

A CASE OF FLOODWAY ROBBERY

Bargaining for Relocatable Easements in Flood Channels

"Land, n. A part of the earth's surface, considered as property. The theory that land is property subject to private ownership and control is the foundation of modern society and is eminently worthy of the superstructure. Carried to its logical conclusion, it means that some have the right to prevent others from living; for the right to own implies the right to exclusively occupy; and in fact laws of trespass are enacted wherever the property (or easement) in land is recognized. It follows that if the whole area of terra firma is owned by A, B and C, there will be no place for D, E and F to be born, or, born as trespassers, to exist." (Ambrose Bierce, The Devil's Dictionary: Unabridged, 1993: 68).

Does the charge assessed for water, sewer, or natural gas utility crossing easements in improved flood channels in urban areas amount to "floodway robbery" in comparison with the term "highway robbery?" Should a municipal water or sewer district or natural gas utility be able to get a free ride by co-locating its underground pipelines in the underutilized portions of an improved flood channel with only a nominal charge? Or should flood districts be able to obtain a "hold-out" price based on a percentage of the land value "across the fence" from the flood right of way for the avoided higher cost to place underground utilities in adjacent private property? It is difficult to answer these questions because a flood control channel is a unique type of right of way.

As will be shown, the correct answer to this controversy is that a percentage of Across-the-Fence (ATF) value or Corridor Value is never an appropriate

basis for monetary compensation for the granting of subordinate or relocatable easements in flood right of ways. But because land within flood ways has a relatively low market value, the compensation for a subordinate easement in a flood channel will likely be insufficient to cover the burden of relocation of underground utility lines by the flood agency. Relocatable easements, where the holder of the easement agrees to relocate its utility lines at the request of the property owner, present an even greater valuation problem. Easements that are subordinate and relocatable do not impact the underlying market value of the land at all. Such easements must be bargained for.

The only economic basis for relocatable easements is to bargain based on the cost savings that routing utility lines through the flood channel offers (i.e., Alternate Route Method).

Power line
right of way
substitues for
ATF Value



Flood channel
does not
substitute
for AFT Value



Lateral gas line
easement crossing
improved flood
channel



Utilities co-located in
road easements over
flood channels are
allowed without
compensation under
the highway act



WHOSE SUBSTITUTION PREVAILS?

The central issue in this controversy is the market Principle of Substitution. The Principle of Substitution is defined as:

*"A valuation principle that states that a prudent purchaser would pay no more for real property than the cost of acquiring an equally desirable substitute on the open market. The Principle of Substitution presumes that the purchaser will consider the alternatives available to him or her that he or she will act rationally or prudently on the basis of his information about those alternatives and that time is not a significant factor. Substitution may assume the form of the purchaser of an existing property, with the same utility."*¹

Whose substitution prevails in the situation of a utility easement in a flood channel right of way? Is it the substitution of the public utility buyers who would otherwise have to assemble their own utility corridor? Or is it the substitution of the seller whose property is impacted by an easement? To complicate the issue, how do you value a fractional property

floodway is typically designated as non-buildable. The area between the watercourse and the embankment is considered buildable at low densities but only if the building pad is raised above the flood elevation. Across-the-Fence (ATF) land is generally defined as land adjacent to an improved concrete lined flood channel in an urban area that may have been removed from the flood plain and has been legally zoned for development at urban densities.

By necessity a flood channel must follow a natural watercourse. The undeniable fact is that flood ways are immovable and non-replaceable. Other types of transportation corridors do not necessarily have to follow natural terrain, as does a flood channel.

Many different types of land can substitute for use as a railroad, freeway, highway, pipeline, or power line right of way. Of course, there are some exceptions such as land with unstable soils that is unsuitable for location of lifeline utility pipelines. But even some of these natural barriers can be surmounted by tunneling (i.e., pipelines and roads), by spanning utilities over mountains (i.e., electric transmission towers), or by resilient engineering design and hardening.

The issue of substitution of use arises in built-out urban areas where there typically is little if any land available for location of underground utility lines. But the legal definition of Market Value excludes the buyer's necessity to acquire easements in an existing utility right of way in lieu of having to acquire substitute land "across the fence." The fact that a public utility may be forced to acquire easements in another right of way rather than private property typically cannot be considered for market valuation purposes.

Moreover, flood channels are usually not considered "transportation corridors." For flood channels to be considered as a "navigable servitude" they must form a continuous waterway over which commerce may be carried. Flood channels are not designed to accommodate boat or barge traffic. And only under unusual circumstances can flood channels be alternatively used as an elevated vehicular transportation corridor. If the air rights over a flood channel have been legally subdivided and sold to a third party for construction of an elevated roadway, then it may be possible to consider a portion of the flood property as a transportation corridor.³

Considering flood channels as substitute canals for conveying raw domestic water to groundwater recharge basins in urban areas is a conceivable secondary longitudinal use of a flood channel as a transportation corridor. But typically water agencies have the right to convey water through flood channels without cost because it is a natural waterway.

WHAT SELLER LOST, NOT WHAT BUYER GAINED FOR LATERAL EASEMENTS

To properly estimate the Market Value of an underground utility easement within a flood channel, it must first be understood that there is no market for easements. Because easements represent burdens placed on real estate, they can only be valued by their impact on the property's hypothetical open Market Value.

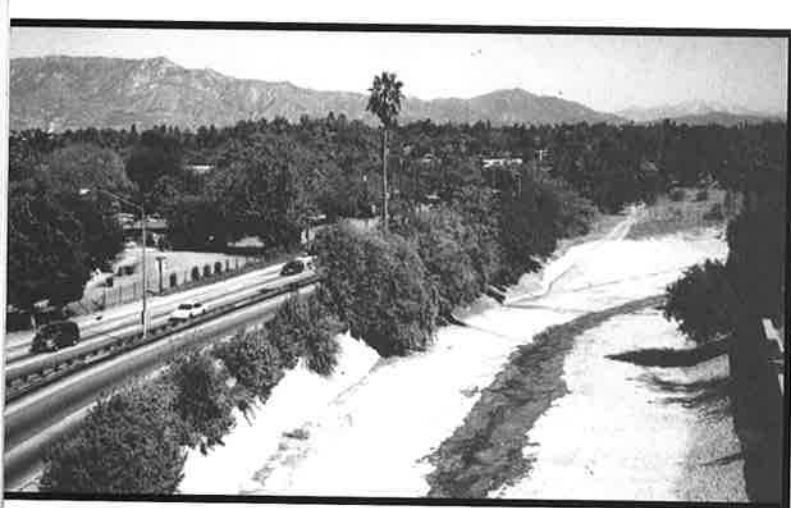
FLOODWAYS HAVE A NON-ADAPTABLE USE

There are different zones of flood land. A flood plain is the land along a natural watercourse subject to overflow and flooding and the adjacent land along the embankments. A

right such as an easement in a natural flood way that is by definition a non-replaceable type of property because floodways are immovable?

Or should a flood agency be able to recoup some of its past capital outlay for channelization of flood ways into narrow concrete hydraulic canals that takes storm water from surrounding properties and removes the adjacent properties from the flood path? In other words, can a flood agency retroactively recover a "special benefit" or "general benefit" to surrounding properties (i.e., can it be reimbursed for a "giving" rather than a "taking"?)

Nearly all of the literature on the valuation of public utility easements assumes that such easements are the dominant type where the rights of the owner of the easement are paramount over that of the underlying property owner.²



The classic statement of the legal basis of compensation for the acquisition of property or easements on property for a public purpose is by attorney Julius L. Sackman in the July 1973 issue of the *Appraisal Journal*, cited below:

"The law regards the just compensation under eminent domain from the viewpoint of the owner and not of the condemnor, i.e., compensation is what the owner has lost not what the condemnor has gained.

The owner is entitled to full indemnification for the loss sustained by him, but the fact that the particular parcel is required for the purpose of the condemnor does not, ordinarily, add to its value. In United States vs. Whitehurst, the Court said:

'Mere physical adaptability to a use does not establish a market. In ascertaining the demand, the requirements of the government for the project for which the land is taken must be excluded.'

However, in *Thompson vs. State*, the Court said:

'Perhaps we should notice in this connection that the claimant argues that the State should have constructed its dam above the island and yet below the junction of the river and canal; that such construction would be more expensive to the state and therefore, because the State has saved money by taking her property and construction of Crocker's Reef, some allowance should be made to this claimant. This claim is without merit. The question is not what has the State gained, but what the claimant has lost.'

In other words, the avoidance cost or opportunity gain that a utility company would realize by routing its subsurface facilities laterally across an existing flood channel, rather than through more expensive land "across the fence," cannot be legally considered for compensation purposes.

This is the opposite of the way that most real estate appraisers are trained to analyze the highest and best use of property. Typically, it is the buyer's use of the property that nearly always establishes its "highest and best economic use." To appraise crossing utility easements in flood channel right of ways it is essential to reverse the conventional method for determining the highest and best use.

Put differently, the legal compensation for an easement is its impact on the open market value for a property, not the price a public utility buyer would pay for the convenience or avoidance of higher costs for placing its facilities in the flood channel.

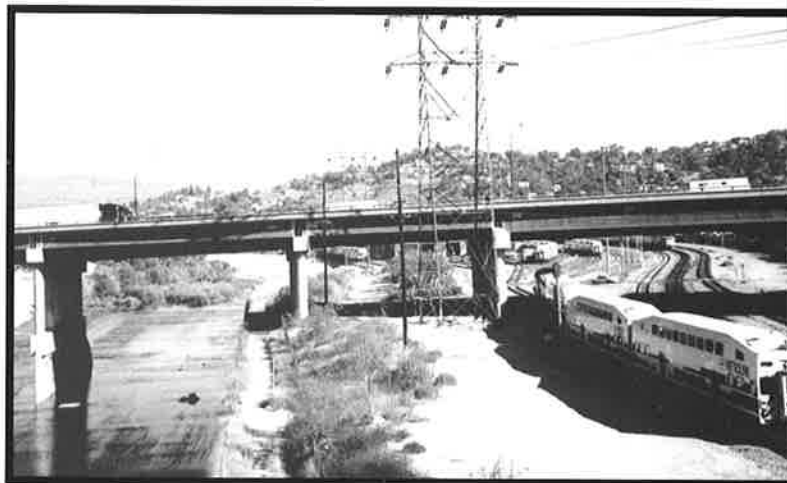
Another way of phrasing this dilemma, is that substituting the buyer's gain for the seller's loss is an example of false substitution. The general rule is that the buyer's gain from using the property cannot be considered except in the rare case where the market's use of the property is the same as the buyer's (i.e., dominant longitudinal easement in a flood channel).

But it is nearly impossible for the public entity acquiring an easement in a flood channel to obtain a dominant easement because the rights of the flood agency nearly always remain paramount in such non-exclusive easements. An exception may be where state transportation departments acquire dominant lateral easements for viaducts or elevated freeways over flood channels.

■ LINEAR EASEMENTS MAY BE VALUED BY WHAT BUYER GAINS

It is all-important when valuing easements within flood channels, or other right of ways, to distinguish between a lateral easement and a longitudinal easement. Running a subsurface utility line laterally across a flood channel does not substitute for anything in the open real estate market except river bottomland. However, routing a utility line longitudinally within an existing right of way does potentially substitute for a transportation corridor or utility corridor.

The co-location of longitudinal easements within other existing public right of ways raises what is called the "free rider" issue. Economists define a "free rider" as "a person who receives the benefit of a good but avoids paying for it."⁴ Applied to the appraisal of sub-easements in utility corridors, a "free rider" is someone who can substitute an existing right of way corridor for having to assemble their own utility corridor at much higher Across-the-Fence values.



However, for a longitudinal easement to substitute for a corridor the easement rights granted must be dominant over the fee-owner's rights. This is virtual impossibility in a flood channel because in such an event the flood agency could legally resist co-location of the easement on the basis of its incompatibility with its flood facilities. As such, longitudinal dominant easements are mostly hypothetical and of no relevance in setting compensation for non-exclusive easements in flood channels. However, the "free rider" issue would arise in the case of a dominant longitudinal easement for a light rail system parallel within an existing rail road corridor for example.

■ BUT SUBORDINATE LINEAR EASEMENTS HAVE NOMINAL-TO-MINIMAL VALUE

The exception to this is the case where a non-exclusive easement is granted to a public utility to locate its underground lines in a flood channel. Subordinate easements may be structured so that the flood control agency is burdened with the responsibility to relocate the underground utilities in its right of way in the event it needs to repair, replace, or enlarge the flood

channel. This is called a "subordinate easement" and typically impacts only the underlying value of the flood land, not ATF value. Because flood way land is relatively low valued the compensation for a subordinate easement in a flood way is often perceived as insufficient to cover the future relocation burden, so ATF value is often sought as a proxy.

RELOCATABLE EASEMENTS HAVE NO IMPACT ON MARKET VALUE

A sub-set of a subordinate easement is a "relocatable easement" or constantly renewing transient servitude where the user of the easement accepts the burden to relocate its utility lines at the request of the property owner. Relocatable easements do not impact land value, whether the land reflects corridor value, Across-the-Fence value, liquidation value, riverbottom value, or waste land value. Because relocatable easements reflect Use Value, not Market Value, the only way to value such easements is to consider the extra construction cost savings from routing the utility line through the flood channel rather than through alternative streets or private property (i.e., Alternate Route Method).

THE DEVIL IS IN THE DETAILS OF EASEMENTS

Because the price of an easement depends on the physical alignment of the easement (lateral or linear) and the terms and conditions of the easement (dominant, subordinate, or relocatable easement), the "devil is in the details" of the conveyance of easements. The table below provides a suggested decision-making framework for the rational selection of different methods for valuation of co-located utilities within flood channels.

obtain an exclusive corridor without having to pay for it. In such hypothetical situations, ATF value would be the proper measure of just compensation. However, because it is impossible for a flood control agency to grant a dominant easement without compromising the integrity and utility of their facilities or operations, this is usually purely a hypothetical possibility that is irrelevant to the issue of compensation for lateral subordinate or relocatable easements.

A lateral or longitudinal subsurface easement where the user of the easement acquires a subordinate right (Cells A-2, B-2), typically only has a nominal or minimal impact on the value of the flood channel land. Where compensation is indicated, it would reflect the diminution to the base flood land value of the channel not ATF value. However, flood agencies typically hold out for ATF value because they perceive that they will have to assume large costs in the future to relocate the subsurface facilities and that market value compensation based on flood land values will not cover these costs. In such cases, the present worth of the hard relocation costs is more indicative of the loss sustained by the flood agency than the ersatz cost of ATF land.

A lateral or longitudinal subsurface easement is where subordinate rights are conveyed and the user accepts the burden of relocation of the pipeline (Cells A-3, B-3) and there is no impact on the underlying land value whatsoever. In such situations, the only approach to valuation is the Alternate Route Method. The resulting value estimated by the Alternate Route Method will reflect Use Value rather than Market Value because the cost savings from the shorter route will be idiosyncratic to each situation. Because a relocatable easement is like a rolling or annually renewing periodic tenancy in land, it may be

RIGHTS ACQUIRED	LATERAL EASEMENT	LONGITUDINAL EASEMENT
Dominant Easement Rights	(A-1) Flood Land Value + Damages	(B-1) ATF Value = Assemblage Factor + Damages (rare)
Subordinate Easement Rights	(A-2) Nominal Value or Minimal Flood Land Value or Present Value (PV) of Hard Relocation Coasts	(B-2) Nominal Value or Minimal Flood Land Value or Present Value (PV) of Hard Relocation Coasts
Relocatable Easement	(A-3) Alternate Route Method Or PV of Avoided Hard &/or Soft Costs	(B-3) Alternate Route Method Or PV of Avoided Hard &/or Soft Costs

A lateral or longitudinal subsurface easement where the user of the easement acquires dominant, exclusive, or vested rights in a flood channel (Cells A-1, B-1), conceivably could impact the underlying land value and the existing and future use or flexibility for expansion of the flood channel. As such, it is theoretically possible that the flood district would have to acquire Across-the-Fence land to expand or replace its facilities. Moreover, the user of a dominant longitudinal easement would

possible to calculate an annual rent from the cost savings by the Alternate Route Method. Applying the risk/return principle of finance, the rent would have to reflect a low annual rate of return for the large risks of relocation assumed by the user of the easement (i.e., inflation rate or safe investment rate, say 3 to 5 percent, historically).

However, capital projects for utility lines usually have a "one-time" only allotment of funds to buy property rights and

construct facilities. Monies for annual ground rent payments are usually not a part of capital project budgets. In such situations, the present worth of the income stream over a lease term equivalent to a fee estate (say 50 years) may be estimated for the one-time payment for a relocatable easement. But this one-time payment should equal the avoided alternate route cost in today's dollars. The appropriate discount rate to the flood agency would be moderate given the reduced risk of a relocatable easement but nonetheless inconvenience and delays involved with relocating subsurface pipelines (say 6 to 10 percent).

■ DRIVING A HARD BARGAIN: "THE DEVIL MADE ME DO IT"

Because a relocatable easement does not impact market value of the underlying land in a flood channel, its valuation is often dependent on one's bargaining power. Bargaining power is defined as:

"The ability to get a large share of the possible joint benefits to be derived from any agreement. This depends on the failure to agree is likely to cause to the various parties to the negotiation. In the absence of agreement, each party has a fallback position: the less uncomfortable this is and the longer any party can afford to stay in it, the stronger their bargaining power. A party with a very uncomfortable fallback position and an urgent need for an agreement has very little bargaining power. Bargaining power is increased by unity, financial reserves and a reputation for toughness and is decreased by division, shaky finances and a reputation for being willing to compromise."

As monopoly organizations, flood districts, railroads and utility companies are accustomed to having a surplus of bargaining power in most transactions. Such monopoly type organizations are accustomed to a "take-it-or-leave-it" way of doing business. However, in the situation of a co-located easement within an existing utility corridor either side has the ability to cancel out the other. The public utility can condemn the easement and the flood district can exercise its "greater public necessity" to exclude the easement. Economists call such transactions involving two monopolies "bilateral monopoly." When two monopolies face off it is often like "two scorpions in a bottle."

Because water, sewer and gas utilities are typically "revenue rich," and flood districts are "revenue poor," flood agencies often are prone to try and value capture by exerting their bargaining power in granting easements in their right of ways. It is customary for flood agencies to inflexibly demand a percentage of Across-the-Fence value for lateral subordinate or relocatable easements within their right of ways because they sometimes erroneously believe the user of the easement is either: (1) avoiding higher costs of placing their facilities in privately-owned land; (2) burdening the flood agency with large future utility relocation costs in the event it has to repair, replace, or enlarge its facilities; or (3) "getting away with floodway robbery" by effectively acquiring a dominant property right for the price of a subordinate easement.

Because all easements are conceived to be alike, flood agencies often charge the higher ATF value as a proxy for cost

recovery of perceived future utility relocation costs or associated risks. Charging the higher ATF value is often justified by stating that this is "agency policy" (i.e., "the devil made me do it"). But ATF value may provide windfall or wipeout compensation because it has no rational relation to actual risks to either of the parties to the easement. Easements must be bargained for in situations where: (1) the compensation from a subordinate easement in a flood channel is deficient to recover future utility relocation costs; or (2) where a relocatable easement has no impact on land value and the only compensation that can be estimated is the cost savings the user of the easement derives for co-locating the easement in the flood channel rather than another longer or more expensive route.

■ STATE RULE REQUIRES COMPENSATION FOR NOMINAL EASEMENTS

A complicating factor in the valuation of co-existing easements in flood channels is that the State Rule of Just Compensation requires compensation for easements where otherwise none is indicated. The State Rule is a computation method for measuring just compensation for a public taking of property. The inductive (i.e., additive) mathematical format of the State Rule makes it impossible to estimate the amount of value diminution to land caused by easements directly from market sales data. The value of the easement under the State Rule must be subjectively estimated rather than taken from the market. The intent of the State Rule (Take + Damages Rule) is to provide compensation to property owners for acquisition of easements where the Federal Rule (Before and After Rule) indicates nominal compensation. The State Rule avoids the appearance of the taking of property rights without providing just compensation as required under the Fifth Amendment of the U.S. Constitution. This rule reflects public policy not necessarily loss to the Market Value of the affected property. But appraising easements based on a percentage of the land value in a flood channel can lead to wipeout compensation. Conversely, appraising easements based on ATF Value or Corridor Value can lead to possible windfall compensation to the flood control district.

■ RELOCATABLE EASEMENTS IN FLOOD CHANNELS MUST BE BARGAINED FOR

Real estate appraisals are limited in estimating compensation for utility easements in flood channels because of the low basis value of flood land and the possible high risk of utility relocation that may be assumed by the flood control district. The State Rule of Just Compensation requires compensation for such easements where there is otherwise no economic loss. To remedy this market deficiency situation, the ATF valuation method is erroneously relied on often resulting in windfall or wipeout compensation.

In such ambiguous situations, the flood control district usually seeks to measure the value of the easement by the Across-the-Fence Method. Conversely, the user of the easement will seek to limit the amount of value captured by the flood

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agency to nominal compensation or to no more than the construction cost savings from routing its subsurface utility lines through the flood channel rather than through alternate public streets or private property. Thus the typical staked-out bargaining positions are as shown below:

who do not know the difference between bargaining and the conventional methods for valuation of easements ("If all you have is a hammer, everything becomes a nail").

4. "A bargain is not a bargain unless you can use the product." Compensation for subordinate and relocatable easements must

ENTITY	STAKE-OUT VALUES
Public owner of existing right of way (flood control agency)	Maximum: high% of AFT Value Minimum: low % of ATF Value
Public utility seeking easement (water, sewer, gas utilities)	Maximum: cost savings from alternate route Minimum: nominal value

Bureaucratic organizations often have difficulty in fitting unstructured transactions that call for bargaining into prevailing "policies and procedures." Often the rules for acquisition of dominant easements are erroneously relied on. The use of informal "rules of thumb" or proverbial knowledge is also often relied on in such unstructured situations. Below are some rules for structuring such bargaining situations from A Dictionary of American Proverbs:

1. "It takes two to make a bargain." Avoid desperation, free wheeling, or one-sided negotiations based on "agency policies and procedures." Utilize engineering estimates of the cost savings of the alternative route as a baseline from which to initiate negotiations. Estimate the present worth of the avoided relocation costs. Once these two staked out values are known the two parties to the transaction can bargain from a position of knowledge rather than ignorance or brute power.

2. "It's a bad bargain that can't run both ways." If the user of the easement must pay all of the cost savings that are derived by routing its utilities through the flood channel, then there is no incentive for it doing so. It might as well route its subsurface utility lines through the longer alternate route at the same cost and without the "hassle factor." Therefore, it behooves both public entities bargaining for a subordinate or relocatable easement to agree on something less than 100 percent of the cost savings. This might be called the "Inducement Factor."

One shorthand arbitration formula to arrive at the amount of the inducement is to "split the difference." However, this averaging formula is usually based on ignorance as to which side to the dispute may be more correct. Because the value of a bargained subordinate or relocatable easement is an intangible asset, another way to arrive at an arbitrated figure might be to offer to pay just the "soft cost" savings, such as time delay, permit fees, avoidance of environmental impact costs, avoided business interruption compensation, bond debt service and avoidance of the "hassle factor."

3. "It takes two to make a bargain and one more to see that it is done all right." Where necessary, utilize an independent appraiser to arbitrate the price of the easement based on the staked out values shown above. Avoid appraisers and attorneys

reflect the true risk to both the public landowner and the user of the easement. Flood channels shouldn't become impassable barriers in urban areas. If utilities cannot use flood channels in a cost-effective manner to co-locate their underground utility lines, they will "bite the bullet" and choose an alternate route. Sometimes utilities can get a "free ride" by crossing flood channels at existing road crossings where the Highway Act in each state may override the jurisdiction of the flood agency (see page 7).

5. "Bargaining has neither friends nor relations." Bargaining, as opposed to negotiations, requires toughness. Avoid selecting someone as the lead bargainer who is friends with the opposing negotiator. However, remember the proverb: "where the devil can't go, he sends his grandmother."

6. "Never make a bargain with the devil on a dark day." When bargaining with the devil, or a value-capturing monopolistic public agency, for subordinate or relocatable easements, remember that you are dealing with an entity that potentially has equal or more power over the bargaining process (i.e., "tollgate position"). In such situations the best bargaining strategy is to have no fear, to continue to point out that the easement may really have only nominal to minimal market value, that ATF value has no bearing on the risks of the easement, that the value capturing may be construed as a hidden form of taxation on the public. ■

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Footnotes

¹AIREA, *Real Estate Appraisal Terminology* (Cambridge, Mass: Ballinger Publishing, 1975: 201).

²The terms dominant and subordinate are used in this paper instead of the legal terms "dominant estate" and "servient estate" respectively. Legal terminology erroneously assumes that all easements are the dominant type and that the fee estate is in the subservient position. In reality, easements can be structured as dominant, subordinate, or inconsequential to the rights of the fee estate.

³Jennifer B. McKinn, "Firm Sets Sights on River Tollway" Orange County Register (May 1, 1999: Metro Section, p.1).

⁴N. Gregory Mankiw, *Principles of Economics* (New York: The Dryden Press, 1998: 222).

⁵John Black, *A Dictionary of Economics* (Oxford University Press, 1997: 26-27).

⁶A Dictionary of American Proverbs (New York: Oxford University Press, 1992:37-38).