

## **It Comes Down to the Investor's Expectations**

By John D. Echeverria

The following short piece was published in the March 26, 2001 Legal Times in response to a piece by Eric Grant, co-counsel for Palazzolo in the pending Supreme Court case. Grant argued against the so-called "notice rule." This piece by John Echeverria argues in favor of the notice rule.

Eric Grant's March 12 criticism of the "notice rule" at issue in the Supreme Court's case of Palazzolo v. Rhode Island represents a straw man argument. He contends that state legislative restrictions in place when an investor purchases property do not represent "background principles" of state law that automatically bar a taking claim. Even if he is correct, so what? The real question raised by Palazzolo (assuming the Court reaches the notice issue) is different: whether an investor's advance notice of regulatory restriction generally means that he lacks sufficient "investment backed expectations" to support a taking claim?

The concept of "background principles," introduced by Justice Antonin Scalia in his opinion in Lucas v. South Carolina Coastal Council, offers a relatively narrow defense to takings claims. Restrictions supported by common law nuisance or property rules, the core of the background principles idea, are sometimes decisive in takings cases. But background principles do not define the limit of our elected representatives' authority to enact laws addressing new social problems without triggering the need for payment under the Takings Clause.

That the case will ultimately turn on investment expectations, rather than background principles, is strongly suggested by Justice Anthony Kennedy's concurring opinion in Lucas. Kennedy has been the decisive voice in the Court's recent takings cases and his views are likely to be influential in this case as well. In Lucas, Kennedy rejected the idea that background principles are the sole or even the primary measure of a regulation's legitimacy under the Takings Clause. Instead, he said, "Property is bought and sold, investments are made, subject to the State's power to regulate. Where a taking is alleged from regulations which deprive the property of all value, the test must be whether the deprivation is contrary to reasonable, investment backed expectations."

Focusing on an investor's actual expectations makes good sense. If an investor knows about restrictions already in place when he purchases property, he cannot reasonably assert that the restrictions result in an unfair taking. Also, the taxpayer should not serve as a guarantor for an investor who purchases property in the hope he can clear the regulatory hurdles, but whose speculation does not pay off. In Lucas, the successful claimant bought property for \$1,000,000 only to see it rendered valueless a few years later by a new coastal law. As Justice Anthony Kennedy recognized, the case would have been different if the law had already been in place and Lucas made, say, a \$100,000 investment in the hope that he might (or might not) be permitted to develop the property.

The focus on actual expectations also is necessary to avoid gaming of the regulatory system. If investment expectations could be disregarded, owners of environmentally sensitive lands could manufacture takings claims by selling off the restricted portions of their properties to a new class of investors with no purpose other than mining the public fisc. In the case of government-authorized physical occupations, which result in compensable takings regardless of their economic impact, the owner lacks the same ability or incentive to reconfigure her property interests in order to manufacture a taking claim. For this reason, contrary to Eric Grant's view, the Court's decision in Nollan v. California Coastal Commission, which involved a physical occupation claim, is irrelevant to the resolution of the regulatory taking claim in Palazzolo.

That investment expectations should generally be decisive in takings analysis does not mean that the rule has to be categorical. For example, should the notice rule necessarily apply when a farmer passes on the family farm to succeeding generations? Perhaps not. The potential need for exceptions in this and possibly other circumstances does not undermine the basic conclusion that an investor's lack of investment backed expectations should bar takings recovery in Palazzolo and the general run of other cases.