



# New Jersey Appellate Division Holds Environmental Escrow in Condemnation Cases Set at Cost of Remediation to Achieve Highest and Best Use

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In New Jersey, governmental entities with the power of condemnation have long battled with owners of real property over the compensation that the government must pay for condemned property. One important issue in these clashes has been the impact of environmental contamination on the valuation of real property and the cost of the investigation and remediation of contamination for which the property owner is otherwise liable. It is well-settled law in New Jersey that courts must value environmentally-contaminated property that is the subject of condemnation based on its “highest and best use” (i.e., the most profitable use for the property, whether residential, commercial or industrial), and that courts should perform this valuation as if the property has been fully remediated. A corollary to this principle allows courts to order the establishment of an escrow (i.e., a financial reserve) to cover the costs of investigating and remediating such property, for which the property owner is responsible. Against this backdrop, the New Jersey Appellate Division recently set the amount of such an escrow at the cost to achieve the use for which the property was valued (i.e., a residential development), even though the governmental entity may only need to conduct a significantly less expensive remediation to achieve its intended use (i.e., an industrial development). New Jersey Transit Corp. v. Mary Franco, et al., Docket No. A-3802-12T4 (N.J. App. Div. Oct. 19, 2016). This ruling answers an important question but, as with many environmental decisions, may result in unintended impacts.

The facts in Franco were as follows. In 2009, the New Jersey Transit Corporation (“NJT”) initiated proceedings to condemn several adjacent parcels of real property located in Hudson County (the “Property”). NJT and the

owners of the Property (the “Owners”) ultimately agreed that the “highest and best use” for the Property was a residential development, but the parties disagreed about many things, including the proper valuation of such residential development and the amount of the environmental escrow. Following a trial, the jury sided with the Owners and determined that the value of the property based on a high-rise residential development exceeded \$9 million. The trial court, however, sided with NJT on the proper amount of the escrow and ordered the establishment of an escrow of approximately \$2 million to account for the cost to remediate the Property for a residential development. In appealing this decision, the Owners argued that the trial court should have set the amount of the escrow at less than \$500,000. In so doing, the Owners asserted that the amount of the escrow should have been based on the remediation costs required to achieve the use of the Property that NJT originally intended (i.e., for a construction shaft associated with a tunnel under the Hudson River), which the Owners estimated at less than \$500,000, even though NJT no longer intended to use the Property for this purpose. In rejecting this argument, the Appellate Division held that “[t]he escrow for the estimated costs of environmental cleanup of a condemned contaminated property should be based on the remediation necessary to achieve the highest and best use of the property used to calculate the amount of the condemnation award.” The Appellate Division refused to determine the amount of the escrow based on the remediation required to achieve the actual use of the property by the condemning authority. Because the parties agreed that the highest and best use was as a residential development, the Appellate Division held that the trial court correctly set the amount of the escrow at the \$2 million required to properly remediate the property for residential use.

This holding, however, may have some unintended impacts, including the potential for a windfall to the Owners and other similarly situated condemnees. That is, the Appellate Division recognized in Franco that the Owners would be entitled to receive any amounts remaining in the escrow after NJT completes its remediation. Even though the Appellate Division approved an escrow based on a remediation to a residential level, if NJT remediates the Property only to a lower level, the Owners would receive the difference remaining in the escrow. This arguably would result in a windfall to the Owners because they would have received the value of the property as if remediated for residential development (i.e., \$9 million) but would only have had to pay for a lower level of remediation (i.e., the \$500,000 required for the originally intended use of the property and not the \$2 million required to support a residential development). Alternatively, however, because the Appellate Division set the amount of the escrow based on a remediation to a residential level, NJT may be free to remediate the Property to the residential standards at the expense of Owners even though the actual use of the Property for transportation purposes may not require that level of remediation. It remains to be seen how the Appellate Division and other New Jersey courts will deal with these impacts and others resulting from Franco if they arise in future litigation involving condemnation of contaminated property.

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