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## Eminent Domain - Taking - Determination of Compensable Interests through Classification of Executory Contracts - Klein v. United States

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**EMINENT DOMAIN—Taking—Determination of Compensable Interests Through Classification of Executory Contracts. *Klein v. United States*, 375 F.2d 825 (Ct. Cl. 1967).**

The Garretts, owners of two tracts of land in Marion County, Iowa, entered into two five year contracts, one in January 1962 with Earl Wagner and the other in October 1962 with Jake Klein. The contracts, which were phrased in terms of leases,<sup>1</sup> granted to Wagner and Klein the right to enter upon the land owned by the Garretts and to take, stock-pile, and remove gravel; in turn, Wagner and Klein agreed to pay ten cents for each cubic yard of gravel removed.

One month after the contract between Garrett and Klein was signed, Cyrus Vance, in his position as Secretary of the Army, placed his signature on a declaration of taking. As a consequence the fee simple titles of several tracts of land, including the two tracts supporting the gravel contracts, were taken as a part of the Red Rock Reservoir Project. Concurrently, moneys were deposited with the United States District Court for the Southern District of Iowa as estimated just compensation.

After the Garretts applied for and received a preliminary disbursement from the district court, but before the condemnation commission appointed by the district court to make a final determination could declare its findings on the issue of just compensation, Klein and Garrett filed separate, identical suits against the United States in the Court of Claims by petition for summary judgment.<sup>2</sup> These cases claimed that as provided in the just compensation clause of the fifth amendment,<sup>3</sup> Klein and Garrett were entitled to compensation for the "taking" of the gravel contracts.<sup>4</sup>

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1. Since interests in land were created by the contracts, it is irrelevant to the purpose of this note to decide if, in fact, leasehold interests were created.
  2. Following a brief period of separateness, the two cases were consolidated as provided by U.S. Ct. Cl. Rule 47(a).
  3. "[N]or shall private property be taken for public use, without just compensation." U.S. CONST. amend. V.
  4. By making their plea to the Court of Claims before the district court proceedings were finalized, the petitioners raised several procedural questions which are not of direct concern to this note. It is enough for present purposes to state that district courts have exclusive jurisdiction of any and all claims at issue in the condemnation case. *Brennan v. United States*, 153 F. Supp. 377 (Ct. Cl. 1957). In order to avoid the charge that the Court of Claims was thereby precluded from hearing the case, Garrett and Klein contended that the contracts were personal property. Thus, they argued that the taking of the fee simple titles included both the real property represented by the gravel as well as the personal property repre-

While cross motions for summary judgment and reply briefs were being filed in the Court of Claims, the condemnation commission reported to the district court that its findings indicated the just compensation for the tract supporting Klein's contract to be \$123,345.<sup>5</sup> This sum, which considered the values of the acreage, the buildings and improvements, and the underlying sand and gravel, allowed \$6,000 as the value of the sand and gravel, of which \$1,000 was assigned to Klein's interest. The district court confirmed these findings.

By making the separate claim to the Court of Claims, Garrett and Klein contended that the value of "taking" had to include the value of the contract. Basing their figures on the royalty interest provided in the contract, the anticipated profit to be made from the sale of the gravel, and the estimated quantity of gravel, they asserted that Garrett was entitled to \$387,200 and Klein should receive \$774,400 for the estimated 3,872,000 cubic yards of underlying sand and gravel.<sup>6</sup>

The Court of Claims rejected this argument in holding that there was not a "taking" of the contracts within the meaning of the fifth amendment; hence, the government was under no obligation to compensate. To justify this holding,

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sented by the contracts. Viewing the instruments as personal property, they contended that this interest was not included within the condemnation cases in the district court, thereby allowing them to make a separate claim for this element of loss in the Court of Claims.

5. In awarding the figure of \$123,345 the commission followed what is known alternately as the undivided or unencumbered fee rule. It provides that in valuing a tract of land sustaining multiple interests the court will consider the land as if it were unencumbered, and then take the separate interests from that sum. *Eagle Lake Improvement Co. v. United States*, 160 F.2d 182, 184 (5th Cir. 1947); *Cuyahoga County v. United States*, 294 F.2d 775, 777 (Ct. Cl. 1961). This rule is not, however, universally applied, especially when the value of the separate interests greatly exceeds the value of the fictionalized unencumbered fee. *Baltimore v. Latrobe*, 101 Md. 621, 61 A. 203 (1905); *Boston Chamber of Commerce v. Boston*, 217 U.S. 189 (1910); *Comstock v. Iowa State Highway Comm'n*, 254 Ia. 1301, 121 N.W.2d 205 (1963); *Knox Lime Co. v. Maine State Hwy. Comm'n*, 230 A.2d 814 (Me. 1967). See also 4 NICHOLS, EMINENT DOMAIN §§ 12.36[1] 12.36[2] (4th ed. 1962) (hereinafter cited as NICHOLS); 1 ORGEL, VALUATION UNDER EMINENT DOMAIN § 112, at 479-80 (2d ed. 1953) (hereinafter cited as ORGEL).
6. The method of valuation asserted by the petitioners represents the unit rule method of computation. This rule measures value by multiplying the number of cubic measuring units (feet, yards, or tons) by a fixed price per unit. Though it is not a compensation formula employed by many courts, it has been accepted directly when the court could find no other criterion of value, and indirectly by courts that state it is not the measure of value, yet it has a definite bearing on value. For illustrations of the three different approaches to the unit rule, see *Knox Lime Co. v. Maine State Highway Comm'n*, 230 A.2d 814, 827 (Me. 1967) ("so speculative that it must be rejected"); *United States v. 237,500 Acres of Land*, 236 F. Supp. 44, 54 (S.D. Cal. 1964) ("no other factor of value"); *Comstock v. Iowa State Hwy. Comm'n*, 254 Ia. 1301, 121 N.W.2d 205, 209 (1963) ("definite bearing on value").

the court relied on the doctrine of consequential loss as explained in *Omnia Commercial Co. v. United States*.<sup>7</sup> There the court reasoned that a contract is a set of mutual rights and obligations as distinct from its subject matter. Therefore, when the government takes the subject matter of a contract (in this case, the gravel), yet does not assume the rights and obligations under the contract, there is no "taking" of the contract. Rather than being appropriated, the contract is ended.<sup>8</sup> This reasoning, then, leads to the conclusion that the loss is consequential and non-compensable.

It is the objective of this note to show that in applying the consequential loss doctrine to the gravel contracts, the court displayed a sense of confusion over the concept of eminent domain and its relationship to contracts. As this case is merely representative of the general confusion found in this area of law, this note will develop an approach to the relationship based on three schemas, each being a type of contractual interest and the rights arising therefrom as a result of a condemnation. As applied to the present case, it will be argued that the court employed reasoning applicable to the third schema, whereas it should have used the principles found in the second. When the classification is established and analyzed in terms of the policy determinants that influence the schematic approach, the law of eminent domain as it relates to contracts becomes less susceptible to confused holdings.

In providing that the government shall not take private property without just compensation, the Constitution delineated one element of what is recognized as a dual concept. In its barest form eminent domain involves both a power and an obligation, yet the Constitution refers only to the latter, leaving the power itself implicitly assumed. Though the federal government is not expressly granted the power to condemn land, courts have held that such a grant is unnecessary as it is an essential "attribute of sovereignty."<sup>9</sup> The fifth amendment, therefore, merely conditions the power by

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7. 261 U.S. 502 (1923).

8. The late Professor Corbin, is referring to *Omnia Commercial Co. v. United States*, *id.*, stated that the appropriation-ending distinction is "not convincing." 6 CORBIN, CONTRACTS § 1344, 424 n.21 (1962).

9. *United States v. 64.88 Acres of Land*, 144 F. Supp. 29, 32 (W.D. Pa. 1956), *rev'd on other grounds*, 244 F.2d 534 (3d Cir. 1957).

obligating the public to give just compensation for its exercise.<sup>10</sup>

The dual nature of the concept has established the two principal policy determinants weighed by the courts in developing this area of the law: 1) Protecting property rights by compensation, and 2) Allowing the government sufficient freedom from excessive awards so as not to frustrate necessary public projects.<sup>11</sup> Consequently, courts will gauge the proper amount of compensation for a particular taking by reference to the two determinants. Such a tendency is noticeable in the following charge to condemnation commissions:

The "compensation" which is guaranteed by the Constitution is not defined in the constitutional provision. The term means a compensation which is just and fair both to the owner of the property taken and the public represented by the condemning authority.<sup>12</sup>

Within the framework of these conflicting policy factors, the scope of eminent domain is impressively large. The power to condemn extends to all private property,<sup>13</sup> whether personal or real,<sup>14</sup> while the accompanying obligation to compensate encompasses all those from whom property was taken. Moreover, it is "settled law" that judicial interest applies only to the question of compensation and, in the absence of fraud, does not extend to the question of the necessity for a particular taking.<sup>15</sup>

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10. It is this condition of compensation which differentiates eminent domain from the police power to regulate. The concepts, however, tend to merge in certain situations such as a permanent injunction against a business due to its non-compliance with air pollution statutes. In such cases the test proposed by Professor Joseph Sax is helpful. He has characterized a compensable loss resulting from the exercise of eminent domain as a "government enhancement of its resource position in its enterprise capacity." Sax, *Takings and the Police Power*, 74 YALE L.J. 36, 63 (1964).

11. For a general discussion of the influence of these determinants, see Kratovil & Harrison, *Eminent Domain—Policy and Concept*, 42 CALIF. L. REV. 596, 597 (1954).

12. *Wilmington Housing Authority v. Harris*, 47 Del. 469, 93 A.2d 518, 521 (1952).

13. *United States v. Lynah*, 188 U.S. 445, 465 (1903).

14. "The constitutional protection against the taking of private property for public use without just compensation applies equally to personal property." JAHR, *LAW OF EMINENT DOMAIN* § 45, at 66-7 (1953) (hereinafter cited as JAHR). See also *Illinois Cities Water Co. v. Mt. Vernon*, 11 Ill.2d 547, 144 N.E.2d 729 (1957).

15. *Brooks v. Shepard*, 157 F. Supp. 379, 383 (S.D. Ala. 1957).

Given this broad power, contract rights are not excluded from the purview of eminent domain.<sup>16</sup> As between the contracting parties themselves the power in the government to take property for public use acts as a condition of performance, relieving both parties from obligation under the contract when the power is exercised.<sup>17</sup> In the normal situation, however, the contracting parties are less interested in the effect of eminent domain on their mutual rights than they are in the newly established relationship with the condemning authority. Faced with the fact that a possibly attractive contract has been dissolved, they are more interested in their ability to receive compensation from the government.

As with other forms of property, eminent domain has a dual nature in relation to contracts. Thus, the government can take, but, at the same time, it must compensate. "When contract rights are taken for public use, there is a constitutional right to compensate in the same manner as when other property rights are taken."<sup>18</sup> Though this statement appears to satisfy the anxiety of the contracting parties, upon closer examination the word "taken" gains great importance. If one were to have a contract with another whose ability to fulfill the contract was defeated by eminent domain proceedings, it would be necessary to prove that a *taking* had occurred of the thing in question through the actions of the condemnor. If this fact could not be established, the government would be under no obligation to compensate under the provisions of the fifth amendment. Such was the situation in *Klein v. United States*.

The relationship between eminent domain and contracts can be elucidated by analyzing the types of situations in which contracts are affected by eminent domain proceedings. A majority of the cases fall into one of three schemas;

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16. Not only are contract rights subject to the federal exercise of eminent domain, but in addition they are subject to action by the state governments. A number of cases have been litigated on the issue of the constitutional provision prohibiting the passage of a state law that impairs the obligation of contracts. Uniformly, the courts have held that the provision is not a limitation upon the power of eminent domain. *Legal Tender Cases*, 79 U.S. (12 Wall.) 457 (1870); *Cincinnati v. Louisville & Nashville R.R.*, 223 U.S. 390 (1912). See generally, 4 NICHOLS § 13.33, at 465. The courts base their conclusion on the theory that the contract is subordinate to the sovereign power of eminent domain, and that this power acts as an unwritten condition of the contracts. For an illustration of this reasoning, see *Cincinnati v. Louisville & Nashville R.R.*, *id.* at 400.

17. See 1 ORGEL § 76, at 328.

18. *Petition of Mackie*, 5 Mich. Ct. App. 543, 147 N.W.2d 441, 445 (1967).

- 1) The condemnor acquires the contract, placing itself in a position similar to that of an assignee;
- 2) The condemnor acquires property supporting multiple interests established by contract; and
- 3) The condemnor acquires property to which a contract relates, thus rendering performance impossible.

Each of these schemas will be treated separately, not only in terms of the rules developed by the courts for each, but also in terms of the confluence of rules and policy determinants.

The first schema falls clearly within the protection of the fifth amendment. When one assumes the obligations and rights of a contract, the courts have stated that there is a definite taking for which compensation is required.<sup>19</sup> It was this principle that was enunciated in *Brooks-Scanlon Corp. v. United States*,<sup>20</sup> a case involving the government's requisition of a contract for the construction of a ship. The definite applicability of the taking principle can be seen in this excerpt from the opinion written by Mr. Justice Butler: "By its orders the Fleet Corporation put itself in the shoes of claimant and took from claimant and appropriated to the use of the United States all the rights and advantages that an assignee of the contract would have had."<sup>21</sup>

In awarding compensation for an appropriation of a contract, the courts clearly resolve the policy conflict in favor of private property rights. This schema, therefore, represents the most certain instance of compensability, with the other two being less certain. This hierarchy provides a framework within which the separate schemas are comprehensible.

The second schema is less pat, standing between the two extremes of the compensability hierarchy. In dealing with condemned property that supports multiple interests, the courts have generally focused on the question of whether a taking of the separate interests has occurred. To assist the determination, courts have developed two general rules to test the compensability of a particular interest. Thus, some courts hold that in order for one to share in the award with the owner one must have an "estate" or "interest" in the

19. *United States v. Willis*, 164 F.2d 453 (4th Cir. 1947).

20. 265 U.S. 106 (1924).

21. *Id.* at 120.

soil.<sup>22</sup> Other courts have been less stringent, allowing one a right to compensation if a "direct and actual concrete connection with the specific land" is shown.<sup>23</sup> Using these two tests, courts have authorized compensation for such diverse interests as oil and mineral leases,<sup>24</sup> appurtenant easements, railroad rights of way, easements in gross,<sup>25</sup> and sand and gravel contracts.<sup>26</sup>

The policy determinants have played an obvious role in developing the applicable rules within the second schema. In resolving the conflict between private property rights and government need, the two tests allow the courts a flexible standard by which to judge a claim. In addition, a comparison of the two rules shows that those courts that have adopted the second test are moving in the direction of private property rights, thereby evidencing a trend toward greater compensability.

The taking principle is most actively applied to deny compensation within the third schema. Courts have held that when, in the lawful exercise of acquiring property for public use, contracts are destroyed or other business losses are incurred that are incidentally related to the subject matter taken, such loss is not a taking and is, therefore, non-compensable.<sup>27</sup> It is this principle that was employed in *Klein v. United States* to defeat the claim that as a separate item of recovery the contract as personal property should be compensated. The court relied on *Omnia Commercial Co. v.*

22. "It is clear that unless petitioner's rights and privileges here amount to an estate or interest in the lands within the statutory meaning it is not entitled to share in the award, whatever possible claims it might conceivably have in some other forum on the basis of a frustrated contract or otherwise." Brooklyn E. Dist. Terminal v. New York, 139 F.2d 1007, 1010 (2d Cir. 1904). See also *A. W. Duckett & Co. v. United States*, 266, U.S. 149 (1924); 2 NICHOLS § 5.23[7], at 73-4.

23. *Deepe v. United States*, 103 Colo. 294, 86 P.2d 242, 243 (1938). See 4 NICHOLS § 13.33, at 469-70.

24. *Angichiodo v. Cerami*, 28 F. Supp. 720 (W.D. La. 1939).

25. See *Brooklyn E. Dist. Terminal v. New York*, 139 F.2d 1007 (2d Cir. 1944).

26. *Comstock v. Iowa State Highway Comm'n*, 254 Iowa 1301, 121 N.W.2d 205 (1963).

27. "Undoubtedly, the United States could here have 'taken' plaintiff's personal property and business, in which case just compensation would be due. But this was not done. The only taking in the present case was of plaintiff's real estate and water rights, for which compensation has been fully paid . . . [T]he additional losses claimed in this proceeding are in the nature of consequential damages, that is to say, they are an 'unintended incident' of the actual taking." *R. J. Widen Co. v. United States*, 357 F.2d 988, 993 (Ct. Cl. 1966). See also *United States v. Carver*, 278 U.S. 294 (1929); *Mullen Benevolent Corp. v. United States*, 290 U.S. 89 (1933); *Cumberland River Oil Co. v. Commonwealth*, 350 S.W.2d 700 (Ky. 1961); 4 NICHOLS § 13.33, at 466-69; JAHR § 114, at 157-59.



*United States*,<sup>28</sup> a Supreme Court case involving a requisition by the government of the producing capacity of a steel company. One who held a contract with the company for a specific amount of steel was denied compensation on the grounds that the loss was consequential. To support this conclusion the Court stated that a contract is a set of obligations and rights wholly apart from the subject matter of the contract. Hence, when the government took the steel production, it only took the subject matter of the contract, not the contract itself. "Plainly, here there was no acquisition of the obligation or the right to enforce it . . . . As a result of this lawful governmental action the performance of the contract was rendered impossible. It was not appropriated but ended."<sup>29</sup>

With this schema the compensability heirarchy is completed. Here the policy conflict is resolved in favor of the government's ability to implement public projects. To achieve this end, courts have employed the consequential loss doctrine against the contracting parties, justifying the application with such statements as damages must be certain,<sup>30</sup> a right must be capable of valuation,<sup>31</sup> and, most usually, speculative damages must be avoided.<sup>32</sup>

The schematic approach to the affect of eminent domain on contracts serves two important functions. First, it clarifies the policy determinants which are used by the courts in deciding whether a compensable interest has been taken by the government. By observing the three schemas consecutively a heirarchy is discernable, blending from a clear case of a compensability, through a less distinct classification in which the courts are given sufficient flexibility to award or deny compensation, and finally to a class of cases in which the courts generally deny compensation. This heirarchy, being the manifestation of conflicting policies within the law of eminent domain, is merely representative of the fact that an economic interest is a property right only if it is a legally protected interest. As the Supreme Court has observed:

But not all economic interests are "property rights"; only those economic advantages are "rights" which

28. *Omnia Commercial Co. v. United States*, 261 U.S. 502 (1923).

29. *Id.* at 510-11.

30. *Puerto Rico v. United States*, 132 F.2d 220 (1st Cir. 1942).

31. *Brooklyn E. Dist. Terminal v. New York*, 139 F.2d 1007, 1011 (2d Cir. 1944).

32. *Olson v. United States*, 292 U.S. 246, 257 (1934).

have the law back of them, and only when they are so recognized may courts compel others to forbear from interfering with them or to compensate for their invasion.<sup>33</sup>

The Court continued by saying the question of whether a particular economic use is a "legally protected interest" is, at least to some degree, dependent upon whether the conflict is with a private or a public interest.<sup>34</sup> Thus, in this area of law, the conflict between the private and public interest has established a hierarchy of compensability.

The second function served by the schematic approach is that in classifying the general factual situations that give rise to questions of compensating a contract for the exercise of eminent domain, courts will be provided an instrument to avoid the confusion surrounding eminent domain and contract rights. In doing so they will be less likely to judge a contract that establishes a definite interest in the property (schema #2) under consequential loss doctrines (schema #3). *Klein v. United States* is an example of a court that made such an error, and is, therefore, representative of the need for greater clarity.

In *Klein*, neither the condemnation commission, the district court, nor the Court of Claims questioned the right of the gravel contractors to be compensated for the interest in land created by the contracts. Both *Klein* and *Wagner* received awards. This, then, places the case within schema #2 as their rights satisfied either of the two tests developed by the courts: "estate" or "interest" and "direct and actual concrete connection." On petition to the Court of Claims it was contended that the contracts should have been compensated separately as personal property. In hearing this claim, the court assumed a schema #3 situation, invoked the consequential loss doctrine, and thereby denied compensation. On the other hand, had the court correctly perceived the contract in terms of creating a compensable interest in land, it would not have resorted to a schema #3 argument. Rather than stating the contract was a consequential loss, the court should have recognized that the contract could only be denied a measure of value, not as a compensable interest. Therefore, in

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33. *United States v. Willow River Power Co.*, 324 U.S. 499, 502 (1945).

34. *Id.* at 503.

failing to make the distinction, the court erred in not holding that the claimants had an interest in land created by the contract, that the district court is given exclusive jurisdiction of claims in condemnations cases,<sup>35</sup> and that the Court of Claims, thus, had no jurisdiction to hear a valuation argument which was not presented in the district court. Had the Court of Claims been able to see the contract in terms of the schematic approach, it would not have invoked an inappropriate concept, the consequential loss doctrine.

The relationship between eminent domain and contracts is, therefore, to be found in three general schemas. This approach is proposed as a means of clarifying an area of law that has received scant attention, but due to its present confused state is deserving of more. The three schemas should provide a framework within which a contract may be properly considered, while the policy determinants can assist courts in deciding the ultimate question of compensability once the contract is properly classified.

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35. See note 4, *supra*.