

Is the *Penn Central* Three-Factor Test Ready for History's Dustbin?

By John D. Echeverria

No other legal issue springs to the minds of both land-use planners and lawyers as quickly as the takings issue. Since 1987 and the famous trilogy of U.S. Supreme Court cases (see the 1987 August and September issues of this publication), the takings issue is encountered with increasing frequency in the legal literature, planners's concerns, and even legislative debates. Now even books on the takings debate are common, proposals for state takings legislation are perennial, and takings claims in land-use cases seem nearly routine. In this month's commentary, attorney John Echeverria takes a fresh look at the issue. Ironically, his stance agrees in part with those who call for an expansive reading of the takings clause—it is time for clarity and change. As takings law unfolds in this new century, it will be interesting to see how much Echeverria's intriguing ideas on takings law will influence our courts' decisions and the ways planners may plan and regulate.

The U.S. Supreme Court decision in *Penn Central Transportation Co. v. New York City*, 98 S.Ct. 2646 (1978), 30 ZD 434, is justly celebrated. The case arose from New York City's efforts to preserve a famous historic landmark by blocking the construction of an office tower on top of Grand Central Terminal. The Court's rejection of the company's "takings" claim represents one of the most famous government victories in the annals of land-use law. And the decision articulated several principles that have turned out to have enduring significance in regulatory takings doctrine.

But the favorable result and the valuable principles established by *Penn Central* have for too long obscured the fundamental problems with the decision's most enduring legacy: the so-called three-factor regulatory takings test. Under this ostensible test, a court must evaluate a regulatory takings claim based on (1) the economic impact of the regulation, (2) the owner's reasonable investment-backed expectations, and (3) the character of the regulatory action. The time has come, I submit, to discard the three-factor *Penn Central* test. Even if it once represented a plausible regulatory takings test, it is now neither defensible as a matter of theory nor mandated as a matter of precedent.

While perhaps somewhat unfamiliar, this argument is hardly revolutionary. In fact, for the reasons discussed below, it simply calls for frank acknowledgment of the state of the law as it (mostly) already exists today. All that would really be lost by discarding the *Penn Central* test are the confusion and uncertainty that this test has engendered.

This article traces the origins of the ostensible *Penn Central* three-factor test, describes the reasons why the test should be discarded, and offers a better, more straightforward alternative.

VALUABLE, ENDURING ELEMENTS OF *PENN CENTRAL*

To avoid misunderstanding, I emphasize at the outset that I am not suggesting *Penn Central* was wrongly decided. I believe *Penn Central* was correctly decided on the facts of the case. In addition, the *Penn Central* decision articulated a number of entirely sound and important legal principles. My point is simply that the three-factor test that has been ascribed to the decision should be discarded.

Before attempting to toss out the *Penn Central* bath water, I want to preserve the *Penn Central* baby. What are the enduring principles in *Penn Central* that should be preserved, even if the three-factor test is discarded? There are basically four. (My purpose here is not to fully explicate or defend these positive aspects of the *Penn Central* decision, but simply to distinguish them from the target of this critique, the ostensible three-factor test.)

The *Penn Central* decision recognized the legal principle that the economic impact of a regulatory restriction must be measured based on the claimant's entire parcel of property, not just the restricted portion. 98 S.Ct. at 2662. This salutary rule prevents claimants from converting virtually any regulatory restriction into a potential constitutional taking. The "parcel as a whole" rule is essential to an interpretation of the takings clause that leaves any room for public planning and regulation of land uses. By keeping takings claims within reasonable bounds, it also respects the basic principle that elected representatives, rather than judges, have primary responsibility for setting social policy in this country.¹

Penn Central rejected "the proposition that diminution in property value, standing alone, can establish a 'taking.'" *Id.* at 2662-63. This principle, which is related to the "parcel as a whole" rule, confirms that not all regulatory restrictions are takings, even if they significantly restrict the profit an owner could otherwise earn by exploiting the property. Again, this principle is critical to maintaining the idea of property as a social institution properly subject to democratic supervision.

In addition, *Penn Central* recognized that a transferable development rights (TDR) program can help offset the economic burden that may be imposed by a regulation, thereby reducing the risk of a taking. *Id.* at 2666. Under a TDR program, a restricted landowner is permitted to exploit the development value of her land by transferring the development rights to other property in the community that is suitable for intensive development. TDR programs have been widely praised as a fair and reasonable tool for promoting strong conservation policies while ensuring that all land owners share in the benefits of community economic development. See generally R. Roddewig & C. Ingraham, *Transferable Development Rights Programs* (1987).

Finally, the *Penn Central* decision is valuable because it recognized that takings doctrine must take into account the fact that regulatory restrictions positively affect property values, including the property values of owners who themselves are subject to the restrictions. As the Court said: "Unless we are to reject the judgment of the New York City Council that the preservation of landmarks benefits all New York citizens and all structures, both economically and by improving the quality of life in the city as a whole—which we are unwilling to do—we cannot conclude that the owners of the Terminal have in no sense been benefitted by the Landmarks Law." *Id.* at 2664. As discussed below, this common sense observation about how regulations affect property values also provides powerful support for discarding the three-factor test that the *Penn Central* decision ostensibly launched.

ORIGINS OF THREE-PART TEST

The so-called three-factor test derives from the following language in the *Penn Central* decision. After describing its prior takings decisions as resting on "essentially ad hoc, factual inquiries," the Court said:

[T]he Court's decisions have identified several factors that have particular significance. The economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are, of course, relevant considerations. So, too, is the character of the governmental action. A "taking" may more readily be found when the interference with property can be characterized as a physical invasion by government, than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good. *Id.* at 2659 (citations omitted).

Putting first things first, it is far from obvious that the Court in *Penn Central* actually intended this enumeration of "significant" factors to define a determinative, free-standing test for a regulatory taking. The Court acknowledged that "[t]he question of what constitutes a 'taking' for purposes of the Fifth Amendment has proved to be a problem of considerable difficulty," *id.*, and that the Court "has been unable to develop any 'set formula' for determining" whether a taking has

occurred. *Id.* The *Penn Central* Court did not purport to solve this doctrinal confusion by enumerating the several "significant" factors quoted above, as evidenced in part by the fact that the Court did not systematically apply these factors to evaluate the Penn Central company's claim. Moreover, the Court referred to a variety of other factors and standards that it said were relevant in takings analysis, but which have little if any connection to the three-factor inquiry. *Id.* at 2659-60, 2664-66.

Nonetheless, one year later, in *Kaiser Aetna v. United States*, 100 S.Ct. 383 (1979), 32 ZD 76, the Court singled out the three factors mentioned in *Penn Central* as the core factors in takings analysis. Subsequent decisions have reinforced the idea that *Penn Central* laid out a freestanding, three-factor takings test.²

It is remarkable to observe, given the frequency with which the Supreme Court has recited this test, that the Court has never upheld a regulatory takings claim based on it. See *District Intown Properties Ltd. Partnership v. District of Columbia*, 1999 WL 1204343, *12 (Williams, J., dissenting) (D.C. Cir. 1999) (confirming this reading of Supreme Court takings precedents). Looking at the relatively few cases in which the Court has ruled in favor of takings claimants, every decision rests on some special factor, such as the fact that the regulation completely destroyed the value of the property, see, e.g., *Lucas v. South Carolina Coastal Council*, 112 S.Ct. 2886, 44 ZD 302 (total elimination of value of coastal lots); *Ruckelshaus v. Monsanto*, 104 S.Ct. 2862, 2874 (1984) (destruction of economic value of trade secret); the fact that the regulation resulted in a physical occupation of private property, see, e.g., *Loretto v. Teleprompter Manhattan CATV Corp.*, 102 S.Ct. 3164 (1982), 35 ZD 21 (forced occupation of private property by cable television equipment); *Dolan v. City of Tigard*, 114 S.Ct. 2309 (1994), 46 ZD 232 (exaction resulting in a physical occupation); *Nollan v. California Coastal Commission*, 107 S.Ct. 3141 (1987), 39 ZD 226 (same); cf. *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 101 S.Ct. 446 (1980) (analogizing appropriation of a fund of money to a physical occupation); or the fact that the regulation abrogated a particularly fundamental type of property interest, see *Hodel v. Irving*, 107 S.Ct. 2027 (1987) (right to devise property).

The closest the Court has come to finding a taking by applying the *Penn Central* test was in *Eastern Enterprises v. Apfel*, 118 S.Ct. 2131 (1998), in which a plurality of the Court applied the *Penn Central* test, joining in the judgment for the Court striking down federal coal legislation as unconstitutional. But a majority of the Court (Justice Kennedy and the four dissenters) actually rejected the takings claim on the ground that the takings clause did not even apply to the type of government action at issue in that case.

In certain lower federal and state courts, the ostensible *Penn Central* three-factor takings test is being deployed to support so-called "partial" regulatory takings claims. While most partial takings claims apparently fail in practice, see, e.g., *District Intown Properties Ltd. Partnership v. District of Columbia*, 23 F.Supp.2d 30 (D.D.C. 1998), *aff'd*, 1999 WL 1204343 (D.C. Cir. 1999), some do not, as illustrated by the August 1999 Court of Federal Claims decision on remand in *Florida Rock Industries v. United States*, 45 Fed.Cl. 21 (1999). The most problematic aspect of these "partial" takings cases is the impossibility of discerning a principled basis for the courts' decisions either to reject or grant the takings claims.

One additional preliminary point. Since 1980, and the Court's decision in *Agins v. City of Tiburon*, 100 S.Ct. 2138 (1980), 32 ZD 256, the three-factor test ascribed to *Penn Central* has existed in uneasy company with a separate, two-part regulatory takings test. According to the *Agins* test, a land-use regulation "effects a taking if the ordinance does not substantially advance legitimate state interests, or denies an owner economically viable use of his land." *Id.* at 2141 (citations omitted). While not cited with the same frequency as the ostensible *Penn Central* test, the *Agins* test has been relied upon repeatedly by the U.S. Supreme Court. See, e.g., *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 107 S.Ct. 1232 (1987) (rejecting takings claim based on two-factor *Agins* test); *City of Monterey v. Del Monte Dunes at Monterey Ltd.*, 119 S.Ct. 1624 (1999), 51 ZD

131 (affirming takings judgment based on jury instructions using the *Agins* two-part test). The question, of course, is how can regulatory takings doctrine include two tests that cover much of the same ground but point in such different directions? The Court has never acknowledged the confusion created by these separate tests, much less attempted to resolve it. This doctrinal confusion provides further evidence of the instability of the three-factor *Penn Central* test. It also suggests that coming to grips with the apparent incoherence of the *Penn Central* test also may help resolve the conflict between the *Penn Central* and *Agins* formulations.³

HOPELESS SEARCH FOR CONTENT

The meaning of the *Penn Central* three-factor test, and exactly how it might help courts decide takings cases, has always been obscure. The obscurity has only deepened with the evolution of regulatory takings doctrine over the last 20 years. This section seeks to explicate the depths of this obscurity.

First, the *Penn Central* Court's "economic impact" factor provides no meaningful guidance on the kind of economic impact that might support a finding of a taking. The *Penn Central* Court said that "economic impact" was a relevant factor in takings analysis. However, the Court did not identify a threshold of impact above which a finding of a taking would occur or below which a finding of a taking would be precluded. One might infer from the phrase "economic impact" that the likelihood of a taking should increase with increasing adverse economic effects. However, this possible reading of the "economic impact" factor is contradicted in *Penn Central* itself by the Court's rejection of "the proposition that diminution in property value, standing alone, can establish a 'taking.'" 98 S.Ct. 2663. In subsequent decisions, the Court has articulated this thought even more forcefully. For example, in *Concrete Pipe & Products*, 113 S.Ct. 2291, a unanimous Court said that "mere diminution in value of property however serious is insufficient to demonstrate a taking." See, e.g., *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 384 (approximately 75 percent diminution in value); *Hadacheck*, 239 U.S. at 405 (92.5 percent diminution)."

On the other hand, more recently, in *Lucas*, the Court said that a taking will generally occur "where regulation denies all economically beneficial or productive use of land." How can one reconcile this statement with the Court's insistence, even following *Lucas*, that mere diminution in value, no matter how severe, cannot effect a taking? Placing these two statements side by side, it is difficult to see how economic impact can ever be a decisive factor except in a *Lucas*-type case. Perhaps the Supreme Court thinks that adverse economic impact short of total elimination of property value can support a finding of a taking, but it seems clear, at least, that adverse economic impact is not sufficient by itself to establish a taking outside the *Lucas* category.

Turning to the *Penn Central* "character" factor, it is apparent that the Court used this term to refer to the issue of whether a regulation results in a forced physical occupation of private property. See 98 S.Ct. at 2659. The difficulty with viewing this factor as part of a three-factor test is that the Court subsequently transmuted it into a per se test for a regulatory taking. According to *Loretto v. Teleprompter Manhattan CATV Corp.*, 102 S.Ct. 3164 (1982), when a regulatory requirement results in a permanent physical occupation of private property, no matter how minute, a compensable taking occurs. If the character factor, when it applies at all, triggers a per se taking, then it obviously no longer fits within a multi-factor takings analysis.

Some decisions, including some handed down by the Supreme Court, suggest that "character" focuses instead on whether the regulation serves a legitimate public interest. Under this reading, the greater the public interest served by a regulation, the less likely a taking will be found. This idea is supported, for example, by the Court's statement in *Agins* that takings analysis "necessarily requires a weighing of public and private interests." 100 S.Ct. at 2141. It is also supported by the language in *Lucas* describing "total" takings claims "as compensable without case-specific inquiry into the public interest advanced in support of the restraint," 112 S.Ct. at

2893, a statement which implies that weighing the public interest served by a regulation may be appropriate in takings cases not covered by *Lucas*.

There are several difficulties with this possible reinterpretation. First, the public interest is certainly not what the *Penn Central* Court meant by the term "character." See 98 S.Ct. at 2659. The courts can obviously adopt a different test in place of the *Penn Central* test. But if the present three-factor test is actually different from the three-factor test originally ascribed to *Penn Central*, then the courts and the bar should be concerned that takings doctrine is even more confused than we previously understood. And that would be saying a lot.

More importantly, the notion that the weight of the public interest served by a regulation should be a factor in takings analysis is inconsistent with the fundamental character of takings claims. The takings clause provides that just compensation must be paid when private property is taken for "public use," meaning that a claim for just compensation presupposes that the government is pursuing some legitimate public purpose. See *First English Evangelical Lutheran Church v. County of Los Angeles*, 107 S.Ct. 2378, 2385-86 (1987), 39 ZD 206. Therefore, the fact that the government action advances the public interest cannot provide a legitimate basis for rejecting a claim for compensation. A practical example illustrates the point. If the government takes private property to construct a road, it owes compensation without regard to the fact that the road will advance the public interest. Likewise, in a regulatory taking case, the fact that the regulation advances the public interest is irrelevant to the issue of whether the claimant is entitled to compensation.

The final factor in the three-factor *Penn Central* test is investment-backed expectations. If, as suggested above, some kind of adverse economic impact (short of *Lucas*-type total loss) is, at most, only a necessary condition for a finding of a taking, and the character factor has been superseded by the *Loretto* per se rule, is the expectations factor the decisive factor? If this factor weighs against a taking, is the claim doomed? If it weighs in favor of a taking, is the claim assured of prevailing, at least if the adverse economic impact rises above some threshold?

In fact, investment-backed expectations turns out to be as problematic as the other factors, but for different reasons. It is widely recognized, if an individual or firm lacks investment-backed expectations because of regulatory restrictions in place at the time of purchase, that a takings challenge to the restrictions will fail. As the Court of Appeals for the Federal Circuit said in *Loveladies Harbor v. United States*, 28 F.3d 1171 (Fed. Cir.1994), 47 ZD 48, a taking claim is barred as a matter of law if the owners cannot "demonstrate that they bought their property in reliance on a state of affairs that did not include the challenged regulatory regime." *Id.* at 1177. The Court explained:

"In legal terms, the owner who bought with knowledge of the restraint could be said to have no reliance interest, or to have assumed the risk of the economic loss. In economic terms, it could be said that the market had already discounted for the restraint, so that a purchaser could not show a loss in his investment attributable to it." *Id.*

More recently, in *Good v. United States*, 189 F.3d 1355 (Fed. Cir. 1999), the Federal Circuit ruled that the expectations defense bars a taking claim even when it is alleged that the owner has suffered a *Lucas*-type property value loss.

But the utility of expectations as a possibly determinative factor is severely undermined by the fact that the converse is not true: A regulation does not result in a taking simply because it unsettles investment-backed expectations. As Justice Scalia said in *Lucas*: "The property owner necessarily expects the uses of his property to be restricted, from time to time, by various measures newly enacted by the State in legitimate exercise of its police power." 112 S.Ct. at 2899. Similarly, in *Concrete Pipe & Products*, the Court said that "legislation readjusting rights

and burdens is not unlawful solely because it upsets otherwise settled expectations . . . [and] even though the effect of the legislation is to impose a new duty or liability based on past acts." 113 S.Ct. at 2659. This conclusion is obviously correct. If the elected branches could not adversely affect settled expectations, they could never adopt new laws affecting property interests without paying compensation under the takings clause. This, of course, is what Justice Holmes had in mind when he said in *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 413, that "[g]overnment hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law."

If in some cases frustrated expectations do not support a compensation award under the takings clause, in what cases do they support such an award? The three-factor test seems to provide no answer.

At the end of the day, there is precious little content to the *Penn Central* three-factor test, particularly when examined in light of subsequent Supreme Court decisions. Today, the three factors are, at most, only two factors. It is impossible to determine based on the remaining factors, economic impact and investment expectations, whether most, many, or only a few rules and regulations would effect a taking or how a court could apply these factors other than on the basis of an individual judge's personal predilections.

ARGUMENTS FOR DISCARDING THE *PENN CENTRAL*/PARTIAL TAKINGS TEST

Setting aside the vague and uncertain content of the ostensible three-factor takings test, the ultimate question remains: Is the three-factor test a valid and appropriate regulatory takings test? More specifically, following *Lucas*, does the *Penn Central* test provide the standard for addressing so-called "partial" takings claims outside the *Lucas* category? Even if this test is not justified as a matter of first principles, is it nonetheless compelled by existing Supreme Court precedent? This section presents the basic arguments for rejecting the "partial" takings theory, as well as the notion that *Penn Central* supports this theory.

First, Supreme Court precedent does not actually support the three-factor *Penn Central* test. Regulatory takings cases are commonly litigated on the assumption that the three-factor regulatory takings test represents an unobjectionable standard. *Penn Central* itself and *Lucas* are frequently cited to support this premise. In fact, upon careful analysis, far from mandating use of this test, Supreme Court precedent appears to be against it.

As discussed above, it is far from obvious that *Penn Central* itself supports the three-factor test. The Court did not describe the three "significant" factors as representing a definitive, free-standing takings test. It is even more difficult to read into *Penn Central* the idea that the decision provides the foundation for a "partial" regulatory takings claim. The term "partial taking" appears nowhere in the Court's opinion. Furthermore, the Court emphasized that only extreme regulatory impacts could support a viable takings claim. See 98 S.Ct. at 2662 (rejecting as "quite simply untenable" the argument that property owners "may establish a 'taking' simply by showing that they have been denied the ability to exploit a property interest that they heretofore had believed was available for development").

Equally important, despite the fact that the *Penn Central* decision was handed down more than 20 years ago, no Supreme Court decision has relied upon the three-factor test to uphold a regulatory takings claim. This fact does not by itself prove the test is illegitimate, but the Court's hesitation arguably reflects intuitive uncertainty about the legitimacy of this ostensible test. For the reasons discussed above, this intuition is well-founded, because it is impossible to articulate a meaningful line under the *Penn Central* three-factor test between a regulation that effects a taking and a regulation that does not.

The idea that *Penn Central* supports a distinct "partial" regulatory takings claim emerged only in the aftermath of *Lucas* and the "total taking" rule established in that case. The language and reasoning of *Lucas* offer some support for this new interpretation of *Penn Central*. In dissent, Justice Stevens criticized the court's new categorical "total taking" rule based on the anomaly of awarding compensation to an owner with a 100 percent loss in value when the owner with a 95 percent loss would get nothing. 112 S.Ct. at 2919. In response, Justice Scalia stated in a footnote that Stevens was wrong to assume that the owner in the 95 percent case would necessarily get nothing. *Id.* at 2895, n. 8. Scalia went on to state that "an owner might not be able to claim the benefit of our categorical formulation, but as we have acknowledged time and again, '[t]he economic impact of the regulation on the claimant and . . . the extent to which the regulation has interfered with distinct investment-backed expectations' are keenly relevant to takings analysis generally." *Id.*, citing *Penn Central*. This can be read to mean that *Penn Central* supplies the relevant test for some category of "non-total" takings cases not covered by *Lucas*.

On the other hand, this is not the only or the best interpretation of *Penn Central* following *Lucas*. The Court certainly did not decide the issue of what standard might or might not apply outside the *Lucas* category, an issue obviously not presented in *Lucas*. In addition, Justice's Scalia's statement that a regulation that results in a diminution in value of 95 percent can still result in a taking can be interpreted as simply recognizing the possibility that the total economic loss rule is not necessarily confined to the case, as in *Lucas* itself, where literally 100 percent of the property value has been eliminated. This reading of *Lucas* is consistent with certain state and lower federal court decisions indicating that a single basic test, whether there is total—or near total—destruction of property value, governs regulatory takings claims. See, e.g., *Reahard v. Lee County*, 968 F.2d 1131, 1135 (11th Cir. 1992), cert. denied, 514 U.S. 1064 (1995), 45 ZD 39; *Zealy v. City of Waukesha*, 548 N.W.2d 528 (Wis. 1996), 48 ZD 335.

The idea that *Lucas* should be read to preserve the vague and uncertain *Penn Central* test for cases not covered by *Lucas* is undermined by the fact that this reading contradicts the judicial philosophy of the author of the *Lucas* opinion, Justice Antonin Scalia. Justice Scalia has championed the idea that constitutional law should be reformed by replacing amorphous balancing tests with relatively bright-line rules. See A. Scalia, *The Rule of Law as a Law of Rules*, 56 U. Chi. L. Rev. 1175 (1989). *Lucas* can be viewed as an application of this philosophy in the takings context. On the other hand, maintaining the three-factor *Penn Central* test, and especially extending it to address so-called "partial" takings cases, would not be consistent with that philosophy. Applying Scalia's "rule of laws" approach, *Lucas* is best read as establishing a "categorical" rule that supplants the vague *Penn Central* balancing test.

As a practical matter, the sharp division on the Court in *Lucas* hardly means that the Court would readily subscribe to the idea that simple diminutions in value can support a takings claim. Despite the 100 percent loss in property value in *Lucas*, five Justices (one of whom has retired) joined in an opinion to uphold the takings claim, one Justice filed an opinion concurring in the judgment, and three Justices refused to support the judgment. This suggests it is doubtful that a majority of the present Court is prepared to say that a regulation resulting in less than total economic loss can support a finding of a taking.

Finally, the Court's split decision in *Eastern Enterprises v. Apfel*, 118 S.Ct. 2131 (1998), casts doubt on the viability of an analysis that focuses on diminutions in property value. In that case, a majority of the Court (Justice Kennedy and four dissenting Justices) rejected a takings challenge to federal coal legislation because, among other things, the law's imposition of financial liability on the plaintiff company did not "operate upon or alter an identified property interest." *Id.* at 2156. See also, *id.* at 2162 (Breyer, J., dissenting). Regulations that make property valueless (or nearly so) arguably "operate upon" an identified property interest. By contrast, regulations that simply restrict certain uses of property, and therefore reduce the income derived from the property, seem more analogous to the types of assessments of financial liability that fall outside the scope of takings doctrine. Thus, *Eastern Enterprises* undermines the legitimacy of "economic impact" as a

relevant factor in so-called "partial" takings analysis. See also, *Florida Rock Industries v. United States*, 18 F.3d 1560, 1573 (Fed.Cir. 1994) (Nies, J., dissenting) ("a claim for loss of value does not constitute a takings claim within the meaning of the Fifth Amendment").

Another objection to the *Penn Central* test is that it is so vague and indeterminate that it invites unprincipled, subjective decision making by the courts. The three-factor test (which may only be a two-factor test) does not provide any clear direction of how to decide regulatory takings cases, inviting judges to decide based on their own personal values. If the test requires weighing the public interest served by a regulation, the test would affirmatively encourage judges to decide takings cases based on subjective assessments of whether regulations are worthwhile.

Two cases illustrate the problem with this ostensible test. The first is *Penn Central* itself. As discussed, the Court's opinion did not actually apply the three-factor test in systematic fashion to the facts of the case. But it is difficult in any event to see how the test could have provided the Court a reasoned basis for decision. Denial of the opportunity to build a new office building in midtown Manhattan obviously deprived the owner of a valuable business opportunity. The historic landmark restrictions postdated the Penn Central company's acquisition of the site, and thus frustrated the company's investment expectations. Yet these factors were apparently not sufficient to establish a taking. In the end, one is left with the distinct impression that the Court was persuaded that historic landmark preservation represented a sound public policy and that this landmark in particular, which every Justice on the Court had undoubtedly visited, was worthy of protection. See 98 S.Ct. 2651 (stating that "historic conservation is but one aspect of the much larger problem, basically an environmental one, of enhancing—or perhaps developing for the first time—the quality of life for people"). While the Court's urban design judgment is unassailable, at least in my personal view, one is left to wonder how application of this amorphous test might be applied to a program with which a court was less sympathetic.

The Court of Federal Claims decision in *Florida Rock v. United States*, 45 Fed.Cl. 21 issued in August 1999, illustrates how easily the wind can shift under the three-factor *Penn Central* test. In that case, the court ruled that the U.S. Army Corps of Engineers's denial of a wetland permit to mine limestone resulted in a compensable taking. As in *Penn Central*, the court found that the regulatory decision had a substantial adverse economic impact. The court also concluded that the Corps's regulatory decision frustrated the owner's investment expectations, because the owner purchased the property prior to the enactment of the Clean Water Act. On their face, the relevant factors seemed to point in approximately the same direction and with approximately the same force as in *Penn Central*. Yet the result was completely different.

The conclusion is virtually inescapable: Just as a majority of the Supreme Court was apparently impressed by the goals of historic preservation, at least as applied to Grand Central Terminal, the judge in *Florida Rock* was apparently unimpressed by the goals of the wetlands regulatory program. The Court of Federal Claims said that the plaintiff's proposed mining operation would result "in only moderate, superficial pollution that does no harm," 45 Fed.Cl. at 30, that its likely impacts were "not very serious," *id.*, and, quoting from the Court of Appeals first decision in the case, that the Corps's concern was "almost exclusively the continued existence of the wetland, not the temporary and moderate pollution incident to the occurrence of the actual mining," *id.*, quoting 791 F.2d at 904. The Court of Federal Claims's conclusion that the wetlands were not worth saving seems as squarely based on personal opinion as the Supreme Court's conclusion that Grand Central Terminal was worth saving.

Because it is so open-ended and value-laden, the *Penn Central* three-factor test invites the courts to second guess legislative judgments. The value to be assigned to a particular policy objective, and whether achieving the objective is worth the social costs entailed in any regulatory program, represent quintessentially legislative issues. If the courts were to evaluate takings claims using essentially the same type of balancing test employed by legislatures, they would run a serious risk of intruding on the responsibilities of the political branches and, within the federal system in

particular, violating the principle of separation of powers which defines the scope of federal judicial power.

The purported *Penn Central* "partial" takings test also is inconsistent with the language and original understanding of the takings clause. The government "takes" property in a literal sense when it seizes it. Regulations that eliminate all (or essentially all) property value can reasonably be viewed as sufficiently analogous to direct appropriations of property to be viewed as "takings" as well. However, regulations that affect only some of the value of property fit less naturally with the word "take."

With respect to the original understanding, jurists and scholars of virtually all ideological persuasions are agreed that the drafters of the Bill of Rights intended the takings clause to apply only to direct physical appropriations, and never intended it to apply to regulations under any circumstances. See, e.g., *Lucas*, 112 S.Ct. at 2900, n. 15 (Scalia, J.) ("early constitutional theorists did not believe the Takings Clause embraced regulations of property at all"). See also John Hart, *Colonial Land Use Law and its Significance for Modern Takings Doctrine*, 109 Harv. L. Rev. 1252 (1996); William Michael Treanor, *The Original Understanding of the Takings Clause and the Political Process*, 95 Colum. L. Rev. 782 (1995).

Given the original understanding, it is appropriate for the courts to seek to define the universe of regulations compensable under the takings clause to match as nearly as possible direct physical appropriations. *Lucas* reflects this approach because the Court rationalized upholding the claim based on the fact that "total deprivation of beneficial use is, from the owner's point of view, the equivalent of a physical appropriation." 112 S.Ct. at 2894. See also, *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922) (Holmes, J) (the issue in a regulatory takings case is whether the regulation "has very nearly the same effect for constitutional purposes as appropriating it or destroying it"). By contrast, the *Penn Central* partial takings test would lead regulatory takings doctrine far afield from direct physical appropriations and the original understanding of the takings clause.

Another objection to the *Penn Central* partial takings theory is that it inaccurately and unfairly minimizes the extent to which regulations (and other government actions) support and enhance private property values, including the property values of owners who themselves are subject to regulation. As discussed in a recent Environmental Policy Project report, "The Congressional Budget Office's 'Regulatory Takings and Proposals for Change': One-Sided and Uninformed" (available on the Environmental Policy Project web site, www.envpoly.org), regulations positively affect property values in two ways. First, regulations protect services and amenities that help create property value in the first place. While regulations limit the income an owner can derive from her property, regulatory restrictions also benefit everyone in the community. If an owner subject to one particular restriction may not especially benefit from application of the same restriction to her neighbors, she frequently will benefit from the enforcement of other regulations. In addition, regulatory restrictions can enhance the value of private property by decreasing the supply of property available for development in the face of existing or growing demand, thereby increasing the value of remaining development opportunities.

The Supreme Court in *Penn Central* explicitly recognized the value-enhancing character of regulation, and, as discussed, relied on this phenomenon to justify rejecting the takings challenge to New York City's historic landmark law. See also, *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 107 S.Ct. at 1244. ("While each of us is burdened somewhat by [regulatory] restrictions, we, in turn, benefit greatly from the restrictions that are placed on others"); *Agins v. City of Tiburon*, 100 S.Ct. at 2142 (observing that takings claimants "share with other owners the benefits and burdens of the city's exercise of its police powers"). Because regulatory restrictions enhance the property values of all owners in the community, it is fair and reasonable to reject claims for compensation under the takings clause when an owner has suffered only a "partial" diminution in value. At least when the "loss" in value is less than total, it is reasonable to presume

that all or most of the value of the property which has been "taken" was actually created by the community's collective efforts to meet land-use and environmental standards.

Another approach to the issue of the benefits conferred by regulations is illustrated by the Court of Federal Claims decision in *Florida Rock Industries v. United States*, 45 Fed.Cl. 21 (1999). The court recognized that the effect of a government regulation should be "non-compensable" when the claimant "has been compensated through the regulation itself." *Id.* at 37. The court also acknowledged that, in that particular case, "the surrounding community benefits from the wetland's filtering actions, stabilizing effect, and the provision of habitat for flora and fauna," *id.*, and recognized that Florida Rock "benefits from being a member of a community which has the potential for a better environment." *Id.* However, the court believed that "there can be no question that Florida Rock has been singled out to bear a much heavier burden than its neighbors, without reciprocal advantages." *Id.* As a result, the court concluded that the "reciprocity of advantage" created by the regulations, while not insignificant, did not preclude a finding of a compensable taking.

There is a decisive difference between the Supreme Court approach to the reciprocity issue in *Penn Central* and the Court of Federal Claims approach in *Florida Rock*. The Supreme Court treated reciprocal benefits conferred by regulations as a general fact about how regulations operate that supports a relatively narrow understanding of regulatory takings doctrine. By contrast, the *Florida Rock* court treated it as a narrow evidentiary issue that is relevant—on the assumption that a taking already has been found—only in determining whether regulation of other property owners can be shown to provide implicit "just compensation" for the taking.

On this issue, as in so many other areas of the law, the allocation of the burden of uncertainty is everything. Demonstrating the economic benefits conferred on a land owner by a specific regulation, not to mention the full array of regulations (and other government actions) that typically affect the value of property, is exceedingly difficult and probably impossible in most cases. Allocating the burden of uncertainty to the public, as under the *Florida Rock* approach, would lead courts to ignore most of the substantial benefits of government regulation and other actions, conferring unjust windfalls on many takings claimants. On the other hand, following the more generalized *Penn Central* approach might exclude from compensation at least certain individuals and firms who in fact are bearing large, disproportionate burdens. It is obviously difficult and complicated to determine which approach is the most "fair" in the abstract.

However, as a matter of constitutional law, it seems implausible that the takings clause should be read to require the public to systematically overcompensate. See D. Elliott, *Givings and Takings*, 48 Land Use L. & Zoning Dig., no. 6 at 3 (1996). Determining whether and to what extent a regulatory program provides a fair array of social benefits obviously presents difficult empirical and policy questions. However, within our system of government, the elected legislature would generally seem to be the most appropriate body to make these kinds of judgments. If so, the takings clause has to be interpreted in a fashion that provides the legislature the necessary latitude to make these judgments. The *Penn Central* approach to reciprocity of advantage provides the appropriate latitude. The *Florida Rock* approach does not.

Finally, the purported *Penn Central* three-factor "partial" taking test appears to create difficult if not insurmountable challenges in crafting an appropriate remedy. If a property is appropriated for a road or its economic value is entirely eliminated by regulation, as in *Lucas*, the crafting of an appropriate remedy is straightforward. The government pays full compensation for the property taken. And, in return, the public obtains full title to the property.

But what is the appropriate remedy on the assumption that the government can be liable to pay compensation for a regulatory taking of some—but not all—of the property? The Federal Circuit debated this issue at some length in the 1994 *Florida Rock* decision. The issue in the case, as defined by the court of appeals, was whether the possibility that the restrictions might be lifted in

the future left the property with sufficient value to defeat a takings claim. Both the majority and the dissent agreed with the basic principle that, whenever a taking is found, the public should receive title to the property taken and for which it is paying compensation. The majority, without definitively resolving what type of property interest the government might receive in "partial" takings case, expressed the view, or perhaps the hope, that "[i]dentification of a specific property interest to be transferred to the Government should pose little problem for property lawyers." 18 F.3rd at 1572, n. 32. The dissenting judge, the late Chief Judge Nies, on the other hand, was much less sanguine about how this task could be accomplished. "Once mining rights are transferred to the government," she observed, "the majority's theory of post-takings value based on offers to buy the land because of possible change in regulations is thrown entirely askew. There could be no change in regulation which would give a subsequent owner the right to mine the mineral estate which the majority agrees becomes government property." *Id.* at 1578, n.12.

The subsequent proceedings on remand support Chief Judge Nies's view of the difficulty of defining the property interest in a "partial" takings case. "If it is necessary to name the government's interest post taking," the Court of Federal Claims said, "the court would suggest the government now owns a negative easement." However, it is obvious that the Court of Federal Claims did not intend to define the property interest with precision, much less require that the owner convey the interest as a condition of receiving compensation. And it is difficult, as Judge Nies had suggested, to understand how it could do so. The value of property based on possible future changes in regulations is necessarily based on estimates of the property's potential future market value, discounted by the likelihood that development will not be permitted under future regulatory regimes. Under the Court of Federal Claims approach, a few years after receiving compensation for the "partial" taking, Florida Rock presumably could try to obtain regulatory approval and proceed with development. But, if that is the case, then the Court of Federal Claims "negative easement" is entirely chimerical. Contrary to the premise of the court of appeals in its 1994 *Florida Rock* decision, the public will receive no actual property interest in exchange for compensation for the "partial" taking. But, as the court of appeals said, to award an owner compensation without ensuring that the public receives title to the property taken would contradict our basic understanding of the right created by the takings clause, converting the "just compensation" remedy into a tort-like damages remedy and subjecting the public to financial liability for no corresponding public benefit.

The problem is different, but only slightly less difficult, if the alleged "partial" taking involves split interests in space, rather than in time, as in *Florida Rock*. If, for example, an owner with a 10-acre parcel, consisting of eight acres of upland and two acres of wetlands, challenged the denial of permission to fill the two acres as a taking, what would be the appropriate remedy? Would the government acquire only a negative easement to prohibit development on the two acres? Would the owner retain other rights in the two acres, such as the right to exclude the public or to use the property for certain types of recreation? If so, the government and the original owner would become, in effect, co-owners of the property, raising various questions about how the property would be jointly managed, on what terms it could be sold, and so on. While these problems are probably not insoluble, at least in theory, they demonstrate that the partial takings idea consistently raises difficult implementation issues.

BETTER TEST: DENIAL OF ALL ECONOMIC VALUE

If the three-factor test is deposited in the dustbin of history, where would that leave regulatory takings doctrine? Exactly where it should be, with a set of relatively well defined rules for identifying regulations that are legitimate takings. According to this viewpoint, based on the authority of *Lucas*, a taking will generally be recognized, subject to certain important exceptions,⁴ if a new regulation eliminates all (or substantially all) of a property's economic value. In addition, a regulation will generally effect a taking if it results in a permanent physical occupation of private property. See *Loretto v. Teleprompter Manhattan CATV Corp.*, 102 S.Ct. 3164 (1982). While

other regulations with other effects on property may be subject to challenge on other statutory and constitutional (and, of course, political) grounds, they are not takings.

A quick reexamination of each of the five issues discussed above demonstrates that this relatively narrow, concise takings test avoids the numerous problems created by the *Penn Central* three-factor test.

As previously suggested, Supreme Court regulatory takings precedents are generally consistent with the idea that takings doctrine should be limited to cases involving total (or near total) economic loss. The holdings and language in *Mahon*, *Penn Central*, and *Lucas*, in particular, support this conclusion. See also *United States v. Riverside Bayview Homes, Inc.*, 106 S.Ct. 455, 458 (1985) (regulatory takings occur only in "extreme circumstances"). This understanding of the basic test for a regulatory taking is similar to if not completely identical to the second prong of the *Agins* test, thereby offering at least a partial resolution of the confusion between the three-factor *Penn Central* test and the two-factor *Agins* test.

In addition, looking at the actual outcomes of Supreme Court takings case, a long string of decisions supports the conclusion that only regulations that cause a total (or near total) economic loss rise to the level of a compensable taking. Compare *Lucas* (total elimination of value of two building lots effects a taking); *Monsanto* (total destruction of value of trade secrets effects a taking) with *Agins* (rejecting takings challenge to zoning restrictions that allegedly reduced property value by 85 percent); *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 384 (1926) (rejecting takings challenge based on 75 percent reduction in value); *Hadacheck v. Sebastian*, 239 U.S. 394, 405 (1915) (rejecting takings challenge based on 92.5 percent reduction in value).

Most lower federal and state courts, with the notable exception of the Court of Appeals for the Federal Circuit and the Court of Federal Claims, also recognize that only a total economic loss is compensable under the takings clause. See, e.g., *Front Royal & Warren County Industrial Park Corp. v. Town of Front Royal*, 135 F.3d 275, 286 (4th Cir. 1998) (rejecting takings challenge when regulation caused "only" a 50 percent diminution in value, because "a regulatory deprivation that causes land to have 'less value' does not necessarily make it 'valueless'"); *Reahard v. Lee County*, 968 F.2d 1131, 1135 (11th Cir.1992), cert. denied, 514 U.S. 1064 (1995) (overturning a finding of a taking where rezoning permitted construction of only one residence on 40 acres, observing that "the only issue in just compensation claims is whether an owner has been denied all or substantially all economically viable use of his property"); *Midnight Sessions, Ltd. v. City of Philadelphia*, 945 F.2d 667, 677 (3d Cir. 1991), cert. denied, 503 U.S. 984 (1992) (no taking where court could not "conclude[] that the alleged diminution in the value of the properties deprived appellees of all economically viable use of them").

Moreover, while the several decisions of the Federal Circuit and the Court of Federal Claims discussed above reflect a different viewpoint, those courts have not adopted a monolithic position. See, e.g., *Jentgen v. United States*, 657 F.2d 1210 (Ct.Cl. 1981), cert. denied, 455 U.S. 1017 (1982) (rejecting takings challenge where regulation prohibited development on 75 percent of land); *Deltona Corp. v. United States*, 657 F.2d 1184 (Ct.Cl. 1981), cert. denied, 455 U.S. 1017 (1982) (rejecting takings challenge where only 25 percent of land could be developed).

Second, unlike the free-ranging three-factor takings test, the total economic loss standard makes takings law far more predictable and less susceptible to variation based on the personal predilections of the particular judge hearing the case. Determining whether a regulation has eliminated all (or nearly all) economic value of a property presents a relatively simple and straightforward issue. In addition, eliminating the public interest served by a regulation as a factor in takings analysis eliminates the need for subjective and value-laden judicial decision making.

A total loss regulatory taking test is consistent with the language and original understanding of the takings clause. A regulation that eliminates all (or nearly all) economic value can plausibly be viewed as effecting an actual "taking," and it is reasonably analogous to the prototypical takings case the drafters had in mind, a direct physical appropriation of private property.

The total loss approach also is consistent with the fact that regulatory restrictions have common and pervasive positive effects on the value of private property, including the property values of owners who are themselves subject to regulation. The total loss approach properly limits regulatory takings doctrine to the extreme cases in which, notwithstanding the benefits of regulation, it is reasonable to conclude that individuals have been required to bear disproportionate and unfair burdens. At the same time, it avoids granting windfalls to many owners who have no equitable claim to compensation based on public efforts that produce higher private property values.

Finally, the total loss approach supports a straightforward remedy. If the economic effect of a regulation is so drastic that the government has "taken" the property, then the government must pay "just compensation," and the public should receive title to the property. If the government does not take, it pays nothing and receives nothing.

CONCLUSION

The Supreme Court correctly ruled that New York City did not effect a taking when it acted to preserve Grand Central Terminal, one of the nation's finest historic landmarks. But the Court's almost offhand reference to three factors that have "particular significance" in regulatory takings cases has been a source of mischief and confusion. Upon analysis, and in light of subsequent developments in takings doctrine, it is clear that the three-factor takings test ascribed to *Penn Central* does not represent a meaningful or coherent standard for evaluating regulatory takings claims.

In short, the three-factor "partial" takings test is not supported by current Supreme Court precedent, invites unprincipled judicial decision making, conflicts with the language and original understanding of the takings clause, would confer unjust windfalls in many cases, and creates seemingly insurmountable problems in terms of defining an appropriate remedy. The time has come to deposit the three-factor test in history's dustbin.

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Footnotes:

1. See *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 107 S.Ct. 1232, 1244 (1987), 39 ZD 221 ("Under our system of government, one of the State's primary ways of preserving the public weal is restricting the uses individuals can make of their property").
2. See, e.g., *Hodel v. Irving*, 107 S.Ct. 2027, 2028 (1987), and *Concrete Pipe & Products v. Construction Laborers Pension Trust*, 113 S.Ct. 2264, 2290 (1993).
3. As I and others have argued, the first prong of the *Agins* test actually refers to a due process issue and does not represent a legitimate general test for a regulatory taking. See John Echeverria, *Does a Regulation that Fails to Advance a Legitimate State Interest Result in a Regulatory Taking?*, 24 *Envtl. L.* ___ (1999) (forthcoming). Jerold Kayden, *Land Use Regulations, Rationality, and Judicial Review: The RSVP in the Nollan Invitation*, 23 *Urb. Law.* 301, 314-316

(1991). See also *Bonnie Briar Syndicate, Inc. v. Town of Mamaroneck*, 94 N.Y.2d 96 (1999) (concluding that the *Agins* means-ends test parallels ordinary "reasonable relation" due process analysis).

4. For example, *Lucas* recognized that, even if a regulation renders property "valueless," a takings claim will not lie if the regulation simply duplicates "the restrictions that background principles of the State's law of property and nuisance already place upon land ownership." 112 S.Ct. at 2900.