. This is a question

of how much of a taking is too much for the lease to continue and who gets to decide how much is too much. In one case the lease provided that:

“In the event that the premises or any part thereof are taken or condemned or are conveyed under the threat of eminent domain, at Lessee’s option the lease may be terminated as of the date of such taking.” Budd Land Company, Ltd. v. K&R Realty Company, 159 Ga.App. 448, 283 S.E. 2d 665 (1981)

The Court of Appeals call this a “standard clause.” A landlord clearly would conclude that this clause is too broad in favoring the tenant. In the Budd Land case, the tenant terminated the lease when a small strip of land was taken in a condemnation action even though the taking did not substantially impair the tenant’s use of the remaining property. The Court of Appeals held that the lessee had a contractual right to terminate the lease and affirmed the trial court’s grant of summary judgment.

The landlord and tenant should negotiate the termination rights for a partial taking based upon the impact of the taking on the tenant’s reasonable use of the leased premises for the purposes of the lease. This standard can be stated in terms of:

- (1) Whether the remaining property is sufficient for the reasonable operation of tenant’s business,
- (2) Whether a specific percentage of the leased premises (building and/or land area) is taken,
- (3) Whether certain access has been impaired,
- (4) Whether a certain amount of parking has been taken, or

(5) Any other issues specific to the tenant's use that the parties agree would significantly diminish the use of the leased premises if taken in a condemnation case.

2. The condemnation clause also should specify who decides whether the partial taking is sufficient to terminate the lease – landlord, tenant or either. The deciding party or parties should be required to make this decision by a reasonable exercise of discretion based upon the facts of the condemnation.

3. The condemnation clause also should specify when the termination would become effective, whether written notice of the effective date is required, and the date through which rent must be paid. The obvious choices are for the termination to be effective would be on the date of taking or on the date the condemning body is granted the right of possession of the property. Normally the rent would continue to be paid until the date of termination.

4. The condemnation clause should address the respective rights of the landlord and tenant in the event the taking of part of the property does not result in the termination of the lease. This provision should specify a formula for determining the rent to be paid on the remaining premises, a provision for restoration of the property, if possible, the party responsible for restoration, and a provision for the source of the funds to restore the property (i.e., the condemnation award).

b. Acquisition of the Entire Leased Premises.

In the event of a condemnation or purchase of the entire leased premises, termination of the lease normally would be automatic and no written notice normally would be required. The condemnation clause still should provide the effective time of the lease termination, either on the date of taking or on the date the governmental body obtains the right of possession of the property. Provision also should be made that rent would be paid until the effective date of the termination.

2. Compensation Issues.

The condemnation clause must provide for the respective rights of the landlord and tenant to recover just and adequate compensation. Georgia law clearly allows a tenant to waive its claim of compensation against both the landlord and the condemnor and to assign its claims to the landlord with or without a right to recover compensation from the condemnor. McGregor v. Board of Regents, supra, Department of Transportation v. Calfee Co., supra. The terms of the waiver or assignment are matters of negotiation between the landlord and tenant.

The first issue normally is compensation for the value of the property and improvements (real estate issues). This is an issue of critical importance to the parties, because the unified fee rule is alive and well in Georgia. Therefore, the tenant's recovery of a leasehold value in the real estate will result in the reduction of the landlord's award for the unencumbered fee simple value of that real estate. It is normal for the landlord to insist upon the tenant waiving and assigning its claim of leasehold interest or value of the unexpired term of the lease so that the tenant has no claim against the landlord or

the condemner for that leasehold value. As a compromise, some condemnation clauses allow the tenant to recover the unamortized portion of any tenant improvements paid for by the tenants that were not reimbursed by the landlord.

A condemnation clause provision that would allow the tenant to recover just and adequate compensation for items that would not reduce the landlord's recovery often are included in the lease. These items would include business damage, fixtures and personal property of the tenant and relocation benefits.

The various options for recovery of just and adequate compensation can be summarized as follows:

a. The landlord is entitled to recover the entire payment of just and adequate compensation, the tenant assigns to landlord all its claims of compensation and waives any claims for compensation against either the landlord or the condemning body.

b. The landlord is entitled to recover the entire payment of just and adequate compensation subject to lessee's right to recover from the landlord a portion of the compensation as provided by law or statute. This type provision most often appears in property that is subject to the Federal Petroleum Marketing Practice Act (15 USCA §2801, et. seq.), but the Georgia courts have interpreted this language in a broader context. Simmerman v. Department of Transportation, 167 Ga.App. 383, 307 S.E. 2d 4 (1983). In that case the Court of Appeals allowed the tenant to recover from the landlord not only business losses as specified in the federal statute but also a possible leasehold interest.

c. The landlord recovers the entire reward of just and adequate compensation, and the tenant waives any claims against the landlord but reserves all claims against the condemnor. See, Department of Transportation v. Calfee Co., supra.

d. The landlord and tenant each may recover just and adequate compensation from the condemning body as allowed by law, provided that neither landlord or tenant shall have a claim against each other.

e. The landlord is entitled to recover the entire award of just and adequate compensation provided that the tenant retains the right to claim a separate award from the condemnor for business damage, fixtures installed by tenant, personal property and relocation expenses.

Summary

A condemnation action taking all or part of a leased premises is a real possibility during any lease term, and the condemnation clause in the lease should be negotiated so that the landlord and tenant each understand their respective rights in the potential valuation and use issues. This paper has touched on some of the more common issues that may arise, but the issues can be as varied and unusual as the property itself. Lawyers must be aware of condemnation issues in drafting leases and in representing clients in condemnation cases involving the recovery of compensation for either the landlord or the tenant.

The following condemnation clause addresses many of the issues and may give some ideas for resolving other issues:

If the whole of the leased premises shall be taken for any public or quasi public purpose or use under any statute, or by right of eminent domain, or by private purchase by any public authority in lieu of the exercise of the right of eminent domain or if any part of the leased premises is so taken and the part not so taken is insufficient for the reasonable operation of tenant's business, then, in either of such events, this lease shall cease and expire on the date when possession shall be taken thereunder of the leased premises or part thereof and all rents, taxes, and other charges shall be prorated and paid to such date.

In the event that only a part of the leased premises is so taken and the part not so taken shall be sufficient for the reasonable operation of the tenant's business, this lease shall remain unaffected except:

- (a) Until restoration pursuant to (b) below, the tenant shall be entitled to a prorate reduction in the rent and any other charges payable by tenant hereunder, after the date of such taking, based on the proportion which the space so taken bears to the space originally demised, provided that consideration shall be given to the respective values of the space taken and the space not taken.
- (b) The landlord shall promptly after such taking, and at the landlord's own cost and expense, restore that part of the improvements not so taken to as near its former condition as the circumstances will permit.

In case of such taking, whether of all or any part of the leased premises, and regardless of whether this lease survives, the entire award shall belong solely to the landlord, and the tenant hereby assigns such award to the landlord; provided, however, landlord shall have no interest in any award made to tenant for landlord shall have no interest in any award made to tenant for damage to tenant's business or for the taking of tenant's fixtures and personal property within the leased premises paid for by tenant and for relocation expenses if a separate award for such items is available to tenant. Tenant shall be entitled to make claim in its own name to the condemning authority for the value of said fixtures and personal property, damage to tenant's business and relocation expenses.