

**INDEPENDENT VALUE + LEGAL ADVOCACY =
JUST COMPENSATION**

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Chapter 10

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§ 10.01 Introduction

In an eminent domain case, the goal of both the condemnor and condemnee in a property appropriation should be payment of “just compensation” based on the fair market value of the part taken, and to fairly assess the damages, as defined by applicable law to the remaining property. The Just Compensation Formula (JCF), as the title of this chapter suggests, is an independent, objective appraisal based on relevant market data, followed by aggressive representation of the clients by competent attorneys. We will explore the various potential points of conflict inherent in the suggested formula for just compensation. It is not unusual for the independent status of the appraiser to be questioned as the advocacy of the attorney becomes more dominant.

§ 10.02 What is Just Compensation?

According to the Dictionary of Real Estate Appraisal, 4th edition, published by the Appraisal Institute, just compensation is:

the amount of loss for which a property owner is compensated when his or her property is taken; should put the owner in as good a position pecuniarily as he or she would be if the property had not been taken; generally held to be market value, but courts have refused to rule that it is always equivalent to market value.

The United Supreme Court and various State Supreme Courts have similarly defined the basis for just compensation as follows:

United States: The Fifth Amendment of the United States Constitution provides that private property may not be taken for a public use without payment of “just compensation.” The United States Supreme Court has said that the usual measure of “just compensation is fair market value of the taken land because such value is what sellers would accept in voluntary transactions.¹

State of Texas: Article 1 Section 17 of the Texas Constitution provides that:

¹ Kimball Laundry Co. v. United States, 338 U.S. 1, 69 S. Ct. 1434, 93 L. Ed. 1765 (1949).

No person's property shall be taken, damaged or destroyed for or applied to public use without adequate compensation being made, unless by the consent of such person; and, when taken, except for the use of the State, such compensation shall be first made, or secured by a deposit of money; and no irrevocable or uncontrollable grant of special privileges or immunities, shall be made; but all privileges and franchises granted by the Legislature, or created under its authority shall be subject to the control thereof.

- State of Florida: Article 10 Section 6 of the Florida Constitution provides that:
No private property shall be taken except for a public purpose and with full compensation therefore paid to each owner or secured by deposit in registry of the court and available to the owner.
- State of California: Article 1 Section 19 of the California Constitution provides that private property may not be taken or damaged by the government unless it pays "just compensation."
- State of New York: Article 1 Section 7a provides that private property shall not be taken for public use without just compensation.

As you can see from these sources, it seems that the intent of the various venues is to follow the reasoning that when a person's property is taken for public use, they should be made whole or put back into the same financial condition as they were before the taking of their property. Most of us know that this is not always the case. According to the JCF, an objective appraisal should be the basis of an offer from a condemning authority for property to be acquired, and the attorneys should seek the market value of the property being acquired and damages, if any, to the remainder as a matter of due course. The landowner, knowing that the offer to purchase his or her property was made according to the JCF, should be comfortable with the offer and readily accept.

Now what is wrong with this concept? People!

Oftentimes, landowners and their lawyers exert tremendous pressure on

appraisers in support of their ideas of the value of their property; likewise, the condemning authority can and will pressure their appraisers to hold down values, especially damages to any remaining property in a partial taking. Only the *appraisers* have the ongoing responsibility to be independent and objective in this process. Achieving just compensation for a landowner should be the goal of both sides. However, since this rarely happens, the tug-of-wars between the appraisers and lawyers usually produce a pretty good balance and shape the end result: just compensation.

§ 10.03 The Role of the Appraiser: Be Independent

In an earlier presentation, we discussed the independent issue of an appraiser in an eminent domain case. One of the first things an appraiser should do is insure that the landowner is the client, not the landowner's attorney. At the initial engagement stage, the agreement for services between the appraiser and landowner should, almost always, be a written fee agreement with the landowner client. Prior to finalizing the engagement, it is the duty of the appraiser to clarify certain issues, including the following:

- Any conflicts of interest;
- Definition of the appraisal problem;
- Scope of the appraisal;
- Preliminary client/attorney expectations or representations;
- Available information concerning the property; and
- Discussion with client/attorney about the appraisers role and obligations.

Once these issues are resolved, the fee contract can be concluded. Failure to secure a written fee agreement may very well lead to disagreements with the client and potentially affect the independence of the appraiser. Depending on the situation, scope of work, and the client, the fee contract may be a simple letter acknowledging the assignment or a fairly complicated legal document. The bottom line is that the contract should set out the understanding of the fee for appraisal services by both parties.

§ 10.04 The Appraiser and the Attorney

In a condemnation case, an experienced attorney can be the insurance policy that just compensation is paid for the taking of property or

property rights. The attorney is going to be the quarterback in the case. However, the appraiser must, at all times, keep the independence required under Uniform Standards of Professional Practice (USPAP) and conform to state law.

Communications between the appraiser and the attorney are essential. Both benefit from discussions as to the information being accumulated. However, in most instances, any written communication between the attorney and the appraiser is discoverable. This is not to say that the appraiser will not be asked about its conversations with the attorney because, most likely those will be discussed during deposition. Most experienced condemnation attorneys will limit the amount of "paper" sent to the appraiser for this very reason.

There are, however, certain things that absolutely must be communicated to the appraiser in writing. At a minimum, the attorney should write the witness early on after his or her engagement and make explicit the expected due date for the appraisal, any existing discovery deadlines, the date for the special commissioners' hearing or trial, and any other date that is critical for the expert to know when scheduling his or her workload. Should the attorney be providing the expert with legal instructions to utilize in the formation of his opinions, both common sense and USPAP require these to be explicit and written. In addition, the appraiser should be provided with at least the following items at the outset of the assignment:

- Current live petition;
- Survey of whole property or at least a detailed description;
- If the property is income-producing, copies of current rent roll and expenses; and
- Plans and specifications of improvements, if present.

If the case involves a partial taking, the attorney must also, of course, provide the appraiser with a right-of-way schematic showing the land area taken and remainder, as well as construction documents showing the proposed improvements for the part taken. It is not intended to portray that these kinds of documents are solely the responsibility of the attorney. It may very well be a combined effort of the parties involved, as well as other experts that have been retained.

From the appraiser's perspective, information received from any source, including the attorney, should be as complete as possible. If the

information is in any way subjective, such as the details of a particular comparable transaction or information about the subject property, the appraiser should independently investigate and verify the details. In the case of legal instruction, it is improper for an Appraisal Institute member to accept without question a hypothetical condition, and any such hypothetical condition must be plainly disclosed in the body of the report. As one authoritative source has said:

Instructions by the attorney to the appraiser on a matter of law is certainly a proper element to be expressed in the attorney-appraiser relationship, but instructions to the appraiser on valuation is another matter. The appraiser has the choice of accepting or rejecting the attorney's premise. "Once accepted without reservation, the premise becomes the appraiser's responsibility."²

Remember, the appraiser's role is to prepare and present an independent evaluation based on the merits of the property and the effect of the taking on the remaining property, if any. Working with the attorney is essential, and, given the above parameters, the appraiser can remain independent and the attorney can pursue the advocacy required in the pursuit of just compensation.

§ 10.05 Legal Issues in Just Compensation

As earlier discussed, the Dictionary of Real Estate Appraisal, 4th edition's definition of "Just Compensation" concludes with the Appraisal Institute explanation that "courts have refused to rule that it (Just Compensation) is always equivalent to market value." Perhaps a more direct paraphrase would be "courts have refused to rule that it (Just Compensation) is always equivalent to *Just Compensation*." Therefore, in a world where market value is not always equal to just compensation, appraisers and attorneys oftentimes find themselves having to work through complex and many times confounding jurisdictional exceptions in the course of serving the interests of independency and advocacy. Some of the more significant and modern era legal cases impacting the way appraisers and attorneys have had to address the issue of just compensation follow.

² Eaton, J.D., MAI, SRA, Real Estate Valuation in Litigation, 540 (2d Ed., Appraisal Institute, Chicago, Illinois 1995).

*State v. Schmidt*³ is arguably the most significant, if not controversial, case in modern Texas condemnation jurisprudence. In *Schmidt*, the court considered the admissibility of certain market factors on the remainder value of condemned properties: diversion of traffic, circuitry of travel, impaired visibility, and construction inconvenience brought about by the public improvement project. The court concluded that all were generally non-compensable in Texas condemnation cases.

Essentially, the court reasoned that in cases like *Schmidt* involving a small, sliver-like taking for a major roadway widening: (a) the value-reducing factors complained of had been traditionally disallowed as bases for recovery in *inverse* condemnation cases;⁴ (b) the factors complained of were not specifically damaging to the landowner, but were rather community in nature;⁵ and (c) the damages claimed resulted from public improvements constructed not on the part taken, but elsewhere.⁶

In *City of Harlingen v. Sharboneau*,⁷ the Texas Supreme Court considered and essentially rejected the admissibility of an unquestionably established appraisal technique known as the “subdivision development method.” *Sharboneau* involved at its base the admissibility of testimony by the landowner’s expert appraisal witness about the subdivision development approach to valuing vacant land. The Appraisal Institute defines this appraisal methodology as follows:

[A] method of estimating land value when subdivision and development are the highest and best use of the parcel of land being appraised. When all direct and indirect costs and entrepreneurial incentive are deducted from an estimate of the anticipated gross sales price of the finished lots, the resultant net sales proceeds are then discounted to present value at a market-derived rate over the development and absorption period to indicate the value of raw land.⁸

The approach and its applicability were published in at least one appraisal text defining the basic methodology by 1964: “The process,

³ 867 S.W.2d 769 (Tex. 1993).

⁴ *Id.* at 777.

⁵ *Id.* at 781.

⁶ *Id.* at 778–779.

⁷ 48 S.W.3d 177 (Tex. 2001).

⁸ The Dictionary of Real Estate Appraisal, 279 (4th ed., Appraisal Institute 2002).

applicable chiefly to undeveloped land, calls for estimating total value as if the land were subdivided and sold, and subtracting the development costs.”⁹ The subdivision development method was further explained in another appraisal textbook devoted solely to subdivision analyses in 1993: “The subdivision method is essentially an income approach which measures the financial rewards, risks, and costs associated with a real estate investment.”¹⁰

The federal government, too, has noted the general acceptability of this appraisal approach in its Uniform Appraisal Standards for Federal Land Acquisitions.¹¹ Indeed, the Appraisal Institute’s current treatise on real estate valuation in litigation notes that this approach may sometimes be the *sole* method of valuation in certain instances.

The development approach is the primary, and sometimes the only, method of valuation in a condemnation case when:

1. The appraiser concludes through proper market analysis that the property in question does, in fact, have a highest and best use for subdivision development purposes;
2. Comparable before and/or after sales are lacking; and
3. Sufficient market and technical data are available to estimate the value of the property being appraised reliably using the development approach.

In the July 2000 issue of the Appraisal Institute’s primary appraisal periodical, two commentators confirmed that the development approach provides a useful valuation alternative in eminent domain cases that may more accurately reflect the true market value of an undeveloped tract of land. By utilizing the same approach that developers themselves do of analyzing the larger parcel and determining the present value of the projected net income stream from the subdivision of the tract, the approach can show the value of potential uses of the property that a

⁹ *Ibid.*

¹⁰ Lovell, Douglas D., MAI, and Martin, Robert S., MAI, SRA, *Subdivision Analysis*, 4 (Appraisal Institute 1993).

¹¹ *Uniform Appraisal Standards for Federal Land Acquisitions*. Interagency Land Acquisition Conference. Sec. A-15 (Appraisal Institute 2000).

conventional comparable sales approach may well overlook.¹²

Plainly, the appraisal literature reflects that the subdivision development method is not only well accepted within the professional appraisal community but also occasionally the preferred method for establishing the value of vacant, undeveloped property, in certain circumstances.

In *Sharboneau*, however, the Texas Supreme Court considered and rejected as irrelevant a subdivision development approach appraisal performed in a condemnation case.¹³ The opinion outlined the steps taken by the landowner's appraiser (Patterson) as follows:

- (a) Patterson initially concluded that the highest and best use of the land was for subdivision development. In fact, the parties stipulated that the highest and best use of the condemned property was as a residential subdivision;
- (b) Patterson then determined how many lots could be carved out of the land based on lots sizes in surrounding neighborhoods;
- (c) Patterson then estimated the gross sales of these lots over a selling period of three years, including an inflation factor of 5% for years two and three;
- (d) Patterson itemized and subtracted the expenses of development, including sales expenses, real estate taxes, closing costs, attorneys' fees, and entrepreneurial profit, to arrive at the net sales proceeds for the subdivision development;
- (e) Patterson applied a discount rate to the annual net sales proceeds to arrive at a present value; and
- (f) Patterson deducted the cost of preparing the land for subdivision use (construction of streets, utilities, etc.) to arrive at his estimate of value for the land, "as is."¹⁴

Comparing these steps to the broad outline in the subdivision development approach quoted in the Appraisal Institute's definition above, it is apparent that Patterson followed accepted appraisal methodology. The court itself even observed that the subdivision development ap-

¹² Duvall, Richard O., J.D., and Black, David S., J.D., *The Development Approach to Valuation in Eminent Domain Litigation: Capitalizing on Potential Use*, Appraisal Journal (July 2000).

¹³ City of Harlingen v. Estate of Sharboneau, 48 S.W.3d 177, 186 (Tex. 2001).

¹⁴ *Id.* at 180-181.

proach, as expressly outlined by the Appraisal Institute in an *amicus* brief, was “broadly similar” to Patterson’s work.¹⁵

The court, nonetheless, disallowed Patterson’s appraisal despite its obvious adherence to appraisal standards. The court opined that Patterson’s analysis was not a true accounting of market value because, it somehow did not account for all market forces:

Patterson’s subdivision development analysis determined only what a developer could hypothetically afford to pay to profitably subdivide the property, not what a developer would pay in the competitive, risk-filled marketplace of the real world. Because the appraisal did not account for these forces, it was not relevant in establishing the market value of Mrs. Sharboneau’s property.¹⁶

Of course, an appraisal professional would respond that an appraiser’s assessment of the discount rate, absorption period, and relative lot prices account for each of the court’s expressed concerns that the appraisal did not reflect the marketplace. Nonetheless, although the court noted that “in some cases” a subdivision approach might be admissible, by disallowing an essentially textbook application of the method, the court has presented a serious roadblock to use of this appraisal approach to value in Texas condemnation cases. Undoubtedly, the decision presents a major issue to any appraiser attempting to both: (a) evaluate raw land amenable to subdivision development and (b) comply with USPAP. If the subdivision development is applicable in a condemnation case, the appraiser should apply the approach in conjunction with the highest and best use section of the appraisal report or invoke the jurisdictional exception provision of USPAP.

In the pipeline easement case of *Exxon Pipeline Co. v. Zwahr*,¹⁷ the landowner’s appraiser concluded that the 1.01-acre parcel desired by Exxon constituted a separate economic unit itself, and the landowner desired to establish the fact that along with its concomitant value as authorized by earlier Texas Supreme Court precedent,¹⁸ it had its own highest and best use and value. In such a case, of course, the market

¹⁵ *Id.* at 181.

¹⁶ *Id.* at 186.

¹⁷ 88 S.W.3d 623 (Tex. 2002).

¹⁸ *State v. Windham*, 837 S.W.2d 73, 76 (Tex. 1992).

value of the severed land may be determined without reference to the remaining property.¹⁹

In *Zwahr*, the landowner's appraiser (Kangieser) determined that the highest and best use of the property taken was for a pipeline easement, and he valued the part taken pursuant to other sales of easement rights-of-way in the vicinity.²⁰ In arriving at his conclusion, Kangieser relied upon the fact that the *Zwahr* property had one pipeline easement along the same alignment as the proposed Exxon easement. This approach is commonly referred to as "corridor valuation," an appraisal approach that is recognized both in regular appraisal literature and in prior Texas case law.²¹

The *Zwahr* court's disapproval of Kangieser's opinions, however, was based not upon his use of the corridor valuation method but rather his conclusion of highest and best use. According to the opinion:

Because Kangieser relied on Exxon's condemnation in establishing a separate economic unit and in assigning a value to that unit, his final opinion reflected enhancement in the land's value that occurred only because of the Exxon project itself . . . value that exists because of the condemnation project is not, under the project-enhancement rule, value for which a landowner may recover.²²

Without offering any critique as to the intellectual correctness of the decision, it is plain that the opinion frowns on further utilization of the corridor valuation technique in Texas condemnation cases. Thus, how may an appraiser *ever* conclude that the part taken is a separate economic unit in such an instance without offending *Zwahr's* interpretation of the project influence rule in an easement case adjacent to an existing easement? To the extent that an appraiser legitimately decides that the use of a strip of land adjacent to a group of easements has a highest and best use of another easement, *Zwahr* appears to discourage him from analyzing and reporting that conclusion. This, once again, is an example of the court essentially excluding an appraisal concept which often affects just compensation.

¹⁹ *Ibid.*

²⁰ *Exxon Pipeline Co. v. Zwahr*, 88 S.W.3d 623, 628 (Tex. 2002).

²¹ *See Bauer v. Lavaca-Navidad River Authority*, 704 S.W.2d 107 (Tex. App.—Corpus Christi 1985, *writ ref'd. n.r.e.*).

²² *Zwahr*, N. 20 *supra*, 88 S.W.3d at 631.

The legal issues to be dealt with in these and a host of other court rulings over the years oftentimes contradict or, at best, convolute the definition of market value (just compensation) in the name of “jurisdictional exceptions.” These jurisdictional exceptions must be successfully worked through in the course of interpreting and, if legally necessary, excluding elements of compensability. Therefore, appropriate just compensation is highly dependent upon the competency of both the appraiser and the attorney. In this connection, there is no substitute for good communication

§ 10.06 USPAP Provisions

Specific provisions of the Uniform Standards of Professional Practice (USPAP) and various appraisal organizations also dictate the independence of an appraiser. Specifically, the conduct provisions are as follows:

- In practice, an appraiser must not perform as an advocate for any party or issue;
- An appraiser must not accept an assignment that includes the reporting of predetermined opinions and conclusions;
- An appraiser must not communicate assignment results in a misleading or fraudulent manner. An appraiser must not use or communicate a misleading or fraudulent report or knowingly permit an employee or other person to communicate a misleading or fraudulent report;
- An appraiser must not use or rely on unsupported conclusions relating to characteristics such as race, color, religion, national origin, gender, marital status, familial status, age, receipt of public assistance income, handicap, or an unsupported conclusion that homogeneity of such characteristics is necessary to maximize value.

Additionally, appraisers cannot accept compensation when it is contingent upon a predetermined opinion. It is unethical for an appraiser to accept compensation for performing an assignment when it is contingent upon:

1. The reporting of a predetermined result (*e.g.*, opinion of value);
2. A direction in assignment results that favors the cause of the client;
3. The amount of a value opinion;

4. The attainment of a stipulated result; or
5. The occurrence of a subsequent event directly related to the appraiser's opinions and specific to the assignment purpose.

The independence of an appraiser in eminent domain should and must be maintained even though, at times, the inevitable conflict with the client and the client's attorney will be a tough test for the appraiser.

§ 10.07 Legal Advocacy—The Role of the Attorney

In an eminent domain case, the landowner's attorney is a sworn advocate for his client. As discussed above, the appraiser is prohibited from being an advocate for his client. Yet, these two professionals must work together for the good of their mutual client.

In performing legal advocacy, an attorney should probably seek the most liberal interpretation of the case law, take advantage of procedural rules when applicable and present arguments to the court most favorably to his client. It is the duty of the lawyer to give the appraiser legal instructions when certain legal issues are important to the valuation of the real property. This is not to say that the attorney should give improper instructions, but it is not unusual for an appraiser to receive instructions based on the legal theories that may have never been ruled upon by the courts. Even if these instructions are hypothetical, the appraiser can utilize them in the appraisal. Nevertheless, USPAP rules must be followed as follows:

Standards Rule 2-1(c): Clearly and accurately disclose any extraordinary assumption, hypothetical condition, or limiting condition that directly affects the appraisal and indicate its impact on value.²³

Therefore, hypothetical or interpretative legal instructions to appraisers can be utilized when properly disclosed in the appraisal report. Certainly, the court may disregard the attorney's theory and then the appraisal testimony will probably be limited or eliminated. The appraiser may want to include conventional valuation theories to prevent the exclusion of his testimony.

The Texas court decisions discussed above limit the appraisal pro-

²³ Uniform Standards of Professional Appraisal Practice 2003 Edition, 21 (Appraisal Foundation).

cedures and, in some instances, restrict the appraiser in estimating fair market value. The *Schmidt* case disallowed the inclusion of market factors, *Sharboneau* disallowed testimony of the landowner's expert appraisal witness about the subdivision development approach to valuing vacant land, and *Zwahr* essentially disallowed the use of linear or corridor evaluation even when those uses are clearly the highest and best use of a property.

As legal advocates, attorneys for landowners in Texas have not remained on the sidelines since these opinions were handed down, especially the *Schmidt* case. Some attorneys have successfully argued that several of the value factors which were assumed to be excluded in *Schmidt* are not. Probably the most important Texas eminent domain case since *Schmidt* is the *Interstate Northborough* case. Northborough's attorneys argued that increased proximity and unsafe access was a damage to the property. The court concluded:

We hold that on the record before us, INP's increased-proximity damages are special damages and therefore compensable.²⁴

[E]vidence regarding unsafe access to remainder property and cost to cure was relevant to determine damages award.²⁵

Another example of legal advocacy in an eminent domain case is *State of Texas v. Whataburger, Inc.*²⁶ The trial court entered judgment awarding the owner over \$1.2 million for statutory condemnation, and an additional \$268,524 for lost profits arising from impairment of access. Because the building had to be razed and relocated on the property, Whataburger contended that the state's partial taking caused a total, but temporary denial of access for nine months as the building had to be razed and rebuilt. The appeals court concluded:

Accordingly, under the facts presented here, we find (1) the trial court did not err in awarding Whataburger compensation for impairment of access; (2) the evidence is legally and factually sufficient to support

²⁴ *Interstate Northborough Partnership v. State of Texas*, 66 S.W.3d 213 (Tex. 2001).

²⁵ *Ibid.* (case summary)

²⁶ 60 S.W.3d 256 (Tex 2001).

the court's finding of an impairment of access; and (3) the court below did not abuse its discretion in admitting evidence of lost profits.²⁷

If these attorneys had not "pushed the envelope" of legal advocacy, and instructed the appraiser on the value factors in these two cases, just compensation may not have been achieved.

Independent appraisal + legal advocacy = just compensation. The appraisal portion of the formula should never change. The legal advocacy will almost always be different in every condemnation case, as it should be. Case law is ever changing, and legal theories will expand based on the special features of any particular property. Major changes in the way roads and public thoroughfares are constructed are probably in the near future. Most likely, toll roads and public transportation will replace freeways and the rights of property owners adjoining the facilities will be the subject of many opportunities for the JCF to be well tested.

²⁷ *Id.* at 263.