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William W. Wade

Misconstruing Size of Economic Impacts as the Determinant of P*enn C*e*ntral* Test Does Not Invoke Average Reciprocity of Advantage

*William W. Wade, Ph.D.**

I. Introduction

This article responds to two recent publications by Daniel L. Siegel[1]: (1) *Evaluating Economic Impact in Regulatory Takings Cases*, published in 2013 in the *Hastings West-Northwest Journal of Environmental Law and Policy*;[2] and (2) its companion article concerning *Penn Central's* parcel-as-a-whole rule, *How the History and Purpose of Regulatory Takings Doctrine Help to Define the Parcel as a Whole*, published in 2012 in the *Vermont Law Review*.[3]

I discuss the economic aspects of Siegel's two articles as they relate to the *Penn Central* test.[4] *Penn Central* created two ironclad requirements for finding a regulatory taking: (1) the *Penn Central* test and (2) the principle of valuing the "parcel as a whole."[5] The *Penn Central* test dictates that courts must examine and balance three factors before requiring compensation: (1) the economic impact of the regulation on the claimant; (2) the extent to

* The author is an economist who has testified as an expert in regulatory takings cases, lectured at CLE seminars, and written numerous articles about the economic underpinnings of the *Penn Central* test, including one article directly on-point to discuss Siegel's extrapolation of the phrase, "average reciprocity of advantage." *See* William W. Wade & Robert L. Bunting, *Average Reciprocity of Advantage: "Magic Words" or Economic Reality: Lessons from Palazzolo*, 39 URB. LAW 319, 319 (2007). The author testified as a financial expert for Plaintiff Anthony Palazzolo in the Rhode Island state trial upon remand from the U.S. Supreme Court and estimated the reciprocal benefits as part of that testimony. Palazzolo v. State, No. WM 88-0297, 2005 WL 1645974 (R.I. Super. Ct. July 05, 2005).

Thanks to the law journal editors, whose careful editorial assistance corrected legal shortcomings, improved readability, and, of course, Bluebooked the article to a level of correctness that wildly exceeded the economist-author's imagined understanding of citation. Remaining errors are the authors.

1. Supervising Deputy Attorney General, California Department of Justice.

2. Daniel L. Siegel, *Evaluating Economic Impact in Regulatory Takings Cases*, 19 HASTINGS W.-NW. J. ENVTL. L. & POL'Y 373 (2013).

3. Daniel L. Siegel, *How the History and Purpose of the Regulatory Takings Doctrine Help to Define the Parcel as a Whole*, 36 VT. L. REV. 603 (2012).

4. Thousands of words by hundreds of litigators and scholars including the author have sought to explicate the *Penn Central* test. *See, e.g.*, William W. Wade, *Temporary Takings, Tahoe Sierra, and The Denominator Problem*, 43 ENVTL. L. REP. NEWS & ANALYSIS 10189 (2013).

5. Penn Cent. Transp. Co. v. City of New York (*Penn Central*), 438 U.S. 104, 124, 130–31 (1978).

which the regulation has interfered with distinct investment-backed expectations; and (3) the character of the government regulation.[6]

While the Court categorized the balancing test as an "*ad hoc* factual analysis,"[7] two of the *Penn Central* prongs entail fact-specific economic analyses that must conform to standard peer-reviewed methods. *Daubert* standards require at a minimum that an expert uses the appropriate analytic techniques that have been tested in actual situations and peer reviewed.[8]

In regulatory takings cases, economic losses must be measured against the "parcel as a whole."[9] This comparison has come to be known as the "takings fraction,"[10] which compares the *with* and *without* regulation values, as the numerator, to the owner's stake in the entire property, as the denominator, to evaluate the severity of economic impact.[11] For partial or temporary takings that involve lost income, the parcel-as-a-whole rule requires that the severity of the economic loss be evaluated in relation to the owner's entire investment in the property as a whole.[12] A claimant's investment is consistent with the notion of the parcel-as-a-whole when income, rather than access to real property, is at the heart of the litigation.

The economic prongs of the *Penn Central* test, when properly measured and evaluated, provide standard financial benchmarks, which reveal when

6. *Id*. at 124.

7. *Id*.

8. Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993); *see also* Fed. R. Evid. 702.

9. *Penn Central*, 438 U.S. at 130–31. The Supreme Court first enunciated the parcel-as-a-whole rule in *Penn Central* to examine how to analyze the significance of New York City's denial of the permit to build an office tower above the Grand Central Terminal. *Id*. The Court corrected the lower court's notion that the parcel included profits earned from an agglomeration of all the property owned by Penn Central in the vicinity—hotels, office buildings, and other valuable real estate. *See Penn Central*, 366 N.E.2d 1271, 1276 (N.Y. 1977).

10. Keystone Bituminous Coal Assn. v. Debenedictis, 480 U.S. 470, 497 (1987) ("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.'" (emphasis added)).

11. For more about the history and purpose of denominator values, see Wade, *supra* note 4.

12. Actually, *Penn Central* benchmarked the property taking to the "extent of the interference with rights in the parcel as a whole—here, the city tax block designated as the 'landmark site.'" *Penn Central*, 438 U.S. at 130–31.

government action goes "too far," as originally envisioned in P*ennsylvania Coal v. Mahon*.[13] Under P*enn Central*, government action has gone "too far" when the claimant is no longer able to earn a "reasonable return" on her investment in the property as a whole.

II. Siegel 2012 Invoked a "Robust Parcel as a Whole"

Siegel's 2012 article concluded that the United States Supreme Court should elaborate upon P*enn Central's* parcel-as-a-whole rule.[14] He called for a robust parcel-as-a-whole rule that not only would include "the entire temporal property interest, including the owner's future interest in the property," but also would comprise the owner's entire "horizontal" interest.[15] The Federal Circuit has already imposed the temporal parcel-as-a-whole rule in C*ienega* X.[16]

C*ienega* X relied on T*ahoe-Sierra* to invoke "the impact on the value of the property as a whole [a]s an important consideration [in a temporary taking], just as it is in the context of a permanent regulatory taking."[17] The C*ienega* X decision adopted T*ahoe-Sierra's* parcel-as-a-temporal-whole.[18] The court

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

14. Siegel, *supra* note 3, at 609, 615–21.

15. I*d*. at 618 (citing Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 535 U.S. 302, 342 (2002)).

16. Cienega Gardens v. United States (C*ienega* X), 503 F.3d 1266, 1281 (Fed. Cir. 2007). C*ienega* X was one of a series of lost income temporary takings case where owners of dozens of Department of Housing and Urban Development low income apartment investments were denied the opportunity to convert to market values at the end of a twenty year contract period, as expected. First, claimants filed contract claims. Subsequently, they filed takings claims to recover damages. The Federal Circuit awarded damages to some of the original claimants, Cienega Gardens v. United States (C*ienega* VIII), 331 F.3d 1319, 1353 (Fed. Cir. 2003), and denied damages to others, C*ienega* X, 503 F.3d at 1291. Each set of claimants proffered standard empirical measurements of the P*enn Central* test, with similar showings of annual lost return on investment.

17. C*ienega* X, 503 F.3d at 1281 (citing T*ahoe-Sierra*, 535 U.S. at 331, 355).

18. I*d*. at 1285 ("The duration of these restrictions is an important factor in the takings analysis." (citing T*ahoe-Sierra*, 535 U.S. at 342)).

proposed two possible ways "to compare the value of the restriction to the value of the property as a whole"[19]:

> First, a comparison could be made between the market value of the property with and without the restrictions on the date that the restriction began (the change in value approach). The other approach is to compare the lost net income due to the restriction (discounted to present value at the date the restriction was imposed) with the *total net income without the restriction over the entire useful life of the property* (again discounted to present value).[20]

Going further than the C*ienega* X court, Siegel's 2012 article asserted that "[a] robust parcel rule not only respects precedent and the Takings Clause's history; it also ensures that the public interest is included in the takings calculus."[21] That article did not address how exactly to include the public interest.

III. Siegel 2013 Misconstrued "Severity of Economic Impact" as a Size of Loss Issue Rather than a Missing Denominator

Siegel's 2013 article reiterated his call for:

> [R]ules that limit regulatory takings to *extreme situations* . . . [and] generally require, among other things, a showing that a regulation's economic impact on property is severe, *counting direct benefits* that the owner receives as part of the impact calculation, and evaluating that impact by including potential future uses of the property (the parcel as a whole).[22]

19. I*d*. at 1282.

20. I*d*. (emphasis added).

21. Siegel, *supra* note 3, at 618.

22. Siegel, *supra* note 2, at 374 (emphasis added). This is akin to Professor Echeverria's notion of "the concept of *reciprocity of advantage*," which he describes as "the idea that regulations often simultaneously benefit and burden affected owners . . . [and], considered in isolation, appear to seriously reduce the value of a claimant's property [but] may not in fact have any net adverse effect at all." John D. Echeverria, P*artial* R*egulatory* T*akings* L*ive*, B*ut* . . . , *in* Taking Sides on Takings Issues: The Impact of Tahoe Sierra 67, 72–73 (Thomas E. Roberts ed., 2003). Such a concept "supports a law of regulatory takings that is confined to truly *extreme cases*." I*d*.

Siegel's 2013 article discussed how to count direct benefits to the owner of the regulation in context with P*enn Central's* average reciprocity of advantage.[23]

P*enn Central* never contemplated Siegel's "extreme situation" criterion and instead emphasized "reasonable return."[24] The phrase "reasonable return" appears nineteen times, in the majority opinion and Justice Rehnquist's dissent, including footnotes. The majority erroneously concluded that Penn Central was earning a reasonable return on the Grand Central terminal as part of its justification for denying the taking.[25] The

23. Siegel, *supra* note 2, at 385–89; *see also* P*enn Central*, 438 U.S. 104, 139–140 (1978) (Rehnquist, J., dissenting) ("But any such abstract decrease in value will more than likely be at least partially offset by an increase in value which flows from similar restrictions as to use on neighboring properties. All property owners in a designated area are placed under the same restrictions, not only for the benefit of the municipality as a whole but also for the common benefit of one another. In the words of Mr. Justice Holmes, speaking for the Court in P*ennsylvania Coal Co. v. Mahon*, there is *an average reciprocity of advantage*." (emphasis added) (citation omitted)).

24. Justice Rehnquist called attention to the majority's lack of definition for "reasonable return" and "economically viable" language and concluded that a rule without definitions poses "difficult conceptual and legal problems." P*enn Central*, 438 U.S. at 149 n.13 (Rehnquist, J., dissenting). The footnote appears to point out politely that the majority was not schooled in the meanings of the economic terms used in their language. Confusion about relevant financial evidence and its interpretation has remained a fatal problem in regulatory takings cases since Justice Rehnquist's prescient remark.

25. P*enn Central*, 438 U.S. at 129 ("[T]he parcel of land occupied by Grand Central Terminal must, in its present state, be regarded as capable of earning a reasonable return . . . ."). It is hard to imagine how the Court determined that Penn Central was earning a reasonable return. In 1970, Penn Central became the largest bankruptcy in U.S. history. Metro North, a subsidiary of New York's Metropolitan Transit Authority ("MTA"), took over operation of Grand Central Terminal in 1983 under a lease from Penn Central. Metro North described their takeover of Grand Central in 1983 as salvaging it from "the wreckage of Penn Central." Grand Central Terminal was eventually restored at public expense by the MTA.

The Court's erroneous decision resulted from plaintiff counsel's failure to rebut the mistaken assumption. Beyond failure to introduce appropriate financial information, no testimony is in the record about changing demographic and economic conditions that resulted in less passenger travel and more freight movement on rails to the detriment of Penn Central. The Penn Central Company needed the rental income

Court reaffirmed *Penn Central* as its "polestar" in *Lingle v. Chevron* and did not overturn *Penn Central's* focus on "reasonable return."

Under *Penn Central*, a regulation that denies an owner a reasonable return on her investment would, in fact, be "so onerous that its effect is tantamount to a direct appropriation or ouster."[26] In other words, if an investor could have foreseen a particular regulatory outcome, she would have moved her money elsewhere. Suffice to say, Siegel's "extreme situation" is a phrase lacking an economic definition, which amounts to a value judgment and not an appropriate basis for a legal decision.

Siegel argued for a compound rule that "count[s] direct benefits that the owner receives as part of the impact calculation, and evaluat[es] th[e] [severity of economic] impact by including potential future uses of the property (the 'parcel as a whole')."[27] Siegel's approach would increase the already difficult evaluation of the *Penn Central* test. His dual standard invokes the measurement of *Penn Central's* reciprocal benefits to offset the burdens of the regulatory constraint at issue,[28] and adopts *Tahoe-Sierra's* concept of a parcel-as-a-temporal-whole as black-letter law.[29]

The temporal aspect of *Tahoe-Sierra* is an economic error, which I have discussed elsewhere[30] and will summarize in Part IV. This article focuses on Siegel's rationale for "counting direct benefits that the owner receives as part of the [severity of economic] impact calculation."[31] Part V considers his

from the foreclosed building in the airspace above Grand Central. Perhaps, the Court thought that people still "met under the clock at Grand Central" as in the movies. The *Penn Central* decision brought forth the *Penn Central* test with no adequate consideration of the economic prongs—without a *Penn Central* test.

26. Lingle v. Chevron U.S.A., Inc., 544 U.S. 528, 537 (2005) (citing Palazzolo v. Rhode Island, 533 U.S. 606, 617–18 (2001) (O'Connor, J., concurring)).

27. Siegel, *supra* note 2, at 374.

28. *See Penn Central*, 438 U.S. at 124 (explaining that finding a taking is less likely "when interference arises from some public program adjusting the *benefits and burdens* of economic life to promote the common good" (emphasis added)).

29. Siegel, *supra* note 3, at 618 (citing Tahoe-Sierra Preservation Council v. Tahoe Reg'l Planning Agency, 535 U.S. 302, 331 (2002)).

30. William W. Wade, *Confusion about "Change in Value" and "Return on Equity" Approaches to Penn Central Test in Temporary Takings*, 38 ENVTL. L. Rep. NEWS & ANALYSIS 10486 (2008).

31. *Seigel*, *supra* note 2, at 374.

notions about including the public interest and weighing the benefits and burdens of regulation.[32]

IV. *Tahoe-Sierra* Provides No Theoretical Support for Measuring Severity of Economic Impact

The *Tahoe-Sierra*[33] decision expanded *Penn Central*'s geographic parcel-as-a-whole rule[34] to include a temporal dimension to deny a regulatory taking. The temporal aspect included "the term of years that describes the temporal aspect of the owner's interest"[35] or the remaining life of the property. *Tahoe-Sierra* rests on a basic misunderstanding of economic theory—time values of money are at the heart of people's investment decisions. Equating "metes and bounds"[36] of land areas to segments of time overlooks the fact that the value of money is measured by time; lost income is not magically restored at the end of a temporary taking. Time values of money differentiate temporal segmentation of the parcel as a whole—per *Tahoe-Sierra*—from physical segmentation. Returning the use of the property after a temporary taking does not return income lost during that period.[37]

Tahoe-Sierra demonstrates a lack of understanding of the effect of money's time value on "economically viable use,"[38] profitability, or

32. William W. Wade & Robert L. Bunting, *Average Reciprocity of Advantage: "Magic Words" or Economic Reality: Lessons from Palazzolo*, 39 URB. LAW 319, 319 (2007). I draw from that 2007 article regarding average reciprocity of advantage.

33. *Tahoe-Sierra*, 535 U.S. at 331. The temporal whole notion actually arose in the Ninth Circuit Court of Appeals. Tahoe-Sierra Preservation Council, Inc. v. Tahoe Reg'l Planning Agency (TSPC IV), 216 F.3d 764, 776 (9th Cir. 2000) (shifting the focus of the Tahoe dispute from the impact of Tahoe Regional Planning Authority's moratorium during its effective period to its impact over the entire useful life of the subject properties).

34. *Penn Central*, 438 U.S. 104, 130 (1978).

35. *Tahoe-Sierra*, 535 U.S. at 330.

36. *Id*. at 331.

37. For more about the economic failings of *Tahoe-Sierra*'s "temporal whole" and its progeny in the Federal Circuit Court, see Wade, *supra* note 4. *Tahoe Sierra*'s temporal parcel confounded the Federal Circuit's temporary takings decisions in ways at odds with standard economic theory and practice. Cienega Gardens v. United States, 503 F.3d 1266, 1281 (Fed. Cir. 2007); CCA Associates v. United States, 667 F.3d 1239, 1247 (Fed. Cir. 2011).

38. Agins v. City of Tiburon, 447 U.S. 255, 260 (1980). Two years after *Penn Central*, the Court in *Agins* applied a two-part legal test derivative of *Penn Central* to

reasonable returns. The factors that are relevant to determine a property's value at a unique point in time are the uses and returns that can be made of and earned by the property during that time. As touched upon in Chief Justice Rehnquist's *Tahoe-Sierra* dissent,[39] the longer the imposed delay from that time to the future uses, the lower the present value of the property's use to its owner.

V. Severity of Economic Impact is Measured by Interference with Investment Backed Expectations—Not by the Size of the Loss

Siegel misconstrued the economic intent of language in the Federal Circuit's *Rose Acre* III;[40] this error facilitated the superimposing of his "counting direct benefits" argument upon the *Penn Central* test. In his 2013 article, Siegel wrote, "for an economic impact to be so onerous that it is similar to eliminating a core property interest, the impact has to be *huge*. As the Federal Circuit has explained, a 'severe economic deprivation' is therefore required by 'the very nature of a regulatory takings claim.'"[41] The actual language from the decision aimed to discuss a lack of denominator comparison and did not imply that "the impact has to be *huge*:"

> [N]either the testimony nor the economic data cited by the trial court appropriately gauge the *severity* of the economic *impact* of the regulations *on* Rose Acre. The cited testimony is not specific to Rose Acre, and the data divorced from any economic context represents only the first step in the required [*Penn Central*] analysis. Simply put, it is not possible to determine the

determine whether a regulatory taking had occurred. *Id*. Subsequently called the *Agins* test, the Court held that a taking occurs if the regulation either does not "substantially advance legitimate state interests," or denies the property owner "economically viable use" of the property. *Id*. A subsequent Court decision eliminated the "substantially advance" element, but left the "economically viable" language unchanged. *See* Lingle v. Chevron U.S.A., Inc., 544 U.S. 528, 540 (2005).

39. *Tahoe-Sierra*, 535 U.S. at 351 (Rehnquist, C. J., dissenting) (discussing the Tahoe claimants' denial of all beneficial use of their properties for six years as the basis for his conclusion that "the 'temporary' denial of all viable use of land for six years is a taking").

40. Rose Acre Farms v. United States (*Rose Acre* III), 373 F.3d 1177, 1195 (Fed. Cir. 2004).

41. Siegel, *supra* note 2, at 377 (citing *Rose Acre* III, 373 F.3d at 1195).

> economic impact of a regulatory scheme applied to a private actor without casting the appropriate absolute measures of the effect of the regulation against the backdrop of relevant indicators of the economic vitality of the actor.[42]

Rose Acre III explicitly disavowed using the absolute size of the impact (e.g., huge) as the appropriate basis for deciding against the plaintiff. The Federal Circuit language cited by Siegel relates to prior discussion and the remand instructions: "First, as noted above, courts have traditionally rejected takings claims in the absence of severe economic deprivation."[43] This rejection stems from the economic prongs of the *Penn Central* test—requiring not that the loss be *huge*; rather, the loss must be benchmarked to some denominator to understand whether investment-backed expectations have been frustrated. The amount or percentage of the loss is not *per se* dispositive.[44] In *Florida Rock* V, the Federal Claims Court invoked language from *Penn Central* to emphasize "the importance of obtaining a 'reasonable return' on the property owner's investment in determining the presence of a taking."[45]

Rose Acre III's rejection of the trial court's award of damages conforms to standard financial practice. The trial court (in *Rose Acre* II) found in favor of the plaintiff with no basis to gauge severity of the economic impact.[46] The plaintiff's economist demonstrated substantial revenue losses, but never benchmarked the losses to any denominator value. The Federal Circuit, citing to both the plaintiff's and the government's testimony on losses, determined succinctly that "[the economist's] analysis was insufficient" and "neither the testimony nor the economic data cited by the trial court appropriately gauge the *severity* of the economic *impact* of the regulations *on* *Rose Acre*."[47]

42. *Rose Acre* III, 373 F.3d at 1185.

43. *Id*. at 1195.

44. Florida Rock Indus., Inc. v. United States (*Florida Rock* V), 45 Fed. Cl. 21, 41 (1999) ("Even though . . . a significant destruction of the value of plaintiff's property [occurred], it is *not dispositive* of the issue." (emphasis added)). Further, "[i]n determining the severity of the economic impact of permit denial, the court must take into account whether Florida Rock was able to *recoup its investment* subject to the regulation." *Id*. at 38. This conforms to standard finance textbook theory and methods.

45. *Id*. at 39 (citing *Penn Central*, 438 U.S. 104, 149 (1978) (Rehnquist, J., dissenting)).

46. Rose Acre Farms v. United States (*Rose Acre* II), 55 Fed. Cl. 643 (2003).

47. *Rose Acre* III, 373 F.3d at 1185.

Opposing experts agreed on the amount of loss, but neither expert provided a denominator value acceptable to the Federal Circuit or consistent with standard economic theory. As such, the court remanded the case "for reconsideration of the severity of the economic impact wrought by the relevant . . . restrictions on Rose Acre, and for consideration of the significance of that impact in light of the other relevant factors, [including] the regulation's interference with Rose Acre's reasonable investment-backed expectations." [48]

Over the last twenty-five years takings cases have consistently evaluated the severity of economic impact in a comparative manner.[49] Siegel's vague and absolute standard for justifying compensation in a taking claim is rhetoric that lacks economic meaning. His mistaken assertion facilitates the objective of his argument. Requiring a "huge" economic impact justifies Siegel's claim that government restrictions and other actions benefit property as well as burden it. However, he claims quantifying the increased value of individual properties due to these benefits is generally very difficult. Therefore, a "huge" diminution requirement accounts for the uncertain nature of the economic evaluation of these benefits.[50]

48. *Id*. at 1195. Expert testimony and argument did not become any clearer during the *Rose Acre* IV trial in the Federal Claims Court. Whether the temporary taking case was about eggs or farms, gross revenues or net profits, lost income or lost value, marginal costs or average costs apparently eluded the judges, the instant parties and experts. Standard economic approaches are hopelessly muddled within all of the two courts' decisions. Both plaintiff and government economic testimony ignored standard financial analysis and produced no relevant calculations to evaluate the investment backed expectations prong of the *Penn Central* test. The interested reader will not find a more economically confused record and decision than Rose Acre Farms, Inc. v. United States (*Rose Acre* IV), No. 92-710C, 2007 WL 5177409 (Fed. Cl. July 11, 2007), and Rose Acre Farms, Inc. v. United States (*Rose Acre* V), 559 F.3d 1260, 1260 (Fed. Cir. 2009).

49. Comparisons based on the percent diminution of tangible asset values have been common. However, in temporary takings cases that involve income losses, such comparisons have been at odds with standard economic practice. *See* Keystone Bituminous Coal Assn. v. Debenedictis, 480 U.S. 470, 497 (1987); *see also* Wade, *supra* note 4, at 10195 n.67 (citing Florida Rock Indus., Inc. v. United States (*Florida Rock* II), 791 F.2d 893, 905 (Fed. Cir. 1986) (identifying, for the first time in the Federal Circuit, the correct economic notion of the taking fraction to evaluate frustration of investment backed expectations)).

50. Siegel, *supra* note 2, at 382.

This requirement makes no more economic sense than going into court with a tort claim for damages of a certain amount, plus some vague additive amount to account for other losses and disappointments experienced in the plaintiff's life. With millions of dollars in investment and personal aspirations at stake in takings cases, counsel should present hard economic evidence of regulatory benefits and burdens to courts, instead of vague arguments or political beliefs. If either plaintiff's or defendant's counsel desires to invoke *Penn Central's* average reciprocity of advantage, the relevant elements should be based on quantifiable evidence.

Estimating the distribution of the benefits and burdens of any regulation is the bailiwick of economics. Economists are qualified to estimate whether "some public program [merely adjusts] the benefits and burdens of economic life to promote the common good,"[51] or if it disproportionately slams a few selected property owners. Hard evidence of regulatory impacts is as relevant to a court's discerning whether reciprocal benefits govern the legal decision as the benefits and costs to state and federal agencies guided by Executive Order 12,866.[52]

VI. Reciprocal Benefits are Measured in Concrete Terms from their First Appearance in Takings Cases

From its first appearance, the reciprocal benefits element of regulations in takings law has required concrete evaluations.[53] *Plymouth Coal*[54] and *Jackman*[55] established average reciprocity in case law by evaluating the directly offsetting benefits and burdens of the regulatory requirement. Specific concrete benefits to the claimants were identified in both cases—e.g., mutual boundary walls that enhanced safety and provided other specific services to the property. In both cases, the burden was deemed less than the benefit of requiring the mutual walls and the courts ruled against the claimant.[56]

Jackman involved the maintenance of a common wall between two properties, which was of mutual benefit to both, due to safety and the

51. *Penn Central*, 438 U.S. at 124.

52. Exec. Order No. 12,866, 3 C.F.R. 638, 638 (1993), reprinted in 5 U.S.C. § 601 (2012) (requiring significant regulatory actions to be submitted to the Office of Information and Regulatory Affairs in the Office of Management and Budget for review).

53. Wade, *supra* note 32, at 325.

54. Plymouth Coal Co. v. Pennsylvania, 232 U.S. 531, 541 (1914).

55. Jackman v. Rosenbaum Co., 260 U.S. 22, 31 (1922).

56. *Plymouth Coal*, 232 U.S. at 540; *Jackman*, 260 U.S. at 32.

economic advantage of sharing the wall to support both buildings.[57] Justice Holmes first used the phrase "average reciprocity of advantage" in *Jackman*.[58] Subsequently, in *Pennsylvania Coal*, Justice Holmes applied the phrase to the earlier *Plymouth Coal* decision to describe how a "pillar of coal . . . left along the line of adjoining property" acted as a barrier for the safety of the mine employees and "secured an average reciprocity of advantage."[59] After determining that the benefits of requiring the mutual walls outweighed the burdens, the court ruled against the plaintiffs' taking claim.[60]

VII. *Penn Central* Invoked a broader Concept of Reciprocity

The phrase "average reciprocity of advantage" next appeared half a century later in Justice Rehnquist's *Penn Central* dissent.[61] Rehnquist's argument was consistent with *Plymouth Coal* and *Jackman*, which both required reciprocity to be evaluated by focusing on the direct benefits specifically affecting the regulated parties. Justice Rehnquist expressly argued that reciprocity of advantage is not satisfied where the benefits flow to the general public.[62]

The *Penn Central* majority concluded otherwise:

> [T]he application of New York City's Landmarks Law has not effected a "taking" of appellants' property. The restrictions imposed are substantially related to the promotion of the general welfare and not only permit reasonable beneficial use of the landmark site but also afford appellants opportunities further to enhance [the Terminal] . . . .[63]

57. *Jackman*, 260 U.S. at 31.

58. *Id.* at 30.

59. Pa. Coal Co. v. Mahon, 260 U.S. 393, 415 (1922) (citing *Plymouth Coal*, 232 U.S. 531 (holding that the burden to the plaintiffs did not exceed the benefit of requiring the mutual walls)).

60. *Plymouth Coal*, 232 U.S. at 540.

61. *Penn Central*, 438 U.S. 104, 140 (1978) (Rehnquist, J., dissenting).

62. *Id.* at 148–49 ("The benefits that appellees believe will flow from preservation of the Grand Central Terminal will accrue to all the citizens of New York City. . . . [A]ppellees would impose the entire cost of several million dollars per year on Penn Central. But it is precisely this sort of discrimination that the Fifth Amendment prohibits.").

63. *Id.* at 138 (emphasis added). Given that Penn Central ceased to exist as a railroad in 1976 and was being operated as Conrail under federal bankruptcy

The majority found that "the preservation of landmarks benefits all New York citizens and all structures, both economically and by improving the quality of life in the city as a whole" and, as a consequence, the Landmarks Law benefited the Terminal's owners.[64] The focus on broad benefits to the general public allows subjective results, perhaps influenced by politics.[65]

VIII. In *Florida Rock*, the Federal Circuit Directed the Claims Court to Evaluate Direct Compensating Benefits

Reciprocity surfaced as an important element in the *Florida Rock* line of cases, specifically *Florida Rock* IV, in which the Federal Circuit Court emphasized the narrow alignment of benefits and burdens,[66] and *Florida Rock* V, in which the Court of Federal Claims analyzed reciprocal benefits and the plaintiff's burden.[67] In *Florida Rock* IV, the Federal Circuit remanded the case to the Federal Claims Court to deal with reciprocity in the original sense, i.e., to evaluate whether direct compensatory benefits to the property offset the requirement to compensate the property owner:

> In addition, then, to a demonstration of loss of economic use to the property owner as a result of the regulatory imposition . . . the trial court must consider: are there *direct compensating benefits* accruing to the property, and others similarly situated, flowing from the regulatory environment? Or are benefits, if any, general and widely shared through the community and the society, while the costs are focused on a few?[68]

protection at the time of the 1978 decision, I wonder what funds the Court imagined might be used for these further enhancements. Ironically, Grand Central Terminal was eventually restored at public expense. This factual outcome speaks more about the lack of economic insight in the *Penn Central* decision than thousands of words since in erudite journals.

64. *Id.* at 134–35.

65. Political considerations are beyond the author's expertise, but seemingly present in the original *Penn Central* decision. For more on the politics, see Gideon Kanner, *Making Laws and Sausages*: A *Quarter Century Retrospective on Penn Central Transportation Co. v. City of New York*, 13 WM. & MARY BILL RTS. J. 653 (2005).

66. Florida Rock Indus., Inc. v. United States (*Florida Rock* IV), 18 F.3d 1560 (Fed. Cir.1994).

67. *Florida Rock* V, 45 Fed. Cl. 21 (Fed. Cl. 1999).

68. *Florida Rock* IV, 18 F.3d at 1570–71 (emphasis added).

Upon remand, Judge Loren Smith wrote the watershed *Florida Rock* V decision.[69] In applying the economic impact prong of *Penn Central*, he specifically contrasted "diminution in value" with "reciprocity of advantage" as two separate parts of the economic impact.[70] The decision threads its way through the *Penn Central* language regarding benefits to the community as well as the original formulation of average reciprocity, which dealt exclusively with evaluating the direct offsetting benefits of a regulation required to avoid payment of compensation:

> Here, the surrounding community benefits from the wetland's filtering action, stabilizing effect, and provision of habitat for flora and fauna. Florida Rock benefits from being a member of a community which has the potential for a better environment. But there can be no question that Florida Rock has been singled out to bear a much heavier burden than its neighbors, without reciprocal advantages. . . . The court finds that Florida Rock's disproportionately heavy burden was not offset by any reciprocity of advantage.[71]

IX. Economic Rigor will Improve Considerations of Average Reciprocity of Advantage

Average reciprocity of advantage has been interpreted narrowly, following *Florida Rock* IV's "reciprocity of advantage test" as labeled by the Alaska Supreme Court,[72] and broadly, following Justice Brennan's application of Justice Brandeis' dissent in *Pennsylvania Coal*.[73] Siegel and other government counsel argue for broader consideration of societal

69. *Florida Rock* V, 45 Fed. Cl. 21. This pathbreaking decision applied the *Penn Central* test to a partial taking and corrected the denominator value in the takings fraction to be the owner's equity or investment in the property, not the "value before" as mistakenly advanced in Keystone Bituminous Coal Assn. v. Debenedictis, 480 U.S. 470, 497 (1987).

70. *Florida Rock* V, 45 Fed. Cl. at 36–37.

71. *Id.*

72. *See* R&Y, Inc. v. Mun. of Anchorage, 34 P.3d 289, 299 (Alaska 2001) (internal quotations omitted).

73. *See* Andrus v. Allard, 444 U.S. 51, 67 (1979) ("a burden borne to secure 'the advantage of living and doing business in a civilized community'" (quoting Pa. Coal Co. v. Mahon, 260 U.S. 393, 422 (1922) (Brandeis, J., dissenting))) .

benefits from the regulation at issue as a benefit to the plaintiff to offset the instant loss that prompted the lawsuit.[74]

Economic efficiency grounds dictate consideration of directly offsetting benefits to deny compensation.[75] Case law has set forth concrete, measurable issues, which various courts have evaluated with greater or lesser understanding. Unlike the extensive literature about the *Penn Central* test, a paucity of legal scholarship exists on the topic.[76]

In 2005, I testified in the *Palazzolo* remand trial.[77] My testimony reported that Palazzolo's single buildable lot in Westerly, Rhode Island, received direct compensating values when a change in the regulations denied development of his surrounding seventeen acres of wetlands. The resulting amenity value to his buildable property was $119,000, which was sharply less than the claimed loss of $3,150,000.[78] The opposing economist opined about the social values to surrounding properties of preserving the salt marsh and maintaining lower density, but provided no numerical values.[79] The benefits of preserving the salt marsh, if it had been shown to be substantial in terms of public-policy value to society, would have been an economic reason to compensate Palazzolo and defray his cost of providing the social benefits to residents of Westerly.

Apparently with an eye toward the vagaries of the range of understanding and estimation of the reciprocal benefits, Siegel eschews any

74. Andrew W. Schwartz, *Reciprocity of Advantage: The Antidote to the Antidemocratic Trend in Regulatory Takings*, 22 UCLA J. ENVTL. L. & POL'Y 1, 64 (2004) (espousing a theory of takings jurisprudence based on his view of reciprocity of advantage: "Takings should accordingly be limited to those narrow cases where the claimant proves a categorical taking and the complete absence of reciprocity, not just from the regulation in question, but from the whole system of applicable economic regulations, of which the particular regulation is just a part.").

75. Wade, *supra* note 32, at 352.

76. For the best from the limited scholarship, see Lynda J. Oswald, *The Role of the "Harm/Benefit" and "Average Reciprocity of Advantage" Rules in a Comprehensive Takings Analysis*, 50 VAND. L. REV. 1449, 1489 (1997).

77. Palazzolo v. State, No. WM 88-0297, 2005 WL 1645974 (R.I. Super. Ct. July 05, 2005).

78. Wade, *supra* note 32, at 357. The lower court found that the remaining "economically beneficial" use of the Palazzolo property was one residential lot. This lot was surrounded by approximately seventeen acres of protected open space, which the state's appraiser valued at $7,000 per acre for their scenic contribution to the residential lot.

79. *Id.* at 361.

attempt to identify the exact offsetting benefits at issue and concludes that because they are "difficult to measure, therefore [they should be] accounted for by the major diminution in value requirement."[80] This vague standard would allow defendant counsel and the judiciary to opine to suit themselves about "how *huge* is *huge* enough."[81]

Infusing economic rigor into measurement of "average reciprocity of advantage" would reduce part of the vexation surrounding the P*enn* C*entral* test.[82] Under takings case law, an economist can interpret reciprocity to discover if positive externalities of the regulation benefit the owner's remaining uses of the property sufficiently to offset instant losses. Following the Federal Circuit's reciprocity of advantage test, an economist would evaluate whether "direct compensating benefits accruing to the property, and others similarly situated, flow from the regulatory environment," or whether the "benefits [are] general and widely shared through the community . . . while the costs are focused on a few."[83]

Economists have been involved in measuring benefits and costs of government policies for decades. Economic support clearly exists to bolster government counsel's presentation of direct offsetting benefits to mitigate or overcome plaintiff's demand for compensation. Economic methods to estimate these offsetting benefits are not only available, but contradict Siegel's belief that these estimates are "generally very difficult . . . [and] therefore best captured by simply requiring the plaintiff to establish a large economic impact."[84] This economically flawed value judgment would further confound regulatory takings' already confused understanding of its economic underpinnings.

80. Siegel, *supra* note 2, at 385.

81. S*ee* Pa. Coal Co. v. Mahon, 260 U.S. 393, 415 (1922) (discussing a variant of this phrase: "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." (emphasis added)).

82. S*ee* Lingle v. Chevron U.S.A., Inc., 544 U.S. 528, 539 (2005) ("The P*enn* C*entral* factors—though each has given rise to *vexing* subsidiary questions—have served as the principal guidelines for resolving regulatory takings claims that do not fall within the physical takings or L*ucas* rules." (emphasis added)).

83. F*lorida* R*ock* IV, 18 F.3d 1560, 1571 (1994) (emphasis added).

84. Siegel, *supra* note 2, at 382.

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