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## Elimination of the Highest and Best Use Principle: Another Path Through the Middle Way

### Cover Page Footnote

Associate Professor of Law, Drake University.

# ELIMINATION OF THE HIGHEST AND BEST USE PRINCIPLE: ANOTHER PATH THROUGH THE MIDDLE WAY

JOSEPH P. TOMAIN\*

*"Yet it is clear that Hobbits had, in fact, lived quietly in Middle-earth for many long years before other folk became even aware of them."\*\**

## INTRODUCTION

TRADITIONAL land use law categorizes governmental activities that affect the value of private property as exercises of either the state's police power or eminent domain power.<sup>1</sup> This dichotomy has created what Professor John J. Costonis describes as the "disparity issue":<sup>2</sup> if in a legitimate exercise of its police power a state reduces the value of land, no compensation is required;<sup>3</sup> if the governmental action devalues land too much, however, it is deemed a taking within the eminent domain power and full compensation according to the land's "highest and best use" is required.<sup>4</sup> Often, this compensation exceeds

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\*\* J. Tolkien, *The Fellowship of the Ring* 21 (1965).

1. The leading articles on eminent domain include: Dunham, *A Legal and Economic Basis for City Planning*, 58 Colum. L. Rev. 650 (1958); Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 Harv. L. Rev. 1165 (1967); Sax, *Takings and the Police Power*, 74 Yale L.J. 36 (1964) [hereinafter cited as Sax I], revised in Sax, *Takings, Private Property and Public Rights*, 81 Yale L.J. 149 (1971) [hereinafter cited as Sax II]. The Michelman article together with B. Ackerman, *Private Property and the Constitution* (1977) assume a jurisprudential, rather than a pragmatic approach to property law. See also D. Hagman, *Urban Planning and Land Development Control Law* §§ 173-187, at 310-43 (1971); J. Nowak, R. Rotunda, & J. Young, *Handbook on Constitutional Law* 437-50 (1978) [hereinafter cited as J. Nowak]; L. Tribe, *American Constitutional Law* §§ 9-1 to -4, at 456-65 (1978); Berger, *A Policy Analysis of the Taking Problem*, 49 N.Y.U. L. Rev. 165 (1974); *Developments in the Law—Zoning*, 91 Harv. L. Rev. 1427, 1497-1501 (1978).

2. Costonis, *The Disparity Issue: A Context for the Grand Central Terminal Decision*, 91 Harv. L. Rev. 402, 403 (1977) [hereinafter cited as *Disparity Issue*]; Costonis, *"Fair" Compensation and the Accommodation Power: Antidotes for the Taking Impasse in Land Use Controversies*, 75 Colum. L. Rev. 1021, 1033-49 (1975) [hereinafter cited as *Fair Compensation*].

3. See, e.g., *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926) (zoning ordinances).

4. See e.g., *United States v. Fuller*, 409 U.S. 488, 490-92 (1973); *Almota Farmers Elevator & Warehouse Co. v. United States*, 409 U.S. 470, 473-74 (1973); *United States v. Reynolds*, 397 U.S. 14, 16-19 (1970). In addition, the different treatment of the issue by the states has created a geographical disparity. Take, for example, a wetlands controversy in which a landowner who desires to backfill and develop his land discovers that his state has passed legislation prohibiting such activity. In one state this may be an exercise of the police power which entitles the landowner to no relief, see, e.g., *Sibson v. State*, 115 N.H. 124, 336 A.2d 239 (1975); *State Dep't of Ecology v. Pacesetter Constr. Co.*, 89 Wash. 2d 203, 571 P.2d 196 (1977); *Just v. Marinette County*, 56 Wis. 2d 7, 201 N.W.2d 761 (1972), while in other states it may be an exercise of eminent domain power which entitles him to just compensation based upon the

the land's present value.<sup>5</sup>

Rather than attempting to solve the problem of when a governmental regulation or overregulation constitutes a taking,<sup>6</sup> Professor Costonis charts "a middle way" through this Scylla and Charybdis.<sup>7</sup> He posits that "for certain types of land use controversies . . . the financial burden of public intervention should fall neither solely upon the landowner, as orthodox police power doctrine would have it, nor upon government, as established eminent domain principles would dictate."<sup>8</sup> As an example of this middle way, Professor Costonis points to the recent decision in *Penn Central Transportation Co. v. City of New York (Grand Central Terminal)*.<sup>9</sup>

To justify his middle way, Professor Costonis poses a series of penetrating questions about the traditional dichotomized approach to land use regulation.<sup>10</sup> This Article will address one of these questions: "[W]hy must compensation be pegged to the prohibitively expensive 'highest and best use' level in cases of overregulation?"<sup>11</sup> It is submitted that in some cases the highest and best use principle is inappropriate. If some compensation can be justified when the state exercises its police power, as in *Grand Central Terminal*,<sup>12</sup> then less than full

highest and best use of the land. See, e.g., *State v. Johnson*, 265 A.2d 711 (Me. 1970); *Morris County Land Improvement Co. v. Township of Parsippany-Troy Hills*, 40 N.J. 539, 193 A.2d 232 (1963).

5. See pt. II *infra*.

6. The extensive scholarship exploring this issue is as rich as it is irreconcilable. See, e.g., Michelman, *supra* note 1; Sax I, *supra* note 1; Sax II, *supra* note 1.

7. See *Disparity Issue*, *supra* note 2, at 406-09; *Fair Compensation*, *supra* note 2, at 1049-82. Professor Costonis suggests that attempts to solve the "taking" problem are doomed to failure. *Id.* at 1021-23.

8. *Disparity Issue*, *supra* note 2, at 403.

9. 42 N.Y.2d 324, 366 N.E.2d 1271, 397 N.Y.S.2d 914 (1977), *aff'd*, 98 S. Ct. 2646 (1978), *discussed in Disparity Issue*, *supra* note 2.

10. The questions posed are: "First, is it the case, as the loose language of innumerable zoning opinions implies, that overregulation is a 'taking,' hence remediable exclusively through eminent domain proceedings? . . . Second, why must compensation be pegged to the prohibitively expensive 'highest and best use' level in cases of overregulation? . . . Third, why must compensation be paid in dollars when government, though often strapped for funds, is in a position to offer various nondollar trade-offs of palpable economic value? Fourth, why must government be constrained by eminent domain's burdensome procedural requirements when the effects of overregulation can be overcome in many cases by providing an appropriate compensatory offset in the regulatory program itself? Finally, should land's value in disparity disputes be fixed independently of the landowner's identity or of government's contribution to the land's profitability?" *Disparity Issue*, *supra* note 2, at 405-06 (footnote omitted).

11. *Id.* at 406. Professor Costonis continues this query as follows: "Is that standard really necessary to insure fair treatment for the landowner? Isn't it absurd a half century after [*Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926)] to allow government to reduce land values far below this level in the run-of-the-mine zoning case but to insist that, should government seek to deal equitably with the landowner, nothing less than restoration of the land's value to its highest and best use will do?" *Disparity Issue*, *supra* note 2, at 406.

12. See pt. I(B) *infra*.

compensation may be appropriate when the state exercises its eminent domain power.

## I. MODELS OF LAND USE DECISIONS

A decision as to whether a governmental action is a regulation or a taking, though not the main concern, is a predicate to the issues discussed herein. Resort to Holmes' enigmatic statement that an over-regulation is a taking<sup>13</sup> is tempting, but should be avoided. Aside from its circularity, the statement contains an implicit assumption that if a governmental activity is categorized as a regulation, then by definition no compensation is required. The obverse is also assumed: if a governmental activity is defined as a taking, then compensation is required. These assumptions are neither necessarily nor implicitly true, and it is becoming clearer that land use decisions no longer fall into traditional categories.<sup>14</sup>

### A. *The Models Defined*

Traditionally, land use decisions, as already mentioned, have been compartmentalized into two basic models.<sup>15</sup> *Grand Central Terminal* provides a third model and the following analysis yields a fourth.<sup>16</sup> These models may be roughly defined as: (I) a governmental measure<sup>17</sup> that falls within the police power and does not require any compensa-

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13. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922). One commentator has rejected the *Pennsylvania Coal* rationale and thereby implicitly rejected the police power/eminent domain dichotomy by proposing a "pure" due process standard, that is, due process "purged of the notion that overly burdensome regulation constitutes a 'taking.'" Comment, *Grand Central Terminal and the New York Court of Appeals: "Pure" Due Process, Reasonable Return, and Betterment Recovery*, 78 Colum. L. Rev. 134, 142 (1978). Traditionally, this "pure" due process has been called "substantive" due process. See *id.* at 142-48.

14. Land use theory is developing into predictable schools of thought. The "police power enthusiasts" are exemplified in Sax I, *supra* note 1, and in F. Bosselman, D. Callies & J. Banta, *The Taking Issue* (1973). *Fair Compensation*, *supra* note 2, at 1024-26. The "private marketeers" include Bernard Siegan and Professor Ellickson. See *id.* at 1026-33 (discussing B. Siegan, *Planning Without Prices* (1977) and Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 Yale L.J. 385 (1977)).

15. See notes 1-4 *supra* and accompanying text.

16. The author acknowledges the dangers and pitfalls in attempting to avoid compartmentalization by creating new categories. See Breitel, *A Judicial View of Transferable Development Rights*, 30 Land Use Law & Zoning Digest 5, 7 (No. 2, 1978) (criticizing the use of boxes); cf. Berger, *The Accommodation Power In Land Use Controversies: A Reply to Professor Costonis*, 76 Colum. L. Rev. 799, 815-23 (1976) (criticizing Professor Costonis' new categories). Nevertheless, the limits of language force the creation of new categories for illustrative purposes, if for no other reason. I am confident this will not yield a "fearful symmetry." W. Blake, *The Tyger*, in *Poems of William Blake* 60 (1974).

17. The word "measure" is used instead of "regulation" because the latter is often defined as being within the police power.

tion;<sup>18</sup> (II) a governmental measure that falls within the police power for which some, perhaps nondollar, compensation is given (*Grand Central Terminal*); (III) a governmental measure that falls within the eminent domain power for which some, but not full, compensation is given (this Article); and (IV) a governmental measure that falls within the eminent domain power and requires full compensation in accordance with the highest and best use principle.<sup>19</sup>

Models I and IV, the polarities, have been employed almost exclusively and have led to indefensible<sup>20</sup> and contradictory results.<sup>21</sup> Models II and III, on the other hand, are accommodation models which create a middle way by first abandoning total allegiance to the police power/eminent domain dichotomy, and, second, by describing situations in which a governmental measure requires some, but not total, compensation. The basic justification for the middle way is the creation of an ethical rather than a technical standard for compensation law.<sup>22</sup> The differences and similarities among these models can be readily ascertained when the models are arranged along a continuum.<sup>23</sup>

VALUATION CONTINUUM			
Model I	Model II	Model III	Model IV
Police Power	Police Power	Eminent Domain	Eminent Domain
No Compensation	Some Compensation	Less than Full Compensation	Full Compensation

Models II, III, and IV allow compensation, but base the allowance on substantively different considerations. Models II and III require, at all times, less than full compensation. Model III differs from Model II

18. See, e.g., *Eastlake v. Forest City Enterprises Inc.*, 426 U.S. 668 (1976); *Gorieb v. Fox*, 274 U.S. 603 (1927); *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926).

19. See, e.g., *United States v. Fuller*, 409 U.S. 488, 490-92 (1973); *Almota Farmers Elevator & Warehouse Co. v. United States*, 409 U.S. 470, 473-74 (1973); *United States v. Reynolds*, 397 U.S. 14, 16-19 (1970).

20. See, e.g., *Miller v. Schoene*, 276 U.S. 272 (1928) (destruction of all cedar trees, some of which were parasite-infested, in order to save all apple trees).

21. Frequently, the same governmental action will be termed an exercise of police power by one court and an exercise of eminent domain power by another court. See note 4 *supra*.

22. See generally B. Ackerman, *supra* note 1, at 100-89; *Fair Compensation*, *supra* note 2, at 1021-23; Michelman, *supra* note 1, at 1214-24.

23. This continuum roughly corresponds with that of Professor Costonis, see *Fair Compensation*, *supra* note 2, at 1050, but under Model III, compensation is not made according to the highest and best use of the land. Depending upon the actual use of the property, Model II may yield a land value equivalent to the land's allowable use, reasonable beneficial use, or resource protective use. See *Penn Central Transp. Co. v. City of New York (Grand Central Terminal)*, 42 N.Y.2d at 331-35, 366 N.E.2d at 1275-77, 397 N.Y.S.2d at 918-21; pt. III *infra*.

in the method of valuation and, therefore, possibly the amount of compensation.<sup>24</sup>

### B. *Model II*: Grand Central Terminal

The New York Court of Appeals' decision in *Grand Central Terminal* represents a significant break with the past. Although a lengthy rehash of Professor Costonis' analysis and Chief Judge Breitel's opinion is unnecessary, a brief review of the decision is in order. In *Grand Central Terminal*, the owner of the Terminal alleged that New York City's landmark preservation ordinance,<sup>25</sup> which prohibited construction of an office building atop the Terminal, was unconstitutional.<sup>26</sup> The court upheld the ordinance as a valid exercise of the police power, emphasizing the transferable development rights (TDR's), a form of nondollar compensation,<sup>27</sup> granted to the owner.<sup>28</sup> Thus, in effect, the court held that compensation was required even though the ordinance did not constitute an exercise of eminent domain power.<sup>29</sup>

On appeal, the Supreme Court affirmed, holding that no taking had occurred because the ordinance did not interfere with the profitability of the Terminal in its present use.<sup>30</sup> The Court, therefore, found it unnecessary to decide whether the TDR's would have constituted just compensation in an eminent domain proceeding. As a result, the constitutionality of the TDR program was ambiguously left open.<sup>31</sup> Nevertheless, the Court suggested, as did the New York Court of Appeals, that a different result would have been obtained if TDR's had not been given to the Terminal's owner:

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24. *Disparity Issue*, *supra* note 2, at 422-26; *Fair Compensation*, *supra* note 2, at 1051-55. *But see* Berger, *supra* note 16, at 816-23.

25. N.Y. City Admin. Code Ann. §§ 205-1.0 to 207-21.0 (Williams 1976).

26. 42 N.Y.2d at 327, 366 N.E.2d at 1273, 397 N.Y.S.2d at 916.

27. The TDR program authorized the owner of the Terminal "to transfer to neighboring properties the authorized but unused rights accruing to the site prior to the Terminal's designation as a landmark." *Disparity Issue*, *supra* note 2, at 407. For additional sources on TDR's, see *id.* at 407 n.13.

28. 42 N.Y.2d at 328, 366 N.E.2d at 1273, 397 N.Y.S.2d at 916.

29. *See id.* at 335-36, 366 N.E.2d at 1278, 397 N.Y.S.2d at 921.

30. 98 S.Ct. at 2666. The dissent maintained that a taking had occurred "with little or no offsetting benefit except for the honor of the designation." *Id.* at 2667 (Rehnquist, J., dissenting). As a result, the dissent stated that the owner was entitled to "a full . . . and perfect equivalent for the property taken," a standard which the TDR program did not meet. *Id.* at 2673 (Rehnquist, J., dissenting) (quoting *Monongahela Navigation Co. v. United States*, 148 U.S. 312, 326 (1893)).

31. *Id.* at 2666. Other commentators, however, believe that the Court explicitly recognized the role and constitutional validity of TDR's, and may well have opened the door to resolving the taking versus regulation impasse. *E.g.*, Marcus, *Penn Central Transportation Co. v. City of New York*, 30 Land Use Law & Zoning Digest 4 (No. 2, 1978). However the Supreme Court opinion is construed, the underlying fact remains the same: Penn Central was given TDR's in mitigation of any damages caused by the landmark law. The TDR program has some value and must be considered in determining whether or not further compensation is required.

While [the TDR's] may well not have constituted 'just compensation' if a 'taking' had occurred, [they] nevertheless undoubtedly mitigate whatever financial burdens the law has imposed on [the landowner] and, for that reason, are to be taken into account in considering the impact of regulation . . . .

. . . 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 afford appellants opportunities further to enhance not only the Terminal site proper but also other properties.<sup>32</sup>

*Grand Central Terminal*, therefore, does not fall within either of the two traditional models.<sup>33</sup> Model I does not apply because of the compensation, albeit nondollar, given by the city; the absence of the eminent domain power renders Model IV also inapplicable. In fact, the court of appeals created a new model—referred to here as Model II.

The court of appeals' reasoning is premised upon the governmental action being a regulation rather than a taking. The important issue, however, is not whether the activity is a regulation or a taking, but whether full compensation should ever be given.

In *Grand Central Terminal*, the owner was not given compensation based on the highest and best use of the Terminal. Chief Judge Breitel stated that "[t]he compensation need not be the 'just' compensation required in eminent domain, for there has been no attempt to take property."<sup>34</sup> At least part of the justification for giving less than full compensation in *Grand Central Terminal*, however, was the social increment in value theory.<sup>35</sup> This theory seeks to segregate increments in land's value resulting from public, as opposed to private, contributions and efforts. In other words, the social increment in value theory would exclude that portion of a property's value that can be traced "to public investment and concomitant community growth."<sup>36</sup>

Although both Chief Judge Breitel and Professor Costonis suggest that *Grand Central Terminal* may be of limited utility because of its unique facts and administrative difficulties,<sup>37</sup> the opinion may open

32. 98 S. Ct. at 2666 (footnote omitted).

33. See notes 17-19 *supra* and accompanying text. The majority and dissent fall into the same trap which this Article seeks to avoid. The majority says no taking has occurred and does not discuss whether TDR's are just compensation. 98 S. Ct. at 2666. The dissent says that a taking has occurred and the TDR's must measure up to a "full and perfect" equivalent. *Id.* at 2666-74 (Rehnquist, J., dissenting). Neither statement is necessarily true; the statements have meaning only if the Court adhered to the traditional dichotomy. The fact that the Court found no taking but awarded TDR's indicates an implicit approval of a middle ground.

34. 42 N.Y.2d at 335, 366 N.E.2d at 1278, 397 N.Y.S.2d at 921.

35. See *Disparity Issue*, *supra* note 2, at 415-18.

36. See *id.* at 416. An additional argument against full compensation exists in a case involving a landmark. A landmark confers a benefit to society as well as to the landowner. Society should not have to compensate a landowner for the entire value of property when part of that property "belongs" to society.

37. 42 N.Y.2d at 331, 366 N.E.2d at 1275, 397 N.Y.S.2d at 918. The administrative difficulty in distinguishing between public and private contributions to increments in land's value is reflected in the subdivision exaction cases, in which an attempt has been made to distinguish



the way for experiments by courts (but preferably by legislatures) to redefine the compensation scheme. The Supreme Court could have significantly advanced "taking" jurisprudence if it had directly addressed the issue of whether a middle way exists rather than forcing the case into a category in which it does not belong. Nevertheless, *Grand Central Terminal* may lead to the creation of a class of land use disputes that are of an intermediate nature. The flexibility allowed in that case, a police power case, opens the possibility for additional flexibility in eminent domain cases, that is, awarding less than full compensation to a condemnee.

## II. A VALUATION ALTERNATIVE

### A. *The Need for a Change*

Land use decisions are becoming increasingly complex and the economic impact of developing categories of land use issues is far from being ascertained. For example, inclusionary zoning, landmark preservation, exclusionary zoning, impact zoning, down-zoning, amortization of nonconforming uses, resource conservation, open space preservation, comprehensive plans, and growth management all address a range of interests much broader than the controversy of landowner versus regulator.<sup>38</sup> Additionally, the effect of externalities, that is, social cost, administrative cost, and transaction costs have, or should have, a significant impact on policymakers. The economic and social impact of land use decisions calls for a realignment of land use issues.

Professor Costonis has suggested that regulation issues in land use decisions have been approached from the wrong perspective. The writings of Sax, Michelman, and Van Alstyne, as well as those of their opponents Ellickson and Siegan, have approached the issues from a dichotomized viewpoint.<sup>39</sup> Costonis has proposed an accommodation to bridge this dichotomy. A further refinement of the accommodation argument is needed, however. The taking problem must be ap-

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between public and private benefit of land. *Compare* *Associated Home Builders v. City of Walnut Creek*, 4 Cal. 3d 633, 484 P.2d 606, 94 Cal. Rptr. 630, *appeal dismissed*, 404 U.S. 878 (1971) and *Krughoff v. City of Naperville*, 41 Ill. App. 3d 334, 354 N.E.2d 489 (1976), *aff'd*, 68 Ill. 2d 352, 369 N.E.2d 892 (1977) with *Pioneer Trust & Sav. Bank v. Village of Mount Prospect*, 22 Ill. 2d 375, 176 N.E.2d 799 (1961). Well-drafted standards appear to be the only sensible method of accommodating public and private rights in land use regulation. *See* *Divan Builders, Inc. v. Planning Board*, 66 N.J. 582, 334 A.2d 30 (1975); Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 Yale L.J. 385 (1977); Johnston, *Developments in Land Use Control*, 45 Notre Dame Law. 399 (1970).

38. One approach to the urban sprawl is an attempt to bring the suburbs to the cities. *See* Huxtable, *Today the Cards Are All in the Builder's Hands*, N.Y. Times, Mar. 26, 1978, § 2, at 29, col. 1; Machalaba, *Municipal Mall: Philadelphia's 'Gallery' Tests a City's Ability To Lure Back Shoppers*, Wall St. J., Mar. 30, 1978, at 1, col. 1.

39. *See* notes 1-4 *supra* and accompanying text. *But see* Hagman, *Compensable Regulation*, in *Windfalls for Wipeouts* 256 (1978) (discussing a wide range of middle way theories that have been used to justify payment to the property owner for severe restriction of land use by the government that results in lower property value).

proached from the perspective of valuing land. Before such an approach can be taken, however, the current principles of land valuation must be understood.

### 1. The Highest and Best Use Principle and Fair Market Value

It is pointless to rewrite the books on valuation and eminent domain proceedings.<sup>40</sup> The general rule can be stated with deceptive simplicity: the condemnee is entitled to the fair market value of his property.<sup>41</sup> An accepted definition of fair market value, for eminent domain purposes, is a price "agreed to by an informed seller who is willing but not obligated to sell, and an informed buyer who is willing but not obligated to buy."<sup>42</sup> Certain inherent attributes of this definition must be noted: (1) it is a hypothetical transaction; (2) it is speculative; and (3) full knowledge on the part of the buyer and seller is presumed.<sup>43</sup> When such a hypothetical sale is created, the land is valued from the buyer's viewpoint because the seller is assumed to know what the buyer plans to do with the property. Thus, the buyer, who is in a position to develop the property to its highest and best use, is valuing that property according to his own desires. Likewise, the seller attempts to set the price to fit the buyer's developmental goals. In theory, therefore, the consequence is that the property is sold for its highest and best use.<sup>44</sup>

It seems somewhat specious to argue that land in an undeveloped state has inherent value apart from its ownership. Nevertheless, the

40. See generally 1 J. Bonbright, *The Valuation of Property* 415-17 (1937); A. Jahr, *Law of Eminent Domain Valuation and Procedure* § 78 (1953); 4 Nichols' *The Law of Eminent Domain* § 12.1[2] (3d ed. J. Sackman 1974); 1 L. Orgel, *Valuation Under the Law of Eminent Domain* §§ 28-31 (2d ed. 1953). See also S. Searles, *A Practical Guide to the Legal and Appraisal Aspects of Condemnation* (1969); S. Searles, *Real Estate Valuation in Condemnation* (1970); Bigham, "Fair Market Value," "Just Compensation," and the Constitution: A Critical View, 24 *Vand. L. Rev.* 63 (1970); Hershman, *Compensation—Just and Unjust*, 21 *Bus. Law.* 285 (1966).

41. A. Jahr, *supra* note 40, § 70; 4 Nichols', *supra* note 40, § 12.2. Each of the words—"fair," "market," and "value"—is laden with ambiguities that have befuddled scholars and courts and will certainly continue to do so for some time. What is fair? The answer to that question will be left to Professors Ackerman and Michelman. See note 1 *supra*. What is the market? For real property, it is not inconceivable to say that there is no such thing as a market, as it is well recognized that for condemnation purposes a hypothetical situation is created. See notes 42-43 *infra* and accompanying text. See also 1 J. Bonbright, *supra* note 40, at 413-19; A. Jahr, *supra* note 40, § 78; 1 L. Orgel, *supra* note 40, §§ 28-31.

42. Uniform Eminent Domain Act § 1004(a). For variations of the willing buyer/willing seller concept as the basis of ascertaining fair market value, see 1 L. Orgel, *supra* note 40, § 20.

43. See 1 J. Bonbright, *supra* note 40, at 414-15; C. McCormick, *Damages* § 129 (1935); 1 L. Orgel, *supra* note 40, §§ 15, 28-30; Hershman, *supra* note 40, at 304-05.

44. See, e.g., Md. Real Prop. Code Ann. § 12-105(b) (1974); 26 Pa. Cons. Stat. Ann. § 1-603 (Purdon Supp. 1978); Wis. Stat. Ann. § 32.09(2), (8)(a) (West 1973); *Fair Compensation*, *supra* note 2, at 1039-45; *Developments in the Law—Zoning*, 91 *Harv. L. Rev.* 1429, 1498 (1978); Lewin, *50,000 Cases in a Swamp*, *Nat'l Law J.*, Nov. 6, 1978, at 10, col. 4.

fair market value of the land in eminent domain cases has been defined in those terms.<sup>45</sup> Why must the landowner be given something more than that which he actually holds? Preliminary research has revealed no affirmative justification for the principle. One commentator has indicated that under Roman law the highest and best use principle was not the only basis of valuation,<sup>46</sup> and that there was no real development of valuation law in early common law cases.<sup>47</sup>

Regardless of which theory of economic development one follows,<sup>48</sup> until recently, land has been regarded as the basis of wealth; moreover, the production and development of land, or, more accurately, the exploitation of our nation's resources, has been the espoused policy on which land use law rests.<sup>49</sup> It is not unusual that courts have valued land according to a highest and best use principle, and thereby have provided a profit incentive that encouraged land development. Today, however, environmental regulations seek to conserve our finite resources,<sup>50</sup> and it seems only fitting that the courts reflect this policy in the area of eminent domain as well.<sup>51</sup> The current trend toward slowing development,<sup>52</sup> or at least not encouraging it,<sup>53</sup> can be im-

45. See, e.g., *Monongahela Navigation Co. v. United States*, 148 U.S. 312 (1893).

46. See Matthews, *The Valuation of Property in the Roman Law*, 34 Harv. L. Rev. 229, 238-49 (1921).

47. See generally Matthews, *The Valuation of Property in the Early Common Law*, 35 Harv. L. Rev. 15 (1921). See also J. Nowak, *supra* note 1, at 438-40; 4 Nichols', *supra* note 40, § 12.1[2].

48. Compare F. Turner, *The Frontier in American History* (1920) with C. Beard, *An Economic Interpretation of the Constitution of the United States* (1913).

49. See L. Friedman, *A History of American Law* 179-201 (1972).

50. See, e.g., F. Bosselman, D. Feurer & T. Richter, *Federal Land Use Regulation* 9-57 (1977); W. Rodgers, *Handbook on Environmental Law* §§ 7.1-.12, at 697-834 (1977).

51. See Yannacone, *Property and Stewardship—Private Property Plus Public Interest Equals Social Property*, 23 S.D. L. Rev. 71, 117-39 (1978). The authorities cited herein recognize the extent of the limitations on one's use of land. No one, including the market theorists, believes in an unfettered right to absolute development. See, e.g., Ellickson, *supra* note 14, at 416-18; Lefcoe, *The Right to Develop Land: The German and Dutch Experience*, 56 Or. L. Rev. 31 (1977). The heart of the common law's land use control is the maxim *sic utere tuo ut alienum non laedas* (use your property in such a manner as not to injure that of another). See also W. Prosser, *Handbook of the Law of Torts* §§ 86-91, at 571-612 (4th ed. 1971).

52. The extent to which municipalities can regulate growth and the extent to which courts will permit development is of vital concern both economically and socially. The proposals herein may play a significant part in an overall growth management scheme. See, e.g., ABA Advisory Commission on Housing & Urban Growth, *Housing for All Under Law*, ch. 1 (1978); 3 N. Williams, *American Land Planning Law*, ch. 66 (1975 & Supp. 1978); Ellickson, *supra* note 14, at 385-511; Wright, *Constitutional Rights and Land Use Planning: The New and The Old Reality*, 1977 Duke L.J. 841, 841-68.

53. This trend, however, does not preclude or discourage development. The developer who buys swamp land takes the risk that he will be able to develop that land. Part of this risk is that the government may restrict development or perhaps even take the land. These risks, however, can be provided for contractually by having the developer enter into an option contract or by making the contract contingent upon the developer obtaining a building permit or upon the vesting of the right to develop. See D. Hagman, *supra* note 1, §§ 99-100. In those instances when developers do

plemented by abandoning the highest and best use principle and adopting the valuation principle set forth in Part II(B).

## 2. The Highest and Best Use Principle Illustrated

In addition to the policy considerations discussed above, the highest and best use principle often leads to questionable results. The problems can be traced to a weakness in the hypothetical transaction used to define fair market value.<sup>54</sup> Landowners frequently sell because of an inability, financial or otherwise, to develop their land profitably. As a result, sellers are frequently compensated for the value of the highest and best use of their land, when, in fact, they had neither the intention nor the ability to develop the land to its highest and best use.

The facts surrounding the development of Columbia, Maryland will be used to demonstrate the inherent unfairness of valuating land according to the highest and best use principle.<sup>55</sup> The first step in the development was to assemble a tract of land suitable for a city of mixed uses with a population of 100,000. The developer, James Rouse, planned to buy land at an average price of \$1,500 per acre, starting at \$1,000 and rising to a maximum of \$3,000 as the project neared completion. The last and most important parcel to be acquired, which was to contain the town center, a symphony hall, and a shopping center, consisted of 1,000 acres and belonged to "Big Bear" Isidore Gudelsky. Rouse was willing to offer Gudelsky significantly more than \$1,000 because of the importance of the parcel. If Gudelsky had not been informed about Rouse's plans for the tract, he might have sold for \$1,000 per acre, the value of the tract to him. Because Gudelsky was informed, however, he and Rouse agreed on a purchase price of \$3,000,000 or \$3,000 per acre.

Assume that the day before the deal was closed, the state condemned the parcel to construct a highway. Since the value of the land to Gudelsky was \$1,000 per acre, it would seem logical that he would be compensated for that value. Condemnee Gudelsky, however, would be entitled to compensation for his land according to its highest and best use which is determined according to the land's fair market value. Since the fair market value is based upon a price agreed to by a willing buyer and a willing seller, in this case \$3,000 per acre,<sup>56</sup> it would seem that Gudelsky would be justly compensated with an award of \$3,000 per acre. Nevertheless, after examining the highest and best use principle, Gudelsky's attorneys could successfully argue that the tract

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not make such contractual provisions, or when those contractual provisions prove to be inadequate, the doctrines of mutual mistake, unilateral mistake, frustration of purpose, and impossibility of performance can be relied upon.

54. See notes 42-43 *supra* and accompanying text.

55. See generally G. Breckenfeld, *Columbia and the New Cities*, ch. 10 (1971).

56. See notes 42-44 *supra* and accompanying text.

as a key to a multimillion dollar deal must be valued as such. Therefore, Gudelsky would be compensated in excess of \$3,000 per acre.

If, however, the state condemned the parcel the day after the deal was closed, condemnee Rouse would also be compensated according to the highest and best use principle. Rouse could argue that the \$3,000 per acre figure is only the price at which Gudelsky sold, not the value of the land's highest and best use, that is, as the key to a multimillion dollar deal. Thus, Rouse would also be awarded much more than \$3,000 per acre.

From this example, it is easy to see the illogical results produced by utilizing a highest and best use principle of valuation. The value of the tract to Gudelsky was \$1,000. He sold the tract for \$3,000. Yet, although he was unable and had no intention of developing his tract, he would receive in excess of \$3,000 per acre, the value of the land to Rouse. Although Rouse also receives somewhat of a windfall, his seems less disturbing because he, in fact, had the ability and intent to develop the land. Considering the inconsistencies produced in using the highest and best use principle, an alternative is needed.

#### B. *The Status of the Owner Standard*

The weakness of the hypothetical willing buyer and willing seller theory is that it attempts to determine the value of the property through the guise of the fully informed and willing buyer figure. If the constitutional mandate is to compensate owners of property,<sup>57</sup> then the value of property should be based upon its value in its owner's hands. In lieu of the highest and best use principle, which emphasizes the particular physical characteristics, topography, and demography of the land, it is submitted that the status of the owner should be the focus of a land valuation. It is not suggested that these traditional factors be ignored, but rather that the status of the owner be the primary factor considered. Support for this proposal can be found in the New York Court of Appeals' decision in *Grand Central Terminal*. Chief Judge Breitel examined the history and ownership of the Terminal, and the potential for development of surrounding parcels, in addition to considering the topographic and demographic characteristics of the Terminal.<sup>58</sup> Only then was it determined that the land on which the Terminal was located had public and private value wholly apart from its physical characteristics.<sup>59</sup>

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57. See U.S. Const. amends. V ("[N]or shall private property be taken for public use, without just compensation."), XIV, § 1 ("[N]or shall any State deprive any person of life, liberty, or property, without due process of law.").

58. 42 N.Y.2d at 331-32, 366 N.E.2d at 1275-76, 397 N.Y.S.2d at 918-19.

59. The *Grand Central Terminal* decision goes further and separates the public (social and governmental) value from the private value. *Id.* at 332-33, 366 N.E.2d at 1276, 397 N.Y.S.2d at 919.

The proposed valuation alternative should be distinguished from a pure value to the owner standard under which property is valued considering attributes peculiarly valuable to the landowner.<sup>60</sup> A landowner should not be permitted to argue, for example, that the condemned land has been in his family for five generations and therefore has acquired a unique value to him which is deserving of compensation.<sup>61</sup>

If the status to the owner standard were applied to the Rouse-Gudelsky hypothetical, a result more sensible than that obtained under the highest and best use principle would occur. If Gudelsky were farming the land, he would receive the value of the land as farm land. On the other hand, if Gudelsky recently purchased the land planning to develop it, the land would be valued by its planned purpose. Gudelsky's plans for the land are a question of fact. Gudelsky may claim that he plans to develop the property as a space center. If that use of the land is unrealistic in Gudelsky's hands, that use should not be used to gauge its market value. If, however, Gudelsky claims that he plans to develop the land as a residential subdivision, and he can prove that he hired an architect and engineer, and submitted plans for approval, it would seem that he did intend to develop a residential subdivision. The land, therefore, should be valued according to its planned purpose.

Although valuing property based upon either its actual use or according to the status of the property holder is not a novel idea,<sup>62</sup> their joint application is. Courts appear to have adopted a value to the owner standard by espousing a policy of indemnification.<sup>63</sup> The courts have said that just compensation is intended to put the property owner in as good a financial position as he would have been in, but for the condemnation; the economic impact of condemnation is to be borne by the public, rather than the individual landowner. In actuality, however, the courts have not provided complete indemnification. Owners have not received compensation for numerous incidental and consequential damages such as loss of business, loss of future profits, business interruption, relocation cost, appraisals, surveys, attorneys' fees, and loss of goodwill of a going concern.<sup>64</sup>

A status to the owner standard can replace the highest and best use

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60. A. Jahr, *supra* note 40, § 69; 4 Nichols', *supra* note 40, § 12.22; 1 L. Orgel, *supra* note 40, §§ 14, 37-46, 66-80; Bigham, *supra* note 40, at 68-70; Hershman, *supra* note 40, at 301-02.

61. See, e.g., *Mitchell v. United States*, 267 U.S. 341 (1925).

62. See, e.g., I.R.C. §§ 1221, 1231(a), 2032A.

63. For a statement of the indemnification principle, see *United States v. Miller*, 317 U.S. 369 (1943) and cases cited note 4 *supra*.

64. See, e.g., S. Searles, *Just Compensation: The Law, in a Practical Guide to the Legal and Appraisal Aspects of Condemnation* 187 (1969); Bigham, *supra* note 40, at 63-70.

principle in all applications of the just compensation clause, or can be selectively used in certain types of governmental takings.<sup>65</sup> For example, if a government takes land for a toll road that essentially will pay for itself, and the landowner is compensated according to the highest and best use principle, the cost of the compensation will be spread among all those who use the road, rather than among the local taxpayers. Thus, although the seller may get a windfall, the taxpayers are not treated unfairly. On the other hand, when the government takes land for uses which are not income-producing, for example, for social benefit such as landmarks, historic sites, and parks, use of the status to the owner standard is more appropriate.<sup>66</sup>

### III. REFINING COSTONIS' ACCOMMODATION ARGUMENT

The consistency between Costonis' accommodation argument and the status of the owner standard can be illustrated by superimposing the Rouse-Gudelsky tract on Costonis' "Spectrum of Land Use Intensity"<sup>67</sup> and on the Valuation Continuum.<sup>68</sup>

ROUSE-GUDELSKY TRACT: COSTONIS' SPECTRUM OF LAND USE INTENSITY			
	<i>Intensity Index</i>	<i>Use</i>	<i>Value Per Acre</i>
Increasing Development Potential ↑	Highest and Best Use Unrestricted by Public Regulation	High Density City	\$5,000
	Allowable Use	New City	\$4,000
	Reasonable Beneficial Use (RBU)	Residential	\$3,000
	Resource Protective Use	Farm	\$1,000
	Zero Intensity	None	-0- or Negative

65. There is a trend in land use legislation to single out "areas of critical state concern," "key facilities," or ecologically sensitive areas for different treatment. See ALI Model Land Development Code § 7-201 (1975); Comment, *State Land Use Statutes: A Comparative Analysis*, 45 Fordham L. Rev. 1154, 1154-55 (1977).

66. It has been suggested by Professor Sax that a difference exists when the government is engaging in a proprietary function, that is, an income producing activity, as opposed to when the government is engaged in an enterprise function. In the case of a proprietary function, Sax would apparently apply the highest and best use principle. See Sax I, *supra* note 1, at 61-76; Sax, *The Public Trust Doctrine in Natural Resource Law: Effective Judicial Intervention*, 68 Mich. L. Rev. 471 (1970). But see Sax II, *supra* note 1, at 177-86.

67. *Fair Compensation*, *supra* note 2, at 1050.

68. See notes 23-24 *supra* and accompanying text.

The value and use figures are arbitrary and are intended to be illustrative only. It is assumed that a totally unrestricted tract can yield a greater return than the \$3,000 per acre purchase price—hence the \$5,000 figure. Development as a city must yield more than the \$3,000 per acre price, otherwise Rouse would have little incentive to buy the tract—hence the \$4,000 figure. The reasonable beneficial use (RBU) category represents the dividing line between the police power and Costonis' accommodation power. As long as a regulation permits the owner a reasonable economic return, or what Costonis terms a reasonable beneficial use, no compensation is required.<sup>69</sup> The RBU category has been assigned a value of \$3,000, the contract price between Rouse and Gudelsky. Finally, the \$1,000 figure is the value of the land to Gudelsky, as a farm, before Rouse's plans for development.

On the Valuation Continuum, the land's value is based upon ownership.

ROUSE-GUDELSKY TRACT WITH ROUSE AS CONDEMNEE: VALUATION CONTINUUM

<i>Use Restriction</i>	<i>Value to Rouse</i>	<i>Compensation</i>	<i>Model</i>
Unrestricted	\$5,000	-0-	
Limited to City	\$4,000	-0-	I
Limited to RBU (Residential)	\$3,000	-0-	II
Limited to Farm	\$1,000	\$3,000	III
Limited to Zero Intensity	-0-	\$5,000	IV

The Valuation Continuum mode of analysis yields significant disparities in treatment. If the property is unrestricted, that is, subject to no ordinance or statute restricting the use of the land, no compensation is due. This case does not fall under any of the four models. Model I is an exercise of the police power; the restriction may make the property less valuable than unrestricted property, but no compensation is required. Under Model IV, the traditional taking model, Rouse would be awarded \$5,000 compensation, because Model IV requires valuation according to the highest and best use principle. The difference in compensation required under Model I and Model IV is the disparity issue of which Costonis speaks.

Model II is Costonis' accommodation model, under which an exercise of police power requires some compensation. If the exercise of the

69. *Fair Compensation*, *supra* note 2, at 1051. See generally *Disparity Issue*, *supra* note 2, at 422-26. Professor Berger has suggested that Costonis' reasonable beneficial use category puts old wine in new bottles. See *Berger*, *supra* note 16, at 816-17.



police power results in a value less than RBU, Costonis requires compensation up to the amount of RBU.<sup>70</sup> Costonis' RBU analysis, however, necessitates categorizing uses into either exercises of eminent domain or police power. Because the point at which a regulation becomes a taking cannot easily be defined,<sup>71</sup> RBU analysis merely adds to the confusion of existing eminent domain-police power law. An accommodation model should be broad enough to include certain governmental actions, whether exercises of eminent domain or police power, for which less than full compensation will be given.

Model III illustrates a governmental taking for which some, but less than full, compensation is awarded the landowner, based upon the actual use, rather than the highest and best use of the land. Thus, if the tract is restricted and that restriction brings the value of the property below its RBU value, the owner would be compensated for the difference in value as restricted and the value of its intended purpose. In the example, the Gudelsky tract, if restricted to farm land, has a reduced value of \$1,000 per acre. Thus, \$3,000 per acre compensation is required under Model III to give Rouse the value of the land to him, that is, \$4,000 per acre. This is more than the \$2,000 Costonis would give, that is, the \$3,000 RBU value minus the \$1,000 value as farm land, but less than the highest and best use value of \$5,000. It is submitted that the \$3,000 is a fair return because Rouse bought the property with an ability and intent to develop; the compensation is based upon the land's value to him.

The value of the property, as well as the compensation required, changes when Gudelsky is condemnee.

ROUSE-GUDELSKY TRACT WITH GUDELSKY AS CONDEMNEE: VALUATION CONTINUUM

<i>Use Restriction</i>	<i>Value to Gudelsky</i>	<i>Compensation</i>	<i>Model</i>
Unrestricted	\$1,000	-0-	
Limited to City	\$1,000	-0-	I
Limited to RBU (Residential)	\$1,000	-0-	II
Limited to Farm	\$1,000	-0-	III
Limited to Zero Intensity	-0-	\$5,000	IV

Gudelsky could not demand compensation until a land use restriction devalued the land below its value to him, that is, \$1,000 per acre. If a

70. *Disparity Issue*, *supra* note 2, at 411-12; *Fair Compensation*, *supra* note 2, at 1051-55.

71. *Fair Compensation*, *supra* note 2, at 1034-37.

regulation limited his land to a use less profitable than farming,<sup>72</sup> Gudelsky could demand compensation based upon the difference in value of the land restricted and as farm land. Gudelsky's compensation, however, would be based upon the \$1,000 figure, not the \$3,000 RBU figure, nor the \$4,000 figure applicable to Rouse. Thus, Gudelsky's compensation would be \$1,000 per acre or less under Model III, which should be compared to the case of a taking under Model IV for which Gudelsky would receive a \$5,000 award.

### CONCLUSION

This Article is a preliminary inquiry. It raises more questions than it purports to answer. Further analysis is needed to determine Model III's economic consequences, ethical foundation, administrative problems, and proper application. The proposal could also create problems in the area of judicial review and equal protection.<sup>73</sup>

Nevertheless, replacing the highest and best use principle with a status of the owner standard is a step in the right direction. Because compensation under Model III would be less, in most cases, than under Model IV, government money may be freed to be used for open spaces, parks, and other benefits to society which are presently desirable but unaffordable. Additionally, elimination of the highest and best use principle may discourage inefficient development which may, in turn, conserve our natural resources.

An accommodation model is not a panacea for the difficult and elusive problem of drawing a line between a regulation and a taking, but it is a palliative. The trend toward limiting development and conserving resources, coupled with the expanded use of the police power for open space, environmental, and ecological purposes, call for an accommodation model that values land according to the status of the owner. Models II and III are the Hobbits of the middle way; they have always lived there but we folk were unaware of them for many long years.

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72. Examples of less intensive development than agriculture are open space, *see, e.g.*, State Dep't of Ecology v. Pacesetter Constr. Co., 89 Wash. 2d 203, 571 P.2d 196 (1977), and aquaculture. *See, e.g.*, Morris County Land Improvement Co. v. Township of Parsippany-Troy Hills, 40 N.J. 539, 193 A.2d 232 (1963).

73. The different treatment accorded the two parties in the Rouse-Gudelsky hypothetical under the status of the owner standard should not present an equal protection problem because the parties are not similarly situated. Additionally, equal protection rights are personal and are not applicable to the different treatment of the same property. *See, e.g.*, L. Tribe, American Constitutional Law § 16-1, at 991-94 (1978).