FAST-FOOD RESTAURANT SEEKS JUST COMPENSATION

When the distinction between equipment and personal property becomes blurred

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In June of 2011, the Virginia Supreme Court struck down a trial court decision that centered on whether a government entity condemning a property should pay a business for equipment inside of a building, even if those items can be moved. The Court ruled that the trial court erred by striking the landowner's evidence that supported the claim that certain items should be considered fixtures, not personal property, and be included when determining just compensation.

The property in question was a Taco Bell fast food restaurant located near the intersection of Route 29 and Gallows Road in Fairfax County, Virginia. The structure was an older improvement and the main building was being severed for the construction, re-construction, alteration, maintenance and repair of Route 29. As part of the project, the building would need to be demolished. On February 15, 2008, the Commonwealth Transportation Commissioner of Virginia filed a Certificate of Take in the amount of $1,496,550 to acquire certain land and improvements owned by Taco Bell of America, Inc.

Prior to trial, the Commissioner filed a motion in limine seeking exclusion of Taco Bell's evidence relating to the nature and value of approximately 42 pieces of equipment used in the operation of the business. The Commissioner argued that because the items were movable and not permanently affixed to the real estate, they were not fixtures and should not be included in the just compensation figure. These items included standard restaurant equipment such as ovens, wire storage racks, tables, chairs, frying baskets, refrigerators, cash registers, warming trays and neon signage. The Commissioner's real estate appraiser testified that, while these movable pieces of equipment were not included in the appraisal, items that are pertinent to the real estate, such as the drive through window, exhaust hoods and walk-in freezer, could be considered part of the real property. The appraiser determined that all these items could be relocated and moved without damaging the building itself and that these items had a fair market value of $49,795.

The Virginia Department of Transportation's appraiser found the highest and best use for the property was for intensive development, and concluded that the restaurant building had no value. On the contrary, the landowner's appraiser opined that since the current Taco Bell, with a drive-through, had been in place continuously since 1970, its use provided a sufficient return to the land to justify its continued use and operation. His value opinion was $3,400,000 of which the building and related improvements had a contributory value of $331,681. Furthermore, Taco Bell's expert stated that the movable items were indeed fixtures, not personal property, and emphasized that they would have no use in the after condition. According to a company representative, Taco Bell places only new equipment in its restaurants and therefore expects them to remain in place for the lifetime of the restaurant. Taco Bell's appraiser further affirmed that the company's restaurants are typically sold with all fixtures and equipment in place, and he valued the movable items at $50,000.

The trial court ruled that these movable items should be considered personal property and that Taco Bell's decision not to use or resell the items was a "business decision." As a result, the jury was not allowed to consider if these items represented real or personal property or determine the value of the items. The trial jury awarded $1,726,802, of which $480,000 was attributed to damages resulting from a lower land value for the remainder of the site because of the acquisition. The jury award was about $230,000 over the original certificate amount.

Although the jury was not surveyed by the DOT's attorney, when evaluating the verdict it can be surmised that the jury concurred with the DOT's appraiser's opinion with regard to highest and best use. Therefore, it is apparent that the value of any furniture, fixtures or equipment that could have been presented to the jury to determine whether or not these items were real versus personal property was in fact moot.

DISCUSSION BY THE COURT

The Virginia Supreme Court ruled that the trial court erred by disregarding the landowner's evidence that supported the claim that certain items were fixtures, not personal property as claimed by the Transportation Commissioner. The crux of the case centered on whether a governmental entity condemning a property should pay a business for equipment inside of a building, even if those items can be moved.

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In this case, it was undisputed that the 42 items were moveable and not physically attached to the real estate. However, Taco Bell's argument that these items were intended to remain with the real estate for the life of the building, and that they were needed for the purpose to which the property was devoted, were the key factors in overruling the lower court.

The Virginia Supreme Court ruled that evidence on the issue of determining if the items should be considered real versus personal property was sufficient enough to be submitted to the jury in order for the jury to make a determination. Judge Lacy wrote in the decision to reverse and remand the case stating that "the intention of the party making the annexation is the paramount and controlling consideration" of the three prong test. This test also includes whether or not the items are affixed to the property and also the "… adaptation to the use of purpose to which the part of the realty to which it is connected is appropriate".

INTERPRETATION

In general, any determination of personal property should include a thorough three-part test that includes:

1) Assessment of the manner in which the item is affixed;

2) Consideration of the character or nature of the item and its adaptation to the real estate; and

3) The intention of the party who attached the item.

From the appraiser's perspective, the issue of personal property should be resolved early in the process, as the Federal Highway Administration's Uniform Act (although it may not apply in every situation) requires that a list of all personal property items be included in the appraisal. By definition, a trade fixture is not real estate endowed with the rights of real property ownership. Such items are considered personal property regardless of how they are affixed. A trade fixture, also known as a chattel fixture, must be removed by the tenant when the lease expires unless this right has been surrendered in the lease. Typical examples of trade fixtures include restaurant booths, gas station pumps, storage tanks, fitness equipment in health clubs and industrial equipment like air hoses, water pipelines and craneways. In the case of any leased property, it is important that the intention of the parties with regard to such issues be noted in the lease.

Depending on which side of the fence one sits on, this ruling by the Virginia Supreme Court can be viewed at two extremes. From the landowner's perspective, it is a landmark decision stating that moveable items can be considered part of the real estate, as long as they are needed "for the purpose to which the property was devoted." Testimony by Taco Bell representatives reinforced the argument that the items were to remain on the property for the life of the business, and that the company had no intention of reusing these items. From the condemnor's perspective, the case was simply a ruling that all the evidence (specifically whether the equipment be considered fixtures or personal property, as well as their value) should have been presented to the jury. Those on the government side of the ruling worry that in the future, an owner can argue that equipment is part of the real estate based solely on their intention to continue using such equipment in operating their business.

The Virginia Supreme Court's ruling in this case seems to negate the concept and treatment of personal property as taught in virtually every appraisal course. However, in owner occupied property, as in this case, the distinction between personal property and real property can become blurred. The 13th Edition of the Appraisal of Real Estate Valuation textbook (published in 2008 by The Appraisal Institute) states that "the distinction between fixtures and personal property is not always obvious." In the absence of a lease or other documentation, the application of common sense must prevail.

As America's infrastructure ages, and more right of way is needed to relieve traffic congestion, more businesses will likely face the prospect of eminent domain. Does this ruling cross the line? Only time will tell if this case can and will be used as the determinative test in the future.

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