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Should Evidence of Environmental Contamination Be Admitted in Eminent Domain Valuation Proceedings?

by Lynda J. Oswald

Editors' Summary: This Article examines whether evidence of environmental contamination should be admitted in eminent domain valuation proceedings. The minority view holds that the evidence is inadmissible and that the condemnee should receive the full value of the property as if clean or remediated. The majority view allows the evidence to be admitted, and bases the property's value either upon its fair market value as contaminated or upon its value as remediated less the remediation costs. The author argues for a third view that addresses the competing interests of the condemnee and condemnor: a trust-escrow technique that would fully compensate the condemnee without providing an inappropriate windfall to either the condemnor or the condemnee because it would account for actual remedial costs.

Suppose that, several years ago, you purchased a former tannery site with the intent of holding onto the parcel for investment purposes until a new industrial use came along. The city, however, has other plans for the parcel—it wants to develop a park.

The city condemns the parcel. At the condemnation valuation proceeding, the city offers evidence that, although the value of the parcel would be $1.9 million if the parcel had never been contaminated, the contamination present on the property as a result of the former owners' activities is extensive. It will, according to the city's experts, cost $1.2 million to clean up the parcel to the point where it could safely be used for park purposes. The fair market value (FMV) of the parcel as remediated would be $1.5 million. (The $400,000 difference between the value if never contaminated and the value as remediated reflects the stigma that the marketplace attaches to property known to be previously contaminated, even after cleanup.) Therefore, the city contends, you are entitled to a condemnation award of $300,000 for the parcel—the value of the parcel if remediated less the costs of cleaning up the site to the extent necessitated by the condemnor's purposes.

But wait! you protest. It is unclear under state law that I have any legal liability for cleanup at this site—that is an issue to be resolved in litigation, and one that will likely involve the interpleading of several former owners of the property. Moreover, I could sell the parcel today for $1 million to an industrial user, whose use would require a far less extensive cleanup than the city proposes. In addition, if I wait just two more years, it is likely that a proposed state brownfield program will fund the majority of the cleanup costs, and I will incur a cleanup bill of only $200,000. So I could sell the property today for $1 million, or could wait two years and sell the property for at least $1.3 million (the value if remediated less $200,000 cleanup costs) plus whatever appreciation the property might incur in the meantime. In either event, the city's offer of $300,000 is hardly the "just compensation" mandated by the state and federal constitution.

This scenario, which has been played out in various permutations in numerous state and federal courts over the past decade, illustrates the tensions and conflicts inevitable when two disparate areas of the law are forced to intersect and interact. On the one hand, American environmental law is largely based on a "polluter-pays" principle that, at both the state and federal levels, creates a potent, though not absolute, liability for landowners to pay for cleanup of their property. At the federal level, statutes such as the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)[1] establish mechanisms for imposing liability for the cleanup of contaminated properties. Similar statutes exist in most of the states.[2] CERCLA, and its many parallel state statutes, impose broad, strict, joint and several liability upon a variety of potentially responsible parties (PRPs), including past and present owners of the contaminated property.[3] These statutes do not automatically impose

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1. 42 U.S.C. §§9601-9675, ELR Stat. CERCLA §§101-405.

2. *See* 7A Nichols on Eminent Domain app. 13B, §2[b] (3d ed. 2004) (listing state statutes).

3. *See* Commander Oil Corp. v. Barlo Equip. Corp., 215 F.3d 321, 326, 30 ELR 20679 (2d Cir. 2000) ("Absent a showing that one of CERCLA's affirmative defenses applies, liability for owners and

liability upon the current owner of contaminated property, however; rather, there are procedural safeguards designed to protect the property owner, and limited defenses that property owners can raise.[4]

Eminent domain law, on the other hand, is designed to ensure that when a property owner's private property is taken for public use, "just compensation" is paid.[5] The issue of whether compensation is "just" is an equitable, not a legal,[6] one, a distinction which injects both flexibility and uncertainty into the compensation equation.

According to the U.S. Supreme Court, the ultimate objective of the Fifth Amendment's just compensation requirement is to put the property owner "in as good a position pecuniarily as if his property had not been taken."[7] The Court has also acknowledged that the "serious practical difficulties in assessing the worth an individual places on a particular property at a given time" mandate "the need for a relatively objective working rule."[8] Generally, then, just compensation is measured by the taken property's FMV, i.e., by the price that "a willing buyer would pay in cash to a willing seller" in an arm's-length transaction.[9] However, courts are free to apply other valuation standards "when market value [is] too difficult to find, or when its application would result in manifest injustice to owner or public . . . ."[10]

In reality, though, the assumptions underlying these measures of just compensation—particularly that of a willing seller—often disappear in the context of a condemnation of contaminated property. While it is often true in any condemnation case that the condemnee is an unwilling participant in the taking, this unwillingness takes on additional ramifications where the property being condemned is contaminated. For example, the property owner might well have declined to enter into a voluntary transfer at this point in time given the nature of the contamination.[11] Rather, delaying transfer might open up opportunities for government or other third-party funding of cleanup. Similarly, controlling the future use to which the property is put might lessen the extent of cleanup required, e.g., property used for industrial purposes might not be subject to as stringent cleanup standards as property intended for use as a school, park, or housing.[12] In both instances, the property owner's potential liability for cleanup costs could be reduced by managing either the timing of the transfer or the subsequent use of the property carefully.

The negative impact of environmental contamination on the market value of real property can be very severe. Most prospective buyers are leery of the potential liability and financial risks that accompany contaminated property (which include potential statutory liability for remediation, potential liability to injured third parties, stigma to the property value even after remediation, potential difficulties with obtaining financing from commercial lenders, and the potential for increased regulation in the future),[13] and these buyers

operators is strict."); B.F. Goodrich Co. v. Murtha, 958 F.2d 1192, 1198, 22 ELR 20683 (2d Cir. 1992) ("Where the environmental harm is indivisible liability is joint and several."). For a general discussion of CERCLA liability, see 7A NICHOLS, *supra* note 2, §13B.02[5].

4. The limited defenses available under CERCLA are listed in 42 U.S.C. §9607, and include an act of God, an act of war, and an act or omission of a third party, which includes an innocent landowner defense and a secured creditor defense. These defenses are described in 7A NICHOLS, *supra* note 2, §13B.02[7][c].

5. The Fifth Amendment provides: "[N]or shall private property be taken for public use without just compensation." U.S. CONST. amend. V. The U.S. Supreme Court has determined that this protection is made applicable to the states through the Due Process Clause of the Fourteenth Amendment. *See* Chicago, Burlington & Quincy R.R. Co. v. City of Chicago, 166 U.S. 226, 235-41 (1897). Similar requirements for compensation arise under the law of every state as well. *See* 3 NICHOLS, *supra* note 2, §8.01[2] n.14 (citing cases).

6. *See* Town of Bedford v. United States, 23 F.2d 453, 456 (1st Cir. 1927) ("The question of just compensation contemplated by the Constitution is more an equitable question than a strictly legal or technical one."); Northeast Conn. Econ. Alliance v. ATC Partnership, 776 A.2d 1068, 1077, 31 ELR 20881 (Conn. 2001).

7. Olson v. United States, 292 U.S. 246, 255 (1934).

8. United States v. 564.54 Acres of Land, 441 U.S. 506, 511 (1979).

9. *Id.* (citation omitted). The Court went on to state: "[T]his Court has refused to designate market value as the sole measure of just compensation. For there are situations where this standard is inappropriate." *Id.* at 512 (citation omitted). Such situations "generally involve property of a type so infrequently traded that we cannot predict whether the prices previously paid, assuming there have been prior sales, would be repeated in a sale of the condemned property." *Id.* at 513. In such situations, other standards may be used but "the dominant consideration always remains the same: What compensation is 'just' both to an owner whose property is taken and to the public that must pay the bill?" *Id.* at 512 (citation omitted). *See also* Kirby Forest Indus., Inc. v. United States, 467 U.S. 1, 10 (1984) (where market value is "too difficult to find" or the "payment of market value would result in 'manifest injustice' to the owner or the public," market value should not be used to measure just compensation). Just compensation damages are to be measured by the loss to the owner from the taking, and not by the gain or the value of the property to the condemnor. *See* Boston Chamber of Commerce v. Boston, 217 U.S. 189, 195 (1910) ("And the question is what has the owner lost, not what has the taker gained.").

10. United States v. Commodities Trading Corp., 339 U.S. 121, 123 (1950), *quoted in 564.54 Acres of Land*, 441 U.S. at 512.

11. *See Northeast Conn. Econ. Alliance*, 776 A.2d at 1087 (McDonald, C.J., dissenting in part & concurring in part) ("Under eminent domain, the condemning authority unilaterally takes the property, unilaterally establishes the time of the taking and, therefore, unilaterally establishes the circumstances with respect to environmental cleanup at the time of taking."). The Florida Supreme Court noted the importance of timing in Finkelstein v. Department of Transp., 656 So. 2d 921 (Fla. 1995), when it stated that where the property was taken while it was in the process of being cleaned up in accordance with a state reimbursement program, it must be valued for condemnation purposes as though it had been remediated. The court concluded: "The timing of the taking should not itself disadvantage the petitioners in valuing the property." *Id.* at 925. The Connecticut Supreme Court explicitly rejected this approach, stating that the *Finkelstein* court "ignore[d] some of the factors that a willing buyer likely would take into account in considering how much to pay for [such] a property . . . , including: the time period over which the cleanup would occur; any potential litigation over the cleanup; and the delay, caused by the cleanup, in having a fully usable parcel of property." *Northeast Conn. Econ. Alliance*, 776 A.2d at 1080 n.13.

12. *See, e.g.*, Joel B. Eisen, *A Case Study of Sustainable Development: Brownfields*, 32 ELR 10420, 10422-23 (Apr. 2002) (noting that many state voluntary cleanup programs allow site-specific, risk-based cleanup standards that may consider factors such as future use of the site).

13. *See Northeast Conn. Econ. Alliance*, 776 A.2d at 1080-81 (citing 7A NICHOLS, *supra* note 2, §13B.04[1][a]). The *Finkelstein* court also looked to *Nichols* in discussing the potential sources of the stigma that might attach to contaminated property:

> As a primary consideration, the knowledgeable buyer would be concerned about the direct costs of remediation. Purchasing the property would subject the owner to strict joint and several liability under CERCLA. Even if the extent of the contamination was known and the remediation costs were estimated, the actual costs may well exceed the estimates. Second, contamination exposes the owner to an increased risk of liability to the public. Third, contamination poses financing problems. Lenders are often wary of contaminated properties, especially if they feel the financing arrangement would provide exposure as an owner/operator under statutes such as CERCLA.

Finkelstein, 656 So. 2d at 924 (quoting 8 NICHOLS, *supra* note 2, §14C.06[1]).

will almost certainly demand a price reduction to compensate for such risk (assuming that they are willing to purchase the property at all).[14]

When environmentally contaminated property is taken in an eminent domain action, condemnation law and environmental law embark on a collision course. The scope of the resultant conflict becomes particularly evident when one considers the most fundamental issue raised in such a setting: should evidence of contamination be admissible for purposes of determining the just compensation necessary to support the condemnation action? As basic as this question seems, the state courts are in sharp disagreement as to the answer.

The minority view maintains that evidence of such contamination is not admissible for purposes of determining just compensation in an eminent domain proceeding and that the condemnee is entitled to the full value of the property as if clean or remediated.[15] (As discussed below, there is actually an important difference between these two valuations.)[16] The majority view, on the other hand, admits evidence of contamination, resulting in the property being valued for just compensation purposes based either upon its FMV as contaminated or upon its value as remediated less the remediation costs.

However, as explained below, neither of these approaches adequately addresses nor completely protects the competing interests of the condemnee and condemnor. Thus, the New Jersey Supreme Court adopted a compromise approach in 2003 in *Housing Authority of New Brunswick v. Suydam Investors, Ltd. Liability Co.*[17] This approach employs an escrow technique in an effort to fully compensate the condemnee without providing an inappropriate windfall to either the condemnor or the condemnee. Subsequently, in October 2004, the appellate division of the New York Supreme Court adopted the same approach in *City of New York v. Mobil Oil Corp.*[18]

Part I below outlines the minority view, which excludes evidence of environmental contamination in eminent domain valuation proceedings. The majority view, which permits evidence of contamination in such proceedings, is described in Part II. The compromise escrow technique is discussed in Part III. Proposed refinements to the compromise escrow technique are made in the concluding remarks of Part IV.

I. The Minority View: Excluding Evidence of Contamination

A distinct minority of courts to date have held that all evidence of contamination must be excluded in a condemnation valuation proceeding.[19] Moreover, it would appear that the minority view, which was never especially popular among the courts anyways, is eroding rapidly.

The theoretical bases underlying the minority view have never been particularly clear or compelling. Rather, an analysis of the handful of cases to date that have held that all evidence of environmental contamination should be excluded from the eminent domain valuation proceeding reveals that these courts have relied upon just a few basic arguments to support their position. In fact, most of these arguments derive from the leading eminent domain treatise, *Nichols on Eminent Domain*, which discusses numerous factors that "may justify exclusion of" evidence of contamination from condemnation valuation proceedings.[20] Some minority view courts have simply adopted without analysis the *Nichols* factors, even though these factors may not have previously been discussed or analyzed by any court.[21]

The leading argument put forth by minority view courts is based on due process. In *U.S. Department of Transportation v. Parr*,[22] for example, the Illinois appellate court held that evidence of environmental contamination was not admissible to determine the FMV of contaminated property because the admission of such evidence would violate the procedural due process rights of the condemnee as provided for by the state Environmental Protection Act.[23] The condemnor, the U.S. Department of Transportation, did not notify the property owners of the nature or the extent of the alleged environmental contamination of their property, nor did it inform the property owners that it sought to hold the owners liable for the costs of remediation before such a decision was made. As a result, the property owners did not receive proper notice of their impending liability or of the reasons for such liability.[24]

Moreover, the state eminent domain act did not provide for procedural safeguards such as third-party actions against other PRPs, nor did it address potential liability for environmental contamination.[25] In light of these deficiencies, the *Parr* court concluded that "the admission of remediation costs at an eminent domain proceeding violates the rights of property owners to have their potential liability adjudicated

14. *See Northeast Conn. Econ. Alliance*, 776 A.2d at 1081 ("That diminished attractiveness would likely affect the price that a willing buyer would pay for the property.").

15. *See, e.g.*, Department of Transp. v. Parr, 633 N.E.2d 19 (Ill. App. Ct. 1994) (superseded by statute as stated in Housing Auth. of New Brunswick v. Suydam Investors, Ltd. Liab. Co., 810 A.2d 1137, 1149 n.3 (N.J. 2002), *aff'd in part & rev'd in part*, 826 A.2d 673 (N.J. 2003); Aladdin, Inc. v. Black Hawk County, 562 N.W.2d 608 (Iowa 1997); W.R. Assocs. of Norwalk v. Commissioner of Transp., 751 A.2d 859 (Conn. 1999).

16. *See infra* note 43.

17. 826 A.2d 673 (N.J. 2003).

18. 783 N.Y.S.2d 75 (N.Y. App. Div. 2004).

19. *See, e.g.*, *Parr*, 633 N.E.2d at 19 (superseded by statute as stated in *Suydam Investors*, 810 A.2d at 1149 n.3, *aff'd in part & rev'd in part*, 826 A.2d at 673); *Aladdin, Inc.*, 562 N.W.2d at 608; *W.R. Assocs. of Norwalk*, 751 A.2d at 859.

20. *See* 7A Nichols, *supra* note 2, §13B.03[2]. *Nichols* lists the following factors: (1) the in rem/in personam distinction; (2) mutual independence of laws; (3) procedural and substantive due process; (4) differing burdens of proof; (5) differing fact finders and the right to a jury trial; (6) exclusive federal jurisdiction over CERCLA actions; (7) the risk of double liability; (8) the "project influence" rule; and (9) "further" justifications, such as inconsistent valuation methodologies; speculative discounting; and overcomplexity of contamination evidence.

21. This is particularly noticeable in *W.R. Assocs. of Norwalk*, 751 A.2d at 859, where the court summarized many of *Nichols*' arguments in concluding that it would not consider evidence of contamination in determining just compensation.

22. 633 N.E.2d 19 (Ill. App. Ct. 1994) (superseded by statute as stated in *Suydam Investors*, 810 A.2d at 1149 n.3, *aff'd in part & rev'd in part*, 826 A.2d at 673). In *Parr*, the record was unclear as to whether there was any contamination on the property.

23. 633 N.E.2d at 22.

24. *Id.* at 23.

25. *Id.*

in a proceeding under the [state Environmental Protection] Act with the attendant procedural safeguards."[26]

The *Parr* court's opinion reflects a common judicial preoccupation with the irrelevant question of the *costs of remediation*, as opposed to the very relevant question of the *impact of the contamination on the FMV*—a preoccupation revealed by the court's statement that "environmental remediation costs, standing alone, have no direct bearing on the valuation of condemned property."[27] To the extent that the condemnation valuation proceeding is used as a shorthand mechanism for assigning liability for cleanup costs, it is clear that procedural, and even substantive, due process has been struck a crippling, if not fatal, blow. However, if the court focuses instead on the real question—what is the impact of the alleged contamination on the value of the property in the open marketplace?—these due process concerns fade away.

The Iowa Supreme Court also addressed the procedural due process argument in *Aladdin, Inc. v. Black Hawk County.*[28] The court stated that under Iowa law, a property owner could not be held liable for cleanup costs absent an action being brought by the state Department of Natural Resources (DNR) or a citizen under state law, in which the DNR or citizen must show that the owner generated the contamination[29]; during such an action the property owner has the opportunity to demonstrate that it is not liable. If the condemnation award to the property owner is reduced by the estimated cost of cleanup, reasoned the *Aladdin* court, the property owner will not receive the procedural safeguards provided by the state cleanup act and will not receive just compensation in the form of full value of the property, yet will still have the same legal liability for cleanup costs as before.[30] Moreover, the court pointed out, the costs of cleanup can be recovered from the owner after the condemnation has occurred; precondemnation recovery is not necessary.[31]

The *Aladdin* court put forth a couple of additional "policy considerations" as to why contamination evidence should be excluded from valuation proceedings, but the arguments are not particularly persuasive. For example, the court noted that allowing contamination evidence into the hearing would require both sides to hire experts qualified to testify regarding the nature and extent of the contamination and the cost of cleanup. The court was concerned that while the condemnor's experts in this regard would be provided by public funds, the condemnee might incur considerable personal expense in countering such testimony.[32] This, however, is the same situation that a condemnee faces whenever expert evidence as to value of property is provided; there is nothing unique with regard to environmental contamination.

The *Aladdin* court was also concerned that the difficulty in locating "comparable" contaminated properties would make it hard, if not impossible, to introduce traditional expert testimony as to FMV based on comparable sales.[33] The net result, the court feared, was that the commission, judge, or jury charged with determining the amount of just compensation due would have to speculate as to what that amount was, potentially leading to more litigation, delay, and expense.[34] However, courts often use alternative methods of calculating FMV when comparable sales figures are not available[35]; the *Aladdin* court did not address why these alternate methods would not be workable in this situation.[36]

The *Aladdin* court concluded that the condemned property must be valued according to what its FMV would be if the property were uncontaminated. Three justices dissented, however, stating: "What is really at issue here is the effect that the environmental contamination of [the] property would have on the decision of a willing buyer to purchase it."[37] The dissent noted that the cost of cleanup is "only one element" that a buyer would consider, but that a buyer would undoubtedly take such a factor into consideration "irrespective of whether it believed that it could be legally compelled to pay for that cost."[38]

The most detailed minority view opinion issued to date—*W.R. Associates of Norwalk v. Commissioners of Transportation*[39]—apparently is no longer good law. Although not expressly overruled by the Connecticut Supreme Court in its 2001 decision in *Northeast Connecticut Economic Alliance, Inc. v. ATC Partnership*,[40] the Connecticut Superior Court's holding in *W.R. Associates of Norwalk* is so contrary to the supreme court's later holding that little, if any, of the earlier decision can survive.

Ironically, *W.R. Associates of Norwalk* put forth the most compelling argument for excluding evidence of contamination—that of the potential for double liability. If evidence of contamination is admissible in an eminent domain case, the owner of contaminated property will undoubtedly receive less than the FMV of the property if it were uncontaminated. However, this reduction in valuation for condemnation purposes does not relieve the property owner of liability for cleanup costs under CERCLA (or parallel state statutes), nor does res judicata limit the property owner's liability in

26. *Id.* The Illinois Legislature apparently disagreed, for in 1997, it amended the state eminent domain statute to provide that evidence of "any violation of any environmental law or regulation" and "the effect of such condition . . . on the fair market value of the property" may be admitted into evidence in a just compensation proceeding. 735 Ill. Comp. Stat. §5/7-119 (1997).

27. 633 N.E.2d at 20.

28. 562 N.W.2d 608 (Iowa 1997).

29. *Id.* at 615 (citing Iowa Code §455B.186 (1997)).

30. *Id.*

31. *Id.*

32. *Id.* at 616.

33. The *Aladdin* court identified several other "policy" considerations that mitigate against admitting evidence of contamination during a condemnation proceeding. *Id.* at 615-16. The court was concerned that in order to protect his property interests, the condemnee must hire potentially expensive experts on contamination and cleanup, whereas the condemnor's experts are typically paid through public funds. *Id.* at 616. Moreover, the court stated, it would be difficult to determine the actual FMV of contaminated property for just compensation purposes because there are seldom comparable properties. *Id.* A similar concern was expressed in *Silver Creek Drain Dist. v. Extrusions Div., Inc.*, 630 N.W.2d 347, 354 (Mich. Ct. App. 2001) ("contaminated properties are like snowflakes; no two are alike"), *aff'd in part & rev'd in part*, 663 N.W.2d 436 (Mich. 2003).

34. 562 N.W.2d at 616.

35. *Nichols* discusses several alternative valuation methodologies for contaminated properties. *See* 7A Nichols, *supra* note 2, §13B.04.

36. The court did, however, note where the "market value" of property is not easily established, "other uniform and recognized appraisal methods" may be used by the tax assessor in calculating the value of property for tax assessment purposes. 562 N.W.2d at 617.

37. *Id.* (Carter, J., dissenting).

38. *Id.*

39. 751 A.2d 859 (Conn. 1999).

40. 776 A.2d 1068 (Conn. 2001).

the environmental proceeding.[41] Thus, the *W.R. Associates of Norwalk* court asserted, it is possible that a property owner would "pay" for the contamination twice—once in the reduced value received for the property in the taking and again in the environmental liability suit.[42]

This problem is best illustrated through an example. Suppose that the property would have a FMV of $6 million after remediation.[43] The cost of cleanup is $2 million; the FMV of the property as contaminated is $3.5 million (a discounted value, which reflects the uncertainty attached to cleanup, such as whether a third party will be found to pay the costs of cleanup, the risk that the costs of cleanup will be higher than anticipated, etc.). In a free market transaction, no rational seller would sell the property for $3.5 million (its FMV as contaminated) or even $4 million (the difference between the value of the property as remediated less the cost of cleanup) *and* retain the $2 million liability for cleanup. In such an instance, the seller would net at best $2 million or, more likely, $1.5 million.

Rather, a rational seller would incur the $2 million cleanup cost, and sell the property for $6 million, netting $4 million. Alternatively, the seller could sell the property in its contaminated state for its FMV as remediated of $6 million and indemnify the buyer for the costs of cleanup, still netting $4 million, but avoiding having to undertake the actual physical task of cleanup (though still footing the bill).[44]

The risk to the condemnee of double liability is very real. Clearly, reducing the condemnation award by the cost of remediation would indeed expose the property owner to inappropriate double liability, as the owner would receive compensation measured by the FMV less costs of remediation, yet would still have to bear the full cost of restoring the property. Yet, as the example above illustrates, calculating compensation based upon the FMV of the property in its contaminated state creates a similar risk of undercompensating the property owner.

The majority view does not adequately address this very real potential for double liability. In *Northeast Connecticut Economic Alliance*,[45] the Connecticut Supreme Court, for example, dismissed this concern by simply stating that

> [i]f there is evidence of environmental contamination and the costs to remediate that condition, and if an expert appraiser testifies that such condition and costs had an effect on the FMV at the time of the taking, to exclude such evidence as a matter of law could result in the condemnee receiving an inflated and fictional value for the property.[46]

In short, the court was concerned with the converse problem—overcompensation of the property owner—and it ignored the risk of undercompensation of the property owner.

This potential inappropriate "windfall" could inure to the benefit of either the condemnee or the condemnor, depending upon the circumstances. First, if a third party pays for the cleanup costs rather than the condemnee or the condemnor, one of the latter two parties will receive a windfall. Either the condemnee will receive the full property value (as though the property were uncontaminated) without having to pay for the cleanup costs, or the condemnor will receive the property at a reduced "contaminated" value but will ultimately end up with a remediated property without having to pay for the cleanup costs.[47]

Second, a windfall may occur when the condemnor is planning on using the property for something that requires either more or less remediation than the property would ordinarily need. For example, property used to create a parking lot may require less cleanup than property intended for residential use or as a park.[48] When a valid and profitable use for the property would require less cleanup than the use the condemnor has planned, the condemnor may receive a windfall by making the property owner pay for cleanup costs that would not be necessary had the property been put to a different legal use.

II. The Majority View: Admitting Evidence of Contamination

A growing majority of courts that have addressed the issue of admissibility of evidence of environmental contamination in eminent domain valuation proceedings have determined that such evidence should be allowed. Generally, these courts reason that environmental contamination is a characteristic of the property that affects its FMV and thus is a factor that should be considered by the trier of fact.[49]

41. *See, e.g.*, 7A Nichols, *supra* note 2, §13B.03[2][g] (citing Penn Cent. Corp. v. United States, 862 F. Supp. 437, 452, 26 ELR 20401 (Sp. Ct. R.R.A. 1994); Detroit v. A.W. Miller, Inc., 842 F. Supp. 957, 961 (E.D. Mich. 1994)).

42. *W.R. Assocs. of Norwalk*, 751 A.2d at 864-65 ("The owner would in effect pay for the cost of cleanup by receiving less money for the condemned property and pay again as a result of any judgment against him. The equitable nature of the condemnation proceeding precludes a double payment.").

43. I use the term "after remediation," and not "if uncontaminated" because it is very possible that a remediated property, even if now "clean," will have a lesser value than identical property that was never contaminated because of stigma or other concerns in the marketplace about the characteristics of the property after remediation. *See* Housing Auth. of New Brunswick v. Suydam Investors, Ltd. Liab. Co., 826 A.2d 673, 685 n.4 (N.J. 2003) ("'As if remediated' is slightly different than 'as if clean' insofar as it incorporates a so-called remediation stigma discount.") (citation omitted).

44. In reality, the selling price might well be discounted to account for the risks, if any, associated with accepting an indemnification from the seller.

45. 776 A.2d at 1068.

46. *Id.* at 1084.

47. In an effort to avoid such a windfall to the condemnor, the Florida Supreme Court, in *Finkelstein v. Department of Transp.*, 656 So. 2d 921 (Fla. 1995), excluded evidence of contamination because a third-party fund existed to pay for the cleanup at the time of taking. *Id.* at 925 n.1. The *Finkelstein* court held that while contamination is generally relevant to the issue of FMV, *id.* at 924, when the costs of remediation were being reimbursed by a third party, "the property should be valued as if the cleaning of the property had been successfully completed at the time of the taking." *Id.* at 925. The dissenting/concurring judges in *Northeast Conn. Econ. Alliance* would have adopted this approach. 776 A.2d at 1086 (McDonald, C.J., dissenting in part and concurring in part).

48. *See supra* note 12 and accompanying text.

49. *See* Redevelopment Agency of Pomona v. Thrifty Oil Co., 5 Cal. Rptr. 2d 687, 689 n.9 (Cal. 1992) ("As a characteristic of the property which would affect its value, the remediation issue was properly before the trier of fact."); City of Olathe v. Stott, 861 P.2d 1287, 1290 (Kan. 1993) (because one of the primary purposes of an eminent domain proceeding is "to determine the fair market value of the property taken," evidence of contamination that "necessarily affects the market value of property" is admissible); Silver Creek Drain Dist. v. Extrusions Div., Inc., 663 N.W.2d 436, 443 (Mich. 2003) (the effect of the estimated costs of remediation on the parcel's FMV—but not the liability of the owner for cleanup—is relevant in a just compensation proceeding); State v. Brandon, 898 S.W.2d 224, 225 (Tenn. Ct. App. 1994) ("evidence of . . . contamination and the cost of remedying it [are] relevant in determining the fair market value of the property in question"). *Cf.* National Compressed Steel Corp. v. Unified

The most comprehensive analysis of the majority approach to date was provided in 2001 by the Connecticut Supreme Court in *Northeast Connecticut Economic Alliance*.[50] The court noted that "just compensation is ordinarily calculated by determining the FMV of the property on the date of taking."[51] Excluding evidence of contamination, the court stated, would result in a "fictional property value."[52] The court stated that it "blinks at reality to say that a willing buyer would simply ignore the fact of contamination, and its attendant economic consequences, including specifically the cost of remediation, in deciding how much to pay for property."[53] Thus, the court concluded, evidence of contamination and remediation costs should not be excluded from a just compensation valuation proceeding. To illustrate its point, the court provided the example of two identical properties, one contaminated and one not. The uncontaminated parcel has a market value of $5 million; the contaminated property has estimated cleanup costs of $2 million, but would be valued at $5 million if clean.[54] As the court correctly points out, no willing buyer would pay $5 million for the contaminated property when he or she could pay the same price for an identical uncontaminated parcel.[55] Rather, the court noted: "[I]t is likely that, in negotiating with the seller of [the contaminated] parcel [ ], the purchaser would insist on some discount from the $5 million value in order to reflect the contamination."[56]

Because the purpose of just compensation is to put the condemnee in the same position that he or she would be in if the sale had occurred in the open market, the court concluded that the contamination must not be excluded from consideration in calculating the FMV of the property.[57] However, the court cautioned, consideration of the costs of remediation does not necessarily require (nor preclude) that the FMV of the property be reduced dollar-for-dollar for the amount of the cleanup.[58] Rather, the court must look to see how the market would respond to such information in the specific case before it—which might be more or less than a dollar-for-dollar reduction.

The *Northeast Connecticut Economic Alliance* court also rejected many of the arguments for excluding such evidence outlined in *Nichols*, stating that these arguments focus too much on the issue of fault, which is not at issue in a just compensation proceeding.[59] Rather, the court explained:

> If a condemnor sought to acquire a property which had been damaged by the negligence of a third party (e.g., lateral support, landslides), the condemnor would not pay the undamaged value of the property because the condition was not the owner's fault. . . . When a parcel of property is taken, the condemnor receives a parcel in a certain condition, with a value attached to that parcel in that condition.[60]

Thus, the *Northeast Connecticut Economic Alliance* court concluded, the admission of evidence of contamination and remediation costs into a valuation proceeding is analogous to consideration of real property damage caused prior to a taking by a third party. The court offered an example: Suppose that just before a property was condemned, three airplanes collided and crashed, destroying the building located on the property. The condemnee would receive the FMV of the property in its current condition, i.e., with the building damaged, and would look to a subsequent tort action to allocate liability among the three airplane owners for the damage suffered to the structure. The condemnee would *not* be entitled to just compensation as though the property had never been damaged.[61]

What the court did not go on to consider, however, is that neither would the condemnee receive the reduced value of the land with its damaged structure *and* incur liability for reconstructing the building. In many ways, the court's analogy is inapt. The airplane example is an instance of where the reduced value of the property is clearly attributable to the actions of third parties, and the property owner's only concern in recovering for such actions is whether those third parties are solvent enough (or well-enough insured) to cover the losses they created. If they are, the property owner will ultimately receive the full value of the land as a combination of the condemnation and tort awards. If not, the property owner will receive the reduced value of the land without the buildings in the eminent domain action, but will not incur the costs of reconstructing the buildings for the condemnor.

In the environmental contamination situation, however, the liability for cleanup may fall upon the property owner, even if the owner was not the actual cause of such damage. The property owner's liability is by no means certain, however, and the property owner may be able to recover the cleanup costs, at least in part, from other parties. Moreover, the extent of cleanup necessary is not a sum certain and may well vary depending upon the proposed future use of the property.[62] All of these uncertainties make it difficult to draft a blanket rule regarding the effect of contamination upon the FMV of condemned property.

III. A Compromise View: The Trust-Escrow Approach

In 2003, the New Jersey Supreme Court adopted a compromise approach in *Suydam Investors*[63]; this compromise approach has since been adopted by a New York appellate

Gov't of Wyandotte County/Kansas City, 38 P.3d 723, 735 (Kan. 2002) ("environmental contamination is relevant to appraising the value of property sought to be condemned," but that the condemnor's attempt to test subsoils for contamination prior to taking exceeded the scope of the examination permitted by state statute). *See also* 7A NICHOLS, *supra* note 2, §13B.03[3] (discussing factors that mitigate for including evidence of contamination in an eminent domain valuation proceeding).

50. 776 A.2d at 1068.
51. *Id.* at 1080.
52. *Id.*
53. *Id.*
54. *Id.* at 1081.
55. *Id.*
56. *Id.*
57. *Id.*
58. *Id.*
59. *Id.* at 1083.
60. *Id.* (citation omitted).
61. *Id.*
62. The case was remanded to the trial court for a decision as to the compensation award. The trial court's decision regarding just compensation was appealed by both parties to the Connecticut Supreme Court, which held that a broad variety of factors could be considered in calculating the FMV for just compensation purposes, including possible third-party funding and compensation sources, and that the weight of that evidence was within the province of the trial court and would not be disturbed upon appeal. Northeast Conn. Econ. Alliance v. ATC Partnership, 861 A.2d 473 (Conn. 2004).
63. 826 A.2d at 673.

court as well, in *Mobil Oil.*[64] Suydam Investors, Limited Liability Company owned three parcels of land that the Housing Authority of the City of New Brunswick sought to condemn for a redevelopment project. The intermediate appellate court had held that environmental contamination is relevant to a determination of the FMV of condemned property,[65] but that part of the condemnation award could not be withheld to satisfy cleanup costs because that would constitute a prohibited prejudgment attachment.[66]

Both sides appealed. The housing authority contended that a true calculation of FMV would necessitate consideration of the contamination.[67] The property owner, on the other hand, argued that if the value of the property were reduced as a result of the contamination while the property was still subject to cleanup, it would be subjected to "an unfair double taking."[68]

The New Jersey Supreme Court noted that condemnation of environmentally contaminated property necessarily implicates federal and state environmental cleanup statutes, such as CERCLA or, as was applicable in this instance, the New Jersey Spill Compensation and Control Act.[69] After recognizing the state court split on the issue of admitting contamination evidence in an eminent domain valuation proceeding,[70] the *Suydam Investors* court stated that it would be "fundamentally unfair" to subject a property owner to a "double-take" as would occur if the property owner received reduced compensation as a result of the contamination and yet was then held liable for full cleanup costs.[71] Moreover, such a "double-take" would result in an unwarranted "windfall" to the condemnor, who would receive the contaminated property at a discount, but then obtain remediation at the condemnee's expense.[72]

The *Suydam Investors* court determined that contaminated property should be valued "in its remediated state."[73] By contrast, valuing the property as contaminated would limit its uses and thus diminish its FMV, even though the property would likely be cleaned up at some point in the future.[74] On a more pragmatic note, the court also thought it important to separate out the "disparate issues" of valuation for condemnation purposes and liability for cleanup costs and to deal with each in the "appropriate forum[ ]."[75] The bifurcated proceedings "would advance[ ] the speed and efficiency that are the hallmark of eminent domain proceedings,"[76] while ensuring that the statutory defenses available in environmental cost recovery proceedings remain available to the property owner.[77]

However, the *Suydam Investors* court went on to require that the condemnor deposit an amount into a trust-escrow account with the court, with the condemnor reserving the right to initiate a separate action to recover remediation costs from the account.[78] The *Suydam Investors* court was somewhat unclear as to the amount that must be placed in escrow. While the court suggests at one point in the opinion that the entire condemnation award should go into escrow,[79] elsewhere in the opinion the court suggests that it is some lesser, but undefined, amount (perhaps measured by the likely cost of cleanup) which should be deposited.[80]

At any rate, the cleanup costs are to be satisfied from the trust-escrow fund and the surplus, if any, returned to the owner.[81] The *Suydam Investors* court believed that this procedure would eliminate what it perceived as a serious risk of unfairness that could arise if the condemnee were to receive the full value of remediated property and then to abscond, leaving the condemnor with the cleanup costs.[82]

According to the *Suydam Investors* court, this trust-escrow approach has received "widespread recognition"—a statement which appears to be more than a bit of hyperbole. The court cited only *Nichols* in support of this assertion[83]; moreover, *Nichols* itself cites only one unpublished decision adopting the approach,[84] and an electronic search yielded no other similar cases decided prior to *Suydam Investors*.

The *Suydam Investors* court's approach has subsequently been adopted by one other court, however—the appellate

64. 783 N.Y.S.2d at 75.
65. 826 A.2d at 680 (citing Housing Auth. of New Brunswick v. Suydam Investors, Ltd. Liab. Co., 810 A.2d 1137 (N.J. 2002)).
66. *Id.*
67. *Id.* at 685.
68. *Id.*
69. N.J. Stat. Ann. §§58:10-23.11 to -23.50 (West 2004) (Spill Act). The Spill Act, like CERCLA, imposes strict, joint and several liability upon persons responsible for the discharge of hazardous waste. *Id.* §58:10-23.11g(c)(1), with limited defenses available to property owners. *Id.* §58:10-23.11g(4).
70. 826 A.2d at 685.
71. *Id.* at 686 (citing Jeffrey Dworin, *Doing a Double Take: Environmental Damage Suits and Eminent Domain*, 1996 Det. C. L. Rev. 687, 689-92).
72. *Id.* (citing Paul W. Moomaw, *Fire Sale! The Admissibility of Evidence of Environmental Contamination to Determine Just Compensation in Washington Eminent Domain Proceedings*, 76 Wash. L. Rev. 1221, 1252 (2002)).
73. *Id.*
74. *Id.*
75. *Id.*
76. *Id.* (citing 4 Nichols, *supra* note 2, §13.10).
77. *Id.* at 687 ("dealing with environmental issues in the cost-recovery proceeding . . . allows for third-party claims against insurers, title companies, and prior owners, none of whom have a place at the condemnation table [and] makes available to the condemnee [statutory] defenses . . . that are not relevant to an Eminent Domain proceeding").
78. *Id.*
79. *Id.* ("where property is contaminated, the condemnor should appraise as if remediated and deposit *that* amount into a trust-escrow account in court") (emphasis added).
80. *Id.* at 676 ("We hold that contaminated property that is the subject of condemnation is to be valued as if it has been remediated and that the condemnor may seek an order requiring a portion of the award to be set aside to satisfy the condemnee's clean-up and transfer obligations.").
81. *Id.* at 687-88 (quoting from 7A Nichols, *supra* note 2, §13B.03[4].
82. *Id.* at 688. The *Suydam Investors* court also found that such a set-aside procedure would not result in an unfair attachment of the condemnee's property because while "attachment is the taking or encumbering of another's property," *id.* at 688 (citing Black's Law Dictionary 126 (6th ed. 1990)), the "withholding [of] only the estimated transactional costs, which, in reality, do not belong to the condemnee, is not an attachment at all." *Id.* The court forestalled concerns over a condemnor asserting excessive or unnecessary cleanup costs by stating that where the condemnor and condemnee disagree about such costs, a trial-type hearing would be held at which the condemnor would bear the burden of proving the actual cleanup costs. *Id.*
83. *Id.* at 687 (quoting 7A Nichols, *supra* note 2, §13B.03[4]).
84. This case, Hennepin County Reg'l R.R. Auth. v. CMC Real Estate Corp., No. CD 2139 (Minn. Dist. Ct. Nov. 25, 1991), is reproduced as an addendum to Amy Brigham Boulris, *Dealing With Contaminated Lands From the Condemnee's Perspective*, ALI-ABA, Eminent Domain and Land Valuation Litigation 197 (1995).

division of the New York Supreme Court, in *Mobil Oil*.[85] The city had condemned a six-acre petroleum storage facility owned by Mobil Oil Corporation for incorporation into a water treatment plant. Mobil's appraiser valued the property at $10.3 million, excluding any remediation costs. The city's appraiser valued the property at $2.6 million, but found that the minimum cleanup costs would exceed $3.7 million; the city therefore contended that Mobil was entitled to a nominal compensation of $1,000.[86] Subsequently, the city brought a cleanup action against Mobil for remediation costs.

Mobil protested that it would suffer "double liability" if the city could decrease the condemnation award because of the contamination and yet subsequently recover cleanup costs in the environmental action.[87] Mobil also argued that the city would receive a "windfall profit" if it were allowed to reduce the award by the higher cost of cleaning up the property for industrial development rather than the lower cleanup costs needed for a water pollution control plant.[88] The city, in return, argued that Mobil would receive a windfall if the condemnation award was not reduced to reflect the environmental contamination and Mobil subsequently avoided cleanup liability in the environmental action.[89]

After discussing the split of authority among state courts on the admissibility of contamination evidence in eminent domain proceedings, the *Mobil Oil* court concluded that it would be "fundamentally unfair"[90] to allow the city to reduce the condemnation award to reflect the contamination yet still recover remediation costs. The court determined that "the most efficacious way" to take account of the potential for cleanup liability on the part of a condemnee was to value the property as remediated, but to withhold in escrow "any condemnation award" pending the outcome of the environmental liability proceeding.[91] The court expressly noted that the value of the property "as if remediated" was not necessarily the same as the value of the property if never contaminated because of the potential that the stigma that would likely attach to property known to be previously contaminated might depress the market value.[92] The residual stigma that might attach to remediated property must, according to the *Mobil Oil* court, be taken into account.[93]

The *Mobil Oil* court clearly ordered that the *entire* condemnation award be placed in escrow pending the outcome of the environmental liability proceeding.[94] However, it is unclear from the opinion whether the court believed that the entire amount should be set aside in every case regardless of the relationship between the condemnation award and potential cleanup costs or whether the court was concerned that the city's appraiser was correct and that cleanup costs were likely to be at least $1.1 million more than the condemnation award.

IV. Conclusion

While the escrow approach outlined in *Suydam Investors* and *Mobil Oil* may not have the widespread recognition that the *Suydam Investors* court suggested, the approach does provide a commonsensical, practical compromise solution for the divisive issue of how to handle valuation of contaminated property in eminent domain proceedings. In an eminent domain valuation proceeding, just compensation is measured by the FMV. FMV itself is "the price that a willing buyer would pay a willing seller based on the highest and best possible use of the land assuming, of course, that a market exists for such optimum use."[95] Ultimately, then, despite the artificiality of this construct in such a setting, the eminent domain valuation proceeding should strive to mimic to the extent possible what the market would do if there were in fact a willing buyer and a willing seller engaged in a voluntary transaction for the transfer of the contaminated parcel.

The market would certainly consider environmental contamination in setting the FMV of property because contamination is indeed a condition that affects the value and/or use of the property. However, contamination is not, as the *Suydam Investors* court recognized,[96] an immutable characteristic—it can usually, though perhaps not always, be remediated—and the market recognizes this fact as well.

In a free market, then, a buyer would either look for certainty in the remediation of the property, or would demand a discount to account for the uncertainty caused by the contaminated state of the property. If it were certain, for example, that the state or federal government or a known third party would pay for remediation, the buyer would probably discount the value of the property as remediated only enough to cover things such as the delay associated with remediation or potential marketplace stigma. Where it appears certain that the seller would be assigned the liability for cleanup, however, the buyer might well turn to a private escrow device similar to that described by the *Suydam Investors* and *Mobil Oil* courts. Alternatively, the buyer might seek an indemnification from the seller—essentially agreeing to pay the cost of the property as remediated, but requiring legal assurances from the seller that it will reimburse the buyer for any cleanup costs incurred.

The escrow approach also addresses an important issue largely ignored by courts adopting the majority view. If we reduce the compensation award to reflect the costs of remediation, we risk placing the condemnee in an intolerable position vis-à-vis recovery from other PRPs. For example, many environmental statutes, such as CERCLA, allow the property owner to sue third parties for recovery of

85. 783 N.Y.S.2d at 75.
86. *Id*. at 76.
87. *Id*. at 77.
88. *Id.*
89. *Id*.
90. *Id*. at 79.
91. *Id*. at 80.
92. *Id.* (citations omitted). *See also supra* note 43 (discussing the distinction between "as if remediated" and "as if never contaminated").
93. 783 N.Y.S.2d at 80.
94. *Id.*

> In order to prevent any potential windfall to either side, we remit the matter to the [lower court], with instructions to hold in escrow any award that may be rendered in the condemnation proceeding until the conclusion of the [environmental liability proceeding], and that the proceeds of the condemnation award shall first be utilized to satisfy whatever judgment is recorded in the [environmental liability] proceeding.

95. Northeast Conn. Econ. Alliance v. ATC Partnership, 776 A.2d 1068, 1078 (Conn. 2001).
96. *See* 826 A.2d at 686 ("to the extent that contamination . . . is subject to cure, it can fairly be argued that it is not an immutable condition of land and that its remediation is more like a transactional cost than a value concept").

remediation costs actually incurred.[97] If a state or federal agency sues to hold the condemnee liable for cleanup costs, the condemnee can then institute a cost recovery suit against other potentially liable third parties. Where the condemnee's condemnation award has simply been reduced to reflect the costs of remediation, however, and the condemnee has not actually incurred any cleanup costs, the condemnee is likely to find itself barred from a cost recovery action.[98] It will have incurred a liability for which it will be unable procedurally to seek contribution from other PRPs.

An undeniable tension between environmental and eminent domain law arises when contaminated property is the subject of a condemnation proceeding. This tension is the genesis of the current split among the courts in dealing with the resultant valuation issue. Adoption of some simple principles could do much to alleviate the tension, however, and to adequately balance the public interest in ensuring that the correct party bears the costs of environmental cleanup and the property owner's right to just compensation in the event of an eminent domain taking.

First, the courts should follow the correct lead of the *Suydam Investors* court in valuing the property for eminent domain purposes as if it were remediated, and not the fiction of valuing it as if it had never been contaminated. Otherwise, the courts run the risk of overcompensating the property owner by ignoring the very real effects of uncertainty and marketplace stigma upon market value. Second, the courts should adopt the escrow approach of the *Suydam Investors* and *Mobil Oil* courts, and set aside part of the escrow award for potential cleanup costs. By doing so, the courts could minimize the risk that the condemnee will abscond with the compensation award, leaving behind a contaminated parcel for which the public will end up picking up the cleanup tab. However, in fairness to the condemnee, the entire condemnation award ought not to be automatically placed in escrow, but rather only that portion estimated by the court likely to be needed to finance cleanup costs for which the condemnee might reasonably be expected to be held liable once an environmental liability proceeding (with all its attendant due process protections and limited defenses) had been held. Finally, there should be an outer time limit on how long the funds can remain in escrow. There must be an incentive for the condemnor to quickly institute cleanup liability proceedings; the condemnee ought not to be left with a partial award for an indefinite period while the condemnor or state regulators ponder whether and how much cleanup to seek in an environmental liability action.

Ultimately, there is no pat answer to the question of valuation of contaminated property in eminent domain proceedings. Rather, the issue is one that requires exercise of the court's equitable powers to ensure that justice is done to all parties. A carefully crafted escrow approach, however, can move us much closer to this goal.

97. *See* 42 U.S.C. §9607(a) (permitting government or private parties to recover from PRPs reimbursement for remediation expenses they have incurred in response to environmental threats).

98. *See* Gussack Realty Co. v. Xerox Corp., 224 F.3d 85, 91, 31 ELR 20035 (2d Cir. 2000) ("CERCLA does not provide compensation to a private party for damages resulting from contamination. Instead, CERCLA permits a private party to be reimbursed for all or some of the costs already incurred in response to contamination.").