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Lender-Involved Condemnation Part 1: Principles of Condemnation

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This is the first installment in a series of articles related to lender-involved condemnation. This article provides an introduction to the principles of eminent domain and condemnation in a question and answer format. The next installment will discuss these principles as they apply to lenders. The final installment will develop a framework for managing lender risk and cost when the need to defend eminent domain litigation arises.

Eminent domain is the power of the government to take property. This power has been delegated to states, counties, municipalities, utilities and others. The Fifth Amendment of the United States Constitution and state constitutions require these entities to pay compensation and take property only for public use.

Condemnation is the exercise of the power of eminent domain. The laws that set forth the procedures to exercise the power of eminent domain are of special importance because they offer certain protections. They also set forth limitations that create certain challenges for property owners. Most condemnations occur under the authority of state law and the laws of each state vary, so it is very important to know the relevant procedures and limitations.

What is a valid public purpose?

Roads, airports, sewer stations, water towers, schools, police stations and public transportation projects are all clear examples of a reasonable public use where the courts will find a justifiable exercise of the power of eminent domain. However, many municipal development authorities have exercised the power of eminent domain to create industrial parks and other amenities whose benefit to the general public were not as obvious. The widely cited 2005 decision of the Supreme Court of the United States, *Kelo v. New London*, 545 U.S. 469, resulted in a slew of state legislation that refined the states' respective definitions of public use. As a result of *Kelo*, 28 states passed legislation that restricted the definitions of public use or public purpose in that state. The publicity and political fallout from *Kelo* served to reduce the instances of condemnation when the public use was questionable. While it does happen occasionally, it has not been common to successfully defend a condemnation from an unlawful public use in recent years.

What can be taken?

Condemnations typically focus on interests in land. However, the loss of essential rights to real property can also result in the destruction or diminution of a business. Commonly taken interests in land include the entire fee interest, permanent easements, temporary easements and access rights. Permanent easements can be taken for the purpose of constructing and maintaining an embankment to a highway. Utility infrastructure can also be constructed on permanent easements. Permanent easements may feature drainage structures like flumes and pipes. Temporary easements are often taken for the purpose of disturbing an area during construction and they generally expire upon completion of the project or on a specified date. The taking of a temporary easement can be utilized to link private driveways to a public road or to use a particular area to stage equipment. Temporary easements are also taken to allow for the demolition of structures. The right to access a particular property can also be taken and a taking of access often can render property worthless.

Can a taking be stopped?

Attempts to stop a taking fall into two general categories: procedural and substantive. The statutes that allow governmental and nongovernmental entities to take property provide very specific procedures that must be followed to authorize a lawful taking. Failure to follow those procedures precisely can nullify the taking so long as a timely objection is filed. However, if there is a valid public purpose, a procedural roadblock to a taking will likely be cured. Procedural attacks can be helpful if there are deadlines related to federal funding that would provide a source of leverage for a negotiated settlement. While it is a good way to delay a taking and possibly obtain a source of leverage, a procedural defect is unlikely to permanently prevent a taking.

A substantive attack on the public purpose of a taking is more likely to permanently prevent the exercise of eminent domain and the taking of private property. However, if the purpose of a project is to construct a road, a school, or any other plainly public use, this alternative will not be successful and it will result in a waste of resources. Public purposes that are most suspect include the remedy of blight, urban redevelopment, industrial development, or any other instance where the end user of the property is a private entity who will have special interest in the property. In these instances, there is a much better likelihood of stopping the project completely. However, after the legislative reaction to *Kelo*, and as a result of the current economic climate, public entities have lost much of their appetite to exercise the power of eminent domain for suspect purposes.

When does title transfer?

The transfer of title varies by state. Even within some states, the date that title transfers varies by condemnation procedure. In Georgia, title to property transfers without a hearing or notice on the day the Georgia Department of Transportation files its declaration of taking and pays its deposit of estimated compensation into the registry of the court. If that same property is taken by an electric company through the "special master method," then title transfers on the day compensation is paid into court and a ruling is entered after a hearing before a special master. The transfer of title varies by jurisdiction and method but there is a common thread. The law typically allows the condemnor to obtain title to property and move forward with a public project so long as certain safeguards are met, because public policy dictates that a project be allowed to proceed with minimal delay for the good of the public.

How much compensation will I receive?

An owner of an interest in condemned property is entitled to compensation according to the Fifth Amendment. A common standard for compensation is "just and adequate." Just and adequate compensation has been defined in different ways, but it typically focuses on a measure of marketable value that would be appropriate if the same property were sold among members of the public who had typical market motives. While property owners may be able to testify to value if they have had an opportunity to obtain an informed opinion, an expert real estate appraiser is often the expert who determines the amount of compensation available in the case. The appraiser may also be required to allocate the value among interested parties. The allocation may be based on market metrics in the case of a below-market lease or a contractual arrangement between the parties in the case of a borrower and a creditor.

Attorney fees and the costs of litigation are not included in the measure of market value even though some states allow property owners to recover fees in certain instances. The states that allow the recovery of attorney fees typically provide for recovery when the ultimate award is some percentage greater than the condemnor's estimate of compensation. In the states where no attorney fees can be recovered, a property owner's compensation will be limited to the market value of the property taken. Attorney fees and litigation costs must be deducted from that amount.

Conclusion

A working knowledge of the general principles of eminent domain is necessary when responding to a condemnation action. Failure to grasp these issues can result in needless expense and exposure to unnecessary risk. Financial institutions have specific set of risks when their secured interest is subject to a condemnation proceeding. The next article will apply these principles to specific circumstances where financial institutions are responding to a condemnation action.