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FEATURE CASE

Clarification from the Federal Circuit On Lost Profits in Takings Analysis

September brought some good news from the U.S. Court of Appeals for the Federal Circuit on how lost profits should be used to measure economic impact in regulatory takings cases. While it's too early to draw firm conclusions, the court appears to be stepping back from a dangerous theory that would have greatly expanded takings liability.

We've previously reported on disturbing developments in the Federal Circuit in which certain judges have suggested using lost profits, rather than lost value, as an appropriate measure of economic impact under the *Penn Central* multifactor test. The earliest cases were handed down in 2003 -- *Cienega Gardens v. United States*, 331 F.3d 1319 and *Chancellor Manor v. United States*, 331 F.3d 891 -- two factually complex cases involving takings challenges to changes made to federal affordable housing programs. The programs offered below-market-rate mortgages and other incentives in exchange for a commitment to charge reduced rents, which restricted the owners to an annual return of six percent of their initial equity investment (which sometimes represented as much as 25 percent on their net cash investment).

The challenged restrictions temporarily limited the ability of the owners to opt out of the federal programs by paying off their federally subsidized mortgage, which would have allowed them to convert their housing stock to traditional apartments that could be rented at market rates. In its 2003 opinions, the court stated that a taking could occur, and in fact had occurred with respect to certain owners, due to the impact of the restrictions on the owners' return on equity. On remand, the trial court awarded more than $43 million in compensation.

This focus on lost profits popped up again in *Rose Acre Farms v. United States*, 373 F.3d 1177 (Fed. Cir. 2004), in which the court addressed a takings challenge to restrictions on the sale of eggs from an egg farm shown to be the source of three separate outbreaks of food poisoning. The restrictions did not prohibit the sale of the eggs, but instead temporarily required that they be sold in the less profitable "breaker" market, where they are pasteurized to kill bacteria and then used for cake mix and the like, rather than as table eggs. Although the loss in value was relatively small, the court suggested the restrictions might work a taking based on the lost profits, notwithstanding the compelling public health justifications for the restrictions. And in fact, the trial court on remand found a taking and awarded $5.4 million in just compensation, plus interest and attorneys fees. As we've explained before, using lost profits as a basis for regulatory takings liability has little basis in law, and makes no sense as a matter of economics because it rewards less efficient, fly-by-night firms that operate with thin profit margins.

The recent good news came on appeal from the remand decisions in *Cienega Gardens* and *Chancellor Manor*. An unusual seven-judge (but not *en banc*) panel issued a decision that addressed both cases and reopens the question of whether a taking occurred at all. *Cienega Gardens*, 2007 U.S. App. LEXIS 22689 (Sept. 25, 2007). Although the trial court on remand adhered to the instructions given by the previous Federal Circuit ruling, on this appeal the Federal Circuit concluded that the trial court's use of a return-on-equity approach to economic impact failed to consider the value of the property as a whole. Citing *Tahoe*, *Penn Central* and other precedent that requires consideration of the parcel as a whole, the appeals court held that "the return on equity approach treated the income from the property for each individual year as a separate property interest from the value of the property as a whole," an approach that violates the whole parcel rule.

Moreover, the Federal Circuit held that the trial court's analysis failed to consider the offsetting benefits the claimants received from the challenged programs. Nor did it adequately consider the temporary nature of the challenged restrictions as required by *Tahoe*. Finally, the appeals court also ruled that the trial court failed to analyze whether there was a nexus between the owner's investment-backed expectations and their investment in the property.

We emphasize that it remains to be seen how the Federal Circuit's new approach to the case plays out on remand. Its most recent ruling, while less than perfect from our perspective, adheres more closely to precedent and is expressly tied to the notion that a regulatory taking occurs only when the challenged restrictions constitute the functional equivalent of an actual expropriation of property. These revisions should have practical benefits in future cases, including the next appeal in the *Rose Acre* salmonella case.

OUTRAGE OF THE MONTH

Environmental Protection Not a "Public Use"?

We've seen some strange things in the aftermath of *Kelo*, but perhaps the strangest yet is the August 14, 2007 ruling from the Washington state court of appeals in *Cowlitz County v. Martin* (No. 34943-4-II). The county petitioned to condemn land to widen a culvert easement to facilitate the passage of salmon. The proposed condemnation followed a county determination that the existing culvert is a barrier to fish passage. The county secured grant money from the Salmon Recovery Funding Board to finance expansion of the culvert.

The surrounding landowners challenged the condemnation, and the trial court upheld it. But the intermediate court of appeals reversed, concluding among other things that protection of the salmon through the improvement of fish runs is not a "public use." Although the state's general condemnation statute broadly provides that a condemnation is for a pubic use "when it is directly or indirectly, approximately or remotely for the general benefit of the county or inhabitants thereof," the court concluded that the issue is controlled by the more specific statute at play, the Salmon Recovery Act, which doesn't grant eminent domain authority. Under this strange analysis, notwithstanding the exceedingly broad grant of authority in the general condemnation statute, if a subject is so important as to warrant separate treatment in its own statute (like salmon recovery), there is no condemnation authority unless the legislature thinks to include it again, which it would have no reason to do given the broad general authority.

The court also emphasized that "nothing in the record suggests that the people of Washington considered acquisition of private property for fish passage a public need at the time our constitution was ratified." But as one local attorney observed, this approach would make condemnation for airports problematic since the state ratified its Constitution well before the Wright Brothers' success at Kitty Hawk.

The county has moved for reconsideration. We hope the appeals court sees the error of its ways.

ON THE HORIZON

Start Greening Those Fleets!

On August 20, the Ninth Circuit gave State and local officials very good news regarding their ability to reduce greenhouse gases and other pollution by purchasing greener fleets and requiring their contractors to do the same. Back in 2004, the U.S. Supreme Court ruled that the federal Clean Air Act preempts State and local laws that require purely private fleet owners to use vehicles that meet air quality standards, but it left open the issue whether the preemption applies to fleets used by State and local governments and government contractors. On remand, the Ninth Circuit ruled that a State's actions as a "market participant" are protected against preemption by the Act, and accordingly California and other States may require their political subdivisions and government contractors to purchase lower emitting vehicles. CRC filed an amicus brief in support of California's fleet program. The opinion is available at http://www.ca9.uscourts.gov/ca9/newopinions.nsf/10EC24771E0FA76F8825733D004C6A36/$file/0556654.pdf?openelement

RECOMMENDATIONS

We commend to your attention a new blog -- LAW OF THE LAND, http://lawoftheland.wordpress.com -- run by Professor Patricia Salkin, Associate Dean and Director of the Government Law Center at Albany Law School. Patty provides case law updates, analysis, and dialogue on all things related to land use literally from A-Z, from adult entertainment to zoning, and everything in between. It's a great resource.

Our friends at the Georgetown Environmental Law & Policy Institute also have some intriguing research available at http://www.law.georgetown.edu/gelpi , including reports on (1) coastal disaster insurance, and (2) the false premise underlying Oregon's Measure 37, namely that land use regulation necessarily reduces the market value of regulated parcels. Check it out.