

# Quarter Notes

## SUPREME COURT ALTERS LANDSCAPE FOR COMMERCIAL TENANTS IN CONDEMNATION



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Most news involving eminent domain focuses on property owners and the often discussed policy debate of government's scope and awesome authority to take title to private property. In the last 12 months, the New Jersey Supreme Court decided two cases with implications for leasehold interests. Those decisions also bring into focus a provision in any reasonably drafted commercial lease: the condemnation clause.

What may have been routine and "left to the lawyers" must now be a point of consideration for landlords and tenants.

The first case is Iron Mountain Information Management, Inc. v. City of Newark, 202 N.J. 74 (2010), and its holding is straightforward. Simply, the state's highest court held that commercial tenants do not have a right to receive actual personal notice when a property is declared an area in need of redevelopment (blighted). *Id.* at 79. That right of actual notice is only afforded to owners of record and those listed in the records of the tax assessor. *Id.*

The second case, Kearny v. Discount Center of Old Bridge, Inc., 2011 NJ Lexis 329 (NJ 2011) was decided March 17, 2011. While that case upheld Iron Mountain's denial of a tenant's right to notice, *id.* at \*12, its influence on commercial leases is harder to discern because the Court was somewhat unclear as to what extent tenants will be permitted to directly negotiate with the condemning authority.

The Court in Kearny found that leasehold interests can be condemned. *Id.* at \*34. The condemnation clause in the lease between the property owner and the tenant stated that in the event of condemnation proceedings for the "property or a portion thereof," a sale or option in lieu of condemnation, or a conveyance to a government authority, the lease would terminate and:

Tenant shall have no claim or be entitled to any portion of any amount which may be awarded as damages or paid as the result of such condemnation proceedings or paid as the purchase price for such option, sale or conveyance in lieu of formal condemnation proceedings; and all rights of the Tenant to damages, if any, are hereby assigned to the Landlord.

*Id.* at \*44.

As the Court noted, this is a fairly typical commercial lease provision, and serves to protect the landlord's condemnation award. *Id.* at \*46, \*47. The Court interpreted the above language to mean that while the tenant would have no right to a portion of any award paid to the landlord, the tenant was not foreclosed from negotiating with the condemning authority and collecting damages caused by the condemnation. *Id.* at \*50, \*51. The holding may be limited because Kearny designated the property owner as redeveloper. "There is simply nothing in the language of the clause to suggest an intention to bar a claim by a lessee or an easement holder when the landlord's fee is not at stake." *Id.* at \*51.

In fact, the Court acknowledged that had a different developer been designated, or had Kearny condemned the property itself, the award would have been limited to the property owner and the clause cutting

off the tenant's right to any damages would have been effective.

In arguing as they do, Kearny and DVL (designated developer/property owner) appear to believe that the contract between DVL and James (tenant) provides that any condemnation of any interest of any party would activate the condemnation clause. Although the parties could have written such a contract, they did not.

*Id.* at \*52.

With these cases in mind, what should you be considering the next time you are entering into a lease—or if you are taking out your own lease and trying to figure out your own rights? The Iron Mountain decision *mandates* that any tenant should ask its attorney to draft a letter to the local tax assessor requesting that its interest in the property be "noted on the assessment records as a claimant to an interest in the parcel." This language is lifted directed from N.J.S.A. 40A:12A-6(b)(3), which is the notice provision of the Local Redevelopment and Housing Law ("LRHL"). The statute directs the tax assessor to place such a note on the assessment. This should protect a tenant from not receiving notice, but it also requires trust that the tax assessor will note the assessment records in compliance with the statute. Parties negotiating a lease should discuss the procedure when the landlord receives notice that a government entity is considering condemnation for the underlying property. What is reasonable? Consider that under the LRHL, notice is sent by regular mail to property owners at least ten days prior to the blight hearing. N.J.S.A. 40A:12A-6(b)(3).

Applying the Kearny case to everyday practice, condemnation clauses should be drafted with a specific provision outlining what happens if the landlord is designated as redeveloper, and the leasehold interest is to be condemned. It is up to the parties to negotiate an outcome that fits the particular deal. This consideration should be of great importance to a tenant. First, it is not unusual for landowners to be declared the designated redeveloper of their own property. Second, a tenant's ability to obtain damages in a condemnation is already limited by law. "Without an option to buy or other relevant agreement, the lessor is generally compensated for his reversionary interest, and the lessee for damages to his leasehold." State v. Jan-Mar, Inc., 236 N.J. Super. 28, 32 (App.Div. 1989). "A tenant may not claim from the award damages for his loss of business, profits, good will, fixtures, cost of removal and the like." New Jersey Highway Authority v. J. & F. Holding Co., 40 N.J. Super. 309, 316 (App. Div. 1956). "The burden descends upon the tenant to disclose by a fair preponderance of the evidence that the fair market value of his lease was greater than the rent reserved." *Id.*

In short, these two recent decisions highlight the need for landlords and tenants to consider the possibility of condemnation more closely and to address that possibility in their leases. A typical condemnation clause, like the one considered in Kearny, should be refined to address instances where the property owner is designated redeveloper and where a third party not controlled, owned or affiliated with the property owner is designated. Condemnation clauses in leases should be reviewed, and landlords and tenants should discuss potential revisions to their current leases to address these issues.