

# The Intersection of Eminent Domain and Environmental Contamination

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Assume that a local public agency needs an operating industrial property to expand its public-works yard. The potential acquisition property has operated as a manufacturing and warehousing center for several decades without interruption. The subject property is not subject to a cleanup order from any regulatory agency, and the owner has neither investigated nor is aware of the presence of any hazardous substance on, in, or near his property. The owner refuses the agency's requests for testing on the property prior to the exercise of eminent domain for expropriation of the land and improvements.

Rather than incur the expense of a precondemnation entry order, the agency decides to proceed in exercising eminent domain to acquire the site. In conducting investigations on the property, the agency detects significant levels of perchloroethylene triggering a hazardous substance-remediation order. The remediation method and associated costs, use, and risk chosen by the agency based upon its self-imposed construction deadline will exceed 90 percent of the current value of the subject property. The agency maintains that the owner must pay for the remediation through an acquisition price reduction. The owner is adamant that he should not bear the cost of the remediation because the cleanup order was only occasioned by the public project that the property is being taken for and at an expedited schedule. Who's right?

One of the most problematic issues in the area of eminent domain has to do with environmental contamination, either real or perceived, found during expropriation. Who pays for the costs of assessment, remediation, and/or diminution in value (if any) associated with the subject property and the project as proposed? Is it the condemning agency, or is it the property owner? Is it a combination of both?

Eminent-domain proceedings are

determined either by a jury, by a judge, by condemnation commissioners or, if the parties agree, by arbitration. The Fifth and Fourteenth Amendments to the U.S. Constitution protect private-property owners and promise that they are paid just compensation for property that is taken for public use.

The challenge to the real-estate appraiser involved in such a matter is to estimate what the just compensation ought to be when there is environmental contamination. The answer depends on which jurisdiction the eminent-domain proceeding takes place in. There are two rules for measuring just compensation—the “before and after” (federal) rule and the “value plus damage” (state) rule.

## De Facto Epistemologies

The before-and-after (federal) rule is a valuation method used in federal cases and many states. (Only the Fifth Circuit has ruled that the before-and-after rule is the only acceptable valuation method; other circuit courts will accept variations of the rule.) Generally, the federal rule states that the value of the property taken is the value before the taking minus the value after the property is taken. The difference in value equals just compensation.

There are some recognized problems with the before-and-after rule. One problem is that it does not provide a component to exclude benefits from the after-value such as offsets for agency-paid remediation costs. Also, the before-and-after rule does not provide a way to exclude non-compensable damages from the after value—such as perceived ongoing environmental risk or goodwill. Because of these problems, there are some jurisdictions that use variations of the rule.

The value-plus-damage (state) rule is an alternative method of calculating just compensation in partial takings: value of the part taken *plus* damages to the remainder *less* benefits (special or general). Special

or general benefits (say, in California) are benefits that the remainder obtains as a result of the public improvement that could include remediation costs among others.

With the value-plus-damage (state) rule, the property owner is given just compensation through payment of fair market value for the property taken, plus severance damages for the remainder. This rule takes a more detailed and in-depth analysis than the before-and-after rule.

What methodology and allocation should the real-estate expert then rely on in arriving at an indication of total just compensation as of the effective date of value? The beginning for such a calculation is the Detrimental Conditions Matrix (DC Matrix) and the Uniform Standards of Professional Appraisal Practice (USPAP).

However, before this system of association is developed, an in-depth discussion of caselaw is necessary. For this discussion, two perspectives—one from New Jersey and the other from California—are presented to shed light on this often conflicting legal scenario.

## The California Perspective

In California, “just compensation” for property taken in eminent domain is generally the “fair market value” of the property as defined by California Code of Civil Procedure § 1263.320(a). In the valuation trial of the property taken, the amount of compensation to be awarded must be determined by a jury, as prescribed by the California Constitution, Article I, §19. The amount of compensation awarded is the equivalent of the fair market value of the property taken. The “fair market value” of a property is intended to represent the price that would be paid in an arms-length transaction in the open market:

The fair market value of the property taken is the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under

no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing and able to buy but under no particular necessity for so doing, each dealing with the other with full knowledge of the uses and purposes for which the property is reasonably adaptable and available. Cal. Code of Civil Procedure §1263.320 (emphasis added).

The constitutional guarantee of just compensation via the award of fair market value is intended to protect the landowner, but it also protects the public by limiting its liability for losses that can fairly be attributed to the taking. See *Emeryville Redev. v. Harcros Pigments, Inc.*, 101 Cal. App. 4th 1083, 1094 (2002). “A landowner is not entitled to be placed in a better position financially than he was before the condemnation; neither is the state required to pay more than land is worth merely because of some theoretical, intangible concept.” *San Diego County Water Authority v. Mireiter*, 18 Cal. App. 4th 1808, 1817 (1993). Thus, the property to be taken must be valued based upon a realistic analysis of the actual property to be taken and its true condition on the date of value. Statutes and caselaw require that the jury determine the fair market value of the actual property to protect the constitutional rights of both the property owner and the public. See *id.*; Cal. Const. art. I, § 19.

In determining a property’s fair market value, the jury is entitled to and should consider those factors that a prudent and knowledgeable buyer in the marketplace would take into consideration in arriving at a fair market value were he or she contemplating a purchase of the property. See *People ex rel. Dept. of Public Works v. Donovan*, 57 Cal. 2d 346, 352 (1962). The “marketplace” is defined as the private market place based on what willing, knowledgeable, nongovernmental buyers and sellers would pay for property to be used for nongovernmental purposes. See *Cnty. of San Diego v. Rancho Vista Del Mar, Inc.*, 16 Cal. App. 4th 1046, 1063 (1993).

The key component in both the statutory definition of fair market value and its

analysis by the courts, is that the buyer evaluate what it would pay for the property with *full knowledge* of the physical characteristics of the property. *Cnty. of L.A. v. Bean*, 176 Cal. App. 2d 521, 527 (1960). Thus,

[t]he rule is, that the owner is entitled to the market value of his land, to be determined in view of all the facts which would naturally affect its value in the minds of purchasers generally. . . . Any existing facts which enter into the value of the land in the public and general estimation, and [tend] to influ-

Procedure §1263.320, requires the jury to consider whether a downward adjustment is necessary because of the presence of hazardous materials. The property’s adaptable uses, when synthesized with the constitutional guarantee of “just compensation” to the property owner, translates into a determination of its highest and most profitable (best) use. See *People ex rel Public Works Board v. Talleur*, 79 Cal. App. 3d 690, 695 (1978). Therefore, the jury determines a property’s “highest and best use,” and then fixes its fair market value based upon that type of use, with a reduction for negative attributes of the

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ence the minds of sellers and buyers, may be considered. *Sierra View Local Health Care Dist. v. Sierra View Med. Plaza Assocs.*, 126 Cal. App. 4th 478, 487 (2005).

In today’s marketplace, prudent buyers will undertake environmental due diligence before purchasing property. The presence, or possible presence, of hazardous materials may cause a prudent buyer in the open market to seek a reduction in the purchase price to account for the hazardous materials. The purchase-price reduction could take various forms—the cost of an indemnity policy purchased by the seller, an escrow “hold-back” to allow an adequate investigation, or a general downward price adjustment to acknowledge that the buyer is purchasing property that will require some form of remediation.

The valuation of the property with “full knowledge” of its adaptable uses, as required by California Code of Civil

particular property at issue. Again, the statutory requirement of a knowledgeable buyer assumes a buyer who is astute enough to appreciate both the positive and negative attributes of a property in determining the price for the property.

However, the only reported decision in California in which the specific question posed in the opening hypothetical received consideration is *Redev. Agency of the City of Pomona v. Thrifty Oil Co.*, 4 Cal. App. 4th 469 (1992). In that case, the valuation opinions expressed by the agency, the property owner, and a third special appraiser appointed by the court all recognized that necessary remediation diminished the value of the gas-station site from what the value would have been had there been no hazardous materials on the property. In that eminent-domain action, the court specifically found that substantial evidence, including evidence of contamination as of the date of value, supported the jury’s conclusion of the fair market value that accorded a reduction

in the purchase price equaling the special appraiser's remediation reduction. *Id.* at 473-74.

Nevertheless, there is considerable conflict over the proper method of valuation concerning property that may be impacted by defined hazardous materials, whether originating on that site or having migrated there from adjacent contaminant sources. The *Thrifty Oil* case referenced above did not address the situation in which the highest and best use is a continuation of the then-current use; in *Thrifty Oil*, all

parties agreed that the property would no longer operate as a gas-station site. Is the public agency entitled to reduce the amount of the purchase price by the anticipated hazardous-materials-remediation cost where there is no cleanup order pending on the property and the only thing necessitating cleanup is the public agency's planned use? Is the property owner entitled to continue under a contaminated condition that previously went undetected, and gain the higher value as if no contamination exists?

Property owners will point to California Code of Civil Procedure § 1263.330 and other provisions of law that indicate there shall be no decrease in compensation because of the implementation of the public project for which the property is being taken. Public agencies will point to the myriad of hazardous-materials regulatory schemes and cases cited previously herein to suggest that the property owner cannot be compensated for a fictional condition of the property. Public agencies may also assert a string of decisions linking the

Exhibit 1 illustrates the legal quandary regarding contamination, using the procedures of the value-plus-damage rule. Depending on the interpretation of caselaw and state regulations, costs, use, and risk issues may be too high to reflect just compensation. This is especially true depending on the motivation of the agency involved and the definition of fair market value.

<b>Exhibit 1. Condemnation involving contaminated property. Damages or Benefits?</b>			
<b>1. Agency - Non-Market Motivation</b>			
<b>Issues:</b>			
<b>Cost</b>	1.1 High due to fast-tracking project completion schedule		\$2,000,000
	Remediation chosen: Scoop and haul. Storage and transportation costs		+
	Possible cost cap insurance needed, plus PLL policy		\$300,000
<b>Use</b>	1.2 Likely use interruption to existing occupants / owner due to fast-track schedule and inefficiencies		\$50,000
<b>Risk</b>	1.3 Possible. Market data driven. Disclosure.		+/-
<b>Amount</b>	1.4	Indicated Diminution in Value - Damages	+/- \$2,350,000
<b>2. Property Owner - Market Motivation - Typical</b>			
<b>Issues:</b>			
<b>Cost</b>	2.1 Likely lower due to choosing other cleanup option & no fast-track remediation schedule		\$500,000
	Bioremediation & vapor extraction chosen: no off-site costs		---
	Likely no need for insurance, but possible indemnification expenses		\$100,000
<b>Use</b>	2.2 Likely no impact on existing use as improved or occupants		---
<b>Risk</b>	2.3 Possible. Market data driven. Disclosure.		+/-
<b>Amount</b>	2.4	Indicated Diminution in Value - Damages	+/- \$600,000

Note: This is for illustrative purposes only. The scenario and dollar amounts are fictional.

1. Agency—Non-Market Motivation. A new evolution seems to have taken hold in various agencies with the power of eminent domain: fast-tracking the public project. To expedite the condemnation process, state and local governments may be violating the U.S. Constitution as the cleanup methods being chosen are more costly compared with what the real-estate market demands (i.e., consider hopes of reducing agency costs by expediting the condemnation process and construction/project life cycle).

presence of hazardous materials with the maintenance of a nuisance on property, the abatement of the nuisance being a proper deduction from the fair market value. See *People v. Gates*, 41 Cal. App. 3d 590, 601 (1974); *Newhall Land & Farming Co. v. Superior Court*, 19 Cal. App. 4th 334, 343 (1993); *Leslie Salt Co. v. S.F. Bay Conservation & Dev. Comm'n*, 153 Cal. 3d 605, 618 (1984).

Both sides of the issue continue to labor under a lack of reported decisions directly on point. Currently, California trial courts

are left to wade into this quagmire of valuation complexities without direct appellate precedent.

### **The New Jersey Perspective**

More densely populated than Japan, New Jersey is an old industrial state. It has a history of remedial legislation for strict joint-and-several retroactive liability for potentially responsible parties to clean up the site before a transfer of the fee can proceed. New Jersey Spill Compensation and Control Act, N.J.S.A. 58:10-23.11 to

23.50 (1976); Industrial Site Recovery Act, N.J.S.A. 13:1K-6 to 14. Brownfields redevelopment intersects with municipal government to place these often abandoned facilities back on the tax rolls. State and county governments look to improve infrastructure for safety reasons and economic rebirth as well. Condemnation triggers both scenarios.

The site-valuation policy of New Jersey was settled in 2003 in *City of New Brunswick v. Suydam Investors*, 177 N.J. 2 (2003). The New Jersey Supreme Court

- 1.1. Cost: \$2,300,000. What gets ignored, however, is the effect that fast-tracking may have on private-property owners. The Cadillac version, such as "scoop and haul" for remediation, is chosen because of expediency in meeting timeline goals and avoiding penalties, especially in design/build projects. Justification is argued as the cost can be passed on to the property owner as a setoff from possible severance damages.
- 1.2. Use: \$50,000. Additional adverse impacts to the tenant or owner/user can be the interruption of use during the repair stage. This may include temporary relocation and lost revenues during the construction phase.
- 1.3. Environmental risk (often inappropriately referred to as stigma) may also be a component of consideration as additional offsets, or not. The real-estate expert must diligently research the local and regional markets for data that support or disprove such a diminution in value.
- 1.4. \$2,350,000. This is the overall diminution in value that could be used as a benefit to the property owner thus reducing compensation or, horror upon horrors, it could even be used as an argument that the owner should pay the agency for the favor of condemning his or her real asset.

2. Property Owner—Market Motivation—Typical. In opposition to fast-tracking public projects, the property owner would likely choose the cleanup method that is least expensive yet accomplishes regulatory requirements. But for the project as proposed, the owner would continue to enjoy the financial benefits derived from the site under typical market forces. Taking into consideration highest and best-use elements, the owner then maximizes his or her financial position. Such a market-driven approach seeks to spend the least to make the most amount of money in selling a property.

- 2.1. Cost: \$600,000. If the regulatory agency sets a de minimis level of cleanup, this is exactly the level of repair that the real-estate market will seek, not some standard that captures a pristine before condition. Assuming that the market value of the subject property is \$2,200,000 as unimpaired, why would anyone spend more to clean it up than it is actually worth?
- 2.2. Use: \$0.00. There would likely not be any interruption in use of the real asset because the method used to clean up the site is arguably non-intrusive.
- 2.3. Environmental risk may also be a component of consideration based on market data.
- 2.4. \$600,000. This is the overall diminution in value that the real-estate market would demand under typical motivations with no undue pressure to either the seller or buyer and assuming that there is no market resistance. It also assumes that the seller has taken on the cleanup responsibility and has not simply passed the matter onto the buyer.

The value implications become arresting if one were to consider that the unimpaired, or baseline value of the site was \$2,000,000. From the agency's perspective, the impaired value of the property could be construed as -\$350,000; from the property owner's perspective, the impaired value of the property could be \$1,400,000.

Consider that the expert appraiser was retained by counsel for the agency. For the real-estate expert to truly aid the trier of fact in its ultimate determination of just compensation as an impartial individual, he or she would likely have to disclose the bias of his or her client under this scenario. In due course, the expert must rely on the jurisdictional definition of fair market value and not "arbitrary and capricious" acts of governmental power. The ultimate value conclusion would have to be the lesser of the two cost, use, and risk scenarios. Such a decision would certainly be unpopular with the retaining attorney, but would be consistent with the concept of market value and moreover helpful in the maintenance of public trust.

determined that a fairer appraisal to the property owners is to accept an appraisal that values the property as remediated to avoid a double loss of diminished value and subsequently reduced again by the cost of the remediation. Noting there is an “inherent tension in every condemnation case,” the court opined that a cost-recovery procedure following placement of the funds in court escrow permits third-party claims to be brought against insurers, title companies, and prior owners who are not part of the statutory condemnation process. A portion of the funds is held back until the exact amount of the remediation is determined and the balance, if any, is paid to the property owner. But the chances are there is no viable owner either because of death, abandonment, or

proceed, the court will send the case to condemnation commissioners to establish the fair value of the property taken. After hearings, the condemnation commissioners will render their decision, which, if acceptable, is reduced to final judgment and becomes the amount paid by the condemning authority to the property owner. Either the condemning authority or the property owner may appeal that decision to the court, after which the matter will proceed with a jury trial. If the condemnation involves the Port Authority of New York and New Jersey and not a state governmental agency, the decision of the condemnation commissioners is only advisory to the court and there is not a jury trial.

The following are two practical applications of eminent domain and its inter-

was reached increasing the award and having the condemning authority take the property “as is” “where is.”

The second example of a condemnation case involving contamination issues was a road-widening project, again in Fort Lee, New Jersey. The municipality was condemning the client’s parcel of land that contained a building consisting of four retail stores with residential units above. The property also contained underground heating-oil tanks. Once again, after a hearing before commissioners, the condemning authority agreed to pay the settlement demand that was in excess of the commissioner’s award and agreed to take the property “as is” “where is” with no responsibility for environmental cleanup on the part of the property owner.

In many cases, the condemning authority is planning on either demolishing or excavating the property for a public-type improvement and is willing to take the risk on the environmental issue. A problem may develop if the taking is for a passive use, such as a golf course or a park. In those types of cases, the condemning authority will usually insist upon the grantor clearing the environmental issue. That said, you are then presented with the unique question: While the condemning authority assumes no environmental obligation, will it, prior to paying the award, ask the court to hold aside the amount necessary to clean up the property? If so, the property owner may be deprived of fair compensation for the taking, because it could have continued to use the property without spending the money to clean up the property. Thus, the property owner would be deprived of the continuing income stream derived from the property, assuming it is rented, which would not have been offset by the cost of the environmental cleanup. It does not appear that any court has addressed this interesting issue yet.

#### **The Real-Estate-Expert Perspective**

The real-estate-valuation expert provides opinions of the value of the property to be taken using industry-accepted methodologies, or approaches to value, to opine to the value to be used as a part of just

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bankruptcy. In that instance, the underlying legislation requiring cleanup comes into play through the state’s Spill Act. The end result may be that the condemning authority foots the bill and no funds are available to the fee or easement owner.

Condemnation cases are commenced with the filing of a complaint by the condemning authority. In most cases, the condemning authority establishes a fair market value for the property being taken for a public purpose and negotiates with the property owner prior to the filing of the complaint. The complaint is filed along with an order to show cause, and the court will set down a return date for the order to show cause, giving the property owner the right to contest the validity of the taking by the condemning authority, and whether the condemning authority complied with the statutory requirements to proceed. If the court finds that the case should

section with the New Jersey and federal cleanup statutes. A client owned a parcel of property in Fort Lee, New Jersey, in close proximity to the George Washington Bridge, which spans the Hudson River between New Jersey and New York. The Port Authority of New York and New Jersey was condemning this parcel for reasons related to its proximity to the bridge. The parcel was used as the home office, base station, and garage for a taxi company. There were underground storage tanks that were removed, and there were issues relating to groundwater contamination. The Port Authority’s condemnation complaint contained the standard language that its taking was not subject to any environmental condition, and it reserved the right to seek payment from the client for any cleanup costs. The case was tried before condemnation commissioners. After the trial, a compromised settlement

compensation. Moreover, the conduct, development, and reporting of an appraisal by an appraiser are subject to the USPAP. In fact, the USPAP does account for contaminated-property valuation with its Advisory Opinion 9: The Appraisal of Real Property That May Be Impacted by Environmental Contamination. At the core of USPAP's Advisory Opinion 9 are the concepts of the "remediation lifecycle stage" and the considerations of cost, use, and risk that accompany each stage.

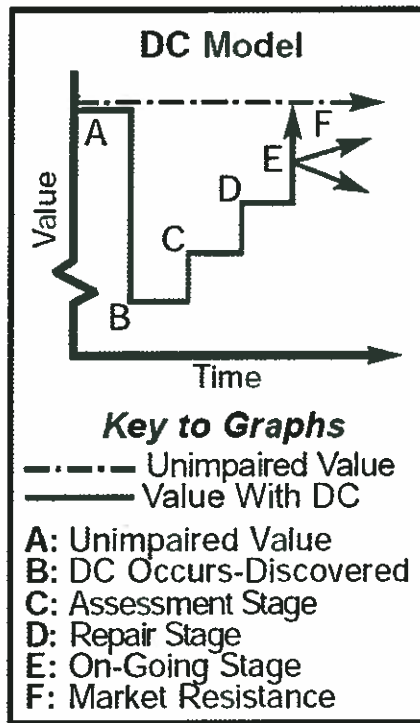
The presence of contamination on the property can have obvious impacts on its market value, or not. Once suspected at a property, contamination takes on a life of its own. The remediation lifecycle of contaminated property begins with assessment, moves to the repair, or remediation, of the contaminant and then into the ongoing stage in which the property may or may not be monitored. From the expert appraiser's perspective, the placement of the subject property in the remediation lifecycle becomes an important valuation consideration as each stage in the cycle brings certain cost, use, and risk components that must be considered before arriving at an opinion of value.

**Detrimental Condition Matrix**

	Assessment	Repair	Ongoing
Cost	Assessment Costs & Responsibility	Repair Costs & Responsibility	Ongoing Costs & Responsibility
Use	Use Impacts While Assessed	Use Impacts While Repaired	Impact on Highest & Best Use
Risk	Uncertainty Factor	Project Incentive	Market Resistance

The Detrimental Condition Matrix summarizes the cost, use, and risk possibilities through the three stages of the remediation lifecycle. See Randall Bell, Orell Anderson and Michael Sanders, *Real Estate Damages: Applied Economics and Detrimental Conditions* (Appraisal Institute 2008).

As a contaminated property moves through the remediation lifecycle, the diminution in value generally shrinks. Value diminution is usually at the highest levels in the assessment stage—when the presence of contamination is detected, but the true extent of the problem is unknown and the anticipated costs and use disruptions are greatest. Accordingly, in the repair phase, the contamination has been assessed and characterized, the costs and use disruptions have been borne, and the risk component becomes project incentive to any prospective buyer. In the ongoing stage, assessment and repair are complete, but diminution in value attributable to any ongoing costs, use impacts, and ongoing market resistance (perceived environmental risk) is still possible.



The Detrimental Conditions Model illustrates the general behavior of contaminated property value as it moves through the remediation lifecycle. See Randall Bell, Orell Anderson and Michael Sanders, *Real Estate Damages: Applied Economics and Detrimental Conditions* (Appraisal Institute 2008).

Depending on the legal assumptions given to the appraiser by the advocate, the amount of compensation will vary, often at significant levels. Where the property

stands in the remediation lifecycle depends on the effective date of value of the appraisal, which is usually dictated from the courts in accordance with jurisdictional mandate. The legal establishment of severance damages and benefits for estimating just compensation then becomes "a not so small fly in the ointment" for the expert appraiser. Depending on the jurisdiction, regulations, and legal interpretations of case law, these issues may or may not make whole the property owner and/or agency. ♻️

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