THE PITFALLS OF OBJECTIVELY MEASURED JUST COMPENSATION: WHEN MARKET VALUE ISN'T ENOUGH

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Introduction

When advocates for property owners take on an eminent domain case, they aim to achieve the best result possible for their clients. In some cases, that means fighting the taking. In other cases, the taking is inevitable, and the objective is to maximize compensation. Despite advocates' best efforts, however, some property owners are inevitably left worse off as a result of the taking.

The goal of just compensation is to place "the property holder in as good a position as she would have been had the taking not occurred."[1] But just compensation—which is based on the "objective" standard of what a property would sell for on the open market—often does not achieve that goal, because owners "subjectively" value their property for more than it would sell for on the open market. That makes sense. If, after factoring in the costs and inconveniences of relocating, a property owner values his or her property less than the open market does, he or she would sell it.

This article explains why a subjective approach to just compensation would lead to more just outcomes for property owners, along with why implementing such an approach would be impractical. It then discusses ways some jurisdictions compensate property owners beyond the market value of their property to capture some of the intangible losses and make property owners closer to whole. Following that discussion, the article summarizes some of the more creative reforms academics have proposed to target this compensation conundrum.

The article concludes by suggesting that states pay displaced homeowners a multiple of fair market value based on how long the owners have occupied the home. That multiplier—based on the average difference between property owners' subjective value and fair market value—would, on average, fairly compensate property owners and also incentivize condemnors to take property only when the value of the public project exceeds the owners' subjective losses.

The Shortcomings of Basing Just Compensation on an Objective Standard

When the government condemns private property for public use, it is required to pay "just compensation" to the property owner.[2] The theory behind this mandate is that no individual owner should bear the burden of paying for a project for which the public, as a whole, benefits.[3] The requirement that the government pay just compensation also helps ensure that the government does not take property that is more valuable to the private owner than it is to the public at large.

As the Supreme Court has explained, "just compensation" is intended to place "the owner of condemned property 'in as good a position pecuniarily as if his property had not been taken.'"[4] In other words, the just compensation should make the property owner "whole."[5]

Courts usually implement the compensation requirement through a "fair market value" standard.[6] Although jurisdictions use varying phrasing, fair market value is generally defined as "[w]hat a willing buyer would pay in cash to a willing seller at the time of the taking."[7]

The problem with this standard is that it does not make all property owners "whole." A homeowner who is not actively selling his or her property is not a "willing seller" and likely values it more than the open market. Judge Posner described this well:

> Compensation in the constitutional sense is ... not full compensation, for market value is not the value that every owner of property attaches to his property but merely the value that the marginal owner attaches to his property. Many owners are "intramarginal," meaning that because of relocation costs, sentimental attachments, or the special suitability of the property for their particular (perhaps idiosyncratic) needs, they value their property at more than its market value (i.e., it is not "for sale"). Such owners are hurt when the government takes their property and gives them just its market value in return. The taking in effect confiscates the additional (call it "personal") value that they obtain from the property.[8]

The shortcomings of determining compensation using an objective standard are particularly pronounced in the residential context. As a straightforward illustration, consider a five-person family that has lived in a suburban home for many years. The children are friends with the neighbors across the street and are comfortable in their local public school. The parents renovated their home to support their hobbies—installing a golf simulator in the basement and garden in the backyard—and have purchased furniture that compliments the home's unique layout. The family is comfortable and has no intention of moving, even before considering the inconveniences of physically relocating their personal possessions. This family is not a "willing seller" and would turn down offers for the home's "fair market value."

Subjective losses also exist in the commercial context, even if they are not always obvious.[9] For example, consider a family-owned pizza shop. The secret behind the business's success—besides its charming décor, which includes walls adorned with Polaroids of local celebrities with the owner—is the brick oven, which the founder built himself using techniques he learned in his small hometown in Italy before immigrating to the United States. The current owner is the founder's grandson and the third generation to own and operate the business. His fondest childhood memories are of his dad teaching him the art of pizza-making at the shop. Several businessmen have attempted to franchise the business and offered to purchase it based on multiples of its revenue and profits, but the owner has turned them all down without hesitation. Like the homeowners described above, the pizza maker is not a "willing seller" and would turn down offers for the "fair market value" of his property.

These examples illustrate some ways that just compensation based on an objective market value ignores the owner's subjective losses. Property is unique, and the objective standard fails to account for the owner's sentimental attachment to the property and its community and other idiosyncratic tastes. Compensation based primarily on market value also ignores the complications involved in relocating (not to mention out-of-pocket expenses such as attorney's fees and closing costs that are often not recoverable).

The Practical Difficulties of Implementing a Subjective Compensation Standard

In an ideal world, just compensation would leave property owners subjectively indifferent to takings. Unfortunately, there are many practical difficulties in implementing a subjective standard.

As an initial matter, it is difficult to place a monetary value on subjective feelings and attachments. If you knock on the door of a settled homeowner and ask them what it would cost for them to sell their home that minute, they will likely struggle to find a number. And in the eminent domain context, we surely could not trust property owners to answer honestly. Imagine how hard it would be for a jury to make that determination.

A subjective standard would create other complications for trials. The property owner and condemnor would likely have to litigate how much the property owner *really* cares about their property. Property owners who wanted to move before the taking would be incentivized to exaggerate their sentimental attachment. Both sides may seek to present character witnesses to speak to the owner's honesty (in valuing the property) or involvement in the community (to show attachment).

As a further complication, the unpredictability of property owners' subjective values would make it impossible for government decisionmakers to predict ex ante how much a public project will cost. By contrast, under the current standard, they can generally estimate the market values of the properties they would need to condemn.

As Justice Marshall explained, these complications are the reason we use an objective standard:

> Because of serious practical difficulties in assessing the worth an individual places on particular property at a given time, we have recognized the need for a relatively objective working rule. The Court therefore has employed the concept of fair market value to determine the condemnee's loss. Under this standard, the owner is entitled to receive "what a willing buyer would pay in cash to a willing seller" at the time of the taking.[10]

Supplementing Market Value

One of the most promising and practical proposed reforms targeted at accounting for the fact that displaced homeowners are not "willing sellers" is to supplement fair market value with a "bonus." That bonus—which is calculated using a multiple of fair market value—approximates the difference between the fair market value and the property owner's subjective value, which I refer to below as the "subjective surplus." Because the subjective surplus is likely larger for owners who have occupied their homes longer, the bonus can vary with length of ownership.

There are many advantages to supplementing market value with a bonus multiplier. First, and most importantly, at a macro level (i.e., on average), this approach can force just compensation to internalize the subjective surplus. Second, this approach uses the existing market-based analysis, which is far more workable than the purely subjective approach. Third, this approach leads to relatively predictable costs for government planners. And, finally, if this approach is executed correctly—ideally estimating how much property owners truly value their property relative to its market value and how many years they have owned the home—then it will incentivize condemnors to take property only when a project's value exceeds the affected owners' subjective losses.

Some of the most prominent property rights experts have discussed the benefits of this type of reform. Professor Richard Epstein, for example, stated that "[b]onus values ... have a great deal to recommend them."[11] He continued, "[I]f no bonus values are awarded, ... compensation will ... fail in its central purpose, as no original owner will be indifferent between retention of the basic property and the substitute award."[12]

In a statement to the Senate Judiciary Committee in the wake of *Kelo v. City of New London*, Professor Thomas Merrill noted:

> Another promising reform idea would be to require more complete compensation for persons whose property is taken by eminent domain. ... For example, Congress could require that when occupied homes, businesses or farms are taken, the owner is entitled to a percentage

bonus above fair market value, equal to one percentage point for each year the owner has continuously occupied the property. This would provide significant additional compensation for the Susette Kelos and Wilhelmina Derys who are removed from homes they have lived in for much of their lives.[13]

There are many potential variations to this type of proposal. For example, it can apply exclusively to residential takings, where the subjective surplus is more pronounced. And the bonus can also be tied to the amount of time the owner has occupied the residence, which likely correlates to the owner's subjective surplus. BYU Law Professor John Fee incorporated both concepts into his proposed reform to supplement just compensation for displaced homeowners by two percent for every year the owner continually resided at the home up to a maximum bonus of 60 percent.[14]

Following *Kelo*, a few states implemented bonus multipliers. Michigan, for example, did so through a constitutional provision that requires condemnors to pay owners 125 percent of the fair market value if the taken property is the owner's primary residence.[15] In Indiana, condemnors must pay displaced property owners 125 percent of fair market value for agricultural land and 150 percent of fair market value for residential property.[16]

Similar reforms exist outside of the United States. For example, in the United Kingdom, displaced residential property owners are entitled to 10 percent compensation bonuses. In some Canadian provinces, including Ontario, there is a five percent bonus. In Australia, the bonus is fixed at $10,000 for federal takings and 10 percent in some of its states. In India, residential property owners are entitled to 30 percent bonuses. And in Pakistan, residential property owners are entitled to 15 to 25 percent bonuses depending on the acquiring entity.[17]

The multiplier approach is not a perfect solution. Perhaps its most critical shortcoming is its reliance on an approximation of the subjective surplus. If executed correctly, it will capture how much the average homeowner values his home relative to its fair market value. However, two homeowners who have occupied their homes for equal periods of time may have extremely different feelings about them. One owner may be a new empty-nester looking to downsize. The other may have young children settled into the local public school. This approach would overcompensate the former owner and undercompensate the latter.

Some academics have criticized this type of reform for providing larger bonuses to wealthier property owners. Brooklyn Law Professor Brian Lee, for example, has argued that "paying owners fixed-percentage bonuses above the taken property's fair market value" is "markedly unjust" because it "perniciously treats rich people's sentiments and autonomy—their personhood—as more valuable than poor people's personhood, thereby failing to respect the moral equality of the rich and poor and their equal value as persons."[18] In criticizing this proposed reform, however, Professor Lee fails to grapple with its underlying motivation: internalizing the subjective surplus. On average, that surplus scales with home value. If you knock on the door of an off-market home with a $100,000 market value and offer its owner $50,000 over market value, the owner is far more likely to accept it than if you make the same $50,000-over-market-value offer to a homeowner in a $10,000,000 home.

Finally, it is worth noting that condemnees are often entitled to other benefits that attempt to make them closer to whole. For example, a property owner may not want to sell her home for its market value because—even if the condemnee can purchase an identical home for the same amount—she will have to incur the cost of relocating all personal property. For federally funded projects, the Federal Uniform Relocation Assistance and Real Property Acquisition Act provides displaced property owners with many relocation and re-establishment benefits.[19] Several states likewise provide for some relocation benefits.

As a second example, property owners typically have to hire an attorney to fight for full market value. If a condemned property is worth $10, but the

condemnor offers only $4, then the property owner may receive only $8 after hiring an attorney on a contingent-fee basis to obtain full market value. In the end, the owner is shortchanged $2 from the property's market value, which already shortchanged the owner by failing to account for his subjective surplus. To address this shortcoming, several states—including Alaska, Arizona, Arkansas, California, Colorado, Delaware, Florida, Idaho, Indiana, Iowa, Michigan, Minnesota, Montana, Nebraska, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Washington, Wisconsin, and Wyoming—have adopted statutes providing for the reimbursement of attorney fees in at least some direct condemnation actions.[20] Note that these are just two examples.

Other Reform Proposals

Several academics have proposed alternative reforms that attempt to make displaced landowners closer to subjectively indifferent to takings.

Abraham Bell and Gideon Parchomovsky propose a "novel self-assessment mechanism that enables the payment of full compensation at subjective value."[21] Under the authors' proposal, once the government announces the possibility of an eminent domain project, each property owner is required to state how much they value their property, and the government can then either take the property at that price or abstain and leave the property subject to two restrictions that are intended to keep owners honest. First, the owner cannot sell for less than the self-assessed price (adjusted for inflation based on the local housing price index). And second, the future tax liability is based on the self-assessed price (with appropriate adjustments).

James Kelly suggests condemnors taking property for economic development should not be able to condemn residential properties unless the majority of the homeowners affected by the project approve the plan.[22] Kelly also proposes that relocation laws should guarantee homeowners "an alienable [entitlement] to replacement housing in the redeveloped district area."[23]

Michael A. Heller and Rick Hills suggest that neighborhoods of homeowners should form "land assembly districts" that can collectively negotiate with developers over land acquisition.[24]

Alberto B. Lopez suggests including subjective damages, such as mental distress, as part of just compensation.[25] Lopez points out that similar damages are available in other areas of law in which they are equally uncertain and difficult to calculate. This is perhaps the most interesting of the reform proposals. Courts have increasingly granted damages for intangible harms such as emotional distress over the past half-century. Perhaps the reforms that have introduced those damages in the tort context can serve as a template for attorneys to introduce them in eminent domain cases.

Conclusion

Just compensation, which is determined using the objective standard of the property's market value, systematically undercompensates property owners, who subjectively value their property more than the open market. Consequently, many displaced property owners—especially in the residential context—are not made whole by just compensation. The existing standard also leads to bad policy, because condemnors may take property even when the value to the public is less than the condemnees' subjective losses.

Unfortunately, there are many practical issues that have discouraged courts from implementing a purely subjective just compensation standard. Over the past half-century, however, courts have increasingly awarded damages for intangible harms in other contexts, particularly for tort claims. Advocates for property owners should consider studying those reforms and evaluate whether similar reforms could be implemented in the context of eminent domain.

Finally, one of the most straightforward and practical proposed reforms, which several states have already adopted, is to provide a bonus multiplier to just compensation, which would, on average, compensate displaced property owners based on how

much they value their properties. This approach would also provide better incentives to condemnors, who would be discouraged from taking property where the public benefit is less than the condemnees' subjective losses.

Notes

1 City of Detroit v. King, 207 Mich. App. 169, 183 (1994).

2 Some states use other terms for the compensation condemnors must pay in eminent domain cases. Texas's constitution, for example, mandates "adequate" compensation. See Tex. Const. art. I, § 17 ("No person's property shall be taken, damaged or destroyed for or applied to public use without adequate compensation being made."). Florida's constitution requires "full" compensation. See Fla. Const. art. X, § 6(a) ("No private property shall be taken except for a public purpose and with full compensation therefor paid to each owner or secured by deposit in the registry of the court and available to the owner."). The distinction in terminology is not particularly important to this paper because in practice, all states rely on an 'objective' standard for compensation based primarily on market value.

3 See, e.g., Armstrong v. United States, 364 U.S. 40, 49 (1960) ("The Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.").

4 United States v. 564.54 Acres of Land, 441 U.S. 506, 510–11 (1979) (quoting Olson v. United States, 292 U.S. 246, 254 (1934)). See also, e.g., Seaboard Air Line Ry. Co. v. United States, 261 U.S. 299, 304 (1923) ("Just compensation rests on equitable principles and it means substantially that the owner shall be put in as good position pecuniarily as he would have been if his property had not been taken."); United States v. Miller, 317 U.S. 369, 373 (1943) ("Such compensation means the full and perfect equivalent in money of the property taken. The owner is to be put in as good position pecuniarily as he would have occupied if his property had not been taken."); United States v. Reynolds, 397 U.S. 14, 16 (1970) ("The owner is to be put in the same position monetarily as he would have occupied if his property had not been taken.").

5 See United States v. Va. Elec. & Power Co., 365 U.S. 624, 633 (1961) ("The guiding principle of just compensation is reimbursement to the owner for the property interest taken. . . . He must be made whole but is not entitled to more.").

6 Kirby Forest Indus., Inc. v. United States, 467 U.S. 1, 10 (1984) ("'Just compensation,' we have held, means in most cases the fair market value of the property on the date it is appropriated."). See also, e.g., McCoy v. Union Elevated R.R. Co., 247 U.S. 354, 365–66 (1918) ("The fundamental right guaranteed by the Fourteenth Amendment is that the owner shall not be deprived of the market value of his property under a rule of law which makes it impossible for him to obtain just compensation.").

7 Kirby Forest Indus., 467 U.S. at 10.Cf. Jack Daniel Distillery v. United States, 379 F.2d 569, 574 (Ct. Cl. 1967) ("The legal definition of fair market value is the price at which property would change hands in a transaction between a willing buyer and a willing seller, neither being under compulsion to buy or sell, and both being reasonably informed as to all relevant facts."); United States v. Certain Land in Borough of Brooklyn, 346 F.2d 690, 693 (2nd Cir. 1965) ("Just compensation is often said to be what a willing buyer would pay a willing seller at the time of the taking, considering the highest and best use of the property in its then condition and situation."); Ark. State Highway Comm'n v. First Pyramid Life Ins. Co., 602 S.W.2d 609, 617 (Ark. 1980) ("Fair market value was defined as, the highest purchase price the land would bring in the market in a transaction between an informed seller and an informed buyer, after they have had a reasonable time for negotiations with the seller being willing, but not forced, to sell, and the buyer being willing, but not forced, to buy.").

8 Coniston Corp. v. Village of Hoffman Estates, 844 F.2d 461, 464 (7th Cir. 1988).

9 Commercial property owners often incur damages that are not compensable and leave them less than "whole" in other ways. For example, many condemned businesses have "lost profits" that courts deem too "speculative" or "uncertain" to be included in just compensation.

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

11 Richard A. Epstein, Takings: Private Property and the Power of Eminent Domain 184 (1985).

12 Id.

13 The Kelo Decision: Investigating Takings of Homes and Other Private Property: Hearing Before the S. Comm. on the Judiciary, 109th Cong. 122 (2005) (statement of Thomas W. Merrill, Professor, Columbia Law School), https://www.judiciary.senate.gov/imo/media/doc/merrill_testimony_09_20_05.pdf.

14 John Fee, Eminent Domain and the Sanctity of Home, 81 Notre Dame L. Rev. 783, 791 (2006).

15 See Mich. Const. art. X, § 2 ("If private property consisting of an individual's principal residence is taken for public use, the amount of compensation made and determined for that taking shall be not less than 125% of that property's fair market value, in addition to any other reimbursement allowed by law.").

16 See Ind. Code § 32-24-4.5-8. In Missouri, condemnors must pay 125% of fair market value for "homestead taking[s]" and 150% of the fair market value if a family has owned the property for fifty years. Mo. Ann. Stat. § 523.039. And in Rhode Island, condemnors must pay 150% of the fair market value of property taken for economic development purposes. R.I. Gen. Laws § 42-64.12-8(a).

17 M.J. Todd, The Application of Solatium Payments in the Assessment of Public Works Compensation 45–46 (2009) (unpublished Master of Property Studies dissertation, Lincoln University, N.Z.), https://researcharchive.lincoln.ac.nz/server/api/core/bitstreams/2f354145-00fb4972-956a-549a2703cbd6/content.

18 Brian Angelo Lee, Just Undercompensation: The Idiosyncratic Premium in Eminent Domain, 113 Colum. L. Rev. 593 (2013).

19 42 U.S.C. § 4601, et seq.

20 See Matthew Ackerman, Why Condemnors Should Pay Property Owners' Attorney Fees in Eminent Domain Cases (and a 50-State Survey on the Issue), (Aug. 21, 2023), https://ackerman-ackerman.com/why-condemnors-should-pay-property-owners-attorney-fees-in-eminent-domain-cases-and-a-50-state-survey-on-the-issue/ (surveying all fifty states' laws on attorney fee reimbursement in eminent domain cases).

21 Taking Compensation Private, 59 Stan. L. Rev. 871 (2007).

22 "We Shall Not be Moved": Urban Communities, Eminent Domain and the Socioeconomics of Just Compensation, 80 St. John's L. Rev. 923 (2006).

23 Id. at 920.

24 Land Assembly Districts, 121 Harvard L. Rev. 1465 (2008).

25 Weighing and Reweighing Eminent Domain's Political Philosophies Post-Kelo, 41 Wake Forest L. Rev. 242 (2006).