COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON 25

B-119782 July 9, 1954

The Administrator
General Services Administration

Dear Mr. Administrator:

Reference is made to your letter of April 19, 1954, requesting a decision concerning the measure of damages incident to the reported breach of the maintenance obligation by the Defense Plant Corporation and its successor and assignee, the Reconstruction Finance Corporation, under a lease dated March 2, 1943, for certain land and improvements at the New York Municipal Airport. Specifically, you request to be advised whether, in determining the amount of the Government's liability for the aforesaid breach and the failure to return the premises in good condition, the value of the realty prior to the construction of the permanent improvements thereon should be used as a basis for determining the difference between the present appraised value and the value at the time of entry upon the premises or whether for such determination the computation should be based on the value of the property after completion of the improvements by the Government.

The property was leased by the City of New York to the American Export Airlines, Inc., with the understanding that the lease would be assigned to the Defense Plant Corporation in connection with the prosecution of the war. From the facts as reported in your letter and the enclosures, it appears that the

Government's interest arose by reason of the referred-to assignment dated May 1, 1943, from the lessee to the Defense Plant Corporation. The original term of the lease is for the period beginning March 2, 1943, and ending December 31, 1952, at an annual rental rate of $4,826.57 with renewal option for one or more successive ten year terms not to exceed three, and the rental for each renewal term to be increased ten percent over the rental for the prior term. Paragraph 11 provides for cancellation of the lease by the lessee in the event of certain contingencies therein set forth. The lease contemplated erection of certain structures by the Defense Plant Corporation which in turn were to be occupied by the American Export Airlines. Paragraph 21 authorizes the construction of such buildings at no cost or expense to the lessor and paragraph 25 provides that the buildings or replacement buildings so constructed shall be and become the property of the lessor and part of the freehold and shall not be removed therefrom upon termination of the lease by expiration or otherwise.

Paragraph 12 provides that at the termination of the lease by expiration or otherwise the lessee shall yield and deliver possession of the premises to the lessor "in good condition, reasonable wear and tear excepted." Paragraph 23 provides that the lessee shall maintain "any and all buildings or structures erected thereon or any or all facilities, utilities, or services

used in connection therewith, in first class condition, ordinary wear and tear excepted, and to make any and all repairs thereto," except those items which the lessor is obligated to maintain or repair. Paragraph 26 provides for amortization of the cost of the buildings over a twenty year period, the established cost to be decreased at the rate of one-twentieth at the end of each year. However, in the event of termination of the lease before the expiration of 20 years, paragraph 27 provides that the unamortized value of the completed improvements shall be forfeited to the lessor, except under certain contingencies not here present. As indicated in your letter the right to repayment of such unamortized value does not attach to lessee's right of cancellation under paragraph 11(b) of the lease in the event of termination of the lessee's contract or right to carry air mail in and about the New York area.

It appears from the facts as stated in your letter and supplemental information furnished in letter of June 17, from your acting General Counsel, that on April 18, 1950, the lease was declared excess to the General Services Administration; that on September 26, 1950, the air carrier certificate issued by Civil Aeronautics Administration to the American Overseas Airlines was cancelled; that on June 28, 1951, the lease was renewed for a ten-year term beginning January 1, 1953, at an annual rental of $5,309.26; and that in addition to the rent, the annual insurance premiums payable by the Government under the terms of the lease amount to $13,500.

You state that in view of the unsuccessful efforts to find a tenant it is now believed to be in the best interest of the Government to cancel the lease either by mutual agreement or pursuant to the provisions of paragraph 11(b). Further, you state that the lessor has offered to cancel the lease upon the payment of $120,000, which amount is stated to represent the cost to raze the buildings and restore the site. With respect to such offer you state that while the lease does not obligate the lessee to restore, by the terms of paragraphs 12 and 23 the lessee is obligated to maintain the premises in first class condition, and upon termination of the lease to return the premises in good condition subject to the usual exceptions.

With respect to the present condition of the premises you state that they are in a state of disrepair, not due to ordinary wear and tear; that the Government is in default with respect to its maintenance obligation; that the cost of the required repairs is estimated by appraisers of the Administration at $130,000; that taking into consideration the present condition of the premises together with the restricted character of the business enterprise which may be conducted on the property and other factors, the Administrative appraisers have set a value upon the Government's leasehold interest in the property at $300,000; that the fee value of the leased property prior to the construction of the structures thereon by the Defense Plant Corporation and the current fee value thereof are not presently available but are in the course of

preparation; and that since the cost of construction of such structures totaled $1,069,146 it is obvious that the original fee value has been greatly increased.

In conclusion you state, in effect, that since as a result of the improvements made by the lessee either the leasehold value or the present fee value is greatly in excess of that required to put the building in good condition, a question has arisen whether the Administration may pay any amount to the Authority as damages for failure to repair either upon a mutual cancellation of the lease or upon cancellation under the provisions of paragraph 11(b). Your letter indicates that your doubt in the matter arises on account of what is stated to be the general rule announced in several court cases and decisions of this Office to the effect that the primary measure of damages to realty is the diminution of the market value thereof or restoration costs, if less than such diminution.

The Government's right to cancel the lease under paragraph 11(b) accrued on September 26, 1950, when the air carrier certificate issued by the Civil Aeronautics Administration to the American Overseas Airlines was cancelled. Since the Government failed to exercise the option within a reasonable time after such cancellation and since the lease was renewed over nine months after the cancellation right accrued, the cancellation right contained in paragraph 11(b) would not appear to be available to the Government

at this late date. 32 Am. Jur. Landlord and Tenant sec. 832; 51 C.J.S. Landlord and Tenant sec. 911; Alpern v. Mayfair Markets, 258 P. 2d 7. In such circumstances and in the absence of the occurrence of any other contingencies contained in paragraph 11 under which the Government properly might be authorized to cancel the lease, any refusal on the part of the Government to accept the cancellation offer would subject the Government to rentals totaling $45,128.71 for eight and one-half years, the balance of the renewal term, together with annual insurance premiums totaling $108,000. Aside from the foregoing, because of the Government's breach of the repair and maintenance obligations upon the Government's failure to effect the necessary repairs, the lessor, by merely exercising the option granted to it in paragraph 23 of the lease, could, if it so elected, make same and add the cost thereof to any rental or other Government obligations under said lease. In such event the Government would become obligated to pay such costs--administratively estimated at $130,000--under the procedure set forth in paragraph 23 of the lease. As indicated in your letter it is true that there is no obligation on the Government to restore the premises to their original condition. However, in the light of the provisions of paragraph 12 of the lease requiring the lessee to surrender the premises in good condition subject to the usual exceptions and the provisions of paragraph 23 of the lease requiring the lessee to maintain the premises in first class condition, to deny the claim on the basis presented on such a technicality--for the reasons stated above--

clearly would not be in the best interests of the Government. Further, in the light of the specific provision in paragraph 23 pertaining to the lessor's right to recover the costs incurred in the event of the lessee's breach of the maintenance and repair obligation, the decisions cited in your letter, holding, in effect, that the measure of damages is the amount by which the premises have been diminished in value because of the lessee's breach of the obligation to restore or leave in a certain condition, would not appear to be for application under the facts of this case. However, even if such theory could apply to the present case it would not operate to preclude payment of the amount of $120,000, which the lessor is willing to accept for cancellation of the lease. If the diminution theory could be applied, necessarily, it would be required to be based on the valuation of the improvements since no separate estimate has been furnished of the valuation of the land at the beginning of lease or at the present time. Since, under the express terms of the lease, the improvements which were required to be constructed by the lessee became the property of the lessor and could not be removed by the tenant, the construction cost of such improvements must be regarded as part of the rental consideration and may not be viewed as enhancing the value of the property for the purpose of determining the proper measure of damages for the lessee's breach of the maintenance and repair obligations. The evidence submitted shows the present estimated market value of the improvements as approximately $300,000. On such basis, and

considering the construction cost it follows that the fee value of the property has not been enhanced as suggested in your letter, but on the contrary, because of the lessee's breach of the maintenance and repair obligations, said fee value actually has decreased more than the amount the lessor is willing to accept for cancellation of the lease.

Accordingly, this Office would not be required to object to the payment of $120,000 to the lessor for cancellation of the lease, provided the lessor will execute a release releasing the Government from all liability arising under the lease. The foregoing is based on the assumption that the various departments and establishments of the Government have been canvassed to determine whether there is any present need for the premises. See in this connection, paragraph 10(b) of the lease.

The enclosures forwarded with your letter are returned herewith.

Sincerely,

FRANK H. WEITZEL

Acting Comptroller General
of the United States

Enclosures