

Contamination and Condemnation

When contamination is discovered during condemnation of a property through eminent domain, many legal questions arise.

By Orell C. Anderson and Alexander R. Wohl

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When contamination is discovered during condemnation of a property through eminent domain, legal questions arise as to whether the cost of remediating that contamination should be deducted from the just compensation awarded the property owner. Valuation questions arise as well. What kind of cleanup, if any, would the local market demand? What kind of discounts, if any, would the local market impose on a sale of the subject property as contaminated? As remediated? As unimpaired? While these are all interesting questions, it is important to first separate the legal challenges from the valuation challenges.

Legal Challenges

Legally, the question of whether contamination may be considered during eminent domain proceedings depends to a great extent on state law, much of which is still uncertain. State laws differ on this question of inclusion or exclusion of the costs of remediation when determining just compensation.

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Broadly stated, the legal framework of an eminent domain appraisal may influence the scope of work, hypothetical conditions, and extraordinary assumptions. Once these parameters are set, the development of an opinion of value and the search for supporting impaired and unimpaired data must follow from the needs of the valuation assignment.

Valuation Challenges

The legal complications should not be confused with the complexities specific to the appraisal assignment. Once the valuation problem is defined, the appraiser is faced with a property and a date. It is the appraiser's responsibility, then, to determine, according to the appropriate definition of *market value*, what the value of the property would be as of that effective date of value. The greatest challenge in completing such an assignment is usually the search for comparable transactional data. In determining market value as of a certain date and absent the influence of the proposed project, an appraiser or valuer must look for relevant market data to determine questions of supply and demand. Legal complexities may obscure straightforward valuation errors.

Moorhead: Example of Remediation-Related Challenges

An important case that illustrates the intersection of eminent domain, contamination, and remediation-related challenges is *Moorhead Economic Development Authority v. Kjos Investments*, which was decided in 2010 in the Minnesota Supreme Court. 789 N.W.2d 860 (2010). The case concerned a March 2001 quick-take action in which the Minnesota Economic Development Authority (MEDA), through a separate entity and agreement set up in in 2002, condemned 24 acres, including a commercial office building in Moorhead, Minnesota, owned by Roger W. Anda. As part of the redevelopment project, the MEDA condemned approximately 20 properties. Following the condemnation, the MEDA discovered fuel-oil contamination on Anda's property, which was to be sold "clean" to Marriott, and on two adjacent parcels. Following the quick-take action and subsequent discovery of the contamination, the property developer, Moorhead Holiday Associates (MHA), remediated the three properties in a week via "scoop and haul" for a cost of over \$1.5 million. The motivation for such an expensive "Cadillac cleanup" was that the developer was required to deliver all of the condemned properties on time to a franchise developer. If even one parcel, such as the Anda site, was not delivered, the entire redevelopment project would be canceled. According to the appraiser for the county, the \$1.5 million cost to remediate far exceeded the value of the property as unimpaired, which

he claimed was \$455,000. Thus, taking the remediation into account, the appraiser found that the property had no market value.

Following appeal, the *Moorhead* case was brought before the Minnesota Supreme Court, which noted that the contamination cost was not relevant and that the owner was to be compensated based on the subject property in a clean condition. Subsequently, the appraiser deducted 2.5 percent for environmental stigma based on informal conversations with four market participants. These conversations were not supported by sales data, including the actual sale of the Anda property to Marriott Hotels in 2010. The sales data, including this 2010 sale, indicated that no discount for environmental risk was applicable in a post-remediated state.

The expedited demands of the condemning party can be confused with market demand. However, the condemning agency is not a typical buyer or seller. In some jurisdictions, such as California, a sale that involves an agency is not admissible as evidence, even if that agency did not exercise its power of eminent domain for that sale. Market demand should be characterized, when possible, by reliance on true arm's-length transactional data.

The timing and costs of remediation in the *Moorhead* case reflected the needs of the MEDA and MHA, the developer, and did not necessarily reflect the type of remediation, if any, demanded by the local market. In fact, the real estate market perceived that the nature and extent of the leaking underground storage tank (LUST) was a minimal cost and only demanded in situ cleanup via natural attenuation.

It is a well-established empirical fact that contamination may impact property values. This is by no means a rule, however. Impacts depend on numerous factors, including the nature and extent of the contamination, health risk perceptions in the market, regulatory climate, intended use, and many other considerations. There is a field of appraisal and econometric research dedicated to this very question. LUSTs are a particularly active area of research. This is likely because state agencies track sites impacted by LUSTs, so widely available and geographically tagged data sets exist.

The Minnesota Supreme Court overturned the lower court's decision in the *Moorhead* case, and the property owner received fair market value for the taking in a post-remediated condition with no discount for the historical contamination.

Conclusion

The *Moorhead* case was decided nearly 10 years ago. In the intervening years, more data sets have become available, and more sophisticated spatial methods have begun to be used by economists and valuation experts. In jurisdictions where historical contamination may be considered in determining just compensation, it is increasingly imperative that claims of discounts due to historical remediation in eminent domain cases be based on transactional data.

Orell C. Anderson, MAI, is the president of Strategic Property Analytics, Inc. (SPA), located in Laguna Niguel, California. Alexander R. Wohl is a research analyst at SPA.

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