



Proposition 207, titled the "Private Property Rights Protection Act," will be voted up or down by Arizona voters this month. But Prop 207 is only the latest and most local of a nationwide response to a firestorm that started with one spark: *Kelo v. City of New London.* That U.S. Supreme Court case ignited a debate about how we define "public use" and "just compensation." We asked some Arizona lawyers to explain and debate eminent domain: • Jay Dushoff begins by describing 19 things

- Jay Dushoff begins by describing 19 things you should know about the concept.
 - And then four lawyers—**Bob Kerrick**, Jeff Gross, Steve Hirsch and Doug Zimmerman—confront the thorny question: Could *Kelo* happen here?

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THE DEBATE: KELO IS NOT



AN ARIZONA PROBLEM, PRO ... p. 30 / CON ... p. 31 / REBUTTAL ... p. 37

If you read this article at bedtime, with a warm glass of milk at your elbow, I can guarantee that you will be asleep in no time flat. If you read this article in the morning, when you are alert and fresh, then by lunch you will be ready to handle your first condemnation case, fully briefed on the exotica of condemnation. Here, then, is a quick look at eminent domain concepts.



What Every Arizona Lawyer Should Know About



EMINENT DOMAIN

1. The "Right to Take."

To exercise the power of eminent domain, the government must show public use and necessity. This is commonly called "the right to take." If a property owner wants to challenge public use and necessity, then the challenge must be made prior to the property owner stipulating to immediate possession or the Court ordering immediate possession after a hearing pursuant to A.R.S. § 12-1116.

2. Right to take challenges are few and far between.

The reason is simple: 99.9 percent of condemnation cases involve situations in which public use and necessity are obvious. If you represent a property owner, do you truly hunger for the opportunity to tell a Superior Court judge that the City of Phoenix does not have "public use and necessity" to widen Indian School Road by six feet?

However, in that rare case when a "right to take" challenge is successful, such as *City of Phoenix v. McCullough*, 536 P. 2d 230

(Ariz. Ct. App. 1975), and *Bailey v. City of Mesa*, 76 P.3d 898 (Ariz. Ct. App. 2003), and the recent battle over the Tempe Marketplace, the property owner is entitled to legal fees, appraisal fees and engineering fees. A.R.S. § 12-1129.

3. What and why is "Immediate Possession"?

ADOT is building a new freeway. ADOT wants to award a construction contract for a two-mile stretch of that freeway. ADOT needs to purchase/condemn right of way from 20 separate owners for that two-mile stretch. But ADOT has been successful in purchasing right of way from only 12 of the owners, in a checkerboard pattern. ADOT then files condemnation actions against the other eight owners. However, those eight condemnation cases won't ripen to judgment for approximately 14 months, and ADOT won't get physical possession of the condemned right of way until it pays those judgments.

It does not make economic sense for ADOT to build the free-



Jay Dushoff is a shareholder at Gallagher & Kennedy PA in Phoenix, where he focuses his practice on eminent domain, inverse condemnation, valuation litigation and zoning, on behalf of property owners. He has handled and tried numerous condemnation cases.

way in hopscotch fashion, namely build right now on the 12 strips of right of way that have been purchased, and build 14 months from now on the eight strips of right of way that are being condemned.

The solution? ADOT applies to the court under A.R.S. § 12-1116 for an Order of Immediate Possession ("OIP"). If an OIP is granted, then ADOT can build the entire two-mile stretch of the freeway right now, even though the just compensation for eight of the parcels of land has not yet been determined. The basic prerequisites for obtaining an OIP are to show the court that there is public use and necessity for the proposed taking, that an OIP is necessary and for ADOT to post cash or a bond in the amount of the probable amount of damages. Typically the cash/bond is in the amount of ADOT's appraisal. The jury at the condemnation trial will not be told about the OIP proceedings. A.R.S. § 12-1116(O). Orders for Immediate Possession are routinely granted, so much so that the condemnation lawyer for the property owner typically stipulates to the OIP.

4. Pre-judgment interest on the condemnation award.

If a government takes immediate possession of the property it seeks to condemn, then the ultimate condemnation award bears interest from the date of the Order for Immediate Possession until the date of final payment. A.R.S. § 12-1123(B). The condemnation interest rate is a semi-floating prime rate. The condemnation interest is established by the prime rate on the first day of each month, which rate then applies for the balance of that calendar month. A.R.S. § 9-409 (cities and towns); A.R.S. § 11-269.04 (counties); A.R.S. § 28-7101 (ADOT). The property owner may withdraw, prior to judgment, all or a portion of the immediate possession bond that has been posted. In that case, the property owner is entitled to interest on the drawdown only from the date of the Order for Immediate Possession through the date of withdrawal. A.R.S. § 12-1123(B).

An Order for Immediate Possession effectively takes the condemned property away from the property owner, but it does not pass title to the government.

5. An Order for Immediate Possession does not convey title to the condemning body.

An Order for Immediate Possession effectively takes the condemned property away from the property owner, but it does *not* pass title from the property owner to the government; the property owner remains the title holder until the end of the case. A.R.S. § 12-1126. The Order for Immediate Possession gives possessory rights only. *Bethune v. United States*, 376 F. Supp. 1074 (W.D. Mo. 1972); *Redevelopment Agency of San Francisco v. Superior Court*, 13 Cal. App. 3d 561 (Cal. Ct. App. 1970).

But note: In the federal system, the declaration of taking (which is the federal equivalent of the Order for Immediate Possession) *does* pass title to the federal government.

6. Real property taxes.

Once immediate possession is taken by the government, and the OIP is recorded with the county recorder, then the condemned property is granted tax-exempt status for future tax rolls. That's the quick and dirty. *See* A.R.S. § 12-1123(D) for the details.

7. Quasi-governmental bodies have the power to condemn.

We have been using the word "government" in this article. However, there are quasi-governmental entities that have the power of eminent domain, such as Arizona Public Service, a privately owned utility.

The eminent domain powers available to a private utility are the same as those enjoyed by the State of Arizona or the City of Tucson or the like, with one exception: The privately owned utility does not have the right to obtain an Order for Immediate Possession. *Hughes Tool Co. v. Superior Court*, 370 P.2d 646 (Ariz. 1962). Therefore, the privately owned utility does not get possession of the condemned property until the condemnation case has been completed, by settlement or by judgment.

8. What are "severance damages"?

In all probability, even if you are a rank beginner to the World of Eminent Domain, you have heard of severance damages. It is one of the basic eminent domain concepts. However, if you go to the Arizona Eminent Domain statutes, A.R.S. § 12-1111 *et seq.*, there will be nary a reference to the phrase "severance damages." What gives?

Gentle readers, fear not. We will show you where the *concept* of severance damages is stated in the Eminent Domain statutes. Look at A.R.S. § 12-1122(A)(2), and then consider this simple explanation of that subsection: If the condemnation takes part of a parcel of land, the property owner is entitled to be paid for the part



that is physically taken. The owner is also entitled to be paid damages for the decrease, if any, in the market value of the remainder property caused by the taking, and/or by the construction of the condemnor's proposed public improvement. Those damages are called "severance damages." *State ex rel. Ordway v. Buchanan*, 741 P. 2d 292, 296 (Ariz. 1987); *County of Maricopa v. Paysnoe*, 319 P. 2d 995 (Ariz. 1957); *Pima County v. DeConcini*, 285 P.2d 609 (Ariz. 1955); RAJI (Civil) 4th, Eminent Domain 12.

However, this simple explanation is an oversimplification. See the next section of this primer.

9. Not all economic damages to real property caused by the construction of a public improvement are compensable.

Manny Mogul owns a thriving retail business on a busy arterial street. The City widens the street and installs a median in the middle of the street, preventing left-hand turns to or from Manny's property. The value of Manny's real property plummets. However, Manny Mogul is not entitled to any damages whatsoever from the City; the installation of the median is a non-compensable police power action. *Rayburn v. State ex rel. Willey*, 378 P.2d 496 (Ariz. 1963). Other examples of non-compensable damages are loss of customers, business or profits. *City of Phoenix v. Leroy's Liquors, Inc.*, 868 P.2d 958 (Ariz. 1993).

10. The date of valuation in a condemnation case is the date of the summons.

The jury is instructed to determine the market value of the condemned property, and the severance damages, if any, to the remaining property as of that date of valuation. A.R.S § 12-1123(A). At first blush, that would seem to preclude the use of comparable sales that occur after the date of valuation. However, the case law indicates that comparable sales taking place after the date of valuation "can be used to show the value of the subject property in the 'before' situation." *City of Tucson v. Ruelas*, 508 P. 2d 1174, 1176 (Ariz. 1973).

11. What are the ramifications to Stanley Developer when ADOT announces a future freeway that will require the condemnation of all or part of his property?

ADOT announces in 2006 that it intends to break ground on the freeway in 2020, and intends to begin the process of acquiring the right-of-way for the freeway (negotiations, followed if necessary by condemnation proceedings) in 2018.

Stanley Developer has a vacant 15-acre parcel at an arterial intersection that is ripe for the development of a shopping center. His parcel of land will be bisected by the proposed freeway. The proposed freeway effectively kills the feasibility of developing a neigh-



Weintraub v. Flood Control District, 456 P.2d 936 (Ariz. 1969); DUWA, Inc. v. City of Tempe, 52 P. 3d 213 (Ariz. 2002).

On the other hand, let us fast forward to 2018. Stanley Developer's land is still undeveloped, and all evidence points to the fact that commercial development (after the 2006 announcement of the future freeway) was not feasible with the condemnation lurking in the background. ADOT in 2018 files a condemnation case. Stanley Developer may have a viable argument under the doctrine of project depression, also known as condemnation blight, that in 2018 his property would have had a substantially higher market value "but for" the proposed freeway announcement in 2006. "The 'project influence doctrine' ... holds that property may not be charged with a lesser or greater value at the time of taking, when the change in value is caused by the taking itself or by anticipation of appreciation or depreciation arising from the planned project." City of Phoenix v. Clauss, 869 P. 2d 1219, 1222 (Ariz. 1994).

12. Can a property owner build in the path of a future public project?

The owner of a property that is in the path of a proposed freeway that has been publicly announced can build a building in the path of that freeway—in most circumstances—and still get paid for the building if and when the government condemns his property.

The key to this seemingly strange statement is that the government cannot, simply by announcing a public project that involves the potential condemnation of Blackacre, restrict the rights of the

borhood shopping center, or any other commercial development on that portion of the 15-acre parcel that will not be taken for the proposed freeway.

Stanley Developer is extremely unhappy about this turn of events. However, he wants to get on with his life. Therefore, he proposes to ADOT that because it has "fingered" his property, ADOT should buy immediately that portion of Developer's parcel of land that is needed for the freeway, instead of waiting until 2018 to acquire a portion of Developer's land.

ADOT responds with a polite "No, thank you. We will knock on your door in 2018, and make an offer at that time to buy the land we need."

Stanley Developer, now rather irate, hires a lawyer to sue ADOT for damages (namely, the reduced value in 2006 of his property that results from the announcement of the future taking) and/or to force ADOT to purchase, right now, the portion of Stanley Developer's land needed for the future freeway.

Stanley Developer, if he chooses to file the lawsuit, will lose. The government can announce a future public project that will require condemnation of someone's land, and it is not liable for damages even though the land that is "fingered" may in fact decrease in value as the result of the announced public project. *See, e.g.*,

owner of Blackacre to use or develop his land. *State ex rel. Willey v. Griggs*, 358 P.2d 174 (Ariz. 1960). The owner is entitled to be paid for the building constructed in the path of the proposed public improvement if the building was made in the natural, ordinary and legitimate use of Blackacre, and not for the sole purpose of enhancing damages in a future condemnation action. *State ex rel. Herman v. Schaffer*, 515 P.2d 593 (Ariz. 1973). *See also Showalter v. State ex rel. Sullivan*, 63 P.2d 189 (Ariz. 1936).

13. Legal fees and expert witness fees.

When Stanley Developer's land is condemned, he has to bear his own legal fees and expert witness fees. *Mastick v. State*, 576 P.2d 1366 (Ariz. Ct. App. 1978). This is true even if Stanley Developer gets an award (by settlement or at trial) that is hugely more than the government's offer. There are exceptions to this rule when the government abandons a condemnation proceeding, or when the property owner successfully moves to have a condemnation case dismissed. A.R.S. § 12-1129.

14. Who's on first, What's on second?

When a civil trial lawyer goes to trial, he takes for granted that the plaintiff puts on his case first. The World of Eminent Domain is dif-

ferent. The defendant property owner has the burden of proof on the issue of just compensation. *Town of Williams v. Perrin*, 217 P.2d 918 (Ariz. 1950); *Choisser v. State ex rel. Herman*, 469 P.2d 493 (Ariz. Ct. App. 1970). In 99.9 percent of the cases, the issue of public use and necessity has already been decided in favor of the government, or has been stipulated to by the owner, and at trial the defendant property owner puts on his case first.

15. The property owner is always an expert.

As trial lawyers, we have had it drummed into our heads that to express an opinion at trial, one needs to be qualified as an expert. Not so in condemnation, if you are the owner of the property being condemned. The owner of the property can get on the stand and give an opinion of market value even though he has no qualifications whatsoever with respect to real estate valuation. *Town of Paradise Valley v. Laughlin*, 851 P.2d 109 (Ariz. 1992). However, as a practical matter, it is rare for an owner in a condemnation case to express an opinion of value at the trial.

16. The significance of a physical taking.

Assume there are two identical apartment complexes, each with 400 dwelling units. A new freeway takes 50 percent of Apartment Complex A. The property owner is entitled to be paid the market value of the 50 percent that is physically taken. The owner is also entitled to severance damages caused by noise, dust, fumes, loss of visibility, proximity to the freeway, etc., that result from construction of the freeway immediately adjacent to the remaining half of Apartment Complex A. *State ex rel. Miller v. J.R. Norton Co.*, 760 P.2d 1099 (Ariz. Ct. App. 1988).

Let's assume that Apartment Complex B has no land physically taken, and that the freeway is built immediately adjacent to the west boundary of Apartment Complex B. Apartment Complex B suffers the same freeway proximity damages (noise, fumes, etc.) as the remainder of Apartment Complex A.

However, due to the fact that not one square inch of Apartment Complex B is

physically taken for the freeway, the owner of Apartment Complex B is not entitled to any compensation whatsoever. *J.R. Norton Co.*, 760 P.2d at 1101.

17. No income tax on the condemnation award? Am I dreaming?

Uncle Sam, in his benevolent wisdom, gives generous income tax treatment to the monies received by a property owner in a condemnation case, or in a pre-filing settlement "under threat of condemnation." I.R.C. § 1033. The "Cliffs Notes" version of Section 1033, viewed through the eyes of a condemnation lawyer, is as follows: Payment of income tax on a condemnation award (whether by court judgment or by out-of-court settlement) is deferred if the property owner buys a replacement property with the condemnation award. To get the deferral, the property owner must buy the replacement property within a minimum of two years from December 31 of the year in which he first receives condemnation funds. The tax basis of the condemned property transfers to the replacement property.

As to monies received by the property owner for severance damages, the property owner does not even have to purchase a replacement property. The property owner can put the severance damages in his pocket and not pay any present taxes. However, the tax basis of his remaining property is reduced by the amount of the severance damages.

18. The Landlord-Tenant dogfight.

Landlord-tenant law is a minefield, especially when it comes to fixtures. When there is a condemnation of leased property, the marriage of landlord-tenant law and condemnation law leads to some unusually gnarly problems.

This is somewhat of an oversimplification, but one does not estimate the condemnation damages of the landlord, then estimate the condemnation damages of the tenant, and then add them together. The custom and usage is to estimate the condemnation damages on a full fee basis, and then allocate or apportion those damages between the landlord and tenant. Typically, the government does not care how the total settlement/award is allocated. The government does not have a dog in that fight. The allocation battle is between the landlord and the tenant.

Of course, the allocation of the settlement/award between the landlord and the tenant is governed by the case law, or by a condemnation clause in the lease that varies the case law. *See County of Maricopa v. Shell Oil Co.*, 327 P. 2d 1005 (Ariz. 1958); *Pepsi Cola Metro. Bottling Co. v. Romley*, 578 P.2d 994 (Ariz. Ct. App. 1978); *Mobil Oil v. Phoenix Central Christian Church*, 675 P.2d 284 (Ariz. 1983).

A cautionary note to real estate transactional lawyers: Draft carefully the condemnation clause, and avoid the Law of Unintended Consequences. For example, I have observed a situation in which a highly valuable long-term lease to a national credit tenant was jeopardized by a poorly drafted condemnation clause, which literally gave the tenant the option to cancel the lease in the event of *any* taking. That meant, as drafted, and as obviously unintended, that a widening of the adjacent arterial street by one foot would trigger the tenant's option to cancel the lease.

19. Relocation assistance.

Harriet Homeowner's house is condemned for a public project. Harriet and the government reach an agreement that Harriet's house has a market value of \$225,000, or a jury awards that amount in a condemnation trial. Harriet buys a new house. Harriet is entitled to moving expenses from the government for her sofa, lawnmower, kitchen table and the rest of her personal property. Someone displaced from a house or business is entitled to moving expenses and/or the cost to re-establish a business location pursuant to the Relocation Assistance statutes (A.R.S. §§ 11-961 et seq. and 28-7141 et seq. and the detailed regulations (49 C.F.R. Part 24)). See also Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, Pub. L. No. 91-646 (codified as amended at 42 U.S.C. § 4601 et seq.).

Have you had enough condemnation exotica? If the answer is yes, then either I have done the job assigned to me by ARIZONA ATTORNEY, or you have drifted off to sleep.