5-1-2005

Just Compensation and the Seller's Paradox

Nathan Burdsal

Follow this and additional works at: https://digitalcommons.law.byu.edu/jpl

Part of the Property Law and Real Estate Commons

Recommended Citation
Available at: https://digitalcommons.law.byu.edu/jpl/vol20/iss1/4

This Comment is brought to you for free and open access by BYU Law Digital Commons. It has been accepted for inclusion in Brigham Young University Journal of Public Law by an authorized editor of BYU Law Digital Commons. For more information, please contact hunterlawlibrary@byu.edu.
JUST COMPENSATION AND THE SELLER’S PARADOX

I. INTRODUCTION

In June of 2005, the Supreme Court announced one of its more controversial decisions, *Kelo v. City of New London, Connecticut.* As the implications of this decision rippled across the legal surface, people on both ends of the political spectrum expressed outrage.

Justice Kennedy inquired whether “there are any writings or scholarship that indicates that when you have property being taken from one private person, ultimately to go to another private person, that what we ought to do is to adjust the measure of compensation.” For the past twenty-five years, the public use debate has certainly been the sexy issue in Takings Clause jurisprudence. However, Justice Kennedy’s question represents a natural transition from what constitutes “public use” to what constitutes “just compensation.”

Public use and just compensation are two necessary elements of the Takings question. Clearly, society cannot have “fair” takings without a legitimate public use or just compensation. However, while the public use debate has been nurtured and coddled, the compensation question has generally been ignored. Justice Kennedy’s question is an obvious signal that there remains more to be said about the compensation question. Significantly, the compensation question may hold the key for deciphering when a public use is truly public. This comment examines the takings issue from the ignored perspective of compensation and argues that the amount of compensation currently paid is far from “just.” Also, this comment will present two alternatives to the current scheme that may be more “just” in the sense that they go farther in truly making the unwilling seller whole.

II. THE COMPENSATION QUESTION

The Takings Clause of the Fifth Amendment to the United States Constitution provides that “private property [shall not] be taken for public use without just compensation.” The Supreme Court has continually held that the just compensation requirement rests upon the equitable principle that owners of property are entitled to the full and perfect equivalent to the property taken. This means that owners should be put in substantially the same position pecuniarily as they would have been if their property had not been taken. However, the Court has also recognized that certain practical difficulties make it necessary to develop and follow “working rules.” These rules enable the Court to determine the level of compensation that puts landowners in the same pecuniary position as they would have been in had their land not been taken. The most prolific of these “working rules” is the “fair market value; a rule so prevalent that its use is almost exclusive.”

But what exactly are the “practical difficulties” to which the Courts allude? Most scholars agree that the “practical difficulties” are the holdout landowners who try to take advantage of the government’s bargaining position. If the government had to purchase land exclusively in the open market, the government would be forced to operate in a bilateral monopoly with the landowner in the driver’s seat. The

4. U.S. Const. amend. V.
5. See United States v. 564.54 Acres of Land, 441 U.S. 506, 510 (1979); United States v. Miller, 317 U.S. 369, 373 (1943); Olson v. United States, 292 U.S. 246, 255 (1934); Campbell v. United States, 266 U.S. 368, (1924); Seaboard Airline R. Co. v. United States, 261 U.S. 299, 304 (1923) (all holding that the just compensation requirement rests upon the equitable principle that the owner is entitled to a “full and perfect equivalent to the property taken meaning that the owner shall be put in substantially the same position pecuniarily as he would have been if his property had not been taken”). See also Monongahela Navigation Co. v. United States, 148 U.S. 312, 327–28 (1893) (holding that landowners have a right based upon principles of natural law to receive compensation for property that is taken). For this article, I will be working under the assumption that this language means that the ultimate purpose of the Takings Clause is to make the landowner “whole” as defined throughout this article.
8. See generally infra notes 14, 15, and 16.
9. A bilateral monopoly is “a hypothetical market condition in which there is only one buyer and one seller, resulting in transaction delays because either party can hold out for a better deal . . . .” Black’s Law Dictionary 1023 (7th ed. 1999). Richard Epstein writes that a bilateral monopoly
landowner would be in the advantageous position and able to refuse to sell the property until he was offered compensation at least equal to the surplus value created from the taking; presumably a greater amount than what the landowner would have accepted in the open market.\footnote{Because the landowner can hold out until he sucks out all the surplus value created due to the taking, a landowner may hold out until the taking is not longer efficient. The idea of efficiency is considered at infra notes 42—55 and accompanying text (arguing that a taking is efficient where the benefits to the public outweigh the costs to the public).}

A simple example demonstrates this problem. If a city needs to purchase twenty homes on a specific street, and the city has already purchased nineteen of those homes, homeowner number twenty is clearly in an advantageous bargaining position. That homeowner can hold out until the city offers him, not the value of his home, but rather the total surplus economic benefit that the city should realize by building the road.\footnote{R. A. Epstein, Simple Rules for a Complex World 116 (Harvard Univ. Press 1995). This hypothetical market would result every time the government attempted to purchase property with a true public need but the landowner was not readily willing to sell and therefore holds out to take advantage of the government’s position.}

Although the fair market value standard was intended to overcome this bilateral monopoly problem, most scholars and individual landowners agree that the fair market value system fails its main function: to put landowners in the same pecuniary position as they would have been in if their land had not been taken.\footnote{Although a true economic decision would surely ignore these sunk costs, the reality is that politicians do not have the luxury to make huge investments with taxpayer money and then ignore the investments at the last minute because of a snag in the process. For example, consider Boston’s infamous “Big Dig” where the politicians have had problems placating upset citizens over these “sunk costs” associated with this development. See Senate Recommends Big Dig Oversight, The BostonChannel.com, Dec. 29, 2004, at http://www.thebostonchannel.com/bigdig/4031850/detail.html.} Most scholars agree that the current fair market value system fails,\footnote{Between 1915 and 1983, forty-two articles were written condemning the fair market value standard, but only one article was written that “contains anything that could be called an attempt at an evaluative defense of [undercompensating property owners].” See Debow, infra note 20 at n. 8 (citing Risinger, infra note 20 at 526).} but few commentators have considered why. I believe the functional ineptitude of the fair market value system begins and ends with the basic definitions of fair market value and willing seller. This article begins by evaluating the fair market value.

Next, this article addresses the definitional ineptitudes associated with
eminent domain – something call the “seller’s paradox.” Finally, this article will describe potential alternative systems of compensation that would resolve the seller’s paradox and thus be more just, while limiting the bilateral monopoly problem.

III. THE FALLIBILITY OF “MARKET VALUE”

There are three basic criteria proposed by courts and scholars by which a compensation scheme should be evaluated: (1) does it ensure that landowners are fairly compensated for their loss;\(^{14}\) (2) does it promote efficient use of the Takings Clause;\(^{15}\) and (3) does it prevent rent-seeking activities by opportunistic landowners.\(^{16}\) Although federal courts claim that the fair market value standard is not a “fetish”\(^{17}\) and that the courts are open to other systems of compensation, the fair market value system is applied almost exclusively in every case where compensation is at issue.\(^{18}\) Unfortunately, the fair market value scheme fails miserably when it is evaluated by the three criteria mentioned above. In fact, the system is so deficient that some courts have compared compensation and eminent domain to a “Serbonian bog.”\(^{19}\)

---

14. See supra notes 5–7 and accompanying text.
18. See supra note 4 and accompanying text. Generally, three alternatives exist to determine the fair market value of land: (1) comparable sells, (2) income capitalization, and (3) reproduction or replacement costs less depreciation. Montague, infra note 20, at 12–1. Many courts will stubbornly apply the fair market value standard even where accepted alternatives are more appropriate.
19. See, e.g., Brazos River Auth. v. City of Graham, 354 S.W.2d 99, 105 (Tex. 1961), quoted in Montague, Supra note 20, at 12–4 (endorsing the dictum although admitting that the author has no idea what a Serbonian bog is). As a metaphor, a “Serbonian bog” refers to “a mess from which there is no way of extricating oneself.” DiFelice v. Aetna U.S. Healthcare, 346 F.3d 442, 454 n.1 (3d Cir.)
A. Adequate Compensation

Under the fair market value system, landowners are not adequately compensated for the loss of their property. Many scholars argue that the fair market value system systematically undercompensates individuals because the system does not consider all the costs that the landowner realizes when his or her land is taken. Some of these costs include lost business profits and goodwill, removal costs, litigation costs, and demoralization costs.


24. Demoralization costs are “the total of (1) the dollar value necessary to offset disutilities which accrue to losers and their sympathizers specifically from the realization that no compensation is offered, and (2) the present capitalized dollar value of lost future production caused by demoralization of uncompensated losers, their sympathizers, and other observers distributed by the thought that they themselves may be subjected to similar treatment on some other occasion.” Frank I. Michelman, Property, Utility, and Fairness: Comments on the Ethical Foundations of “Just Compensation” Law, 80 HARV. L. REV. 1165, 1214 (1967) (footnote omitted). Homeowners suffer significant demoralization costs when their homes are taken because the homeowner is required to abandon his or her home as well as suffer the emotional distress caused by being pushed aside so the government can use the land as it sees fit. Durham, supra note 15, at 1306–08 [does this refer to the Durham article in note 16?]. This may even be amplified in traditional American society because most property owners view land as literally belonging wholly to the landowner, rather than belonging to the landowner unless the government wants the land. See JOHN LOCKE, TWO
In addition to the past and present costs associated with losing property, the market value approach also fails to adequately compensate individuals because it does not adequately consider future interests. Courts have consistently recognized that owners of reversions and remainders – both vested and contingent – are entitled to share in condemnation awards based on the fair market value of the entire fee. However, executory interests, possibilities of reverter, and powers of termination are considered too remote and speculative to be capable of valuation. These interests are not calculated into the compensation award.

Empirical evidence supports the contention that the fair market value fails to justly compensate landowners. Specifically, the disparity between the “fair market” value and the jury award or negotiated settlement – presumably based on what a jury or arbitrator believe the fair market value to be – is often very large. For example, the government offered $357,000 for the General Motors Poletown plant in the famous Poletown Neighborhood Council v. Detroit case. However, the negotiated settlement increased the amount of compensation to $5,100,000. Other cases show compensations for different takings moving from $11,500 to $200,000, and from $11,000 to $5,000,000. Clearly, these disparities indicate that, at a minimum, the fair market value is simply not a good indicator of actual market value.

TREATISES OF GOVERNMENT (1690) (this is a leading treatise that was instrumental in shaping American property rights).

25. Burney, supra note 20, at 802.


27. Id.

28. When a jury is evaluating the compensation question, the model jury instruction in federal courts is that the jury should consider the following: Ordinarily just compensation for property taken is arrived at determining the ‘fair market value.’ However, fair market value is not the sole measure of just compensation in eminent domain proceedings. ‘Fair market value’ is the price at which a willing buyer and a willing seller will trade, both having a reasonable knowledge of the facts. 3A Fed. Jury Prac. & Inst. Ch. 154 7(a) (5th ed.) (internal citations omitted). Thus, the jury is considering the same question as the government appraisers.


32. This does not mean that there is no place for fair market value as an indicator of value; rather, this article posits the theory that, at least, it is not a very good indicator of actual value as...
An additional piece of evidence that the system of compensation is inadequate is the sheer number of cases and complaints concerning compensation in eminent domain actions. Common sense tells us that almost every individual who is subject to condemnation and subsequently loses his or her land is upset. Why is this the case? Maybe the explanation for these ill feelings is derived from the idea that Americans traditionally feel that their land belongs to them; the taking of their land is diametrically opposed to this perceived property right. However, most landowners who complain about losing their property complain, not because their property rights have been violated, but rather because the level of compensation the landowners receive is perceived to be unjust.

The Utah Ombudsman office of the Department of Natural Resources releases an annual report tracking the number of calls it received concerning questions and complaints. The office is open to the public to answer questions concerning “any issue involving local land use and other controls placed on private property by state or local government agencies.” In 2003, out of a total 190 calls concerning takings, the office fielded 137 calls where landowners were primarily concerned about the amount of compensation awarded. Economic theory postulates that most individuals are neutral to the idea of their property being taken if they are compensated justly. The reasoning for this is that the landowner who is justly compensated feels that he is no

---

33. See infra note 36.
34. For an interesting example of this pervasive view in America, see Gary Andrew Poole, Hold it! This Land is My Land!; Led by Commissioner Dick Carver, Nevada’s Nye County is Now Ground Zero in the West’s War against the U.S. Government, LOS ANGELES TIMES, Dec. 3, 1995 at 28.
35. See infra note 36.
37. CRAIG M. CALL, OMBUDSMAN’S REPORT ON PRIVATE PROPERTY (2003). The figure of 137 calls is achieved by adding up the calls concerning the "settlement of the amount of just compensation due in an eminent domain action" (130 calls) and the calls concerning "relocation of families or businesses displaced by eminent domain" (seven calls). Relocation is a form of compensation and therefore, it is included under questions concerning compensation. The total number of compensation questions includes the previous two categories added to “General questions about the law of eminent domain” (34 calls), “General questions about “takings law” (eleven calls), and “General questions about eminent domain procedure” (eight calls).
38. SHARON OSTER, MODERN COMPETITIVE ANALYSIS, UNDERSTANDING THE IMPEDIMENTS TO ENTRY, 51-83, (Oxford Univ. Press 1994) (indicating that a risk-neutral profit maximizing firm should base its decision to enter a market based on the net present value of expected profit). However, this analysis leads to a second problem: most homeowners are not risk-neutral. Risk-averse landowners should base their decision to enter a market based on even higher discount rates than risk-neutral firms use to base their decisions to enter a market.
worse off after the taking than he was before the taking. However, the reality is that most landowners do not feel that they are as well off after the taking as before; and so they complain and litigate.

Any one of these factors alone sufficiently demonstrates the inadequacy of the fair market value system. However, these factors together unequivocally demonstrate that landowners do not perceive the just compensation scheme to be just at all.

B. Efficiency

In addition to the problem of inadequate compensation awarded in a taking, the government does not internalize all of the costs associated with the takings because the government systematically undercompenses the landowners for their loss. This leads to inefficient takings. The evidence that supports this contention is similar to the evidence that supports the notion that the fair market value fails the first criteria. In reality, this second criteria is a corollary of the first. Governments do not internalize the true costs associated with the taking because they do not pay the true costs. Along with the factors discussed above, demoralization costs are important in understanding how the fair market value fails to promote efficiency. When the government does not fully compensate landowners for the value of their property, government officials suffer under the fiscal illusion that the resources taken have no opportunity costs; this leads to these officials engaging in excessive takings. A taking is excessive when the true economic benefits do not exceed the true economic costs.

Landowners can be emotional, sometimes even irrational, when it comes to their property. This leads to landowners valuing property at well above its “market value.” According to the fair market value standard, governments are required to pay 100 percent of the appraised

39. Id.
40. See supra note 37.
41. By “internalize” I mean realize and be forced to deal with. Although a government may say that it considers the total costs associated with a taking, unless and until the government is forced to pay the true costs associated with the taking, the government does not internalize these costs.
42. See supra notes 20–37 and accompanying text. See also Thomas W. Merrill, Incomplete Compensation for Takings, 11 N.Y.U. ENVTL. L.J. 110, 131 (2002).
43. See supra note 24.
45. See Heller, supra note 44.
“market value” for the property they take. Ideally, the fair market value system allows governments to take property that they value at its market value and use it in a way whereby the property would be valued at greater than its current market value. However, the flipside to this argument is that governments may also take property from individuals who value the property at well above the market rate (say 150 percent of the appraised market rate) and use it for a less valuable purpose (say 110 percent of the appraised market rate).

Clearly, using property for a less valuable purpose after a taking than it was being used for before is an inefficient exercise of the Takings Clause. In addition, it leads to demoralization costs for the landowner. Demoralization costs are “the total of: (1) the dollar value necessary to offset disutilities which accrue to losers and their sympathizers specifically from the realization that [inadequate] compensation is offered, and (2) the present capitalized dollar value of lost future production caused by demoralization of uncompensated losers, their sympathizers, and other observers disturbed by the thought that they themselves may be subjected to similar treatment on some other occasion.” When property is taken and used for a less valuable purpose, it makes sense that the landowners’ disutilities are increased because of the increased frustration associated with losing property when the property will not even be a net benefit to society.

The following two examples of recent takings actions demonstrate the disutility associated with inefficient or perceived inefficient takings. First, consider the case of Joanne and Jim Saleet who have owned their home for thirty-eight years and refuse to sell to the city of Lakewood, Ohio. When Jim and Joanne were dating, Jim would point to the neighborhood in which he and his wife now live and say, “Joanne, one of these days we are going to have one of these houses.” The Saleets do not want to sell their home – even at the fair market value – because they love where they live, and thus they value their home above the appraised market rate. However, under the fair market value scheme, Lakewood is not required to compensate the Saleets for the love and affection they

46. See supra note 7 and accompanying text.
47. Although one can argued that a 10 percent increase in valuation over the market value to the entire public is more significant than a 50 percent increase in value to one landowner, this position, nevertheless, demonstrates that the criteria of promoting efficient government decisions, as a corollary to making landowners whole, fail because they inadequately compensate landowners for the value of their property.
48. See Michelman, supra note 24.
feel towards their property. Clearly, the fair market value does not attribute any value to emotional attachment of property.

Second, consider a case in Worcester Massachusetts where a city wanted to raze a hundred-year old church for a bank parking expansion. How much did the landowner value the church? What about the neighboring community and all the people who could say, that is where I was blessed, baptized, or married? The church had enough support in the neighborhood that a local preservation society raised funds through private donations to relocate and renovate the church. Surely, the value of the church to those who had an emotional interest was greater than the value of the parking lot expansion; however, because Worcester did not have to consider the emotional costs associated with razing the church, the compensation for the property did not put these landowners in the same pecuniary position that they otherwise would have been in if the church had not been taken.

Besides these demoralization costs, the substantial risks of high litigation costs associated with takings makes it impossible for the government to make efficient decisions. Governments cannot know the total costs of a taking until years after the taking has occurred, after the litigation dust has settled. If a project is expected to create an economic value of $1,000,000 in present day figures, and the expected costs associated with eminent domain and development are only $750,000, the government would conclude that the benefits exceed the costs and that this is a positive use of its eminent domain power. However, in the actual scenario, a government cannot know what the expected costs associated with eminent domain and development will be before opting to go ahead with the project. Detroit obviously did not think the costs associated with

---

53. See supra note 5.
54. But see Ravi Jagannathn & Iwan Meier, *Do We Need CAPM for Capital Budgeting?*, 31 (4) FIN. MGMT., Dec. 22, 2002 at 55. This article presents the financial management tool of CAPM, whereby the efficiency of a project may be discovered by discounting the future cash inflows and comparing that value to the initial outlays. Part of the CAPM is unearthing the true costs of the inflows using probability analysis. This is accomplished by multiplying different values by the probability of that value being correct and then adding the products together. Governments should become involved in this kind of analysis to estimate the cost of the takings product by: (1) multiplying the initial offering by the probability that the offering will be accepted; (2) multiplying an estimated final settlement by the probability that the settlement will be awarded but not litigation costs; (3) multiplying the final settlement and litigation fees by the probability that both would be awarded; and (4) adding up the three figures. The final figure could then serve to evaluate the efficiency of the taking. Although this may make sense in theory, discovering the probabilities and estimations of litigation and litigation outcomes is practically impossible. Thus, the government, despite financial decision-making tools, cannot make efficient decisions.
taking property in Poletown would be $5,100,000 instead of the measly $357,000 originally offered. Sometimes governments take property and spend so much money in litigation that the funds for a project dry up.  
55 Surely this is an inefficient use of the Takings power.

C. Prevent Rent-Seeking

Finally, the current system of compensation does little to prevent rent-seeking, as defined below.  
56 Rent-seeking is a term “designed to describe the behavior in institutional settings where individual efforts to maximize value generate social waste rather than social surplus.”  
57 In the Takings context, landowners engage in rent-seeking by trying to maximize the gain that they receive from society even when the gain creates social waste; this is just another way to describe the holdout problem.  
58 Although the fair market value system prevents rent-seeking by not allowing landowners to receive more compensation than the appraised market value of their property, the fair market value system actually works to encourage rent-seeking by others.  
59 A substantial amount of literature shows that economic agents will engage in rent-seeking to influence the establishment of legal policies, including Takings and compensation.  
60 Rent-seeking must be discouraged because it diverts limited public funds to private landowners.  
61 Unfortunately, the

56. See Farber, supra note 16, at 290–94. Farber argues that prohibiting compensation but still allowing government takings would be more effective at preventing rent-seeking because the landowners whose land is taken will more likely fight inefficient takings. Thus, Farber concludes, “rent-seeking theory has a serious flaw as an account for the takings clause: it seems to present a stronger case for banning compensation than for mandating it, if we are serious about controlling rent-seeking.”
57. See James M. Buchanan, Rent Seeking and Profit Seeking, in Toward a Theory of the Rent-Seeking Society, 3, 4 (James M. Buchanan et al. eds., 1980); Merrill, supra note 16, at 65 (citing Landes & Posner, Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of the Law and Altruism, 7 J. LEGAL STUD. 83, 91 (1978)) (arguing barriers to voluntary exchange include the holdout who is in a position to extract large profits from the government because of the bargaining position that a holdout has over the government).
58. See supra note 10 and accompanying text.
59. But see Farber, supra note 16, at 294.
61. See generally Richard Epstein, supra note 16 at 166–69 (1985); William Fischel, The Offer/Ask Disparity and Just Compensation for Takings: A Constitutional Choice Perspective, 15 INT’L REV. & ECON. 187, 193 (1995) (arguing that paying landowners more than market value – defined by what a reasonable person would pay for the property, not what the seller would accept as adequate compensation to induce the sale – is wrong because this would waste public resources that otherwise could have been used for public benefit).
fair market value system does little to stave off the wasteful use of funds for two reasons: the high administrative costs and the high litigation costs associated with takings.

Administrative costs associated with takings are astronomical. One notable scholar postulates that administrative costs are so high in certain circumstances, that the open market may be more efficient than eminent domain. 62 Specifically, given what can collectively be called, “due process costs” of eminent domain (i.e., obtaining legislative authority, drafting and filing the complaint, serving process, securing a formal appraisal, etc.) “it is safe to conclude that in a thick market setting, eminent domain is a more expensive way of acquiring resources than market exchange.” 63 High administrative costs can offset any benefit that society recognizes from using eminent domain. Thus, the only real difference between traditional rent-seeking and these high administrative costs is the individual who ultimately reaps the surplus. 64 Under the current system, administrators and lawyers, rather than landowners, profit from the economic surplus that should go to society.

Besides administrative costs, litigation costs associated with takings are extremely high. Consider the experience of the Goia family in Garden Grove, California, who paid $778,000 for a parcel of land in 1990 and added $100,000 to the land so they could open a small auto-repair shop. 65 Seven years later, the City Council condemned the Goia’s land, and the market value was set at only $640,000. 66 The Goias sued, claiming the compensation award was not just, and a jury awarded them $1,070,000. 67 Additionally, after three years of litigation, another jury

---


63. Plinsky, supra note 63, at 1. A “thin” market is a market in which rent-seeking opportunities can occur by the seller. For instance, the market may be “thin” in our situation where the government has purchased a row of nineteen houses and has built the road up to the twentieth house. The twentieth homeowner knows that the government needs his property and has already invested a large sum of money to purchase and develop the first nineteen lots. Thus, the twentieth homeowner stands in a position to take advantage of the government and extract high costs to sell his land. In theory, the government would be willing to pay up to the point where the public benefits are being paid entirely to the twentieth landowner instead of going to the public. In contrast, a market is “thick” where market conditions do not allow the seller to extract economic rents. See also Saul Levmore, Explaining Restitution, 71 VA. L. REV. 65, 79–81 (1985), for another example of the use of thick and thin markets.

64. Rent-seeking distributes funds to sellers. Administrative costs distribute the same funds to assessors, planners, and attorneys for both sides of the case.


66. Id.

67. Id.
awarded the Goias $620,000 for their attorney fees; an amount almost as high as the originally offered compensation. Like administrative fees, high litigation costs reallocate limited public resources from society to others. These costs have the same effect as overpaying opportunistic landowners; however, instead of opportunistic landowners stealing the surplus from society, attorneys and litigants get it instead.

Although the fair market value system does a good job of preventing rent-seeking by landowners, the system is so deficient that it actually encourages rent-seeking by others. This list includes the number of administrators, attorneys, and litigants.

IV. THE SELLER’S PARADOX

As stated, courts use the fair market value of the condemned land almost exclusively to determine what level of compensation is just. Fair market value is defined as the price that a willing buyer would pay a willing seller in the open market. When a government flexes its eminent domain muscle, society knows who the willing buyer is – the government. But who is the willing seller? A willing seller is a seller who is willing to sell at market value. This definition, however, does not make sense in the Takings context because of the circular nature of the definition of a willing seller.

By substituting the definition of fair market value (ignoring the willing buyer) into the definition of willing seller, the willing seller is

68. Id.

69. See supra note 7. However, the courts said that they are at least open to the idea of using income capitalization and/or reproduction or replacement cost, less depreciation, to determine market value. See Montague, supra note 20, at 12-29 (citing AMERICAN INST. OF REAL ESTATE APPRAISERS, THE APPRAISAL OF REAL PROPERTY (6th ed. 1974)).


71. The term “willing seller” is not actually defined anywhere. The definition used in this article comes from logical extrapolation of the definition of market value from BLACK’S LAW DICTIONARY 1548 (7th ed. 1999).

Fair Market Value – The price that a seller is willing to accept and a buyer is willing to pay on the open market and in an arm’s-length transaction; the point at which supply and demand intersect.

In essence, the definition of market value is the price that a willing seller would accept. Therefore, I conclude that a willing seller is a seller who is willing to accept the market value. Some state courts, have defined “willing seller” to mean, “a seller who is willing to sell but who is not compelled.” Bowers v. Fulton County, 146 S.E.2d 884, 893 (Ga. 1966). However, this is the essentially the same as saying “the seller who is neutral to the idea of selling because they are no worse- (or better-) off after the sale than they were before the sale and are therefore willing to sell, but not compelled.” See supra note 5.
defined as the seller who is willing to sell at a price at which the seller is willing to sell. Confused yet? It is no wonder that courts have compared just compensation analysis to a Serbonian bog! This is confusing precisely because fair market value, by definition, assumes a willing seller; but a willing seller, by definition, assumes a fair market value.

The definition of willing seller is borrowed from general economics. However, as we just saw, the definitions are circular and confusing when applied to the housing market. The housing market is not a traditional market. In a traditional market, the goods are fungible and easily obtained. In the land market, however, the goods are not fungible in the least; every piece of land is unique. In a market for a fungible good, the market price is the price at which the supply and the demand curves intersect. Because substitutes are readily available, a seller would not be able to sell any product if the seller priced the product above the prevailing market rates. On the other side of the coin, however, a seller could sell 100 percent of his wares at the prevailing market price and thus has no incentive to offer his wares for below market price.

In the housing market, “fair market value” is a fiction. Every piece of land is unique, and thus a traditional market with perfect substitutes does not exist. Also, in the housing market, only one seller exists as opposed to a number of sellers with substitute goods. The only common characteristic that the land “market” shares with a traditional market is that generally a number of different buyers exist. Appraisers use this characteristic to justify their imprecise evaluations. Appraisals in housing markets focus solely on the buyer. An appraiser looks through a home and tries to guess what a buyer would offer. This analysis, however, completely ignores the willingness of the seller because the appraisal

72. See supra note 19.
73. The term “willing seller” is so confusing that some courts have held that any reference to the willingness or unwillingness of the seller to sell should not be included in jury instructions for fear that it may be prejudicial. See Bowers, 146 S.E.2d at 893; Illinois I & M. R. Co. v. Easterbrook, 71 N.E. 1116, 1118 (Ill. 1904).
74. A traditional market is a market where the goods are fungible and substitutes are readily available. The goods traded on the Chicago Board of Trade are examples of goods in a traditional market.
75. The Chicago Board of Trade is a traditional market where many substitutes exist.
76. It is precisely because every piece of land is unique that government needs eminent domain. If land were not unique, a bilateral monopoly would not exist. See supra note 9. A government does not need to use eminent domain to purchase fungible goods in a thick market. See Merrill, supra note 16, at 77-78. Whether the government should use eminent domain powers when it is such a large purchaser that the government changes the supply and demand curve for normal markets is debatable. However, it is because land is unique and the government needs that particular piece of land with no available substitute that necessitates eminent domain.
assumes that the seller will accept the highest price offered after a reasonable time.\textsuperscript{78}

With these considerations in mind, the housing market is more like an auction with a reserve price rather than a traditional market.\textsuperscript{79} Courts conveniently ignore these distinctions and approximate what the market price for the land would be, and then claim that the willing seller is the seller who would be willing to sell at the approximated value.\textsuperscript{80} This is an impermissible leap of logic that I call the seller's paradox.

The seller’s paradox arises because courts define the willingness of sellers to sell by using the fair market price, which assumes a willing seller. Using an unknown variable (fair market value) to define a second unknown variable (willing seller) does not lead us any closer to deriving the actual value of the first variable (fair market value). A seller’s willingness is a matter of degree that is affected by a multiplicity of factors.\textsuperscript{81} Most notably, a seller’s willingness is a derivative of opportunity costs and personal preferences.

“Willing” is a term of relativity, much like the term “cold.” Using the term “willing” brings us no closer to understanding how willing the seller is, just like using the term “cold” does not express what the actual temperature is. It is not difficult to imagine a range of homeowners who are “willing” to sell at different market values depending on the individual homeowner’s situation. A small group of sellers will sell property at any price because they do not need the money or want the property. Some sellers are “motivated” because they have a second home or because they have another higher need for

\textsuperscript{78} The justification that courts use for this premise is that the landowner should only be compensated for the land and not for personal preferences. However, this reasoning is flawed. The only reason land has any value is because the owner is willing to sell. Where an item has so much intrinsic value that a seller would never sell, we call it “priceless.” Only the seller can decide when the buyer’s offer adequately compensates the seller for the seller’s opportunity costs and personal preferences. Thus, although the appraisal has some value — estimating the amount of money that a buyer would be willing to pay — this is only the first step in the analysis. The unanswered question that an appraiser ignores is whether the seller would be willing to sell at the price that the buyer offers. The appraisal does not answer this question nor does it attempt to answer this question. This does not mean that the appraisal has no value, but it does not fully answer the question of where the willing seller and willing buyer would meet in an arms-length transaction. See Olson, supra note 5.

\textsuperscript{79} The reserve price would be the lowest price that the landowner would accept.

\textsuperscript{80} ALAN T. ACKERMAN, Effective Use of Real Estate Appraisers, in CURRENT CONDEMNATION LAW (Paul V. O’Leary ed., American Bar Association 1994).

\textsuperscript{81} See Barbra White, Coase and the Courts: Economics for the Common Man, 72 IOWA L. REV. 577, 610–11 (1987) (arguing that “willingness” to purchase a good is determined by desire and the wealth of the buyer so that “the marketplace . . . is not a value-free indicator and should be used with extreme caution.”). This same argument applies equally well to the willingness of a seller to sell, as will be presented, and indicates that market value should be used with extreme caution even in the absence of a true willing buyer. See also Ackert et al., Emotion and Financial Markets: Human Decisions Affect Economy, 88 (2) ECON. REV. (ATLANTA, GEORGIA), Apr. 1, 2003, at 33 (arguing that “unemotional logic” in financial decision-making is misplaced).
money. Some sellers are neutral to the idea of selling their home and will hold out until they are offered a price that is “fair” – i.e., a price that leaves them no worse off. Other sellers are reluctant to sell because they have emotional ties to their property or they are concerned with finding adequate substitute property; but ultimately these sellers can still be bought off at a price higher than neutral sellers. Finally, some sellers will refuse to sell their property regardless of how unreasonable their refusals seem to be. Obviously, “willing” is not a well-defined term, and as such, it is improper to use a term that is not well defined in the first place to define a different term in the second place.

Which of these five options accurately describes the willing seller in an eminent domain action? If we were dealing with fungible goods, it would be the neutral seller because every player in the transaction knows the market price and can therefore know what the fair price is. Thus, with fungible goods we can derive exactly how willing the sellers are because we start with a firmly defined fair market price. However, when we are dealing with a unique good, like land, we do not have a fair market value to start with; and hence, we cannot say how willing the willing seller should be.  

The seller’s paradox is not unresolvable, however. It may be resolved in one of two ways: either we must accurately assess the fair price of a piece of property and then derive the willing seller – like as in fungible markets – or we must define who the willing seller is and then derive the fair price. Scholars who address the compensation question do so by first trying to better define the fair market value in a way that will better satisfy the three criteria discussed in Part II and thereby implicitly derive who the willing seller is.  However, the alternative approach of first defining the willing seller and using that definition to derive the fair market value more accurately, as demonstrated below.

V. **THE WILLINGNESS MODELS**

The willingness model attempts to define exactly how willing the seller is to sell before the land is taken, and then to use that precise

---

82. This does not mean that appraised land values are useless. Obviously there is some need to have land appraised. However, in the context of eminent domain, land appraisals generally are useless. Courts do not want to pay “too much” for land so they make the seller and the buyer faceless entities. Still, property only has value because someone is willing to sell at a price (otherwise it is called priceless). Rational sellers are only willing to sell to the extent that they are compensated for their opportunity costs and personal preferences. As applied to eminent domain actions, it makes no sense to try to estimate what an average buyer would be willing to offer and impose that average buyer standard on a seller when the housing market is so difficult to appropriately estimate. This is the only area of law where the injured victim is consciously ignored.

83. See supra notes 20, 24, and 57–62.
definition of willingness to determine the fair market value of the land. Two methods exist to determine the willingness of sellers of land: the macro approach and the micro approach.

A. The Macro Approach

The macro approach is based on statistical measurements. The fair market value fails to justly compensate landowners because the willing seller is not defined, and the willing seller is a central assumption in assessing fair market value. However, if the housing market were a perfectly normalized market and just as many sellers were willing to sell below market price as above, then paying the mean price would adequately compensate landowners on the whole. This result is likely because on a normalized bell curve, the number of sellers who would be willing to sell for less than market value would actually be paid more, and the number of sellers who would only be willing to sell for more than the fair market value would actually be paid less. These two groups would be properly averaged and overall the landowners would be put in substantially the same position pecuniarily as they would have been if the government had not taken their property.

The key to the macro approach is to be able to normalize the sellers’ willingness. To normalize this curve, first, enough data would have to be gathered to determine the willingness of sellers to sell their property. Second, the data would have to be organized in some meaningful way, dependant on the factors that sellers consider when they determine their level of willingness. Third, the data would have to be normalized in a perfect bell curve. Finally, using the normalized bell curve, the mean could be used as a multiplier of the fair market value.

For example, if it is discovered through data farming that the average homeowner in a community who has lived in her home for four years and has 50 percent of her wealth invested in the home would be neutral to the idea of selling her home at 1.2 times the estimated market

---

84. For instance, the length of time that landowners have resided at their home will affect their attachment to the land and ultimately affects their willingness to sell. Other factors may include the percentage of a landowner’s total wealth that the land represents, the landowner’s sex, and the amount of sweat equity that the landowner has invested in the property.

85. A bell curve is normalized by finding how far from the mean an individual is by counting standard deviations. In the macro approach, the mean would be some measure of neutral willingness, and then the number of standard deviations from that willingness would determine the breadth of the curve.

86. To see an example of a hypothetical, non-normalized curve of the willingness to sell in relation to the assessed price using current assessment measurements, see graph 1 in appendix A. Although this graph is just a hypothetical estimation and is not based on any data, it is likely a reasonable estimation.
value, then the 1.2 figure can work as a multiplier for all homeowners similarly situated. Surely, some homeowners in this category would be willing to sell for only 1.1 times the estimated market value and others would only be willing to sell for 1.3 times the estimated market value. However, on average, these similarly situated landowners would be fairly compensated. The nicety of this approach is that it first defines how willing a seller is to sell, and then uses that figure to define the market value that would make the seller whole.

One difficulty of this approach, however, is the moral hazard of data farming. Data farming would assess the willingness of the public through surveys or other techniques. No matter what technique the government employs to data farm, ultimately, the landowners – or at least a statistically significant sample of landowners – must give the information about their willingness to sell. The landowners participating in the surveys have a strong incentive to vastly underestimate their willingness to sell, but they have no incentive to overestimate their willingness to sell. Practically, unless data farming is done carefully, the holdout problem that the fair market valuation scheme attempts to avoid would occur earlier in the process – before the taking instead of after.

Another difficulty with the macro approach is determining how the multiplier should change depending on multiple owners of a single piece of property. For instance, suppose three recorded owners for a piece of property exist: a cosigner who has never lived on the property; a husband who has lived in the house for ten years and has invested sweat equity into making the house just as he likes it; and a wife who has lived in the house for two years, but who hates it. Should the macro approach advocate choosing one of the three landowners or some kind of fictional person where the three individuals are multiplied together? This is a difficult question, but must be answered if the macro approach is serious about determining the landowner’s willingness to sell.

B. The Micro Approach and the Self-Assessment Model

The micro approach is based on determining each landowner’s individual willingness to sell and then using that figure to determine the appropriate market value. One way to do this is through self-assessment. A self-assessment mechanism can be used in conjunction with the tax-based insurance model to determine the willingness of individual sellers.

Under the self-assessment model, first landowners would receive a property value assessment. In many states, property taxes are already determined through an annual assessment. The value of the assessment represents the value that the landowner initially paid for the property
adjusted for appreciation. If the property owners could increase this valuation, it would then reflect their willingness to sell. They would return the increased assessment to the government, and pay taxes on their valuation of the property. If their land is taken within a predetermined period of time,\textsuperscript{87} landowners would receive a discounted amount of their self-assessed valuation.\textsuperscript{88} If their land is taken after the introductory period, landowners would receive the full amount of their self-assessed value.

For example, assume a government determines that five years is a sufficient introductory period for the self-assessment model to effectively deter rent-seeking.\textsuperscript{89} A landowner buys a home in year one for $100,000. The landowner receives a property tax assessment in year one that assesses the value of his home at $100,000. However, this landowner feels that he got a good deal on the property and values his property at ten percent more than his initial price; he thus returns the assessment saying, “I value my land at $110,000.”\textsuperscript{90} Thus, the property owner would pay taxes on his self-assessed valuation or $110,000; and if the property owner pays 30 percent taxes, he would pay $3,300 in taxes the first year. In year two, the landowner would receive a property value assessment of $110,000 ($100,000 adjusted for the 10 percent increase) plus any appreciation. If the landowner feels that this is correct, he would pay taxes on this assessment. If the landowner now feels that 10 percent is

\textsuperscript{87} The initial period must be long enough so that the landowner cannot anticipate the government’s actions and take advantage of the information by adjusting their valuation. This satisfies one of the problems addressed by Daniel Farber in his article *Public Choice and Just Compensation*, 9 CONST. COMMENT. 279, 284 (1992) (arguing that adverse selection of privatized insurance could be limited by requiring private insurance coverage to be purchased well in advance of the taking).

\textsuperscript{88} The amount of compensation would be 100 percent of the initial property valuation assessment, adjusted for each year with an increase toward 100 percent of their self-assessed value. See Appendix A, illustrating this increase.

\textsuperscript{89} Because individuals would be required to pay taxes under the higher self-assessed model, taxpayers have an incentive not to overvalue their property. However, information is clearly the key to this system. This system works to avoid rent-seeking by forcing the landowner to value the property at a period of time before any information about the potential taking could leak to the general public. Otherwise, the landowner would be in a position to engage in rent-seeking. See Farber, supra note 16.

\textsuperscript{90} Practically, the landowner would not value the land at 10 percent over the market value and then adjust the property assessment by that amount. Rational landowners would consider the probability that their land is taken and multiply this by the desired percentage increase. This amount would work as a multiplier for the property assessment value. For instance, if a landowner values the land at 10 percent above the valuation, and the property owner thinks there is a 2 percent chance that his property would be taken, the rational landowner would increase the amount of property valuation assessment by 0.2 percent. Therefore, if his property were valued at $100,000, the landowner would increase the assessment to $100,200 ($100,000 * 1.002).

Note also that takings are often considered low-probability events. Kaplow, supra note 44, at 602. Arguably, a number of landowners would think that their property was “safe” from takings and not self-assess for a greater value.
too low, he can up the valuation again. This process would continue until the landowner transferred the property, in which case the scenario would start over. If the government takes the land and the landowner has paid the higher rate consistently for the five-year period, then the landowner would get the full amount of the assessment. If the land were taken within the five-year period, then the landowner would get the initial valuation plus a portion of the increase depending on the statutory valuation.\footnote{See Table 1 in Appendix A for an example of a valuation chart.}

The self-assessment model avoids the multiple-landowner problem left unresolved by the macro approach. In the self-assessment model, the multiple landowners (not the government) have the burden of coming together to determine how much they value their property.

VI. THE PROS AND CONS OF THE WILLINGNESS MODELS

The specific approaches of the willingness models have been invented to resolve the seller’s paradox. This section will discuss some of the strengths and perceived weaknesses of the willingness models.

The willingness models satisfy the three criteria enumerated in section III of this paper better than the fair market value system.\footnote{See supra notes 14–68 and accompanying text.} First, the willingness models would more justly compensate the landowners for the value of their property. As previously discussed, the land market is not a traditional market;\footnote{See supra notes 74–77 and accompanying text.} instead, it is more like an auction with a reserve price. In an auction market, the highest bidder is the winner, not the average bidder. Because land is truly unique, landowners are in the advantageous position to hold out until the bidder meets their reserve price. Using a general market schematic to replicate the housing market is simply inappropriate as it completely distorts this auction process. The self-assessment model, on the other hand, replicates an auction model by allowing landowners to self-declare at what price they would be willing to sell; much like the sellers at an auction setting their reserve price. Because the willingness models compensate individuals based on their willingness to sell, landowners are brought much closer to the pecuniary position that they would have occupied if their land had not been taken than if they were compensated under the fair market value system.

Second, the willingness models will lead to more efficient decisions by governments than the current market value system.\footnote{See supra note 42–55 and accompanying text.} The willingness models better reflect the true cost of the land by reflecting the value of

---

91. See Table 1 in Appendix A for an example of a valuation chart.
92. See supra notes 14–68 and accompanying text.
93. See supra notes 74–77 and accompanying text.
94. See supra note 42–55 and accompanying text.
the land to the landowner. Under the willingness models, the government internalizes the cost of the land to landowners, because the government has to pay for the cost of the land to landowners. Additionally, under the self-assessment model specifically, litigation costs are lower and the possibility that landowners would receive large payouts for the value of their land from a sympathetic jury is greatly reduced. The landowner of course is free to litigate the amount of compensation he received for his land, but under the self-assessment model it is considerably more difficult for a landowner to go to court and argue that the amount of compensation should be greater than the amount the landowner received because the landowner has already declared what he feels is just. Because governments are forced to internalize the costs at the outset of a project, governments will be able to accurately determine the cost of the taking. Governments could then weigh those costs against the projected benefits to society. Where the benefits outweigh the true costs, governments can go ahead with the taking with a high level of confidence that their decisions are truly efficient.

Third, the willingness models would lower the probability of rent-seekers. Although the amount paid to landowners for their property would likely be higher when the land is taken, the net amount of the self-assessment model would likely be much lower. First, as demonstrated above, the self-assessment model would limit litigation costs. Also, the self-assessment model would limit administrative costs associated with takings. Using the self-assessment model, landowners have a strong incentive to ensure that the property tax assessment accurately reflect the value of the land to the landowners. Governments could rely on the property appraisals and thus would not have to waste a significant amount of resources on administrative costs.

Finally, although it may cost more to compensate landowners, more money will be available because landowners will pay more in property taxes. The underlying purpose of preventing rent-seeking is to reserve the maximum amount of money possible to use for the public good. The self-assessment model works to serve the needs of the public better than the fair market value model by saving money on administrative and litigation costs and raising more money to serve public needs. The net

95. See supra notes 42 and 44
96. This assumes that landowners values their land as reasonable landowners would value the land. The only wiggle-room that would exist for the landowner would be for valuation that a reasonable landowner would not reasonably anticipate. For instance, if a landowner owns land that sits atop a large oil reserve, the landowner could litigate the valuation of the land that did not include the value of the oil where the reasonable landowner would not know about the oil.
97. See supra notes 56–68 and accompanying text.
98. See Fischel, supra note 61, at 193.
effect will be an increase in funds to serve the public. Thus, the purpose of preventing rent-seeking would be adequately served by the self-assessment model despite paying additional funds to property owners.

The self-assessment model proposed here is not really a novel approach. Although the majority of jurisdictions do not allow tax assessments to be used as evidence for compensation purposes in an eminent domain action,\(^99\) the idea has been considered in some.\(^100\)

The biggest concern associated with the willingness model, and specifically the self-assessment model, is that the assessment is effectively a tax on the poor. The best analysis for whether this is the case emerges from a consideration of vertical equity.

Vertical equity is the idea that taxpayers who have lower incomes should pay less in income than taxpayers who have higher incomes.\(^101\) Some persons may argue that eminent domain actions generally go through poorer neighborhoods more often than through rich neighborhoods, and therefore poorer individuals have a greater incentive to value their lands at higher rates than rich individuals, in violation of vertical equity.\(^102\) However, this may not necessarily be the case.

It is true that eminent domain actions do affect poorer neighborhoods significantly more often than rich neighborhoods. It would appear, therefore, that poor individuals have a greater incentive to value their lands at higher rates than rich individuals, in violation of vertical equity. Even if this is true, however, the self-assessment model may change this trend. Eminent domain may go through poor neighborhoods for a number of reasons, but one large consideration is that poorer neighborhoods are cheaper to take. However, if the residents in the poor neighborhoods begin to value their lands at higher amounts, it will not necessarily be “cheaper” for a government to go through the poorer areas. This is particularly true in light of the argument that poor individuals are more risk-averse and therefore will value their property at


\(^100\) See generally F & M Brewing Co. v. Lehigh County Bd. of Appeals, 530 Pa. 451, 456-459 (1992) (discussing the difference of value-in-use, a variation of the self-assessment model, and fair market value as applicable to tax assessments and eminent domain actions). See also Heindel v. Town of Grafton, 140 Vt. 147, 149 (1981). Heindel discusses the rule that if the landowner wants to lower the property assessment, the landowner bears the burden of proving that the government’s assessment is higher than the fair market value. Theoretically, the government could later condemn the land and use the landowner’s own arguments against the landowner to justify paying a lower price for the land.


\(^102\) Joseph J. Lazzarotti, Public Use or Public Abuse, 68 UMKC L. REV. 49, 69 n. 163 (1999).
higher amounts than rich individuals.\textsuperscript{103} As the poor value their land at higher amounts, the government’s incentive to condemn the poorer property decreases. But as governments take more from the affluent landowners, affluent landowners will have greater incentives to pay additional taxes to protect their property. Thus, all parties will eventually self-assess their land. The fact that eminent domain currently affects poorer neighborhoods more often than richer neighborhoods is not necessarily indicative of what the trend will be like in the future. Therefore, it is not clear that the self-assessment model violates vertical equity or would be simply a poor person tax.

\textbf{VII. CONCLUSION}

If we are serious about putting landowners in the same pecuniary position as they would have occupied had their property not been taken, the seller’s paradox must be resolved. This paper presents two possible solutions to resolve the seller’s paradox, but surely additional (and possibly better) solutions exist. The seller’s paradox is not a justification to overcompensate landowners at the expense of the public good. Rather, the seller’s paradox is an attempt to compensate landowners to the extent that they are made \textit{neutral} to the taking.

Whether the self-assessment micro approach or the macro approach to resolving the seller’s paradox actually works remains uncertain. However, until legislatures and courts stop ignoring the logical inconsistencies of the fair market value system by overlooking the willingness of a seller to sell, those who stand in the way of the public need will continue to be systematically undercompensated for the value of their property.

\textit{Nathan Burdsal*}

\textsuperscript{103} See Farber, \textit{supra} note 16.

* JD candidate, 2006. With special thanks to Professor John Fee for his mentorship, and with loving gratitude to Lisa Burdsal for her patience and support.
APPENDIX A

Table 1

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent of self-assessed value to be paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 0</td>
<td>0 %</td>
</tr>
<tr>
<td>Year 1</td>
<td>15%</td>
</tr>
<tr>
<td>Year 2</td>
<td>35%</td>
</tr>
<tr>
<td>Year 3</td>
<td>55%</td>
</tr>
<tr>
<td>Year 4</td>
<td>80%</td>
</tr>
<tr>
<td>Year 5</td>
<td>100%</td>
</tr>
</tbody>
</table>

Graph 1

Price, expressed as a percentage of current assessed fair market value

NOTE TO GRAPH 1—This graph is just a hypothetical estimation and is not based on any farmed data. However, common sense says that the number of landowners who are willing to sell at or above the market rate will take a form similar to what is presented here. Please note that the percentage is the lowest price that the willing seller would have accepted. Again, the goal is to make the seller whole, meaning make the seller neutral to the forced sell because he is no worse or better off than before. Any rent-seeking individual would accept a price at or above their willingness level.