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# The Compensation Constraint and the Scope of the Takings Clause

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## Introduction

The idea I wish to explore in this Essay is whether the established methods for determining just compensation can shed light on the meaning of other issues that arise in litigation under the Takings Clause. Specifically, is it possible to "reverse engineer" the Takings Clause by reasoning from settled understandings about how to determine just compensation in order to reach certain conclusions about when the Clause applies, what interests in private property are covered by the Clause, and what does it mean to take such property?[1]

The proposed exercise is positive or descriptive in nature rather than normative. The hypothesis is that the ability to calculate just compensation, using established valuation techniques, is a necessary condition for finding that the Takings Clause applies. That the compensation constraint is a necessary condition for applying the Clause does not establish that it is a sufficient condition. There may be other factors, not addressed here, that enter into any final determination that government action gives rise to liability under the Clause. The Essay is concerned only with whether the ability to determine the amount of just compensation is a limiting principle on the scope of the constitutional right.

## I. How to Determine Just Compensation

The Takings Clause is unique among constitutional provisions in that it specifies a remedy for its violation: the payment of just compensation. Moreover, by common consensus this is the exclusive remedy for violation of the Clause.[2] As the Supreme Court has observed, the Clause "is designed not to



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1 The Takings Clause provides: "nor shall private property be taken for public use without just compensation." U.S. Const. amend. V.

2 This does not mean that anticipatory relief should be prohibited if it will serve to speed the resolution of litigation. *See* Thomas W. Merrill, *Anticipatory Remedies for Takings*,

limit the governmental interference with property rights *per se*, but rather to secure *compensation* in the event of otherwise proper interference amounting to a taking."[3] The question for consideration is whether this uniquely limited remedy also limits the substantive protection afforded by the Clause.

The possibility of a compensation constraint gains force when one considers that the approach to determining the measure of just compensation is by far the most settled of the various issues that can arise under the Clause. The reason for this is that most disputes governed by the Clause involve express exercises in the taking of property under the power of eminent domain.[4] The primary contested issue in such cases is the amount of compensation that is owed; as a result, the basic principles that govern the determination of just compensation have been repeatedly adjudicated by courts over a significant period of time.

When one peruses the leading decisions on the meaning of just compensation and the treatises on eminent domain like *Nichols*, one learns that the general principle in all cases is that just compensation means fair market value.[5] Fair market value is further defined to mean what a willing buyer would pay a willing seller in an arm's-length transaction.[6] This is obviously an imputed number. By definition, when the government takes property there is no arm's-length transaction: we are dealing with forced exchanges of property, not voluntary exchanges. The determination of fair market value therefore is based on an imaginary transaction of the subject property, and an estimate or guess about the price that would be agreed upon in such a hypothetical transaction.

These generalities are further particularized by considering a number of methods that are permissible to use in calculating fair market value. The method most commonly used is (1) to examine recent transactions of other property similar to the property taken, making adjustments for differences in the size, age, location, and the quality of improvements. Other techniques that have been used less often include (2) considering recent transactions of the property in question, making adjustments for general changes in market prices since the date of those transactions; (3) estimating the rental value of the property in question, and capitalizing this to generate an imputed purchase price using a rate of return commonly used as a benchmark for

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128 HARV. L. REV. 1630 (2015) (arguing that declaratory relief should be available if conditions warrant it). But the final judgment in any case that successfully establishes that the government engaged in a taking of property for public use will always be an award of just compensation for the taking.

3 First English Evangelical Lutheran Church v. Cnty. of Los Angeles, 482 U.S. 304, 315 (1987).

4 Indeed, virtually all the reported cases that address the meaning of just compensation involve express takings. A small number of decisions that involve regulatory takings are referenced in Christopher Serkin, *The Meaning of Value: Assessing Just Compensation for Regulatory Takings*, 99 NW. U. L. REV. 677, 684–85 (2005).

5 4 JULIUS L. SACKMAN, NICHOLS ON EMINENT DOMAIN § 12.02[1], at 12–60 to 12–67 (3d ed. 2006).

6 *See* United States v. Miller, 317 U.S. 369, 374–75 (1943).

investments in similar property; and (4) estimating the replacement cost of the property in question, making adjustments to reflect depreciation due to age and wear and tear of the property in question.[7]

A critical point to make about the established methods of determining fair market value is that each presupposes that the property in question is of a type that is commonly exchanged in voluntary transactions. This is most obvious with respect to the first method—looking to comparable transactions—which rests on the understanding that the property taken is similar to other properties that have recently been exchanged for value. But it is also true of the other valuation techniques as well. The previous transaction of the subject property method presupposes that there has been at least one recent voluntary transaction of the property in question; the capitalization of rental value method presupposes that similar properties are leased and the rents reflect voluntarily negotiated leases; and the replacement cost method assumes that there is a market for the relevant inputs (typically land and building materials) such as would be needed to create a replacement to the property that has been taken.

To generalize, all methods of determining just compensation rest on some variation of the understanding that compensation is measured by voluntary transactions for value involving property similar to the property taken. One looks to the money that changes hands when similar property is voluntarily transferred, and this provides the benchmark that fixes the compensation that must be paid when the government compels a transfer of property. Just compensation for forced exchange is fixed by drawing inferences from voluntary exchange.

## II. Some General Implications

Let us consider some implications of the general principle that just compensation for takings is based on fair market value as determined by extrapolating from the amount of money that changes hands in voluntary exchanges of similar property. If we take this principle as our Archimedean point of departure, what if any conclusions can be drawn about other, more contested aspects of the law that governs takings of property?

One very broad implication is that a constitutional right to just compensation for takings of property makes sense only in a society in which voluntary exchange is the norm and forced exchange is exceptional. Imagine, for example, a society that adopts a just compensation clause in which all factories but one are owned and operated by the state. The government decides to eliminate the anomaly by nationalizing the one factory in private hands.

7 David A. Dana & Thomas W. Merrill, Property: Takings 169–71 (2002); Sackman, *supra* note 5, § 12.02[1], at 12–60 to 12–67; *see also* Brian Angelo Lee, *Just Undercompensation: The Idiosyncratic Premium in Eminent Domain*, 113 Colum. L. Rev. 593, 616–17 (2013) (listing methods 1, 3, and 4 (as enumerated here) as the three most used methods); Katrina Miriam Wyman, *The Measure of Just Compensation*, 41 U.C. Davis L. Rev. 239, 252 & n.46 (2007).

How is just compensation for this taking going to be determined? Clearly, there will be no transactions in comparable properties that can be used to estimate what just compensation will be for taking the one non-state-owned factory. Nor will there be a rental market for factory properties from which one can derive a fair rental value and an appropriate rate of capitalization. Conceivably, there will be a transaction involving the seized factory sometime in the past, but this may have occurred long ago and in a different context that gives the transaction little probative value. Replacement cost is another possibility, but unless all the inputs that would go into constructing a new factory, including land and all the materials needed to build a factory, are freely exchanged in competitive markets, the derivation of compensation using the replacement cost method is not likely to work either.

So one very broad implication of starting from the principles of just compensation is that protection against government takings can exist only in a society that has a market economy. One cannot have something like a takings clause in a hunter-gatherer society where there is no formal system of exchange of goods. Nor, to take the other extreme, does a takings clause make sense in a thoroughgoing socialist economy where the government controls all relevant resources. The simple reason is that in such a system there will be no way to calculate just compensation in return for forced exchanges of resources.

Another important implication is that the Takings Clause cannot be applied to entitlements that are not exchanged for value—bought and sold. There are a variety of reasons why things are not bought and sold.

One reason is that they are too plenteous, under current conditions of technology and levels of supply and demand, to generate any kind of exchange of rights.[8] Wind and sunlight might be examples. Both are quite useful, for example, in generating electricity. They definitely have value. But at least under current technology and levels of supply and demand, there is no market for transferring wind and sunlight from one landowner—who is assumed to have the right to capture these resources when they enter the column of space above the land—to other users. This could change. We are beginning to see occasional nuisance suits complaining about neighbors casting shadows on nearby solar collectors or erecting windmills that diminish the flow of air on nearby land.[9] This could conceivably evolve into a general practice of exchanging solar or wind easements for value, in which case the

8 *See* Carol Rose, *The Comedy of the Commons: Custom, Commerce, and Inherently Public Property*, 53 U. CHI. L. REV. 711, 717–18 (1986) (discussing the idea of "plenteous" goods as an explanation for the absence of private rights).

9 *See, e.g.*, Prah v. Maretti, 321 N.W.2d 182 (Wis. 1982); Tenn v. 889 Assocs., Ltd., 500 A.2d 366 (N.H. 1985); Burch v. Nedpower Mount Storm, LLC, 647 S.E.2d 879 (W. Va. 2007). The general rule is that casting a shadow on neighboring property is not actionable. *See* Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc., 114 So. 2d 357 (Fla. Dist. Ct. App. 1959). For recent disputes among landowners over "wind shadow" or "wind wake" created by the construction of nearly wind turbines, see Yael R. Lifshitz, *Rethinking Original Ownership*, 66 U. TORONTO L.J. 513, 539–43 (2016).

conditions for calculating just compensation for blocking sun or wind might arise. Or a system of government-created exchangeable wind rights or sunlight rights might emerge.[10] But as things currently stand, wind and sunlight are regarded as "free goods" that can be captured by whoever controls the column of space in which these resources happen to enter. These resources thus cannot be valued in monetary terms in such a way as would be required in order to calculate just compensation for their taking.

Another reason things are not bought and sold is that they are regarded as rights that belong to the public in general. Prime examples would be navigable waterways, public lands held in an open access status, and ideas and images in the public domain. Such resources are commonly protected against private claiming, either by statute or under the nebulous public trust doctrine. Since private exclusion rights are prohibited, there is no basis for buying and selling such public rights. They are "not the 'property' right of anyone—hence the sardonic maxim, explaining what economists call the 'tragedy of the commons,' *res publica, res nullius*."[11] To be sure, a proposal to sell off public assets could be subject to valuation, if the hived-off assets are subject to exclusion rights.[12] But if the assets are indelibly impressed with an open-access status, as was held in the leading public trust decision,[13] no one will bid for such rights. There will, accordingly, be no basis for determining their fair market value, and hence no basis for assimilating them to the obligation to compensate for takings.

A third reason things are not bought and sold is that they have a negative value. A prime example might be general liabilities. By a general liability I mean one that is payable from any source of funds, like a personal loan or an income tax or inheritance tax. Commentators have occasionally mused about whether taxes should be regarded as takings of property, at least in some circumstances.[14] But general liabilities are not bought and sold. The right to *receive* payments based on general liabilities are bought and sold. We call this the bond market. Bonds and other forms of assignable rights to receive monies like securitized receivables are transacted all the time, and valuing these instruments is easy. So it is reasonable to assume that a government seizure or cancellation of an assignable right to receive payments would be regarded as a taking.[15] But general obligations to *pay* someone else, including obligations to pay taxes to the government, are not bought and

10 *See generally* Alexandra B. Klass, *Property Rights on the New Frontier: Climate Change, Natural Resource Development, and Renewable Energy*, 38 ECOLOGY L.Q. 63 (2011).

11 Coll. Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 673 (1999) (footnote omitted).

12 *See* Richard A. Epstein, *The Public Trust Doctrine*, 7 CATO J. 411, 421 (1987).

13 Ill. Cent. R.R. Co. v. Illinois, 146 U.S. 387, 460 (1892).

14 *See e.g.*, Eric Kades, *Drawing the Line Between Taxes and Takings: The Continuous Burdens Principle, and Its Broader Application*, 97 NW. U. L. REV. 189 (2002); Eduardo Moisés Peñalver, *Regulatory Taxings*, 104 COLUM. L. REV. 2182 (2004).

15 Thus, the Court has occasionally held that government interference with the right to receive interest on a sum of money can be a taking. *See* Phillips v. Wash. Legal Found., 524 U.S. 156, 163, 172 (1998); Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155

sold, since these obligations have only a negative value.[16] Which suggests, under the hypothesis being considered, that taxes cannot be takings, at least when they take the form of general obligations like income or inheritance taxes.

A fourth example might be things that clearly have value but which by law cannot be assigned or transferred. Many years ago, the Supreme Court considered whether a delegated power of eminent domain given to a hydroelectric company is an interest that should be compensated when the right is eliminated.[17] The right to condemn property is said to be a type of sovereign authority, but it is often delegated to common carriers, utility companies, and the like. What one does not see, not in any legally sanctioned sense, is the buying and selling of the right of eminent domain. The Court held in the referenced case that the delegated power of eminent domain is not subject to compensation for a taking.[18] This seems correct, under the hypothesis we are considering, given that there is no way to determine what the just compensation should be for taking such a power.

One can generalize the point by saying that any type of nonassignable government power, privilege, or license is not going to be regarded as something eligible for compensation if it is taken away. A license to practice law or medicine, a nontransferable liquor license, a certificate of public convenience and necessity to operate a railroad or other common carrier or utility—any of these permissions, if they cannot be assigned from one holder to another, will not generate any information about what a willing buyer would pay and a willing seller would accept in an arm's-length transaction. Consequently, it will not be possible to determine what just compensation should be given if they are cancelled or terminated by the government. The hypothesis under consideration therefore suggests that they will not be regarded as giving rise to a right to compensation.[19]

A final example might be things that are given to particular persons for reasons unique to that person. Possible illustrations include personal awards (a Pulitzer Prize), titles (a knighthood), powers (a power of appointment under a will), invitations to join an honorific society (the National Academy of Sciences), or even dinner invitations. Such things can be cancelled or rescinded, but it is not possible to imagine that they might be taken for just

(1980) (clerk of court takes interest on fund of money deposited in court in an interpleader action).

16 *See* E. Enters. v. Apfel, 524 U.S. 498, 539–40 (1998) (Kennedy, J., concurring in the judgment and dissenting in part); *id.* at 554 (Breyer, J., dissenting). The Court distinguished *Eastern Enterprises* in *Koontz v. St. Johns River Water Management District*, 570 U.S. 595 (2013), which involved a challenge to an exaction of money as a condition for permitting development of a parcel of property. The Court distinguished an exaction imposed as a condition for developing an individual parcel from a tax, which it affirmed could not be regarded as a taking.

17 United States *ex rel.* Tenn. Valley Auth. v. Powelson, 319 U.S. 266, 276–81 (1943).

18 *Id.*

19 For a discussion of the narrower category of things that cannot be sold but can be gifted away, see *infra* notes 45–46 and accompanying text.

compensation. Given their personalized nature, they are never exchanged for value. And because they are never exchanged for value, there is no way to determine how to measure just compensation if they are cancelled or rescinded.

## III. The Meaning of Private Property

The reverse engineering exercise is therefore capable of generating some general conclusions about the scope of the Takings Clause. Of greater doctrinal interest, it would seem that the compensation constraint also has value in identifying what sorts of interests will qualify as "private property" for purposes of the Clause.

In theory, "private property" could refer to well-established bundles of rights, like the fee simple, the life estate, the lease, the trust, and so forth. Or it could refer to every incident associated with property, like the right to exclude, the right to use, and the right to transfer. When we start with the compensation constraint, it would seem that private property must refer to discrete assets that can be exchanged for consideration on a standalone basis.[20] Steven Eagle has called this the "commercial unit test," meaning an interest that is "actually recognized as traded in a market in the community in which it is located."[21]

The rationale for limiting private property for takings purposes to packages of rights that are "exchangeable on a standalone basis" or "tradeable in the local market" follows directly from the requirement of determining just compensation. The measure of just compensation is market value, and market value is obviously difficult if not impossible to determine when the government has taken an interest that is not bought and sold in the market. Under other conceptions of the meaning of private property, such that it refers to every incident in property, we would frequently be faced with claims that the government has taken interests for which there is no market, creating a conundrum for how to determine just compensation.

Limiting the definition of private property to exchangeable rights also fits well with longstanding practice associated with exercises of the power of eminent domain. All agree the Constitution requires compensation when the government exercises the power of eminent domain. The question then becomes: When does the government see fit to exercise the power of eminent domain?

The answer, which is abundantly clear from long experience, is that the government resorts to eminent domain when it needs to acquire a configuration of assets that is commonly tradeable or exchangeable in the market, but which for one reason or another cannot be purchased by the government at

20 Dana & Merrill, *supra* note 7, at 68–81; Thomas W. Merrill, *The Landscape of Constitutional Property*, 86 Va. L. Rev. 885, 974–78 (2000).

21 Steven J. Eagle, *Property Tests, Due Process Tests and Regulatory Takings Jurisprudence*, 2007 BYU L. Rev. 899, 941; *see also* Steven J. Eagle, Regulatory Takings §§ 7-7(e)(5), 7-8 (5th ed. 2012).

what would ordinarily be its market value.[22] In other words, the government would ordinarily purchase the configuration of assets, but finds it cannot do so at a price that falls within what it regards as the range of existing market prices. Usually, this will be because the property enjoys some feature that gives the existing owner the ability to hold out for a price in excess of what would otherwise be its market value.[23] Less commonly, it might be because the government has an urgent need for the property that precludes going through the process of ordinary negotiation of a sale. In short, eminent domain is used to acquire assets that are tradeable in the local market, or exchangeable on a standalone basis, but which, for reasons particular to the project in question, cannot be acquired at a price approximating normal market value.[24]

The relatively small number of decisions that have considered the meaning of private property for purposes of eminent domain are consistent with this conclusion. The Court has held that flowage easements, leases, trade secrets, and security interests are all types of "private property" that require the payment of just compensation if they are taken by the government or transferred pursuant to forced exchange.[25] All of these interests are exchangeable on a standalone basis and are ordinarily acquired through some kind of voluntary exchange of rights. In contrast, the Court has held that the head of water in rivers, a delegated power of eminent domain, future social security benefits, prospective business customers, and freedom from general liabilities are not "private property" for takings purposes.[26] These interests are all subject to significant contingencies, whether they be natural, governmental, or commercial. In any event, they are the kinds of interests that are not transacted, at least not on a standalone basis, and consequently would present very difficult challenges of valuation.

Even if "private property" is limited to exchangeable assets for purposes of eminent domain, it does not inevitably follow that the same understanding

22 This is confirmed by the nearly universal practice, which is sometimes required by law, of seeking to acquire the property by negotiation before resorting to eminent domain.

23 *See generally* Thomas W. Merrill, *The Economics of Public Use*, 72 CORNELL L. REV. 61 (1986) (presenting a survey of eminent domain decisions showing that nearly all involve acquiring assets with some kind of holdout power).

24 Saul Levmore, *Takings, Torts, and Special Interests*, 77 VA. L. REV. 1333, 1340–41 (1991) ("The predictive rule for takings law . . . [is] that compensation will be required when the intervention is readily seen as a substitute for a private purchase.").

25 United States v. Va. Elec. & Power Co., 365 U.S. 624, 631 (1961) (flowage easement); United States v. Gen. Motors Corp., 323 U.S. 373, 381–83 (1945) (lease); Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1003–04 (1984) (trade secrets); United States v. Sec. Indus. Bank, 459 U.S. 70, 75–76 (1982) (security interests).

26 United States v. Willow River Power Co., 324 U.S. 499, 511 (1945) (head of water in river); United States *ex rel.* Tenn. Valley Auth. v. Powelson, 319 U.S. 266, 276–81 (1943) (delegated power of eminent domain); Flemming v. Nestor, 363 U.S. 603, 608 (1960) (future social security benefits); Coll. Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 672 (1999) (prospective customers); E. Enters. v. Apfel, 524 U.S. 498, 539–40 (1998) (Kennedy, J., concurring in the judgment and dissenting in part); *id.* at 554 (Breyer, J., dissenting) (immunity from liabilities).

should prevail for regulatory takings purposes. The regulatory takings doctrine has taken on a life of its own in recent decades, as a kind of stand-in for the protections that used to be provided by the Contracts Clause or the doctrine of substantive due process. More generally, the Supreme Court has defined "property" differently for different constitutional purposes.[27] For instance "property" means something different for procedural due process purposes than it does for substantive due process purposes, and something different still for purposes of eminent domain. Thus, it is conceivable that "private property" might be defined one way for eminent domain purposes, and a different way for regulatory takings purposes.

There is one insuperable barrier, however, to effectuating a divorce between the definition of private property as it applies to explicit and implicit takings. The ultimate remedy for any kind of taking under the Constitution is the payment of just compensation to the party who has suffered the taking. Just compensation is determined, as we have seen, using a variety of valuation techniques keyed to market values. Thus, regulatory takings, like exercises of eminent domain, must retain at least a significant nexus to a conception of private property that takes the form of exchangeable assets.

One would predict, therefore, that regulatory takings claims, to the extent they succeed, will be limited to government regulations that impair the value of forms of property that are themselves tradeable or exchangeable on a standalone basis. Regulations of interests associated with real property are an obvious example. Regulations of interests associated with tangible personal property would be another. Regulations that apply to intangible rights that are tradeable or exchangeable on a standalone basis, like security interests or intellectual property rights, would be a third.

This is consistent with the observed pattern of cases. By far the largest number of regulatory takings cases involves regulatory restrictions on the use of real property, such as those imposed by zoning restrictions or environmental laws. Another cluster of cases concerns rent controls, again usually those applied to leases of real property.

## IV. The Meaning of Taking

The most contested term in takings jurisprudence concerns what it means to "take" private property. This is not an issue in eminent domain proceedings, where the government (or its delegate) explicitly asserts the power to acquire an interest in private property through forced exchange. This is unambiguously a "taking" of property. The issue arises almost exclusively in cases where the government denies it is taking any property, and claims only to be regulating the use of property. These cases by convention are called "regulatory takings."

By general consensus, the decisional law that seeks to specify what it means for the government to "take" property, when its action falls short of appropriating or destroying the property, is a mess. The most frequently

27 *See generally* Merrill, *supra* note 20.

quoted line, which comes from Justice Holmes's opinion in the foundational regulatory taking case, is that a taking occurs when the government "goes too far" in regulating the use of property.[28] The modern formulation favored by the Court is that a "taking" is determined by applying a three-part test said to have been laid down in 1978 in the *Penn Central* decision.[29] The Court has never clarified whether this is a balancing test, a list of three conditions any one of which will qualify a regulation as a taking, or a list of three conditions, the failure of any one of which will *disqualify* a regulation from being considered a taking.[30] Lower courts, regulators, attorneys advising clients, and commentators understandably bewail the uncertain state of the doctrine.

Perhaps further progress can be made by considering how the compensation constraint limits the universe of potential regulatory takings cases. The hypothesis generated by the reverse engineering exercise is that courts will find that a restriction on the use of property is a regulatory taking only if there is a feasible way of determining compensation for the lost value caused by the restriction. If determining compensation is not feasible using established conventions for measuring compensation, there is no point in going down the regulatory takings path in the first place. In pursuing this implication of the compensation constraint, I will consider three possible bases for concluding that a regulation of the use of property satisfies the compensation constraint, and thus is at least eligible for being characterized as a regulatory taking: the anticircumvention theory, the partial taking model, and the public utility model.

### A. *The Anticircumvention Theory*

One way to square the regulatory takings doctrine with the compensation constraint is to consider the doctrine as an anticircumvention device. The idea here is that a regulatory taking occurs when the government seeks to evade its responsibility to compensate for taking property by labeling what would ordinarily be an exercise in eminent domain as a police power measure.[31] This is a plausible interpretation of the Supreme Court's first major regulatory takings decision, *Pennsylvania Coal Co. v. Mahon*.[32] It also finds distinct echoes in more recent opinions, which describe the regulatory takings doctrine as seeking "to identify regulatory actions that are functionally equivalent to the classic taking in which government directly appropriates private property or ousts the owner from his domain."[33]

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28 Pa. Coal Co. v. Mahon, 260 U.S. 393, 415 (1922).

29 Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978).

30 *See* Adam R. Pomeroy, Penn Central *After 35 Years: A Three Part Balancing Test or a One Strike Rule?*, 22 FED. CIR. BAR J. 677 (2013).

31 *See generally*, Thomas W. Merrill, *The Eagle Theory*, 9 BRIGHAM-KANNER PROP. RTS. J. 17 (2020) (attributing the theory to Steven Eagle and spelling out its strengths and weaknesses as a general theory of regulatory takings).

32 260 U.S. at 413 ("But obviously the [police power] limitation must have its limits, or the contract and due process clauses are gone.").

33 Lingle v. Chevron U.S.A. Inc., 544 U.S. 528, 539 (2005).

The anticircumvention interpretation could be regarded as the exclusive understanding of the regulatory takings doctrine. More modestly, it could be considered as a kind of safe harbor in understanding when a regulatory taking has occurred—a "categorical rule" to use the vocabulary generally used in discussing different takings doctrines. Either way, the idea would be that when the government purportedly uses its police power to acquire an interest in property that would ordinarily be acquired by eminent domain, the court should declare the police measure a regulatory taking, or "inverse condemnation," to use an older expression. Eminent domain, as we have seen, is ordinarily used to obtain by force a variety of interests that are commonly acquired in the relevant market by voluntary exchange. Under the anticircumvention theory, it follows that an attempt by the government to use the police power to obtain an interest in property that is commonly exchanged on a standalone basis should be declared to be a taking for which the owner is entitled to just compensation.

The Court's *Loretto* decision, which involved the transfer of a utility easement to a cable TV company by operation of government regulation, is an illustration of this approach.[34] The Court held that the regulation was a taking of property,[35] and properly so, given that utility easements are ordinarily purchased or acquired through a delegated power of eminent domain. Other decisions in which the Court has held regulations of property to be categorical takings can similarly be explained on this basis.[36]

Although the anticircumvention theory will not appeal to the more ardent friends of property rights, it has one signal virtue: it limits regulatory takings to circumstances that satisfy the compensation constraint. If the government is acquiring for public use an interest that is exchangeable on a standalone basis, this means the interest acquired is amenable to valuation using the established conventions associated with measuring just compensation.

### *B. The Partial Takings Model*

Another model that could be used to determine the measure of just compensation for a regulatory taking would be based on the approach taken in partial physical takings cases.[37] Many, perhaps most, physical takings are

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34 Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 421 (1982).

35 *Id.*

36 This would include decisions characterizing demands for the conveyance of a public easement to be categorical takings, *see* Dolan v. City of Tigard, 512 U.S. 374, 396 (1994); Nollan v. Cal. Coastal Comm'n, 483 U.S. 825, 842 (1987), as well as a decision characterizing the compelled transfer of interest on a fund deposited with a lawyer to a charitable trust as a categorical taking, *see* Brown v. Legal Found. of Wash., 538 U.S. 216, 240 (2003). In each case, the government by regulation was seeking to compel the transfer of an interest in property that is exchangeable on a standalone basis.

37 This Section and the next draw in part on Thomas W. Merrill, *Incomplete Compensation for Takings*, 11 N.Y.U. ENV'T L.J. 110, 121–26 (2002).

partial takings.[38] That is, the condemning authority acquires only a portion of the owner's property and leaves the rest in the owner's hands. This will commonly occur, for example, when the taking is for a highway or a utility easement. Regulatory takings can be said to be a type of partial taking, in the sense that the regulation reduces the uses of the property, but leaves other aspects of the property untouched, if only because the owner remains in possession. Hence, we could attempt to derive the measure of compensation in regulatory takings cases by looking to the decisional law that deals with the measure of compensation for partial physical takings of property.

The rules for computing fair market value in partial takings cases differ in important respects from those that apply in total takings cases. Most notably, in partial takings cases the owner is compensated not only for the fair market value of the part that is taken, but also for the loss in value of the part that is not taken. These losses in value are typically called "severance damages."[39] Thus, for example, if the government condemns a 200-foot strip of land across an owner's land for a highway, the owner is entitled to the fair market value of the 200-foot strip of land. In addition, if construction of the highway reduces the value of the remaining land—perhaps because it makes access to the remaining land more difficult—the owner is also entitled to severance damages reflecting the reduced market value of the land not taken.

Most jurisdictions, including the federal government, also permit the court in partial physical takings cases to take into account offsetting benefits that may have increased the market value of the portion of the property not taken.[40] To continue with the highway example, if the taking of the 200-foot strip for a highway increases the market value of the remaining land—perhaps because the remaining land is now valuable for use as a strip mall rather than for residential or agricultural purposes—then the court will subtract the higher value of the remaining land from the compensation that is owed the owner for the land taken. In theory, offsetting benefits can reduce the amount of compensation in partial takings cases to zero (although it appears the government never seeks restitution if the project results in a net gain to the owner).

The practice of reducing compensation for offsetting benefits can give rise to certain problems of horizontal equity if the project creates costs or benefits for owners who experience no physical taking as well as those who do. For example, suppose the new highway increases the market value of land a block lot away from the new highway, as well as the land that is subject to condemnation of the 200-foot strip. If the offsetting benefits rule allows the compensation to the owner whose land is partially taken to be reduced to zero, this owner will have suffered a loss of 200 feet of land with no compen-

38 *See* Abraham Bell & Gideon Parchomovsky, *Partial Takings*, 117 COLUM. L. REV. 2043, 2049 (2017).

39 4A SACKMAN, *supra* note 5, § 14A.03[1], at 14A–41 n.3.

40 Bauman v. Ross, 167 U.S. 548, 557 (1897); 4A SACKMAN, *supra* note 5, § 14A.01[2], at 14A–4.

sation, whereas the owner one block away will have received a benefit in terms of higher property values but will have lost no land at all. To account for this perceived inequity, many jurisdictions have adopted a distinction between "general" and "special" benefits. If the benefit is general—that is, if it affects persons whose property is not partially taken as well as those whose property is partially taken—then no offset is permitted. If the benefit is special, in the sense that it affects only those whose property is partially taken, then an offset is permitted.[41]

The distinction between general and special benefits is often difficult to apply, and so other jurisdictions have abandoned the distinction and instead apply a simple before-and-after test.[42] Under this approach, in the event of a partial taking, two determinations of fair market value are made: one for the total value of the property before the partial taking, and a second for the total value of the property after the partial taking. This is thought to capture both severance damages and offsetting benefits in one before-and-after comparison.[43] If the pre-taking value is higher than the post-taking value, the owner is entitled to the difference as just compensation. If the difference is zero, or the post-taking value is higher than the pre-taking value, the owner gets no compensation.

This before-and-after valuation approach could be adopted for use in determining just compensation in regulatory takings cases. In effect, the court would take a snapshot of fair market value before the imposition of a burdensome regulation, and a snapshot of the value after the imposition of the regulation. The difference in fair market value would, in effect, represent the capitalized (negative) value of the regulatory restriction. This approach would obviously account for any benefits to the property conferred by the regulation, as well as the costs.

The partial takings analogy reveals that it is theoretically possible to determine just compensation in regulatory takings cases, at least when the regulation applies to a unit of property that is commonly exchanged on a standalone basis in market transactions.[44] Nevertheless, it also underscores that the compensation constraint imposes some potentially significant limitations on the regulatory takings doctrine.

One interesting limitation concerns regulations that prohibit any sale or exchange for consideration of certain types of property. For example, in *Andrus v. Allard*, the Court considered a statute and regulations that prohibited any sale of eagle feathers or of any object containing eagle feathers, but

41 Bell & Parchomovsky, *supra* note 38, at 2056 –57.

42 *See* Borough of Harvey Cedars v. Karan, 70 A.3d. 524, 527 (N.J. 2013).

43 Of course, it will be necessary to exclude changes in value due to other factors besides the adoption of the regulation, which may be difficult.

44 This appears to be the approach implicitly adopted by the Court in *Brown v. Legal Foundation of Washington*, 538 U.S. 216, 235–36 (2003), which concluded that zero compensation was owed because the value was zero before the regulation was imposed and zero afterwards.

did not bar gifts or inheritance of such objects.[45] The Court rejected a regulatory takings challenge to the measure without giving any consideration to how compensation could be measured. But the prohibition on any sale or exchange for value would obviously make any calculation of lost value impossible under a before-and-after approach patterned on the partial physical takings model. One could presumably gather evidence of market value before the prohibition took effect. But any transaction afterward would be illegal, which would make any determination of market value difficult if not impossible to establish and verify. This, standing alone, should be sufficient reason to reject a regulatory takings claim. The Court relied in part on Prohibition-era decisions rejecting similar claims with respect to stocks of liquor produced before sales were made illegal.[46] Again, these decisions did not rest on the compensation constraint, but the difficulty of doing a before-and-after valuation when sales are rendered illegal would seem to be a sufficient reason to reject a regulatory taking claim for any statute that renders certain goods inalienable for consideration.

Another possible implication of the partial takings model is that it will be difficult to establish that a regulation has reduced the value of property if the regulation generally applies to all similarly situated property. For example, if a zoning ordinance is passed that prohibits any construction in the community above a certain height, it will be difficult to establish that any decline in market value for a particular lot in the community is due to the regulation. With a more targeted regulation, the inference of causation is more plausible (although even with a targeted regulation there may be difficult questions of causation). But if all otherwise similar properties are equally restricted, any decline in value after the regulation is adopted may be purely coincidental.

The problem of causal attribution raises a more general concern about relying on any before-and-after measure of valuation to establish a regulatory taking. In this regard, it is significant that the rules for determining compensation for partial physical takings apply only to owners who have suffered *some physical appropriation* of a portion of their property. They do not apply to owners who have not had any of their property physically taken. Thus, to return again to the highway example, if the new highway generates noise and congestion in the area, such that owners of land one block away suffer a loss in the market value of their land, this is universally regarded a *damnum absque injuria*—a noncompensable loss. Courts have consistently rejected the idea that the government has some general obligation to compensate owners for the adverse effects of government projects that affect the value of their property but do not physically touch the property.[47]

45 444 U.S. 51, 55–56 (1979).

46 *Id.* at 67 (first citing James Everard's Breweries v. Day, 265 U.S. 545 (1924); and then citing Jacob Ruppert v. Caffey, 251 U.S. 264 (1920)); *see also* Mugler v. Kansas, 123 U.S. 623 (1887).

47 United States v. Miller, 317 U.S. 369, 376 (1943) ("As respects other property of the owner consisting of separate tracts adjoining that affected by the taking, the Constitution has never been construed as requiring payment of consequential damages . . . .").

The historical reluctance of courts to award any compensation to owners who have suffered a decline in the market value of their property, without more, casts light on the failure of courts to implement the idea that regulatory takings can be identified by some measure of "diminution in value" standing alone.[48] The Court has singled out for categorical treatment the limiting case where the regulation reduces the market value of the property to zero.[49] But such cases are rare. And the courts have been unable to identify any threshold below 100% as the line at which a regulatory taking should be found. Such a threshold has been established by legislation in some states, but the experience with these statutory protections has been unhappy for various reasons, often leading to their repeal or significant modification.[50] This does not mean that a better designed statute could not succeed. But it suggests that courts are unlikely to develop a body of judge-made rules that define regulatory takings in terms of a before-and-after measure of reduction in market value standing alone.

### *C. The Public Utility Model*

A third model that could be adopted for determining just compensation in regulatory takings cases is the approach followed in public utility cases. It has long been established that the rates charged by public utilities are subject to review under the Takings Clause.[51] The public utility cases present a situation analogous to regulatory takings, in that the government has not taken title to property nor has it physically appropriated any physical assets. Instead, the government has regulated the property in a way that restricts the freedom of the owner to determine the price or level of services associated with its use, thereby impairing the value of the property.

In the public utility cases, a variation on the fair market value standard is used—the fair return on investment standard. The fair return standard operates in a manner similar to the fair market value standard. The objective is to determine just compensation based on benchmarks that reflect the behavior of other actors in the relevant market. One key understanding is that the regulated firm is entitled to recover only the reasonable costs of providing the service in question. It is assumed that, if the firm were operating in a competitive environment, it would be able to recover from consumers only reasonable costs; any attempt to charge more would result in a loss of business to competitors. Another key understanding is that the regulated

48 For the Supreme Court's wandering pronouncements, see Thomas W. Merrill, *The Supreme Court's Regulatory Takings Doctrine and the Perils of Common Law Constitutionalism*, 34 J. LAND USE & ENV'T L. 1, 8–26 (2018).

49 *See* Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1029 (1992). The Court added the qualification that even in a total wipeout case, the regulation will not be regarded as a taking if it tracks the result that would be obtained under the common law of nuisance. *Id.*

50 *See, e.g.*, Bethany R. Berger, *What Owners Want and Governments Do: Evidence from the Oregon Experiment*, 78 FORDHAM L. REV. 1281 (2009).

51 *See* Verizon Commc'ns Inc. v. FCC, 535 U.S. 467, 497 (2002); Duquesne Light Co. v. Barasch, 488 U.S. 299, 305 (1989).

firm is entitled to recover a rate of return on investment comparable to the return that investors expect to receive when committing funds to investments of comparable risk. In a competitive market, the firm would be able to attract investment capital only if it were able to provide a return at least as high as investors require before committing funds to other investments of similar risk.

These inquiries entail considerable complexity. At least with respect to public utility companies, the complexity of determining reasonable costs and a fair return on investment means that these inquiries have been given over to specialized administrative bodies. In practice, courts give these bodies broad discretion in determining what constitutes reasonable cost and a fair return on investment. For example, the Supreme Court has said that regulators are free to value investment property using either an original cost or replacement cost method.[52] The Court has also permitted regulators to impose rates on certain services below cost, so long as the total effect of the rate order permits a fair return on investment.[53] The constitutional standard nevertheless lurks in the background and has played an important role in structuring the inquiry in public utility rate cases.

In theory, the approach followed in the public utility cases could also be applied to regulatory takings issues, such as those presented by land use and environmental controls. The general task of the court would be to develop a model of what an otherwise identical firm would incur in the way of costs and would require in terms of a return on investment in a competitive environment. If the impact of the regulation is to drive the return on investment below the benchmark rate of return, the government, as in the public utility cases, would be required to provide compensation to close the gap. The amount of compensation, as under the partial takings model, should in theory represent the capitalized (negative) value of the regulatory restriction.

There are reasons to question the practicality of the public utility model as a basis for determining just compensation with respect to most run-of-the-mill regulatory takings cases, such as those that arise out of zoning and other land use restrictions. One is the great complexity of the public utility model, which at the very least would require extensive expert testimony on the part of the claimant and, presumably, the regulatory authority. This would inevitably be expensive, and the expense may discourage courts from going down this route. Another is that the public utility model has fallen into disuse in recent years in the sphere of its original application. In part this is due to persistently low inflation and interest rates, as these conditions tend to mute controversy over utility rates. In part, it is due to the emergence of genuine or induced competition in many markets formerly served by natural monop-

52 *See Verizon*, 535 U.S. at 539.

53 *See Duquesne*, 488 U.S. at 312; Balt. & Ohio R.R. Co. v. United States, 345 U.S. 146, 148 (1953).

oly utilities, which has displaced the need for traditional rate-of-return ratemaking.[54]

More serious, perhaps, is the legal theory that justifies the application of the Takings Clause to public utility rate regulation in the first place. Although the courts have not made this entirely clear, it would seem that the justification for applying the Takings Clause in this context is that the state has compelled the utility to dedicate its property to the provision of public service within a defined territory.[55] In effect, the state has appropriated the property to a public use, and therefore has a legal obligation to provide just compensation. If this is indeed the underlying theoretical justification, then it is a condition precedent to invoking the public utility model that the property owner cannot exit from the market it currently serves. Some property owners may be able to make such a claim; for example, owners of apartment complexes subject to rent controls who are not allowed to convert their apartments to condominiums. But others will not be able to mount any such showing. Grape growers who do not like government limitations on the quantity of grapes that can be sold in the raisin market can divert their crop to the production of bulk wine.[56] Thus, the public utility model may be of limited use outside the context of class actions challenging draconian rent control regimes and similar sorts of claims.

### D. *The* Penn Central *Case*

The facts of the Court's leading decision on regulatory takings—the *Penn Central* case—can be used to illustrate how considerations about the ability to determine just compensation might enter into resolving a difficult case raising regulatory takings claims.[57] In the case, the City of New York imposed a historic preservation order on the Grand Central Terminal in Manhattan, then owned by the Penn Central Railroad. The Landmarks Preservation Commission denied two proposals by the owner to use the air rights above the original terminal building for development by a third party. Although there was some uncertainty about whether a further proposal might eventually be approved, the company claimed that the preservation order and its implementation constituted a regulatory taking of its air rights.

Assuming the preservation ordinance and its interpretation constituted an indefinite prohibition of any construction in the portion of the air rights

54 Joseph D. Kearney & Thomas W. Merrill, *The Great Transformation of Regulated Industries Law*, 98 COLUM. L. REV. 1323, 1408 (1998).

55 *See* Bowles v. Willingham, 321 U.S. 503, 517 (1944) (indicating that the Takings Clause does not apply to price controls when the owner is legally free to exit the market). A more realistic justification would be that the owner has invested in specific assets that cannot be redeployed to alternative uses. *See* Thomas W. Merrill, *Constitutional Limits on Physician Price Controls*, 21 HASTINGS CONST. L.Q. 635, 640, 643–50 (1994).

56 *But see* Horne v. Dep't of Agric., 576 U.S. 351, 365 (2015) (summarily rejecting "let them sell wine" as a defense to an action for physical appropriation of a portion of a raisin crop).

57 Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 107 (1978).

eligible for development, the first question would be whether such air rights are commonly bought and sold in Manhattan in standalone transactions with third parties. It does not appear that any record evidence was developed on this point and presented to the Court.[58] We know that such transactions occasionally occur in dense urban markets.[59] If evidence had been presented that such transactions occur in Manhattan, the preservation order could be regarded as a regulatory taking under the anticircumvention theory. The City was attempting to acquire by regulation an interest that is ordinarily exchanged on a standalone basis by voluntary transactions. Just compensation should be capable of being determined by considering comparable sales of air rights in the relevant area.

Another approach to the controversy, which is closer to the line of attack developed by the company and adopted by the dissent, would be to challenge the preservation ordinance as a form of impermissible spot zoning.[60] Assuming this line of attack had succeeded, it should not be barred by any concern about the valuation constraint. The historic preservation order was targeted to this one parcel of property and did not apply to other properties in the area. Thus a before-and-after measure of market value, modeled on the partial physical takings cases, could be used to develop the quantum of compensation necessary to make the company whole for the effect of the regulation.

A third characterization of the preservation order, which was explored in the lower courts and appears obliquely in the Supreme Court's opinion, is that it deprived the Penn Central Company of a fair return on its investment in the terminal.[61] The Penn Central Railroad was of course a common carrier, subject to regulation as such, and it was presumably required by law to continue to operate the Grand Central Station as a terminal unless and until it was given permission to abandon the facility. Thus, the principles of the public utility cases, which have long applied to railroads, would seem to be applicable. Whether compensation would be awarded to the carrier under these principles was nevertheless highly uncertain, as the Court intuited. The railroad was teetering on bankruptcy, but its financial problems had complex roots that went well beyond the inability to capitalize on the air rights above the terminal. The public utility cases allow regulators to require

58 Penn Central's contentions in this regard focused on whether certain "transfer development rights" (TDRs), which allowed the company to develop above applicable zoning height restrictions on nearby property, could be regarded as adequate compensation for the alleged taking. *See id.* at 129; *id.* at 150–52 (Rehnquist, J., dissenting).

59 *See* JOSEPH D. KEARNEY & THOMAS W. MERRILL, LAKEFRONT: PUBLIC TRUST AND PRIVATE RIGHTS IN CHICAGO 235 (2021) (describing the transfer of air rights above the Illinois Central Railroad terminal in Chicago for construction of the Prudential Financial, Inc. building). It also appears that such transfers were familiar in New York City. *See generally* Note, *Conveyance and Taxation of Air Rights*, 64 COLUM. L. REV. 338 (1964); Note, *Development Rights Transfer in New York City*, 82 YALE L.J. 338 (1972).

60 *See Penn Cent.*, 438 U.S. at 132; *id.* at 146–47 (Rehnquist, J., dissenting).

61 *Id.* at 136 (majority opinion) (concluding that the ordinance did not deprive the company of a fair return on its investment); *id.* at 129 (treating the company as having conceded the point).

companies to operate some functions at a loss, provided adequate revenues are available to allow an adequate return on total firmwide investment.[62] The question whether the railroad was denied just compensation by the preservation order would thus have to be resolved, at least initially, by a regulatory body with more general authority over the finances of the carrier, presumably the Interstate Commerce Commission. The New York state courts, where Penn Central filed its takings claim, could not make the relevant determination about just compensation under the public utility model.

*Penn Central* thus reveals that any one of the three alternatives to developing a market-based measure of compensation might have been available in the case, had the litigation been framed in such a way to develop an adequate record supporting the claim for a regulatory taking.

## Conclusion

This Essay argues that the established nature of the relief available for a taking of property—the payment of just compensation as measured by market value—operates as a constraint on the scope of the Takings Clause, including the universe of interests that are regarded as "private property" and the circumstances that justify a finding that the government has "taken" such property. In this respect, the argument is a version of the more general claim that limits on formulating appropriate remedies can shed important light on the judicial understanding of nature and scope of constitutional rights.[63] The most general point of the Essay is that any right that is remedied by the payment of compensation based on market value will make sense only so long as market exchange remains the norm and compulsory exchange the exception. If the realm of government-administered pricing grows, the scope of operation for the Takings Clause will inevitably recede. This is not an argument in favor of markets and against government-administered prices. It is merely a positive prediction about the expected domain of the Takings Clause.

62 *See supra* notes 52–53 and accompanying text.

63 *See generally* Daryl J. Levinson, *Rights Essentialism and Remedial Equilibration*, 99 Colum. L. Rev. 857 (1999).