

Focus On

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The Federal Process in Gas Storage Condemnation Litigation

OWNERS OF GAS storage operations throughout the country continually face the harsh reality of condemnation. This issue resonates in the natural gas and oil communities as the government tries to snatch more and more land for other public uses, such as power generation, highway construction, water reservoirs, and dam expansion.

In the United States, most existing gas storage is in depleted natural gas or oil fields near consumption centers. Converting depleted fields from production to storage saves time and money because of the ability to use existing wells, gathering systems, pipelines, and the reservoir itself. Significant demand for conversion exists as gas production has continued to grow.

However, governments often have their eye on depleted fields that can be used for other purposes. Ironically, while governments direct their taking power to these properties, gas storage companies have begun to rely on delegated eminent domain power as the most common method to acquire gas storage interests. Thus, practitioners—even those experienced in state condemnation actions—should familiarize themselves with federal eminent domain litigation and valuation both to defend against and pursue condemnation in the gas storage context.

This article briefly discusses basic procedural concerns and then delves into the crux of any condemnation action—valuation of property.

Rules and Statutes

In federal condemnation actions, federal procedural and substantive laws are controlling.¹ Currently, Fed. R. Civ. P. 71.1 (formerly Rule 71A) controls condemnation actions. This rule's uniform procedure pre-empts all federal statutes except those that evince a clear legislative intent to supersede the rule—a rarity.²

There is nothing particularly complex about Fed. R. Civ. P. 71.1. Section (c)(2) sets forth some specific requirements for complaints. Perhaps most important is § (e), which states that, in order to preserve any objection to a taking, the property owner must file an answer within 21 days of the filing of the complaint.

However, owners who do not object to the taking need to file only a notice of appearance.

One federal statute is especially relevant to gas storage operations, regardless of whether a taking is involved. The Natural Gas Act (NGA), 15 U.S.C. §§ 717 to 717Z, regulates the interstate transportation and sale of natural gas for ultimate distribution to the public. The NGA requires a company to obtain a Certificate of Public Convenience and Necessity from the Federal Energy Regulatory Commission (FERC) in order to transport, sell, construct, expend, acquire, or operate any natural gas facility—including gas storage fields.

Property owners should be aware that challenging necessity in federal utility takings is effectively futile, because courts give complete deference to final FERC decisions regarding necessity.³ Thus, most challenges to takings when it comes to natural gas storage will revolve around the compensation prong of eminent domain.

Property Standards and Just Compensation

At first glance, the deck seems stacked against property owners when it comes to “just compensation.” The Fifth Amendment mandates compensation for “property taken,” yet courts ordinarily employ a narrow concept of “property” in the condemnation context. In *Lynch v. Household Finance Corp.*,⁴ which did not involve a taking, the Supreme Court elaborated on “property:”

Property does not have rights. People have rights. The right to enjoy property without unlawful deprivation, no less than the right to speak or the right to travel, is in truth a “personal” right, whether the “property” in question be a welfare check, a home, or a savings account. In fact, a fundamental inter-dependence exists between the personal right to liberty and the personal right in property. Neither could have meaning without the other.

The Court's discussion of property in *United States v. Petty Motor Co.*,⁵ a case involving eminent domain, is a stark contrast to the approach adopted in *Lynch*: “Just compensation is the value of the interest taken. This is not the value to the owner for his particular purposes, but a so-called ‘market value.’ It is recognized that an owner often receives less than the value of the property to him, but experience has shown that the rule is reasonably satisfactory.”

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The Supreme Court defines fair market value as the most probable price that a willing buyer and willing seller would negotiate when neither is under compulsion and both are fully informed. However, this “ordinary negotiation” model is misleading. Compensation is only for land actually taken, without regard to the property owner’s particular circumstances, such as reluctance to part with the property or its unique suitability for his or her particular purposes.⁶ Consequential losses to business value, business opportunity, and good will are also irrelevant. Furthermore, the owner is not compensated for any gain to the condemning authority.⁷

Owners can boost compensation, however, by arguing that there are potential better uses of the land itself. This is key in the gas storage context, because, as discussed above, the high demand for gas storage creates a potentially better use for depleted oil and gas reserves, thereby increasing their value. The following sections discuss various theories for raising property value by arguing better potential uses for land.

The Highest and Best Use Standard

This “liberal” standard frees the fact finder to determine the highest and best use of property, thus increasing the valuation. In *Olson v. United States*,⁸ the government condemned land abutting a lake in order to flood and store water for use in hydroelectric dams. In a subsequent suit for damages, the property owners argued that the trial court should have valued the property based on the special adaptability of the land to reservoir purposes—which made it worth much more than it had been worth as farmland. *Olson* relied upon *Boom Co. v. Patterson*⁹ and *Clark’s Ferry Bridge Co. v. Public Service Commission of Commonwealth of Pennsylvania*,¹⁰ maintaining that—

The sum required to be paid the owner does not depend upon the uses to which he has devoted his land, but is to be arrived at upon just consideration of all the uses for which it is suitable. The highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future is to be considered, not necessarily as the measure of value, but to the full extent that the prospect of demand for such use affects the market value while the property is privately held.¹¹

However, “best use” cannot be too speculative. Despite the preceding quote, *Olson* upheld the trial court’s valuation of the land for agricultural purposes only. Potential purchasers would not have considered the possibility that the government would acquire all the land surrounding the lake and use it for flowage. This idea was “too remote to warrant a finding that market value of petitioners’ lands was thereby enhanced.”¹²

Nonetheless, “best use” applies where maximizing

property value does not depend on acquiring large amounts of property. In *Boom*, the government sought to condemn three islands that were perfectly arranged to create a “boom” to trap logs floating down the river. Factoring in the particular use of the island as a boom, the Court valued the property at 20 times more than it would have been worth otherwise. The *Olson* Court distinguished *Boom* because of “the number of parcels, private owners, Indian tribes, and sovereign proprietors to be dealt with” in the lake flowage project.¹³

In the gas storage context, litigants are more likely to find situations analogous to *Boom*. Gas storage reservoirs are not like the monumental project in *Olson* that required acquisition of *all* the land surrounding a lake. Moreover, gas storage facilities built on depleted oil and gas reservoirs already have equipment in place. Because of the ease of conversion from reserve to storage, this “best use” is hardly speculative.

The Possibility of a Different Use

In *Olson*, the dam project was already in place and the land abutting the lake had been flooded. However, the highest and best use standard can apply where use of a land is purely speculative. In *McCandless v. United States*,¹⁴ cattle ranchers claimed that, in the foreseeable future, they would have the opportunity to grow sugarcane, which was more profitable than using the land for raising cattle. The trial court refused to allow proofs that the possibility of converting the land to a sugarcane plantation increased value. In reversing the lower court’s ruling, the Supreme Court held the following:

The rule is well settled that in condemnation cases, the most profitable use to which the land can probably be put in the reasonably near future may be shown and considered as bearing upon the market value; and the fact that such use can be made only in connection with other lands does not necessarily exclude it from consideration if the possibility of such connection is reasonably sufficient to affect market value.¹⁵

“Other lands” referred to the fact that irrigation systems would be required to grow sugarcane. As in *Olson* and *Boom*, the key issue was the speculativeness of the property owners’ claim. The Court sided with the owners in *McCandless* probably because of the overwhelming evidence that they had been negotiating for an irrigation supply, that any purchaser would convert the land to sugarcane growing, that any other sugarcane plantation would require an outside water supply, that the land was perfectly suited to sugarcane, and so forth.¹⁶

The possible future use of a depleted gas reserve as a gas storage facility seems hardly speculative and is certainly less so than the use of a cattle ranch to grow sugarcane. Thus, owners of gas reservoirs should have

no problem citing *Boom* and *McCandless* as compelling the court to allow evidence that the property has a profitable use as a gas storage facility.

Possibility of Assemblage

Another frequent issue in determining the highest and best use of a property is whether courts may consider assemblage or if valuation must occur in isolation from other properties. One of the leading cases on assemblage is *Baetjer v. United States*,¹⁷ in which the First Circuit held that tracts physically separated from one another may constitute a “single tract” for the purpose of calculating severance damages if they could be put to an integrated, unitary use, or even if there is a possibility of combination for such a use in the reasonably foreseeable future.¹⁸

Moreover, *Bd. of Co. Supervisors of Prince William Co. v. United States*,¹⁹ a developer committed a 16-acre tract of land for a county road in exchange for rezoning his 550-acre property. The federal government then condemned the land and paid the developer but disputed the value of the county’s 16 acres. The government argued that the court should value the 16 acres only as a road, with no regard to adjoining parcels. The Federal Circuit, however, held that the property might be considered in combination with adjoining parcels in the determination of the highest and best use of the land. Citing *United States v. Powelson*,²⁰ the panel held that it would allow valuation based on a combination of properties as the highest and most profitable use so long as there was a reasonable probability that the parcels would have been combined in the reasonably near future.

Recent developments in national security law have frustrated owners’ efforts to demonstrate assemblage of property for gas storage purposes. Federal law and FERC regulations prohibit the disclosure of “Critical Energy Infrastructure Information,” which includes FERC’s “[g]eological and geophysical information and data, including maps, concerning wells.”²¹ Without this information and maps, litigants will find it difficult to prove that separate parcels can be assembled to provide storage for natural gas.

Conclusion

As producing gas and oil reservoirs are depleted, the condemnation of gas storage interests will rise in frequency. Knowing the various legal theories of valuation is key, as gas storage is a potentially value-raising use that may not be initially apparent in a condemnation action. **TFL**

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Endnotes

¹*United States v. Miller*, 317 U.S. 369 (1943).

²*Kirby Forest Industries v. United States* 467 U.S. 1 (1984); *Southern Natural Gas Company v. Land, Cullman County, 2.0 Acres of Land*, 197 F.3d 1368 (11th Cir. 1999).

³See *Williams Natural Gas Co. v. Oklahoma City*, 890 F.2d 255, 264 (10th Cir. 1989); *Tenn. Gas Pipeline Co. v. 104 Acres of Land More or Less*, 749 F. Supp. 427, 430 (D.R.I. 1990); *Tenn. Gas. Pipeline Co. v. Mass. Bay Transp. Auth.*, 2 F. Supp. 2d 106, 110 (D. Mass. 1998); *Cincinnati Gas & Elec. Co. v. Fed. Power Comm'n*, 376 F.2d 506, 509 (6th Cir. 1967).

⁴405 U.S. 538, 552 (1972).

⁵327 U.S. 372 (1946).

⁶*Monongabela Navigation Co. v. United States*, 148 U.S. 312 (1893).

⁷*Miller*, 317 U.S. at 369.

⁸292 U.S. 246, (1934).

⁹98 U.S. 403, 408 (1878).

¹⁰291 U.S. 227, 238 (1934).

¹¹*Olson*, 292 U.S. at 255.

¹²*Id.* at 261.

¹³*Id.* at 260.

¹⁴298 U.S. 342 (1936).

¹⁵*Id.* at 345 (citing *Olson*, 292 U.S. at 255–56).

¹⁶*Id.* at 343–44.

¹⁷143 F.2d 391 (1st Cir. 1944).

¹⁸For a discussion of assemblage in the context of treatment of separate parcels as a single parcel for the purpose of calculating severance damages to a parcel not taken, see Ackerman, *Just Compensation: Remainder Damages in Partial Taking Cases*, 61 MICH. BAR J. no. 6 (June 1982), available by link at www.ackerman-ackerman.com.

¹⁹276 F.3d 1359 (Fed. Cir. 2002).

²⁰319 U.S. 266 (1943) (holding that the fact finder can determine value in light of a special or higher use that need not be measured by the current use of the property or only its uses as a separate tract).

²¹5 U.S.C. 522; 18 C.F.R. 388.113 (c) defines “Critical Energy Infrastructure Information” as “specific engineering, vulnerability or detailed design information about proposed or existing critical infrastructure that: (i) [r]elates details about the production, generation, transportation, transmission or distribution of energy; (ii) [c]ould be useful to a person in planning an attack on critical infrastructure, (iii) [i]s exempt from mandatory disclosure under the Freedom of Information Act. 18 C.F.R. § 388.107(h) states that “[g]eological and geophysical information and data, including maps, concerning wells” is exempt from mandatory disclosure under the Freedom of Information Act. See also Presidential Directive 7 to the U.S. Department of Homeland Security.

²²5 U.S.C. § 552 (b)(3)(b)(4), (b)(9).