

**The Stigma Enigma:
Doublespeak, Double Standards, and Double Dipping
in Toxic Tort Property Damage Claims**

“Ignorance is strength”

“2 + 2 = 5”

Mottos of “Big Brother” excerpted from the novel 1984 by George Orwell

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Perhaps no recent concept in real estate appraisal has gained such unquestioned popularity as the term “stigma.” Numerous articles have been written in the last fifteen years applying the concept to the negative effects of every conceivable type of environmental condition. Use of the term arose not out of thin air or from real estate markets, but after the passage of the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) in the 1980’s. The very use of the term in an appraisal or published article connotes some sort of specialized or esoteric knowledge about the impact of environmental conditions on the market value of real estate. The term stigma has been so loosely defined so as to mean anything anyone wants it to mean. One might even say that there is a stigma surrounding the use of the term stigma in toxic tort property cases. As such, stigma has become an enigma.

Reminiscent of George Orwell’s classic novel, 1984, the stigma concept often reflects “doublespeak” in that the term has evolved to often mean the opposite of what the word literally means and the methods for its calculation are deceptively prone to reflect double arithmetic.

The purpose of this paper is first to survey case law from strictly a real estate valuation perspective to derive a legal definition of stigma, or at least what stigma is not. The reader is cautioned that the case law summary that follows is not definitive and that no legal reliance should be made on the interpretation of such cases offered herein. Secondly, this paper will make a comparison of the legal definitions of stigma, and professional buzzwords used to mean the same thing, with the definitions of stigma promulgated by the real estate appraisal profession. The dilemma of pre-defining environmental conditions as “detrimental” or “stigmatizing” is addressed in view of the prohibition in professional appraisal standards to avoid predetermined valuations. A modest recasting of definitions used in real estate damage valuations is offered at the conclusion for further professional consideration.

Evolution from the “Lesser-Of Rule” to the “Personal Reason Exception”

The term stigma has been so abused that it is sometimes as enlightening as absurdly humorous. A recent posting on an online chat line for professional real estate appraisers asked for advice as to how to value the stigma remaining after a condominium unit had been completely rebuilt following a natural gas line leak resulted in a near-total fire damage loss. One can only surmise that the appraiser did not take

into account that insurance proceeds would not only provide for restoration of the unit to a new condition without any physical depreciation, but would also bring the unit up to modern building code standards. Thus, in the after condition the property could be said to reflect “positive stigma,” a doublespeak term, or what is called in insurance terminology “betterment.”

In a similar case, a California court considered whether a landowner should be compensated for damages that paradoxically resulted in an increase in the value of the property. In the course of cutting a road through the landowner’s property, the defendant removed or damaged a few hundred trees and destroyed the vegetative undergrowth. Ironically, the intrusive alteration of the property created an access route to the property increasing its value by some \$5,000 (see *Heninger vs. Dunn*, 101 Cal. App. 3d 858, 1980). Prior to this case, the conventional standard that applied in real property tort cases was the “lesser of rule” stated below.

“Lesser-Of Rule:” *A property owner is entitled to the lesser of the cost to repair, or diminution in value.*

However, in the case cited above the court allowed the cost of repair even though it exceeded the diminution in value. The court held, however, that it would be unreasonable to allow restoration at a cost that exceeded the value of the land. Nonetheless, the court decided that proxy restoration was valid (e.g., replanting of saplings instead of mature trees). The *Heninger-Dunn* case created an exception to the “Lesser Of” damage rule known as the “Personal Reason Exception,” which may be restated as follows:

“Personal Reason Exception:” *Where there is loss of beneficial personal use of the property not recognized by the market, there nonetheless may be sound reasons for the awarding of damage compensation equal to or higher than any diminution;*

- *but not including the full reproduction cost of unique improvements;*
- *or where the repair cost will far exceed the damage the defendant has caused.*

In a contraindicating case, an appeals court had to reverse a Florida jury award of \$300,000 against Orkin Exterminating Company for stigma from termite damage remaining after Orkin paid \$78,000 to a homeowner to repair his home (*Orkin v. Delguidice*, July 13, 2001, 5th District, Florida Court of Appeal, Case No. 5D00-1999). The court limited the award to only “actual damages” and disallowed additional hypothetical “stigma” damages. In the case of termite damage the court made it clear that claims of stigma damage were, figuratively speaking, a “bugaboo.”¹

¹ Bugaboo. Something that causes fear or distress out of proportion to its importance, Webster’s Ninth New Collegiate Dictionary 1984.

The Pierpont Inn Principle: nearly anything goes

In a landmark California case of *San Diego Gas and Electric vs. Daley* (205 Cal. App. 3d 1334 [1988]), the court ruled that a real estate appraisal expert was entitled to consider buyer fears of electromagnetic fields (EMF's) as a factor affecting the market value of property, even if those fears are unfounded and irrational. The Daley case invoked what is called the "Pierpont Inn Principle," which held that "any loss of market value proven with a reasonable degree of probability should be compensable." In an extension of the Daley case, a court ruled that offsite conditions could be taken into account in determining the impact on market value of the plaintiff's property (see *Emery vs. the City of Palos Verdes Estates*, 6 Cal. App. 4th 679, 687 [1992]). This is unlike eminent domain law where proximity damages are only compensable in limited situations or under claims of inverse condemnation.

From preponderance of evidence to "more likely than not"

The above cases appear to inaugurate a new burden of proof standard to replace the "preponderance of the evidence" rule in most civil cases: "the more likely than not standard." The "more likely than not" evidentiary standard apparently applies in tort cases, whereas the "preponderance of the evidence" standard applies in most eminent domain cases and the "beyond a reasonable doubt" standard in criminal cases.

Apparent Burden of Proof Standards

- Real property torts – "idiosyncratic evidence" ("personal reason exception" - California)
- Eminent domain, inverse condemnation – "preponderance of evidence"
- Criminal cases – "beyond a reasonable doubt"

What might be called the "idiosyncratic evidentiary standard" offers almost no barrier to the entry of evidence in toxic tort property damage claims despite the overwhelming impartial scientific evidence indicates that the health effects from toxic waste sites are negligible or de minimus, other than possibly affects on groundwater supplies (see *Aaron Wildavsky, But Is It True? A Citizens Guide to Health and Safety Issues, Harvard University Press, 1995: 183; and Wayne Lusvardi, "The Dose Makes the Poison: Environmental Phobia or Regulatory Stigma," Appraisal Journal, April 2000: 184-190*). Even in the case where groundwater has been contaminated no affect has been found on property values (see *Mark Douthour, "Groundwater Contamination and Residential Property Values," Appraisal Journal, July 1997: 279-285*). Under the idiosyncratic rule it would appear that speculative, conjectural, and hypothetical evidence could be entered in a litigation valuation proceeding. This could include purely subjective opinion and hearsay by a professional real estate appraiser.

Courts have paradoxically ruled stigma can be objectively measured despite defining it as a subjective factor

Even though such cases have made it clear that legal claims filed for emotional distress from the subjective fear of living near electric transmission lines, contaminated properties, or other perceived unwanted land uses, are not compensable, it has been deemed that the loss of market value to one's property is a condition that can be objectively measured. As will be discussed below, this is a highly questionable legal ruling given the intangible, speculative, and short-lived nature of stigma. The basis of tort property damage claims has evolved from the more objective "lesser of rule" to the more subjective "personal reason exception." The more lenient standard of tort law, as opposed to eminent domain and inverse condemnation law, raises heretofore unanswered questions about the capability of experts to testify as to subjective damages not supported by market evidence, the applicability of the Evidence Code to such cases, and the ethical dilemma as to when an expert valuation witness is nothing more than an advocate. While the "Personal Reason Exception" may provide relief to property owners heretofore not recognized under conventional eminent domain and insurance damage law, it begs the question whether such claims are based on the mere self-interest and avarice of property owners. Moreover, as will be elaborated upon below, such an ambiguous standard ignores whether such claims may result in double compensation.

The California courts have placed some limits on subjective environmental damage claims however. In *Potter vs. Firestone* (6 Cal 4th 965, 985 [1993]), the California Appellate Court negated the notion that the public fear of power line EMF's somehow bestows an inverse condemnation claim upon all neighboring property owners.

It is unclear whether stigma damage claims in EMF cases apply to toxic tort claims. But in *Paoli Rail Road P.C.B. Litigation* (35 F. 3d 717, 197 [3d Cir. 1994]), it was ruled that "compensation in a tort case is generally at least as great as in a takings case...including property lost and incidental injuries not recognized in eminent domain actions."

Stigma need not entail actual harm

Several cases outside of California have refused to allow the recovery of damages where the level of hazardous substances are small or pose no demonstrable health risk (*Graham vs. Canadian National Railway Co.*, 749 F. Supp 1300, 1320 [D. Vermont 1990]; *Bradley vs. American Smelting and Refining Co.* [635 F. Supp. 1154, 1157-58 [W.D. Washington 1986]). But some state courts have clarified that recovery for mere nuisance for alleged diminution in property value due to unfounded fears of contamination is not compensable (*Adkins vs. Thomas Solvent Company*, 440 Michigan 293, 487 N.W. 2d 715 [1992]).

Negligible exposures have been deemed noncompensable

The above summarization of case law is reminiscent of the statement by British writer George Orwell that “we have now sunk to the depth at which restatement of the obvious is the first duty of intelligent men.” All of the above cases seem to come to the obvious conclusion that damage recovery is not permitted where the contamination is small or where claims of personal loss are speculative and hypothetical. On the other hand, the courts continue to believe that real property stigma losses can be objectively measured from the market. As will be elaborated upon below, this is a highly questionable legal and economic assumption.

“Personal Reason Exception” based on use value, not market value

In *Orndorff vs. Christiana Community Builders* (217, Cal. App. 3d 683 [1990]), the court allowed the “personal reason exception” in a case involving the construction of a home on negligently compacted soil and where it was alleged that the home was worth less after repair and the cost of repair exceeded the entire value of the property. The court affirmed the standard that “all that is required is some personal use and a bona fide desire to repair or restore.” In other words, the damage need not be to the property’s “market value” but to the beneficial personal use of the owner(s) who have a sufficiently lengthy investment in the home such that they desire to restore it to continue residency and protect their equity. The only limitation placed on property damage claims in such cases is that “the application of the personal reason exception does not permit a plaintiff to insist on reconstruction of a unique product where the cost of repair will far exceed either the value of the product or the damage the defendant caused.” The court affirmed that recovery couldn’t be entertained when “only slight damaged has occurred and the cost of repair is far in excess of the loss in value.” In real estate appraisal terminology, the court is saying that full recovery for reconstruction of a replica of a unique property may not be attainable through legal means.

By definition, use values, as opposed to market values, cannot be measured from market evidence. The double standard of the court ruling that subjective damages can be objectively measured makes the valuation of stigma a murky issue.

A tentative conclusion from the above tort cases is that where there are obvious damages to real property and where there is an obvious cause of action against another party, what is in dispute is whether a claimant can impose damages in excess of the value of the property as long as it does not far exceed that value. Unfortunately, the jurisdictions where the “personal reason exception” prevails have not enumerated a qualitative or quantitative test to determine whether a given subjective claim is objectively reasonable or equitable. To accomplish such a subjective standard requires a more precise definition of “stigma damages.”

Stigma claim need not show that affected property is itself contaminated

As discussed above, “stigma” or “personal” damage actions are legally permissible in some jurisdictions based on “irrational public fears” and even in some cases where there are no demonstrable negative health effects. This “irrational” and “subjective” definition of stigma has been extended in the law such that it may not be necessary to show that the impacted property is itself contaminated. In *DeSario vs. Industrial Excess Landfill, Inc.* (68 Ohio App. 3d 117, 129, 587 N.E. 2d 454,461 [1991]), the court held that a class action nuisance lawsuit “may be premised on the public’s perception of contamination irrespective of actual land contamination” (also see *Allen vs. Uni-First Corp.*, 151 Vermont 229,558 A. 2d 961, 963-964 [1988]).

The conventional standard applied in eminent domain and inverse condemnation cases is that there must have either been a physical taking, a physical invasion, or the loss of investment-backed expectations for a damage to be compensable. Clearly, the definition of stigma or personal damages as pure perception would not impose any such tests.

Stigma must result from physical not merely proximate or perceptual causes

In *Lamb vs. Martin Marietta Energy Systems, Inc.*, (835 F. Supp. 959 [W.D. Kentucky 1993]), the court denied a property damage claim alleging a private nuisance from a uranium enrichment plant two miles distant from the alleged affected property because: (1) the property showed no detectable amounts of contamination;(2) remediation efforts had begun to halt the further spread of the contamination plume; and (3) it was uncertain whether the plume would ever reach the subject property. Thus, “proximate cause” was denied as a basis of damage or stigma.

In *Berry vs. Armstrong Rubber Company* (989 Mississippi F. 2d 822 [5th Circuit 1993]), a complaint was brought alleging that a tire manufacturing plant dumped hazardous waste on or near the area of the purported damaged property from 1937 to 1987. The trial court ruled that there was no credible evidence of contamination on the property. Additionally, the court rejected the expert testimony of the property owner’s real estate appraisal expert that a negative stigma significantly reduced the value of the affected property. The court ruled that even though state courts had held that a decrease in value emanating from “stigma” was compensable, some evidence of physical invasion of the property must be presented. In contrast, in *Pruitt vs. Allied Chemical Corp* (523 F. Supp 975 [E.D. Virginia 1981]), pure economic loss without any direct physical contact was allowed, but only for businesses, such as recreational fishing related businesses, affected by discharged pollutants into Chesapeake Bay.

Stigma must not emanate from negative publicity (but stigma is negative publicity)

Negative publicity has also been denied as a definitional component of stigma. In *Adkins vs. Thomas Solvent Company* (441 Michigan 293, 487 N.W. 2d 715 [1992]), diminution damages were denied on the basis of negative publicity as interfering with

the personal use and enjoyment of the land. However, as stigma is, by definition, a form of negative publicity in the real estate market, the courts have obscured its valuation.

Stigma must be permanent (but that is pretty unlikely)

Perhaps most importantly, many courts have defined recoverable damages as those that are permanent and unremediable. In the case of Paoli Rail Road P.C.B. Litigation (35 F. 3d 717 [3d Circuit 1994]), a Federal Appeals Court found that it was only “permanent” damages for which a property owner could recover. At least theoretically, damages could be sought before a cleanup of a toxic waste site was complete, as market evidence of diminution should reflect a permanent decrease in value. Contra many of the cases cited above, the Paoli Rail Road case ruled that: (1) to recover stigma damages permanent physical damages to the land need not be proven, (2) that it must be demonstrated that remediation will not recover the full value of the property, and (3) that there must be some ongoing risk to the property. But the damages must not be temporary or cyclical. In real estate appraisal terminology, stigma damages must result in capitalization in perpetuity. This is again contradictory as stigma is an intangible that by definition is rarely ever permanent and is highly inconstant.

Double recovery as a form of welfare insurance against loss

The Achilles heel of stigma damages, even when properly defined, is that it reflects a windfall “double recovery” from both a court in the near term and the market in the probable future. Double recovery is especially prevalent where the courts deviate from merely providing compensation for relatively small costs to cure damage as provided in the “lesser-of rule.” In those cases where the cost to cure greatly exceeds diminution, the intent of the court seems precisely to provide double compensation as a sort of insurance mechanism to protect a homeowner’s property equity.

In the case of California at least, we are again faced with a multiplicity of definitions as to whether claimants can recover damages to abate both present contamination and any future damages beyond cleanup. California Code of Civil Procedure Section 731 states that “the nuisance may be enjoined or abated as well as damages recovered therefore” while Polin Vs. Chung Cho (8 Cal. App. 3d 673, 678 [1970]) states no damages may be awarded beyond the action granted.

If stigma is foreseeable, an award would constitute double recovery

The conventional rule in such situations is called the “**foreseeability test**,” which generally states that:

Foreseeability Test: *Inasmuch as the damage was foreseeable, mitigatable, minimizable, or avoidable prior to the damaging event, compensation is not indicated.*

The legal concept of “market value” entails willing, knowledgeable, and prudent parties. The presumption must be made in analyzing real estate market data that the bulk of the sales data reflects transactions that are between knowledgeable parties. This presumption is a reality with modern disclosure laws. Applying the knowledgeability criterion of the definition of market value to real estate damage cases means that when a property owner is harmed by some environmental condition that is entirely foreseeable that compensation may not be legally considered. This is called the doctrine “that only unforeseeable harm is recoverable.”² This principle of law has been understood as far back as 1823 when, in the case of *Callender vs. Marsh* (1 Pick. 417, 430 [1823]) the court said:

“Those who purchase house lots...are supposed to calculate the chance of (damages) and as their purchase is always voluntary, they may indemnify themselves in the price of the lot which they buy.”

Under the market value foreseeability test, the assumption is that buyers have indemnified themselves against the risk of any future loss by appropriately discounting the sales price of a property for the condition at hand. This discounting, or hedging, process involves quantifying the probability of the risk of future loss. For example, increased noise impacts to surrounding properties from adding a new runway onto an existing airport is likely to be a compensable damage because it probably was not foreseeable. Conversely, moving near a preexisting toxic waste site that was disclosed, as part of the purchase contract in a real estate transaction, is probably not compensable because it was foreseen and thus capitalized in home prices. Although there is a large amount of literature that supports the notion that the public is not intuitively good at quantifying environmental risks such as exposure to toxic waste sites,³ it is not health risks but potential wealth risks (loss of property equity) that the public is mainly reacting to.⁴

Taking the “foreseeability principle” to an illogical extreme, however, no damages could arise from 9/11 because the malicious intent of some parties was well known, even to the extent of a previous attack, and that therefore should have been well discounted in pre-9/11 prices.

Stigma claims must not ignore duty to mitigate or indemnify

The California Supreme Court ruled in *Spaulding vs. Camerson* (38 Cal. 2d 265, 269 [1952]), that the lower trial court’s award of damages for diminution in value resulting from the persistent threat of future mudslides was not recoverable because the

² H.L.A. Hart and Tony Honore, *Causation and the Law*, 2nd Ed. (Oxford: Clarendon Press, 1985): 259.

³ John Adams, “Cars, Cholera, and Cows: The Management of Risk and Uncertainty,” Policy Analysis No. 335, Cato Institute (Washington D.C., March 4, 1999).

⁴ Allan Mazur, *A Hazardous Inquiry: The Roshomon Effect At Love Canal* (Massachusetts: MIT Press, 1999). Also, Wayne Lusvardi, “But Is It Market Value?: Separating Market Appraisal from the Liability Model,” *Appraisal Journal*, October 1999.

court had ordered the defendant to build protective structures to prevent future mudslides. The court stated:

“plaintiff would obtain a double recovery if she could recover for the depreciation in value and also have the cause of that depreciation removed.”

Since the enactment of the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA or “Superfund” law) in the 1980’s, the use of environmental insurance policies and indemnifications has grown. Given appropriate clean up measures, with sufficient insurance coverage and indemnifications, stigma may become nothing more than an enigma (i.e., something difficult to explain, understand, interpret or measure).

Lesser-of rule versus Greater-of rule

What the courts seem to be saying in property tort cases is that when the damage is temporary, only repair costs are recoverable consistent with the “the lesser-of rule.” Conversely, when damages are permanent or reflect a wipeout of the property owner’s equity, diminution or cost to cure is recoverable following what might be called “the greater of rule.”

Appraisers’ definitions: an absence of control factors

The response of the appraisal profession to CERCLA and the ensuing case law summarized above was to issue a “Guide Note” addition to its standards of Professional Appraisal Practice (1991). The crucial concern of such guidelines is to prevent real estate appraisers from liability for erroneous appraisals by clearly disclosing whether appraisals reflect the value of property containing alleged hazardous substances “as if clean,” or “as-remediated.” The purpose of such guidelines is to reduce the possibility of legal action against an appraiser for overvaluation of so-called contaminated properties. No definition of “stigma” was offered in the guidelines or in the Dictionary of Real Estate Appraisal (1993), the standard book of professional terminology.

This didn’t stop a number of real estate valuation experts from promoting their own different buzzword definitions of stigma in the professional literature, without much, if any, consideration of the legal definitions coming out of the court system. In the interest of brevity and at the risk of oversimplification, these definitions are summarized in the table below.

British novelist and essayist George Orwell once said something to the effect that a characteristic of propaganda was that it was less defined by what it stated than what it omitted. This is not to cast aspersions on the definitions of stigma of the appraisal profession as mere propaganda, but rather is to say such definitions leave out most of the legal criteria defined by the courts for considering environmental damage claims. Not only is there a disconnect between the professional and legal definitions of environmental damages and stigma, but such professional definitions lack any

consideration of controlling for extraneous causes, double accounting, and foreseeability tests. Appraisal is as much art as it is science. But a definition of science is the use of controls, whether they are definitional, methodological, or statistical. Inasmuch as the prevailing definitions of environmental real estate damages lack consideration of control factors, real estate damage appraisal cannot lie claim to being considered as even partly a science. This is all-important because the valuation of stigma damages without the use of controls would thus fail to meet what are called “Daubert tests” for scientific rigor required in Federal and many state damage courts (see *Daubert vs. Merrell Dow Pharmaceuticals*, 1993).

While the appraisal profession has thrown up a multitude of definitions of stigma and related property damage buzzwords, it has not addressed the crucial aspect of proper research design for property damage valuations (*for an exception see Wayne Lusvardi and Charles B. Warren, “Daubert-Compliant Research Design for Property Damage Valuations,” Environmental Claims Journal, Winter 2001: 33-52*).

Stigma valuation like fitting square peg into round hole

Moreover, the courts gravitation to the “Personal Reason Exception” discussed above is based more on the “use value” of the property than its “market value.” Hence, the definitions and valuation methods propounded by the appraisal profession are like trying to fit a square peg into a round hole. To be fair, the courts have issued contradictory and unhelpful rulings that stigma can be “objectively” measured while at the same time pushing the envelope of the legal standard for measuring environmental damages from the “lesser-of rule” (i.e., market value standard) to the idiosyncratic “personal reason exception” (i.e., use value standard). Finally, use value is subjective, and the criteria may be idiosyncratic yielding a unique "value". In the normal course of a market there are a myriad of "use value" bids, and the highest wins. Absent the market, what objective reference can calibrate a "use value"?

Appraiser stigma definitions leave out knowledgeable buyer criteria

Perhaps most disturbing and confusing is that real estate appraisers, of all professionals, have promoted definitions of environmental damages and stigma that are wholly inconsistent with the “knowledgeable buyer” criteria contained in the definition of “fair market value,” as incorporated into the “foreseeability test” of the law discussed above.

For the real estate appraisal industry to meet the tests of being a profession it must be measuring what it says it is measuring when it promotes definitions and methodologies for the valuation of environmental damage claims. As professors Peter B. Moyer and Christopher Reaves of the Kentucky Institute for Environment and Sustainable Development at the University of Kentucky state in their review of the appraisal literature entitled “Accounting for Stigma on Contaminated Lands:”

“So, in reality, it is not clear that some ambiguous, undefinable or unmeasurable separate market factor such as stigma, assumed by the appraisal community, actually exists.”⁵

We believe that a stigma factor empirically exists, but that it may be so temporary, intangible, and unmeasurable as to be an enigma.

Appraiser definitions and methods as scientifically ignorant

In *Rockwell Corp. vs. Vance Wilhite, et al* (Court of Appeals, Kentucky, Case No. 97-CA-000188, April 14, 2000), the Kentucky Court of Appeals ruled that a real estate appraiser was unqualified to appraise damages to properties allegedly exposed to low-levels of PCB's as he: (1) lacked scientific education as to the “dose-response” relationship of PCB's, nor relied on any experts for such; (2) performed no comparative sales analysis; (3) failed to discover that local lending institutions had made 90 loans on allegedly contaminated properties at the usual market rates; (4) many of which were generated after the damage case was filed; and (5) failed to consider that many of the purported damaged properties sold for full price and property owners continued to pay taxes on and insure properties for full market value. The court characterized the real estate appraiser's opinion as “a little voodooish” and not based on accepted valuation methodology. What the court perhaps did not understand is that no accepted definitions or methodology for the valuation of contaminated properties have ever been endorsed by the appraisal profession and ratified by educational peer review outside the profession.

Moreover, in the *Rockwell vs. Wilhite* case the court ruled that even though the appraiser held the highest educational designation in his profession and had completed professional coursework on contaminated properties sponsored by the leading professional association, his testimony was nonetheless disqualified. This case corroborates the assertions of this paper that the appraisal profession is prone to inventing its own definitions of environmental stigma damages irrespective of legal definitions. Additionally, there is a lack of integration of a scientific knowledge base into the professional training for valuation of contaminated properties in the appraisal profession which can render such so called expert testimony as inadmissible. These observations seem to validate British novelist George Orwell's aphorism quoted at the beginning of this article that “ignorance is strength.”

Stigma valuation confounded by externality factor

A complicating factor in the valuation of stigma damages not discussed in the professional literature other than that offered by the authors of this paper is what is called the “externality problem.” In rapidly inflating real estate markets, negative characteristics of properties are often ignored or minimized. However, in periods of market decline the market often recognizes and discounts such negative characteristics.

⁵ Peter B. Moyer and Christopher Reaves, “Accounting for Stigma on Contaminated Lands,” Working Paper 1998, Center for Environmental Policy Management, Kentucky Institute for Environment and Sustainable Development, University of Louisville.

Thus, indirect external forces either can overcome or magnify so-called “detrimental conditions” or stigma.

“Stigma” may not show up at all until there is a downturn or down cycle in a given market. But then, such purported stigma may be indiscernible from the “background effect” of the price movement brought about by larger market forces (*see Wayne Lusvardi and Charles Warren, “The Externality Principle” Transfer Seeking as an Economic Basis of Regulatory Takings, Environmental Claims Journal, Spring 2001: 63-88*). This explains why the real estate damage appraisal business is most active during down market cycles when property owners may try to recover losses from whatever causes from claims of environmental stigma damages.

“Detrimental” or disadvantageous conditions? Predetermined definitions versus professional standards

The use of such terms to describe environmental conditions as “detrimental,” “defect,” “contaminated,” and “stigma” may not be as appropriate as perhaps such terms as “risky,” “disadvantageous” or “unfavorable.” In fact, the use of such negative terms may be viewed as conclusionary and prejudicial in a legal context. Accepted real estate appraisal standards prohibit real estate appraisers from reporting “predetermined values or a direction in value that favors the cause of a client.” The very definitions employed in the appraisal profession to environmental damages cases would seem to contradict such standards. Here one is reminded of the self-fulfilling prophecy phenomenon described by social psychologist W.I. Thomas: “If a situation is defined as real, it is real in its consequences.”⁶ Once environmental conditions are labeled as “detrimental” or “stigmatizing,” it can only be concluded that they somehow damage property values, which may or may not be the case mainly depending on whether such conditions were foreseeable and whether external market conditions permanently recognize such environmental conditions.

The Double Effect in Stigma Damage Valuations

The “double effect” is a concept that states from one action two effects will follow, one good, and the other bad. As some of the case studies above point out some seemingly environmentally damaging conditions can have positive consequences on property values and vice versa. What this infers is that real estate appraisal should avoid such biased terms as “detrimental conditions.” Perhaps more neutral terminology such as that suggested above should be considered (i.e., risky, disadvantageous or unfavorable conditions). However, use of less biased terms would not facilitate marketing by real estate appraisers as specialists in damage valuation.

Summary, conclusions and some modest redefinitions

The courts have preferred to define environmental damages and stigma by what it is not; the real estate appraisal profession by what it is. Most of the definitions offered

⁶ W.I. Thomas, *The Unadjusted Girl*, Boston: Little, Brown Publishers, 1923.

by the appraisal profession fail to consider or control for those factors the courts have ruled out (e.g., negative publicity only, foreseeability, impermanency, lack of duty to mitigate, mere proximity). Of course, as with eminent domain, there are always things that may measurably affect value but which are not compensable (e.g., noise, dust, circuity of travel, mere proximity, etc.).

Of the definitions of stigma summarized in the attached table, that offered by Roddewig is perhaps the most useful and legally consistent, and that offered by Bell the least; albeit all definitions grossly fall short of the mark in view of the “Personal Reason Exception” and the “Foreseeability Test” codified into case law.

The appraisal profession has been prone to throw around loose terms such as “stigma,” “environmental defects,” “detrimental conditions,” “impaired properties,” “harmful,” “environmental damages,” and “diminution” as if they all were the same thing. The profession has never adopted a formal set of definitions or methodologies for real estate damage valuations outside of those used in eminent domain cases that were established from case law.

It is an American cultural value is to either “put up, or shut up” and not merely offer criticism. So, in closing we humbly offer up the following tentative set of modest definitions and possible acronyms for further professional consideration:

“Environmentally Affected Real Estate Equity” (EAREE’s aka eerie’s) are those physical conditions that are prone to be a potential disadvantage or a handicap affecting the equity of real property under certain unfavorable market or regulatory conditions. A **decline** in value is area wide. Depending on the nature of the problem and the size of the area it might or might not have anything to do with any specific environmental or regulatory cause (i.e. loss of employment in California leading to lower house sales volume and sometimes lower prices). **Diminution** of value is specific to one or a small class of properties and can be tied to specific causes. **Damage** implies that the diminution is attributable to some specific action. So there may be a diminution of value due to cliff erosion generally, but only damage when the collapse of the bluff affects the one or few properties. Damage also implies legal compensability. **Stigma** is another word for uncertainty of past or the future (i.e., for “foreseeable unforeseeability”). Either the past problem has been addressed more or less well and the market has already discounted for any stigma affects, or the occurrence is current and the magnitude of its affects is unknown. In the latter case stigma would be a function of the probable magnitude of any future problem, probability of public acceptance of the present fix and/or the probability of recurrence of the problem.

A **decline, diminution, damage,** or a **stigma** can all take two forms: **“capitalized”** or **“uncapitalized.”** The former is noncompensable as it was foreseeable and the market has already adjusted for its effects, and the latter is compensable as it was unforeseeable and unavoidable. In the case of uncapitalized stigma, the stigma effect will dissipate, as the actual magnitude of the problem becomes known. While stigma may dissipate that is not to imply that damages necessarily do. If the problem is a landslide, the damages may erase the property and almost all of its value. Alternatively, if the problem is the public scare of the day, EMF, Urethane foam insulation, lead paint, or mold, public information and education may dissipate both the stigma and the damage over time. Publicity effects, miscalculations, and foreseeable factors are all grist for the mill as the market determines price from information.

A **scapegoated,** or **environmentally embargoed,** property is one that suffers from environmental over-regulation that will have negligible positive health effects from remediation or regulation but significant wealth effects on surrounding properties.⁷ There are examples that arise from most environmental laws, especially the Endangered Species Act, and the Clean Air Act.

See table below

⁷ See Wayne C. Lusvardi, “Condemnation of Over-Regulated Toxic Properties,” Right of Way, November-December 1998: 20-27, 42.

Summary of Appraisers' Definitions of Environmental Damages and/or Stigma

Author	Date	Definition
Patchin	1988	Stigma is residual after "costs of cleanup" and "liability to the public" (<i>Peter J. Patchin, Valuation of Contaminated Properties, The Appraisal Journal, January 1998: 7-16</i>).
Patchin	1991	Stigma is fear of hidden cleanup costs, the "trouble factor," fear of public liability (i.e., lawsuits), and lack of mortgageability. (<i>Peter J. Patchin, "Contaminated Properties – Stigma Revisited," The Appraisal Journal, April, 1991: 167-172</i>).
Arens	1997	Environmental defects are from Category I Losses (not easily measureable) or Category II Losses (measurable from comparable sales data) measured by "cost to remediate, additional vacancy, additional financing, insurance costs, and monitoring costs." (<i>S. B. Arens, "The Valuation of Defective Properties: A Common Sense Approach," The Appraisal Journal, April 1997: 143-148</i>).
Mundy	1992	Stigma is the probabilistic fraction of the reduction in price of the property between its "before contamination" and "after contamination" that is in excess of the cost to cure the known pollution. (<i>Bill Mundy, "Stigma and Value," The Appraisal Journal, January 1992: 7-13</i>).
Roddewig	1996	Stigma, as it applies to real estate affected by environmental risk, is generally defined as "an adverse public perception about a property that is intangible and not directly quantifiable." Can be a temporary condition. (<i>Richard Roddewig, "Stigma, Environmental Risk and Property Value: 10 Critical Inquiries," The Appraisal Journal, October 1996: 375-387</i>).
Bell	1999	"Detrimental conditions" (DC) defined as diminution measured by (a) value of property in undamaged condition, (b) value upon occurrence of DC, (c) the costs to assess the situation, (d) the costs to repair, and (e) the costs of any ongoing conditions of monitoring (i.e., "residual adverse market reaction" or "stigma." DC's are defined according to a classification scheme including benign DC, temporary DC, Imposed DC, Super and Sub-surface DC's, Environmental DC, Natural Condition DC, and Incurable DC. (<i>Randall Bell, Real Estate Damages: An Analysis of Detrimental Conditions, Appraisal Institute, 1999</i>).