THE POWER of condemnation

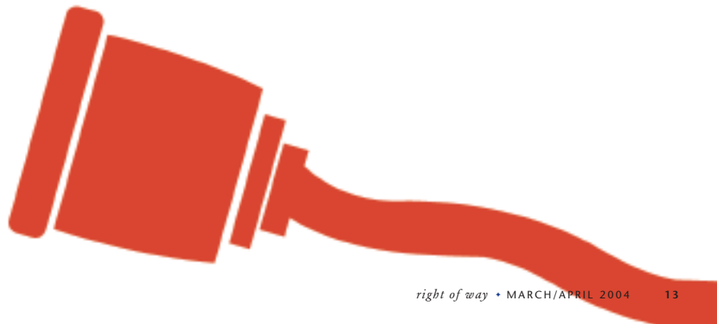
to take a public utility

BY DAVID L. REIN, JR.

As if Mayor Franklin Tate's job wasn't difficult enough, a coalition of industrial users just left his office after demanding he do something about the natural gas and water rates they pay. The not-so-veiled threat was that the failure to produce results will spur the industrial users to move jobs elsewhere.

Mayor Tate's options are limited if the utilities cannot or will not voluntarily lower rates. State regulators approve most utility rates and while the city can provide input in the rate process, the city does not control the rates. Investors would not likely support two competing utilities in a city of his size – even if the regulators would allow another to operate in the city. Finally, although the industrial users have promised to find investors to help pay for the purchase of the existing natural gas and water utilities, there is no guarantee the utilities would agree to the city's price or even agree to sell at all.

Although Mayor Tate is not real, the scenario is real. A mayor who wants to control local utilities has limited options and may feel he or she has no choice except to "municipalize" the utilities.[1]



Does Municipalization Come With Cheese? Deciphering a Word

Municipalization is a big word that is seldom overheard at the backyard barbecue, but its importance to cities, utilities, land appraisers, business valuation experts and others involved in eminent domain cannot be understated. While it has yet to find its way into a Jay Leno joke or otherwise into mainstream conversation, it is a word that cities and utilities have become more familiar with over the last few years.

Although the word has received little attention since its addition to the dictionary in 1889, it has received considerable attention these last few years. Last year alone, several cities were actively involved in trying to take over a utility's facilities. In California, the city of Concord announced it would buy or, if necessary, condemn Pacific Gas & Electric Company's street lighting system, while in Oklahoma, a city continued its four-year battle to condemn an electricity cooperative.

Condemnations last year were not limited to small utilities. Portland, Ore. threatened to condemn a utility that served 750,000 customers.

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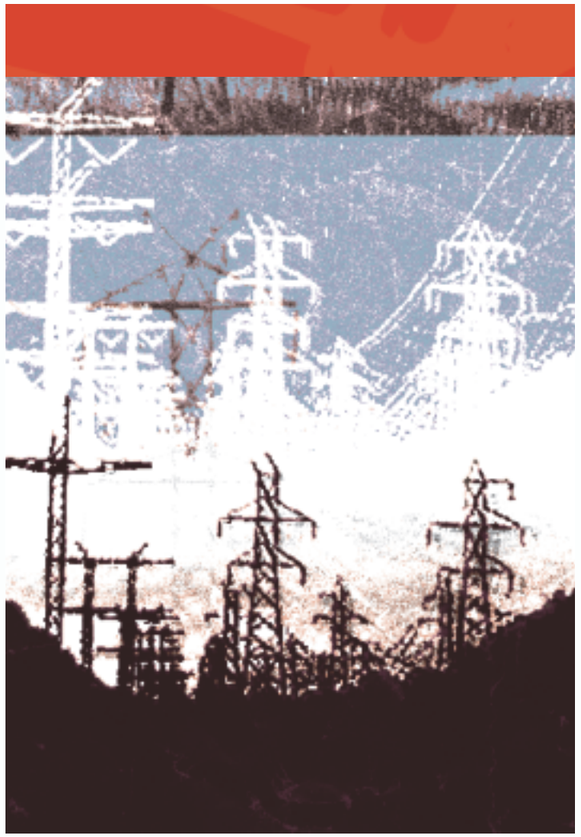
The good news is that while the word may not be familiar, it is conceptually easier to understand than the Internet, and those familiar with municipalization are not instant candidates for a Nobel Prize.

Merriam-Webster's Dictionary defines municipalize as "to bring under municipal ownership or supervision." For example, a city may decide it would do a better job providing electric, gas, streetlight and water service to its residents and businesses through city-owned utilities; then attempt to take over the utility infrastructure from private companies.



And some condemnations end up in a tug of war between municipalities, such as in Florida where a water company agreed with a city to be condemned only to have the county step in and sue both the water company and the city for control of the water company.

Regardless, the condemnations tend to be expensive. In Kentucky, the condemnation of a water company serving approximately 100,000 customers will cost both the utility company and the city more than a million dollars each in legal, public relations and expert fees. In another condemnation, a small city's legal expenses will exceed all of its other expenses combined.

The debate concerning the merits of municipalization is not new either. Some cities and other municipalities believe that by taking control of the public utility's distribution systems, the city can provide utility service at lower rates to residents and businesses in the community. Lower utility rates, the thinking goes, will help spur economic development and keep existing businesses from relocating thereby increasing tax revenue and benefits to the municipality overall. Others are skeptical that cities can operate utilities efficiently or that an expensive condemnation and purchase of a utility is the best use of scarce taxpayer revenue. Some of these critics insist that the threat of municipalization is simply used to bluff utilities into lowering their rates.

Regardless of the merits of whether a city or other municipality should take over privately run utilities, some facts of life remain true: 1) the municipality is unable to pay full value for the utility or like most buyers, the city wants to pay as little as possible; and 2) the utility does not want to sell – or at least not at the price offered.

These two facts of life can collapse the negotiation of voluntary agreements to sell and can lead to conflict. This conflict leads to the inevitable question where municipalization is concerned, i.e. can the city take the utility's property through the power of eminent domain if the city cannot reach a voluntary agreement with the utility? To the extent that such a condemnation fails, it is usually because the court determines that the city did not have sufficient statutory authority.

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Indeed, this statutory authority is such a contentious issue that the courtroom brawl sometimes spills over to a fight in the legislature to change the statutes that authorize the condemnation. Given that the statutory authority is the key battleground, we will focus on what authority a municipality needs to condemn a public utility. The answer is one that pleases no one except the lawyers who practice in this area – "it depends."

A Quick Refresher Course

Certain governmental bodies and quasi-public governmental bodies such as utilities have varying degrees of condemnation power. That is to say, they have varying rights to go to court and get an order forcing property owners to give them their property. Although property owners are compensated for the taking, they are forced to give up their property even though they did not want to sell it.

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Cities and other municipalities do not have the natural right to condemn property. The power to condemn property lies with the federal government and the states. Municipalities only have the power to condemn to the extent the state constitution or a statute gives them such power. A review of how the courts have interpreted the statutes is also necessary before one will know if the statutory authority is sufficient to condemn an existing public utility.

Municipalities Have Condemnation Power. What Else Do I Need To Know?

Many statutes giving a city the power to condemn only give it general authority to condemn. More likely than not, the condemnation statute our mayor has will say something to this effect: "the city is authorized to construct, maintain and operate [electric, gas, streetlight or water facilities] and to acquire real estate and personal property for that purpose by … eminent domain." This is different from specific condemnation authority, which would say that the city has the authority to condemn existing electric, gas, streetlight or water utilities.

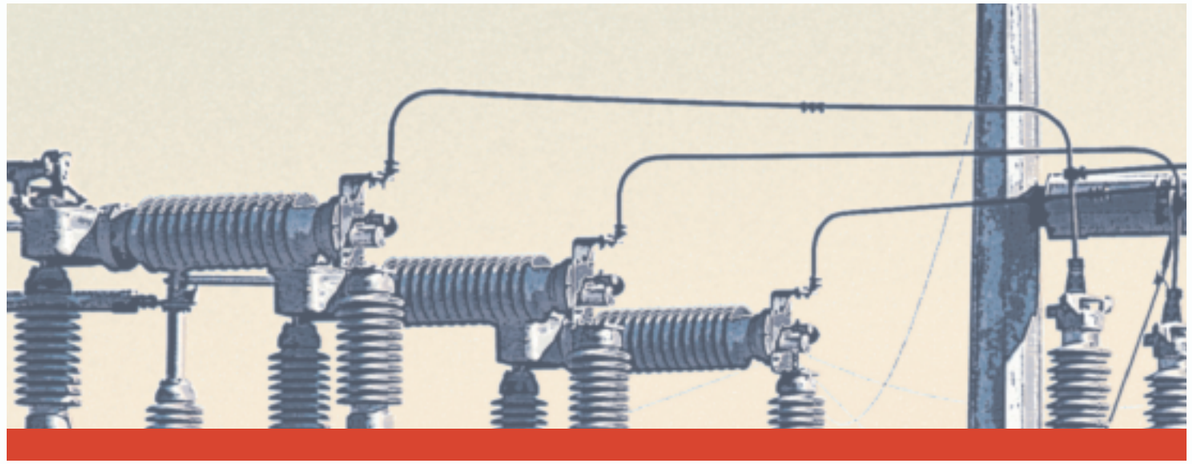
General authority is usually sufficient to condemn easements or bare land to build hospitals, fire stations, streets and other city facilities. For example, a city with general condemnation authority wishing to condemn an easement through a farmer's field for a natural gas transmission line should not have any difficulty condemning the property assuming that the city meets the other requirements imposed by state law.

The expensive mistake some cities make is they assume this general condemnation power is sufficient to condemn a public utility's facilities within their boundaries. That is not always the case.

Lesson 1: *Condemnation of a utility is an expensive proposition. City administrators should ensure they are comfortable that the city at least has the necessary statutory authority to proceed before incurring considerable time and effort to condemn the utility. Likewise, a utility trying to defeat the condemnation should carefully examine the city's authority.*

Location, Location, Location

The ability of a city to take a utility company's facilities by condemnation depends largely on which state the condemnation will occur. That is to say, a city's ability to condemn or municipalize is dependent upon which state's law will apply.



Almost all states agree on the proposition that a city may condemn property already devoted to a public purpose if the taking will not materially interfere with the existing public purpose. This will not prevent a city from condemning an easement for underground water lines from a hospital because it is unlikely to seriously interfere with the hospital's operations. But, it might prevent a city from taking property that is the sole access to the hospital's emergency room because of the obvious interference such a taking would pose.

While knowing the general proposition is helpful, there are still unanswered questions. If there is material interference, can the condemnation continue?

Lesson 2: *Relying on general statements of the law is dangerous when pursuing or defending against a condemnation of a utility company. The state legislatures and courts are still grasping for what they uniformly believe is fair or what the law requires.*

Take heart in knowing that we will not dissect each state's approach. Rather we will explore the predominant approaches to develop a checklist of issues you can use when discussing your own state's approach with counsel.

Specific Statutory Authority

If there is a majority rule, it is that the city needs to have specific statutory authority to condemn a public utility's property unless the condemnation will not materially interfere with the existing public use. Stated another way, the city's general power to condemn land and personal property will not be enough to take the utility's property if the condemnation will materially interfere with the existing public use.

The states that most likely follow this rule (either they expressly say that they follow this rule, have statutes authorizing the condemnation of some public utilities, or court decisions suggest they would follow such a rule) include Arizona, California, Georgia, Idaho, Illinois, Louisiana, Mississippi, Missouri, Montana, Nebraska, New Jersey, New Mexico, Nevada, Ohio, Oklahoma, Tennessee, Texas, Utah, Vermont, Virginia and Washington.

The decisions in Utah illustrate how courts have applied the majority rule. In a case in which the town of North Salt Lake wanted to condemn a water utility, the court held that the statute providing the city with the power to condemn "all or any part of any … waterworks system" was sufficient to take the water utility. But, where 18 towns and cities combined to condemn an electric power utility, the court blocked the condemnation because the towns and cities only had authority to condemn for "all public uses." The Utah legislature authorized the taking of a water company, but had not authorized the taking of an electric power company.

These states require specific authority because of the extraordinary circumstances involved when a city takes an existing utility. As the Missouri Supreme Court stated, "a municipality's condemnation of an entire public utility, already operating under a certificate of convenience and necessity, for the same use, is an extraordinary exercise of the power of eminent domain." Therefore, such condemnation power "may only be exercised, if at all, upon the express and specific authorization of the legislature."[2]

What each state allows by statute varies. As seen from the Utah cases where there was authority to condemn water utilities, but not electric utilities, some states limit which utilities a city may take through condemnation. The variety of statutory schemes is tremendous: a condemnation of any utility in Virginia and most utilities in Mississippi need approval from the state agency that regulates utilities,[3] a city that wants to start its own utility in Arizona must purchase the existing public utility or condemn it rather than forming a competing utility, Nebraska has an elaborate set of rules that limit a city's ability to condemn natural gas utilities and Missouri prohibits municipalities from condemning most utility companies.

Several of these statutory schemes also require the city to show its use of the property is "more necessary" or "a higher public purpose" than the existing use by the utility. In those states, the courts are required to weigh the benefits of the existing and proposed use in deciding whether the condemnation will take place. In making such an assessment, the state courts have struggled with whether municipal control of a utility as opposed to private control is itself a higher public purpose. For

example, Idaho says municipal control in and of itself is a sufficient showing of a higher public use while Montana demands more.

More Expansive View

Florida illustrates one of the more expansive approaches. In Florida, a city decided it would be in the public interest for its water system to serve everyone in the city. When negotiations for the sale of the private company's facilities broke down, the city-owned water company went to court to condemn the property.

If the condemnation simply transfers ownership from one political subdivision to another, then there is no real benefit to the public.

The court held that the condemnation could proceed without specific statutory authority to condemn an existing water utility because the city-owned utility would continue using the property for the same public purpose. The courts in Florida held that because the property was not going to be used for a different public purpose, general statutory authority was sufficient.

Therefore, under the Florida approach, if the property to be condemned will be used for the same public purpose, i.e. as a public utility, then general statutory authority to condemn lands to build a utility is probably sufficient. But, specific authority is necessary if the property will not be used for a public utility.

It is unlikely that a city would go through the trouble of condemning an existing natural gas distribution system, for example, but use it for some other purpose. Given that the property will likely be used for the same public purpose, general condemnation authority is sufficient for the city to condemn an existing public utility in states following this rule.

Minnesota's approach is similar to Florida's. The Minnesota courts will allow a city to use its general condemnation authority to take a utility's property if the city will: 1) use it for the same purpose; and 2) if the city's purpose is for a higher public purpose, i.e. the city must show that the condemnation will result in a new public benefit. In the context of the taking of a utility company, this is an easy test to meet in Minnesota because Minnesota courts hold that public ownership of a utility is a higher public purpose. Thus, as long as the city will continue to use the property for utility purposes, it may be able to rely on its general condemnation authority.

Tug of War

Sometimes the condemnation pits a city against a utility owned by another political subdivision such as a county. Almost all states will require the city to show specific statutory authority to condemn a publicly owned utility and some states like Ohio simply prohibit such a condemnation.

If the condemnation simply transfers ownership from one political subdivision to another, then there is no real benefit to the public. Further, allowing political subdivisions to condemn one another would result in back and forth condemnations – an absurd result.

What we do know is that the first step in any condemnation is an examination of the statutes. If the statutes only provide general condemnation authority, the city should be cautious before initiating an expensive condemnation it may not be able to win.

So, What Do You Know?

You may have gathered that doing an exhaustive 50-state analysis along with a few United States territories for good measure would fill more pages than this short article would permit. Even if we wadded the variations, they are bound to change.

The same year as the Missouri Supreme Court decision, the Missouri legislature passed laws that with a couple of exceptions prohibit a city from condemning property of an existing public utility, and a public utility from condemning another public utility's facilities. Likewise, the state legislature in another state passed legislation in direct reaction to a pending condemnation between a city and a utility company and the Nebraska legislature enacted a new statutory scheme last year addressing condemnations of natural gas utilities. Given the political nature of these condemnations, it is not surprising that the statutory authority that the legislature delegated to a city may change in reaction to a condemnation filing or a court decision or simply because the new legislature has a policy change of heart.

The current statutory scheme of your state may very well change by the time you are involved in such a condemnation. It is more helpful to be sensitive to some of the approaches the states are taking so as to be able to evaluate whether the condemnation can be defeated.

What we do know is that the first step in any condemnation is an examination of the statutes. If the statutes only provide general condemnation authority, the city should be cautious before initiating an expensive condemnation it may not be able to win. To the extent a condemnation of a public utility fails, it is usually because the court determines that the municipality does not have the necessary statutory authority.

We also know that while it may be true that more states follow the rule that a city must have specific statutory authority to condemn an existing public utility than those that do not, we cannot say "this is the rule." Instead, we have seen states prohibit a city from condemning an existing public utility – regardless of its authority to condemn existing public uses, there are states that have elaborate schemes permitting and dictating exactly how a city goes about such a condemnation and there are multiple variations in between.

The cases and statutes do provide us with some guidance that may be useful for in-house counsel, administrators, engineers, right of way agents, and anyone else who may play a role in seeking to condemn a public utility or defend against such a condemnation. Anyone examining the statutory authority will want to be sensitive to the following distinctions:

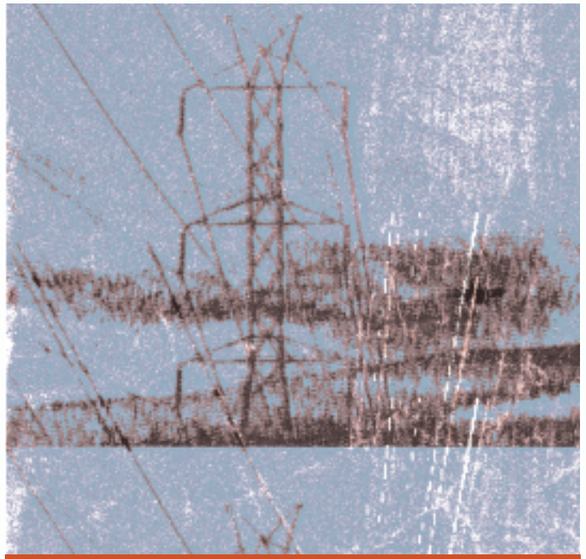
• Is the city's condemnation authority general (the power to condemn land and personal property for a particular purpose) or specific (the power to condemn, for example, natural gas or electric utilities)?

• Is the property sought in condemnation an existing public use? It probably is if it is an existing public utility, but note that not all entities that provide utility service are considered public utilities. For example, merchant energy facilities usually are not considered a public utility.

• Is the city seeking all or a significant portion of the public utility's property within the city or just a small portion such as a nonexclusive easement where the condemnation will not materially interfere with the public utility's operations?

• Will the city use it for the same or a different public purpose?

• Is the condemnation an expansion of the city-owned utility or the start of a new city-owned utility?



• Is the public utility owned by a political subdivision such as a water district or county or is it privately owned?

• Is the city's purpose more necessary than the public utility's purpose? Will it provide a greater benefit to the public than previously by providing more services or serving more people? Is the property being condemned only incidental to the public utility's primary operations?

That's A Wrap

If a utility does not agree to sell its facilities to the city, the only alternative our mayor may have is to municipalize the utility through condemnation. But, such an alternative is not a promising one for the city if it does not have sufficient authority to condemn an existing public utility.

The fact that the states have not followed a uniform approach to whether cities ought to be allowed to condemn an existing public utility and if so, under what circumstances, requires an assessment by legal counsel. But, both city and utility decision makers should be aware of the issues and some of the distinctions states have made to be able to make a fully informed opinion. ❖

REFERENCES

[1] To steal a phrase or two from Michael Feldman of *Whad' Ya Know?* The opinions expressed in this article are those of the author and are not of Blackwell Sanders Peper Martin LLP, its affiliates or lackeys.

[2] *Missouri Cities Water Co. v. Hodge*, 878 S.W.2d 819 (Mo. 1994).

[3] Some states specifically require a municipality to obtain regulatory approval before it can condemn an existing public utility, but, in an effort not to compete with various sleeping aids available on the market, this article does not attempt to address any regulations or procedures established by the state's public service or utility commission. Nor does the article address federal laws and regulations that may be applicable, such as those that apply to condemning certain natural gas pipelines.