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Recent State Supreme Court Decision Has Significant Implications for Indemnity and Insurance Clauses in Commercial Leases

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Introduction

Indemnity and insurance provisions are key components of commercial leases. However, due to a number of open legal issues related to the enforceability of these types of provisions, Massachusetts practitioners have faced the challenge of adequately protecting their clients' interests while lacking clarity as to whether certain lease provisions would in fact be deemed enforceable by state courts.

This article examines the Massachusetts Supreme Judicial Court's recent decision in *Norfolk & Dedham Mutual Fire Ins. Co. v. Morrison et al.*,[1] which resolved several open questions related to indemnity and insurance clauses in commercial leases. In particular, the court clarified that Mass. G.L. c. 186 § 15 applies to commercial leases and residential leases alike, and held that under Mass. G.L. c. 186 § 15, the parties to a commercial lease cannot contract away any amount of liability for a landlord's negligent acts. The court also distinguished between obligations to indemnify and obligations to purchase liability insurance, thereby validating commercial lease provisions requiring that the landlord be named as an additional insured under the tenant's insurance policy.

In addition to reviewing the substance of the court's decision in *Norfolk & Dedham Mutual Fire Ins. Co.*, as well as its significance with respect to commercial lease provisions, this article identifies those issues that remain unresolved following the court's decision and provides practical tips for navigating these lingering uncertainties.

Massachusetts General Laws c. 186 § 15

Massachusetts General Laws c. 186 § 15 voids lease provisions that require tenants to indemnify landlords or release them from liability for their own negligence. Specifically, § 15 provides that:

> [a]ny provision of a lease or other rental agreement relating to real property whereby a lessee or tenant enters into a covenant, agreement or contract, by the use of any words whatsoever, the effect of which is to indemnify the lessor or landlord or hold the lessor or landlord harmless, or preclude or exonerate the lessor or landlord from any or all liability to the lessee or tenant, or to any other person, for any injury, loss, damage or liability arising from any omission, fault, negligence or other misconduct of the lessor or landlord on or about the leased or rented premises or on or about any elevators, stairways, hallways or other appurtenance used in connection therewith, shall be deemed to be against public policy and void.

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The purpose of § 15 is to prevent a landlord from shifting responsibility for its own negligence to its tenants. The statute does not specify whether or not it applies to both commercial and residential leases. However, Massachusetts practitioners have long assumed that the statute applied to commercial leases and residential leases alike. The supreme judicial court in *Norfolk & Dedham Mutual Fire Ins. Co.* held that this is in fact the case, noting that there was "nothing in the words of the statute or its context that would suggest that its reach was intended to be less than all leases relating to real property."

Norfolk & Dedham Mutual Fire Ins. Co. v. Ellen Morrison et al.

The landlord in *Norfolk & Dedham Mutual Fire Ins. Co.* owned an office park and leased a portion of the property to a medical office. During the term of the lease, a patient visiting the medical office injured herself on a newly constructed cement curb in the parking lot of the office complex. The patient subsequently sued both the tenant (the owner of the medical office) and the landlord, alleging negligence. Following the commencement of that action, the landlord demanded that the tenant and the tenant's insurer, Norfolk & Dedham Mutual Fire Insurance Company, indemnify the landlord in accordance with certain provisions of the lease, as the landlord was named as an additional insured under the tenant's policy. The tenant's insurer sought a declaratory judgment in superior court that the liability and insurance provisions of the lease were void under Mass. G.L. c. 186 § 15. Accordingly, the tenant's insurer argued that it did not have a duty to defend or indemnify the landlord.

The lease contained the following liability provision:

> *LIABILITY. LESSEE shall be solely responsible as between LESSOR and LESSEE for deaths or personal injuries to all persons and damage to any property, … occurring in or on the leased premises (including any common areas as described below) and arising out of the use, control, condition or occupancy of the leased premises by LESSEE, except for death, personal injuries or property damage directly resulting from the sole negligence of LESSOR. LESSEE agrees to indemnify and hold harmless LESSOR and OWNER … from any and all liability, including but not limited to costs, expenses, damages, causes of action, claims, judgments and attorney's fees caused by or in any way arising out of any of the aforesaid matters, except for death, personal injuries or property damage directly resulting from the negligence of LESSOR. All common areas, including but not limited to any parking areas, stairs, corridors, roofs, walkways and elevators … shall be considered a part of the leased premises for liability and insurance purposes when they are used by LESSEE or LESSEE's employees, agents, callers or invitees.*

The insurance clause contained in the lease provided as follows:

> *INSURANCE. LESSEE shall secure and carry at its own expense a commercial general liability policy insuring LESSEE, LESSOR and OWNER against any claims based on bodily injury (including death) or property damage arising out of the condition of the leased premises (including any common areas as described above) or their use by LESSEE, including damage by fire or other casualty, such policy to insure LESSEE, LESSOR and OWNER against any claim up to $1,000,000 for each occurrence involving bodily injury (including death), and $1,000,000 for each occurrence involving damage to property. This insurance shall be primary to and not contributory with any insurance carried by LESSOR, whose insurance shall be considered excess. LESSOR and OWNER shall be included in each such policy as additional insureds … and each such policy shall be written by or with a company or companies satisfactory to LESSOR.*

In granting summary judgment to the tenant's insurer, the lower court judge did not rule on the validity of the liability provision, finding that it did not effectively shift liability to the tenant for injuries resulting from the "sole" negligence of the landlord in the manner prohibited under § 15. Specifically, the judge concluded that because the injury occurred in a common area for which the landlord was responsible, the injury, if it was in fact the result of negligence, could only have been attributable to the landlord's sole negligence.

In addition, the lower court judge ruled that the insurance provision of the lease was void under § 15, because naming the landlord as an additional insured under the tenant's insurance policy amounted to the type of indemnification prohibited by the statute. This holding left many commercial landlords in a precarious position, as it called into question the widespread practice of requiring that the landlord be named an additional insured under the tenant's liability insurance policy.

As noted above, the supreme judicial court ruled on appeal that § 15 does, in fact, apply to commercial leases as well as residential leases. With respect to the liability provision of the lease, the court upheld the second clause of the provision. That is, the tenant would indemnify the landlord and hold the landlord harmless from liability for injuries and property damage arising out of the use or condition of the premises *except* for injuries resulting directly from the landlord's negligence. The court found that this second provision was consistent with § 15 because it did not release the landlord from liability for injuries caused by the landlord's negligence.

The court then turned to the first clause of the liability provision, which had been the focus of the lower court judge's review. This clause provided that the tenant would be solely responsible for injuries and damage occurring on the leased premises, *except* for those resulting from the "sole negligence" of the landlord. The court found that the language would effectively shift to the tenant responsibility for injuries and damage arising from negligent acts for which the landlord may be partially, but

not solely, responsible. Consequently, the court concluded that the clause was void as violative of § 15. The effect of this holding is that under § 15, the parties to a commercial lease cannot contract away any amount of liability for a landlord's negligent acts.

Additionally, the court disagreed with the lower court's ruling that the insurance provision amounted to the type of indemnification barred by the statute, concluding instead that indemnity provisions impose "obligations that are separate and distinct from the obligations imposed by an insurance provision." The court reasoned that § 15 does not apply to insurance provisions because the duty of indemnification resides not with the tenant, but rather with the insurer. In support of its conclusion, the court cited a federal district court decision interpreting Massachusetts law [*Great N. Ins. Co. v. Paino Assocs.*, 364 F.Supp.2d 7(D. Mass. 2005)], which distinguished an obligation to purchase liability insurance from an obligation to indemnify in a dispute involving a commercial lease and the provisions of § 15, as well as a number of cases from other jurisdictions that have recognized this distinction. This holding validates lease provisions requiring that the landlord be named as an additional insured under the tenant's insurance policy.

Nevertheless, while the court's decision in *Norfolk & Dedham Mutual Fire Ins. Co.* resolved a number of open questions with respect to indemnity and insurance clauses in commercial leases, it also raised new questions with which commercial landlords and tenants must now grapple.

Remaining Open Issues—Waivers of Subrogation and Tenants Who Opt to Self-Insure

The most significant open issue after *Norfolk & Dedham Mutual Fire Ins. Co.* concerns the relationship between waivers of subrogation and tenants who self-insure. In order to demonstrate the ambiguity that remains, each of these issues will be addressed in turn below.

Simply stated, the right of subrogation is the right to pursue another party's claim as if it were your own. As many readers are aware, it is quite common in commercial leases for the parties to waive subrogation rights. Waivers of subrogation typically state that the parties each waive rights of recovery against the other to the extent that the loss is covered by insurance, and that the parties agree to obtain insurance policies in which a party's insurance company waives any rights of subrogation that it may have against the other party, even if the other party were at fault.

The reason for including a waiver of subrogation in a lease is illustrated by the following example: Suppose that a building built by the tenant is damaged in a fire caused by the landlord's negligence. Without a waiver of subrogation, and assuming that the tenant is carrying fire insurance, the insurance company could pay the tenant for the value of the damaged portion of the building and then bring an action against the landlord to recover the amount it paid to the tenant. In most cases, such a result is contrary to the parties' intent, as the parties typically intend that both parties benefit from the protection of the insurance policy. A waiver of subrogation will ensure that both parties are protected when damages occur. Under *Norfolk & Dedham Mutual Fire Ins. Co.,* a waiver of subrogation, on its own, is still valid, since a third-party insurer, not the tenant, would be the party releasing the landlord from liability.

Just as it is common for commercial leases to include waivers of subrogation, it is not uncommon for commercial leases to provide that tenants may self-insure. This option is appropriate for sophisticated tenants with sufficient resources to give landlords comfort that they will be able to cover any damages that may arise during the term of the lease and that would otherwise be covered by an insurance policy. It is typical to require that a party satisfy certain creditworthiness tests in order to qualify for self-insurance. In almost all cases, even if full self-insurance is not permitted, some form of self-insurance exists because of the presence of insurance deductibles and coinsurance arrangements, which require that the insured pay for a portion of any losses. While self-insurance more typically involves casualty issues, it is not uncommon in liability issues, as well, where some insureds maintain huge deductibles (sometimes called self-retention). Self-insuring is advantageous for tenants because it can represent significant savings as compared to the cost of procuring and maintaining insurance through a third-party insurer.

Where a lease includes a waiver of subrogation and also provides that the tenant may self-insure, the landlord is no longer released from liability by a third-party insurer, which would be valid under *Norfolk & Dedham Mutual Fire Ins. Co.,* but is instead released from liability by the tenant. As discussed above, after *Norfolk & Dedham Mutual Fire Ins. Co.,* lease provisions in which the tenant agrees to release the landlord from liability arising from the landlord's sole, or even partial, negligence are void under §15. Thus, it is unclear whether waivers of subrogation will still be enforceable in cases where tenants have opted to self-insure.

Practical Tips/Suggested Language

After *Norfolk & Dedham Mutual Fire Ins. Co.,* parties that wish to include both a waiver of subrogation and a provision stating that the tenant may self-insure run the risk that a court could deem the waiver of subrogation provisions unenforceable, even if the tenant does not elect to self-insure. In such a scenario, the landlord would be left without the benefit of the waiver, even if the tenant did not self-insure. However, if a landlord is willing to take this risk, it should be sure to include carefully drafted language in the insurance section of its lease, so that it is protected to the maximum extent possible.

Suggested language in this instance is as follows:

> *During all periods in which the Tenant shall be permitted to self-insure its merchandise and leasehold improvements in the demised premises, the rights and obligations of the Landlord and the Tenant shall remain the same as if the Tenant shall have purchased and*

kept in force thereon insurance from an independent, institutional insurer of recognized responsibility, and, without limitation, the provisions of Sections ___ [Landlord has no liability for Tenant's Fixtures Furniture & Equipment] and ____ [waiver of subrogation] of this lease shall remain in full force and applicable. Without limitation of the foregoing, it is specifically agreed that if Tenant so self-insures in accordance with the foregoing, and with respect to any and all payments made by Tenant (i) to satisfy any applicable insurance deductible and (ii) pursuant to any coinsurance arrangements, Tenant shall, for purposes of Mass. G.L. c. 186 § 15, be deemed to be the insurer of any loss which is suffered by Tenant as the result of so self-insuring, and Tenant hereby expressly waives any claims it may have against Landlord for losses in excess of such self-insurance even if such damage arises from the negligent acts or omissions of Landlord, or Landlord's agents or employees; provided, however, that Tenant shall not be required to pay "proceeds" to any person or entity as the result of being deemed the insurer of any such loss. The foregoing provisions (as well as any other provisions dealing with indemnity and the like by Tenant of Landlord) shall be deemed to be modified in each case by the insertion in the appropriate place of the language: "except as otherwise provided in Mass. G.L. c. 186 § 15".

The last saving clause is most critical to try to protect the enforceability of the release of liability when the tenant insures with a third-party insurance company.

Conclusion

The court's decision in *Norfolk & Dedham Mutual Fire Ins. Co.* provided much-needed guidance with respect to the enforceability of indemnification and insurance provisions in commercial leases, clarifying that: (i) Mass. G.L. c. 186 § 15 applies to commercial leases; (ii) § 15 should be strictly interpreted to preclude landlords from shifting any responsibility for their own negligence to tenants; and (iii) lease provisions requiring that the tenant name the landlord as an additional insured under the tenant's insurance policy are valid.

The issue remains whether a tenant who self-insures will be able to assert a claim against the landlord for damages arising out of the landlord's negligence because of its status as a tenant and the impact of Mass. G.L. c. 186 § 15 or whether the tenant can waive that claim by placing itself in the status of an insurer. The careful draftsperson will seek to put the issue in its best light, but also will draft so that the nullifying effect of Mass. G.L. c. 186 § 15 is limited.

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[1] *Norfolk & Dedham Mutual Fire Insurance Co. v. Morrison*, N.E.2d, 2010 WL 1345156 (Mass. April 8, 2010).

Access Denied: When a Taking of Property Is Not a 'Taking'

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Recently, the Indiana Supreme Court held that property owners are not entitled to compensation for reduced traffic flows caused by street configurations or for limitations placed upon a property, which prevent the expansion of existing access points. This case is a recent example of how "*just* compensation" in condemnation of access cases has come instead to mean *no* compensation. The reasoning for the decision's refusal to award damages to property owners for loss of access is antiquated, inconsistently applied and counter to the concept of just compensation. Though it may take legislative action to correct, it is time for the law to recognize realty: that is, access is a valuable property right, and loss of or impairment to such access caused by state action negatively impacts the property's value and, therefore, demands the payment of compensation.

In *State of Indiana v. Kimco of Evansville, Inc.,* the State sought to acquire by eminent domain a strip of land owned by Kimco Realty.[1] The roadway improvements resulted in lane modifications that restricted southbound drivers from directly entering the shopping center. In addition, the shopping center lost the ability to add access points or to widen the existing access points in the future.[2] The State recognized its obligation to pay the shopping center for the strip of land, but refused to compensate the shopping center for "consequential damages" resulting from the reduced customer flow.[3]

Kimco's appraiser testified to damages of approximately $2.3 million.[4] The trial court denied the State's objections to Kimco's presentation of access damages, and the jury awarded Kimco $2.3 million. The Indiana Court of Appeals affirmed the trial court's verdict and award, finding that the State's improvements amounted to more than mere inconvenience and that Kimco suffered a taking as a matter of law.[5]

On the State's appeal, the Indiana Supreme Court, in a 3–2 opinion, reversed, finding that under Indiana law, the physical taking of the strip of land and the State's "coincident roadway improvements" were distinct governmental actions, "even if concurrent."[6] In its opinion, the court reaffirmed its previous holding in *State v. Ensley* that "roadway improvements that reduce or interfere with traffic flow to a commercial property do not constitute takings of a property right of the owner of the property."[7] Critical to the court's decision was the fact that, although the shopping center in Kimco could not add access drives or widen its entrances, and while the traffic flow to the shopping center had been redirected, "[n]either of the property's existing points has been eliminated or narrowed as a result of the condemnation. Nor have any of the reconfigurations deprived the owners of their rights of ingress or egress."[8]

In reaching its holding, the court explained that commercial property owners do not have property rights in the "free flow of traffic" past their properties nor do they have a right to "unlimited access" to adjacent property at any point along a state highway.[9]

Consequently, the State's coincident roadway improvements that redirected customer traffic flow and reduced revenues to the shopping center did not constitute a compensable taking.[10] While the Indiana Supreme Court's decision in Kimco denied the property owner damages relating to access, it did not change existing law. If anything, it left open the issue in Indiana of whether compensation would have been awarded for access damages, had the State eliminated or narrowed one of the property's existing points of access points.

The issue of whether a property owner is entitled to compensation for a limitation of access is one that has been raised numerous times in numerous jurisdictions. While all property owners recognize that access is a critical component of the property's value, it is often a property interest that can be substantially altered or impaired by the government without payment of just compensation.

Access Is a Recognized Property Right

Over the decades, there has developed a universal rule that the owner of land abutting a street or highway has a right of access to and from the adjacent street.[11] The right is considered a natural easement and an incident of land ownership. Consequently, access is a property right, and its deprivation requires payment of just compensation.[12] While a property owner's right of access is almost universally recognized, it is not unlimited. Rather, courts have determined that a property owner is not entitled to access to his or her land at every point between it and the highway, but only to "free and convenient access" to the property and improvements on it.[13] Moreover, through the exercise of its police power, a government may regulate access to and from the road for public safety and welfare.[14] Consequently, the rights of an abutting property owner are deemed subordinate to the right of the public to the proper and safe use of the highway, as well as the right of the government to regulate such access.

Police Power v. Eminent Domain: A Property Owner Is Entitled Only to 'Reasonable' Access

Where a government's police power is properly exercised, the regulation does not constitute a taking for which just compensation is required.

> The general rule is that acts done in the proper exercise of governmental powers, or pursuant to authority conferred by a valid act of the legislature, **and not directly encroaching on private property**, although their consequences may impair its use or value, do not constitute a taking … and do not entitle the owner of such property to compensation, **in the absence of constitutional or statutory provisions requiring compensation to be made for damaging**, injuring, or destroying property. [*State, by Comer of Transp. v. Divert*, 319 N.J. Super. 310, 321, 725 A.2d 119 (App. Div. 1999) (citing, *inter alia,* 29A *C.J.S. Eminent Domain* § 84 at 238 (1996).]

Generally, a state or municipality may do many things that are not compensable to an abutting property owner, such as the rerouting or diversion of traffic; the use of suitable traffic control devices; prescribing one-way traffic; prohibiting particular types of turns at specified places; and restricting the speed, weight, size and character of vehicles allowed on certain highways. Furthermore, a state or municipality may, in the lawful exercise of the police power, regulate the right of ingress or egress to a street or highway without compensation, as long as there is no unreasonable or absolute denial of ingress, or egress to the street or highway. Any inconvenience, reduction in profits or depreciation in value of the property that results from the legitimate exercise of the state's police power is *dumdum Basque injuries* (i.e., no legal damage).

It is the recognition of the government's general police power and the determination that a property owner has only a right to "reasonable" access that has severely limited a property owner's ability to obtain compensation for any taking or modification of access by a governmental agency. In essence, the limitation placed upon a property owner's right of access and the broad police powers conferred upon the sovereign are in conflict with a property owner's constitutional right to just compensation under the Fifth Amendment of the Constitution.

Courts have long recognized the difficultly in determining where the line of permissible regulation of access ends and where such regulations cross acceptable boundaries resulting in a compensable taking. In considering the breadth of the police power, Justice Douglas noted in *Berman v. Parker,* 348 U.S. 26, 32, 99 Led. 27, 75 Sect. 98 (1954):

> An attempt to define its reach or trace its outer limits is fruitless, for each case must turn on its own facts. The definition is essentially the product of legislative determinations addressed to the purpose of the government, purposes neither abstractly nor historically capable of complete definition.

Thus, while the police power is difficult to define, courts for the past century have nonetheless consistently erred on the side of granting broader powers to the government at the expense of property owners.

The Cited Reasons for Denying Access Damages Are Dubious

Many courts have denied compensation for a limitation of access by holding that the right of access is not specific to a particular location, and, thus, is subject to regulation without compensation so long as some reasonable access remains. Such a holding fails to recognize that in today's world, access is often specific to a particular location. That is, due to the expansion of the government's regulation of access, it is typical that a property will only have access to the abutting roadway due to the grant of a permit for such access from the State. Such a permit is specific to a particular location. Moreover, it is quite often the case that the property owner will have gone through an approval process at considerable expense to secure such a permit. Accordingly, the justification that access is not specific to a particular location does not hold true when the government eliminates or modifies an existing permitted access point.

Courts often improperly separate the modification or limitation of access from the taking, although they are part of the same project and jointly may result in damages to the property. Any attempt to carve out the access modification from the taking or project is flawed. First, any change to an existing access point requires a taking. Quite often, a governmental entity will need to directly encroach on private property in order to implement the changes to access.

For example, when a governmental entity revokes an access permit as part of a roadway improvement project, it will typically need to enter the site in order to curb across the access point. Furthermore, access changes often result in on-site damages such as a reduction in maneuverability or on-site circulation and a loss of building design options. Accordingly, any physical encroachment or on-site damage demands the payment of just compensation. Second, it may be impossible in certain instances to separate which damages stem from the taking as opposed to those that stem from the change in access. Third, it is impracticable to try to completely eliminate access from consideration when estimating damages. Certainly, the availability and convenience of access was a consideration in any comparable sale that is to be used by an appraiser, though it will not show as a line item on the sales records. From an appraisal perspective, a sale that was comparable before, when a property had direct access to a state highway, may no longer be comparable to the property in the after-taking/after-access modification property if its access is limited to a local roadway. Any new comparable sales will inherently reflect the change in access.

What Is Reasonable or Free and Convenient Access?

In declining compensation for a loss of access, courts have frequently held that a property owner is not entitled to access to his or her land at every point between it and the highway, but only to free and convenient access to the property and improvements

on it.[15] In other words, so long as the remaining access is reasonable, there is no taking. Nevertheless, courts differ on what they consider reasonable or convenient.

The determination of whether a property owner has reasonable or free and convenient access following a governmental action is ultimately a question of whether there has been a taking. The question of whether or not there has been a taking (i.e., whether free and convenient access has been impaired or whether reasonable alternative access has been provided) is a question of law to be answered by the court. Nonetheless, certain courts defer to the actions and/or findings of the governmental agency that is regulating the access. In other words, the court is deferring to the fox that is watching the hen house.[16]

In condemnation cases examining damages caused by a change in access, the analysis of whether free and convenient access has been impaired or whether reasonable alternative access has been provided is often limited to engineering standards established by the government while ignoring real market considerations. Moreover, considerable time is spent by litigants and the court fighting over such a nebulous issue, attempting to examine it mathematically rather than from a practical standpoint.

For example, courts will ordinarily find that an access change that results in inconvenience or circuity of travel is generally held to be non-compensable. However, we are also told that the remaining access must be reasonable, convenient and direct. At what point does circuitry of travel become compensable—requiring customers to drive an additional mile, 3 miles, 10 miles? Certainly, it is possible to have a car travel the extra mileage or take the alternative route, but at what point does it become inconvenient? Also, while the question of whether a taking has occurred is a question of law, the question of whether access is reasonable is essentially fact-based. As a result, is it more appropriate for the jury to make such a determination?

In addition, regardless of whether the court or a jury is making the determination, an examination of whether the alternative access is reasonable should take into consideration real market impacts. From a market perspective, anyone with a general knowledge about commercial real estate would tell you that the property is less valuable as a result of the loss of access or by causing customers to have to take a more circuitous route. Often, the market impacts from a limitation of access can be significant. Nevertheless, the loss in value that may result is rarely, if ever, a consideration in the determination as to whether such alternative access is reasonable or convenient.

Courts differ considerably as to what they consider reasonable. As a result, the analysis of whether a modification of access is compensable is inconsistently conducted and the results difficult to predict. Rather than attempt to quantify reasonableness or convenience, the fact that other means of access to the property are available merely should affect the amount of damages—not the right of recovery itself. Such a rule would reduce unnecessary litigation, recognize how the market actually values land and better reflect the safeguards of the Fifth Amendment.

The Denial of Damages Caused by a Limitation of Access Is a Denial of Just Compensation

The Fifth and Fourteenth Amendments of the Constitution require that no private property shall be taken without the payment of just compensation. The Constitution requires that a property owner must be made whole for the taking, and should be put in as good a financial position as if his property had not been taken. Just compensation implies full indemnity to the owner. In this sense, just compensation must be the full and perfect equivalent for the property taken and should include all elements of value that inhere to the property. Moreover, the Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.[17]

Accordingly, we are told that just compensation should be the fair market value of the property at the time of the taking, which is to be ascertained by what a willing buyer would pay in cash to a willing seller. Nonetheless, when it comes time to compensate a property owner, the change in access is ignored, even though it is an item that any willing buyer and seller would most certainly consider in an open-market transaction.

By denying property owners' compensation for a diminution of access, courts are depriving property owners of just compensation. The property owner is not made whole if damages caused by the limitation of access are not included; the property owner is not paid the full equivalent for the property taken if access is not considered; a property owner is denied the fair market value of his property when access is eliminated from consideration. Access is an important property interest and any governmental access that limits or reduces access demands the payment of just compensation. The law already recognizes that access is a property right. It is time for the law to take the next step, recognizing that any regulation or obstruction that injures limits or deprives an abutting property owner access to and from his property is a taking for which compensation should be paid.

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[1] *State of Indiana v. Kimco of Evansville, Inc.*, 902 N.E.2d 206, 208 (Ind. 2009).

[2] *Id.* at 214.

[3] *Id.* at 209.

[4] *Id.* at 209.

[5] *Id.* at 209-210.

[6] *Id.* at 216.

[7] *Id.* at 208 [citing *State v. Ensley,* 240 Ind. 472, 164 N.E.2d 342 (1960)].

[8] *Id.* at 214.

[9] *Id.* at 214-215 (citations omitted).

[10] *Id.* at 215-216.

[11] 4 Nichols on Eminent Domain § 13.23[1] (Sackman, 3rd Ed.).

[12] *Id. See Mueller v. N.J. Highway Auth.,* 59 N.J. 583, 158 A.2d 343 (App. Div. 1960).

[13] *Mueller, supra,* 59 N.J. at 595 (citations omitted). *See Wolf v. Department of Highways,* 422 Pa. 34, 220 A.2d 868 (1966).

[14] 4 Nichols § 13.23[1].

[15] *Mueller, supra,* 59 N.J. at 595.

[16] In New Jersey, the Legislature delegated authority over State highway access to the New Jersey Department of Transportation (NJDOT) through the *State Highway Access Management Act*, N.J.S.A. 27:7-89 to -98, (the SHAM Act) and its implementing regulations. The NJDOT has established a process for determining, in the case of a revocation of access, whether it has provided reasonable alternative access. Though a property owner has a right to challenge the determination of the commissioner of NJDOT, the courts will give deference to the commissioner's determination. There are no reported decisions involving a challenge to this process.

[17] *Armstrong v. United States,* 364 U.S. 40 (1960).

DOJ Update of ADA Regulations on Public Accommodations

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The U.S. Department of Justice (DOJ) is updating the regulations under Titles II (public sector) and III (public accommodations) of the Americans With Disabilities Act by adopting new Final Regulations and a pair of Advance Notices of Proposed Rulemaking (ANPRMs).

The new Final Regulations were published in the *Federal Register* on September 15, 2010. They are scheduled to take effect March 15, 2011. Compliance for new construction and alterations as well as barrier removal is required by March 15, 2012. Comments on the ANPRMs must be submitted no later than January 24, 2011.

The Title III changes include revisions to the DOJ's regulations related to accessibility requirements in design and the construction of new or renovated public establishments and facilities. Entities that own, develop, build, or manage commercial facilities or facilities of public accommodation will be interested in these changes.

The revisions adopt standards for accessible design that are consistent with the proposed ADA-ABA Accessibility Guidelines, which were published by the U.S. Architectural and Transportation Barriers Compliance Board (Access Board) in July 2004. The DOJ has used the Access Board standards as guidelines; now, they will be mandatory.

Before the effective date of compliance with the new 2010 standards, existing facilities not in compliance with the 1991 standards must be modified to the extent readily achievable to comply with either the 1991 standards or the 2010 standards. On or after the compliance date, such facilities that do not fall under the safe harbor must be modified, to the extent readily achievable, to comply with the 2010 standards.

Beyond issues of accessible design, the new regulations also address a variety of accessibility issues, such as:

- Selling and issuing tickets to individuals with disabilities;
- Standards for when accommodation of service animals must be provided;
- A new two-tiered approach to wheelchairs and other power-driven mobility devices;
- The provision of auxiliary aids or services to assist in communication with disabled persons, depending upon the nature, length and complexity of the communication involved;
- The option to use, in appropriate situations, video remote interpreting (VRI) services in order to communicate with patrons with disabilities; and
- Rules governing the making of reservations in places of lodging, as well as the extension of certain Title III rules to timeshares and condominium hotels.

Examples of the changes regarding accessibility design appear below:

- ***Reach Range Requirements.*** The side reaches range requirements for covered elements (outlets, switches, thermostats and other controls) have been modified from a range of 9 in. to 54 in. above finished floor elevation to 15 in. to 48 in. above finished floor elevation.
- ***Water Closet Clearances in Single-User Toilet Rooms.*** The clearances in single-user toilet facilities must now provide clearance for both forward and parallel approaches; and, in most situations, the lavatory cannot overlap the water closet clearance. The new standard now provides for a door that swings into the clearance, if there is sufficient clear floor space within the toilet room beyond the door's arc.
- ***Assembly Areas.*** Although the overall number of seating for people with disabilities has been reduced in large facilities (more than 500 seats), the new design standards provide more specific guidance on vertical and horizontal dispersion, sightlines over other standing spectators, companion seating, and accessibility of lawn and overflow-seating areas.

Circulation Paths and Accessible Routes

In employee work areas, the new 2010 standards require new and altered work areas to include accessible common-use circulation paths rather than merely access to approach, enter and exit the area.

Additionally, all accessible routes that connect site arrival points with accessible building entrances must now coincide with or be in the same area as general circulation paths. Where such a general circulation path is in the facility's interior, the accessible route must also be located in the interior. Furthermore, where levels of a parking garage have direct pedestrian con-

nections to another facility, each of the facility's direct entrances must be fully accessible. Directly accessible routes to stages, whether temporary or permanent, are also required from seating areas if such a circulation path exists for people without disabilities.

Service Animals

The new rules require public accommodations to modify their policies to allow for the use of service animals by individuals with disabilities. For example, the rules prohibit surcharges against individuals accompanied by service animals. The same rules, however, do provide that disabled individuals, and not affected covered entities, are responsible for the care and maintenance of the service animals that they use. Under the rules, public accommodations may make only two inquiries when assessing a disabled individual's need for a service animal and their responsibility to accommodate that individual: (1) whether the use of the animal is required because of a disability and (2) what tasks or services the animal is trained to perform. Public accommodations may exclude only those animals that cannot be controlled by the disabled individual attempting to use them and those animals that are not housebroken.

Under the rules, a service animal is defined as a dog that has been trained to do work or perform tasks for an individual with a disability, including physical, sensory, psychiatric, intellectual or other mental disability. Although it is not technically considered a service animal under the rules, a miniature horse must also be permitted by a public accommodation when the horse has been specifically trained to do work or perform tasks for an individual with a disability and it would be reasonable for a public accommodation to permit use of the animal. The rules provide factors that public accommodations must consider when assessing the reasonability of their permitting the use of miniature horses by individuals with disabilities.

Wheelchairs and Other Power-Driven Mobility Devices

Under the new rules, covered entities must modify their practices and procedures to allow for the use of wheelchairs, manually powered mobility aids and other power-driven mobility devices. Public accommodations now must ensure that individuals who require the use of wheelchairs—which are any manually operated or power-driven devices designed primarily for use by individuals with mobility disabilities—or manual mobility aids, such as crutches and braces, have access to any areas open to pedestrian use. Public accommodations must also make reasonable modifications to allow for the use of other power-driven mobility devices by individuals with disabilities when such use does not compromise legitimately adopted safety guidelines.

Under the new rules, the term "power-driven mobility device" includes *any* mobility device powered by batteries, fuel or other engines, regardless of the use for which the device is primarily designed. The rules specifically include golf carts and electronic personal assistance mobility devices (EPAMDs), such as the Segway PT, within this definition. In assessing the safety risks posed by the allowance of power-driven mobility devices other than wheelchairs, public accommodations are required to consider specific factors enumerated in the rules, including a facility's volume of pedestrian traffic and the risk of serious harm that the use of such devices may cause to the accommodations' immediate environment and natural or cultural resources.

Effective Communication

Other sections of the new rules require that public accommodations communicate effectively with patrons with disabilities. For example, these sections require that public accommodations not rely upon individuals with disabilities to be accompanied by nondisabled individuals in order to interpret for the disabled individual. Instead, the public accommodation must provide auxiliary aids or services that will vary, based on the nature, length and complexity of the communication involved. The new regulations also give public accommodations the option to use, in appropriate situations, VRI services to communicate with patrons with disabilities. However, public accommodations using VRI must ensure that they do so with high-quality equipment and in a clearly visible and audible fashion.

Reservations Made by Places of Lodging

Under the new rules, places of lodging, including hotels, motels, inns and other entities that provide guest rooms under similar conditions and with similar amenities, must modify their policies and procedures to ensure access by individuals with disabilities. Specifically, the rules require that places of lodging ensure that individuals with disabilities are able to make reservations for accessible rooms during the same hours and in the same manner as nondisabled individuals who do not need accessible rooms. Places of lodging must also provide information in detail sufficient to allow individuals with disabilities to assess whether particular rooms meet those individuals' specific needs and ensure that accessible rooms are held for use by disabled individuals until all other rooms have been rented. The new rules will go into effect six months after their publication in the *Federal Register.* Note, however, that the effective date for 2010 ADA Standards for Accessible Design and those regulations related to Reservations Made by Places of Lodging is 18 months from the publication date.

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Federal District Court Case Involving Classification of Franchisees Raises Concerns

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On March 23, 2010, in *Awuah, et al. v. Coverall North America, Inc.*, Civil Action No. 07-10287-WGY, Judge William G. Young of the U.S. District Court for the District of Massachusetts granted the plaintiffs' motion for partial summary judgment. The court found that under state law, Coverall's Massachusetts franchisees had been misclassified as independent contractors.

The court found that the commercial cleaning franchisees should have been treated as employees, which would require franchisor Coverall to pay a variety of taxes and obtain insurance, among other things.

In its misclassification ruling, the court found that Coverall was not able to establish the second prong of a three-prong test set forth in the Massachusetts Independent Contractor Law. The law provides that an individual performing a service is considered an employee, unless the following apply:

1. The individual is free from control and direction in the performance of the service, both under his or her contract, and in fact;

2. The service is performed outside the usual course of the employer's business; and

3. The individual is customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed.

To satisfy the second prong, Coverall was required to establish that the worker performed services that were part of a business independent of Coverall. But the court found that some cases cited by Coverall to support its assertion that franchising is a business distinct from the cleaning service business actually suggested the opposite. The court even stated that, based on one such case, the franchising business "sounds vaguely like a description for a modified Ponzi scheme."

The court did find the following facts to be persuasive—that is, that Coverall had:

1. Trained its franchisees;

2. Provided them with uniforms and identification badges;

3. Contracted with customers until May 2009;

4. Billed all customers for the cleaning services performed; and

5. Received a royalty on revenue earned on cleaning services.

However, at the beginning of trial, the plaintiffs failed to present sufficient evidence of damages for the misclassification claim, so the court dismissed it. The plaintiffs proceeded to trial with their remaining claims; and, on May 26, 2010, the jury entered a verdict in favor of Coverall after all but two of the original plaintiffs had been dismissed.

Coverall is likely satisfied with the favorable verdict and dismissal of the misclassification claim. However, it appears that the legal dispute will continue, as the court permitted the plaintiffs to file an amended complaint on July 9, 2010, adding new class members based on the misclassification ruling. As a result, this case may yet evolve into a class-action claim on behalf of other Coverall franchisees in Massachusetts.

Potential Consequences

Although the *Awuah* court ultimately dismissed the plaintiffs' claims for damages, it did so because the plaintiffs failed to show damages from the misclassification—not because the court changed course; the court found that the franchisees were not Coverall employees.

While it is unclear how other courts will approach the issue, especially in states that use a test similar to that of Massachusetts, determining whether a franchisor is the "employer" of its franchisees or its franchisees' employees could have serious consequences. For example, a franchisor could be held liable for the acts of its franchisees or their employees, failing to withhold or remit certain taxes, violations of workers' compensation statutes, and employment discrimination committed by a franchisee.

Moving Forward

What steps should a franchisor take to minimize the danger that a court will determine it to be the employer of its franchisees? The answer will vary from one franchise system to another, but every franchisor should minimize the amount of day-to-day control over its franchisees' businesses without weakening the franchisor's ability to maintain and protect its brand.

To devise an approach that will minimize a franchisor's potential exposure, it is important to review the company's actual operations, and consider certain revisions to the following: the franchisor's disclosure documents, the franchise agreement and related contracts, the operations manual, and the manner in which the franchisor polices its system standards.

Awuah is one example of the attacks on independent contractor status that are being waged nationwide by legislatures, regulators and plaintiffs. In particular, states view this as an income stream in a time of financial shortfalls. The elements of the legal analysis will vary widely, depending on many factors.

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New Compliance Burdens for Gift Cards and Consumer Promotions

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Nearly every company that sells a gift card or provides promotional benefits to consumers will need—as of August 22, 2010—to comply with the CARD Act (Credit Card Accountability, Responsibility and Disclosure Act of 2009). But what is the CARD Act, and how will it affect your loyalty programs and your gift cards?

Broader Scope Than You May Realize

The CARD Act sounds like one more consumer credit regulation, but almost any business that uses modern technology to interface with consumers needs to pay attention. In fact, the CARD Act covers gift cards; gift certificates; and, to the surprise of many, offers and rewards from promotional programs (e.g., certain online coupons and sweepstakes prizes) and/or loyalty programs (e.g., programs awarding customers "$10 off" coupons or cards after spending a certain amount of money at a particular store). The CARD Act imposes disclosure requirements on offers and rewards from promotional and loyalty programs, and implements both substantive requirements and disclosure requirements for gift cards, gift certificates, and the like.

Among the CARD Act's other changes to common industry practice, all gift cards and other covered items sold on or after August 22, 2010, must:

(a) Have an expiration date of the underlying funds of no earlier than five years after purchase or re-load (or no expiration date at all), with that expiration date clearly and conspicuously displayed on the card; and

(b) Not impose dormancy, inactivity or service fees against the consumer unless there has been no activity on the gift card within the prior year and, even then, only one fee (of any type) can be charged per month and only as long as the fees are clearly and conspicuously disclosed to the consumer before the consumer purchases the card.

The CARD Act also requires covered offers or rewards from promotional offers and/or loyalty programs to:

(a) Be labeled on the front of the offer or reward with "Reward," "Promotional" or a similar statement;

(b) Be labeled on the front of the offer or reward with the expiration date for the underlying funds, if there is an expiration date;

(c) Disclose on or with the offer or reward the amount and conditions of fees, if there are any fees associated with the offer; and

(d) Disclose on the offer or reward or offer a toll-free telephone number and website if there are any fees associated with the offer.

Compliance Required by August 22, 2010; Lawsuits May Ensue

Even those who knew this was coming may be surprised by the looming deadline for compliance. An "extension" related to the CARD Act that Congress passed this past spring has lulled many into believing that they need ***not*** comply with the CARD Act until January 31, 2011. This extension, however, does not apply to all the provisions of the CARD Act. In fact, the extension is very limited in scope, applying only to gift cards and promotions produced before April 1, 2010.

As a result, the vast majority of gift card products and programs must still comply by ***August 22, 2010,*** and even those that qualify for the extension require some amount of compliance by August 22, 2010 (i.e., certain disclosure requirements must be met). Consequently, now is the time to put products and programs into compliance. Failure to act could subject the non-complying party to lawsuits from individual consumers or even class-action suits.

Penalties for non-compliance may include actual damages, statutory damages of $100 to $1,000 per consumer (subject to a cap in class actions of the lesser of $500,000 or 1 percent of the defendant's net worth) and the costs of the suit, including attorney fees. A prompt investment in compliance now may avoid the great expense of litigation later.

Compliance Required by Both Issuers and Vendors

What's more, the CARD Act unambiguously states that *all* parties involved in the sale of gift cards are responsible for compliance. The Final Rule promulgated by the Federal Reserve Board encourages all parties in the distribution chain (e.g., the

issuer, program manager and retailer) to contract among themselves to allocate responsibility for compliance and to impose liability for non-compliance. As a result, products and programs should be reviewed for compliance with the CARD Act, and existing agreements with other parties in the distribution chain must now be re-evaluated.

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A Shopping Center Developer's Guide to Carried Interest Legislation

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The typical shopping center seems far removed from the Wall Street hedge fund and private equity world, and yet these two worlds are now brought together by politics and proposed changes to partnership tax law. A developer spends years laying the groundwork for a shopping center and accepts all liability for the project before being joined by long-term investors, whereas a fund manager raises money for a fund and then invests it.

The two situations certainly seem very different. The developer views the investor as joining his project, and does not see himself merely as a manager of someone else's money. However, despite the differences, the two have something in common: Both determine a portion of their economic return through what Congress calls a "Carried Interest."[1] Even the terminology can seem foreign to developers who have traditionally used the term "promote" to define their share of back-end profit that exceeds their share of capital investment.

This Carried Interest is under attack by Congress. The wealth of certain fund managers has "caught the eye" of the legislators, and Congress wants to nearly double the tax rates on their Carried Interest in a way that extends into the typical and traditional real estate partnership or joint venture. The legislation, lurking in Washington since 2007, has been approved by the House of Representatives several times, but until this year has not been considered by the Senate. A proposed Senate compromise almost became law in July and may be resurrected by the end of this year. This article provides an overview of the most recent Senate version, which is likely to be closest to any law that may ultimately be passed.

For comparison, the following charts highlight some key aspects of both the Senate version and the more recently passed House version.

Proposed Ordinary Income Percentages for Carried Interest

	House version	Senate version
2011–2012	50% ordinary income	75% ordinary income
2013 and later	75% ordinary income	75% ordinary income
2011 and later gain from assets held 5+ years	No special rule	50% ordinary income

Proposed Federal Blended Rates for Carried Interest[2]

		Current Rates	House Blended Tax rate	Percentage Increase	Senate Blended Tax Rate	Percentage Increase
Capital Gains held less than 5 years	2011 and 2012	20%	31.25%	56.25%	36.875%	84.4%
	2013 and later	20%	37.55%	87.75%	37.55%	87.75%
Capital Gains held for 5 years	2011 and 2012	20%	31.25%	56.25%	31.25%	56.25%
	2013 and later	20%	37.55%	87.75%	31.7%	58.5%

The Legislation Raises Tax Rates, Even on Existing Deals

The legislation is based on the idea that a Carried Interest should be taxed more like a salary, subject to the higher ordinary income rates as well as applicable employment taxes. As a compromise, the Senate proposed to treat only 75% as compensation income. Even after this compromise, the effective tax rate would almost double if the underlying income would otherwise be long-term capital gain. The proposed legislation would be effective in 2011, covering both new and existing partner-

ships. As such, developers who have interests in real estate deals that originated many years ago will see a substantial increase in their taxation when they sell their properties after the end of this year. The scheduled 2011 top federal tax rates are 20% for long-term capital gains and 42.5% for compensation income (39.6% income tax plus 2.9% self-employment tax). Therefore, if a "top tax bracket" developer would otherwise receive a $100 long-term capital gain, taxing 75% of the capital gain as compensation means that the federal tax would increase from $20 to $36.88 on that $100 gain. If the asset is held for at least five years, a special rule treats only 50% as compensation, so the tax in such a situation would be $31.25.

The Legislation Denies Deductions, Raising Taxes Even Without a Sale

The legislation defers tax deductions that relate to the 75% "tainted" portion of the Carried Interest so that those deductions can only be used against future ordinary Carried Interest income. This is applied on a per partnership basis so that the suspended deductions can only be used against future Carried Interest from the same partnership. For example, if the Carried Interest would otherwise provide $100 of net deductions in 2011, then $75 of the 2011 deductions would be suspended. Importantly, this deduction suspension would not apply to deductions related to the developer's capital investment if a narrow "qualified capital" exception is met. Further, the deductions would still be available to offset future ordinary income from that specific Carried Interest, such as upon sale of the underlying asset. Additional suspended deductions could occur if the developer guarantees a greater share of debt than its share of capital. Thus, even though many think of the Carried Interest tax as a back-end issue, the tax hit can occur much sooner because these suspended deductions could result in other unrelated income losing its sheltered status.

The Legislation Might Tax the Developer on Property Distributions and Interest Transfers

To stop taxpayers from avoiding the Carried Interest tax by swapping out the partnership interest for another asset, the legislation may accelerate some or all of the Carried Interest tax whenever the developer (1) receives property distributions from the partnership, or (2) transfers or exchanges the partnership interest for another asset. There is an exception on some common exchanges that allows taxpayers to elect to carry over the Carried Interest taint to another partnership interest. Unfortunately, that exception does not cover a lot of common transactions, including a simple liquidation of a lower-tier partnership or, in some cases, the transfer of a Carried Interest to a family member.

Carried Interest May Include the Developer's Side-by-Side Equity

Although the proposed legislation purports to exempt the developer's equity investments from the new tax, the exception in the proposed legislation is far too narrow. The income from the developer's cash or property investments is excluded under this "qualified capital" exception only if the developer's return on that equity and liquidation priority is comparable to that held by an unrelated equity investor in the partnership who does not provide investment services. If there is no comparable unrelated equity investor, the default rule requires that the entire interest is subject to the higher taxes on Carried Interest unless a narrow exception applies for partnerships with only pro rata sharing or the IRS writes regulations providing more favorable rules.

What Can You Do Now?

If a developer is otherwise considering cashing out, there may be significant tax savings to selling out before the new law may take effect. Unfortunately, selling depreciable real property to a related party converts the gain to ordinary income, so it is best to find an unrelated buyer. Another option that may reduce taxes is to consider converting the Carried Interest to a non-Carried Interest in an operating partnership of a REIT, preferably before the legislation becomes effective. If such a significant legal and economic change is not possible, it may still be beneficial to modify existing partnership documentation so that the Carried Interest is clearly separate from the developer's side-by-side capital, in the hopes that the side-by-side capital is not also tainted with the Carried Interest tax.

Finally, estate planning may include a tax-basis step-up at death in the Carried Interest, although the legislation is not clear on whether a stepped-up basis is still available for the Carried Interest. Given the pitfalls and potential planning opportunities associated with Carried Interest and the uncertainty of future legislation, developers should consult their tax advisers when considering transactions involving Carried Interest.

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[1] The Carried Interest represents a percentage of profit allocated to the Developer that exceeds the Developer's share of capital. For example, a Developer may contribute 10% of the capital and after a preferred return is paid on all capital, the Developer may receive an additional 20% of profits beyond its 10% capital share. This 20% is the Carried Interest.

[2] This chart assumes that (1) the underlying gains relating to the Carried Interest were otherwise long-term capital gains subject to the applicable 15% or 20% federal rate, depending on the year; (2) federal ordinary income tax rates increase to 39.6% in 2011; and (3) the percentage of Carried Interest treated as ordinary income under the legislation is subject to 2.9% Social Security taxes before 2013 and 3.8% thereafter, and would in many circumstances not otherwise be subject to Social Security taxes.

Ruling Narrows Availability of Class Action Certification

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A recent ruling by the United States District Court for the District of New Jersey narrows the circumstances under which certain individuals can sue employers as a class under the Fair Labor Standards Act (FLSA, the Act).[1] In *Zavala v. Wal-Mart Stores, Inc.*,[2] the court held that because the plaintiffs—all janitors working at Wal-Mart stores—were employees of multiple contractors across the country rather than direct employees of a retailer, then because the retailer's potential defenses to the allegations were diverse, and because fairness and procedural considerations made management of the proposed class difficult, the plaintiffs were not "similarly situated" as contemplated by the Act. Therefore, the court refused to grant final certification of a class in an action with respect to wage and hour disputes. The bases of the court's decision provide some guidance to other retailers planning their workforce needs.

Certification of a class under the Act is a two-stage process. At the first stage, the court may grant conditional certification to a class. Because the court initially has limited evidence to determine whether the individuals are actually similarly situated as contemplated by the Act, it applies a liberal standard to the determination. At the second stage following discovery (applicable in this instance), the examination is more rigorous and relies upon information revealed during discovery. The court engages in a three-pronged analysis, looking at (i) the similarity or dissimilarity of the facts surrounding the proposed class, (ii) the variability of potential defenses with respect to the individual members of the proposed class, and (iii) the fairness and manageability of allowing the action to proceed with a class. At this second stage, as exemplified in this instance, the plaintiffs have the burden of demonstrating that they are similarly situated. If they do not satisfy that burden, the conditional class is decertified and final certification of the class is denied.

In November 2003, attorneys for Victor Zavala and 16 other janitors working at Wal-Mart stores filed a complaint alleging that the retailer had violated §§ 206 (Minimum Wage) and 207 (Maximum Hours) of the FLSA. In December 2004, the court conditionally certified a class that consisted of undocumented and recently documented workers who had been janitors at Wal-Mart stores since January 2000. Although the members of the proposed class did not work directly for Wal-Mart, they all performed similar jobs; the court took note at the initial stage that janitorial work at the stores was governed by guidelines developed by the retailer.

Discovery in the case revealed several facts that the court cited in its first-prong analysis of the final certification question. These included that the individuals in the proposed class actually worked for 70 different private contractors and subcontractors rather than for the retailer directly, had worked in a total of 180 stores in 13 states, and worked differing schedules for differing wages. The court also noted that in addition to working at the Wal-Mart stores, some of the individuals worked at other stores during the period in question. The court paid particular attention to the compensation examination, noting that the standards of compensation among the contractors varied dramatically in wages, payment periods, bonus availability and tax withholding. While the court did not find these factors determinative, it said that the variations undermined the plaintiffs' request for certification and played a critical role in the ultimate refusal to certify.

In its second-prong analysis, the court focused on the defenses the retailer might have against the plaintiffs individually and collectively, specifically saying that whether or not they were actual direct employees was not alone the dispositive question. The court took note of several factors in concluding that the defenses were too diverse to apply to the entire class. Among these were the facts that hiring and firing decisions belonged to the contractors rather than to the retailer; that the contractors themselves developed the work schedules; that the differences in length of employment might suggest more permanence for some of the individuals; and that Wal-Mart said that the consideration paid to the contractors was sufficient for the contractors to satisfy the minimum wage provisions of the Act. The court dispatched the argument that the existence of Wal-Mart's cleaning guidelines was itself persuasive, noting that the mere existence of guidelines did not establish actual control over the workers. The court concluded that these diverse factors would result in varying defenses across the proposed class, and said that the diversity of defenses weighed against finding that the plaintiffs were similarly situated.

The court actually paid short attention to the third prong—manageability of the case and fairness to the parties if prosecuted as a class—although on the first two prongs, little further analysis appears to have been necessary. The court simply concluded that the involvement of myriad locations and contractors and the variability of the individualized facts suggested that the cases probably could not be prosecuted fairly in a collective action. Taking the three prongs together, the court held that the plaintiffs had not satisfied the burden of showing they were similarly situated under the Act. Therefore, the court decertified the conditional class.

The result in *Zavala* suggests some pointers for regional and national retailers as they develop workforce policies. The most important appears to be that to the extent a retailer engages contractors to carry out activities pursuant to the retailer's guidelines, those guidelines should not be so specific as to amount to control of the contractors' employees. Areas to avoid would include specifics on the exact amounts of money that contractors' employees will be paid, the specific schedules the

employees may work and the details of the employees' benefits. Also, the engagement of several different contractors to perform the work will help insulate the retailer from class actions by the contractors' employees.

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[1] Fair Labor Standards Act of 1938, 29 U.S.C. §§ 201 *et seq*.

[2] *Zavala v. Wal-Mart Stores, Inc.*, 03-cv-5309 (D.N.J. June 25, 2010).

In California Malls, Free Speech Rights Reign Supreme: An Analysis of *Snatchko v. Westfield LLC*

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In a ruling published in August 2010, a California appeals court overturned a lower court decision and declared that certain common area rules imposed by the owner of a large regional shopping mall in Roseville, CA, are "unconstitutional on their face" because the rules prohibited peaceful, consensual, spontaneous conversations between strangers about topics not related to the mall, its tenants or their related activities. *Matthew Snatchko v. Westfield LLC et al.* (187 Cal.App. 469, Cal.App.3rd, Aug. 11, 2010). The California Supreme Court denied review on October 20, 2010. It should be noted that the appellate opinion was authored by Tani Cantil-Sakauye, who was confirmed by the California voters in November 2010 as the next chief justice of the California Supreme Court.

At the heart of the case are the actions of Matthew Snatchko, a 27-year-old youth pastor. Snatchko often visited the Galleria at Roseville in search of opportunities to share his Christian faith. While in the common area one evening, he approached three young women who agreed to talk with him. A store employee reported Snatchko's activities to the mall security officer, who, after observing some "nervous behavior" by the women, asked Snatchko to stop talking to the women or leave the mall. Snatchko refused to comply with the officer's request; the officer called for backup, and a senior security officer responded and ordered Snatchko out. When Snatchko continued his refusal to comply, the security officers placed him under citizen's arrest, handcuffed him and then turned him over to Roseville police. Snatchko was booked and released; and, when he appeared in court for arraignment, all charges were dropped. The Placer County District Attorney later stipulated that Snatchko was factually innocent, and a superior court judge issued an order stating the same.

Snatchko sued Westfield, the owner of the Galleria, the security firm employed at the Galleria and the arresting officer. He claimed monetary damages in an unspecified amount for false imprisonment, assault, battery, intentional infliction of emotional distress, negligence, malicious prosecution and a general violation of his rights under the Unruh Civil Rights Act.

The specific common area rule at issue prohibits (i) a person from approaching other people in the common area with whom he or she was not previously acquainted for the purpose of communicating about a topic unrelated to the business interests of the mall or its tenants or (ii) a noncommercial activity sponsored by the mall or a tenant without first applying for, and receiving, a permit from Westfield.

The court began its analysis of this rule with the landmark 1979 California Supreme Court ruling in *Pruneyard Shopping Center v. Robins.* In *Pruneyard,* the court held that Article 1, § 2, of the California state constitution protects the rights of free speech, reasonably exercised, in a privately owned shopping mall. With *Pruneyard* as the starting point, the court applied the type of free speech analysis generally used for governmentally imposed speech restrictions to Westfield's common area rule.

The first step in the analysis was to determine whether the permit requirement for common area speech is triggered by the specific words, ideas and content of the speech, or if the permit requirement applies equally to all types of speech regardless of the specific words, ideas and content being expressed. After several pages of analysis, the court concluded that the Westfield common area rule is triggered by the specific content of the speech. The court reasoned that conversations between strangers—even consensual, spontaneous and non-disruptive conversations—regarding topics that are unrelated to the business of the Galleria and its tenants are limited by the permit requirement. In contrast, the Westfield rule allows anyone to discuss matters related to the Galleria, its tenants, or noncommercial activities sponsored by the mall without a permit or other interference.

Since the Westfield common area rule limits specific types of speech between certain types of speakers (e.g., words, ideas and content unrelated to the Galleria) but freely permits other types of speech with no restrictions (e.g., words, ideas and content related to the Galleria), the court determined that the rule is "content specific." Because the rule is content-specific, the court stated that the rule must pass a higher threshold in order to be deemed constitutional. Westfield needed to prove that its content-specific limitation on common area speech was both necessary to serve a compelling interest and narrowly tailored to achieve such interest.

Westfield argued that its limitation on strangers discussing topics not related to the business of the Galleria and/or its tenants in the common area served a compelling interest in reducing mall congestion and promoting public safety. The court rejected this argument because the rule would permit an unlimited number of friends and acquaintances from congregating and talking in the common area. Westfield also claimed that the common area rule promoted its compelling economic interest in providing a convenient, comfortable shopping atmosphere to its patrons. The court resoundingly rejected this claim as well, stating that providing a stress-free shopping experience is not a compelling interest when compared to the importance of free speech rights. The court then went on to find that Westfield's common area rule is not narrowly tailored to the least restrictive means of promoting its alleged compelling interest. The court reasoned that the Westfield rule is overbroad and prohibits more speech than is necessary.

Although the court could have ended its analysis at this point and overturned the Westfield rule, the court continued in its analysis. The court said that even if it determined that the Westfield rule applied to all speech equally, regardless of the specific content, the rule would still not survive constitutional review. To prove this point, the court applied the lower standard of review appropriate for so-called "content-neutral" speech restrictions: Does the content-neutral restriction burden more speech than necessary to further the interests protected by the speech restriction? Again, the court determined that the Westfield common area rule was overbroad and limited far more types of speech than necessary. The court specifically described a number of types of consensual, spontaneous conversations between strangers in the common area that are prohibited by the Westfield rule, including discussions regarding sports, the weather or other types of "chit chat." The court labeled these types of conversations as "classic free speech" and found that such conversations should not be unduly restricted.

Accordingly, based on the *Snatchko* ruling, it seems advisable to review common area rules carefully so as to ensure that the rules permit spontaneous free speech regarding any and all topics between strangers who mutually agree to converse and who cause no disturbance or otherwise interfere with the operation or enjoyment of the shopping center.

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Cases

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Landlord & Tenant

The Texas Court of Appeals considered and rejected various legal theories that would permit a landlord to recover damages from affiliates of its tenant. *Big Easy Cajun Corporation v. Dallas Galleria Limited,* 293 S.W. 3d 345 (2009).

Galleria leased space in a food court to Big Easy Cajun-Dallas, Inc. (BEC Dallas). Eventually BEC Dallas defaulted on its lease and abandoned the premises. Galleria brought an action for damages and obtained a default judgment against BEC Dallas.

Galleria brought a subsequent action to enforce the judgment against various affiliates of BEC Dallas, including operators of food courts in other shopping centers, a management company and an operating company (collectively, the BEC Defendants). Although BEC Dallas and each of the other BEC Defendants was independently organized, Galleria alleged in its complaint that BEC Dallas and the BEC Defendants operated as a single business enterprise and constituted an implied partnership. As such, Galleria claimed that the BEC Defendants should be liable for the default judgment against BEC Dallas.

The appellate court, citing to the Texas Supreme Court case of *SSP Partners v. Gladstron Investments (USA) Corp.,* 275 S.W.3d 444 (Tex. 2008), rejected the single business enterprise theory as a mechanism for disregarding corporate separateness or piercing the corporate veil. Galleria alleged that it had obtained an implicit finding of actual fraud, which was sufficient to distinguish this case from that of *SSP Partners,* but the appellate court disagreed and reversed the trial court on the single business enterprise claim.

In evaluating the implied partnership claim, the Appellate Court set forth intent, and an agreement to share liabilities of, and make contributions to, the business, as relevant factors in determining the existence of a partnership, but determined that the most important factors are the sharing of profits and participation in the control of the business. Galleria was unable to persuade the court that any facts existed to support Galleria's implied partnership claim and, in particular, there was no evidence that BEC Dallas and the BEC Defendants shared profits or participated in the management of the business; therefore, the appellate court upheld the directed verdict against Galleria that had been issued by the trial court. This decision emphasizes the importance to a landlord of a direct contractual agreement (lease or guaranty) with an entity whose assets encompass more than the leased premises and related property.

Leases

The parole evidence rule will not bar extrinsic evidence in the absence of a separate integration provision in a lease amendment. *Atlantic Pier Associates, LLC v. Boardakan Restaurant Parnters,* 647 F.Supp.2d 474 (Pa. Dist. Ct. 2009).

A basic tenet of contract law is that the contractual writing of the parties is governed by the terms of the written agreement. If the parties intend to embody all of the terms in the writing, they "integrate" the written agreement(s). Many times contract amendments, particularly lease amendments, will simply incorporate and ratify the unchanged terms of the original lease. However, *Atlantic Pier Associates* reminds us of why it is important to think about the temporal nature of integration provisions, and illustrates how the incorporation of such a provision can alter the terms of a written agreement.

In *Atlantic Pier Associates,* the court found that in the absence of a separate integration provision in a lease amendment, the parole evidence rule will not bar extrinsic evidence, such as statements and representations made after execution of the lease, even when the statements altered the co-tenancy clause of the lease amendment. In *Atlantic Pier Associates,* the owner (the Landlord) of the Pier at Caesars in Atlantic City (the Pier) entered into two substantially similar leases with a well-known restaurateur, Steven Starr (the Tenant), for retail space located on the Pier. During the Tenant's build-out, the Landlord entered into two leases with another prominent restaurateur, Jeffrey Chodorow (the Chodorow Restaurants). However, on November 11, 2005, the Chodorow Restaurants sent notice to the Landlord, exercising an early termination option.

In connection with the negotiation of a lease amendment, in late 2005, the Landlord supplied a detailed schedule to the Tenant, showing the percentage of the Pier under binding leases and the parties thereto. In addition to including the Chodorow Restaurants on the schedule, the Landlord allegedly told the Tenant that the Chodorow Restaurants were "definitely opening." The subsequent lease amendment contained a co-tenancy clause, which required that five of the seven restaurants named therein (including the Chodorow Restaurants) be occupied and open for business before the opening of the Tenant's restaurants.

In the Tenant's tort action against the Landlord for fraud in the inducement, the Tenant argued that the lease and the subsequent amendment were not an integrated writing and, therefore, the representations regarding the Chodorow Restaurants were admissible as parole evidence. Under Pennsylvania law, the parole evidence rule precludes prior representations, even when made fraudulently, when (i) the "same subject matter" test is met and (ii) the written agreement contains

an integration clause. The court found that because the representations relating to the Chodorow Restaurants dealt directly with the co-tenancy clause, the first element was met. With respect to the integration clause, the court found that although the original lease contained an integration clause and the lease amendment incorporated all unchanged provisions in the original lease, the mere incorporation of the integration clause will only preserve the original integration clause (and preclude all communications made before the original lease's execution); however, the integration clause will not extend the temporal reach to the period between the execution of the original lease and the lease amendment. Consequently, the lease and its amendment are not fully integrated and any communications meeting the first prong of the test may be admitted to modify the original lease.

As this case demonstrates, both landlords and tenants should pay attention to miscellaneous provisions such as the integration clause when drafting contract amendments. While the incorporation of unchanged terms may be sufficient in most instances, Atlantic Pier Associates is an example of how such an approach may have the unintended effect of altering the written agreement of the parties.

Tortious Interference/Statute of Frauds

The Court of Appeals of Kansas found that there was an issue of fact for the jury to consider, as to whether the various writings exchanged between the parties resulted in the formation of a contract. In addition, with regard to tortious interference with contract, the court held that the issue of the defendant's motives and the presence or absence of malice are typically questions of fact for a jury. *M West, Inc. v. Oak Park Mall, L.L.C. and Cingular Wireless, L.L.C.*, 234 P.3d 833, Kansas Court of Appeals, June 18, 2010.

The Court of Appeals of Kansas recently considered a case of interest for retail landlords and tenants. The issue involved a claim for tortious interference with a business relationship arising out of the landlord's refusal to consent to an assignment of a lease by its tenant to a third party, where the landlord subsequently negotiated a termination of the lease with the tenant. In this case, the court of appeals also considered whether language in a proposal stating that the proposal was non-binding and subject to various conditions, prevented the proposal from being a writing that satisfied the Kansas statute of frauds. Both M West, Inc. (M West) and Cingular Wireless, L.L.C. (Cingular) were tenants of Oak Park Mall in Overland, KS. Tenant M West was looking to lease additional space. Cingular had signed a 10-year lease at Oak Park Mall in April of 2004 and, in early 2006, with eight years remaining in the term, began discussions with M West to have Cingular's lease assigned to M West. Cingular's lease agreement with Oak Park Mall, L.L.C. (Oak Park), the landlord, required Oak Park's consent to an assignment, and also gave Oak Park the right to terminate the lease if Cingular requested consent to an assignment.

M West and Cingular negotiated the terms of a proposed assignment, exchanging written correspondence and e-mails, but they did not enter into any formal written assignment agreement. In correspondence sent in April 2006, Cingular's representative sent a proposal to M West regarding the proposed assignment, which provided for the assignment to be effective as of June 30, 2006, with Cingular to pay M West $330,000 to assume the lease, and with Cingular to also remain liable under the lease. The proposal was countersigned and accepted by M West. The proposal stated that it was not intended to be binding and was contingent on the final approval of Cingular's real estate committee, the consent of the landlord and the full execution of a formal binding written assignment agreement that was mutually acceptable to the parties. There were subsequent e-mail exchanges between the parties, clarifying certain terms in the proposal. During this period, M West also exchanged e-mails with a representative of Oak Park regarding whether Oak Park would approve such an assignment, and Oak Park's representative indicated that she "liked the idea."

By letter dated May 11, 2006, Cingular requested Oak Park's consent to the proposed assignment. On May 17, 2006, Oak Park offered to terminate Cingular's lease in exchange for a payment of $465,000 to Oak Park. Six days later, Oak Park rejected Cingular's request for consent to the assignment to M West. On June 7, 2006, Cingular sent a letter to Oak Park, confirming an agreement between Cingular and Oak Park that Cingular would pay $400,000 to Oak Park, and Cingular's lease would be terminated as of June 15, 2006.

M West sued Cingular for breach of contract and Oak Park for breach of contract and tortious interference with prospective business advantage or business relationship. The trial court granted summary judgment in favor of Cingular and Oak Park, finding as a matter of law: (i) that the writings between Cingular and M West showed only continuous negotiations and that a written contract between Cingular and M West did not exist, as required by the statute of frauds in Kansas, and (ii) on the tortious interference claim, that Oak Park had a contractual right to engage in the conduct complained of and that the evidence was not sufficient, as a matter of law, to support a claim of tortious interference, because M West did not present sufficient evidence demonstrating that Oak Park acted with malice and that Oak Park was not justified in terminating Cingular's lease for the consideration paid by Cingular.

The Kansas statute of frauds applies to agreements for the assignment of an interest in property for a term of more than one year and requires that those agreements be in writing, signed by the party assigning or granting the interest. The trial court concluded that no enforceable agreement existed between Cingular and M West, relying on the language that the proposal was not binding and was subject to various contingencies. The court of appeals, however, found that there was an issue of fact for the jury to consider, as to whether the various writings exchanged between the parties resulted in the formation of a contract. The court of appeals indicated that a jury could find that the material terms of an agreement were reflected in the

proposal and subsequent correspondence between Cingular and M West. While the court of appeals noted the non-binding language in the proposal from Cingular to M West, it also noted that the proposal contained language that "time was of the essence" and required M West's countersignature and acceptance. The submission of the terms of the proposed assignment to the landlord for consent was further evidence to the court of appeals that an agreement may have been reached. Accordingly, the court of appeals reversed the trial court's grant of summary judgment on the statute of frauds issue.

On the tortious interference claim, the court of appeals noted that in order to prevail on that claim, under Kansas law, M West would have to demonstrate that each of the following elements had been satisfied: (i) the existence of a business relationship with the probability of future economic benefit to M West; (ii) knowledge of the relationship by Oak Park; (iii) that except for the conduct of Oak Park, M West was reasonably certain to have continued the relationship or realized the expectancy; (iv) intentional misconduct (i.e., malice and improper conduct) by Oak Park; and (v) damages suffered by M West as a direct or approximate cause of Oak Park's misconduct. The major element at issue in the case was whether there was intentional misconduct by Oak Park (i.e. "malice," under the case law), or whether Oak Park was privileged or justified in interfering with the business relationship between M West and Cingular.

The trial court held that, as a matter of law, Oak Park had a contractual right to engage in the conduct complained of (because of the recapture and consent rights in the lease) and thus did not engage in intentional misconduct or malice that would support a claim for tortious interference. The court of appeals, however, held that the issue of the defendant's motives and the presence or absence of malice are typically questions of fact for a jury and that the existence of the termination right in favor of Oak Park, as well as its right to consent to the proposed assignment, were not sufficient, as a matter of law, to justify a conclusion that Oak Park acted properly. The court of appeals focused on Oak Park's conduct; in reversing the trial court's grant of summary judgment, the court concluded that a jury could find that Oak Park acted improperly when its representative told M West that Oak Park would probably approve an assumption of the lease by M West, while at the same time engaging in negotiations with Cingular to terminate its lease, and that an issue of fact existed as to whether Oak Park used fair means and good faith in exercising its right to terminate Cingular's lease.

Both landlords and tenants should take note of this case, as it illustrates that courts will not always respect non-binding language in proposals and may look to other facts and circumstance in determining whether a contract has been formed. Also, the case illustrates that landlords and tenants should proceed with caution when entering into negotiations to terminate a lease, if the tenant has previously been negotiating with a third party to take an assignment of the lease, in order to avoid exposing themselves to a potential breach of contract/tortious interference claims.

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From Canada

Enforceable or Unenforceable? That Is the Question: A Landlord's Right to Terminate After Receiving a Request to Assign

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Introduction

Commercial landlords often seek to include a clause in their leases that allows them to terminate a lease when a tenant makes a request to assign the lease. (In this article, such clauses will be referred to as Assignment Termination Clauses). In recent years, two types of Assignment Termination Clauses have been considered by the courts. The first type gives the landlord an automatic and absolute right to terminate the lease upon receiving a request from the tenant to assign; the second type gives the landlord a right to terminate, but this right is subject to the ability of the tenant to withdraw its request for an assignment.

In *550 Capital Corp. v. David S. Cheetham Architect Ltd.*[1] (*550 v. David S. Cheetham*), the ability of a landlord to rely on an Assignment Termination Clause was considered by a Master and Judge of the Alberta Court of Queens Bench and the Alberta Court of Appeal. After reviewing the Assignment Termination Clause within the greater context of the lease, the Master, the Judge and the Court of Appeal all concluded that it could not be relied upon in the specific circumstances of the case. Having the final word on the matter, the Court of Appeal held that the Assignment Termination Clause was inconsistent with other terms of the lease and, as a result, was unenforceable.

The case *550 v. David S. Cheetham* presents a clear indication that termination rights cannot be considered in isolation from the remainder of a lease. Careful consideration must be given to rights or obligations that may be inconsistent with such termination rights.

The Facts

The parties to *550 Capital v. David S. Cheetham* were 550 Capital Corp. (550 Capital), Group 2 Architecture Engineering Interior Design, a partnership (the Partnership) and Group 2 Architecture Engineering Ltd. (the Company). Pursuant to a written lease entered into in January 2005 (the Lease), the Partnership leased premises from the then-landlord, ACM Project 50 Ltd. (ACM) and ACM subsequently assigned its rights as landlord under the Lease to 550 Capital.

The Lease contained three clauses of interest. The first clause of interest allowed the Partnership to seek consent to assign the Lease to a new tenant:

> The Tenant shall not pledge or assign this Lease or sublet or part with possession of the Premises or any part thereof, directly or indirectly, without the prior written consent of the Landlord which consent the Landlord agrees not to unreasonably withhold or delay . . . . (the Assignment Clause).

The second clause of interest provided that if the Partnership assigned the Lease without consent, 550 Capital could give notice of such default to the Partnership and if such default was not cured, 550 Capital could terminate the Lease:

> In the event that the Tenant shall pledge or assign this Lease or sublet or part with possession of the Premises or any part thereof otherwise than in accordance with the provisions of this Lease, the Landlord may give the Tenant notice of such default hereunder where upon the Tenant shall have fifteen (15) days to cure such default failing which the Landlord shall be entitled to terminate the Lease and to re-enter the Premises (the Default Clause).

The third and final clause of interest provided that if 550 Capital received a request from the Partnership to assign the Lease, 550 Capital could terminate the Lease:

> Notwithstanding section 10.02 [which gave the Partnership the ability to seek consent to assign], within 30 (30) days after the receipt by the Landlord of such request for consent and all of the information which the Landlord shall have requested hereunder (and if no such information has been requested, within ten (10) days after receipt of such request for consent) the Landlord shall have the right upon written notice to the Tenant, if the request is to assign this lease or sublet the whole of the Premises, to cancel and terminate this Lease…. If the Landlord shall not exercise the foregoing

> right of cancellation then the Landlord's consent to the Tenant's request for consent to assign or sublet shall not be unreasonably withheld…. (the 550 Assignment Termination Clause).

Approximately one year after entering into the Lease, the Partnership incorporated the Company and transferred all of the Partnership's assets, including the Lease, to the Company. The Company wrote to 550 Capital to advise that the Partnership incorporated and became the Company, and that the Lease had been transferred to the Company. The Company also advised 550 Capital that the Partnership had retained a 100 percent ownership of the Company and that control of the firm had not changed. The Partnership did not request that the Lease be assigned to the Company since the Partnership maintained full ownership and control over the Company.

By letter dated January 3, 2007, 550 Capital notified the Partnership that the Partnership was in default of the Lease, as it had assigned the Lease to the Company without first seeking consent from 550 Capital, as required. The Partnership was given 15 days to cure this default and, within the 15-day period, the Partnership sought consent to assign. Consent was not forthcoming. Instead, just prior to the expiry of the 15-day curing period, 550 Capital notified the Partnership that it was terminating the Lease pursuant to the 550 Assignment Termination Clause.

The Partnership and the Company did not vacate the leased premises as purportedly required by 550 Capital's notice of termination. As such, 550 Capital brought an application to enforce the Lease and its notice of termination.

The Decision and Reasoning of the Courts

The Decision of the Master in Chambers

550 Capital's application to enforce the Lease and its notice of termination was initially heard by a Master of the Alberta Court of Queen's Bench in Chambers. Although unreported, it is clear from subsequent decisions in the proceeding that the Master dismissed 550 Capital's application on the basis that the 550 Assignment Termination Clause was inconsistent with the Assignment Clause and therefore unenforceable. 550 Capital appealed the decision of the Master to a Judge.

The Decision of the Judge in Chambers

After reviewing the history of the matter, the Judge of the Alberta Court of Queens Bench varied the order of the Master. The Judge did not make a finding that the Assignment Clause and the 550 Assignment Termination Clause were inconsistent. Rather, the Judge found that by terminating the Lease prior to the expiry of the 15-day curing period under the Default Clause, 550 Capital acted inequitably. The Judge, therefore, held that the Company should be given 10 days to reassign the Lease to the Partnership. 550 Capital appealed to the Alberta Court of Appeal.

The Decision of the Court of Appeal

The key issue for the Alberta Court of Appeal was not whether 550 Capital had acted inequitably or whether it had terminated the Lease prior to the expiry of the curing period in the Default Clause. Instead, the Alberta Court of Appeal identified the key issue as whether the Assignment Clause and the 550 Assignment Termination Clause were inconsistent. As expected, the Partnership argued that they were, while 550 Capital argued that they were not. According to 550 Capital, the relevant clauses gave 550 Capital three options: it could (1) consent, (2) not consent or (3) terminate the Lease. In considering whether the Assignment Clause and the 550 Assignment Termination Clause were inconsistent, the Alberta Court of Appeal was mindful of the introductory language of the 550 Assignment Termination Clause (that the rights in that clause existed, notwithstanding the Assignment Clause) and was also mindful of two decisions from the Alberta Court of Queens Bench: *Zurich Canadian Holdings Ltd. v. Questar Exploration Inc.*[2] *(Zurich Holdings v. Questar),* which was affirmed by the Alberta Court of Appeal, and *Orbus Pharma Inc. v. Kung Man Lee Properties Inc.*[3] *(Orbus Pharma v. Kung Man).* In these cases, similar clauses were considered and held not to be inconsistent.

Given this matrix of fact and law, one might conclude that the Court of Appeal found in favour of 550 Capital; but it did not. After reviewing the language of the relevant clauses, the Alberta Court of Appeal held that the 550 Assignment Termination Clause impinged on and collided with the Partnership's Rights in the Assignment Clause:

> I appreciate that [the 550 Assignment Termination Clause] opens with the words "Notwithstanding [the Assignment Clause]". However, rather than creating a separate option to terminate on the part of [550 Capital], I see that provision as impinging on, or colliding with, the rights conferred in the prior provision….[4]

But, according to the Alberta Court of Appeal, the 550 Assignment Termination Clause did not only impinge on or collide with the Partnership's rights in the Assignment Clause, but it also effectively took away those rights:

> [The 550 Assignment Termination Clause] is inconsistent with the Assignment Clause. The two articles cannot stand together. [550 Capital's] right to terminate under [the Assignment Termination Clause] eliminates its obligation not to unreasonably withhold or delay its consent to an assignment by a tenant under [the Assignment Clause].[5]

In a situation such as this, the cases of *Zurich Holdings v. Questar* and *Orbus Pharma v. Kung Man,* which were referred to and considered by the Alberta Court of Appeal, were not of assistance to 550 Capital. This is because in those cases, the Assignment Termination Clauses were markedly different. They provided the tenant with the opportunity to withdraw the request to assign in the event that the landlord opted to terminate the lease. According to the Alberta Court of Appeal in *550 v. David S. Cheetham,* the effect of this difference was that in *Zurich Holdings v. Questar* and *Orbus Pharma v. Kung Man* "the mere request for consent does not jeopardize the continuing tenancy of the tenant."[6]

Given all of this, the Alberta Court of Appeal found that the 550 Assignment Termination Clause was unenforceable because it destroyed rights given earlier in the Lease in the Assignment Clause. The 550 Assignment Termination Clause was repugnant and the earlier clause, the Assignment Clause, prevailed.

Discussion

550 v. David S. Cheetham raises an important question for landlords who want to be able to terminate a lease upon receiving a request to assign and for tenants who will want to avoid such a result. That question is whether Assignment Termination Clauses are enforceable.

Prior to *550 v. David S. Cheetham,* the Ontario District Court in *Priftis v. Trilea Holdings Inc.*[7] *(Priftis v. Trilea)* suggested that landlords who had automatic and absolute Assignment Termination Clauses and who relied on such clauses did so at their own risk. In *Priftis v. Trilea,* the Ontario District Court considered a clause permitting the tenant to seek consent from the landlord, which consent was not to be unreasonably withheld, and an Assignment Termination Clause that was very similar to the one contained in *550 Capital v. David S. Cheetham.* The court in *Priftis v. Trilea* held that the two clauses created an ambiguity that should be interpreted in favour of the tenant and, in doing so, held that the Assignment Termination Clause was unenforceable.

But if *Priftis v. Trilea* created risk for landlords, it appears as though some were willing to take that risk. This may be due to the fact that *Priftis v. Trilea* is an unreported decision or, perhaps, because it has been considered by some to be of questionable authority. For instance, in *Orbus Pharma v. Kung Man,* which is the only case that cites *Priftis v. Trilea,* the Alberta Court of Queens Bench noted the following:

> In each of these cases, [including *Priftis v. Trilea*] the Court interprets an option to terminate as being subject to the right not to unreasonably withhold consent. However, again, these cases turn on differently worded leases governing different situations. Furthermore, these cases were decided in a different legal context (considering both the passage of time and the differences in jurisdiction) and do not constitute persuasive authority.

550 Capital v. David S. Cheetham arguably changes the landscape and imposes risk on landlords who seek to include Assignment Termination Clauses in their leases and/or try to enforce such clauses. Here, we have a 2009 decision of an appellate court.

While *550 Capital v. David S. Cheetham* arguably imposes risk on landlords, Assignment Termination Clauses should not automatically be considered unenforceable. In Alberta, there are two clear lines of binding authority. The case of *550 v. David S. Cheetham* provides that where a landlord has an automatic and absolute right of termination upon receiving a request to assign, such right may be unenforceable since it may be inconsistent with other provisions in the lease. On the other hand, *Zurich Holdings v. Questar* and *Orbus Pharma v. Kung Man* provide that where a tenant is given the opportunity to withdraw its request to assign, a landlord's right to terminate may be enforceable. As a result, it seems that one must closely examine the particular facts in play and, perhaps most importantly, the particular lease terms. The key consideration on such examination will be whether the landlord's termination rights are inconsistent with other provisions of the lease.

Outside of Alberta, *550 v. David S. Cheetham* and the two lines of authority that have developed are not binding. Despite being a decision of the Alberta Court of Appeal, *550 v. David S. Cheetham* is, at best, persuasive in Canada's other common law jurisdictions. It therefore appears as though the law on point in Canada's other common law jurisdictions has yet to be fully developed. In all likelihood, however, *550 v. David S. Cheetham* and the two lines of established Alberta authority will inform the development of this law.

Given all of this, and from a landlord's perspective, *550 v. David S. Cheetham* speaks words of caution. A landlord will want to consider carefully what type of Assignment Termination Clause it includes in its leases. If such a clause already exists in a lease and it includes an absolute right to terminate, a landlord will want to consider carefully acting on such a clause. Based on the two lines of authority that exist, an Assignment Termination Clause that does include an automatic and absolute right to terminate may be unenforceable if it conflicts with an earlier assignment provision. On the other hand, an Assignment Termination Clause that allows a tenant to withdraw its request to assign may be enforceable (all other things being equal).

From a tenant's perspective, *550 v. David S. Cheetham* may signal an improvement in tenant bargaining power. As a form of leverage, the case increases the likelihood that a tenant can negotiate a lease that, at the very least, does not include an Assignment Termination Clause with an automatic and absolute right for the landlord to terminate upon requesting an assignment. In any event, where such a lease purports to give a landlord such a right, there is now a strong and viable argument that the clause is nevertheless unenforceable.

Conclusion

On a general level, *550 Capital v. David S. Cheetham* casts doubt on the ability for parties to agree to terms that limit or restrict a right granted in another provision. More specifically, it calls into question the enforceability of an Assignment Termination Clause that gives a landlord an automatic and absolute right to terminate a lease upon receiving a request from a tenant to assign. Although the decision is not binding outside of Alberta, and although the decision turned upon the facts at issue, *550 Capital v. David S. Cheetham* nevertheless suggests that landlords should be cautious about including Assignment Termination Clauses in their leases and further suggests that landlords should be cautious about exercising their right to terminate under such clauses. On the other hand, for tenants, *550 Capital v. David S. Cheetham* may signal an improvement in tenant bargaining power and, specifically, the ability to negotiate out Assignment Termination Clauses.

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[1] 2009 ABCA 219.

[2] 1998 ABQB 489 aff'd 1999 ABCA 75.

[3] 2008 ABQB 754.

[4] *Supra,* note 1 at para. 38.

[5] *550 v. David S. Cheetham,* at para. 34.

[6] *550 v. David S. Cheetham,* at para. 48.

[7] (unreported, June 17, 1988, Ont. Dist. Ct.).