REGULATORY TAKINGS

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I. INTRODUCTION

This paper concerns governmental restrictions on the use and development of private real property. Justice Oliver Wendell Holmes, writing for the Court in the first regulatory takings case to reach the United States Supreme Court, framed the regulatory takings issue as follows: "The general rule at least is that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 413, 43 S.Ct. 158, 160, 67 L.Ed.2d 322 (1922). Subsequent to *Mahon*, the question in regulatory takings cases is often couched in terms of whether the regulation at issue has gone "too far." If so, the private property owner must be compensated for the regulatory taking of his property.

The issue of whether a restriction on the use or development of private property is compensable stems from the Texas and Federal Constitutions, which guarantee that private property shall not be taken for public use without just compensation. U.S. CONST. amend. V; TEX. CONST., art. I, § 17. This guarantee "was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49, 80 S.Ct. 1563, 1569, 4 L.Ed.2d 1554 (1960). This principle is relatively easy to understand and apply in the context of physical appropriations. If the State builds a highway across private property, the State has appropriated that property by taking possession of it, and the State must pay for it. But, the analysis is difficult in the context of government *regulation* of private property. If, for example, property is downzoned in order to control growth and urban blight (a public benefit), and as a result of being downzoned, the value of the property drops significantly (a private burden), is the loss of value or use a compensable regulatory taking? Should the public be forced to purchase property preserved as green belt area or may the government require a private citizen to bear the expense of leaving some property undeveloped so the community may enjoy the aesthetic and environmental benefits of the undeveloped land? What if the government enacts a moratorium on development that lasts several years, the purpose of which is to control growth, prepare a comprehensive plan, or even just to use as a tool for negotiating with (or extorting from) developers? How far can a regulation go before it has gone "too far" and results in a compensable taking?

A survey of case law is of limited use in answering this question because courts have steadfastly refused to adopt *per se* rules in regulatory takings cases, preferring instead to analyze each case on an ad hoc basis. *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302, 326, 122 S.Ct. 1465, 1481, 152 L.Ed.2d 517 (2002). The precedent for such ad hoc analysis was set by Justice Holmes in *Pennsylvania Coal v. Mahon*, where he wrote that the question of whether a regulation constitutes a compensable taking is one "of degree – and therefore cannot be disposed of by general propositions." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. at 416, 43 S.Ct. at 160. As a result, regulatory takings cases have been characterized as "the most litigated and perplexing in current law." *Sheffield Development Co. v. City of Glenn* Heights, 2004 WL 422594, *7 (Tex. 2004), citing *Eastern Enterprises. v. Apfel*, 524 U.S. 498, 541, 118 S.Ct. 2131, 2155, 141 L.Ed.2d 451 (1998).

The struggle with the compensability of property regulations results from the attempt to balance the government's police power on one hand and the right of citizens to use and enjoy their privately-owned property on the other. Courts have recognized that regulations may diminish property value to some extent without being compensable, but courts have also recognized that regulations that go "too far" in interfering with the use and enjoyment of property should be compensated. Consideration of all the above begs the question: If courts have disapproved the use of "general propositions" and *per se* rules, and not all reductions in property value are compensable but some are, how, then, can a practitioner evaluate whether a regulation has gone "too far"?

Regulatory takings claims are evaluated under three analytical frameworks. One line of cases stems from the United States Supreme Court decision in *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 112 S.Ct. 2886, 120 L.Ed.2d 798 (1992). Under *Lucas*, a regulation that deprives property of all economically beneficial or productive use is a compensable taking. *Lucas*, 505 U.S. at 1015, 112 S.Ct. at 2893. Such a result is extremely rare. In the majority of cases, the claimant must admit the property retains some value even after the regulation is in effect, and in those cases the regulatory takings claim is evaluated under the *Penn Central* analysis (from the United States Supreme Court opinion in *Penn Central Transportation Co. v. New York*, 438 U.S. 104, 98 S.Ct. 2646, 57 L.Ed.2d 631 (1978)). In short, the *Lucas* analysis pertains to claims that a regulation has deprived the real property of all value; the *Penn Central* analysis pertains to all the rest. The third analytical structure applies only to cases where the developer is required to dedicate property or pay for public improvements as a condition of obtaining approval to develop. These cases are examined under the *Nollan/Dolan* analysis (*Nollan v. California Coastal Commission*, 483 US. 825, 107 S.Ct. 3141, 97 L.Ed.2d 677 (1987) and *Dolan v. City of Tigard*, 512 U.S. 374,

114 S.Ct. 2309, 129 L.Ed.2d 304 (1994)), which involves a determination of whether the required dedication or exaction is proportional to the burden on public improvements that the proposed development is anticipated to create. Because these cases provide the framework for regulatory takings analysis, they are summarized in the section below.

In addition to the discussion of *Lucas, Penn Central, Nollan* and *Dolan*, this paper addresses the following:

- The applicability of Federal case law to Texas cases, and whether Texans have a choice of making a Federal section 1983 claim instead of or in addition to a claim under the Texas constitution;

- The administrative steps necessary to ripen a takings claim;

- Whether a regulatory takings claim is waived or estopped by compliance with the unconstitutional conditions of a development permit (this is pertinent to dedications and exactions);

- Whether a regulatory takings claim survives a transfer of title;

- The "denominator problem" – the amount of physical property and property rights included in the analysis of whether a regulation constitutes a compensable taking; and

- The success of regulatory takings claims in Texas in the following categories: zoning and use restrictions; moratoria; development conditions, exactions and dedications.

The Texas Supreme Court decided two regulatory takings cases in the first half of 2004: *Sheffield Development Company, Inc. v. City of Glenn Heights*, 2004 WL 422594 (decided March 5, 2004) and *Town of Flower Mound v. Stafford Estates Limited Partnership*, 135 S.W.3d 620 (decided May 7, 2004). Particular attention and analysis is given to these cases because they addressed many of the issues listed above (*Sheffield* addressed ripeness, moratoriums and downzoning; *Stafford Estates* addressed exactions and § 1983 claims) and they are the most recent indicators of whether and how regulatory takings claims will be successful in Texas.

II. THE THREE CATEGORIES OF REGULATORY TAKINGS

A. *Lucas* and the Denial of All Economically Beneficial or Productive Use

While it is true, as stated above, that courts generally have rejected categorical rules in regulatory takings cases, there is one category of regulatory action that is *per se* compensable regardless of the public interest advanced by the regulation. A regulatory action is compensable if it "denies all economically beneficial or productive use of land." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1015, 112 S.Ct. 2886, 2893, 120 L.Ed.2d 798 (1992). This refers to the "extraordinary" and "rare" situations in which "no productive or economically beneficial use of land is permitted." *Lucas*, 505 U.S. at 1017-1018, 112 S.Ct. at 2894.

In *Lucas*, the claimant had purchased two beachfront lots zoned for residential use. Subsequent to his purchase, the State passed legislation permanently prohibiting the construction of permanent habitable structures on the lots. The state trial court found that the regulation, as applied to the subject lots, rendered the lots valueless. *Lucas*, 505 U.S. at 1006-1007, 112 S.Ct. at 2889. The state supreme court held the legislation's effect on the claimant's property was irrelevant on the basis that, because the legislation was enacted and designed for the purpose of preventing serious public harm, the claimant's injury was non-compensable. *Lucas*, 505 U.S. at 1010, 112 S.Ct. at 2889. On review, the United States Supreme Court reversed and remanded, noting that "regulations that leave the owner of land without economically beneficial or productive options for its use – typically, as here, by requiring land to be left substantially in its natural state – carry with them a heightened risk that private property is being pressed into some form of public service under the guise of mitigating serious public harm." *Lucas*, 505 U.S. at 1018, 112 S.Ct. at 2894-2895.

B. The *Penn Central* Factors

Extremely few cases involve categorically compensable regulations that render property entirely without any value at all. The majority of cases concern regulations that have greatly diminished the property's value or interfered with the owner's development expectations, but have not rendered the property totally valueless. In determining whether the regulations in these cases effect a compensable taking, the court will consider the following factors as having "particular significance": (1) the economic impact of the regulation on the claimant; (2) the extent to which the regulation has interfered with distinct investment-backed expectations; and (3) the character of the governmental action. *Sheffield Development Co., Inc. v. City of Glenn Heights*, 2004 WL 422594, *7-8 (Tex. 2004), citing *Penn*

Central Transportation Co. v. City of New York, 438 U.S. 104, 124, 98 S.Ct. 2646, 2659, 57 L.Ed.2d 631 (1978).

In *Penn Central*, New York City's Planning Commission designated Grand Central Terminal and the city block it occupies a "landmark site." *Penn Central*, 438 U.S. at 115-116, 98 S.Ct. at 2655. Subsequently, Penn Central entered into an agreement to lease the Terminal, under which agreement the lessee was to construct a multistory office building above the Terminal. The Planning Commission denied the applications submitted by Penn Central and its lessee to construct the development on top of the Terminal because the Commission believed the development would "overwhelm" the Terminal and "reduce the Landmark itself to the status of a curiosity." *Penn Central*, 438 U.S. at 117-118, 98 S.Ct. at 2655-2656.

In holding that the development restrictions resulting from the "landmark" designation did not constitute a compensable taking, the United States Supreme Court relied in particular upon the following facts:

- the governmental action at issue in the case in no way impaired the existing use of the Terminal;
- the claimant conceded the property was capable of earning a reasonable rate of return; and
- the development rights being taken or denied to the subject property (the ability to develop upwards) could be transferred to other properties and thus offset the damage to the subject property.

Penn Central, 438 U.S. at 129, 136-137, 98 S.Ct. at 2662, 2665-2666.

The Court summed up its holding and reasoning in concluding as follows:

> "On this record, we conclude that the application of New York City's Landmarks Law has not effected a 'taking' of appellants' property. The restrictions imposed are substantially related to the promotion of the general welfare and not only permit reasonable beneficial use of the landmark site but also afford appellants opportunities further to enhance not only the Terminal site proper but also other properties. [FN36]
>
> FN36. We emphasize that our holding today is on the present record, which in turn is based on Penn Central's present ability to use the Terminal for its intended purposes and in a gainful fashion. The city conceded at oral argument that if appellants can demonstrate at some point in the future that circumstances have so changed that the Terminal ceases to be 'economically viable,' appellants may obtain relief.

Penn Central, 438 U.S. at 138, n. 36, 98 S.Ct. at 2666.

C. The *Nollan/Dolan* Essential Nexus and Rough Proportionality Tests for Exactions and Dedications

A property dedication or exaction required as a condition of obtaining government approval to develop is not analyzed as a use restriction under *Lucas* or *Penn Central* because it has an element of a physical taking (being that the developer loses possession of the property), but it is also not a categorically-compensable physical taking because in theory its purpose is to mitigate the burden on public improvements that will result from the proposed development. Because of the physical taking element, a dedication or exaction is a compensable taking "unless the condition (1) bears an essential nexus to the substantial advancement of some legitimate government interest and (2) is roughly proportional to the projected impact of the proposed development." *Town of Flower Mound v. Stafford Estates Limited Partnership*, 135 S.W.3d 620, 634 (Tex. 2004) (restating the rule of *Nollan* and *Dolan*).

The two-part test for exactions and dedications is a combination of the United States Supreme Court decisions in *Nollan v. California Coastal Commission*, 483 U.S. 825, 107 S.Ct. 3141, 97 L.Ed.2d 677 (1987) and *Dolan v. City of Tigard*, 512 U.S. 374, 114 S.Ct. 2309, 129 L.Ed.2d 304 (1994). The first part of the test – the requirement that the exaction or dedication bear an "essential nexus" to the substantial advancement of a legitimate government interest – was first stated by the Court in *Nollan*. The second part of the test, requiring that the dedication or exaction be "roughly proportional" to the projected impact of the proposed development, is from *Dolan*. Following is a summary of the two opinions.

Nollan involved an application to demolish an existing rundown beachfront bungalow and replace it with a three-bedroom house, which would be consistent with the neighboring properties. The Coastal Commission granted the development application subject to the condition that the Nollans grant the public an access easement to pass across their private beach, as their private beach area was bound on both sides by public beaches. *Nollan*, 483 U.S. at 827-828, 107 S.Ct. at 3143-3144. The Nollans contested the condition, arguing that the condition could not be imposed unless their proposed development would directly adversely impact public access to the beach. The Commission held a public hearing, after which it determined the proposed home would increase blockage of the view of the ocean

from the road, contributing to a "wall of residential structures" that would prevent the public from realizing a publicly-accessible beach existed nearby. *Nollan*, 483 U.S. at 828, 107 S.Ct. at 3144. The Court began its analysis by noting that a compensable taking would have occurred if, absent the development application, the Nollans had simply been required to make an easement across their beachfront available to the public. *Nollan*, 483 U.S. at 831, 107 S.Ct. at 3145. "Given, then, that requiring uncompensated conveyance of the easement outright would violate the Fourteenth Amendment, the question becomes whether requiring it to be conveyed as a condition for issuing a land-use permit alters the outcome." *Nollan*, 483 U.S. at 834, 107 S.Ct. at 3147. In holding that the imposition of the public access easement as a condition of development was a compensable taking, the Court reasoned that the easement did not have the necessary "essential nexus" to the Commission's stated purpose of protecting the view of the beach from the roadway. *Nollan*, 483 U.S. at 837, 107 S.Ct. at 3148-3149. The Court explained:

> "It is quite impossible to understand how a requirement that people already on the public beaches be able to walk across the Nollans' property reduces any obstacles to viewing the beach created by the new house. It is also impossible to understand how it lowers any 'psychological barrier' to using the public beaches, or how it helps to remedy any additional congestion on them caused by the construction of the Nollans' new house. We therefore find that the Commission's imposition of the permit condition cannot be treated as an exercise of its land-use power for any of these purposes."

Nollan, 483 U.S. at 838-839, 107 S.Ct. at 3149.

Because the Court in *Nollan* held the condition did not meet the first test of having an "essential nexus" to the goal stated by the government, the Court did not reach the second question, which is: If the condition does have an "essential nexus" to the stated governmental goal, to what extent must the imposed condition relate to the projected impact of the proposed development. The Court addressed that question in *Dolan*.

In *Dolan*, the claimant owned a plumbing and electric supply store located in the City's central business district and next to a creek. Part of the property was within the creek's 100-year floodplain. *Dolan*, 512 U.S. at 379, 114 S.Ct. at 2313. When the claimant applied for a permit to redevelop the property, increasing the store size by nearly double and paving a parking lot, the Planning Commission granted the permit application subject to the conditions that Dolan dedicate the property within the 100-year floodplain for improvement of a storm drainage system and dedicate an additional 15-foot strip adjacent to the floodplain as a pedestrian/bicycle pathway. *Dolan*, 512 U.S. at 379-380, 114 S.Ct. at 2314. The amount of property in the dedication encompassed roughly 10% of the whole property. *Id.*

Finding, as a threshold matter, that the required nexus existed between the government's purpose of preventing flooding and the development condition that would limit development within the floodplain, and also between the government's purpose of reducing traffic congestion and the development condition that would provide a pedestrian/bicycle pathway, the Court then moved on to the question of the relationship between the degree of the exactions and the projected impact of the proposed development. *Dolan*, 512 U.S. at 387-388, 114 S.Ct. at 2318. After reciting a survey of the types of relationships required in various states, the Court held: "We think a term such as 'rough proportionality' best encapsulates what we hold to be the requirement of the Fifth Amendment. No precise mathematical calculation is required, but the city must make some sort of individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development." *Dolan*, 512 U.S. at 391, 114 S.Ct. at 2319-2320. In *Dolan*, the Court held the government had failed to make any individualized determination that the amount of traffic generated by the proposed development reasonably related to the requirement of a dedication of a pedestrian/bicycle easement. *Dolan*, 512 U.S. at 395, 114 S.Ct. at 2321. Additionally, the Court found the dedication of the floodplain area to be overcompensation, when the government could have met its goal by merely restricting the ability to develop within the floodplain, rather than requiring the landowner to dedicate the property. The Court explained, "It is difficult to see why recreational visitors trampling along petitioner's floodplain easement are sufficiently related to the city's legitimate interest in reducing flooding problems ..., and the city has not attempted to make any individualized determination to support this part of its request." *Dolan*, 512 U.S. at 393, 114 S.Ct. at 2320-2321.

III. APPLYING FEDERAL LAW TO TEXAS CASES

A. The Precedential Value of Federal Cases

While both the Texas and Federal Constitutions require compensation for the taking of private property, the Texas Constitution goes further and also requires compensation for the *damaging* of private property. Tex. Const. art. I, § 17 ("no person's property shall be taken, *damaged* or destroyed ... without adequate

compensation being made"). It is arguable, therefore, that the Texas Constitution provides greater protection than the Federal Constitution and supports takings claims based on less intrusive regulations than would be held to effect a compensable taking under the Federal Constitution. Despite this presumptive difference, the last three decisions by the Texas Supreme Court concerning regulatory takings quoted from and applied the analysis of United States Supreme Court decisions in regulatory takings cases. See, e.g., *Town of Flower Mound v. Stafford Estates Limited Partnership*, 135 S.W.3d 620 (Tex. 2004) (an exactions case applying the *Nollan/Dolan* analysis); *Sheffield Development Co., Inc. v. City of Glenn Heights*, 2004 WL 422594 (Tex. 2004) (a moratorium and downzoning case applying the *Penn Central* analysis); *Mayhew v. Town of Sunnyvale*, 964 S.W.2d 922, 932 (Tex. 1998) ("for the purposes of this case, we assume, without deciding, that the state and federal guarantees in respect to land-use constitutional claims are coextensive, and we will analyze the Mayhews' claims under the more familiar federal standards").

To date, there is no reported Texas case in which a party raised the argument that a regulation resulted in a compensable taking under Texas law even though it would not have under Federal law. However, it should be noted here that in 1995 the Texas Legislature enacted the Private Real Property Rights Preservation Act, which defines a "taking" for purposes of the Act under two categories, one of which is a reduction of at least 25 percent in the market value of private real property affected by, and the subject of, governmental action. TEX. GOV'T CODE § 2007.002 (2003). This Act is limited in applicability because of the litany of governmental actions to which the Act does not apply (see TEX. GOV'T CODE § 2007.003(b)), and in fact, all but one of the few reported cases concerning claims brought under the Act have held that the Act did not apply either due to one of the exceptions or to lack of standing. See, *Bragg v. Edwards Aquifer Authority*, 71 S.W.3d 729 (Tex. 2002) (holding that the regulation fell within an exception to the Act); *Chambers County v. TSP Development, Ltd.*, 63 S.W.3d 835 (Tex. App. – Houston [14th Dist.] 2001, pet. denied) (holding that the claimant did not have standing); *Duncan v. Calhoun County Navigation Dist.*, 28 S.W.3d 707 (Tex. App. – Corpus Christi 2000, pet. denied) (holding that the Act did not apply because the case presented an exception to the Act); *McMillan v. Northwest Harris County Municipal Utility District No. 24*, 988 S.W.2d 337 (Tex. App. – Houston [1st Dist.] 1999, pet. denied) (holding the governmental act complained of was an exception to the Act). But see, *South West Property Trust, Inc. v. Dallas County Flood Control Dist. No. 1*, 136 S.W.3d 1, 11-12 (Tex. App. – Dallas 2001)(no pet. hist.) (insufficient evidence to support summary judgment on the basis of an exception to the Act).

Because the issue of whether Federal case law is applicable to takings claims based on the Texas Constitution has not been raised in a reported decision in Texas, and because in the absence of argument the Texas Supreme Court has relied upon and approved Federal case law in considering claims based on the Texas Constitution, regulatory takings cases decided by the United States Supreme Court should be considered to have persuasive value in Texas. *Accord, Sheffield Development Co., Inc. v. City of Glenn Heights*, 2004 WL 422594, *9 (Tex. 2004) (noting that, while the Texas Supreme Court was not bound to follow a United States Supreme Court decision because the Texas claimant made no claim under the Federal Constitution, the Texas Supreme Court does "look to federal takings cases for guidance in applying our own constitution," and "to that end," the federal case "remains authoritative." *Id.*

B. Federal Takings Claims in Texas

As stated above, the Texas Constitution arguably provides more protection for private property owners than the Federal Constitution. Why, then, would a property owner in Texas seek to bring his takings claim under the Federal Constitution? The answer is that the property owner is attempting to recover attorney fees. Attorney fees are not recoverable under a regulatory takings claim in Texas, but they are recoverable in a claim brought under 42 U.S.C. § 1983, which provides for a civil action for deprivation of rights secured by the Federal Constitution. 42 U.S.C. §§ 1983, 1988(b) (2003).

Unfortunately for property owners in Texas, a § 1983 claim does not ripen until the claimant has sought, and been denied, compensation from the State. "[I]f a State provides an adequate procedure for seeking just compensation, the property owner cannot claim a violation of the [Federal takings clause] until it has used the procedure and been denied just compensation." *Williamson County Regional Planning Commission v. Hamilton Bank*, 473 U.S. 172, 195, 105 S.Ct. 3108, 3121, 87 L.Ed.2d 126 (1985). Texas has been held to have an adequate procedure for seeking just compensation for regulatory takings because Texas allows inverse condemnation actions to be brought for violations of the Texas takings clause, which is found in article I, section 17 of the Texas Constitution. *Town of Flower Mound v. Stafford Estates Ltd. Partnership*, 135 S.W.3d 620, 646 (Tex. 2004); *Hollywood Park Humane Society v. Town of Hollywood Park*, 2004 WL 502559, *3, 5 (W.D. Tex. 2004).

In *Town of Flower Mound v. Stafford Estates*, the

Supreme Court recently considered two issues regarding the applicability of § 1983 to regulatory takings claims in Texas. In that case, the claimant had pursued both a State takings claim and a § 1983 claim in the same lawsuit. Having successfully obtained compensation under its State takings claim, the Court held the claimant could not also prevail on its § 1983 claim, and therefore could not recover attorney fees. *Stafford Estates*, 135 S.W.3d at 646. The claimant and amicus curiae raised two objections to the Court's holding: (1) because the § 1983 claim and the State takings claim arose out of a common nucleus of operative facts, the claimant should be allowed to recover attorney fees under § 1983, and (2) the holding "was tantamount to saying that state and federal takings claims cannot be brought in the same lawsuit." *Id.*

Regarding the claimant's reasoning that the Court should allow it to recover attorney fees based on the common nucleus of operative facts, the Court reasoned that the claimant "would have a strong argument if its federal claims were simply 'not reached.' But because Stafford has obtained adequate compensation through state procedures, it has no federal claims to be reached. Stafford's rights under the United States Constitution simply were never violated." *Id.*

Regarding the amicus curiae's complaint that the Court's refusal to consider the § 1983 action effectively was a ruling that state and federal takings claims cannot be brought in the same lawsuit, the Court disagreed. "The fact that the federal constitutional guarantee is not violated if state law affords just compensation does not preclude both claims from being asserted in the same action. Recovery denied on the state takings claim may yet be granted on the federal claim, in the same action." *Id.*

Though the above suggests that § 1983 provides a second chance at just compensation for claimants unsuccessful in state court, and with an added bonus of a chance at recovering attorney fees, it really does not. Federal courts are obligated to give full respect to state adjudications under the Full Faith and Credit Clause and its accompanying Federal statute. U.S. CONST. art. IV, § 1; 28 U.S.C. § 1738; *Migra v. Warren City School District Board of Education*, 465 U.S. 75, 80-81, 104 S.Ct. 892, 896, 79 L.Ed.2d 56 (1984). Accordingly, state court opinions have a res judicata effect on § 1983 claims. The result seemingly is a no-win situation for property owners – if the State takings claim is successful, the property owner can recover compensation for the taking, but cannot recover the expenses of pursuing that compensation; if the State takings claim is unsuccessful, the property owner can attempt to pursue a § 1983 claim, but the federal court will likely find that the state court opinion bars it from considering what is substantially the same claim.

IV. ADMINISTRATIVE AND STRATEGIC ISSUES TO CONSIDER BEFORE FILING SUIT

A. Exhaust Administrative Remedies to Ripen the Claim

Courts are not in the business of interpreting regulations to determine how and to what extent a particular regulation, as written, affects a particular property, then issuing an advisory opinion on whether the regulation, if enforced against the property as the court interprets the regulation, would constitute a compensable taking. Courts recognize it is usually not the existence of the regulation that mandates compensation; rather, it is the manner in which the regulation is enforced against a particular property that may cause a compensable taking. Therefore, in order to "ripen" a regulatory takings claim and empower a court with jurisdiction to consider the claim, a property owner must get a "final decision" from the governmental entity enforcing the regulation as to the effect of the regulation on the property at issue. *Mayhew v. Town of Sunnyvale*, 964 S.W.2d 922, 929 (Tex. 1998); *Williamson County Regional Planning Comm'n v. Hamilton Bank*, 473 U.S. 172, 186, 105 S.Ct. 3108, 3116, 87 L.Ed.2d 126 (1985). "A 'final decision' usually requires both a rejected development plan and the denial of a variance from the controlling regulations.... However, futile variance requests or re-applications are not required." *Mayhew*, 964 S.W.2d at 929.

The Texas Supreme Court first considered the ripeness of a regulatory takings claim in *Mayhew v. Town of Sunnyvale.* The ripeness issue arose in *Mayhew* because the property owners had submitted only one development plan, and, after it was denied, had filed suit without applying for a variance to the regulation. *Id.* at 931. The Court noted, "Normally, their failure to reapply or seek a variance would be fatal to the ripeness of their claims," but the Court went on to reason that further applications from the Mayhews would have been futile, and being that futile requests are not required, the Mayhews claims were ripe. *Id.* In so holding, the Court relied on the following facts:

- The Mayhews had first submitted a development proposal to build between 3,650 and 5,025 units on their land. After receiving a "negative response," the Mayhews met with Town council members, and subsequently, in an attempt to compromise, agreed to alter their application to request approval for only 3,600 units. The Court stated, "Such a compromise proposal can sometimes be sufficient to satisfy the variance requirement." *Id.* at 931.

- The modified application requested permission to develop the minimum number of units the Mayhews believed necessary to make economically viable use of their land, "not the most profitable use envisioned...". *Id.* at 931. The Court stated, "The ripeness doctrine does not require a property owner ... to seek permits for development that the property owner does not deem economically viable." *Id.* at 932.

Subsequent to *Mayhew*, the futility doctrine was also found determinative in *City of Houston v. Kolb*, 982 S.W.2d 949 (Tex. App. – Houston [14th Dist.] 1999, pet. denied), where a subdivision plat application was denied because it would prohibit use of a planned freeway. While the landowners never filed a variance request, the court agreed such a request would have been futile given the evidence at trial that no variances had ever been granted for approval of a development where the freeway was proposed to intersect the property, the alignment of the proposed freeway was protected so that future acquisition cost for the right of way would be decreased, and the governmental entity in control of the development permits had no authority to alter or amend the pathway of the proposed freeway. *City of Houston v. Kolb*, 982 S.W.2d 949, 956 (Tex. App. – Houston [14th Dist.] 1999, pet. denied), *cert. denied*, 530 U.S. 1243, 120 S.Ct. 2690, 147 L.Ed.2d 962 (2000).

However, while the property owner does not have to seek approval for developments that are not economically feasible, the property owner cannot ripen a regulatory takings claim by seeking and being denied approval for only "grandiose" developments, leaving open the question of whether a less grandiose, but still profitable, development would have been approved. *See, City of Grand Prairie v. M.B. Capital Investors, Inc.*, 1996 WL 499790, *5 (Tex. App. – Dallas 1997, appeal dism'd) (not designated for publication) (recognizing that a landowner may have to submit more than one development plan to ripen its claim in order to determine whether the government would permit a less grandiose plan).

The property owner should also be leery of relying on the futility doctrine to avoid completing even one application for development, even if the property owner's claim is a *Lucas*-type claim that his property is left without any economically viable use. Consider the case of *Howard v. City of Kerrville and Upper Guadalupe River Authority*, 75 S.W.3d 112 (Tex. App. – San Antonio 2002, pet. denied), where the landowner claimed that floodplain regulations requiring him to fill his property to a certain level rendered any development prohibitively expensive. *Howard v. City of Kerrville and Upper Guadalupe River Authority*, 75 S.W.3d 112, 17-118 (Tex. App. – San Antonio 2002, pet. denied). Despite the landowner's claim that there was no economically feasible way to develop the property, the court still held his regulatory takings claim was not ripe because he failed to complete any application process under the existing ordinances. *Id.* at 118.

B. Giving In To a Condition of Development Approval and Beginning Development Before Filing Suit Challenging the Condition As an Unconstitutional Taking

This issue relates to development exactions and dedications required as conditions for obtaining development approval. Under the *Nollan/Dolan* test, such conditions constitute compensable takings unless they have an essential nexus to the substantial advancement of a legitimate governmental interest and are proportional to the projected impact of the proposed development. *Town of Flower Mound v. Stafford Estates Limited Partnership*, 135 S.W.3d 620, 634 (Tex. 2004). However, a developer will not want to hold up his development for years as his takings claim makes its way through court. The question, then, is whether a developer may agree to the condition, obtain approval to develop and begin development, all before filing suit to challenge the condition as failing the *Nollan/Dolan* test.

This year, in *Town of Flower Mound v. Stafford Estates*, the Texas Supreme Court answered that question affirmatively. *Stafford Estates*, 135 S.W.3d at 630. In *Stafford Estates*, the city code required developers to improve abutting substandard streets, regardless of whether the improvements were necessary to accommodate the projected impact of the proposed development. *Id.* at 622. Importantly, the developer objected to the condition at every administrative level and requested an exception. Though the Town had granted exceptions to other developers on a project-by-project basis, the Town denied the request for an exception in this case. *Id.* at 624. The developer rebuilt the abutting road, then sued to recover the cost.

The Town argued the developer should not be allowed to accept the conditional permit, begin development, then sue, for two reasons: (1) it is in the public interest for the government to have the opportunity to withdraw a condition of approval found to constitute a taking and thereby avoid the expense to taxpayers of money damages; and (2) it is unfair to allow the developer to accept the benefit of the development approval and later challenge the condition upon which it was based. *Id.* at 628. The Court noted the Town did not attempt to characterize its argument as waiver or estoppel, but the Court suggested such an argument would have been invalid due to the developer's objection

to the condition at every opportunity. *Id.* at 630.

Regarding the Town's argument that a developer should be barred from pursuing a taking claim once the government has lost its opportunity to spare tax money by withdrawing the condition, the Court suggested the Town, having been put on notice of the developer's objection at every level, could have offered to allow the developer to defer improving the road and escrow the cost pending a judicial determination of the validity of the condition. *Id.* If the condition had been found unconstitutional, the escrowed money would have been returned to the developer; otherwise, it would have been used to fund the required improvement. Legislation codifying such a procedure was enacted in California in response to court decisions requiring developers to challenge a condition of development before satisfying it. *Id.* at 629. There is no such legislation in Texas, but the Court recognized the Town should not be allowed to extort an unconstitutional condition from a developer who does not want to suffer the delay of litigation, when the Town could protect its interest in avoiding damages and the developer's interest in avoiding delay by using such a procedure. Having declined to pursue that option, the Court found the Town's policy arguments "unconvincing," and held, "No limitation barring Stafford's suit exists, and we decline the invitation to create one." *Id.* at 630.

C. Can a Regulatory Takings Claim Survive a Title Transfer?

Two of the three *Penn Central* factors ask essentially the same question: does the regulation prohibit the claimant from making a profitable use of the regulated property? *See, Penn Central* factors one and two: (1) the economic impact of the regulation on the claimant (note that this factor considers the impact on the *claimant*, not the *property*)[1], and (2) the extent to which the regulation has interfered with distinct investment-backed expectations (note that this factor qualifies the "expectations" of the claimant so that the court will consider whether the claimant payed a discount for the property due to the regulation). Given these factors, it is clear the best claimant of a regulatory takings claim is the owner of the property at the time the regulation becomes effective. Because subsequent purchasers will likely pay a discount for the property as a result of the regulation, and should consider the regulation when setting their expectations regarding the use and development of the property, subsequent purchasers will not have as strong a claim under these two *Penn Central* factors.

There are, however, many factors that can affect a subsequent owner's regulatory takings claim. For example, what if the subsequent owner did not purchase the regulated property, but inherited it instead? Does the subsequent owner then also "inherit" the previous owner's regulatory takings claim? What if the contract of sale specifies that the subsequent purchaser is purchasing not only the regulated property (presumably at less cost than the purchaser would pay if the property were not regulated), but is also "purchasing" the previous owner's regulatory takings claim? Can a subsequent owner overcome the assumptions of the *Penn Central* factors in this way – by claiming in the regulatory takings case that his "investment-backed expectation" was that the regulation would be found unconstitutional, as shown by the fact he paid for the former owner's claim?

The issue of what happens to a regulatory takings claim when title to the regulated property is transferred was considered by the United States Supreme Court in 2001 in *Palazzolo v. Rhode Island*, 533 U.S. 606, 121 S.Ct. 2448, 150 L.Ed.2d 592 (2001). The division among the Supreme Court Justices on this issue indicates the answers to the questions posed above are far from certain.

In *Palazzolo v. Rhode Island*, the claimant (Palazzolo) was a principle in the corporation that purchased the subject property. After the corporation acquired the property, Palazzolo bought out his associates and became the sole shareholder. *Palazzolo v. Rhode Island*, 533 U.S. 606, 613, 121 S.Ct. 2448, 2455, 150 L.Ed.2d 592 (2001). During the time the corporation owned the property, the State enacted legislation regulating the property. *Palazzolo*, 533 U.S. at 614, 121 S.Ct. at 2456. Subsequently, the corporation's charter was revoked, and Palazzolo, as the sole shareholder, obtained ownership of the property. *Id.* Palazzolo then submitted applications to develop the property, which were rejected due to their conflict with the regulations imposed during corporate ownership of the property. *Palazzolo*, 533 U.S. at 614-615, 121 S.Ct. at 2456.

Writing for the Court on the issue of the effect of Palazzolo's post-regulation acquisition of title, Justice Kennedy, joined by four other Justices, wrote that "unreasonable" regulations "do not become less so through passage of time or title." *Palazzolo*, 533 U.S. at 627, 121 S.Ct. at 2462. Justice Kennedy also rejected the "notice" rule proposed by the State:

> "Nor does the justification of notice take into account the effect on owners at the time of enactment, who are prejudiced as well. Should an owner attempt to challenge a new regulation,

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[1]But also see *Mayhew v. Town of Sunnyvale*, where the Texas Supreme Court stated, "The first factor, the economic impact of the regulation, merely compares the value that has been taken *from the property* with the value that remains in the property." *Mayhew v. Town of Sunnyvale*, 964 S.W.2d 922, 935-936 (Tex. 1998) (emphasis added).

but not survive the process of ripening his or her claim (which, as this case demonstrates, will often take years), under the proposed rule the right to compensation may not be asserted by an heir or successor, and so may not be asserted at all. The State's rule would work a critical alteration to the nature of property, as the newly regulated landowner is stripped of the ability to transfer the interest which was possessed prior to the regulation. The State may not by this means secure a windfall for itself."

Palazzolo, 533 U.S. at 627, 121 S.Ct. at 2463.

In holding Palazzolo's claim was not barred by the "mere fact" he acquired title after the effective date of the regulation, the Court relied in part on *Nollan v. California Coastal Comm'n*, 483 U.S. 825, 107 S.Ct. 3141, 97 L.Ed.2d 677 (1987) as controlling precedent. The Court noted that the "principal dissenting opinion" in *Nollan* (Justice Brennan), would have found it dispositive that the Nollans purchased their beachfront property after the regulation at issue was in effect. "A majority of the Court rejected the proposition. 'So long as the Commission could not have deprived the prior owners of the easement without compensating them,' the Court reasoned, 'the prior owners must be understood to have transferred their full property rights in conveying the lot.'" *Palazzolo*, 533 U.S. at 629, 121 S.Ct. at 2463-2464, citing *Nollan*, 483 U.S. at 834, n.2, 107 S.Ct. at 3147.

Though Justice Kennedy was joined by four other Justices, two of the four (O'Connor and Scalia) wrote concurring opinions expressing their very different understandings of the Court's opinion. Justice O'Connor would hold, in the future, that the timing of the transfer of title, in relation to the effective date of the regulation, should be one factor considered in determining whether the regulation effected an unconstitutional taking. Justice Scalia would hold the timing of the transfer of title is irrelevant and should not be considered.

Justice O'Connor wrote that her understanding of the Court's holding was *not* that "the timing of the regulation's enactment relative to the acquisition of title is immaterial to the *Penn Central* analysis. Indeed, it would be just as much error to expunge this consideration from the takings inquiry as it would be to accord it exclusive significance." *Palazzolo*, 533 U.S. at 633, 121 S.Ct. at 2465 (O'Connor, concurring).

Justice Scalia characterized the principle underlying Justice O'Connor's concurrence as follows:

"The principle that underlies her separate concurrence is that it may in some (unspecified) circumstances be '[un]fai[r],' and produce unacceptable 'windfalls,' to allow a subsequent purchaser to nullify an unconstitutional partial taking (though, inexplicably, not an unconstitutional total taking) by the government. . . . The polar horrible, presumably, is the situation in which a sharp real estate developer, realizing (or indeed, simply gambling on) the unconstitutional excessiveness of a development restriction that a naive landowner assumes to be valid, purchases property at what it would be worth subject to the restriction, then develops it to its full value (or resells it as its full value) after getting the unconstitutional restriction invalidated."

Palazzolo, 533 U.S. at 636, 121 S.Ct. at 2467 (Scalia, concurring).

Justice Scalia then responded to the principle underlying Justice O'Connor's concurrence (as he had characterized it):

"There is something to be said (though in my view not much) for pursuing abstract 'fairness' by requiring part or all of that windfall to be returned to the naive property owner, who presumably is the 'rightful' owner of it. But there is nothing to be said for giving it instead to the *government* – which not only did not lose something it owned, but is both the *cause* of the miscarriage of 'fairness' and the only one of the three parties involved in the miscarriage (government, naive original owner, and sharp real estate developer) which *acted unlawfully* – indeed *unconstitutionally*."

Palazzolo, 533 U.S. at 636-637, 121 S.Ct. at 2468 (Scalia, concurring).

Of the four Justices who dissented, three agreed with Justice O'Connor on this issue. *See*, Justice Ginsburg's dissent, joined by Justice Souter and Justice Breyer ("If Palazzolo's claim were ripe and the merits properly presented, I would, at a minimum, agree with Justice O'Connor, Justice Stevens, and Justice Breyer, that transfer of title can impair a takings claim). *Palazzolo*, 533 U.S. at 654, 121 S.Ct. at 2477 (Ginsburg, dissenting). *See also,* Justice Breyer's dissent ("I add that, given this Court's precedents, I would agree with Justice O'Connor that the simple fact that a piece of property has changed hands (for example, by inheritance) does not always and *automatically* bar a takings claim"). *Palazzolo*, 533 U.S. at 654-655, 121 S.Ct. at 2477 (Breyer, dissenting).

Justice Stevens took a different view altogether on this issue. He would have held that the key to this issue

is the discrete moment of the taking. He explained the issue this way:

> "If [the regulations] changed the character of the owner's title to the property, thereby diminishing its value, petitioner [Palazzolo] acquired only the net value that remained after that diminishment occurred. . . . If the regulations are invalid, either because improper procedures were followed when they were adopted, or because they have somehow gone 'too far,' petitioner may seek to enjoin their enforcement, but he has no right to recover compensation for the value of the property taken from someone else. . . . [But], [i]f the determination by the regulators to reject the project involves such an unforeseeable interpretation or extension of the regulation as to amount to a change in the law, then it is appropriate to consider the decision of that body, rather than the adoption of the regulation, as the discrete event that deprived the owner of a pre-existing interest in property."

Palazzolo, 533 U.S. at 642, 644, n.7, 122 S.Ct. at 2470-2471, 2472 (Stevens, dissenting).

Though a majority of the Court held the post-regulation transfer of title did not bar Palazzolo's claim, the differences stated in Justice O'Connor's concurrence, Justice Scalia's concurrence and Justice Stevens' dissent indicate this issue may not be settled. In Texas, dicta from the Texas Supreme Court in 1998 (prior to *Palazzolo*), indicated that the fact a regulation exists at the time of purchase is a relevant factor in determining the claimant's reasonable, investment-backed expectations. *Mayhew v. Town of Sunnyvale*, 964 S.W.2d 922, 936 (Tex. 1998) ("Knowledge of existing zoning is to be considered in determining whether the regulation interferes with investment-backed expectations").

V. THE DENOMINATOR PROBLEM

The denominator problem refers to the question of how much property, including property rights, should be considered in the determination of whether a regulation causes a compensable taking. For example, a setback regulation would probably be held compensable under *Lucas* if only the land within the setback area was considered in the takings analysis. Similarly, a moratorium on development is essentially the same as the government taking a leasehold interest in the affected property, and would probably be held compensable if only the period of the moratorium was considered in the takings analysis. As the United States Supreme Court put it, "To the extent that any portion of property is taken, that portion is always taken in its entirety; the relevant question, however, is whether the property taken is all, or only a portion of, the parcel in question." *Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California*, 508 U.S. 602, 643, 113 S.Ct. 2264, 2290, 124 L.Ed.2d 539 (1993). The Fifth Circuit Court of Appeals recently explained the denominator problem as follows:

> "[I]f the amount of Blackacre owned by Landowner is 2 acres, and the amount of Blackacre affected by the government regulation is 1 acre, the denominator is 2 and the numerator is 1; thus, the property's use is diminished by fifty percent. The *Lucas* rationale relied on a hundred percent deprivation of all economically viable use of property. If a hundred percent deprivation is required, then the regulation of property in the above example is not a taking because Landowner may continue to use one-half of Blackacre."

Vulcan Materials Co. v. City of Tehuacana, 369 F.3d 882, 889 (5th Cir. 2004), citing Stephanie E. Hayes Lusk, COMMENT: *Texas Groundwater: Reconciling the Rule of Capture With Environmental and Community Demands*, 30 St. Mary's L.J. 305, 339 (1998).

It should come as no surprise that the denominator issue has been the subject of some disagreement among Justices. For example, in the most recent United States Supreme Court opinion to discuss the denominator issue, the majority opinion stated, "Of course, defining the property interest taken in terms of the very regulation being challenged is circular. . . . [I]n regulatory takings cases we must focus on 'the parcel as a whole.'" *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302, 331, 122 S.Ct. 1465, 1483, 152 L.Ed.2d 517 (2002), citing *Penn Central*, 438 U.S. at 130-131, 98 S.Ct. at 2662. But Justice Thomas, joined by Justice Scalia, dissented: "The majority's decision to embrace the 'parcel as a whole' doctrine as *settled* is puzzling. See, e.g., *Palazzolo v. Rhode Island*, 533 U.S. 606, 631, 121 S.Ct. 2448, 150 L.Ed.2d 592 (2001) (noting that the Court has 'at times expressed discomfort with the logic of [the parcel as a whole] rule'); *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1017, n.7, 112 S.Ct. 2886, 120 L.Ed.2d 798 (1992) (recognizing that 'uncertainty regarding the composition of the denominator in [the Court's] 'deprivation' fraction has produced inconsistent pronouncements by the Court,' and that the relevant calculus is a 'difficult question')." *Tahoe-Sierra*, 535 U.S. at 355, n, 122 S.Ct. at 1496) (Thomas, dissenting).

No Texas state court has directly addressed the

denominator issue (though the issue is inherent in exaction and dedication cases, which must address the issue indirectly through the *Nollan/Dolan* test). *See, e.g., City of College Station v. Turtle Rock Corporation*, 680 S.W.2d 802, 806 (Tex. 1984) (holding that a parkland dedication ordinance that required the developer to dedicate a "small portion" of his tract as a condition of development "[did] not render the developer's entire property 'wholly useless' nor [did] it cause a 'total destruction' of the entire tract's economic value"); *City of Houston v. Kolb*, 982 S.W.2d 949, 956 (Tex. App. – Houston [14th Dist.] 1999, pet. denied), *cert. denied*, 530 U.S. 1243, 120 S.Ct. 2690, 147 L.Ed.2d 962 (2000) (holding that a required dedication of right of way for a planned highway unreasonably interfered with the landowners' right to use, enjoy and develop the property). In lieu of state case law, Texas practitioners should be aware of the following United States Supreme Court and Fifth Circuit cases wherein this issue was discussed.

- *Vulcan Materials Co. v. City of Tehuacana*, 369 F.3d 882 (5th Cir. 2004). The claimant held a mineral lease to mine limestone. The lease covered approximately 300 acres, only 1/6th of which was within the City limits and subject to the City's regulatory authority. The City passed an ordinance forbidding mining within the City limits. *Id.* at 885. The Fifth Circuit noted that, as an initial matter, it must determine what "property" was relevant to its takings determination: "we must first examine which particular limestone mining rights are relevant to this determination – all of Vulcan's leasehold interests or only [those within the City limits]." *Id.* at 889. Reversing the district court, which had considered not only the 48 acres leased within the City limits, but also the adjacent 250 acres outside the City limits, the Fifth Circuit held the relevant parcel was Vulcan's leasehold interest on the property within the City limits. *Id.* at 891. Because the City ordinance deprived Vulcan of all value of its property rights within the relevant parcel, the Fifth Circuit held the ordinance was a *Lucas* categorical taking. *Id.* at 891-892.

- *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302, 122 S.Ct. 1465, 152 L.Ed.2d 517 (2002). The Tahoe Regional Planning Agency enacted two moratoria during which development on lands in "Stream Environmental Zones" or "SEZs" around Lake Tahoe was prohibited entirely. The two moratoria were presented to the Court as separate takings; one lasting 2 years, and the other lasting 8 months. *Tahoe-Sierra*, 535 U.S. at 306, 122 S.Ct. at 1470. Regarding the denominator problem, a majority of the Court agreed that the 32-month moratorium period could not be severed from the Landowners' fee simple estate and reviewed as if the property was taken in its entirety for that period. 533 U.S. at 331, 122 S.Ct. at 1483. The Court reasoned, "An interest in real property is defined by the metes and bounds that describe its geographic dimensions and the term of years that describes the temporal aspect of the owner's interest. . . . Logically, a fee simple estate cannot be rendered valueless by a temporary prohibition on economic use, because the property will recover value as soon as the prohibition is lifted." 533 U.S. at 331-332, 122 S.Ct. at 1484. The Court was careful to avoid crafting a *per se* rule that moratoria can never effect a taking: "[W]e do not hold that the temporary nature of a land-use restriction precludes finding that it effects a taking; we simply recognize that it should not be given exclusive significance one way or the other." 533 U.S. at 336, 122 S.Ct. at 1486. But see, *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, 482 U.S. 304, 107 S.Ct. at 2378, 96 L.Ed.2d 250 (1987) (holding that an ordinance that prohibited development for over six years, until it was struck down as unconstitutional, effected a compensable taking of the property for the term it was effective).

- *Keystone Bituminous Coal Assoc. v. DeBenedictis*, 480 U.S. 470, 107 S.Ct. 1232, 94 L.Ed.2d 472 (1986). The Pennsylvania Department of Environmental Resources (DER) is charged with implementing and enforcing a program to prevent or minimize subsidence and regulate its consequences. 480 U.S. at 476, 107 S.Ct. at 1237. In 1966, the DER began to require that 50% of the coal beneath certain structures be left in place in order to provide surface support. 480 U.S. at 477, 107 S.Ct. at 1238. A group of coal miners filed a facial challenge to the regulation, arguing that the regulation was a *per se* taking of the coal that must be left in the ground and a *per se* taking of the "support estate" (a separate legal interest in land recognized in Pennsylvania). 480 U.S. at 493, 496-497, 107 S.Ct. at 1246, 1248. The Court disagreed that the regulation was a *per se* taking because the Court did not agree with the petitioners' denominator: "Petitioners described the effect that the [regulation] had ... on 13 mines ..., and claimed that they have been required to leave a bit less than 27 million tons of coal in place... The total coal in those 13 mines amounts to over 1.46 billion tons. . . . Thus [the regulation] requires them to leave less than 2% of their coal in place." 480 U.S. at 496, 107 S.Ct. at 1247. In holding that the regulation was not a compensable taking, the Court also noted that petitioners "never claimed that their mining operations, or even any specific mines, have been unprofitable since the [regulation] was passed. Nor is there evidence that mining in any specific location

affected by the 50% rule has been unprofitable." 480 U.S. at 496, 107 S.Ct. at 1248.

VI. TEXAS REGULATORY TAKINGS CASES

This section provides a primer on regulatory takings case law in Texas organized by the following categories: (A) Zoning and Use Restrictions; (B) Moratoriums; and (C) Development Conditions, Exactions and Dedications. This section is intended to provide a general overview of the case law in each category; it is not intended to be an all-inclusive listing of Texas regulatory takings cases.

A. Zoning and Use Restrictions

The Texas Supreme Court issued two opinions in the last decade regarding whether density-limiting zoning ordinances, applied to undeveloped, residentially-zoned properties, effected a compensable taking. In each case, the Court held the regulation did not cause a compensable taking.

The most recent opinion from the Court on this issue considered the regulatory takings claim of Sheffield Development Company based on the application of a City ordinance that increased the minimum size of residential lots on Sheffield's property from 6,500 square feet to 12,000 square feet, thereby diminishing the permissible development density by half. *Sheffield Development Co. v. City of Glenn Heights*, 2004 WL 422594, *1-2 (Tex. 2004). The jury found a reduction of 50% in the value of the property. *Id.* at *4. Recognizing that "the rezoning clearly had a severe economic impact on Sheffield," the Court still held it did not rise to the level of a compensable taking. *Id.* at *12. In so holding, the Court discounted the importance of the property's diminution in value and gave premium significance to the developer's continued ability to obtain a profit:

> "But diminution in value is not the only, or in this case even the principal, element to be considered. It is more important that, according to the jury verdict, the property was still worth four times what it cost, despite the rezoning, because this makes the impact of the rezoning very unlike a taking. Sheffield argues that its business acumen or good fortune in acquiring the property cannot be considered in assessing the economic impact of rezoning, but we think that investment profits, like lost development profits, must be included in the analysis."

Id.

Six years prior to *Sheffield*, the Court considered a regulatory takings claim based on a Town's refusal to upzone, which the Court also found noncompensable. *Mayhew v. Town of Sunnyvale*, 964 S.W.2d 922 (Tex. 1998). The Mayhew family owned approximately 1,200 acres, which was zoned for single family residential use at a density of one-dwelling-per-acre. *Id.* 925. The Mayhews held meetings with Town officials to lobby the Town to increase the permissible density, resulting in the Town amending its zoning ordinance to allow planned developments in excess of one-dwelling-unit-per-acre upon council approval. *Id.* at 925-926. Subsequent to the amendment, and after spending over $500,000 conducting studies and preparing evaluative reports, the Mayhews submitted a development proposal requesting approval to develop at a density of over three units per acre. *Id.* at 926. The Town employed a professional planning and engineering firm to consult on the proposal, and the firm recommended approval. *Id.* However, the Town council indicated it would not approve such a dense development, and following meetings between the Mayhews and the council's negotiating committee, the Mayhews amended their proposal to request permission to develop the minimum density the Mayhews considered economically feasible, which was 3 units per acre. *Id.* The Town council denied the amended proposal. *Id.* In holding that the council's denial of the Mayhews' amended proposal did not constitute a compensable taking, the Court focused on the investment-backed expectations prong of the *Penn Central* analysis: "Because we hold that the Mayhews had no reasonable investment-backed expectation to build 3,600 units on their property, we hold that the Town has not unreasonably interfered with their right to use and enjoy their property by denying their planned development proposal." *Id.* at 937. The Court found the Mayhews had no investment-backed expectation to build the proposed development for the following reasons:

- The Mayhews originally purchased the property for ranching, not for development;
- The Mayhews used the property for ranching for nearly four decades ("Historical uses of the property are critically important when determining the reasonable investment-backed expectation of the landowner");
- The Mayhews' development would have quadrupled the Town's population;
- At the time the Mayhews purchased the additional property for development purposes, the Town's zoning ordinance restricting development to one-unit-per-acre had been in effect for twelve years. "The existing zoning of the property at the time it was acquired is to be considered in determining whether the regulation interferes with investment-backed expectations."

Id. at 937-938.

As demonstrated by *Sheffield* and *Mayhew*, obtaining compensation even for significant diminution in property value has not been common where the basis for the regulatory takings claim is the diminished development potential of undeveloped or underdeveloped property. But what about existing uses that become nonconforming as a result of regulation? Often, such uses are grandfathered and may continue as "legally nonconforming," but some ordinances do not provide grandfathered status for existing nonconforming uses. Instead, the nonconforming uses are allowed to continue over an amortization period, and then must cease. The Texas Supreme Court approved the amortization technique in *City of University Park v. Benners*, 485 S.W.2d 773 (Tex. 1972), and held that no compensable taking will result from an ordinance prohibiting the continuation of a nonconforming use so long as the amortization period is reasonable. *Benners*, 485 S.W.2d at 778-779. The reasonableness of the amortization period is determined by whether the property owner is afforded sufficient time to recoup his investment. *Id.* at 779, n.7.

Benners involved two commercial lots that were rezoned to permit duplexes. *Benners*, 485 S.W.2d at 775. The rezoning ordinance provided for the termination of the commercial uses after a 25-year amortization period. *Id.* Considering the propriety of using an amortization period to terminate existing nonconforming uses without the payment of compensation, the Court stated

> "[T]here is no difference in kind between terminating a land use which pre-dates a zoning change, with allowance for recoupment, and restricting future land uses not presently utilized. The former requires no more than that the property owner be placed in the equivalent position of the latter, i.e., that he be afforded an opportunity to recover his investment in the structures theretofore placed on the property. The reasonableness of the opportunity for recoupment thus afforded is to be measured by conditions at the time the existing use is declared nonconforming and not, as viewed by the intermediate court, by conditions upon expiration of the tolerance period. . . . It is evident that the owners of the property were given sufficient time in which to terminate the commercial uses and to recoup any loss in property value occasioned by the reclassification of the lots from commercial use to residential use..."

Id. at 779.

The amortization technique has been used most commonly with billboard ordinances. See, *Eller Media Co. v. City of Houston*, 101 S.W.3d 668 (Tex. App. – Houston [1st Dist.] 2003, pet. denied); *Lubbock Poster Co. v. City of Lubbock*, 569 S.W.2d 935, 942 (Tex. App. – Amarillo 1978, writ ref'd n.r.e.), *cert. denied*, 444 U.S. 833, 100 S.Ct. 63, 62 L.Ed.2d 42 (1979) (interpreting *Benners* to exclude consideration of market value in determining the sufficiency of the recoupment period). However, it has also been used to terminate a sexually oriented business (SOB) and a lead smelter. *MJR's Fare of Dallas, Inc. v. City of Dallas*, 792 S.W.2d 569 (Tex. App. – Dallas 1990, writ denied) (three-year amortization period for SOB); *Murmur Corp. v. Board of Adjustment*, 718 S.W.2d 790, 801 (Tex. App. – Dallas 1986, writ ref'd n.r.e.) (holding the value of the land cannot be offset against the owner's investment to determine his recoverable investment, if any, in the nonconforming use).

Termination-of-nonconforming-use-by-amortization cases explicitly proclaim their distinction from statutory takings cases, wherein the government is exercising its power of eminent domain, based on the level of compensation required (recoupment of investment versus diminished market value). Based on the application of the *Penn Central* factors that question the effect of regulations on the *claimant* (rather than the property) and the claimant's *investment-backed* expectations (i.e., investment), it is arguable that courts historically have analyzed ordinances restricting future development of property under the same ability-to-recoup-investment standard by which courts analyze the reasonableness of an amortization period terminating an existing use of property, rather than under an analysis that gives primary consideration to the diminished market value of the property.

B. Moratoriums

The main issue regarding moratoriums as regulatory takings was summarized previously in this paper in section IV concerning the denominator problem, *supra*. Rather than repeat section IV's recitation of the United States Supreme Court's analysis in *Tahoe-Sierra*, where the Court held a 32-month moratoria period was not a compensable taking and that the moratorium period should not be considered a distinct segment for purposes of the takings analysis, this section includes only a summarization of the Texas Supreme Court's decision in *Sheffield Development Co. v. City of Glenn Heights*, 2004 WL 422594 (Tex. 2004), where the Texas Supreme Court held a 15-month moratorium was not a compensable taking. *Sheffield Development Co. v. City of Glenn Heights*, 2004 WL 422594 (Tex. 2004).

The relevant facts of *Sheffield*, as concerns the

moratorium, are as follows. Prior to purchasing the subject property, Sheffield met with City officials several times to advise them of his plans to develop as permitted by the existing zoning and to ascertain that no zoning changes were planned. *Id.* at *1-2. Though the City was considering a moratorium and downzoning, the City did not tell Sheffield for fear he would quickly close on the property and file a plat to vest his zoning rights. *Id.* at *2. Three days after Sheffield closed on the property, the City Council met in executive session to discuss downzoning the property. *Id.* Subsequently, the City enacted a one-month moratorium, which it extended for another month, and then, after it expired briefly, extended several times for a sum total of 15 months. A few weeks before the expiration of the moratorium, the City Council voted to downzone the property. *Id.* at *3. Sheffield filed suit, claiming, in part, that the moratorium caused a compensable taking. The Texas Supreme Court found there were two aspects of the takings claim: (1) whether the moratorium substantially advanced a legitimate government interest, and (2) whether the moratorium unreasonably interfered with Sheffield's use of the property.

On the issue of whether the moratorium substantially advanced a legitimate government interest, Sheffield argued there was evidence at least one councilmember wanted to use the moratorium as leverage to pressure Sheffield to agree to a less dense development plan, which the City "candidly but remarkably" argued was a legitimate government function. *Id.* at *14. The Court disagreed that the use of delay for extortion is a legitimate government function, but held that "evidence of one official's motives cannot be attributed to the City." *Id.* In holding the evidence suggested the moratorium advanced a legitimate government interest, the Court found it persuasive that, during the moratorium, the City rezoned seven PDs, which the Court found to suggest that it simply "took time" for the City to finish an "orderly, albeit slow" process of resolving the differences between the City Council, the Planning and Zoning Commission and the City's consultant. *Id.*

On the issue of whether the moratorium unreasonably interfered with Sheffield's use and enjoyment of his property, the Court noted that Sheffield failed to present evidence of the economic impact of the moratorium, nor did Sheffield present evidence that his "reasonable, investment-backed expectations excluded the possibility of a fifteen-month delay in a decision on its development plans." *Id.* The Court did not preclude the possibility that a moratorium could effect a compensable taking, stating, "We can easily imagine circumstances in which delay was aimed more at one person, or was more protracted with less justification, and more indicative of a taxing," but held the moratorium in this case "[did] not approach that situation." *Id.*

C. Development Conditions, Exactions and Dedications

Unlike other types of regulatory takings cases, the burden is on the government to effectively disprove a compensable taking in exactions and dedications cases. This is because the *Nollan/Dolan* test requires the government to make "some sort of individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development." *Town of Flower Mound v. Stafford Estates Limited Partnership*, 135 S.W.3d 620, 633 (Tex. 2004), citing *Dolan*, 512 U.S. at 389-391. Accordingly, unlike other types of regulatory takings cases (and, in fact, exactions and dedications can be fairly called a hybrid physical taking and regulatory taking), landowners have had much better success in obtaining compensation for exactions and dedications required as a condition of development approval than in obtaining compensation for other types of regulations. Note, for example, that both the namesake exaction/dedication cases, *Nollan* and *Dolan*, were cases in which the Court found for the claimant, and the same is true for the recent exactions case decided by the Texas Supreme Court (*Stafford Estates*), while *Penn Central* was a case in which the Court held the claimant did not present a compensable takings claim, and neither has any known Texas case been found to present a compensable taking under the *Penn Central* analysis.

The Texas Supreme Court has addressed the compensability of exactions or dedications required as conditions of development approval twice: first in *City of College Station v. Turtle Rock Corp.*, 680 S.W.2d 802 (Tex. 1984), before the United States Supreme Court decided *Nollan* and *Dolan*, and then again this year in *Stafford Estates*. Additionally, the Fourteenth District Court of Appeals in Houston decided an important dedication case in 1999, styled *City of Houston v. Kolb*, 982 S.W.2d 949 (Tex. App. – Houston [14th Dist.] 1999, pet. denied), *cert. denied*, 530 U.S. 1243, 120 S.Ct. 2690, 147 L.Ed.2d 962 (2000). These three cases will be discussed in chronological order.

In *City of College Station v. Turtle Rock Corp.*, Turtle Rock sued the City for an inverse taking over a $34,200 fee Turtle Rock elected to pay in lieu of a parkland dedication required as a condition of subdivision development pursuant to the City's parkland dedication ordinance. *City of College Station v. Turtle Rock Corp.*, 680 S.W.2d 802, 803-804 (Tex. 1984). The Court noted the ordinance would not constitute a taking if it was "substantially related" to a legitimate government goal and if it was reasonable, not arbitrary. *Id.* at 805. These factors are similar to the *Nollan/Dolan* factors that

would be applied today. However, the Court also stated there was a presumption the ordinance was reasonable and valid, and that the one challenging the ordinance bore the burden of proof. *Id.* at 805. The burden has since been shifted to the government to prove the validity of the development condition. *Town of Flower Mound v. Stafford Estates Limited Partnership*, 135 S.W.3d 620 (Tex. 2004). Overturning the court of appeals, which effectively held that all parkland dedication ordinances are *per se* invalid, the Texas Supreme Court held the ordinance was not unconstitutionally arbitrary or unreasonable on its face, and remanded the case for a determination of whether there was a "reasonable connection" between the "increased population arising from the subdivision development and the increased park and recreation needs in this neighborhood." *Turtle Rock*, 680 S.W.2d at 807. The Court explained:

> "Both need and benefit must be considered. Without a determination of need, a city could exact land or money to provide a park that was needed long before the developer subdivided his land. Similarly, unless the court considers the benefit, a city could, with monetary exactions, place a park so far from the particular subdivision that residents received no benefit."

Id.

Following *Turtle Rock*, and subsequent to the *Nollan* and *Dolan* cases decided by the United States Supreme Court in 1987 and 1994, respectively, the Fourteenth Court of Appeals in Houston considered the constitutionality of a required reservation to accommodate plans for a future highway (Grand Parkway) as a condition of development approval in *City of Houston v. Kolb*, 982 S.W.2d 949 (Tex. App. – Houston [14th Dist.] 1999, pet. denied), *cert. denied*, 530 U.S. 1243, 120 S.Ct. 2690, 147 L.Ed.2d 962 (2000). In *Kolb*, the testimony elicited from City employees and consultants at trial was that (1) Kolb's development application would not have been approved unless he dedicated at least a hundred feet of right of way for the Grand Parkway, and (2) the alignment of the Grand Parkway corridor was protected so future acquisition costs for the right of way would be decreased. *Id.* at 953-954. In support of the City's claim that the required dedication or reservation was not compensable, the City argued (1) Kolb's injury was a noncompensable "community damage," and (2) the land required to be reserved may never be taken through eminent domain if the Grand Parkway is not built, and therefore Kolb cannot recover in the present for a possible future taking. Additionally, the City argued that if the Court found the reservation requirement a compensable taking, then the City should be awarded a property interest in the land. The court of appeals disagreed with the City on all points.

Regarding the City's argument that Kolb's injury was noncompensable because it was "common to the community," the court replied, "Unlike other property owners who may eventually be affected by the visual impact, noise, traffic congestion, and other characteristics commonly associated with close proximity of a major highway, the Kolbs have suffered a present and specific loss that is not common to all landowners. . . . [T]he damages alleged by the Kolbs – the denial of a permit – were not shared by the community in general." *Id.* at 955.

Regarding the City's argument that the Kolbs should not be able to recover compensation for a planned future taking that may never occur, the court noted it was not the possibility of future acquisition that determined the reservation caused a compensable taking; it was the present interference with the use of the property. *Id.* at 955 The court found the Kolbs had suffered "a real and current taking." *Id.*

Finally, regarding the City's proposition that, if the court held Kolb had suffered a compensable taking, then the court should award the City a property interest in the "taken" property, the court reasoned the City had already obtained something of value:

> "The City denied Kolbs' development plat, in part, to decrease the costs of any future acquisition of a right-of-way. The City has achieved its objective. So long as the City continues to insist upon the dedication of a right-of-way for the Grand Parkway, and the Kolbs are unwilling to grant it, the land will remain undeveloped. Thus, the cost of any future acquisition of the corridor has been minimized, and the judgment represents, in an abstract sense, the cost of suspending development."

Id. at 957.

The Texas Supreme Court revisited exaction- and dedication-related regulatory takings this year in *Town of Flower Mound v. Stafford Estates Limited Partnership*, 135 S.W.3d 620 (Tex. 2004), where the Court announced the following rules:

- "[C]onditioning government approval of a development of property on some exaction is a compensable taking unless the condition (1) bears an essential nexus to the substantial advancement of some legitimate government interest and (2) is roughly proportional to the projected impact of the proposed development." *Id.* at 634, citing *Nollan* and *Dolan*.

- Monetary exactions will not be analyzed different from possessory dedications in determining whether there has been a taking. *Id.* at 635.

- The burden is on the government to "make some sort of individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development." *Id.* at 643.

- Though the government should determine whether the exaction or dedication is roughly proportional to the projected impact of the development before the condition is imposed, the government is not precluded from making that determination after the fact. *Id.* at 644.

- In determining the proportionality of the exaction to the projected impact of the development, the government may consider "the development's full impact ... and is not limited to considering the impact [only on the adjacent road]." *Id.* at 644.

- A developer is not barred from pursuing compensation for an unconstitutional taking even though the developer complies with the condition and begins development if the developer puts the government on notice that the developer contests the validity of the condition before complying with it. *Id.* at 630.

Stafford Estates concerned a developer's objection to the application of a city code that required developers to improve abutting substandard streets as a condition of development approval, even if the improvements were not necessary to accommodate the projected impact of the development. *Id.* at 622. As applied to the asphalt road abutting Stafford's development, the code required Stafford to rebuild the road with concrete. *Id.* at 623. Because the asphalt road was not in disrepair and the Town had made no attempt to determine whether the condition was roughly proportional to the projected impact of Stafford's development, Stafford argued it should not be required to pay the entire cost of the improvement and objected to the condition on its development at every administrative level. *Id.* at 624. Ultimately, Stafford rebuilt the road as required, at a cost of nearly half a million dollars, transferred the improvements to the Town, then sued to obtain reimbursement for the Town's proportional share of the expense. *Id.* The Supreme Court agreed with the district court that the exaction effected a compensable taking, reasoning as follows:

> "In sum, the Town has failed to show that the required improvements to Simmons Road bear any relationship to the impact of the Stafford Estates development on the road itself or on the Town's roadway system as a whole. On this record, conditioning development on rebuilding Simmons Road with concrete and making other changes was simply a way for the Town to extract from Stafford a benefit to which the Town was not entitled. The exaction the Town imposed was a taking for which Stafford is entitled to compensation."

Id. at 645.

VII. BIDDING ON THE FUTURE

Vernon L. Smith, a 2002 Nobel Prize winner in economics and a professor of economics and law at George Mason University, is currently conducting studies to determine the projected success of policies that place zoning decisions in the marketplace. Professor Smith's article on this topic appeared in the September 2004 edition of Forbes magazine, and is attached as an appendix to this paper. Vernon L. Smith, *Buy Me Out*, Forbes (Sept. 2004) at 48. In short, Professor Smith poses that those who desire a zoning change should submit bids stating how much they are willing to pay for the change, and those who desire the status quo should submit bids doing the same in support of their position. The side that bids the highest wins the zoning policy, but must ante up their bids to pay the losers. Each loser receives a check for the amount of his losing bid. Thus, the winners compensate the losers. Losers cannot be heard to complain their compensation is too low because each loser sets his own compensation by his bid. Accordingly, each person should not bid too low because if he loses, he will not receive adequate compensation for his loss, and each person should not bid more than the zoning policy is actually worth to him because if he wins, he will have to pay too much.

Though recognizing the proposal is not perfect (issues arise with what to do with the excess money after the payout to the losers, and with gamers who are bidding against their preference in order to share in the payout to the losers and also obtain the benefit of the preferable zoning policy), the professor believes the proposal is still superior to the current state of the law, where zoning beneficiaries pay nothing for the damage inflicted on the zoning injured. While there would certainly be many issues to consider in implementing such a policy (for example, the period of time for which the winners have purchased the zoning policy), perhaps the "most litigated and perplexing" area of current law should be addressed legislatively, and a bidding war is at least a place to start.

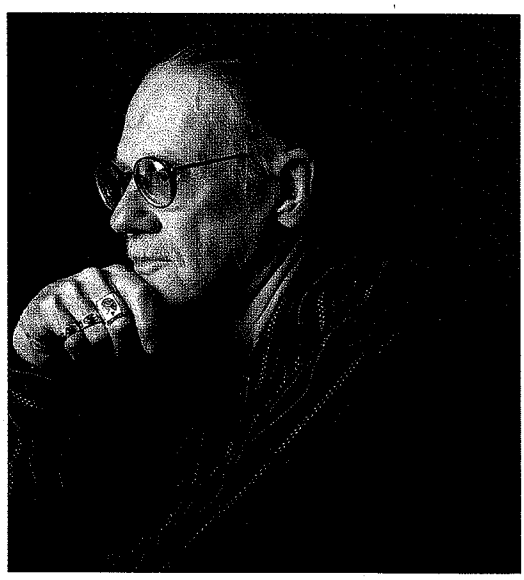
By Vernon L. Smith, A 2002 NOBEL PRIZE WINNER IN ECONOMICS AND PROFESSOR OF ECONOMICS AND LAW AT GEORGE MASON UNIVERSITY.

Buy Me Out

When the public good is at stake, maybe it's better to be ruled by dollars than by votes.

SUPPOSE NEW YORK CITY PROPOSES A ZONING LAW CHANGE that would permit the construction of taller office buildings in one part of town. The neighbors, or others who see the change as hurting them, will turn out to vote "no" in a referendum on the issue. Those who stand to gain will turn out to vote "yes."

Whichever side commands a majority will enjoy a capital gain, while the other side will suffer a capital loss. Some existing properties will increase in value while others will decrease. Much money may have been spent on lobbying for or against the measure. Democracy at work. The majority imposes reduced wealth on the minority and votes more wealth for itself.



"Those who think they will be hurt by the zoning change send in bids stating how much they are willing to pay for the status quo."

As noble as democracy is, it is excluded from most of the choices we make. We don't use majority rule to decide whether New York will build a Metropolitan Opera House, whether Yo-Yo Ma will play at Carnegie Hall or whether Volkswagen will discontinue the newest version of the Bug. If enough people are willing to pay to have an opera house, see Yo-Yo Ma or buy the Bug, those things happen. But in zoning, because the public good is at stake, people think the majority should hold sway.

Maybe there's a fairer way to divide the spoils—fairer and more practical, too. Together with George Mason University graduate students Ryan Oprea and Abel Winn, I've been running experiments to test an alternative approach using what we call a Referendum Center. We use real people and we pay real money, but we test hypothetical situations. Here's how we would approach the zoning dilemma.

Suppose those who think they will be hurt by the zoning change simply send to the Referendum Center a bonded bid stating how much they are willing to pay for the status quo. Those who think it's a good idea to loosen the rules and who see themselves as benefiting would send in bonded bids stating how much they are willing to pay for rule change.

So there are two piles of money bids. The biggest one, say $100 million, wins. The losing pile of bids was, let us say, $90 million. Each person who bid for the losing option receives a check for the amount that he or she bid. The money put up by the winning bidders is used to compensate the losers.

What if a losing bidder complains that his compensation is not high enough? We'd say it's his fault; he should have bid higher. But he must not bid more than the zoning change is truly worth to him because if he wins, he'll have to pay too much.

If he expects to win, his motivation is to bid less than the true worth to him, because everyone wants a bargain. But if he overplays this hand he will lose the bidding war. And then his compensation will be less than what he will lose in worth. In short, it's not easy to game the result. You have to put real money on the table.

Our solution is not ideal. But the bidding procedure is simple, fair and less coercive than majority rule, where the winners provide zero compensation for the damage they inflict on the downtrodden minority.

We're still examining a number of questions. Since more is bid by the winners than is needed to compensate the losers, what do you do with the surplus ($10 million in the example) after deducting the cost of conducting the referendum? Keep it as if it were a tax, or distribute it as a bonus to the losers?

We're also examining possible pitfalls. Suppose that lots of the people who bid for choice B actually prefer choice A. They think B will lose, and they hope to share in the payout to be funded by the choice A winners. Would this sort of speculation cause instability, even though there are incentives not to do this and to simply make a straightforward bid? In our experiments we find that the only subjects who do this are those who are assigned (randomly) very low values so that they have little to gain and also little to lose. These "dishonest" bids are therefore inconsequential because they are small and involve only those with little at stake. It's a behavioral issue that we learn about with experiments. F

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