Court of Appeal Upholds Regulatory Takings Decision Under Penn Central Test

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Regulatory takings claims are notoriously hard to prove. Myriad substantive legal obstacles exist to establishing a successful claim. Even worse for property owners, often they never even get the chance to argue their cases on the merits, as they fail to overcome one or more of the several procedural hurdles. As a result, it is rare to see a published decision come down in favor of a property owner – and even more rare to see a decision upholding a claim based on the U.S. Supreme Court's landmark decision in *Penn Central*.

But this is exactly what happened earlier this week in a decision arising from a down zoning in the City of San Clemente. In *Avenida San Juan Partnership v. City of San Clemente*, 2011 Cal.App. LEXIS 1564 (Dec. 14, 2011), the Court of Appeal upheld a judgment that ordered the City of San Clemente to choose between (1) rescinding a decision rejecting the owners' applications for development permits or (2) paying the owners damages for a regulatory taking of their property.

In reaching this decision, the Court navigated the complex substantive and procedural issues, concluding that the claim was timely and proper procedurally, and that the owner had established all of the requirements for a taking under *Penn Central's* three-prong test. The Court remanded for a redetermination of the damages to be awarded in the event the City elects the second of its two options.

The Background. The story for this case dates back 30 years. The owners purchased the property in 1980, with the intention of building four residences on the 2.85-acre property, a density permitted under the property's zoning. Shortly after purchasing the property, the owners secured entitlements for just such a development. Despite securing the entitlements, the owners did not commence construction.

In 1983, a group of neighbors petitioned the City to rezone the property as open space. The City refused because, among other reasons, the City attorney opined that such a rezoning would constitute a compensable taking. For the next decade, little happened with the property.

In 1993, the City amended its general plan, creating a new zoning category, RVL (residential, very low), which provided for one residential unit per 20 acres. In the enabling legislation for the new zone, the RVL designation was described as being intended for preserving "open space in canyons" by rezoning "significant acreage." The property at issue was less than three acres, and it was not located in a canyon. Despite this, the City applied the new RVL zoning to the property in 1996. All the surrounding properties remained zoned RL, which permitted four dwellings per acre.

Again, most of a decade passed without incident. Finally, in 2006, the owners submitted new applications, once again seeking the right to develop four dwellings. In light of the RVL zoning, the applications included requests to change the zoning and general plan, presumably to return the property to its prior, RL designation. In 2007, the City denied the applications, concluding that the development plan did not conform to the property's zoning, and the owners sued.

The Trial Court Proceedings. The court first heard the owners' writ of mandate claim, seeking to overturn the denial of their applications. The trial court concluded that the down zoning qualified as an arbitrary and capricious "spot zoning," and it issued the writ.

With respect to the inverse condemnation claim, the court found that a compensable taking had occurred. The court awarded damages of $1.3 million, which it found to be the overall value of the property ($2.8 million), less the anticipated cost to build a driveway needed to support its development ($1.5 million).

The City filed a motion for new trial claiming, among other things, that the two decisions had the effect of a "double recovery" by forcing the City both to rescind its decision and to pay damages. The trial court agreed, and pursuant to *Hensler v. City of Glendale* (1994) 8 Cal.4th 1, the court modified the judgment to provide that the City could elect to either rescind its decision or pay the damages. The City appealed.

Spot Zoning. In analyzing the propriety of the writ, the Court of Appeal examined the rules related to so-called "spot zoning." The idea is simple: if the government targets a specific property for zoning treatment different from other similarly-situated properties – especially where it does so for an improper purpose – the zoning can be invalidated. The Court held that the City had specifically targeted this property for down zoning, leaving it as an "island" of "minimum lot size zoning in a residential ocean of substantially less restrictive zoning." This was enough to qualify as "irrational discrimination" under cases such as *Hamer v. Town of Ross* (1963) 59 Cal.2d 776. The Court upheld the writ.

Penn Central and "Economically Viable" Uses. Next, the Court turned to the takings decision. The City argued that its action fell short of a regulatory taking, as a matter of law, because the RVL zoning did not leave the owner with no economically viable use of the property, a fatal flaw under *Lucas v. South Carolina Coastal Council* (1992) 505 U.S. 1003. The Court found this view "too limited," explaining that a taking occurs where a regulation goes "too far," even if some economically viable use remains. (See *Palazzolo v. Rhode Island* (2001) 533 U.S. 606.) Where this occurs, courts look to the three-part test established in *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978), analyzing:

1. The economic effect on the landowner;
2. The extent of the regulation's interference with investment-backed expectations; and
3. The character of the governmental action.

The Court quickly concluded that all three factors "readily appl[ied]" in this case. In terms of economic effect, the Court reasoned that the trial court's determination that the damages suffered were $1.3 million established the first prong.

In terms of investment-backed expectations, the Court again made quick work of the issue, concluding that the owners' reasonable expectation when they purchased the property was that they could develop it in accordance with the property's then-existing zoning – a zoning which predominated the area.

Finally, in terms of the character of the governmental action, the Court was convinced that the City's motivation was merely to keep the property as open space, as evidenced by the facts that (a) the RVL zoning, on its face, seemed to have no application to the property, (b) the RVL zoning was inconsistent with a residential area, and (c) the surrounding properties all retained the earlier RL zoning, leaving the property as an island.

The Court affirmed the trial court's decision that a taking had occurred.

Standing. Before turning to the damages award, the Court examined the procedural hurdles, looking both at statute of limitations and ripeness defenses. Many regulatory takings claims fail these dual tests, and the City raised a number of arguments that the owners were both too late – and too early – to make their claims.

The City argued that the owners waited too long to challenge the RVL zoning, which was applied to the property more than 10 years before the lawsuit commenced. The Court disagreed, concluding that the statute of limitations began to run on the challenge only when the City denied the owners' development applications in 2007. The Court went through a painstaking analysis of the difference between "facial" and "as applied" challenges, holding that the owners' challenge mirrored the challenge in *Travis v. County of Santa Cruz* (2004) 33 Cal.4th 757. As the court held in Travis, this type of challenge falls on the "as applied" side of the ledger, making it timely.

Next, the City argued that if the owners' claims were not too late, then they were too early, failing on ripeness grounds because the owners failed to apply for entitlements to build what the RVL would have allowed them: a single dwelling. The Court rejected this argument as well, holding that the Supreme Court had rejected almost the exact argument in *Palazzolo*.

Damages. Having upheld the trial court's determinations on the merits, the Court turned to the damages calculations. The trial court had performed a simple analysis, taking opinions of the value of the property absent the RVL zoning, and subtracting out the cost the owners would have incurred to build the (expensive) driveway necessary to support the property's development.

The Court correctly noted that this methodology only worked if the taking was complete – i.e., if the taking left the owner with no economically viable use of the property. Otherwise, a proper damages assessment must take into account the property's residual value. As the Court explained: "A very large taking is not a total taking." While this sounds like good news for the City, there was a bit more to the story. The Court concluded that the trial court may have intentionally understated the damages figure at a time when it believed the City would have no choice but to pay the award.

In other words, at the time the Court set the $1.3 million figure, it had not yet reached its decision under *Hensler* that the City would have the option to rescind its decision to avoid paying the damages. The Court specifically noted that the trial court claimed to have "low-balled" the damages, and that it may not have been "really focused, as the law requires, on fair market value."

Attorneys' Fees. Finally, the Court turned to the attorneys' fees award, which the owners had appealed. The owners complained that the trial court had not awarded any fees for one of the owners' time, even though the owner was an attorney. They also complained that the trial court failed to apply a fee multiplier in recognition of the nature of the case and its risk. Such multipliers are common in direct eminent domain actions where the court concludes that the nature of the case, its complexity, the amount at stake, and the risk the attorneys took in taking the case warranted such a multiplier.

The Court rejected both claims. Applying the plain language of Code of Civil Procedure section 1036, the Court noted that fees could be recovered only to the extent they were "actually incurred." Concluding that the owners incurred no actual fees for the services of the attorney-owner and no "multiplier" fees, the Court upheld the fee award, noting that if public policy demanded that provisions exist for things such as fee multipliers in inverse condemnation cases, that was for the Legislature to address, not the courts.

Lessons Learned. From the government's standpoint, the opinion serves as a reminder that the tide may well be turning in regulatory takings jurisprudence. Blatant efforts to spot zone a property with a zoning designation that, on its face, should not apply to that property may well result in liability. Courts may also look with more scrutiny at a common tactic cities have used to stave off takings claims. The "just because we rejected this application does not mean we'll reject some other application" defense has long been used to defend these types of claims, but where the government's intent is pretty clear, the courts may not require owners to continue in futile entitlement efforts before imposing liability.

From an owner's perspective, the lessons are a little trickier to divine, which makes sense: the owners won. But a couple of thoughts come to mind. First, even though it worked here (at least so far, pending any California Supreme Court review), it seems unwise to allow a decade to pass after the city down zones your property. While the Court held that this challenge qualified as an "as applied" – and therefore timely – challenge, the result could have gone the other way. And, if the City had provided better notice to the owners back in 1996, it may well have. Second, if you're counting on a massive fee award, take care to structure your fee arrangements so that you meet the "actually incurred" test. With respect to the owner-attorney, the owners' group could have solved the problem by having a fee agreement under which the owner would be compensated for his time. (There's risk there, of course, as this could leave an owner with a massive fee bill if the claim fails, but a careful contingency fee could help address that issue.)