Landlord/Tenant Apportionment Issues in Eminent Domain

Jill S. Gelineau

is a litigator with Schwabe, Williamson & Wyatt, P.C., who represents landowners in condemnation and land use litigation. She represented the Dolan family in the Dolan v. City of Tigard trial following its remand from the U.S. Supreme Court. She also represented Michael Kelley and the other plaintiffs in Danebo Properties LLC v. City of Eugene, which settled for $3.95 million. She has been a speaker at numerous local, national, and international conferences primarily speaking on the topics of condemnation and land use, including speaking at the Law Society of England in Wales and London in 1995. Ms. Gelineau is the former Co-Chair of the ABA Section of Litigation – Condemnation, Zoning and Land Use Committee. In 2006, Governor Kulongoski appointed Ms. Gelineau to serve on the Task Force for Land Use Planning, which was charged with performing a thirty-year review of Oregon’s land use system. She is also the Oregon member of Owners’ Counsel of America, an organization of experienced eminent domain lawyers that selects only one attorney from each state. She has been a Superlawyer in Oregon in the specialty of eminent domain for the years 2007-2014. Ms. Gelineau acknowledges the assistance of Angela M. Hanslovan, B.A., Pacific University 1996; J.D., Northwestern School of Law, Lewis & Clark College, 2014, in preparing this article.

When it comes time to apportion the condemnation award, the landlord and tenant want to maximize their respective portions. Tensions are inevitable, but there are ways to address them.

AN AGENCY’S USE OF eminent domain power to acquire a property encumbered by a lease impacts not just the owner/landlord of the property but also the tenant. Presumably both the owner/landlord and the tenant desire to maximize their individual outcomes in a proceeding. This effort to maximize individual outcomes gives rise to tensions between the owner/landlord and tenant, including the proper apportionment of any condemnation award, whether items are properly classified as trade fixtures or fixtures, what occurs when either the owner/landlord or tenant desires to settle the case, and the effects of the threat of condemnation on the lease, among other things. A brief discussion of these tensions follows.

APPORTIONMENT OF THE CONDEMNATION AWARD • The apportionment of an award of condemnation proceeds is typically set forth in a state’s eminent domain procedures statutes. The standard rule is the “undivided-fee rule”; however, a minority of jurisdictions
utilize other approaches. A discussion of various approaches follows.

The Undivided-Fee Rule

The undivided-fee rule provides for a two-step process to fix valuation in eminent domain proceedings. Under this approach, the property is first valued as a whole, and is typically presented in a lump-sum determination that encompasses all interests in the property. When the fee owner of the property is the sole interest, this valuation approach does not give rise to complications because there is only one interest to be valued.

After the value for the property as a whole is established, the undivided-fee rule provides for a separate apportionment proceeding. This apportionment proceeding determines the compensation due to each property interest, including the fee owner, tenants, mortgagors, easement holders, or lienholders. This apportionment occurs by contract (i.e., by the terms of the lease), or by judicial intervention. Because the total compensation that the condemnor is obligated to pay was determined in the prior proceeding fixing the valuation (the first step under the undivided-fee rule), the condemnor need not participate in the apportionment proceeding—the condemnor’s role ended with the condemnation award since condemnors do not, as a practice, apportion awards among the various possessory interests involved with the property.

2. The undivided-fee rule is also known as the “unit rule” or the “undivided-basis rule.” *Nichols on Eminent Domain* § G30.02[1] (2013).
3. *Id.; United States v. 14.02 Acres of Land*, 547 F.3d 943, 956 (9th Cir. 2008); *United States v. 1.377 Acres of Land*, 352 F.3d 1259, 1269 (9th Cir. 2003).
5. *Id.*
6. *Id.*
9. *See Alamo Land & Cattle Co., Inc. v. Arizona*, 424 U.S. 305 (1976) [“. . . the fair rental value of the land may increase during the term of the lease. If this takes place, the increase in fair rental value operates to create a compensable value in the leasehold interest” (in addition to the value of the use and occupancy of the leasehold for the remainder of the tenant’s
separate component from the value of the use and occupancy of the leasehold for the remainder of the tenant’s term, plus the value of the right to renew, less the agreed rent the tenant would pay for such use and occupancy.10

Jurisdictions vary in how strictly they apply the “undivided-fee rule.” A strict application of the undivided-fee rule often denies the tenant this “bonus” value or leasehold advantage, which is likely unavailable in any new lease negotiations the tenant may undertake for a replacement site. In these and other exceptional circumstances, the undivided-fee rule fails to provide adequate compensation to tenants.11 Jurisdictions which apply the undivided-fee rule strictly regardless of the circumstances involved in the case include Alabama,12 Florida,13 Hawaii,14 Illinois,15 Indiana,16 Kansas,17 Kentucky,18 Louisiana,19 Massachusetts,20 Michigan,21 Minnesota,22 Mississippi,23 New Jersey,24 New York,25 Ohio,26 Oklahoma,27 South Carolina,28 West Virginia,29 and Wisconsin.30

Aggregate of Interest Rule

A minority of states fix the valuation by valuing each individual property interest holder’s interest, and then add the values of each of the interests to determine the value of the whole property.31 This approach is known as the aggregate of interest rule or the summation method. The states that apply this rule typically never apply the “undivided-fee rule,” reasoning that the guarantee of just compensation applies to each property interest condemned rather than a fictitious fee simple estate owned by a single entity.32 Under this approach the tenant’s interests, including the leasehold advantage in addition to value of the use and occupancy of the leasehold for the remainder of the tenant’s term, plus the value of the right to renew, less the agreed rent, are separately evaluated and added together to arrive at the total compensation.33

See Lennep v. Mississippi State Highway Comm’n, 347 So. 2d 341, 343 (Miss. 1977).
See City of Milwaukie Post No. 2874 Veterans of Foreign Wars v. Redevelopment Auth., 768 N.W.2d 749, 759 (Wis. 2009), cert. denied, 130 S.Ct. 3493 (2010).

10 See Nichols on Eminent Domain, § 12.05[1] (2013) (where exceptional circumstances exist so that strict adherence to the undivided-fee rule will fail to provide adequate compensation for all interests taken, a strict application of this rule may be unconstitutional).
17 See Commonwealth v. Sherrod, 367 S.W.2d 844, 848 (Ky. 1963).
rent the tenant would pay for such use and occupancy.

States utilizing the aggregate of interest rule include Arkansas, Arizona, Iowa, Maryland, Nebraska, Pennsylvania, and Utah. In addition, the District of Columbia utilizes this approach. Some argue that the aggregate of interest rule complies with the U.S. Supreme Court’s holding in *Boston Chamber of Commerce v. Boston*41 where the Court refused to value divided interests as though they were consolidated in one owner, as the undivided-fee rule does, because doing so defies reality as well as the protections in the Fifth Amendment of the United States Constitution: “... [T]he Constitution does not require a disregard of the mode of ownership, of the state of the title. It does not require a parcel of land to be valued as an unencumbered whole when it is not held as an unencumbered whole. It merely requires that an owner of property taken should be paid for what is taken from him. It deals with persons, not tracts of land. And the question is, What has the owner lost? not, What has the taker gained?42

Under this approach, one proceeding may be held to determine the value and the apportionment rather than the two-step process under the “undivided-fee rule.”

**Model Eminent Domain Code Approach**

Section 1012 of the 1974 Uniform Law Commissioners’ Model Eminent Domain Code43 proposes to take into account the impact of individual property interests on the fair market value of property—an approach that attempts to bridge the undivided-fee rule and the aggregate of interests rule approaches. Section 1012 of the Model Eminent Domain Code provides:

“The amount of compensation for the taking of the property in which divided interests exist is based upon the fair market value of the property considered as a whole, giving appropriate consideration to the effect upon market value of the terms and circumstances under which the separate interests are held.”44

Section 1012 allows the mode of ownership to be taken into account to the extent that the market would do so as between a willing buyer and seller.45

---

33 See *Arkansas State Highway Comm’n v. Fox*, 322 S.W.2d 81, 82-83 (Ark. 1959).
34 See *State ex rel. LaPrade v. Carrow*, 57 Ariz. 429, 114 P.2d 891 (1941); see also *Nichols on Eminent Domain § G30.02[1]* n.3 (2014).
36 See *City of Baltimore v. Latrobe*, 61 A. 203, 205 (Md. 1905).
39 Utah Code 78B-6-511 provides:

“The court, jury, or referee shall hear any legal evidence offered by any of the parties to the proceedings, and determine and assess:

“(1) (a) the value of the property sought to be condemned and all improvements pertaining to the realty;

“(b) the value of each and every separate estate or interest in the property; and

“(c) if it consists of different parcels, the value of each parcel and of each estate or interest in each shall be separately assessed.”;

See also *Town of Perry v. Thomas*, 22 P.2d 343 (Utah 1933); *Nichols on Eminent Domain § G30.02[1]* n.3 (2014).
40 See *United States v. Seagren*, 50 F.2d 333, 335 (D.C. 1931).
41 217 U.S. 189 (1910).
42 *Id.* at 195.
45 See Comment on Model Eminent Domain Code § 1012, supra.