



COUNSELOR'S CORNER

Considerations for Banks Named as Parties in Eminent Domain Actions

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Eminent domain or condemnation is the process by which the government is permitted to acquire a citizen's private property, with due monetary compensation, for public use. Typically, property is acquired by the government through the use of eminent domain for public projects such as highways, parking structures, public utilities, public buildings and railroads. Section 16 of the Washington State Constitution states, "No private property shall be taken or damaged for public or private use without just compensation having been first made ..."

Property that is subject to being acquired by eminent domain is often encumbered by one or more loans. Lenders are required to be joined as parties in condemnation actions

under Washington law. The lender has the right to obtain counsel and participate in the case along with the property owner and any other parties who have an interest in the property. Condemnation cases have

three phases: (1) adjudication of public use and necessity, (2) determination of just compensation to be awarded to the owner, and (3) payment of just compensation and transfer of title.

In the first phase, the court must determine whether the proposed acquisition is actually for a public use and whether the acquisition is reasonably necessary under the circumstances. Challenges to public use and necessity are rare, but do occasionally occur. Lenders should monitor the public use and necessity phase of the case to make sure that the property owner raises any valid objections.

More importantly, the lender will want to be sure the borrower/property owner presents strong arguments during the second phase, which is the primary trial on just compensation. The lender may not argue its particular interest at that stage, only the value of just compensation for the taking as a whole, assuming a single fee simple owner. Following the trial and absent agreement between the lender and the borrower, there is a post-trial apportionment hearing before the court sitting in equity (without a jury) to determine the lender's share of the just compensation award.

Most banks rely on the borrower's counsel to make sure the just compensation award is appropriate during condemnation proceedings and that they do not engage separate counsel. Most of the time, that is an intelligent choice that saves legal expense. However, banks should not automatically

assume that their interests will be protected by the property owner. Someone knowledgeable on behalf of the bank — an experienced credit manager, inside counsel or outside counsel — should carefully review the loan documents to determine the bank’s interest in the event of condemnation. They should also make the threshold judgment of whether the bank should retain its own counsel when the bank first receives notice of a condemnation proceeding.

When an entire property is acquired or “taken” by eminent domain, the bank must be careful to be sure that it is paid in full. Depending on the amount of just compensation awarded, the bank’s security position could be in jeopardy. Similarly, if the government is only taking part of the property and that “partial take” causes substantial severance damages to the remaining property, the bank must be careful to protect its security position. Most courts in condemnation actions try to protect the adequacy of the bank’s security and limit the lender to recovery of an appropriate proportion of the just compensation award.

There may be times when the bank is entitled to the entire just compensation award. For example, when a mortgage is foreclosed and a deed in foreclosure is delivered prior to an acquisition by eminent domain, the mortgagee’s interest is no longer a lien, but a fee interest. In that case, the mortgagee is entitled to the entire just compensation award.

The condemnation of a property subject to a loan presents many choices for the lender. The bank may choose to put its relationship with the borrower ahead of strict compliance with the loan documents, even if the loan documents provide that 100 percent of all condemnation awards be paid to the bank. But, before choosing to rely on its borrower and borrower’s counsel, the bank should review the loan documents, its security interest and the nature of the government’s “take,” to determine whether it needs independent counsel to protect its security and receive the compensation that it is entitled to.



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