DENIAL OF PERMIT TO DEVELOP COASTAL WETLAND, AN UNCONSTITUTIONAL TAKING?

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As described in the May 1995 "NRPA Law Review" column, the U.S. House of Representative approved H.R. 925, the proposed "Private Property Protection Act of 1995" on March 3, 1995. As noted in the column, "H.R. 925 would require the federal government to compensate owners of private property for the effect of certain regulatory restrictions, most notably wetlands and endangered species protection which results in a loss of property value." Specifically, H.R. 925 would require payment of compensation for loss in property value of any portion of the property whose fair market value is reduced by 20 percent or more as a result of wetlands or endangered species regulation by the federal government. As characterized by Republicans in the House, H.R. 925 would adopt the reasoning of the federal appeals court described below in *Loveladies Harbor, Inc. v. United States*, 28 F.3d 1171 (1994) to determine whether federal environmental controls effect "a regulatory taking" requiring compensation.

DEPRIVATION OF ALL ECONOMICALLY FEASIBLE USE?

In the case of *Loveladies Harbor, Inc. v. United States*, the plaintiffs (Loveladies) sought a fill permit under section 404 of the Clean Water Act from the Army Corps of Engineers (Corps) to complete the final stage of an ongoing real estate development project. The facts of the case were as follows:

> The property at issue in this dispute is a 12.5 acre parcel consisting of 11.5 acres of wetlands and one acre of filled land, located on Long Beach Island, Ocean County, New Jersey. Barnegat Bay bounds the wetlands on the west, while single-family homes bound it on the east and southeast. The 12.5 acres is part of a 51 acre parcel owned by Loveladies, which in turn is part of an original 250 acre tract which Loveladies had acquired in 1958. The balance of the 250 acres--199 acres--had been developed before 1972 and the enactment of section 404 of the Clean Water Act.
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> In order to develop the remaining 51 acre parcel for residential use, Loveladies needed to fill 50 acres, the one acre having been previously filled, and that in turn required Loveladies to obtain permission from both the New Jersey Department of Environmental Protection (NJDEP) and the Corps. That process proved to be lengthy and contentious, marked by several years of negotiation (with Loveladies submitting progressively less ambitious and less environmentally objectionable proposals), a 1977 permit denial, appeal of that denial to the Commissioner of NJDEP, and judicial review in state court.

> During the course of the proceedings, NJDEP offered, as a compromise, permission for Loveladies to develop 12.5 of the 51 acres. Loveladies initially declined that offer. Eventually Loveladies acquiesced to the 12.5 acre limitation, the dispute was resolved, and the permit, on September 9, 1981, issued. The permit granted permission to fill and develop 11.5 acres in addition to the one acre which had been filled previously--this is the 12.5 acre parcel at issue--and to construct 35 single family homes thereon.
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> The permit was issued subject to several conditions, including a requirement that Loveladies submit a "deed restriction or conservation easement which insures that the site's remaining wetlands, lagoons, creeks, and bay bottom will not be filled or used for non-water dependent uses."
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> Loveladies then sought the requisite federal permit for the development project. As required, the Corps sought the views of the counterpart state agency, the NJDEP. NJDEP in its response acknowledged that they had issued Loveladies the permit as they were obligated to do under the terms of the settlement, but denied that the permit approval was in compliance with the state's requirements. The response went on to explain that the 12.5 acre development would be "anachronistic," a "throwback to the 1950's--1960's style of shore development," and closed by noting, "a denial of the federal permit appears appropriate under this Division's understanding of the pertinent federal law." [Based upon this information], the Corps rejected Loveladies' section 404 permit application on May 5, 1982. Loveladies again resorted to the courts.
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> Following a full hearing, those factual issues were resolved in favor of Loveladies. The court found that the fair market value of the parcel prior to the permit denial was $2,658,000 whereas the value after the permit denial was $12,500. This greater than 99% diminution of value, "coupled with the court's earlier determination of a lack of a countervailing substantial legitimate state interest," led the court to conclude that there had been a taking.

The Government appealed the judgment of the Court of Federal Claims. According to the appeals court, the issue was who should bear the cost of fulfilling the Government's obligation "to preserve and protect the public interest" Specifically, the appeals court considered whether "the cost of obtaining that public benefit" should "fall solely upon the affected property owner, or is it to be shared by the community at large."

The federal appeals court found the U.S. Supreme Court, in *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 98 S.Ct. 2646, 57 L.Ed.2d 631 (1978), refined the notion of when a regulation "went too far." According to the Supreme Court, the following three criteria would determine the outcome:

> (1) the character of the governmental action, (2) the economic impact of the regulation on the claimant, and (3) the extent to which the regulation interfered with distinct investment-backed expectations.

According to the federal appeals court, "[t]he first criterion required that a reviewing court consider the purpose and importance of the public interest reflected in the regulatory imposition."

> In effect, a court was to balance the liberty interest of the private property owner against the Government's need to protect the public interest through imposition of the restraint. This included considering not only the avowed need of the Government--the interest of the public being protected.

The second criterion, "economic impact of the regulation on the claimant," as described by the appeals court "was intended to ensure that not every restraint imposed by government to adjust the competing demands of private owners would result in a takings claim."

> Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law. Reflecting in part the presumed facts in the cases, what emerged was a threshold requirement that the plaintiff show a serious financial loss from the regulatory imposition. This came to be phrased as a denial of "economically viable use of an owner's land.

The third criterion, "interference with distinct investment-backed expectations," as characterized by the appeals court, "was a way of limiting takings recoveries to owners who could demonstrate that they bought their property in reliance on a state of affairs that did not include the challenged regulatory regime."

> A reasonable investment backed expectation must be more than a unilateral expectation or an abstract need. In legal terms, the owner who bought with knowledge of the restraint could be said to have no reliance interest, or to have assumed the risk of any economic loss. In economic terms, it could be said that the market had already discounted for the restraint, so that a purchaser could not show a loss in his investment attributable to it.

In this particular instance, the trial court had found that "the fair market value before was $2,658,000, and after was $12,500." Accordingly, the trial court found that "[t]he diminution in value of 99% was deemed sufficient to qualify under this part of the test for a taking."

> Concerning the first criterion--denial of economically viable use of the land--the trial court in this case concluded that the relevant comparison for purposes of determining

> whether there had been a denial of economically viable use of the land by the regulatory imposition was a comparison of the value of the 12.5 acre parcel before and after the imposition...
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> With regard to whether the owner had investment-backed expectations--the second criterion--the trial court concluded that the facts left little doubt that such expectations drove the project. And regarding the third criterion--the balance of public and private interests--after a lengthy consideration of the competing values offered by the Government, on the one hand, for imposing the restriction and by the property owner, on the other, for protecting the interests of private property ownership under the circumstances, the trial judge concluded that "plaintiffs have shown that their private interest in developing and utilizing their property outweighs the public value in preserving these wetlands."

The trial court, therefore, entered judgment for Loveladies. The federal government appealed.

Under the circumstances of this case, the appeals court described the general principles governing "the law of regulatory taking" as follows:

> A property owner who can establish that a regulatory taking of property has occurred is entitled to a monetary recovery for the value of the interest taken, measured by what is just compensation.
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> With regard to the interest alleged to be taken, there has been a regulatory taking if
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>> (1) there was a denial of economically viable use of the property as a result of the regulatory imposition;
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>> (2) the property owner had distinct investment-backed expectations; and
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>> (3) it was an interest vested in the owner, as a matter of state property law, and not within the power of the state to regulate under common law nuisance doctrine.
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> With regard to the second criterion--investment-backed expectations--it is not disputed that Loveladies purchased the land involved with the reasonable expectation and intention of developing it over time for sale to purchasers of the improved lots; that the regulation constitutes an interference with their investment-backed expectations cannot be denied.

The specific issue before the federal appeals court was, therefore, "whether a regulatory taking requires that there be a denial of essentially all remaining economic use, or whether loss of a substantial part, but not all, of the economic use may constitute a compensable partial taking." According to the appeals court, "a partial taking may have occurred" depending on "the final fair market value before and after the regulatory imposition on the particular property involved" Specifically, "whether there has been a partial or total loss of economic use, depends on what is the specific property that was affected by the permit denial."

> If the tract of land that is the measure of the economic value after the regulatory imposition is defined as only that land for which the use permit is denied, that provides the easiest case for those arguing that a categorical taking occurred. On the other hand, if the tract of land is defined as some larger piece, one with substantial residuary value independent of the wetlands regulation, then either a partial or no taking occurred.. This is the denominator problem...
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> Because our test for regulatory taking requires us to compare the value that has been taken from the property with the value that remains in the property, one of the critical questions is determining how to define the unit of property "whose value is to furnish the denominator of the fraction."

On appeal, the Government argued that "virtually all economic use must be taken (that is, destroyed by the regulatory imposition) in order to have a compensable regulatory taking." In this particular instance, the Government contended that "the proper denominator is the original 250 acre parcel or, at the least, the total acreage remaining unsold in 1982, when the permit was denied."

On the other hand, Loveladies urged the court to "adopt a brightline rule that the denominator of the takings fraction is that parcel for which the owner seeks a permit." In response, the Government contended that "such bright-line rules would encourage strategic behavior on the part of developers--'conveying away the non-wetlands portions of their parcels prior to applying to the Corps for a permit to fill the remaining wetlands'."

Given the "array of possible denominators," the appeals court acknowledged that "the rhetorical force of the 'deprivation of all economically feasible use' rule is greater than its precision."

> Under that assumption, the key question is, when comparing the value of the property before and after the imposition, what is the property whose value is compared. On the facts here, is the test the effect of the imposition on the value of just the 12.5 acres, or is it the effect of the imposition on the total value of, say, the original 250 acres, or on some other size unit.
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> In 1982, as we have noted, Loveladies owned 51 undeveloped acres; the other 199

> had been developed and all but 6.4 of those acres had been sold. Under their agreement with New Jersey in settlement of its lawsuit, Loveladies could develop only the 12.5 acres of the 51; the development rights in the remaining 38.5 acres were to be dedicated to the state in return for the NJDEP permit. Of the 12.5 acres, one acre was already filled; there remained 11.5 acres of wetlands for which Loveladies sought the section 404 permit.

The federal appeals court decided to adopt the trial court's following "flexible approach, designed to account for factual nuances," including "consideration of the timing of transfers in light of the developing regulatory environment."

> In determining this, the [trial] court took into account the facts that while plaintiffs were blocked from developing two of the three projects for which they sought permits, they were granted a permit for the third; and that within the two that were denied, they had 111 acres of uplands which could be developed, and whose value exceeded by twice the original price paid for the two tracts. There was no taking.
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> New Jersey apparently made no effort to impose restrictions on the development of this wetland area until after the initial project had been approved for development, and until 199 acres had been developed. This development occurred over a substantial period of years beginning in 1958, and involved many kinds of government permits.
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> The trial court concluded that land developed or sold before the regulatory environment existed should not be included in the denominator.

Under the facts of this case, the appeals court found that "the Government has failed to convince us that the trial court clearly erred in this conclusion."

> With regard to the land remaining after the regulatory fabric was in place, the trial court excluded from consideration the 38.5 acres which for all practical purposes had been promised to New Jersey in exchange for the NJDEP permit.
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> This is only logical since whatever substantial value that land had now belongs to the state and not to Loveladies. It would seem ungrateful in the extreme to require Loveladies to convey to the public the rights in the 38.5 acres in exchange for the right to develop 12.5 acres, and then to include the value of the grant as a charge against the givers.

As a result, the appeals court concluded that "the relevant property for the takings analysis is the 12.5 acres, for which the trial court found the remaining value to be *de minimis*."

> This is not, then, a case of a partial taking, involving linedrawing between noncompensable "mere diminution" and compensable partial taking. Rather, this is a case in which the owner of the relevant parcel was deprived of all economically feasible use.
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> The trial court's conclusion that the permit denial was effectively a total taking of the property owner's interest in these acres is fully supported in the record; there is no clear error in that conclusion.

The appeals court, therefore, affirmed the judgment of the trial court that "a taking occurred when the Federal Government denied the section 404 permit."