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**CLOSING THE LAST *LUCAS* LOOPHOLE:
THE PARTIAL INTEREST PROBLEM**

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CLOSING THE LAST *LUCAS* LOOPHOLE: THE PARTIAL INTEREST PROBLEM¹

As we approach the twentieth anniversary of the Supreme Court’s landmark decision in *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992), one outstanding question that deserves closer consideration and clear resolution is whether there can be a categorical taking of a partial interest in real property. Although the context of *Lucas* was the regulation of the use of land owned in fee simple, the decision left open the question of whether the categorical or per se rule announced in that case might be applied to a regulatory action that impacts the already diminished expectations and limited potential uses associated with a partial interest in land.

The need for clarification from the courts on this particular aspect of *Lucas* becomes readily apparent in the context of mineral interests. Although mineral interests come in a variety of forms—from a fee interest in the mineral estate to a non-participating royalty interest—such interests are generally regarded under applicable state law as constitutionally protected property interests even when they lack many of the hallmark characteristics of protected property. As the fee estate becomes increasingly segmented, is every person holding a stick out of the original bundle of rights associated with the full fee estate entitled to benefit of the *Lucas* per se rule when a regulatory action severely restricts or precludes the development of the minerals? Or should all takings claims involving a partial interest be analyzed under the ad hoc *Penn Central* test?²

To logical result, based on a survey of the Supreme Court’s decisions on takings, is that when the owner of a fee simple estate in land severs that estate into segments answer hinges in part on understanding the nature of mineral rights, including the background principles of state law that limit the exercise of those rights. The history and nature of regulations that have long governed the exercise of mineral rights is equally important to the assessment of the reasonable investment-backed expectations of parties who own a mineral estate or lesser mineral interest that has been severed from the fee or the surface estate. If takings claims involving mineral interests are analyzed under *Penn Central*, such expectations are an important and potentially dispositive factor. Although that is the more logical approach to such claims, some courts have (and others no doubt will in the future) decide that when a regulation deprives a mineral right owner of all access to and use of the minerals, such claims must be analyzed under the categorical rule of *Lucas*. In this setting, the context of the *Lucas* decision, including the role that a property owner’s “reasonable investment-backed expectations” play in the analysis of all regulatory takings, including those “relatively rare” cases that fall squarely within the confines of

¹This paper incorporates and expands upon the paper presented at the 11th Annual Regulatory Takings Conference titled “Expectations: The Final *Lucas* Frontier.” As of this juncture, the paper continues to be a work-in-progress.

²*Penn Central Transp. Co. v. City of New York*, 438 U.S. 104 (1978).

the *Lucas* categorical rule.³

I. Compensable Property Interests: The Full Bundle vs. A Few Sticks

The genesis of all Fifth Amendment takings litigation is the Takings Clause of the Fifth Amendment, which proscribes the taking of private property for public use without just compensation.⁴ “Property,” in the constitutional sense is frequently described conceptually as a “bundle of sticks” with each stick in the bundle representing a different right that is inherent in the ownership of the physical thing that we typically think of as property, such as a parcel of land. *See United States v. General Motors Corp.*, 323 U.S. 373, 377-78 (1945) (describing the term “property” as referring to “the group of rights inhering in the citizen’s relation to the physical thing, as the right to possess, use and dispose of it.”). Those rights include the right of possession, the right to use the property, the right to dispose of or transfer the property, and the right to exclude others from the property. Although every stick in the bundle is potentially important in assessing a takings claim, the right to exclude others, including the government, is frequently described as the most “fundamental” and “treasured” of all property rights. *See Lingle v. Chevron U.S.A., Inc.*, 544 U.S. 528, 539 (2005) (describing an owner’s “right to exclude others from entering and using her property [as] perhaps the most fundamental of all property interests.”); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435 (1982) (describing the right to exclude others as “one of the most treasured strands in an owner’s bundle of property rights.”); *Kaiser Aetna v. United States*, 444 U.S. 164, 176 (1979) (the right to exclude others from the property is “one of the most essential sticks in the bundle of rights that are commonly characterized as property”).

There is no question that a fee simple absolute ownership interest in real estate is a compensable property interest for purposes of the Fifth Amendment. A fee simple interest has long been recognized as “an estate with a rich tradition of protection at common law[.]” *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1016 n.7 (1992). As explained by one court, “[t]he characteristics of a fee simple estate include: (1) it is a present estate in land that is of indefinite duration; (2) it is freely alienable by deed inter vivos, by will post-mortem and involuntarily by execution or judicial sale; (3) it carries with it the right of possession; [and,] (4) the holder may make use of any portion of the freehold without being beholden to any person except to the extent that the sovereign has not limited such right of use.” *Cienega Gardens v.*

³Justice Scalia acknowledged in his majority opinion in *Lucas* that situations in which a regulatory action by the government deprives a landowner of all economically beneficial uses of that property are “relatively rare situations[.]” 505 U.S. at 1017. The Court’s subsequent decisions confirm this, noting that “the categorical rule in *Lucas* was carved out for the ‘extraordinary case’ in which a regulation permanently deprives property of all value[.]” *Tahoe-Sierra Preservation Council v. Tahoe Reg. Planning Agency*, 535 U.S. 302, 332 (2002).

⁴“[N]or shall private property be taken for public use, without just compensation.” U.S. Const. amend V.

United States, 331 F.3d 1319, 1328 n.18 (Fed. Cir. 2003) (citing 2 George Lefcoe & David A. Thomas, THOMPSON ON REAL PROPERTY § 17.02 (David A. Thomas ed., 2d ed. 2000)). A fee simple interest also includes “the right to sole and exclusive possession—the right to exclude strangers, or for that matter friends, but especially the Government.” *Cienega Gardens*, 331 F.3d at 1336 n.30 (quoting *Mitchell Arms, Inc. v. United States*, 7 F.3d 212, 215 (Fed. Cir.1993)). In takings parlance, the owner of a fee simple estate in land may be said to hold a full bundle of sticks or rights.

When a regulatory takings claim involves the ownership of a fee simple estate in land, it is well established that the owner cannot break that fee estate into segments in order to establish a taking of the regulated segment. *E.g.*, *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104, 130-31 (1978) (“Takings’ jurisprudence does not divide a single parcel into discrete segments and attempt to determine whether rights in a particular segment have been entirely abrogated”); *Andrus v. Allard*, 444 U.S. 51, 65-66 (1979) (“At least where an owner possesses a full ‘bundle’ of property rights, the destruction of one ‘strand’ of the bundle is not a taking, because the aggregate must be viewed in its entirety”); *Keystone Bituminous Coal Ass’n v. DeBenedictis*, 480 U.S. 470, 500 (1987) (rejecting plaintiff’s attempt to define the relevant parcel as only its “support estate” even though that segment was recognized as a legally distinct property interest under state law); *Tahoe-Sierra Preservation Council v. Tahoe Reg. Planning Agency*, 535 U.S. 302, 331 (2002) (“Of course, defining the property interest taken in terms of the very regulation being challenged is circular. With property so divided, every delay would become a total ban; the moratorium and the normal permit process alike would constitute categorical takings.”). But what rule applies when the segmentation of the fee is not a conceptual segmentation created on paper by lawyers for the purposes of litigation, but is the legal segmentation of the fee under applicable state law that occurs in the normal course of land ownership and development (and speculation) prior to the regulation giving rise to a takings claim?

Such segmentation is common in the area of mineral interests. Indeed, many states allow a fee simple absolute interest to be severed into fee simple ownership of the surface and fee simple ownership of the mineral estate. Other mineral interests include a mineral servitude, an exclusive right to develop minerals under a long-term lease, or a royalty interest. Although the bundle of rights associated with such interests is only a subset of the rights associated with ownership of a fee simple interest in land, mineral interests are widely regarded as protected property. A good example is a non-participating royalty interest, which is simply the right to receive a portion of the proceeds from mineral development, if and when such development occurs. Under Tennessee state law, for example, a non-participating royalty interest (“NPR”) is treated as a protected or compensable property right even though the owner of the NPR does not participate in the other incidents of mineral estate ownership. The owner of the NPR has no right to execute a lease for exploitation, no personal right to develop or to explore and, if a lease exists, no right to share in the payment of delay rental or bonus money paid to the owner of the fee.” *J.M. Huber Corp. v. Square Enterprises, Inc.*, 645 S.W.2d 410, 412 (Tn. Ct. Appeals 1982) (internal citations omitted). Thus, “although the NPR constitutes an interest in the underlying

mineral estate, the executive owner [i.e., the fee owner] controls the disposition of that interest” pursuant to fiduciary duties established under state law that govern the relationship between these owners of two legally distinct parts of the mineral estate. *Id.* at 416.

When the bundle of rights associated with a fee simple interest in land have been broken up and distributed to multiple owners of various segments of the original fee, the voluntary relinquishment of certain rights by the seller of the partial interest (presumably at fair market value), and the diminished expectations of the purchaser of the partial interest (again, with the seller presumably compensated at market rates for the partial realization of the expectations associated with the original fee interest), ought to be part of the regulatory takings analysis. Applying the *Penn Central* test to claims involving partial interests would ensure that all of these factors are taken into consideration. Applying the *Penn Central* test to regulatory takings claims involving partial interests is also a logical extension of the “parcel as a whole” rule set forth in *Penn Central* and reaffirmed in *Tahoe*. Indeed, it makes little sense to preclude the owner of the fee from segmenting that fee in order to establish a taking of any one regulated segment, but to allow that owner to sell off partial interests and then allow the purchaser of those partial interest to claim a categorical regulatory taking of such interest because that is all she acquired.

Although the logic of applying *Penn Central* to regulatory takings claims involving partial interests would seem self-evident (at least to those of us defending such claims), property owners and their attorneys have not bought into this application of *Penn Central* and the question remains an open one with the courts.

II. The Context of *Lucas* – A Full Bundle

The question of whether takings claims involving partial interests would be subject to the categorical rule announced in *Lucas* or subject to the *Penn Central* test was flagged, but left unresolved, in the *Lucas* decision. Justice Stevens criticized the majority’s categorical rule in his dissenting opinion, predicting that the rule would “prove unsound in practice” due to “the elastic nature of property rights[.]” *Lucas*, 505 U.S. at 1065 (Stevens, J., dissenting). Justice Stevens explained that the categorical rule, as applied,

will likely have one of two effects: Either the courts will alter the definition of the “denominator” in the takings “fraction,” rendering the Court’s categorical rule meaningless, or investors will manipulate the relevant property interests, giving the Court’s rule sweeping effect. To my mind, neither of these results is desirable or appropriate, and both are distortions of our takings jurisprudence.

Id., 505 U.S. at 1066. Justice Stevens commented further that the “unfortunate possibility” that the categorical rule would be manipulated and applied to smaller estates, where it was more likely that a regulatory change could effect a total or categorical taking, was “created by the

Court's subtle revision of the 'total regulatory takings' dicta." *Id.* at 1066 n.4. Specifically, Judge Stevens explained,

In past decisions, we have stated that a regulation effects a taking if it "denies an owner economically viable use of his *land*," *Agins v. City of Tiburon*, 447 U.S. 255, 260 . . . (1980) (emphasis added), indicating that this "total takings" test did not apply to other estates. Today, however, the Court suggests that a regulation may effect a total taking of any real property interest.

Id. The offending language in the Court's opinion referenced by Justice Stevens in his dissent appears in footnote 7 of the opinion, in which the Court acknowledged, with regret, that "the rhetorical force of our 'deprivation of all economically feasible use' rule is greater than its precision, since the rule does not make clear the 'property interest' against which the loss of value is to be measured." *Id.*, 505 U.S. at 1016, n.7. Although the Court acknowledged this "difficulty," it deemed it unnecessary to address the question further since the "interest in land" at issue in *Lucas* was a fee simple interest or estate. *Id.* In other words, *Lucas* possessed a full bundle at the time of the regulatory action in question.

The Supreme Court has not been presented with the opportunity to squarely address the "partial interest" question since *Lucas*. However, it offered some insight into how it might rule on that question in its 2002 decision in *Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency*, in which the Court ruled that a parcel of land (owned in fee simple, as in *Lucas*) cannot be segmented into partial interests (physical, temporal or functional) in order to assess whether a regulatory action has effected a compensable taking. 535 U.S. 302 (2002). In that context, the Court explained that the categorical rule from *Lucas* applies when a regulation causes a "permanent 'obliteration of the value' of a *fee simple estate*[" 535 U.S. at 330-31 (emphasis added).

Recognizing that the "partial interest" problem was not present in *Lucas* or in *Tahoe*, those cases still provide grounds for a ruling that regulatory takings claims involving partial interests should be analyzed under *Penn Central* to allow for consideration of all relevant factors and thereby diminish the possibility that the Supreme Court's takings jurisprudence will be manipulated or distorted to achieve a desired result in the manner described by Justice Stevens in his *Lucas* dissent.

III. Clarifying Lucas Provides An Alternative Path for Defending Regulatory Takings Claims Involving Partial Interests

Until the application of *Penn Central* to partial interest takings claims becomes established law, the litigators among us should also continue to advance an alternative argument under *Lucas* based on the argument that the *Lucas* decision did not eliminate reasonable investment-backed expectations from the test to be applied in cases in which the regulatory action results in a total loss of value.

There is a lingering misconception that in the realm of categorical regulatory takings – sometimes referred to as “total takings” or “per se regulatory takings” – that the property owner’s expectations are irrelevant. This misconception was ignited by the majority opinion in *Lucas*, which included no express discussion of David Lucas’ investment-backed expectations, and is fueled by subsequent judicial opinions that describe categorical regulatory takings in stark terms that include no reference to expectations. For example, in *Palazzolo v. Rhode Island*, the Court noted that “we have observed, with certain qualifications, . . . that a regulation which ‘denies all economically beneficial or productive use of land’ will require compensation under the Takings Clause.” 533 U.S. 606, 617 (2001) (citing *Lucas*, 505 U.S. at 1015). The “certain qualifications” referenced by the *Palazzolo* court were not the property owner’s expectations, but those “background principles” of state law that may restrict the use of property but do not result in a taking because those limitations are said to inhere in the property owner’s title. *Palazzolo*, 533 US. at 629. A year later, the Supreme Court repeated this articulation of its categorical rule in the *Tahoe* case, stating that “compensation is required when a regulation deprives an owner of ‘all economically beneficial uses’ of his land.” *Tahoe*, 535 U.S. 302, 330. More recently, in *Lingle v. Chevron U.S.A. Inc.*, the Supreme Court again noted that one of the two situations “that generally will be deemed *per se* takings for Fifth Amendment purposes” occurs when a regulation or regulatory action “completely deprive an owner of ‘all economically benefit us[e]’ of her property.” 544 U.S. 528, 538 (2005).

Trial courts and lower appellate courts have, for the most part, adopted or simply repeated (often in *dicta*) the Supreme Court’s articulation of the categorical rule from *Lucas*, with no reference to the role that reasonable investment-backed expectations play. See, e.g., *Casitas Mun. Water Dist. v. United States*, 543 F.3d 1276, 1289 (Fed. Cir. 2008) (“[R]egulatory action can qualify as a *per se* taking when the regulation ‘completely deprive[s] an owner of “all economically beneficial use” of her property”). This lack of clarity in the articulation of the categorical rule is then compounded by the fact that nearly every statement of the *Lucas* rule is followed or preceded by a description of the *Penn Central* factors, which always includes reference to reasonable investment-backed expectations as a key factor in *that* analysis (suggesting further that it expectations are not a factor in the categorical context).

Given this backdrop, a property owner’s attorney does not need to be particularly clever, and certainly does not need to go out on a limb, to argue to a court that in a categorical regulatory takings case, the property owner’s expectations (or lack thereof) are irrelevant. Eliminating

expectations from consideration may not matter in cases involving the “permanent ‘obliteration of the value’ of a fee simple estate.” *Tahoe*, 535 U.S. at 330. Indeed, there is little doubt that such an obliteration will always interfere with the investment-backed expectation of someone who owns the full bundle of rights associated with ownership of a fee simple estate.⁵ However, in a regulatory takings case involving a partial interest, the determination of whether expectations are part of the analysis can change the outcome of the case.

A. Expectations Were a Factor in *Lucas*

In future cases, any lingering confusion over the proper role of expectations in analyzing a regulatory takings claims should be addressed by returning to the *Lucas* decision and emphasizing that expectations were a factor in the outcome of that decision, and were not clearly eliminated from the analysis by the categorical rule announced and applied in that case.

In *Lucas*, the plaintiff bought two residential lots on the Isle of Palms, a South Carolina barrier island near Charleston. *Lucas*, 505 U.S. at 1007-08. At the time of acquisition, the lots were not subject to any coastal zone building permit requirements and David Lucas intended to do exactly what the owners of the immediately adjacent lots had done: erect single-family homes on the beach-front lots. *Id.* at 1007-09. The State of South Carolina subsequently enacted a Beachfront Management Act that barred Lucas from erecting any permanent inhabitable structures on his lots. This regulatory restriction was determined to have rendered the lots “valueless.” *Id.* Lucas brought suit alleging a taking of the lots. The state trial court ruled in his favor and awarded him \$1,232,387.50 in just compensation. *Id.* at 1009. Following a reversal by the South Carolina Supreme Court (based on the finding that the Beachfront Management Act was intended to protect a threatened public resource and therefore could not result in a taking), Lucas’s petition for a writ of certiorari was granted by the United States Supreme Court, 502 U.S. 966 (1991). The subsequent decision of the Court set forth a categorical rule applicable to regulatory takings: “when the owner of real property has been called upon to sacrifice *all* economically beneficial uses in the name of the common good, that is, to leave his property

⁵In cases involving fee simple ownership of land, the deprivation of all economically viable use as a result of regulatory restrictions is viewed by the courts as not unlike a physical occupation by the government. In both cases, the government action is viewed as interfering with one of the core sticks in the bundle of rights associated with the fee simple ownership of land: the regulatory restrictions interfere with the owner’s right to make some use of his property and the physical occupation interferes with the owner’s right to exclusive possession. *See Cienega Gardens v. United States*, 331 F.3d 1319, 1328 n.18 (Fed. Cir. 2003) (describing the characteristics of a fee simple estate). In both situations, the government’s destruction of one of the core sticks bundle of rights associated with the ownership of a fee simple estate may result in a taking because the government has interfered with the settled and long-protected expectations associated with the ownership of a fee simple estate.

economically idle, he has suffered a taking.”⁶ 505 U.S. at 1019.

Although the categorical rule articulated in the decision does not make reference to David Lucas’s investment-backed expectations, a look back at the argument and close consideration of the Court’s opinion, concurrence and dissents, reveals that the Justices understood that Lucas had investment-backed expectations and that those expectations were reasonable.

Beginning with the argument before the Supreme Court, the questions posed by the Justices show that there was little doubt that Lucas’ investment-backed expectations were reasonable. The questions directed to the Coastal Council’s attorney included the following:

QUESTION: When they [the owners of other nearby lots of land] built, there was nobody else who had houses. I would think [Lucas’s] case is even better. He laid out a million dollars, looking at these houses all up and down the street, and you don't think he had any expectation that he could build a house?

* * *

QUESTION: There is no doubt that there was an investment expectation here. Are you saying that it was unreasonable as a matter of law?

See http://www.oyez.org/cases/1990-1999/1991/1991_91_453/argument/ (last visited September 29, 2008).⁷

The majority opinion reveals a similar understanding. In the third paragraph of the opinion, Justice Scalia noted that “at the time Lucas acquired these parcels, he was not legally obligated to obtain a permit from the Council in advance of any development activity. His intention with respect to the lots was to do what the owners of the immediately adjacent parcels had already done: erect single-family residences.” 505 U.S. at 1008. The majority opinion also cites to the trial court’s finding that “at the time Lucas purchased the two lots, both were zoned for single-family residential construction and . . . there were no restrictions imposed upon such

⁶Although not relevant to this paper, the Court’s articulation and application of this categorical rule did not result in a straight reversal. Instead, the Court reversed and remanded to the state court for a determination of whether the uses proscribed by the state’s Beachfront Management Act were part of the uses otherwise prohibited by background principles of nuisance and state property law, in which case the restrictions would not constitute a taking. 505 U.S. at 1031-32.

⁷The Justices posing these questions are not identified in the written transcript of the oral argument and this writer’s voice-recognition skills are admittedly not refined enough to identify the Justices (with the exception of Justice O’Connor) by voice.

use of the property by either the State of South Carolina, the County of Charleston, or the Town of the Isle of Palms.” *Id.* at 1009. Although Justice Scalia did not use the phrase “reasonable investment-backed expectations” in connection with his recitation of the undisputed facts or his description of the trial court’s findings, the facts referenced are those that were relevant to the assessment of whether David Lucas’s investment-backed expectations were reasonable.

The absence of any explicit discussion of expectations in the majority opinion led Justice Kennedy to file a concurring opinion in which he expressly stated his view that investment-backed expectations must be considered in evaluating a categorical taking claim. *Id.* at 1034 (Kennedy, J., concurring) (“The finding of no value must be considered under the Takings Clause by reference to the owner’s reasonable, investment-backed expectations”) (“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”). *See also Tahoe*, 535 U.S. at 330 n.24 (noting that Justice Kennedy concurred in the *Lucas* judgment “on the basis of the regulation’s impact on ‘reasonable, investment-backed expectations’”). Although expectations were not the focus of either of the dissenting opinions, references there also make it perfectly clear that there was no dispute among the Justices that David Lucas possessed reasonable investment-backed expectations. *See Lucas*, 505 U.S. at 1075 (Steven, J., dissenting) (“Admittedly, the economic impact of this regulation is dramatic *and petitioner’s investment-backed expectations are substantial.*” (emphasis added)).

Finally, in addition to what appears to be an across-the-board understanding that David Lucas had reasonable investment-backed expectations that were interfered with by the State’s regulations, the majority’s articulation of its categorical rule expressly excludes from consideration only the “character of the government action” prong of the *Penn Central* analysis. For example, the Court states that it has “described at least two discrete categories of regulatory action as compensable *without case-specific inquiry into the public interest advanced in support of the restraint.*” 505 U.S. at 1015 (emphasis added). *See also* 505 U.S. at 1018 (noting that the “functional basis” for the government’s regulatory action need not be considered when that regulatory action deprives the landowner of all economically beneficial uses). This express exclusion of the “character of the government action” factor from the analysis stands in contrast to the Court’s handling of the expectations factors, further supporting the position that expectations were a factor in *Lucas* and are (or should be) a factor in all regulatory takings claims.

B. The First Set of Post-*Lucas* Decisions Indicate That The Courts Understood That Expectations Were Relevant in All Regulatory Takings Cases, Including Those Presenting “*Lucas*” Claims

The first case after *Lucas* to present the Federal Circuit with the question of whether expectations remain part of the regulatory takings analysis where there has been a “complete prohibition” of use was *Loveladies Harbor, Inc. v. United States*, 28 F.3d 1171 (Fed. Cir. 1994). The property at issue in *Loveladies* was a 12.5 acre parcel of land on Long Beach Island, New Jersey, consisting of 11.5 acres of wetlands and 1 acre of filled land. The trial court found that the denial of a federal permit required to develop the property resulted in a diminution of value of greater than 99%, which the court determined to be a deprivation of all “economically feasible use” of the property under *Lucas*. 28 F.3d at 1182. However, the takings analysis did not end at this point. Instead, the Federal Circuit specifically noted that it was “not disputed” that the *Loveladies* landowner had “reasonable expectations” for development when it purchased the subject property. *Id.* at 1179. The Federal Circuit also signaled its understanding of the relevance of investment-backed expectations in *Lucas* when it noted that “[t]here was no question that Lucas had reasonable investment-backed expectations for his property.” 28 F.3d at 1178. Accordingly, both “economic impact” and the landowner’s “reasonable expectations” were part of the analysis to determine whether a regulatory taking had occurred in the first instance. The Federal Circuit’s approach is fully consistent with the plain language of the majority opinion in *Lucas*, which explicitly excluded only the “character of the government action” factor from consideration in its assessment of a categorical regulatory takings claim.

In light of the clear statements in *Loveladies* regarding the relevance of reasonable investment-backed expectations in every case, it is understandable why the Federal Circuit adhered to the course set by *Loveladies* in the next case before it to raise this same issue: *Good v. United States*.

In *Good*, the plaintiff purchased a 40-acre parcel of property on Lower Sugarloaf Key, approximately 15 miles northwest of Key West, Florida, in 1973. *Good v. United States*, 39 Fed. Cl. 81, 85 (1997). The 40-acre parcel, known as “Sugarloaf Shores,” consisted of 26 acres of both salt and freshwater wetlands separated by 8 acres of uplands. *Id.* The permitting history of this property, which is long and complex, eventually culminated in a 1994 decision by the U.S. Army Corps of Engineers (“Corps”) denying Good’s application for a permit to dredge and fill approximately 10 acres of wetlands due to a determination by the U.S. Fish and Wildlife Service that the proposed project would jeopardize the continued existence of an endangered silver rice rat that inhabited the property and would also impact the endangered Lower Keys marsh rabbit. *Id.*, 39 Fed. Cl. at 86-93.

Four months after the Corps denied his permit application, Good filed suit alleging that this regulatory action had deprived him of all economically viable use of his property and thus constituted a categorical or per se regulatory taking under *Lucas*. 39 Fed. Cl. at 84, 98-99. In the alternative, Good argued that a regulatory taking had occurred under the multi-factor test set forth

in *Penn Central*. *Id.* at 84, 108-09. The trial court rejected Good’s categorical claim, finding that the federal regulation of the property did not require the subject property to be left in its natural state and did not deprive the property of all economic value. *Id.* at 100-101. The trial court proceeded to address Good’s alternative theory under *Penn Central*, and in that context addressed Good’s investment-backed expectations. *Id.* at 108-113. The trial court rejected this alternative theory as well, finding that Good did not have a reasonable investment-backed expectation of securing all approvals needed to develop his ecologically sensitive property. *Id.* at 114.

Good appealed to the United States Court of Appeals for the Federal Circuit, which affirmed the trial court’s grant of summary judgment in favor of the government after concluding that Good’s lack of reasonable investment-backed expectations was dispositive as to both Good’s *Lucas* claim and his *Penn Central* claim. *Good v. United States*, 189 F.3d 1355, 1360 (Fed. Cir. 1999). In so holding, the court of appeals expressly acknowledged that Good was arguing that “the Supreme Court has eliminated the requirement for reasonable, investment-backed expectations, at least in cases where the challenged regulation eliminates virtually all of the economic value of the landowner’s property” in *Lucas*. *Id.*, 189 F.3d at 1361. Good further argued that *Loveladies Harbor* “should be reversed as contrary to *Lucas*.” *Id.* The court of appeals rejected both the premise of Good’s argument and the invitation to reverse *Loveladies Harbor*, stating “[w]e agree with the *Loveladies Harbor* court that the Supreme Court in *Lucas* did not mean to eliminate the requirement for [reasonable investment-backed expectations] to establish a taking.” *Id.* Instead, the court explained, “[a] *Lucas*-type taking . . . is categorical only in the sense that the courts do not balance the importance of the public interest advanced by the regulation against the regulation’s imposition on private property rights.” *Id.* (citing *Loveladies Harbor*, 28 F. 3d at 1179).

Good sought further review with a petition for a writ of certiorari that presented the following question:

Whether the Federal Circuit erred in holding—contrary to *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992), and in conflict with the decisions of many other federal courts of appeals and state appellate courts—that a government regulation depriving a property owner of all economically viable use of his land does not result in a *per se* or categorical taking under *Lucas* unless the property owner can also prove “reasonable, investment-backed expectations.”

Good v. United States, No. 99-881, Petition for a Writ of Certiorari, 1999 WL 33732720 (U.S. Nov. 24, 1999). The petition was denied on April 3, 2000. 529 U.S. 1053 (2000).

Shortly after the denial of certiorari in *Good* left intact the Federal Circuit’s ruling that “[r]easonable, investment-backed expectations are an element of *every* regulatory takings case,” 189 F.3d at 1361 (emphasis added), the Federal Circuit’s interpretation of *Lucas* was confirmed

by the same court that decided the *Lucas* case prior to its appeal to the U.S. Supreme Court. The case of *McQueen v. South Carolina Coastal Council*, 530 S.E.2d 628 (S.C. 2000), which presented facts very similar to *Lucas*, involved two unimproved lots located on manmade, saltwater canals and created by fill. There was no dispute that the denial of a permit to build bulkheads on these unimproved lots deprived McQueen “of all economically viable use of his property.” 530 S.E.2d at 631. Despite the deprivation of all economically viable use, the court held that in order to recover on his takings claim, McQueen “must establish the regulation interfered with his distinct, investment-backed expectations.” 530 S.E.2d at 633. In so holding, the court explained that,

[w]ithout the requirement of investment-backed expectations, a property owner could obtain a windfall by claiming a taking in the face of new regulations, without any real intent to develop. *This issue was not discussed in Lucas as there was no question David Lucas had distinct investment-backed expectations. See Loveladies Harbor*, 28 F.3d at 1178. Nor was the issue disputed in *Loveladies Harbor. Id.* at 1179.

530 S.E.2d at 633 (emphasis added).⁸

C. The Federal Circuit Muddies the Waters in *Palm Beach Isles*

This then brings us to the case of *Palm Beach Isles Associates v. United States*.

In 1956, the Palm Beach Isles (“PBI”) plaintiffs acquired 311.7 acres in the City of Rivera Beach in Palm Beach County, Florida, for \$380,190. *PBI*, 42 Fed. Cl. 340, 342 (1998). The large strip of land was bordered on the east by the Atlantic Ocean, and on the west by the waters of

⁸The *McQueen* court’s discussion regarding whether David Lucas had reasonable, investment-backed expectations is not affected by the subsequent history of the *McQueen* case. On appeal to the U.S. Supreme Court, the petition for writ of certiorari was granted, the judgment was vacated, and the case was remanded to the South Carolina Supreme Court “for further consideration in light of *Palazzolo v. Rhode Island*, 533 U.S. 606 . . . (2001)”. 533 U.S. 943 (2001). On remand, the state court again found that no compensable taking of McQueen’s lots had occurred, but this time based its conclusion on the determination that background principles of state law – specifically the public trust doctrine as applied to lands bordering navigable waters – already restricted McQueen’s proposed use of his lots, and that “the State need not compensate [McQueen] for the denial of permits to do what he cannot otherwise do.” 580 S.E.2d 116, 120 (S.C. 2003). Citing both *Good* and the Federal Circuit’s subsequent decision in *Palm Beach Isles* (discussed *infra*), the South Carolina court noted the confusion over whether investment-backed expectations are a factor in a “total deprivation case[,]” but did not reach or attempt to resolve this issue. *Id.* at 119 n.5. A subsequent petition for a writ of certiorari was denied. 124 S. Ct. 466 (2003).

Lake Worth, a marine water basin that is part of the Atlantic Intracoastal Waterway. *Id.* Approximately 50 acres of the subject property were submerged lands on the Lake Worth side of the property. *Id.* In 1968, the plaintiffs sold 261 acres of their property for approximately \$1 million. *Id.* at 343. This property sold was the oceanfront portion of the property and consisted of most of the “uplands” or dry land. The 50 acres retained by the plaintiffs consisted of 49.3 acres of lake bottom lands within Lake Worth and 1.4 acres of adjacent shoreline wetlands, a portion of which was above the mean high water mark. *Id.*

In 1989, the plaintiffs applied to the Corps for a permit to dredge and fill their remaining 50 acres for development purposes. That permit was denied in 1990, *id.* at 345-46, and the takings suit followed.

The trial court’s assessment of PBI’s takings claims rested largely on its determination that the “relevant parcel” was the full 311.7 acres. In addition, the trial court found that the 49.3 acres of submerged lands were subject to the federal navigational servitude, which is a background principle of federal law. These determinations took PBI’s claims out of *Lucas* territory and placed them squarely in the realm of *Penn Central*. In the final analysis, the plaintiffs’ 1968 sale of most of its uplands for \$1 million (which the court viewed as a “reasonable return on investment”), the impact of the federal navigational servitude on the submerged lands and the diminished expectations with respect to the remaining 1.4 acres led to a grant of summary judgment in favor of the government.

The Federal Circuit took a different view. The three-judge panel hearing PBI’s appeal first took issue with the trial court’s determination that the relevant parcel consisted of the 311.7 acres originally acquired by PBI in 1956. Citing *Loveladies Harbor, supra*, the panel noted that the Circuit’s “precedent displays a flexible approach” to the relevant parcel determination that is “designed to account for factual nuances.” *PBI v. United States*, 208 F.3d 1374, 1381 (Fed. Cir. March 31, 2000) (quoting *Loveladies Harbor*, 28 F.3d at 1181). The “factual nuances” that the court of appeals found compelling were PBI’s stated intent that it never planned to develop the 311.7-acre parcel as a single unit, the fact that the uplands and wetlands portions of the property were physically separated by a county road, and the fact that PBI’s 1968 sale of the 261 acres of oceanfront uplands located east of the county road occurred prior to the 1972 enactment of the Clean Water Act and the regulatory restrictions imposed thereunder. *Id.* at 1381. The court of appeals concluded that the relevant parcel consisted of the 50.7 acres located west of the county road that PBI had retained in 1968. With the relevant parcel thus defined, the court converted what the trial court had analyzed as a partial taking under *Penn Central* into a categorical taking to be analyzed under *Lucas*. *Id.*

Now, had the *PBI* panel treated *Good*’s holding that investment-backed expectations are a factor in all regulatory takings claims as binding precedent, it would have proceeded to an assessment of PBI’s expectations, and the judgment of the trial court might have been affirmed

on that basis.⁹ However, the PBI panel did not follow this path. Instead, the court cited its earlier decision in *Florida Rock Industries* as explaining “that ‘[i]f a regulation categorically prohibits all economically viable use of the land – destroying its economic value for private ownership – the regulation has an effect equivalent to a permanent physical occupation. There is, without more, a compensable taking.” *PBI*, 208 F.3d at 1379 (quoting *Florida Rock Industries v. United States*, 18 F.3d 1560, 1564-65 (Fed. Cir. 1994)). The *PBI* panel’s only reference to *Good* was in the footnote suggesting that *Good* was not controlling or precedential because it was inconsistent with *Florida Rock*:

Anything in subsequent cases inconsistent with this analysis cannot, of course, change the law (absent a decision en banc), under the doctrine of *South Corp. v. United States*, 690 F.2d 1368 (Fed. Cir. 1982). See, e.g., *Good v. United States*, 189 F.3d 1355, 1361 (Fed. Cir. 1999).

PBI, 208 F.3d at 1379 n.3.

The government petitioned for rehearing and rehearing en banc. Among the issues raised in that petition was “[w]hether, as this Court held in *Good*, ‘reasonable investment-backed expectations are an element of every regulatory takings case,’ 189 F.3d at 1361, without regard to the economic impact of the challenged regulation.”¹⁰ In response to the petition for rehearing, the PBI panel issued a lengthy decision explaining that the Federal Circuit’s prior decisions on this question, including *Loveladies* (relied on by the *Good* panel) and *Florida Rock* (relied on by the *PBI* panel) were non-binding dictum. *PBI v. United States*, 231 F.3d 1354, 1359 (Fed. Cir. Nov. 6, 2000). The *PBI* panel explained that it also viewed the pronouncement in *Good* as non-binding dictum because that case “did not involve a categorical taking.” *Id.* at 1360. The panel concluded that the answer to the question of whether expectations are a factor in all regulatory takings claims required going back to *Lucas*. *Id.* at 1361.

In its review of *Lucas*, the *PBI* panel again concluded that in the relatively few cases in which a land use restriction “den[ies] the owner of the regulated property all economically viable uses of it . . . we have no doubt that both law and sound constitutional policy entitle the owner to just compensation without regard to the nature of the owner’s initial investment-backed expectations.” *Id.* at 1364. Although the panel concluded that expectations are not a factor in determining liability in the categorical context, it did not go so far as to hold that expectations are

⁹Relevant facts may have included PBI’s ability to sell the 261-acre uplands and oceanfront portion of its property and PBI’s retention of the remaining wetlands acreage and submerged lands for several more decades in the face of increasing regulation of wetlands.

¹⁰*Good v. United States*, No. 99-5030, Petition for Rehearing and Petition for Rehearing En Banc of Defendant-Appellee (Fed. Cir. May 26, 2000) (on file with the author and available on Westlaw®).

irrelevant in such a case. To the contrary, the panel acknowledged that “[a] purchaser who pays a substantial price for a parcel can be assumed to have expectations that the parcel can be used for some lawful purpose.” *Id.* at 1364. This seems to suggest that a regulation that denies an owner all economically viable use of land interferes with that owner’s reasonable investment-backed expectations as a matter of law. That interpretation would be consistent with *Lucas*, where it was undisputed that David Lucas possessed reasonable investment-backed expectations with respect to his land. The PBI panel explained further that expectations may continue to play a role in the assessment of the just compensation due for a categorical taking:

This does not mean that use restrictions are irrelevant to the takings calculus, even in a categorical takings case. Once a taking has been found, the use restrictions on the property are one of the factors that are taken into account in determining damages due the owner.

Id. at 1363.

The panel decision denying the government’s petition for rehearing was followed one week later by the court’s denial of the government’s petition for rehearing en banc. *PBI v. United States*, 231 F.3d 1365 (Fed. Cir. Nov. 13, 2000). Circuit Judge Gajarsa, a member of the *Good* panel, dissented from the order denying the request for rehearing en banc. The dissent, which is certainly a must-read for anyone faced with briefing the expectations quandary in a categorical case, interprets *Lucas* as having eliminated the “character of the government action” prong of the *Penn Central* test, but as having “never removed or modified” the investment-backed expectations prong of that test. *Id.*, 231 F.3d at 1368. The dissent contends that the *PBI* panel decision “eliminates a critical element from the categorical takings analysis: the inquiry into investment-backed expectations. This reconstruction of takings jurisprudence contradicts holdings of [the Federal Circuit] and the Supreme Court, and belies the purpose, intent, and necessity of the inquiry into investment-backed expectations in all cases.” 231 F.3d at 1370; *see also id.* at 1367 (“Investment-backed expectations must be considered in all regulatory takings cases, even in those rare situations where the government has deprived a landowner of all economically beneficial use”).

Following the denial of the government’s petition for rehearing en banc, the *PBI* case was remanded to the Court of Federal Claims for further proceedings. 208 F.3d at 1386-87 (panel decision); 231 F.3d 1354, 1364-65 (panel rehearing); 231 F.3d 1365, 1366 (order on petition for rehearing en banc). That remand resulted in a determination that there had been no regulatory taking of the subject property based on factors that did not implicate the question of whether expectations are a factor to be considered under *Lucas*. Specifically, the trial court found that PBI’s 49.3 acres of submerged lands within Lake Worth were subject to the federal navigational servitude and that the Corps’ denial of a permit to dredge and fill those lands had a legitimate navigational purpose. *PBI v. United States*, 58 Fed. Cl. 657, 669, 673-81 (2003). Based on these findings, the court determined that the government’s invocation of the

navigational servitude served as a complete defense to what would otherwise be treated as a categorical taking of PBI's 49.3 acres of submerged lands within Lake Worth. *Id.*, 58 Fed. Cl. at 681. The trial court also rejected PBI's claim with respect to the remaining 1.4 acres, finding that PBI had failed to demonstrate any "economical uses of the 1.4 acre parcel either before or after permit denial, apart from joint development with the 49.3 acres of submerged lands." *Id.* at 683. In assessing the economic impact of the Corps' permit denial on the 1.4 acre parcel, the trial court further found that PBI could not rely on value that was attributable to or dependent upon development of the adjacent 49.3 acres of submerged lands that were subject to the federal navigational servitude. Consequently, the court determined that the lack of economically viable uses of the 1.4 acres resulted from the physical nature and location of the strip of land rather from the Corps' permit denial, and concluded that the permit denial did not result in a compensable regulatory taking. *Id.* at 686-87.

IV. Inconsistency in Appellate Decisions Leads to Confusion in the Lower Courts: The Partial Interest Problem

Practitioners can (and certainly have) come up with many reasons why lower courts should treat *Good* as controlling on the question of whether expectations are a factor in assessing a categorical takings claim under *Lucas*, and many other justifications for arguing that *Palm Beach Isles* represents the Federal Circuit's determination that expectations are never a factor in a categorical regulatory takings case. The bottom line is that the tension between those two decisions still exists and presents a lingering problem for future cases. The problem becomes most apparent in the context of regulatory takings claims involving something less than a fee simple interest in land, often referred to as a "partial interest."

One post-*Good vs. PBI* case that helps to put the partial interest question in perspective is the consolidated cases of *Cane Tennessee, Inc. v. United States* and *Wyatt v. United States*, which were decided by the United States Court of Federal Claims through a series of summary judgment decisions and one post-trial decision. The factual summary that follows is culled (in an admittedly abbreviated form) from the numerous published decisions involving the subject property and the efforts of the owners and their lessees to develop surface coal mining operations on the property.¹¹

¹¹The trial court's decisions in the Cane case include the following: *Cane I*, 44 Fed. Cl. 785 (1999); *Cane II*, 54 Fed. Cl. 100 (2002); *Cane III*, 57 Fed. Cl. 115 (2003); *Cane IV*, 62 Fed. Cl. 481 (2003); *Cane V*, 60 Fed. Cl. 694 (2004) (Wyatt claims); *Cane VI*, 62 Fed. Cl. 703 (2004) (Wyatt claims); *Cane VII*, 63 Fed. Cl. 715 (2005); *Cane VIII*, No. 00-513L, slip op. (Fed. Cl. Oct. 27, 2005), *aff'd per curiam*, 214 Fed. Appx. 978, 2007 WL 188155 (Fed. Cir. 2001). Additional background facts can be found in the decisions involving an earlier set of takings claims involving the same property: *Wyatt v. United States*, 271 F.3d 1090 (Fed. Cir. 2001), *rev'g Eastern Minerals International, Inc. v. United States*, 36 Fed. Cl. 541 (1996).

In 1953, Wilson W. Wyatt, Sr. and his wife Anne purchased a fee simple interest in approximately 10,000 acres of land, consisting of an 8,000 acre “Main Tract” and four nearby tracts of land, each approximately 500 acres in size.¹² The lands were located in eastern Tennessee, in an area with some history of coal mining. The 8,000-acre Main Tract also abutted and shared a watershed with Fall Creek Falls State Park, the “crown jewel” of Tennessee’s State Park System.¹³ The Wyatts acquired the Tennessee property as a long-term investment. Following their purchase, the Wyatts undertook a variety of activities aimed at generating some income from the property including timber sales, the planting of pine seedlings for future harvest and sale, various agricultural and farming endeavors, and the leasing of oil and gas interests in the property. The Wyatts also pursued the development of the coal resources on the property and, between 1953 and 1975, small scale strip mining operations on the property resulted in the removal of approximately 688,610 tons of coal and the payment of approximately \$228,000 in royalties to the Wyatts.

In the late 1970's, the Wyatts found a purchaser who was interested in further developing the coal resources on the property. In 1979, the Wyatts sold their 10,000 acres of land to Cane Company Ltd. (later renamed Cane Tennessee, Inc.) (both referred to herein as “Cane”) for \$5.1 million.¹⁴ Although the Wyatts conveyed fee simple title to the property, they retained a non-participating coal royalty interest that gave them the right to 3.5% of the gross sales price of any coal mined from the property.¹⁵ Contemporaneously with its acquisition of the property from the

¹²All acreage numbers cited herein have been rounded for discussion purposes. The Wyatts’ 1953 acquisition included an additional 9,400 acres of land plus the mineral rights to approximately 8,400 acres of land. The total purchase price for all of these lands and mineral rights was \$87,000.

¹³Fall Creek Falls State Park was first set aside as a park by the National Park Service in 1935, and was transferred to the State of Tennessee in 1944. The park is considered to be “the focal point” of Tennessee’s State Park System, and is home to several spectacular water falls including Falls Creek Falls, which is the highest waterfall east of the Rocky Mountains, and Cane Creek Falls, which is fed by a creek that flows through the property acquired by the Wyatts in 1953.

¹⁴Prior to the 1979 sale to Cane, Wilson W. Wyatt, Sr. and Anne Wyatt has transferred their fee simple interest in approximately 2,500 acres of their property into trusts (the “Wyatt Trusts”) created for their three children. The \$5.1 million sales price was allocated between the Wyatt parents and the trusts based on the acreage conveyed by each, with \$1 million going to the Wyatt Trusts.

¹⁵At the time of the sale to Cane, the retained ownership of the coal royalty interest was divided between the Wyatt parents and the Wyatt Trusts in accordance with the divided ownership interest of the lands. In 1991, the Wyatt parents conveyed their retained the 3.5% coal royalty interest in the subject property directly to their three children in equal, undivided 1/3

Wyatts, Cane leased the property to Eastern Minerals International (“EMI”) for the purposes of developing the coal resources on the property.

In 1977 – two years prior to the Wyatts’ sale of their property to Cane – Congress enacted the Surface Mining Control and Reclamation Act, 30 U.S.C. §§ 1201-1328 (“SMCRA”), which required the issuance of a permit prior to conducting surface coal mining operations. In 1980 and 1981, EMI secured one-year permits from the State of Tennessee authorizing the company to disturb approximately 33-acres of the surface in order to prepare a “box cut” intended to be used to access and extract coal beneath the surface. EMI’s subsequent efforts to obtain further permits, first from the State, and later from the federal Office of Surface Mining were unsuccessful. EMI’s lease expired in 1991 on its own terms, without the development of the large-scale coal mining operation envisioned by the parties in 1979.

In 1995, a group of citizens and local environmental organizations filed a petition under § 522 of SMCRA, 30 U.S.C. § 1272, to designate approximately 85,588 acres of land located within the watershed and viewshed of Fall Creek Falls State Park as unsuitable for surface coal mining operations. On June 17, 2000, the Secretary of the Interior issued his final decision designating certain lands within the petition area, including the 10,900 acres sold by the Wyatts to Cane in 1979, as unsuitable for surface coal mining operations. As a result of the designation, surface coal mining operations are precluded on that property unless and until the designation is lifted or modified.

Both Cane and the Wyatts filed suit alleging that the Secretary’s designation resulted in a categorical taking of their property interests. With respect to Cane’s claim, the trial court rejected Cane’s claim that the relevant parcel to be analyzed should be limited to its mineral interest or mineral estate, and instead held that the relevant parcel was Cane’s fee simple interest in the land, which included both the surface estate and the mineral estate (subject only to the reserved coal royalty interest held by the Wyatts). *Cane II*, 54 Fed. Cl. 100, 105-08 (2002); *Cane III*, 57 Fed. Cl. 115, 121 (2003). As a result of this ruling, Cane’s takings claim was analyzed under *Penn Central*. The court ruled that Cane could not have reasonably expected that its proposed use of the subject property – coal mining – to be free of regulation under SMCRA,

shares. The reported value of that retained royalty interest at the time of the transfer to the trusts was \$0.

The coal royalty interest retained by the Wyatts is a “partial interest” in the land. As explained by the trial court, a non-participating royalty is “an interest in the gross production of oil, gas, and other minerals carved out of the mineral fee estate as a free royalty, which does not carry with it the right to participate in the execution of, the bonus payments for, or the delay rentals to accrue under, oil, gas and mineral leases executed by the owner of the mineral fee estate.” *Cane V*, 60 Fed. Cl. at 699 (quoting *Fed. Land Bank of Houston v. United States*, 168 F. Supp. 788, 789 n.1 (Ct. Cl. 1958)). The trial court further held that a non-participating royalty interest is a protected property right under Tennessee state law. *Cane I*, 44 Fed Cl. at 790-92 (citations to Tennessee case law omitted).

including the provisions of the Act that allowed for the designation of lands as unsuitable for surface coal mining operations. *Cane VII*, 63 Fed. Cl. at 725-30. Following a trial on economic impact, the court found that the fair market value of the subject property was between \$3.9 and \$4.8 million after the regulatory action in question, and concluded that the Secretary's designation "did not constitute a sufficiently 'serious financial loss' to constitute a taking[.]" *Cane VII*, 71 Fed. Cl. at 464 (quoting *Cienega Gardens*, 331 F.3d 1319, 1341 (Fed. Cir. 2003)). The weight of these two *Penn Central* factors led the court to conclude that Cane had failed to establish that its property had been taken.

If the Secretary's designation decision – which precluded surface coal mining operations – did not result in a taking of Cane's fee simple interest in the 10,000 acres at issue, shouldn't the result be the same for the Wyatts? The Wyatts owned the fee simple interest in the lands from 1953 to 1979. The family then took the full bundle of rights they possessed with respect to that property, and divested themselves of all but a coal royalty interest, under which they would receive royalties when and if any coal was mined from the property in the future. In other words, the Wyatts retained a small, non-controlling portion of the "mineral estate" and conveyed every other stick in the bundle of rights associated with the property to Cane for \$5.1 million. It was this limited, partial interest in the land that the Wyatts owned at the time of the regulatory decision designating the *land* as unsuitable for surface coal mining operations. There was little dispute that the Wyatts' partial interest was effectively rendered valueless by the Secretary's designation. But is this – or should it be – considered a taking in light of the factual history of the property and the Wyatts' ownership thereof?

The question of whether the Wyatts' takings claims should be analyzed as categorical regulatory takings claims under *Lucas*, or partial regulatory takings claims under *Penn Central*, turned on the trial court's determination of whether the "relevant parcel" consisted only of the coal royalty interest held by the Wyatts at the time of the regulatory action. The trial court's decision on this issue was split as a result of the complex factual history of the land. At the time of the regulatory action, the Wyatt children's ownership of the coal royalty interest was divided in that they owned the royalty interest in approximately 2,500 acres in their individual capacities, but were only equitable owners of the royalty interest in the remaining acreage as a result of the transfer of that interest by their parents into three separate trusts created for their benefit (the "Wyatt Trusts"). The trial court ruled that these interests could not be consolidated into a single "relevant parcel" for the purposes of the takings analysis. With the coal royalty interests thus divided, the trial court then considered whether the relevant parcels were further limited to the coal royalty interest owned on the date of the regulatory action (the Secretary's designation decision), or whether the relevant parcel consisted of the full fee simple interest acquired by the Wyatt family in 1953 and still held at the time that SMCRA was enacted.

With respect to the takings claims brought by the Wyatt Trusts, the trial court held that the relevant parcel was the full fee simple interest in approximately 2,500 acres of land that had been transferred by the parents into the Wyatt Trusts for the benefit of their children in 1973 and 1974. Following the enactment of SMCRA, the Wyatt Trusts had sold their fee simple estates in most of these lands to Cane for \$1 million (the allocated portion of the \$5.1 million sale price),

and retained only the coal royalty interest. As a result of this relevant parcel determination, the \$1 million in revenue from the 1979 sale of property to Cane was a significant factor in the trial court's to conclude that the Wyatt Trusts had not suffered a categorical taking under *Lucas* or a compensable taking under *Penn Central*. *Cane V*, 60 Fed. Cl. at 703-706.

The outcome with respect to the takings claims brought by the Wyatt children in their individual capacity was much different. There, the trial court concluded that the relevant parcel was limited to the coal royalty interest that had been conveyed by the Wyatt parents to their children (as a gift) in 1991. The Wyatt parents had also conveyed the oil and gas interests in the same land to their children in a series of earlier transactions, and there had been some rental payments paid to the family based on a leasing of those interests prior to 1986. However, the court concluded that the oil and gas interests should not be considered as part of the relevant parcel—even though both interests were segments of the fee simple estate in the same land—because those interests were conveyed to the children at a different time and there was no common development scheme for the oil and gas interests and the coal estate. *Cane VI*, 62 Fed. Cl. at 710-711. Consequently, the trial court held that the alleged taking of the Wyatt children's coal royalty interest was a “categorical” taking to be analyzed under *Lucas*, whereas consideration of the income generated from leasing the oil and gas interests would have brought the claims under the rubric of *Penn Central*.

The trial court's relevant parcel determination, and the resulting decision to analyze the Wyatt children's claims as categorical claims under *Lucas*, squarely raised the question of whether the categorical rule announced in *Lucas* can be applied to a partial interest in land in a manner that excludes consideration of the owner's reasonable investment-backed expectations, which are necessarily diminished from the onset when the owner acquires only a segment of the fee simple estate.

The government, relying on *Lucas*, *Loveladies* and *Good*, and distinguishing *Palm Beach Isles*, argued before the trial court that the Wyatts' reasonable investment-backed expectations were a necessary factor in the assessment of their claim that their partial interest in the lands at issue has been taken. *See Cane VI*, 62 Fed. Cl. at 711-716. The trial court reviewed the decision in *Lucas*, as well as the Federal Circuit's subsequent decisions in *Loveladies*, *Good*, *Florida Rock* and *Palm Beach Isles*, and concluded otherwise. Specifically, citing the panel rehearing decision in *Palm Beach Isles* (231 F.3d 1354), the trial court found that the Federal Circuit had “squarely considered, addressed, and rejected” the government's argument that expectations are a relevant factor in the assessment of all regulatory takings claims, including categorical claims under *Lucas*. *Id.* at 716. As a result of this ruling, the expectations of the Wyatt children with respect to the coal royalty interest—which were necessarily shaped by the regulatory restrictions on coal mining, their parents' sale of the fee simple estate (at a significant profit) and relinquishment of all control over whether any coal would be mined from the property, the fact that the parents considered the royalty interest to be “valueless” after Cane's lessee was unable to secure necessary permits and capital funding and allowed its lease to expire in 1991—were excluded from the analysis of whether a taking had occurred.

At the end of the day, the takings claims brought by Cane and the Wyatt Trusts were analyzed under *Penn Central*, the reasonableness of their investment-backed expectations were considered by the court, and their takings claims were rejected. By contrast, the expectations of the Wyatt children individually—which are necessarily derivative of the investment-backed expectations of their parents—were excluded from consideration in the analysis of the Wyatt children’s takings claims, resulting in a finding by the court that there had been a categorical taking of the Wyatt children’s partial interest that required compensation.

Is this a logical or fair result? Is it a just result? Is it a result contemplated by the Supreme Court when it first announced its categorical rule in *Lucas*?

V. The Need for Clarification

The inconsistency in the results with respect to the takings claims addressed by the Court of Federal Claims in the consolidated *Cane* and *Wyatt* cases illustrates the need for further guidance from the courts on the question of whether regulatory takings claims involving partial interests must be analyzed under *Penn Central* or *Lucas*. If the courts lean away from *Penn Central*, then the question to be resolved is whether the categorical rule from *Lucas* can be applied in a manner that excludes from consideration the diminished investment-backed expectations of the owner of a partial interest and the already realized expectations of the owner who segmented the original fee simple interest in the land.

The need for such clarification on the partial interest problem is heightened by the current push to extract natural gas from shale formations. Although there are shale formations containing natural gas reserves in many areas of the country, there has been a tremendous amount of recent press regarding proposals to drill for natural gas from the Marcellus shale that underlies part of New York, Pennsylvania, Ohio and West Virginia.¹⁶ Interest in the Marcellus shale is the result of a convergence of several factors: the ever-present interest in decreasing the nation’s dependence on foreign natural resources in favor of domestic resources, the search for “cleaner” fuels in the era of climate change, and advances in drilling technology.

The concern that has been raised regarding the current push to drill for natural gas from the Marcellus shale (and other similar shale formations in other areas of the country) relates to the method of drilling that is used. The technology—called hydraulic fracturing or “fracking”—is a directional drilling method in which a well is drilled vertically, then extended horizontally into the target formation (the shale). The developers then pump a mixture of water, sand and chemicals into the well at high pressure to fracture the formation in a manner that allows for the release of more gas than would be accessible from the drilling of a standard vertical gas well.

¹⁶See

http://www.pennlive.com/midstate/index.ssf/2009/11/state-issued_marcellus_shale_g.html (reporting a 300% increase in state-issued Marcellus shale gas well drilling permits in Pennsylvania in 2009) (last visited November 4, 2009).

Although “fracking” is not new technology, the environmental risks associated with such drilling are not fully understood. By some reports, there are 1,000 cases of documented water contamination resulting from hydraulic fracturing in Colorado, New Mexico, Alabama, Ohio and Pennsylvania.¹⁷ In New York, real concerns have been raised regarding the potential impact that drilling in the Marcellus shale could have on public drinking water supplies.¹⁸ Regulations have been proposed, and restrictions on drilling resulting from those regulations will certainly be tested in the form of takings claims.

The successful defense of such claims involves many pieces. Background principles of state law—a topic beyond the scope of this paper—will be important given that new regulations affecting the drilling of the Marcellus shale and other shale formations will focus in part on preventing the creation of a nuisance. Such action by the government does not take any rights that the mineral interest owner had to begin with. Beyond background principles, application of the *Penn Central* test, or a clarified version of *Lucas*, is important so that investment-backed expectations are part of the analysis. In the area of mineral interests, such expectations are necessarily shaped by the fact that the development and extraction of natural resources through mining or drilling has a long history of heavy regulation due to the adverse environmental impacts that can result. See *District Intown Props., Ltd. v. District of Columbia*, 198 F.3d 874, 884 (D.C. Cir. 1999) (“[b]usinesses that operate in an industry with a history of regulation have no reasonable expectation that regulation will not be strengthened to achieve established legislative ends.”), *cert. denied*, 531 U.S. 812 (2000). An analysis that excludes consideration of this factor is certain to lead to illogical results.

¹⁷See <http://www.ombwatch.org/node/3847> (last visited Oct. 30, 2009).

¹⁸See <http://greeninc.blogs.nytimes.com/2009/10/30/fight-over-shale-gas-drilling-not-over/> (last visited November 4, 2009).