

*A novel property rights challenge is a constitutional morass.*

# Takings Law Made Hard

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**T**oday, when most people think of takings law, they instinctively turn to the now-infamous 2005 decision in *Kelo v. City of New London*. In *Kelo*, the Supreme Court held that taking property for economic redevelopment falls within the public use language of the Takings Clause. Whatever its limitations, *Kelo* was largely a matter of ordinary language interpretation that did not raise any mind-boggling technical questions. That dubious honor falls to the vexed questions of deciding when and why certain government actions should be classified compensable events, and others not.

The keystone of this shaky edifice is the dubious distinction between physical takings and regulatory takings. Generally speaking, the former involve the occupation of property by the state or those acting under its authority, while the latter embrace “mere” restrictions on an owner’s rights of use and disposition for parties whom the state leaves in possession of their property. This distinction is not plucked out of the air. It has a powerful political purpose, which is to downgrade the scope of the just compensation requirement so that it does little or nothing to interfere with the ability of land-use planners to implement their vision of the just or sound community without having to compensate any landowners caught in the undertow. To aid with this objective, basic takings law is surrounded by an impressive array of procedural barriers on such topics as standing (“Do I have the right to sue?”) and exhaustion (“Must the case remain inside the administrative apparatus?”) that must be hurdled before facing any takings problem on the merits.

It is therefore a source of amazed pleasure to report one notable exception to this dreary trend just published by Judge Jay Bybee of the Ninth Circuit Court of Appeals. His opinion in *Guggenheim v. City of Goleta* represents a concerted effort to bring down the fortress that the law has erected to protect land planners. Instead of getting lost in the forest of irrelevant

distinctions, Bybee breaks with precedent by ordering the City of Goleta to pay compensation to owners of mobile home pads on the ground that Goleta’s Rent Control Ordinance (RCO) operates as a regulatory taking.

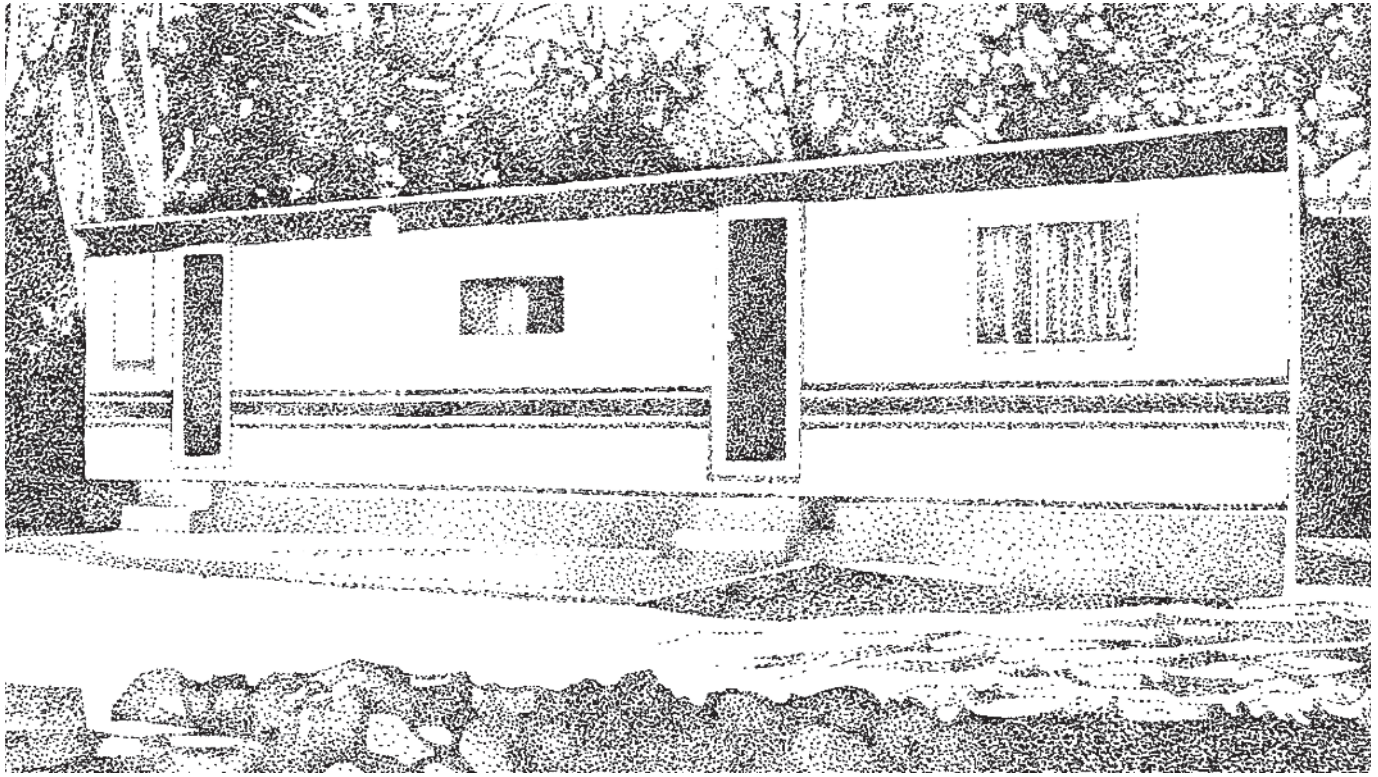
## THE GOLETA RCO

Goleta, CA lies about eight miles to the west of its more famous neighbor, Santa Barbara, on the Pacific Ocean about 90 miles northwest of Los Angeles. Land in this desirable location is at a premium, especially since the city’s rigid zoning ordinances slow down land development, thereby driving up the scarcity value of usable plots. Back in 1979, when Goleta was an unincorporated area of Santa Barbara County, California passed a generalized rent control ordinance applicable to mobile home pads. In effect, the ordinance restricted the rate increase that pad owners could charge their mobile home tenants. The core provision of the RCO restricted base increases in the rental value to 75 percent of the increase in the cost of living index. Thereafter, it adopted a cumbersome case-by-case process that allowed various additional increases to landowners who could prove that their cost increases exceeded that figure.

The precise details of this ordinance are irrelevant to the central problem once it is understood that by conscious design, the RCO typically sets the rental increases to trail the increases in underlying land values. As with most stabilization schemes, rent adjustments are all based on cost figures that never take into account the changes in demand for the property in question. Over the past 30 years, the value of the Goleta properties subject to this ordinance tended to rise more rapidly than the Consumer Price Index, thereby increasing the gap between the market and rental value more than the rent increase formula might suggest. Of course, the situation might have been different if increases in property values had lagged below the CPI, in which case the landowners would have been forced to bear the decline in land values in the form of lower rents.

It is crystal clear that this, like all other stabilization ordinances, put mobile home tenants at the time of the ruling in an enviable “heads-I-win-tails-you-lose” position. As matters sorted themselves out over time, the rental increases lagged

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far behind the rental value of the premises. Property values increased over the relevant period by 225 percent, but rental increases were limited to 75 percent of CPI, resulting in tenants receiving an 80 percent discount relative to market rents. Those dollars did not disappear. They remained in the pockets of the owners of the rental homes who, under the explicit language of the RCO, could only be evicted for a narrow set of causes, and who in practice were entitled to remain in possession of the pads in perpetuity.

The duration of the discount was not, of course, set by the terms of the lease. Rather, the RCO stipulated that any tenant who wished to move away was not required meekly to cede possession of the land back to the landlord where it could be re-let at market rates. Instead, the RCO allowed the sitting tenant in the immovable mobile home to sell the unit to a buyer who could then take over the lease (subject to an allowance that the landlord could increase the rent by 10 percent). Most of these homes were old and dilapidated, but the opportunity to stand in the shoes of the prior tenant meant that the buyer of the mobile home purchased two assets: the beat-up mobile home and the perpetual lease. Thus it was reliably estimated that the “RCO has resulted in transfer premiums of approximately 90 percent of the sale price of mobile homes, enjoyed by the incumbent tenants.” Put otherwise, a party would pay over \$100,000 for a mobile home worth \$12,000 just to get his hands on the lease. In effect, the state-mandated extension of the lease resulted in a huge wealth transfer from the landlord to the initial tenant, who could take his loot out in one of two fashions: pay low rents or make a profitable sale. The new tenant did not get any bargain; he just had to pay upfront a substantial portion of the rent to the seller of the mobile home, who did not own the site, instead of to the landlord who did. As the old song goes, “It’s nice work if you can

get it, and you can get it, at least in Goleta, if you try.”

#### **A SIMPLE TAKINGS ANALYSIS**

Put yourself in the advantageous position of not knowing anything about the current constitutional law of takings in order to understand how this transaction works. First, note that a simple lease transaction generates two distinct interests out of one. The owner has the right to reclaim the property at the expiration of the lease, which is called the reversion interest (i.e., the property reverts to the owner), and the right to collect a specified rent during the term of the lease. The lease thus amounts to a partial sale of the real estate for the duration of the lease. The purchase price for that term of years could be paid in a lump sum or over time. Either way, any movement in the value of the underlying property will work to the tenant’s benefit while the lease is alive, and to the benefit of the landlord once the lease expires. If the value of the land goes up, the tenant will enjoy that increase equal to the difference between the present discounted value of the future use of the land less the current discounted amount of the rents. The landlord will of course get a parallel increase in the value of his reversion, which again has to be discounted to present value.

The RCO changes the economics by extending the lease beyond its original term at the option of the tenant. Now the landlord must surrender his reversion, year by year, to the tenant for rent set below fair rental value. The dollar value of the take thus depends on the size and duration of the discount that the RCO forces on the landlord. At this point, the takings analysis is pretty straightforward: the surrender of the reversion with a market value of, say, \$100,000 mandated for a series of future payments whose present market value is \$25,000. In principle, the \$75,000 shortfall has to be made up by the City of Goleta, which does not have that kind of money in its

treasury. The legal analysis calling for compensation under the Takings Clause just tracks the economics. Goleta may decide to pay in a lump sum or in installments, but pay it must.

### RENT CONTROL UNDER THE CURRENT LAW

The analysis of this problem assumes surrealist dimensions under the current law. The initial threshold involves the various procedural questions that often prevent courts from ever reaching the merits of the underlying case. In *Guggenheim*, the first of these obstacles relates to standing: how and when can the pad owner show a pocketbook interest that is hurt by the RCO? That issue is complicated in cases like this when the named plaintiff acquired the property in 1997, which is 18 years after the ordinance was adopted and 10 years after it was amended. Does he get the right to bring the lawsuit, or did that cause of action belong to the property owners as of 1979?

If the then-owner of the land had sued in 1979 for a taking under the above theory, that should have been the end of it. If he had won, he would have received a recovery equal to the value that he lost in the forced extension of the lease. Once he put that money in his pocket, he would have then completed the sale to the current owners, who would have paid (and did pay) a reduced price to reflect the diminished rentals left under the ordinance. All the accounts would be square, and it would be a miscarriage of justice to allow the buyer of the land to recover a second time for the losses inflicted by the regulation. Alternatively, if the 1979 owner had lost his suit, the matter would have been resolved, as the rules on the finality of litigation allow any landowner and his successors in title only one bite at the apple.

The plot thickens, however, when the first party does not or cannot bring the suit. One way to close the case is to hold that the statute of limitations has run out, so that the claim of the present owner is barred. The difficulty with this point of view is that it is often far from clear whether the then-owner would have been allowed to challenge the RCO at that time.

In the *Guggenheim* decision, Judge Bybee does not discuss the statute of limitations question. He just assumes that the claim survives, only to ask whether the right to challenge the RCO passes to the buyer on the landlord's sale. This question can be resolved in only one of two ways: The first assumes that the seller let the claim die at sale, even if it had some chance of success. The second assumes that he assigns his claim to the buyer along with his reversionary interest in the property. From a self-interested point of view, the only plausible assumption is the second, because no rational party wants to make gifts to strangers, least of all the city that has taken him to the financial cleaners. Hence, the buyer of the landlord's interest stands in the shoes of the seller, his claim for just compensation intact, as Judge Bybee rightly held.

Yet when can this claim be brought? The conventional wisdom says only after all administrative remedies have been exhausted, which quickly becomes a marathon as savvy local governments string out their internal review processes. That endless delay is not tolerated in such areas as free speech, but for land-use cases, the ill-conceived 1985 Supreme Court decision in *Williamson County Regional Planning Commission v.*

*Bank of Hamilton* raises administrative review to an art form, often extending a generation or more. Yet no compensation is owed for the loss of use in the interim, for the Supreme Court has decreed that "normal delays" in local land-use proceedings are outside the Takings Clause.

Judge Bybee, however, performed a nifty end run around the *Williamson* exhaustion requirement. He noted that this rule only applied to challenges of local government decisions made on an "as applied" basis — that is, those challenges that turn on the peculiar way the law applies to the distinct facts at hand. But other Supreme Court cases have recognized that there is no reason to countenance these delays to facial challenges that only require a landowner to "demonstrate that the mere enactment of the ordinance constitutes a taking," which in Bybee's view it does, given the implicit transfer of wealth incident to the passage of the RCO.

That last point is an audacious shocker because in the last several generations the courts have never sustained a facial takings challenge to a statute under the Takings Clause. For example, in *Hodel v. Virginia Surface Mining & Reclamation Association* (1981), the Court refused to entertain a challenge to a conservation statute that required all strip miners to restore the land to its "original contour" once their work was finished. So long as the burden, if any, could not be determined until the end of the reclamation project, the challenge was only timely at the end of the process, not when the statute was enacted.

### TAKINGS: PHYSICAL AND REGULATORY

One of the major difficulties in *Guggenheim* is that it does not represent the first challenge to the Goleta RCO. The entire scheme has long been a target of disgruntled owners of mobile home sites. In the first of these challenges, the 1987 opinion of *Hall v. City of Santa Barbara*, Judge Alex Kozinski faced the serious problem that rent control statutes had long been held constitutional even though they limited the right of the landlord to evict a tenant at the end of the term. He distinguished the mobile home case from the standard rent control case by noting that only in the former does the tenant plop his independent property on the plaintiff's land. The decision in his view counted as a physical taking of the land, which was not present in the ordinary rent control case where the tenant stays on at the protected rent at the expiration of the term.

As an economic matter, that charming evasion makes no sense because the expropriation of the landlord's interest is every bit as blatant in the conventional rent control case as in the exotic mobile home variant. In both cases the owner is demoted from the holder of an equity, who benefits from all appreciation in land prices, to a composite owner/creditor, who gets none of the appreciation but who would take all of the loss if land prices fall.

Kozinski's *Hall* solution had only a short half-life. When the identical issue reached the Supreme Court in the 1992 case of *Yee v. Escondido Village*, Justice Sandra Day O'Connor had a very different take on the plaintiff's effort to exploit the now well-established distinction between physical and regulatory takings. Rather than hew to the Kozinski line, she rejected the

view that the RCO worked a physical taking at all. Instead, she treated it as a mere restraint on the right to use or dispose of the pad, which falls within the class of regulatory takings.

In so doing, Justice O'Connor took a page from *Alice in Wonderland* by insisting the per se takings rule for physical takings only applies where an RCO “requires the landowner to submit to the physical occupation of his land.” That, she insisted, did not happen here because the landowners “voluntarily rented their land to mobile home owners.” She then tells a little white lie by saying that “neither the city nor the State compels [pad owners], once they have rented their property to tenants, to continue doing so.” The sole ground for that statement was that the ordinance allowed the landlord to give between six and 12 months notice before evicting tenants if they wished to change their land use, which of course they do not. The RCO, however, makes it crystal clear that the only grounds for eviction are contained in the ordinance; getting the property back

extent to which it interferes with “investment-backed expectations,” an elusive substitute for the constitutional words “private property,” coined for the occasion. The bottom line was that regulatory takings required “ad hoc determinations” based on all the relevant factors, which in this case had to be decided for the City on the ground that Penn Central could still make money operating the terminal even if not free to develop its air rights.

Two features from *Penn Central* carry over to this case. First, the facts showed that the mobile home landowners still enjoyed a rate of return of around 10 percent, which meets the state’s obligation under *Penn Central*. Second, in all the post-*Penn Central* cases, the “ad hoc” nature of the inquiry precluded the facial challenge that Judge Bybee adopted. That is especially true with those weird investment-backed expectations, which on some occasions the Supreme Court has gone so far as to say means that anyone who buys any

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at the expiration of the original term is not one of those grounds. In light of that simple truth, her position is necessarily that the law is entitled to give tenants valuable options to renew for free at a fixed rate, such that a lease for a year and a lease for 100 years should be treated in the same way. One sleight of hand thus undoes centuries of property law that have uniformly held that leases expire at the end of their terms unless renewed by mutual consent.

Once finished with her flight of property law fancy, Justice O'Connor then notes that the landowners did not raise any regulatory takings claim, so *Yee* sputtered to an early and inglorious end. It was that last observation, however, that opened the way for the plaintiffs in *Guggenheim* to trot out their novel theory that this RCO should be treated as a per se regulatory taking, restricting land use, because of the immediate wealth transfer it works between the parties.

The genesis of the regulatory takings test is Justice Brennan’s 1978 decision in *Penn Central Transportation Co. v. City of New York*, which upheld New York’s landmark preservation statute that was used, without compensation, to block the construction of a fancy new Marcel Breuer tower atop New York’s Grand Central Station. As a technical matter, *Penn Central* is manifestly wrong because it demotes Penn Central’s air rights, which are fully recognized under New York law, to a mere part of the parcel that lay below it. That redefinition allowed Justice Brennan to conclude that physical invasions are “more readily” to be found takings than mere regulations, which are examined by a two-part test that looks first to the economic impact of the regulation and next at the

property with notice that certain regulations are in place cannot protest the takings, which would doom the *Guggenheim* challenge. Some other cases treat the notice as irrelevant to the case, on the sensible ground that all real property would be rendered practically inalienable if its sale necessarily blocked the new owner’s future challenge to an existing ordinance that was not ripe — i.e., ready for judicial challenge — when the transfer was made. Finally, others treat notice as a factor to be taken into account. Any which way, current law does not support the per se regulatory challenge.

### FINAL REFLECTIONS

Why did Judge Bybee bite off more than he could chew? Because he was visibly — and rightly — angry at the explicit and deliberate wealth transfer that the so-called regulation worked on the date of its inception. But how does that distinguish the case from all the landmark preservation zoning cases that usually survive the “as applied” challenges raised against them? His answer is that the direct transfer of the benefit to the determinate person on the opposite side of the transaction is sharply distinguishable from the diffuse set of public benefits that come from a landmark designation or zoning statute. In his view, the concentrated benefits under the RCO render it vulnerable to challenges that preservation and zoning laws escape.

Ponder the implications. If Bybee is right, then all rent control statutes must fall, given that their restrictions necessarily result in a wealth transfer as well, which can sometimes be transferred within families at death. This approach flouts the

basic logic of the takings law, which holds that we should always look to the loss of the owner and not to the gain of the state or those with whom it deals. Take that as a given, and Bybee's startling new rule subjects all land-use regulation to per se review so long as the rules work implicit wealth transfers, which they always do.

I regard Judge Bybee's ingenious truncation of *Penn Central* as reason enough for the Supreme Court to take this case. The question is what they should do with it. Judged by the normal canons of judicial review, the likely outcome is that the Court will do to Bybee in *Guggenheim* what it did to Judge Kozinski: reverse and enter judgment for the defendant. If *Yee* and *Penn Central* are rightly decided, Bybee's opinion will die an inglorious death. But that would be a pity because there is not a shred of sensible economic analysis in either *Penn Central* or *Yee*, let alone the economic literature that falsifies, on either descriptive or normative grounds, Judge Bybee's central claim that the Goleta RCO works an illicit wealth transfer from landlords to tenants.

There is of course another way. One of Justice Scalia's prescient remarks in his 1988 dissent in *Pennell v. City of San Jose* was to identify a good and a bad way to make these implicit transfers. The bad way is to sock it to the landlords, who often do not live in the city that makes the laws, and who, if they do, are in any event outvoted by tenants lining their own pockets. Local ardor for transfers to a discrete group of ten-

ants will die off if the taxpayer voters have to foot the bill for this enormous subsidy instead of imposing it on the landlord minority. That one simple requirement forces a level of democratic accountability, which will in turn generate the level of transparency needed for the responsible deliberation over social alternatives that so many communitarians prize. And that result could be happily reached if the Court recognizes and repudiates the incoherence of Justice O'Connor's preposterous claim that a lease for a year could be converted by a snap of legislative fingers into a perpetual lease. Describing the mobile home owner's perpetual occupation of the pad against the will of its owner as a mere regulatory taking is intellectually bankrupt.

For good measure, the Court should also reconsider its moribund decision in *Penn Central* that strips air rights of all constitutional protection. That one indefensible move shows just how far the takings law has strayed from its private law roots.

We now know why current takings law is "hard." It abandons every coherent conception of private property in its misguided effort to allow governments and their planning commissions to run roughshod over discrete and insular minorities within their communities. If the multiple technical deficiencies in Judge Bybee's *Guggenheim* opinion forces the Supreme Court to confront the poverty of its own takings jurisprudence, his errors will not have been made in vain. R

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