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The Newsletter of the Real Property & Financial Services Section of the Hawaii State Bar Association

August 2001

From the Chair

Amazingly, we are already more than halfway through a year of lively monthly Board meetings and excellent seminars, including our most recent presentations from national expert Steven Weise on the revised Article 9 of the Uniform Commercial Code (if you missed it, be sure to order the video from the HSBA), our Annual Legislative Update (with thanks once again to Program Chair Deb Chun and speakers Donna Leong, Mitch Imanaka and Andy Char), and our Landlord-Tenant Law and Procedure Seminar and Manual (with thanks to Program Chair Mark Clement and a panel of eight distinguished speakers).

Now we move into that part of the year where we are also happy to showcase two of the outstanding papers produced by law students at the William S. Richardson School of Law at the University of Hawaii. We try to select articles of interest to the real property practitioners who primarily make up our section, and I think you will agree that the two students whose papers have been chosen for publication in this Newsletter and the one coming up in October are certainly deserving of the honor, as well as of the $500 award they will be receiving from the Section for their efforts.

With the close of the 2001 legislative session, some of our members have also begun working on technical amendments to some of the laws that were enacted this year and other matters for the 2002 session. Of particular interest to Section members in the *new* Hawaii Nonprofit Corporations Act, Act 105, that significantly changes the prior law, H.R.S. Chapter 415B, and that is currently set to go into effect on July 1, 2002. This new Act, as written, has many practitioners worried about its potential adverse effect on the management and operation of condominium associations, cooperatives, and other areas of real property practice where the non-profit corporation is utilized. If you are interested in learning more about this topic, or in participating in the Hawaii State Bar Association's efforts (coordinated with our Section and other HSBA sections) to make modifications to this new law, please contact HSBA Legislative Chair Gary Slovin (547-5746 or gslovin@goodsill.com) or HSBA Executive Director Coralie Matayoshi (537-1868 or cmatayoshi@hsba.org).

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More New Laws

Since the last edition of the Section Newsletter went to print, Governor Cayetano signed a number of bills that enact laws that directly affect real estate and banking practitioners and their clients. All of these new laws, together with their legislative history and other information, can be accessed through the Section's website, www.hsba.org/sections/rpfs/legis.html, or the Legislature's website, www.capitol.hawaii.gov on the "Status and Documents" page.

New laws that Section members should be aware of include:

Residential Real Estate Disclosures. Act 224 amends Hawaii's Mandatory Seller Disclosures in Real Estate Transactions Act, H.R.S. Chapter

508D, which applies primarily to resales of improved residential property. The amendments, which became effective on June 13, 2001, make a number of substantive and technical changes to the Act, including:

- The exemption from disclosure that was previously available to absentee owners has been eliminated.

- The definition of "material facts" that must be disclosed has been revised to include only facts, defects or conditions which a reasonable person would expect to measurably affect the value of the property.

- A seller's obligation to disclose information that the seller discovers after the seller has made disclosures, and the buyer's right to rescind upon discovery that a seller's disclosure was inaccurate or incomplete, were limited to apply only where the newly-discovered, incorrect or omitted information "directly, substantially, and adversely" affects the value of the property.

- The buyer's right to rescind a purchase when the seller discloses new information after initial disclosures was limited to apply only if the purchase has not been recorded.

- The statutory notice that must be included on a seller's disclosure form has been amended.

- A seller's obligation to disclose material information contained in public records has been limited to information regarding flood zones, aircraft noise, and tsunami inundation that is contained in the public records that are specifically identified in Section 15 of the Act.

- The requirement that sellers disclose material information contained in documents recorded in the Bureau of Conveyances has been eliminated.

Mandatory Mediation of Condominium Disputes. Act 232 enacts a new Section of H.R.S. Chapter 514A that permits a condominium owner or association to require mediation of disputes involving the interpretation or enforcement of a condominium's declaration, bylaws, or house rules and certain provisions of Chapter 514A. The Act, which became effective on June 13, 2001, also provides that a court may take a party's refusal to participate in the mediation into consideration in deciding whether to award attorneys' fees and costs in connection with the dispute.

Registration and Disclosure Requirements for Time Share Plans Located in Condominium Projects. Act 237 provides that a time share plan that is located in a new condominium project and that is registered under H.R.S. Chapter 514E must also be registered with the Real Estate Commission and secure an effective date for a condominium public report under H.R.S. Chapter 514A. However, the time share developer does not have to provide that report to time share purchasers and is exempt from the provisions of H.R.S. § 514A-41 pertaining to supplemental public reports.

Limited Liability Partnerships. Act 241 amends the limited liability partnership provisions of H.R.S. Chapter 425, effective July 1, 2001, to make a variety of technical amendments and to require that a foreign limited liability partnership registering to do business in Hawaii submit a certificate of good standing from the state in which it was organized.

Real Estate Brokers. Act 245 amends H.R.S. Chapter 467 to exempt licensed, active brokers that manage condominium hotels from the condominium hotel registration and fidelity bond requirements. Act 245 also revises the experience requirements for a broker's license.

Great Expectations and *Lucas* Takings: Why Investment-Backed Expectations Are Irrelevant to Total Regulatory Taking Claims

By Calvert Chipchase

Introduction

James Madison pledged that our government would be "instituted no less for the protection of property, than of the persons of individuals." His rhetoric became substance in the Takings Clause, which the states ratified as part of the Fifth Amendment to the United States Constitution. The Takings Clause restricts the inherent power of the sovereign by guaranteeing that "private property [will not] be taken for public use, without just compensation." Like much of the Constitution, the text of the rule is simple, but its application has often proved complex and problematic. That observation is particularly true in the context of property regulations and regulatory takings. For guidance through the morass of conflicting law, state and lower federal courts generally rely on two U.S. Supreme Court opinions.

First, in Penn Central Transportation Co. v. New York City, 438 U.S. 104 (1978), the Court suggested that a balancing test is required when a regulation has partially taken the economic value or use from a parcel of land. The Penn Central Court held that a regulatory takings claim requires an "ad hoc, factual inquiry" where the "economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are . . . relevant considerations. So, too is the character of the governmental action."

The Court recognized a second test in the case of Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992). The Lucas Court established a categorical rule to be applied in a "total takings" situation. The Court held, "When . . . a regulation [that] declares 'off-limits' all economically productive or beneficial use of land goes beyond what the relevant background principles would dictate, compensation must be paid to sustain it."

The Penn Central and Lucas tests are mutually exclusive. The latter applies when the regulation deprives an owner of all the economically beneficial use of her property, while the former applies when she loses something less. Many courts, however, have confused these tests by imposing elements of the Penn Central analysis to a total taking claim under Lucas, and thereby denied recovery to owners who had suffered a total taking because they lacked distinct investment-backed expectations, or knew of a regulation or regulatory scheme before purchasing the property.

Those courts have misapplied the Supreme Court's takings rulings. A total deprivation of economically viable use, like a physical invasion, forces a landowner to shoulder a particularly heavy public burden. In Lucas, the Court recognized the unique nature of these intrusions and created an appropriate remedy: a regulation, which extinguishes the economically viable use of land, effects a compensable taking, unless a narrow exception is satisfied. In this analysis, a landowner's investment-backed expectations - or lack thereof - are irrelevant as to whether a total taking of property has occurred. Instead, an owner's expectations and any existing governmental regulations, which do not merely express background principles of state law, are relevant as to valuation when determining what compensation is due. By improperly reading the Penn Central investment-backed expectations factor into the Lucas rule, courts have denied

property owners the full protections of the Takings Clause.

When a Regulatory Taking Requires Compensation

The import of the Takings Clause is simple: the government may take private property, but only for public use and it must pay the owner for the value taken. Opinions diverge as to the scope and application of the Clause, but most commentators agree, and the Supreme Court has consistently held, that the Takings Clause prevents the government from forcing excessive public burdens upon private individuals. To implement this restriction, the Court has fashioned three steadfast rules. First, a taking of property must be "rationally related to a conceivable public purpose." Second, any physical intrusion of property requires compensation. Finally, a restriction on the use of property that "goes too far" effects a taking of property.

The express language of the Takings Clause requires that any taking of property be for public use. The 1984 case of Hawaii Housing Authority v. Midkiff, 467 U.S. 229 (1984), is the Court's standing pronouncement as to what satisfies that provision. In Midkiff, the Court emphasized judicial deference to legislative decision-making, and held that the Court "will not substitute its judgment as to what constitutes a public use 'unless the use be palpably without reasonable justification.'" The Court reasoned this standard does not require that the intended good in fact materialize, and does not mean that the government must take "actual possession of the land."

This is a low hurdle, and consequently few courts strike down a taking because it does not further a public use. Nevertheless, the public use requirement retains some bite, because the Midkiff Court limited its holding to situations involving an exercise of eminent domain. Thus, in a takings claim where there has not been a formal exercise of eminent domain - such as a regulatory taking - the public use requirement continues to ensure that when the government takes property it is not for a private purpose, and the taking at least has the possibility of advancing a legitimate state interest.

It is well settled that a physical invasion of property requires compensation, whether there has been a formal exercise of eminent domain or not. Two Court opinions - spanning a century - illustrate the immutability of this rule. In the 1871 case of Pumpelly v. Green Bay Company, 80 U.S. 166 (1871), the Court held that the continual flooding of Pumpelly's land caused by a state-authorized dam effected a taking of his property. The Court reasoned that such an intrusion was a taking because "where real estate is actually invaded by superinduced additions of water, earth, sand, or other material, or by having any artificial structure place on it, so as to effectually destroy or impair its usefulness, it is a taking, within the meaning of the Constitution."

The Court reiterated that principle in Loretto v. Teleprompter Manhattan CATV Corp, 458 U.S. 419 (1982). In Loretto, the Court held that placing a small cable box, pursuant to state authorization, on the top of a multi-story apartment building was a physical invasion of property and required compensation. Summarizing the jurisprudence, the Court stated, "[W]hen the 'character of the government action' is a permanent physical occupation of property, our cases uniformly have found a taking to the extent of the occupation, without regard to whether the action achieves an important public benefit or has only minimal economic impact on the owner."

For much of its history, the Court applied Takings Clause to eminent domain actions and the types of physical invasions addressed in Pumpelly and Loretto, but not to the regulation of property. This is not surprising, as land use regulations were generally limited to proscribing activities akin to public nuisances. The twentieth century, however, witnessed a proliferation of state and federal regulations - well beyond anything seen in the previous century. Zoning classifications, historic districts, aesthetic standards and particularly the multitude of environmental regulations have imposed new burdens upon landowners and have brought a new dimension to takings jurisprudence.

The Court addressed some of these issues in the landmark case of Pennsylvania Coal v. Mahon, 260 U.S. 393 (1922). The controversy arose in 1921 when the state legislature passed the Kohler Act, which prohibited the mining of coal beneath any inhabited structure. The Act had the effect of depriving the Company of its subsurface rights in a parcel of land. In an eloquent opinion authored by Justice Holmes, the Court reasoned that although government may regulate property and consequently affect property values to some extent, when a regulation "reaches a certain magnitude . . . there must be an exercise of eminent domain." Justice Holmes concluded that whether a regulation has reached such a magnitude will depend on the facts before the Court, and he did not establish a firm analytical model to be applied in subsequent cases. It was clear to the Court, however, that the Kohler Act had exceeded the bounds of permissible regulation because the Act made it "commercially impractically" to mine coal. Consequently, the Court held that the Act was unconstitutional.

A strong line of precedent did not follow from Pennsylvania Coal. In general, the Court left it to state and lower federal courts to define the parameters of regulatory takings jurisprudence. As land use regulations grew more detailed and comprehensive, however, the need for a more lucid test became palpable. In the 1978 Penn Central case, the Court endeavored to deal with these issues when it addressed a takings challenge to New York City's Landmarks Preservation Law.

The controversy arose when the Penn Central Transportation Company applied for, but was denied permission to erect an office building atop Grand Central Station, which had been designated a "landmark" in 1967. The Company claimed that the prohibition effected a taking and therefore required compensation. A divided Court disagreed.

The Court began its analysis by acknowledging that it has been unable "to develop any 'set formula' for determining when . . . economic injuries caused by public action" become a taking of property, and concluded that it will generally depend upon the circumstances of the case. The Court, however, identified three factors which are usually assessed when "engaging in these essentially ad hoc, factual inquires[.]" The Court reasoned that "[t]he economic impact of the regulation on the claimant and, particularly the extent to which the regulation has interfered with distinct investment-backed expectations are . . . relevant inquiries. So, too, is the character of the governmental action."

Applying these factors to Penn Central's takings claim, the Court first compared the City's Landmarks Preservation Act to zoning regulations and other examples of land use restrictions enacted for public safety, and concluded that the Act furthered an important state interest. As to the economic impact of the Act on Penn Central, the Court reasoned that the restriction only affected the air rights above the terminal, not the whole "city tax block designated as the 'landmark site,'" and therefore the impact was minimal. Lastly, the Court determined that the Act did not abridge the Company's investment-backed expectations, because the "law [did] not interfere with the present uses of the Terminal." After thus weighing the relevant inquiries, the Court held that the Landmark Law did not effect a taking, because "the restrictions imposed are substantially related to the promotion of the general welfare and not only permit a 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."

As the opinion demonstrates, the Penn Central test is flexible. Individual courts must determine the relevant weight to accord each factor and then balance the competing interests. This is highly case-specific, and an owner need not allege a total destruction of either property value or use to bring a takings claim under Penn Central. Because courts generally find that the "character of the government action" is a legitimate exercise of police power, whether a regulation effects a taking of property will largely depend upon the aggrieved owner's ability to show a significant economic impact and clear interference with distinct investment backed expectations.

Until 1992, this balancing test was the primary analytical tool available to state and lower federal courts. That changed when a very different Court fashioned a categorical rule for regulatory takings in Lucas. This case arose in 1988, when the South Carolina Legislature enacted the Beachfront Management Act. The Act had the effect of denying David Lucas the ability to erect any "permanent habitable structures" on two beachfront parcels, which he had purchased in 1986. Lucas immediately filed a takings claim. Lucas conceded that the Act was a valid exercise of police power, but argued that he was nevertheless entitled to compensation because the Act had completely extinguished the economic value of his property. The Court agreed.

Writing for the majority, Justice Scalia began the opinion by examining seventy-years of precedent, and concluded that a case-specific inquiry has never been required when a regulation either compels a "property owner to suffer a physical 'invasion,'" or "denies all economically beneficial or productive use of land." Following this precedent, the Court held that when a regulation reaches such a magnitude, compensation is always required. Because the trial court found that the regulation had extinguished the economic value of Lucas' lots, the Court applied the categorical rule to his claim.

With the effect of the regulation and the appropriate rule established, the only issue left before the Court was whether the legitimate purposes of the act were sufficient to deny compensation. The Court reasoned that they were not, as there is no "objective, value free basis" for determining the relative weight to be accorded the state's justifications. Instead, the Court concluded that "[a]ny limitation so severe cannot be newly legislated or decreed . . . but must inhere in the title itself, in the restrictions that background principles of the State's law of property and nuisance already place upon ownership."

In determining when a regulation will satisfy this standard, the Court reasoned that the starting point of the analysis is the recognition that although a property owner may expect to have the uses of her property restricted, "from time to time," she does not hold title with an "implied limitation" that a regulation may "subsequently eliminate all economically viable use." Rather, the Court concluded, such a regulation must "do no more than duplicate the result that could have been achieved in the courts by adjacent landowners . . . under the State's law of private nuisance, or by the State under its complementary power to abate nuisances or [for actual necessity]." In concluding its opinion, the Court noted that it was unlikely South Carolina's common law principles would prevent Lucas from building upon his lots, but the Court remanded this issue as a question of state law.

As the reasoning and holding of the opinion indicate, the Lucas test is not flexible; compensation is owed when a regulation extinguishes the beneficial economic use of land, unless the restriction falls within a narrow exception. The burden is on the landowner to show that a regulation has denied all economically viable use of her property. Once she meets that burden, the government cannot avoid compensation unless it proves that "an objectively reasonable application of relevant precedents would exclude those beneficial uses in the circumstances in which the land is presently found."

Confusion Among the Lower Courts

From a thorough reading of Penn Central and Lucas, it is clear that the opinions establish mutually exclusive modes of analysis. Of course, a court that finds an owner has not suffered a total deprivation of economically viable use - Justice Scalia noted that a "total taking" will be relatively rare - should employ a Penn Central partial takings analysis to determine if that owner has nevertheless suffered a loss sufficient to warrant compensation. Such an approach is logical and has been followed by a number of courts. When confronted with a total, Lucas taking, however, far too many courts have inquired into an owner's investment-backed expectations while purporting to apply the categorical Lucas rule. These courts have denied compensation because a property owner was unable to demonstrate such expectations, or because the owner knew of a regulation or regulatory framework when she acquired title.

For example, in Burgess v. State of Florida, 2000 Fla. App. Lexis 8450 (Fla. App. 2000), a landowner brought a total takings claim when the Florida Department of Environmental Protection denied his permit to build a dock, boardwalk and a camping shelter on land which had recently been designated as wetlands, and consequently was subject to stringent permitting requirements. The court reasoned that to prevail in a total regulatory takings claim, Burgess would need to prove not only that he was deprived of all economically beneficial use, which the trial court found, but also "demonstrate that the permit denial interfered with his reasonable, distinct, investment-backed expectations, held at the time he purchased the property[.]" The court held that Burgess failed to meet this burden because had always used the property for recreation - the state permitted this use to continue - and Burgess' claim that he purchased the property as an "investment" was too vague.

Similarly, in McQueen v. South Carolina Coastal Council, 530 S.E.2d 628 (S.C. 2000), a property owner applied to the South Carolina Coastal Commission for a permit to build bulkheads on his land to prevent further soil erosion. The Council denied his application, and the owner filed suit claiming that this denial effected a taking without compensation. The trial court found that by denying the permits, the Council had extinguished the economic value of the lots and thereby effected a taking. The State Supreme Court reversed. That court held, "In order to recover on a takings claim, a property owner must establish the regulation interfered with his distinct investment-backed expectations." It reasoned that the property in question had been "the subject of at least some regulation for over a century," and concluded that this "pre-existing permit requirement is relevant to [the owner's] investment-backed expectations." The court held that the owner's "prolonged neglect of the property and failure to seek developmental permits in the face of ever more stringent regulations demonstrate a distinct lack of investment-backed expectations."

A final example reveals that some federal courts - at least in dicta - have succumb to a similar interpretation of the categorical rule. In Good v. United States, 189 F.3d 1355 (Fed. Cir. 1999), the owner purchased a parcel of land in 1973 and initiated the development process in 1981. The next thirteen years involved a cycle of federal, state and local permits being granted and revoked as the owner endeavored to comply with the comprehensive - and often duplicative - regulatory schemes. Finally, in 1994 the Army Corps of Engineers, upon the recommendation of the Fish and Wildlife Service, issued a conclusive denial of the permits. The owner filed a takings claim. The district court concluded that the owner was not required to leave his land in its natural state, and therefore the categorical rule was inapplicable. The circuit court affirmed, and because the owner was not deprived of all economically viable use of his property, applied the Penn Central balancing test. Before reaching that conclusion, however, the court engaged in a general discussion of the categorical rule and reasoned that the " Lucas Court did not hold that the denial of all economically beneficial or productive use of land eliminates the requirement that the landowner have reasonable, investment-backed expectations of developing his land." The court concluded, "One who buys with the knowledge of a restraint assumes the risk of economic loss."

These cases illustrate the way in which some state and lower federal courts have analyzed a total regulatory takings claim. These courts have essentially held that an existing property restriction or regulatory superstructure made it impossible for the landowner to have had any reasonable, distinct investment-backed expectations in developing her land. Unfortunately, these examples are far from an exhaustive list. The primary error of these opinions is a simple misinterpretation of Lucas. An additional - and more fundamental mistake - is that these courts have ignored the unique nature of a total regulatory taking and mistakenly inquire into an owner's investment-backed expectations in such cases.

Investment-Backed Expectations Are Irrelevant in a Total Taking Case

As the preceding discussion demonstrates, a number of courts have interpreted Lucas as implicitly incorporating the investment-backed expectations factor. Such an interpretation necessarily means that the Lucas rule is not categorical at all, but instead requires an "ad hoc, factual inquiry" into why the claimant acquired title and whether her intentions were reasonable. An examination of the Lucas majority's analysis and holding, however, does not support such a conclusion.

In Lucas, the Court juxtaposed the different types of regulatory takings claims. The Court reasoned that while most such claims require a balancing test, a case-specific inquiry is unnecessary when the property restriction either "compels a physical 'invasion,'" or "denies all economically beneficial or productive use." In contrasting these factually-distinct takings claims, the Court expressly recognized two categories of regulatory takings: on one side are those that merely diminish property values, and on the other are those that either compel a physical invasion or remove all economically viable use from land. The Court followed this dichotomy and announced, "[W]hen the owner of real property has been called upon to sacrifice all economically beneficial uses in the name of the common good, that is, to leave his property economically idle, he has suffered a taking." This rule is plainly categorical. Its text simply does not permit a consideration into why the owner purchased the property, what she planned to do with it, or which regulations were in place when she acquired title.

The Court applied this rule to Lucas' claim. The Court did not examine whether Lucas had reasonable, distinct investment-backed expectations, held at the time he purchased the property. Instead, the Court's reasoning was simplistic: Lucas proved that the application of South Carolina's Beachfront Management Act had extinguished the economically beneficial use of his property, and therefore the regulation effected a taking. There is no indication that the Court assumed Lucas had investment-backed expectations in developing his property, and no discussion of whether such expectations were reasonable. Thus, the analysis of Lucas' claim tracks the plain text of the categorical rule, and there is no hint that an owner's investment-backed expectations were an implicit component of either.

This conclusion is supported by the majority's response to some of the many criticisms leveled by the dissenting Justices. Significantly, Justice Stevens attacked the categorical rule as being "wholly arbitrary," because "[a] landowner whose property is diminished in value 95% recovers nothing, while an owner whose property is diminished 100% recovers the land's full value." The majority responded by acknowledging that a landowner who has not been deprived of all economically viable use "might not be able to claim the benefit of our categorical formulation," but insisted that she will be able to bring a takings claim under the usual Penn Central balancing test. Specifically, the Court recognized that the "economic impact of the regulation on the claimant and . . . the extent to which the regulation has interfered with distinct investment-backed expectations are keenly relevant to takings analysis generally." Thus, in answering the dissent, the Court again made an analytical distinction between regulations which effect a total loss of economically viable use and those that merely diminish property values. This distinction would be irrelevant if a property owner's investment-backed expectations were a necessary component of the categorical rule, because the first factor - the economic impact - is an essential part of every regulatory takings claim. To give this distinction substance, the severity of the economic impact must be the only element of a total takings claim.

Finally, the Lucas exceptions do not suggest a different result. Significantly, the Court reasoned that with respect to real property, an owner's interest has "a rich tradition of protection at common law[.]" Consequently, a landowner does not hold title "subject to the 'implied limitation' that the State may subsequently eliminate all economically valuable use[.]" Instead, the government may save an otherwise compensable taking "only if the logically antecedent inquiry into the nature of the owner's estate shows that the proscribed use and interest were not part of his title to begin with." That is, a regulation is relevant if it simply "duplicate[s] the result that could have been achieved in the courts-by adjacent landowners . . . under the State's law of private nuisance, or by the State under its complementary power to abate nuisances that affect the public generally, or otherwise." In that circumstance, no taking has occurred, not because of a lack of investment-backed expectations - as the owner's expectation is generally to make economically viable use of her property - but rather because background "principles of [state] nuisance and property law," demonstrate that the proscribed use was never part of her title. Thus, the opinion is internally consistent, and each section weighs against qualifying the categorical rule.

The conclusion that investment-backed expectations are irrelevant in a total takings analysis need not rest solely on the Lucas opinion. A total deprivation of economically viable use is unique, both in its effect on a landowner and in its analysis, and the Court has frequently recognized as much. Lucas was not an exercise in Delphic inspiration, but rather represents an application of existing precedent and principles of regulatory takings jurisprudence.

In Lucas, Justice Blackmun dissented, and he lambasted the majority for ignoring precedent. This sentiment has since been echoed by a number of legal commentators. Those criticisms are misplaced, because the Court has consistently recognized that a case-specific inquiry is not required when a regulation extinguishes the economic viability of property.

For example, in the 1980 case of Agins v. City of Tiburon, 447 U.S. 255 (1980), the Court held that the very enactment of a property regulation effects an unconstitutional taking of property when the measure either "does not substantially advance legitimate state interests, or denies an owner economically viable use of his land." The Court phrased this rule in the alternative, and both facets are plainly unqualified. When either element of the rule is satisfied, no consideration of a landowner's investment-backed expectations is appropriate, and no balancing test is necessary. Since Agins, the Court has restated this rule in a number of situations. Thus, the categorical rule already existed, and far from remaking the world anew, Lucas is merely an extension of this jurisprudence.

The Takings Clause assures Americans that they will not be forced to sacrifice their property for a public good without compensation. Of course, the government may regulate property to some extent, which will indirectly affect property values, but a total regulatory taking exacts an unusually heavy toll. In such cases, the landowner is forced to sacrifice a great deal for an assertedly public benefit. She is denied the right to make any economically viable or productive use of her property. If a lack of investment-backed expectations or the mere existence of a regulatory scheme - even a pervasive one - is sufficient to defeat a takings claim, the Takings Clause becomes qualified, and "the natural tendency of human nature is to extend the qualification more and more until the last private property disappears." To ensure that private owners are not forced to bear a disproportionate public burden, the categorical rule requires government to pay when it demands that property remain economically fallow.

The Court has generally held that physical invasions of any sort require compensation. In such cases, when and how the owner acquired the property, or what her expectations were with respect to its use are irrelevant. In Lucas, the Court recognized this general rule, and concluded "similar treatment must be accorded confiscatory regulations, i.e., regulations that prohibit all economically viable use of land." Standing alone, this analogy would seem to dispel the notion that investment-backed expectations are necessarily a component of the categorical rule. It need not, however, because well before Lucas, the Court made identical comparisons.

Significantly, in Pennsylvania Coal, the progenitor of modern regulatory takings jurisprudence, the Court held that the Kohler Act effected a taking of property because it completely extinguished the company's right to mine coal for a profit. The Act did not physically dispose the company of any property interest, but merely prohibited a specific activity. The Court reasoned, however, that rendering a legal use "commercially impracticable has very nearly the same effect as appropriating or destroying it." That is, the Kohler Act was unconstitutional because extinguishing the economically viable use of land is tantamount to physically seizing or invading it.

The Court has reached the same conclusion in other contexts. For example, in Armstrong v. United States, 364 U.S. 40 (1960), the Court held that a forced transfer of personal property to the United States, which had the effect of destroying the value of liens held by the plaintiff against that property, was a taking and required compensation. The government had not physically taken these liens, and indeed the government action was not directed at the plaintiff. Nevertheless, the Court reasoned that "[t]he total destruction by the Government of all value of these liens . . . has every possible element of a Fifth Amendment 'taking.'" That is, in rendering these liens valueless by regulation, the government essentially destroyed the claimant's property. If there is any substance to the Court's repeated statements that a total regulatory taking is analogous to a physical taking, it must be that, like a physical taking, a landowner's investment-backed expectations and any preexisting regulations are irrelevant when the government asks her to sacrifice all beneficial use of her property for a public good.

Proper Application of the Categorical Rule Will Not Result in Windfalls

An objective evaluation of Lucas and the preexisting principles of takings jurisprudence establishes that investment-backed expectations are not a component of the categorical rule. The courts reaching a contrary conclusion have generally offered little legal explanation for their position. Instead, the usual justification is a fear that a landowner will reap a "windfall" if she purchases property with knowledge of an existing regulation, is denied a development permit, but is still able to sue for compensation. A windfall, however, is unlikely - never mind that such fears should be insufficient to circumvent the Constitution - because a total regulatory taking is atypical, and no compensation is owed if the regulation merely made explicit what was always prohibited. The most salient argument against the windfall explanation, however, is valuation; regulations, which existed before the acquisition of title, will certainly be relevant when awarding compensation.

As an initial matter, it is important to note that a total regulatory taking is a relatively rare phenomenon. More often, a regulation will merely diminish property values or impair the economic use of property, and consequently the categorical rule will be inapplicable. When a landowner alleges something less than a total taking, her distinct investment-backed expectations will be "keenly relevant" to the analysis. Of course, mere notice of a preexisting regulation neither precludes the existence of investment-backed expectations, nor presumes the constitutionality of that regulation, but such notice is relevant as to what the landowner's expectations were. That is, the regulation and its effect on the landowner's investment-backed expectation will be considered and evaluated with the economic impact of the regulation and the legitimate government interest it purportedly serves to determine if a taking has occurred. It is only with respect to total takings that the regulation is wholly irrelevant.

When the categorical rule is appropriate, the government may save an otherwise compensable taking "if the logically antecedent inquiry into the nature of the owner's estate shows that the proscribed use interest were not part of his title to begin with." That is, no taking has occurred if the property restriction, either preexisting or subsequently enacted, merely expressed what was always prohibited. This exception is narrow, but it will deny compensation to an owner who, for example, is denied a permit to engage in a landfilling operation which would have the effect

of flooding her neighbors' land, because such a "use was never permissible under relevant property and nuisance principles." In that circumstance, the proscription has taken nothing.

Assuming no background principle of state law saves the taking, the fear of a windfall is misplaced because it overlooks the important issue of valuation. Once it has been determined that a regulation effected a total taking of property, unless the government rescinds that regulation, the issue of "just compensation" remains. Compensation can be a complicated issue. The goal, however, is simply to place the owner "in the same position monetarily as he would have occupied if his property had not been taken." To achieve this result, compensation is generally "measured by 'the market value of the property at the time of the taking contemporaneously paid in money.'" Thus, valuation is essentially a two-part inquiry: first, what is the "market value" of the property; and second, when did the taking occur.

The market value of the land taken is "equivalent to the full value of the property," and consequently all factors that would affect its value or influence a potential buyer are relevant. The government is only obligated to pay for "the fair market value of the parcel, not the owner's hopes regarding its use." Any existing and applicable zoning ordinances and land use or property restrictions are therefore relevant to valuation, because the uses to which a property may be put will influence what the land is worth.

To complete the valuation equation, the date of the taking must be determined, because a regulation will only be relevant if it predates the taking. When the very enactment or application of a regulation results in a total taking, the market value should be assessed as the value of the land before implementation of that restriction. This is fair because before the regulation, the land had value and economic potential. It was the enactment or enforcement of the regulation that rendered the property economically worthless, and consequently effected the taking. Therefore, it would be unjust to consider this regulation as a component of the market value.

A different situation arises when a regulation predates the taking, because the effect of the restriction on property values has already materialized. That is, the taking occurred after the land had been devalued because of the property restriction. For example, if a claimant acquired property, which she knew to be the subject of stringent permitting requirements, a taking has certainly occurred if she must leave the land economically fallow because her permit applications are subsequently denied. It would be unfair, however, to pay her the value of the property either fully developed, or undeveloped but unfettered in its possibilities. Instead, the market value of the property should reflect the affect of the preexisting restriction, and consequently the aggrieved claimant will almost certainly receive what she paid for the land or less. Thus, while investment-backed expectations and existing regulations will not be relevant to whether a categorical taking has occurred, the danger of a windfall is obviated by the recognition that the preexisting restrictions are relevant as to what the owner will receive.

Conclusion

In Lucas, the Court recognized that a total deprivation of economically viable or productive use presents a unique claim, and consequently requires an independent analytical framework. In fashioning an appropriate remedy for these total takings, the Court carefully distinguished between a total regulatory taking and regulatory takings generally, and created an analytical dichotomy: a categorical rule applies when a property owner has been denied all economically viable use of her property, while a balancing test applies when she loses something less. This dichotomy is consistent with precedent and furthers the purpose of the Takings Clause, as it ensures that property owners will not be forced to bear a disproportionate public burden. Thus, Madison's promise that our government will protect property as vigorously as it does the other pillars of freedom remains more than hyperbole.

Unfortunately, many courts have weakened the categorical rule by requiring that owners who

demonstrate that their property has lost all economically viable use also prove that they had reasonable, distinct investment-backed expectations. The proffered reason is generally an abstract fear that the categorical rule will result in an unjust windfall for some property owners. This fear, however, is unwarranted because, even in the relatively rare situation where a total regulatory taking is found, any restrictions or regulations that existed before she purchased her land are relevant when determining what compensation is due. Consequently, under the categorical rule, there is little danger that the government will shoulder the cost of a bad bargain and there is no reason to eviscerate the protections of Takings Clause.

Epilogue

The Court issued its decision in Palazzolo v. Rhode Island, 121 S.Ct. 2448 (2001), after this article was written. In Palazzolo, the Court took a significant step toward bringing confused and wayward courts back in line with the jurisprudence. The Court held that an owner who acquires title to land encumbered by regulation is not absolutely precluded from asserting that the regulation effects either a total or a partial taking. In doing so, the Court invalidated the unfortunate idea that once a parcel which is burdened by an unconstitutional regulation changes hands, it is forever so burdened. Several issues, however, remain unresolved.

First, the Court did not consider "the precise circumstances when a legislative enactment can be deemed a background principle of state law or whether those circumstances are present here." The result of this equivocal statement will likely be a legion of conflicting and largely unsatisfactory standards. That is particularly unfortunate - and troubling - because Lucas, of course, established that a positive enactment is only relevant when it merely "duplicate[s] the result that could have been achieved in the courts-by adjacent landowners . . . under the State's law of private nuisance, or by the State under its complementary power to abate nuisances that affect the public generally, or otherwise."

Second, the issue of whether investment-backed expectations are a proper consideration in a total takings analysis was not directly before the court, and consequently remains unsettled. The holding does lend force to the argument that such concerns are irrelevant, but without a definitive statement, many courts will likely continue to follow the analytical framework discredited in this comment.

Finally, Palazzolo revealed a jurisprudential split on the Court. Justice O'Connor concurred in the decision, and wrote separately to assert her belief that an existing regulation entirely precludes investment-backed expectations, but does not necessarily prevent the landowner from asserting a partial takings claim. Justice Scalia also concurred in the decision and wrote separately only to refute Justice O'Connor's opinion. Justice Scalia argued that an unconstitutional law does not become constitutional by mere passage of time or title, and therefore it should not be presumed that a purchaser lacked the required expectations simply because he acquired regulated land.

These issues are likely to provoke fresh academic and judicial debate, but their resolution remains for another day.

Calvert Chipchase is the recipient of the Real Property and Financial Services Section's 2001 C. Jepson Garland Memorial Scholarship. Cal is a third-year student at the William S. Richardson School of Law.

Due to space constraints, this article is published without accompanying footnotes. If you would like a copy of the article with footnotes, please contact newsletter editor Rick Kiefer at RKiefer@Carlsmith.com.

What Has Your Board Been Up To?

June 2001

At the Board's June meeting, Chair Trudy Burns Stone reported that 146 people attended the Section's Seminar on the New UCC Article 9, and that another 27 ordered videos of the Seminar.

Rick Kiefer reported that significant amendments to Hawaii's Mandatory Seller Disclosure Law were enacted effective as of June 13. The amendments, among other things, eliminate the absentee owner exemption from disclosure.

Past-Chair David Callies briefed the Board on recent takings litigation and also suggested that the Section consider co-sponsoring a major land use seminar.

The Board discussed questions and concerns that have arisen about the scope of the Real Estate Commission's recent informal directive that condominium limited common elements must be described by a metes and bounds description. Mitch Imanaka reported that the Commission intends to clarify that the new requirement is limited to yard areas that are designated as limited common elements and does not apply, for example, to parking stalls.

July 2001

At the Board's July meeting, Gail Tamashiro and Nancy Grekin announced that the Conveyancing Manual is being finalized for printing in August and presentation in September at a seminar during the HSBA's Convention.

Nancy Grekin reported that the DCCA will soon begin accepting electronic filings. The DCCA's electronic forms and a link to the DCCA's website are available on the Section's website, www.hsba.org/sections/rpfs.

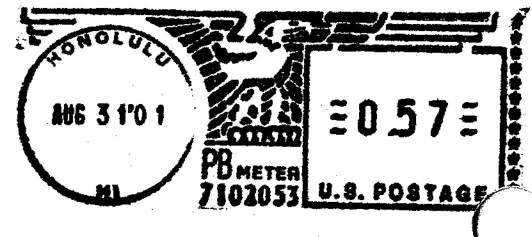
David Callies briefed the Board on the recent U.S. Supreme Court case Palazzolo v. Rhode Island. In a split decision, the Court held, among other things, that an owner who acquires title to land after the enactment of a land-use regulation which deprives the owner of all economic use of the land, is not barred from asserting a taking claim.

Joyce Neeley reported on serious concerns about the potential effects of the new Nonprofit Corporations Act, 2001 Act No. 105, on the management of condominium association, cooperatives, and other planned communities that use the nonprofit corporation form of organization. It was suggested that the Act, which becomes effective on July 1, 2002, may require significant amendment and that it may be desirable to secure an extension of its effective date.

Professor Denise Antolini from the William S. Richardson School of Law, the chair of the Natural Resources Section of HSBA, addressed the Board as part of our efforts to develop inter-section synergies. The Natural Resources Section has about 170 members consisting of lawyers and non-lawyers (law students and other community members active in the environmental field). The section charges no annual dues, and primarily keeps in touch with its membership through e-mails. Their activities are mostly informal, but they also participate in helping to put on environmental programs and seminars. Nancy Grekin will reinstall a link to their section's website on our website.

Comments?
Please send them to:
rkiefer@carlsmith.com

And check our website:
http://www.hsba.org/sections/rpfs



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CALENDAR OF EVENTS

August 2001
No Board of Directors Meeting

September 21, Noon to 1:30 p.m.
Board of Directors' Meeting
Pacific Tower, 22nd Floor

September 28, 8:00 a.m. to Noon
Conveyance Manual Seminar
At the HSBA Bar Convention
Hilton Hawaiian Village

October 19, Noon to 1:30 p.m.
Board of Directors' Meeting
Pacific Tower, 22nd Floor