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# DAMAGE AWARDS AS PUBLIC POLICY IN INVERSE CONDEMNATION LITIGATION

by Chester C. McGuire, CRE

## EVOLUTION OF THE ISSUE

The Fifth Amendment to the Constitution states, among other things, that private property shall not be taken without paying just compensation, a provision known as the “takings clause.” Just compensation has usually meant fair market value for the property in its highest and best use. The government has two lawful means to obtain private property: outright purchase and eminent domain. Both measures result in the government purchasing the property and taking title. In eminent domain procedures, the property is legally condemned, and a fair price negotiated through the appraisal process, or litigation. Either way the private property owner is compensated for the loss of the use of the property.

## ABOUT THE AUTHOR

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Governments, however, have another way to acquire the use of private property, by regulatory intervention, in the name of the public interest—government regulation to strip away the right of an owner to use a property. This is reasonable when that use is a nuisance or danger to the community. For example, a person may be prohibited from using property as a garbage dump in a residential area. The courts would not consider this a regulatory taking. However, consensus among most legal scholars is that landowners should generally receive compensation for regulations, except when the offending land use would be prohibited by nuisance law (Epstein 1985).

Governments restrict the use of private property for a variety of reasons—for example, zoning regulations. The courts have held that there must be a reason and nexus between the property and a public purpose for the regulation to be lawful. However, when regulations are arbitrary or have no reasonable nexus between the property and a public purpose the regulation may be a “regulatory taking.”

According to Justice Oliver Wendell Holmes in his opinion in the Pennsylvania Coal case:

A strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying the charge. . . The general rule at least is that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking.<sup>1</sup>

Many landowners have been so frustrated by local governments that they have taken their grievances to court claiming inverse condemnation. Governments have enormous arsenals of delaying tactics and drawn-out administrative procedures that work against the property owner. Therefore, property owners are increasingly turning to the courts for remedies when they are restricted from using their property. The following description was provided for an actual case currently under review by the Supreme Court (Mandelker 1997):

In 1981, the property owners submitted a subdivision proposal to build 344 residential units. The plan was rejected, and city planners informed that a plan for 264 units would be reviewed favorably. The owners then submitted a plan for 264 units; city planners rejected it, and informed that a plan for 190 units would be viewed favorably. The owners then submitted a plan for 190 units; city planners rejected it, and the owners appealed to the city council. The city council found the plan "conceptually satisfactory," and granted a conditional 18-month use permit to commence construction for the project. Subsequently, the developer worked with planning board staff to meet the city council's conditions for the 190-unit development. Staff recommended approval of the site plan, but the planning board overrode staff's recommendation and issued a denial. The property owners then appealed this decision to the city council, which this time denied the site plan for 190 units. Meanwhile, a sewer moratorium was imposed, a request to extend the special use permit was rejected, and the permit expired. The local officials thus expected the developer to start from square one. Following this Kafkaesque process, the federal district court dismissed a taking claim for lack of ripeness, but the appellate court then reversed it.<sup>2</sup>

#### REMEDIES FOR REGULATORY TAKINGS

There are two kinds of remedies available to plaintiffs: 1). invalidating the regulation; or 2). monetary

damages. If the plaintiff succeeds in proving inverse condemnation the court may simply invalidate the regulation (ordinance) and allow the property owner to proceed with development or other use of the property. Or, the court may award actual monetary damages.

The Supreme Court has defined temporary regulatory takings as "those regulatory takings that are ultimately invalidated by the courts."<sup>3</sup> But even if the taking is temporary, the delay caused by the regulation may be compensable. If the regulatory action forbids virtually all use of the property, then the taking is complete and compensation for the value of the property is the logical remedy. However, this is not altogether clear, as the courts have ruled on both sides of this issue.

The invalidation remedy has two drawbacks (Fischel 1986).

1. Invalidation provides no relief for delay of development, and the government has no incentive to act in a timely manner.
2. Invalidation merely requires the community to redo the ordinance, which does not always provide relief.

A monetary damages remedy overcomes the problems of the invalidation remedy since it provides relief from delaying tactics. Furthermore, paying damages may induce both parties to settle, which may be the most important aspect of the damage solution (Rolf 1983).

#### RATIONALE FOR LOST PROFITS AS THE MEASURE OF DAMAGE

Most of the landmark cases in inverse condemnation have concerned individual property owners rather than commercial developers who are in the business of developing real estate. For the non-commercial individual landowner, the appropriate remedy is usually either invalidating the regulation or paying for lost land value as damage. But for the real estate developer, who is in the business of developing property, the regulatory taking eliminates a business opportunity. The proper remedy for lost business opportunity is lost profits, defined as the difference between the firm's actual profits during the damage period and the profits it would have made but for the unlawful regulatory action.

The courts have been reluctant to consider lost profits from real estate development in awarding damages, even when inverse condemnation can be

proved. There are several reasons for this reluctance. One objection is that real estate development is speculative, and the damage claim is based on something that might happen in the future. In this respect, real estate development is different from some other businesses. For example, if the inverse condemnation harmed an existing business, such as a grocery store or factory, that enterprise will have had a history of operations and any forecast of future lost profits can be based on actual experience.

Perhaps courts have been reluctant to award damages because the damage amount looms so large in typical cases, especially involving large projects. Appropriate damages may seem exaggerated because the aggrieved developer may seek payment for the total value of a project, which can run into the millions of dollars, and have the appearance of overcompensation (Fischel 1985).

Another reason may be that lost profits from a land development venture tend to be large amounts of money, and defendants and the courts may consider that amount an "unjust windfall." Note that the words "unjust" and "windfall" are not economic concepts.

Although the real estate developer has a much harder task in proving lost profits, it is not an impossible task. However, a careful case must be made that the land developer has the capacity, capability, and a reasonable project.

#### **DAMAGES AS EFFICIENT PUBLIC POLICY**

Public officials have both a public interest and a budgetary interest that must be balanced (Miceli 1995). If government officials view their actions as having zero cost it will create what Justice Holmes described as "fiscal illusion."

Public policy may be best served by litigation that claims damages for lost profits, even if the dollar amount of such claims is large. If the threat of large judicial awards will caution government officials against unreasonable and irresponsible actions it will serve the public purpose, as compensation may curb government excesses. In this sense the damage threat serves the same purpose in inverse condemnation as it does in product liability, medical malpractice, patent infringement, and antitrust.

The threat of damages may also lead the parties constructively toward a negotiated settlement. For example, if the community rezones a parcel of land

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to a restrictive degree and the court decides that it is a taking, the community should be given the option of rescinding the regulation or paying damages (Fischel 1985 and Rolf 1983). From a social standpoint this is more efficient than the all-or-nothing approach implied by invalidation alone. Damages remedy provides areas of compromise between the litigants.

A claim for lost profits from an unlawfully foreclosed business opportunity, whether from land development, or any other venture, is firmly grounded in both economics and the law. In some areas of the law, notably antitrust litigation, the concept of lost profits has been accepted and established. Several analytical methods used to quantify lost profits have been vetted successfully in litigation. The antitrust cases provide a useful model that could be emulated in seeking inverse condemnation damages. According the American Bar Association:

Profit is the cornerstone concept in assessing damages in antitrust cases. When the legal system awards damages to make a plaintiff whole, the award should be the profit that the plaintiff would have made but for the defendant's unlawful conduct. In principle, the plaintiff's damages should be the difference between the plaintiff's profit given the unlawful conduct and the profit that the plaintiff would have earned had it been unaffected by unlawful conduct.<sup>4</sup>

Damages arising from land development losses in unlawful takings should have the same respect in the courts as any other type of litigation. The objective of damages is to leave the landowner, or any other plaintiff, with the same net worth as if the project had not been denied.<sub>REF</sub>

## NOTES

1. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922).
2. *Del Monte Dunes at Monterey, Ltd. v. City of Monterey*, 920 F. 2d 1496 (9th Cir. 1990).
3. *First English Evangelical Church v. County of Los Angeles*, 482 U.S. 304, 321 n.6 (1987).
4. American Bar Association, *Proving Antitrust Damages: Legal and Economic Issues*, Chicago (1996) page 89.

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