VALUATION OF CONTAMINATED PROPERTY ACQUIRED BY EMINENT DOMAIN

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I. OVERVIEW

Should evidence of a diminution in value resulting from environmental contamination be admissible in a condemnation valuation trial? Some jurisdictions answer this question in the affirmative, some in the negative, while other jurisdictions have held that when dealing with contaminated property, a condemnation award should be placed in escrow pending the outcome of the cost recovery action.

In all cases, the starting point must be the recognition that the 5th Amendment to the United States constitution, as applied to the States through the 14th Amendment, requires that private property shall not be taken without just compensation.[1] Just compensation is defined as the fair market value of the property when put to its highest and best use on the date of the taking.

A. THE POWER OF EMINENT DOMAIN IS A SOVEREIGN RIGHT

a. The power of eminent domain is the power of the sovereign to take private property for public use, as long as just compensation is paid. This power is inherent in the sovereign.

B. JUST COMPENSATION

a. The owner of property that has been taken by a condemning authority is entitled to just compensation. U.S. Const., 5th Amend. A condemnation award must be fair and just not merely to the condemnee but also to the public entity that must pay the award. When property has been taken by the government, "the fundamental question to be answered is 'what the owner has lost, not what the taker has gained' [citation omitted], " St. Agnes Cemetery v. State of New York, 3 N.Y.2d 37, 41 (1957); Matter of County of Clinton (Orel Gagnon), 204 A.D.2d 898, 899-900 (3d Dep't 1994); Metropolitan Transportation Auth. v. K. Capolino

[1] Each State constitution either limits or expands the rights afforded under the U.S. Constitution. See 1A-3 Nichols on Eminent Domain §3.01

Design & Renovation, Ltd., 123 A.D.2d 696, 699 (2d Dep't 1986), appeal denied, 69 N.Y.2d 610 (1987); Fonda, Johnstown and Gloversville R.R. Co. v. State, 29 A.D.2d 240, 241 (3d Dep't 1968). As the United States Supreme Court has said, "the general rule is that the loss to the owner from the taking, and not its value to the condemnor, is the measure of the damages to be awarded in eminent domain proceedings." Kimball Laundry Co. v. United States, 338 U.S. 1, 13 (1949).

See also:

Alaska: Gackstetter v. State, 618 P.2d 564, 566 (Alaska 1980).

Arkansas: Arkansas State Highway Commission v. Southern Development Corp., 469 S.W.2d 102, 105 (Ark. 1971).

Illinois: Peoples Gas Light & Coke Co. v. Buckles, 182 N.E.2d 169, 180 (Ill. 1962).

Indiana: Indiana & Michigan Electrical Co. v. Hurm, 422 N.E.2d 371, 378 (Ind. Ct. App. 1981).

Kansas: Hoy v. Kansas Turnpike Authority, 334 P.2d 315, 326 (Kan. 1959).

Louisiana: State v. Hayward, 150 So. 2d 6, 8 (La. 1963).

Minnesota: State v. Dangers, 312 N.W.2d 668, 670 (Minn. 1981).

Mississippi: Times Square Realty, Inc. v. City of Grenada, 421 So. 2d 1053, 1055 (Miss. 1982).

Missouri: Public Water Supply District No. 2 v. Alex Bascom Co., 370 S.W.2d 281, 289 (Mo. 1963)

Nebraska: Mathis v. State, 135 N.W.2d 17, 21 (Neb. 1965).

New Jersey: State v. Wemrock Orchards, Inc., 229 A.2d 804, 808 (N.J. 1967).

New York: Brighton Plaza, Inc. v. State, 224 N.Y.S.2d 411, 416 (1961).

Oregon: Santiam Lumber Co. v. Conhaim, 334 P.2d 247, 249 (Or. 1959).

Texas: Northern Natural Gas Co. v. Johnson, 278 S.W.2d 410, 412 (Tex. 1954).

Virginia: State Highway Commissioner v. Crockett, 127 S.E.2d 354, 356 (Va. 1962).

Washington: State v. Larson, 338 P.2d 135, 137 (Wash. 1959).

Wisconsin: Besnah v. City of Fond du Lac, 151 N.W.2d 725, 727 (Wis. 1967).

II. VALUATION OF REAL ESTATE CLAIMS

A. GENERAL RULE - PROPERTY IS VALUED AS OF THE VESTING DATE

The general rule used to establish just compensation is the fair market value of the property taken when put to its highest and best use. Fair market value has been defined as the price a willing buyer under no compulsion to buy, would have paid a willing seller, under no compulsion to sell a property, taking into consideration all uses for which the land was suited and might be applied. Generally, fair market value is to be measured and fixed as of the time of the taking.

B. HIGHEST AND BEST USE

Valuation of real property in a condemnation case is not necessarily based on the current use of the property as of the vesting date. It is based on the highest and best use. However, the use must be reasonably probable and not speculative. Even if a proposed use would be lawful under zoning and other applicable regulations, a claimant cannot obtain compensation on the basis of such a use if that use is speculative. The claimant must show that there is a reasonable probability that the property could or would have been put to that use at the time of the taking or shortly thereafter. Matter of City of New York (Broadway Cary Corp.), 34 N.Y.2d 535, 536 (1974); Matter of Shorefront High School, City of New York, Borough of Brooklyn, 25 N.Y.2d 146, 149-50 (1969), remittitur amended, 26 N.Y.2d 748 (1970); Consolidated Edison Co. v. Neptune Assoc., 190 A.D.2d 669, 670 (2d Dep't 1993).

See also:

Alabama: Alabama *ex rel.* Alabama State Docks Dep't. v. Atkins, 439 So. 2d 128, 132-133 (Ala. 1983).

Arkansas: Arkansas State Highway Commission v. First Pyramid Life Insurance Co. of America, 602 S.W.2d 609, 612-613 (Ark. 1980); Arkansas Louisiana Gas Co. v. Cates, 664 S.W.2d 897, 898-899 (Ark. Ct. App. 1984).

Colorado: Goldstein v. Denver Urban Renewal Authority, 560 P.2d 80, 83 (Colo. 1977).

Hawaii: State v. Dillingham Corp., 591 P.2d 1049, 1057-1058 (Haw. 1979).

Louisiana: Southwestern Electric Power Co. v. Scurlock, 485 So. 2d 72, 78 (La. Ct. App. 1986).

Maryland: Baylin v. State Roads Commission, 475 A. 2d 1155, 1160-1161 (Md. 1984).

Nevada: Clark County v. Alper, 685 P.2d. 943, 946-947 (Nev. 1984).

Pennsylvania: *In re* Appeal of Andora Associates, 562 A.2d 953, 954-956 (1989).

Vermont: Sharp v. Transportation Board of State of Vermont, 451 A.2d 1074, 1076-1078 (Vt. 1982).

West Virginia: West Virginia Dep't of Highways v. Berwind Land Co., 280 S.E.2d. 609, 614-621 (W. Va. 1981).

However, when the property acquired is contaminated, determining the highest and best use can be difficult to ascertain.

III. METHODS OF VALUATION

There are three traditional approaches to valuation—the income capitalization approach, the sales comparison method and the cost approach, and there are varying opinions among appraisers and other experts as to the appropriate methodology for determining the value of property affected by contamination.

A. INCOME CAPITALIZATION APPROACH

In jurisdictions that allow evidence of contamination in condemnation valuation trials, this approach is the best to use when valuing contaminated property which generates an income stream. Under this approach, income less expenses is capitalized to estimate value. Utilizing this method, remediation costs and testing costs can be offset against income as operating expenses to determine the fair market value of a contaminated property.

B. THE SALES COMPARISON APPROACH

This approach is generally seen as the most reliable method of determining the fair market value of both improved and unimproved residential properties, as well as unimproved commercial and industrial land. The sales comparison approach compares similarly situated properties with similar characteristics that sold in the marketplace at or around the time a condemning authority acquires title. It can be challenging to use this method in jurisdictions that require evidence of sales of comparable contaminated properties to show that contamination has decreased the value of the property, since it is often difficult to ascertain the level and extent of contamination of comparable properties.

C. THE COST APPROACH

This approach is usually limited to property that is considered a specialty. A specialty is a unique property that is not commonly bought and sold. Examples can include a gothic cathedral, an airport or a football stadium. Under this approach, the appraiser would estimate the costs of reproducing the property, which would include all direct and indirect costs (soft costs, overhead, and profit), less depreciation and would add that value to the value of the land.

Each of these approaches to value requires considerable data from the marketplace to support its conclusions. This has caused jurisdictions to apply varying approaches regarding whether evidence of contamination is appropriate in a condemnation valuation trial.

Three different approaches have emerged:

1. Jurisdictions holding that contamination evidence is admissible.

2. Jurisdictions holding that contamination evidence is inadmissible.

3. Jurisdictions holding that contamination evidence is inadmissible, however, the condemnation award is placed in escrow pending the resolution of the cost recovery action.

IV. VARYING APPROACHES TO VALUATION OF CONTAMINATED PROPERTY

A. JURISDICTIONS HOLDING CONTAMINATION EVIDENCE ADMISSIBLE

A majority of jurisdictions have determined that evidence of contamination is admissible in a condemnation valuation trial. The Courts justify the inclusion of such evidence because the presence of contamination impacts the price a buyer would be willing to pay for a particular piece of property. Accordingly, the fair market value of the property would need to reflect the contamination since the two are inextricably linked.

1. Contamination is inextricably linked to the fair market value of a property

California: Redevelopment Agency of Pomona v. Thrifty Oil Co., 5 Cal. Rptr. 2d 687 (Ct. App. 1992) (finding that remediation issue was properly considered since it was an important characteristic of the property which would affect its value, where City took possession of gas station property and engaged in a remediation procedure to clean up contaminated land); San Diego County Water Authority v. Mireiter, 23 Cal. Rptr. 2d 455 (1993) (finding that the amount of compensation due to a property owner must consider facts discovered between the date of valuation and the date of trial which reduced the property's fair market value).

Connecticut: Northeast Ct. Economic Alliance v. ATC Partnership, 776 A.2d 1068 (Conn. 2001) (holding that evidence of environmental contamination and remediation costs is relevant to the valuation of real property taken by eminent domain and admissible in a condemnation proceeding to show the affect, if any, that those factors had on the fair market value of the property on the date of the taking).

Florida: Finkelstein v. Dept. of Transportation 656 So. 2d 921 (Fla. 1995) (holding that in an eminent domain valuation proceeding, evidence of contamination is admissible only if there is sufficient factual basis for concluding that the contamination does affect the market value of the property taken. If there is no evidence in the record upon which the finder of fact can determine that the value of the property has been decreased,

then the petitioner would be entitled to the fair market value of the property valued as uncontaminated.)

Georgia: Stafford v. Bryan County Board of Education, 466 S.E.2d 637 (Ga. Ct. App. 1995), rev'd on other grounds 476 S.E.2d 727 (1996). (concluded that trial court properly allowed evidence of contamination at trial regarding the value of the condemned property, since it was a relevant factor in fairly assessing the market value of the property, not simply as to the condemnor, but as to all prospective buyers)[2].

Kansas: Olathe v. Stott, 861 P.2d 1287 (Kan. 1993) (holding that the Kansas Storage Tank Act did not preempt the General Statutes regarding eminent domain; thus, the evidence of contamination, which necessarily affects the market value of real property is admissible in eminent domain proceedings to determine the fair market value of the property taken); National Compressed Steel Corp. v. Unified Gov't of Wyandotte County/Kansas City, 38 P.3d 723 (2002) (stating that environmental contamination is relevant to appraising the value of property sought to be condemned).

Michigan: Silver Creek Drain District v. Extrusion Division, Inc., 663 N.W.2d 436 (Mich. 2003) (holding that in determining just compensation for a property, a court must take into account all factors relevant to market value, and that contamination, and its affect was properly considered in determining fair market value).

Oregon: Oregon v. Hughes, 986 P.2d 700 (Or. Ct. App. 1999) (holding that evidence related to the contamination that existed on the property on the date that the condemnation action was filed, and evidence regarding whether the contamination could have been discovered at the time of the taking is relevant to determining the market value of the property, since such evidence would bear directly on the fair market value).

Tennessee: Tennessee v. Brandon, 898 S.W.2d 224 (Tenn. Ct. App. 1994) (reversing the lower court's order excluding evidence that the soil and water on the condemnees' property was contaminated since evidence of contamination and the cost of reasonable steps taken to remedy it were relevant in determining the fair market value of the property).

[2] This decision was reversed on a technicality, by Stafford v. Bryan County Board of Education, 476 S.E.2d 727 (1996). Accordingly, it is unclear if the Court would affirm its holding in the original Stafford case which held that evidence of contamination is admissible in a condemnation valuation trial.

2. Fault is irrelevant in determining fair market value

Connecticut: Northeast, *supra* 776 A.2d at1083 (finding that fault should not be an issue in a condemnation proceeding. The condemnor is acquiring property in a given condition, with a value based on that condition. How the property got to be that way and who is responsible has nothing to do with that determination. To deny the condemnor the right to put on evidence as to one of the significant determinants of that condition- and hence value- because it may not reflect the owner's degree of responsibility for the condition misses the point of the eminent domain valuation process).

B. JURISDICTIONS HOLDING CONTAMINATION EVIDENCE INADMISSABLE

Some jurisdictions have held that evidence of contamination is inadmissible in a condemnation valuation trial for a variety of reasons, such as the potential for double liability, the lack of procedural due process protections or interpleader of third parties that may be responsible for the contamination, as well as the view that this evidence would over complicate the valuation trial.

1. Double liability issue:

Iowa: Aladdin, Inc., v. Black Hawk County, 562 N.W.2d 608, 615 (Iowa 1997) (held that, in determining just compensation in an eminent domain proceeding, remediation costs are not admissible, since a landowner would incur additional liability to clean up the property, and not receive just compensation since the award would be less than full value).

New York: *In re* City of New York v. Mobil Oil Corp., 12 A.D.3d 77 (2d Dep't 2004)(expressing concern about a "double taking" result if the City were permitted to offset the contamination and remediation costs in the condemnation proceeding, while a separate Navigation Law action to recover remediation costs was pending); *In re* Syracuse Industrial Development Agency v. Carousel Landing, 2005 N.Y. App. Div. LEXIS 6209 (4th Dep't 2005) (taking issue with the possibility of a "double taking" if evidence of contamination was admitted in a condemnation proceeding); *In re* Northville Industries Corp. v. New York, 14 A.D.3d 817 (3d Dep't 2005) (upholding trial court's decision to exclude evidence of and testimony relating to environmental contamination and remediation costs in determining just compensation in a condemnation proceeding).

2. Lack of procedural due process protections in a condemnation trial—no joinder of other potentially responsible third parties

Illinois: Dep't of Transportation of the State of Illinois v. Parr, 633 N.E.2d 19, 20 (Ill. App. Ct. 1994) (holding that environmental remediation costs were inadmissible in determining the fair market value of the condemned property, because their admission would violate the due process rights of property owners under the Illinois remediation statute).

Iowa: Aladdin, *supra* 562 N.W.2d at 615-617 (finding that if clean up costs were admissible in the condemnation proceeding the procedural due process rights of the owner would be violated, since the Iowa remediation statute did not contain procedural safeguards).

3. Over – complicates valuation trial

New Jersey: Housing Authority of New Brunswick v. Suydam Investors, 826 A.2d 673 (N.J. 2003). (reasoned that omitting the complications of contamination from the valuation process thus advances the speed and efficiency that are the hallmark of eminent domain proceedings).

Ohio: Wray v. Duffy, 1993 Ohio App. LEXIS 233 (Ohio Ct. App., 1993) (holding that evidence of contamination cleanup costs and of soil contamination was inadmissible in an eminent domain proceeding because the fair market value was determined at the date of the taking and the law did not require the owner to clean up the contamination).

4. Uncertainty of mandated remediation

Iowa: Aladdin, *supra* 562 N.W.2d at 616 (finding admission of contamination evidence as resulting in speculation of damages further litigation and delays and expenses).

C. **JURISDICTIONS HOLDING THAT CONTAMINATION EVIDENCE IS EXCLUDED BUT MONEY PLACED IN ESCROW TO PAY FOR ANY DAMAGES RECOVERED IN SEPARATE ENVIRONMENTAL LITIGATION**

Under this approach, evidence of contamination is excluded from the condemnation valuation trial, and the property is valued "as if clean." The condemnation award, however, is placed into an escrow account until the exact amount of cleanup costs can be determined in a cost recovery proceeding.

New Jersey: Housing Authority of New Brunswick v. Suydam Investors, 826 A.2d 673 (N.J. 2003). (held, that where property is contaminated, the condemnor should appraise the property as if remediated and deposit the condemnation award in a trust-escrow account in Court to satisfy the condemnee's clean-up and transfer obligations).

New York:

Second Department: In re City of New York v. Mobil Oil Corp., 12 A.D.3d 77, 78 (2d Dep't 2004) (reasoning that because the condemnee faced potential liability for contamination under the Navigation Law and a possible "double taking" result if the City were permitted to offset the contamination and remediation costs in the condemnation proceeding the trial court's decision to exclude evidence related to environmental contamination should be affirmed. The court, however, agreed that the effect of stigma could be considered in the condemnation valuation trial).

Third Department: *In re* Northville Industries Corp. v. New York, 14 A.D.3d 817 (3d Dep't 2005) (upholding trial court's decision to exclude evidence of and testimony relating to environmental contamination and remediation costs in determining just compensation in a condemnation valuation trial).

Fourth Department: *In re* Syracuse Industrial Development Agency v. Carousel Landing, 2005 N.Y. App. Div. LEXIS 6209 (4th Dep't 2005) (holding that environmental clean-up and remediation costs should not be considered when valuing the fair market value of property because such costs are recoverable under a Navigation Law proceeding. The court, however, agreed that the effect of stigma could be considered in the condemnation valuation trial).

V. WHAT CAN A MUNICIPALITY DO TO PROTECT ITSELF WHEN ACQUIRING CONTAMINATED PROPERTY BY EMINENT DOMAIN

A. ENVIRONMENTAL DUE DILIGENCE

Know what you are acquiring! The proper level of environmental due diligence depends on many factors. The most important factors are the prior and current uses of the property being acquired. While no property should be assumed to be free of contamination, certain types of property, in certain areas are more likely to be contaminated than others. Examples include any current or previous industrial or commercial site, any suspected former landfills, any areas without vegetation, any areas with a history or likelihood of underground storage tanks, or any site adjacent to any of the above. To be safe, however, a Phase I Environmental Assessment should be done on all properties to be acquired by eminent domain.

1. **Phase I Environmental Assessment**- This attempts to identify recognized environmental conditions by undertaking four general areas of inquiry:
    - Historical site information;
    - Site visit and interview(s);
    - Database radius searches; and
    - Regulatory agency inquiries.

A Phase I should also include a general discussion of the environmental setting of the property and a set of recommendations for further inquiry, if any.

If an environmental condition is discovered in a Phase I Environmental Assessment, a Phase II Environmental Assessment should be obtained.

2. **Phase II Environmental Assessment**- The objective of a Phase II Environmental Assessment is to evaluate the conditions that were identified in a Phase I test. Components of a Phase II Environmental Assessment include:
    - Developing the scope of work
    - Assessment Activities
    - Evaluation and presentation of data, and
    - Presentation of findings and conclusions.

A Phase II can be done merely to confirm the presence of contamination and arrive at an estimate of the cost to remedy it, or to confirm that there has been no disposal or release of hazardous materials on the site.

VI. CONCLUSION

The area of the law where eminent domain and environmental law intersect is still evolving. In order for a municipality to protect itself, it must fully comprehend the level and extent of contamination on a property it intends to acquire by eminent domain. Accordingly, it is essential for a municipality to conduct the appropriate due diligence afforded by Phase I and Phase II Site Assessments. With the appropriate inquiry and testing, a municipality can identify the level and extent of contamination early in the acquisition process so that it can make an informed decision as to whether to proceed with condemnation and a cost recovery action, as necessary. Whether your jurisdiction admits or excludes evidence of environmental contamination in a condemnation valuation trial, one issue is constant- - encouraging development through eminent domain and safeguarding the public against contaminated properties cannot be mutually exclusive.