

## Recent Utah Decision Enforces the Importance of Eminent Domain Provisions In Commercial Leases

Mar 08 2019

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A recent Utah case serves as a cautionary tale of the importance of eminent domain provisions in commercial leases. In *Utah Dep't of Transportation v. Kmart Corp.*, 2018 UT 54, 428 P.3d 1118, the Utah Supreme Court examined a provision in Kmart's shopping center lease which provided the lease terminated if eminent domain left Kmart's "points of ingress and egress to the public roadways...materially impaired." In 2010, the Utah Department of Transportation ("UDOT") condemned property which provided access to the property Kmart leased. Both Kmart, as tenant, and its landlord, FPA, sought compensation from UDOT for the condemnation of the access point. In 2012, the Utah Supreme Court held that Utah's just compensation statute required courts and appraisers to determine the value of a condemnation award for each party's property interest separately using the "aggregate-of-interests approach" and remanded it to the district court for further proceedings. Upon remand, after review of separate appraisals of FPA's and Kmart's respective property interests, the district court determined UDOT's condemnation "materially impaired access and caused the [l]ease to terminate" and awarded Kmart \$1.4 million plus interest. UDOT appealed.

On appeal, UDOT urged the Utah Supreme Court to adopt the "termination clause rule" which had been adopted by other jurisdictions. Under that rule, when a lease's termination clause is triggered, the tenant loses its claim to just compensation because any of the tenant's continuing interest in the leased property is extinguished.

Kmart argued the 2012 Utah Supreme Court decision, where the "aggregate of interests" approach was adopted, rendered UDOT's "termination clause rule" argument meaningless. Kmart argued that a condemnation clause's sole purpose is to determine the landlord's and tenant's separate shares of condemnation awards. Because the "aggregate of interests approach" determined the value of each party's interests separately, there was no reason to contract for each party's share of the award. Thus, said Kmart, the condemnation clause in its lease should have no effect.

The Utah Supreme Court disagreed with Kmart and instead adopted UDOT's "termination clause rule." In rejecting Kmart's argument, the court explained the "aggregate of interests" rule addressed only the value of a party's property interest. In contrast, the "termination clause rule" dictated whether a tenant even had a property interest following condemnation. Put another way, the "termination clause rule" determines what is *owned* where the valuation method determines what is *owed*.

In examining Kmart's lease, the Utah Supreme Court determined the termination clause was triggered when condemnation left "points of ingress and egress to the public roadways...materially impaired." Because the district court already concluded UDOT's taking left access "materially impaired," the termination clause—in terminating Kmart's lease—extinguished Kmart's property interest. Consequently, the Utah Supreme Court held Kmart was not entitled to just compensation since it no longer had an interest in the property.

Issues relating to condemnation clauses in leases have also arisen in Wisconsin. In 1980, the Wisconsin Supreme Court tacitly acknowledged that it had "become customary" to include condemnation clauses in leases. Like Utah, Wisconsin courts hold that these clauses can terminate the tenant's interest and bar any claim the tenant would have had to a portion of a just compensation award.

The importance of reviewing condemnation clauses in leases is often undervalued. Unclear drafting of condemnation clauses may also result in landlords having to share condemnation proceeds with tenant. *Maxey v. Redevelopment Auth. of Racine*, 94 Wis. 2d 375, 288 N.W.2d 794 (1980). Clauses that fail to contemplate Wisconsin's specific eminent domain rules can also result in the inability of landlords to collect attorney fees. *Van Asten v. State*, 214 Wis. 2d 135, 571 N.W.2d 420 (Ct. App. 1997).

The Kmart case serves as a warning as to the drastic effects that a condemnation clause can have on the compensation of leasehold interests in a condemnation. To avoid the potentially devastating results of a poorly worded condemnation provision, landlords and tenants should request their real estate attorneys review the condemnation provisions in their leases to confirm that their rights are adequately protected.

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