TAKINGS AND STATUTORY ENTITLEMENTS: DOES THE TOBACCO BUYOUT TAKE QUOTA RIGHTS WITHOUT JUST COMPENSATION?

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INTRODUCTION

Several of the prominent domestically grown crops are or have been grown under a government-imposed quota system.[1] Under such a system, Congress creates quota rights that are distributed to farmers, providing them with the exclusive right to produce the crop.[2] In the global economy, however, such regulated markets have led to ever-decreasing demand for expensive domestic crops.[3] Instead, manufacturers buy the crops from foreign producers at significant price savings.[4] Because the quota holders' property interests are calculated as percentages of the domestic crop output, the property interests become less valuable as a result, which in turn increases the cost of farming domestically.[5]

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1. *E.g.*, 7 U.S.C. §§ 1311–1316 (2000) (repealed 2004) (tobacco); §§ 1321–1330 (2000) (corn); §§ 1331–1340 (2000) (wheat); §§ 1341–1350 (2000) (cotton); §§ 1351–1356 (2000) (rice); §§ 1357–1359a (2000) (peanuts).

2. *See, e.g.*, § 1313(a) (2000) (repealed 2004).

3. *The Necessity of a Tobacco Quota Buyout: Why It Is Crucial to Rural Communities and the U.S. Tobacco Industry: Hearing Before the Subcomm. on Production and Price Competitiveness of the Senate Comm. on Agric., Nutrition, and Forestry*, 108th Cong. 9 (2004) [hereinafter *Necessity*] (statement of Larry Wooten, president, North Carolina Farm Bureau).

4. *See* Thomas C. Capehart, Jr., *U.S. Tobacco Industry Responding to New Competitors, New Challenges*, AMBER WAVES, Sept. 2003, http://www.ers.usda.gov/amberwaves/september03/features/ustobaccoindustry.htm ("With cheaper tobacco available on the world market, U.S. tobacco is losing global and domestic market share.").

5. *Id.* Beyond economic concerns, the legality of the U.S. quota and price-support system has been questioned, increasing the uncertainty faced by quota holders. *See* Danny McKinney, Burley Tobacco Growers Cooperative Association, Season of Change, http://www.burleytobacco.com/Default.aspx?tabid=27&mid=399&ctl=Details&ItemID=101 (last visited Feb. 2, 2006) (noting that the World Trade Organization in 2004 was preparing to evaluate the legality of the U.S. quota and price support system).

Recent changes to tobacco law illustrate the rising inefficacy of quota systems and problems arising from their dissolution. With the passing of the Fair and Equitable Tobacco Reform Act of 2004 (FETRA, more commonly referred to as the Buyout)[6] as part of the American Jobs Creation Act of 2004,[7] tobacco became the first American crop to move instantaneously from a government-regulated market to a free-market system.[8] Thus, tobacco presents a ready case study in whether the elimination of a regulatory quota system constitutes a compensable taking.

The market for domestically grown tobacco had contracted by half from 1998 to 2004.[9] As a result, the amount of tobacco that a quota holder may produce has similarly decreased by over 50 percent.[10] Moreover, the signing of the Master Settlement Agreement (MSA)[11] in 1998 between tobacco manufacturers and several states has led to an increase in the cost of producing tobacco.[12]

Not surprisingly, tobacco quota holders and their representatives have been clamoring for years for buyout legislation that would eliminate the crippled quota system while justly compensating quota holders for their property interest in the quota rights.[13] Quota holders have witnessed several failed attempts at passing such a buyout.[14]

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6. Pub. L. No. 108-357, §§ 601–643, 118 Stat. 1418, 1521–36 (2004). This Note will use "FETRA" to refer to the act itself, and "the Buyout" to refer to the program as a whole.

7. Pub. L. No. 108-357, 118 Stat. at 1418.

8. Kelly Tiller, Agricultural Policy Analysis Center, The U.S. Tobacco Buyout, at slide 2 (Nov. 1, 2004), http://agpolicy.org/tobuy/ITGA-Tiller-US_Tobacco_Buyout-1Nov2004.ppt. Although peanut quotas were eliminated by the Farm Security and Rural Investment Act of 2002, former peanut producers remain eligible for other types of support and tariffs. Pub L. No. 107-171, 116 Stat. 134 (2002); *see* Capehart, *supra* note 4 (noting that unlike tobacco producers, former peanut producers "may also be eligible for other types of support (such as direct payments, marketing assistance loans, counter-cyclical payments) and are protected by high import tariffs").

9. *See* Tiller, *supra* note 8, at slide 7 (demonstrating graphically that the total flue-cured and burley quotas fell from 1.7 billion pounds per year in 1998 to 0.8 billion pounds per year in 2004).

10. *Id.* at slide 6–7; *Necessity*, *supra* note 3, at 47 (testimony of D. Keith Parrish, CEO, National Tobacco Growers Association).

11. *See infra* Part I.B.

12. One community leader noted, "For nearly every grower, the 2004 crop will be the smallest ever produced. Yet, the 2004 crop will be the most expensive I have ever grown on my farm." *Necessity*, *supra* note 3, at 12 (statement of Sam Crews, president, North Carolina Tobacco Growers Association).

13. Quota holders and their representatives believe that the elimination of the quota system without just compensation would indeed effect a taking. *See, e.g.*, *The Tobacco Quota Buyout: Hearing Before the House Comm. on Agric.*, 108th Cong. 4 (2003) [hereinafter *Quota*]

Although the Buyout at least partially has compensated quota holders for their rights to grow tobacco, it also represents a sudden shift to financial independence for those who were formerly reliant on such rights for their livelihood. Indeed, many tobacco quota holders are elderly persons relying on the stream of income from leasing the quota right to tobacco farmers.[15] Thus, the question of whether the Buyout represents a taking without just compensation is far from abstract for those persons relying on quota leases as their primary source of income.

The Buyout represents the most drastic change in American tobacco policy since 1938.[16] This Note will first describe the history of tobacco quotas in the United States, from 1938 to present. Then, this Note will develop the current structure of takings doctrine. Applying this doctrine to the Buyout, this Note will show that the Buyout changes the tobacco landscape in such a way as to constitute a compensable taking.[17] Additionally, this Note will show that the Buyout payments are only partial compensation[18] and do not rise to the level of "just compensation" required by the Fifth Amendment.[19]

(statement of Rep. William L. Jenkins (Tennessee)) ("I hope that at the end of this process, those with property rights can receive the compensation to which they are entitled."); *id.* at 15 (statement of John William Carter III, owner and operator, Carter Farms) ("We must find a way to compensate current quota owners for their production rights."); *id.* at 18 (statement of Donald L. Moore, owner and operator, Moore Farms) ("I don't believe it is right to take it away without compensation.").

14. The first serious legislative proposals were introduced concurrently with the litigation leading to the MSA. *E.g.*, Tobacco Transition Act, S. 1313, 105th Cong. (1997) (offering Buyout payments to quota holders in exchange for relinquishment of all quota rights); Tobacco Market Transition Act, H.R. 3437, 105th Cong. (1998) (eliminating the quota system while making compensation payments to eligible quota holders). Several other bills followed but were similarly unenacted. *E.g.*, Tobacco Equity Elimination Act of 2002, H.R. 5035, 107th Cong. (2002) (same); Tobacco Equity Elimination Act of 2003, H.R. 245, 108th Cong. (2003) (same); Tobacco Market Transition Act of 2003, S. 1490, 108th Cong. (2003) (same).

15. *See, e.g.*, *Quota*, *supra* note 13, at 18 (statement of Donald L. Moore, owner and operator, Moore Farms) ("Over half of the quota I produce is rented from primarily retired farmers or widowed farm wives who consider this quota a retirement asset.").

16. Tiller, *supra* note 8, at 2 (noting that the Agricultural Adjustment Act, enacted in 1938, marked the genesis of the tobacco quota system); *see infra* text accompanying notes 25–26.

17. *See infra* Part 057 Tw5021.4925 0 TD0.007 Tw[(1)-14.40.0(4.40.0(g(.)-.1(e)-11.1(d)0.2(the ge)-11.1(n)15.1(e)-11.1(si)-9

I. HISTORY AND BACKGROUND OF TOBACCO QUOTAS

The tobacco-growing industry is one of the largest of all crop industries in the United States.[20] In several states, such as Kentucky and North Carolina, tobacco is the most significant crop in the state economy.[21] There are two primary types of tobacco, together constituting about 94 percent of U.S. tobacco production: flue-cured and burley.[22] North Carolina specializes in flue-cured, whereas Kentucky specializes in burley.[23]

A. The Origins of the Tobacco Quota System

As part of the Agriculture Adjustment Act of 1938 (AAA),[24] the federal government instituted a price support and marketing quota system.[25] The tobacco quota system was created to protect farmers from "uncontrollable natural causes" that affected their operations.[26] Congress deemed it an appropriate industry for federal intervention because tobacco farmers "[were] not so situated as to be able to organize effectively, as [could] labor and industry through unions and corporations enjoying Government protection and sanction."[27] Ultimately, the AAA established a quota system to combat the lack of "orderly marketing" of tobacco, which had resulted in the production of "abnormally excessive supplies" of tobacco that were "dumped indiscriminately on the Nation-wide market."[28] The overabundant supply led to a significant reduction in the price of tobacco.[29]

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20. NAT'L AGRIC. STATISTICS SERV., U.S. DEP'T AGRIC., 6–7 tbl.1 (2002) (Historical Highlights: 2002 & Earlier Census Years), http://www.nass.usda.gov/census/census02/volume1/us/st99_1_001_001.pdf.

21. *See* NAT'L AGRIC. STATISTICS SERV., U.S. DEP'T AGRIC., 241 tbl.1 (2002) (State Summary Highlights: 2002), http://www.nass.usda.gov/census/census02/volume1/us/st99_2_001_001.pdf (showing that in North Carolina, for example, more pounds of tobacco (353 million) were produced than any other crop in 2002).

22. JASPER WOMACH, CONG. RESEARCH SERV., TOBACCO PRICE SUPPORT: AN OVERVIEW OF THE PROGRAM 1 (2004), *available at* http://www.ncseonline.org/NLE/CRSreports/04Jun/95-129.pdf.

23. *Id.* at 2.

24. 7 U.S.C. §§ 1281–1521 (2000).

25. *Id.* This Note deals exclusively with the tobacco quota system, *id.* §§ 1311–1316 (repealed 2004), and not the tobacco price support system, *id.* § 1445 (repealed 2004).

26. *Id.* § 1311 (repealed 2004).

27. *Id.* § 1311(a) (repealed 2004).

28. *Id.*

29. *Id.* § 1311(b) (repealed 2004).

Under the tobacco quota system, the federal government initially disseminated production rights to tobacco-growing states,[30] which in turn distributed the rights to particular farmers.[31] The quota rights were attached to certain parcels of land but could be traded within geographic constraints specified by regulation.[32]

Pursuant to the AAA, it was illegal to farm and sell tobacco without first holding a property interest in corresponding quota rights.[33] Thus, a significant secondary market emerged in tobacco quota rights.[34] Such rights could be leased, for example.[35] This secondary market concentrated actual tobacco growing in far fewer persons than those who held quota rights;[36] it also artificially inflated the cost of producing tobacco because most growers leased their quota rights at a substantial cost.[37]

Importantly, the quota rights did not convey the privilege to produce a particular *amount* of tobacco per year. Instead, the secretary of agriculture each year established the amount of tobacco of each type that would be grown in the United States, in light of the projected demands of the major tobacco companies. Thus, the quota rights represented the right to produce a certain *proportion* of the secretary's prescribed yearly total.[38]

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30. *Id.* § 1313(a) (repealed 2004).

31. *Id.* § 1313(b), (c) (repealed 2004).

32. *Id.* § 1316 (repealed 2004).

33. *See id.* § 1314(a) (repealed 2004) ("The marketing of . . . any kind of tobacco in excess of the marketing quota for the farm on which the tobacco is produced . . . shall be subject to a penalty of 75 per centum of the average market price . . . ."); *see also* State v. Philip Morris USA Inc., No. 98 CVS 14377, 2004 WL 2966013, at *4 (N.C. Super. Dec. 23, 2004) ("[T]he only way a producer of tobacco can sell his or her product in the United States is to own or lease quota from a quota owner.").

34. *Philip Morris*, 2004 WL 2966013, at *4.

35. *See Quota*, *supra* note 13, at 12 (statement of Jeff Aiken, owner and operator, Carter Farms).

36. *See Philip Morris*, 2004 WL 2966013, at *4 (noting that in 2002 there were nearly four times as many tobacco quota holders as tobacco growers).

37. *See id.* ("It is clear then that part of the cost of [tobacco] leaf was for leasing quota, a wholly artificial cost created by the federal statutory scheme."); *Quota*, *supra* note 13, at 12–13 (statement of Jeff Aiken, owner and operator, Carter Farms) ("[T]here is another major non-value-added expense I have to pay, the cost of acquiring quota to maintain sufficient levels of production to sustain my farming operation.").

38. To make this distinction clearer, suppose the secretary has determined that F_t pounds of flue-cured tobacco may be produced for year t. A given quota holder might hold the rights to a proportion P of the secretary's total. Thus, the quota holder's property interest in year t is equal to $P \times F_t$ pounds of tobacco. Note, however, that the quota holder's property interest in

B. The Need for a Buyout

On November 23, 1998, the five largest tobacco companies (the Settling Companies)[39] signed an agreement with representatives of forty-six states (the Settling States and, together with the Settling Companies, the Settling Parties), ending litigation in various stages that had been winding through the judicial system across the nation.[40] In order to pay for the MSA,[41] the Settling Companies immediately raised the price of a pack of cigarettes by forty-five cents.[42]

Realizing that the increased price of cigarettes would likely lead to reduced demand and thus reduced revenue for tobacco farmers, the Settling Parties agreed that the Settling Companies would make certain payments (Phase II payments)[43] to farmers on a quarterly basis until 2010.[44] The Phase II payments are intended to compensate the farmers for the economic losses incurred as a result of the MSA and subsequent price increases.

The subsequent decline in demand for domestic tobacco, however, has escalated beyond that envisioned by the Settling Parties.[45] For example, in North Carolina, "farm receipts from tobacco sales [in 2003] were less than $600,000,000, a decline of over

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year $t+1$, namely, $P \times F_{t+1}$, might be equivalent to a greater or lesser number of pounds of tobacco than in year t.

39. The Settling Companies were Brown & Williamson Tobacco, R.J. Reynolds Tobacco Company, Lorillard Tobacco Company, Philip Morris, Incorporated, Commonwealth Tobacco and Liggett & Meyers. JOY JOHNSON WILSON, NAT'L CONFERENCE OF STATE LEGISLATORS, SUMMARY OF THE ATTORNEYS GENERAL MASTER TOBACCO SETTLEMENT AGREEMENT (1999), http://academic.udayton.edu/health/syllabi/tobacco/summary.htm#Preface (last visited Feb. 3, 2006). The first two companies have since merged, forming Reynolds American Inc. News Release, *RJR Shareholders Approve Proposed Combination of Reynolds Tobacco and Brown & Williamson*, July 28, 2004, http://www.reynoldsamerican.com/News/ViewRelease.asp?docID=955.

40. Wilson, *supra* note 39.

41. Over the twenty-five years spanning 1998 to 2023, the Settling Companies will make certain payments, known as the Phase I payments, to the Settling States totaling $206 billion. *Philip Morris*, 2004 WL 2966013, at *7.

42. Capehart, *supra* note 4.

43. Contrast these Phase II payments, made to farmers, with the Phase I payments, made to the Settling States. *Philip Morris*, 2004 WL 2966013, at *7.

44. *Philip Morris*, 2004 WL 2966013, at *3.

45. *See Necessity*, *supra* note 3, at 8 (statement of Larry Wooten, president, North Carolina Farm Bureau) (noting that the regulated market was "never designed to withstand the consequences of the Master Settlement Agreement").

$500,000,000 as compared to 1997."[46] One cause of this decline is the continued availability of cheap foreign-grown tobacco.[47] The secretary has reduced the amount of tobacco that may be produced nearly every year since 1998.[48] In fact, the projected cut for 2005, had buyout legislation not been enacted, was 30 percent.[49] Facing a decline in the poundage associated with their quota property interest, quota holders had, since 1998, begun increasing the prices at which they were willing to lease their quota rights.[50] This is perhaps due in part to the fact that in many cases, tobacco quota holders are elderly persons relying on the quota leases to maintain a constant income stream.[51]

The two largest tobacco-producing states, North Carolina and Kentucky, have been hardest hit by the decline in demand.[52] In such tobacco-reliant states, the decline has had a "ripple effect" in related industries, including those of farm equipment and pesticides.[53]

In light of the decreasing demand for domestic tobacco, the eventual cessation of Phase II payments, and the threat of economic peril, tobacco growers and quota holders have been lobbying for the quota system to be discontinued by way of a buyout for many years.[54] Finally, in 2004, Congress enacted FETRA to address quota holders' concerns.[55]

C. FETRA

FETRA provides for an end to the tobacco quota system as well as an end to the price support program in favor of a free-market

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46. *Id.* at 2 (statement of Sen. Elizabeth Dole (North Carolina)). More dramatically, the quotas for burley tobacco were reduced by 45 percent in *one year*, 2000. *Philip Morris*, 2004 WL 2966013, at *5.

47. Capehart, *supra* note 4.

48. *See* Tiller, *supra* note 8, at 7 (numerically demonstrating the steady quota decline).

49. *Necessity*, *supra* note 3, at 8 (statement of Larry Wooten, president, North Carolina Farm Bureau).

50. Capehart, *supra* note 4.

51. *See Quota*, *supra* note 13, at 18 (statement of Donald L. Moore, owner and operator, Moore Farms) ("Over half of the quota I produce is rented from primarily retired farmers or widowed farm wives who consider this quota a retirement asset.").

52. *See Necessity*, *supra* note 3, at 2 (statement of Sen. Elizabeth Dole (North Carolina)) (noting that this decline "equates to a $1.1 billion hit on North Carolina's economy at current quota levels").

53. *Id.*

54. *See supra* note 14 and accompanying text.

55. Pub. L. No. 108-357, §§ 601–643, 118 Stat. 1418, 1521–36 (2004).

system.[56] Under FETRA and its elimination of the tobacco quota system, most observers expect there to be "a decrease in the cost of production (leasing costs being eliminated) and an increase in the amount produced in the United States (restrictions on production being eliminated), combined with a reduction in the price paid for" tobacco by the tobacco companies.[57] Considering these factors, Congress provided that the dissolution of the quota system would be associated with a buyout of the quota holders' and tobacco growers' property interest (the Buyout Payments).[58]

The Buyout Payments for quota holders consist of $7.00 per pound of quota owned as of 2002, to be paid in equal installments from 2005 through 2014.[59] The Buyout Payments are estimated to cost the government approximately $9.6 billion over ten years.[60] Not all of this money constitutes a net gain for tobacco farmers and quota holders. The Buyout triggers a clause in the MSA that ends the Phase II payments to farmers from the Settling Companies.[61]

The Buyout Payments are "offered" to the tobacco quota holders.[62] Although this might imply that quota holders have an option to reject the Buyout Payments, thereby obviating a takings claim by giving a quota holder a choice, FETRA negates the value of the quota rights regardless of whether the "offer" is accepted.[63] Thus, a tobacco quota holder has little incentive to reject the Buyout Payments.[64]

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56. *Id.* §§ 611–612, 118 Stat. at 1522–24.

57. State v. Philip Morris USA Inc., No. 98 CVS 14377, 2004 WL 2966013, at *4 (N.C. Super. 2004).

58. Pub. L. No. 108-357, §§ 622–623, 118 Stat. 1418, 1525–28 (2004).

59. *Id.* § 622(e), 118 Stat. at 1526–27.

60. *Necessity*, *supra* note 3, at 3 (statement of Hon. Richard Burr, Rep. of North Carolina).

61. *Philip Morris*, 2004 WL 2966013, at *11. Whether Phase II payments are to be terminated at the beginning of 2004, after the third quarter of 2004, or after the fourth quarter of 2004 is the subject of present litigation before the North Carolina Supreme Court. *Id.*

62. As the statute indicates:

> CONTRACT OFFERED.—The Secretary shall offer to enter into a contract with each tobacco quota holder under which the tobacco quota holder shall be entitled to receive payments under this section in exchange for the termination of tobacco marketing quotas and related price support under the amendments made by sections 611 and 612. The contract payments shall constitute full and fair consideration for the termination of such tobacco marketing quotas and related price support.

Pub. L. No. 108-357, § 622(a), 118 Stat. at 1525.

63. *Id.*

64. *Id.*

Because farmers will begin competing directly with foreign growers, many farmers are likely to abandon the growing of tobacco, and many quota holders are left with no other means of income but the Buyout Payments.[65] Therefore, it remains critical that the Buyout Payments constitute "just compensation" if FETRA effects a taking of the quota holders' property interest in their quota.

II. TAKINGS ANALYSIS

The Takings Clause of the Fifth Amendment provides, "[N]or shall private property be taken for public use, without just compensation."[66] The "aim of the Clause is to prevent the government 'from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.'"[67] Nevertheless, "a party challenging governmental action as an unconstitutional taking bears a substantial burden" in proving that the taking is unconstitutional.[68] A takings analysis begins by first identifying the property or property interest allegedly taken,[69]

65. *Quota*, *supra* note 13, at 18 (statement of Donald L. Moore, owner and operator, Moore Farms).

66. U.S. CONST. amend. V.

67. E. Enterprises v. Apfel, 524 U.S. 498, 522 (1998) (quoting Armstrong v. United States, 364 U.S. 40, 49 (1960)).

68. *Id.* at 523.

69. U.S. CONST. amend. V; *see* Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1192–93 (1967) (insisting that the "particular thing" allegedly taken must be defined before takings analysis may proceed).

Notably, a takings claim alleging a physical occupation or exercise of eminent domain, *see infra* notes 77–79 and accompanying text, requires a showing that the taking was for a "public use." *See* Thompson v. Consol. Gas Utils. Corp., 300 U.S. 55, 80 (1937) ("[O]ne person's property may not be taken for the benefit of another private person without a justifying public purpose, even though compensation be paid."). Nevertheless, this "public use" requirement has been broadly construed. *See, e.g.*, Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 240 (1984) ("The 'public use' requirement is thus coterminous with the scope of a sovereign's police powers."). Thus, the Court has held that even a state-sponsored real property redistribution scheme constituted a "public use." *Id.* at 241–42; *see also* Kelo v. City of New London, 125 S. Ct. 2655, 2668 (2005) (finding potential economic development to be a satisfactory public purpose).

In the case of regulatory takings, however, "a public use has [never] been a necessary component." Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 535 U.S. 302, 326 (2002). Therefore, a government need not demonstrate as a threshold matter that its actions serve a public purpose. The existence of a public or private use has no bearing on the finding of a regulatory taking.

Note also that state action must be shown before a takings claim will lie. Barron v. City of Baltimore, 32 U.S. 243, 247 (1833). Moreover, the Takings Clause does not in itself protect private property interests from actions by state governments. *Id.* Nevertheless, the Takings

proceeds by determining whether such interest was actually taken,[70] and if it was, finally concludes by assessing whether just compensation was provided.

At the outset, it would appear that there are two ways to incorporate the "taking" and "just compensation" elements of the Takings Clause. In the first method, a court ignores any proffered compensation, determines whether the property interest has been taken, and only then considers whether the proffered compensation is sufficiently "just." In the second method, a court weighs any proffered compensation as a retained interest in the property allegedly taken.

Consider the following hypothetical. Suppose a property owner has a property interest, the value of which is $100,000. Imagine that the government is about to pass a regulation that would reduce the fair market value of the property to a mere $20,000. An organization representing the interests of the property owner and those similarly situated then successfully lobbies to attach a provision that provides partial compensation of $30,000 to the property owner.

Under the first method (ignoring proffered compensation initially), the $30,000 is inapposite to the question of whether a taking has occurred. Such a regulation may constitute a taking that requires just compensation.[71] If so, the government must compensate the property owner in the amount of $80,000.[72] Thus, a court would find that the provision of $30,000 is not "just" in light of the proper compensation due of $80,000. The court would levy a judgment against the government in the amount of $50,000.[73]

Alternatively, consider an analytical method whereby the *actual compensation* given, if any, is considered as part of the takings analysis. Under this approach, the $30,000 paid to the property owner concurrently with the passage of the statute would be added to the $20,000 of in-kind value remaining in the property interest. Then, a

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Clause is considered incorporated under the Due Process Clause of the Fourteenth Amendment, and thus applies to the States. Chi., B. & Q.R. Co. v. City of Chicago, 166 U.S. 226, 232 (1897). In the case of the buyout of tobacco quota holders, the enactment of FETRA is sufficient to meet the state action requirement.

70. *See infra* Part II.B.

71. *See infra* Part II.B.

72. *See infra* Part II.C.

73. That is, the property would have been reduced in value from $100,000 to $20,000, or $80,000. Because the provision of $30,000 is less than the $80,000, the government would still owe $80,000 less $30,000 or $50,000 to the property owner.

court would decide if the regulation, which deprived the property owner of only 50 percent (versus 80 percent under standard takings analysis) of the property value, constitutes a taking. Notably, the balancing test often used to determine whether an action constitutes a taking does not establish a bright line beyond which a taking must be found.[74] Thus, a court might find that no taking occurred.[75]

The Court has embraced the first method, ignoring proffered compensation until a taking is found: the compensation, if any, provided by the government is considered only as part of the just compensation question.[76] The question, therefore, remains what precisely constitutes a taking. The Court has identified at least three distinct categories of takings, which are regulatory takings, eminent domain, and physical occupation.[77] This Note will focus on applying

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74. *See infra* Part II.B.2.

75. *See* Pa. Coal Co. v. Mahon, 260 U.S. 393, 415 (1922) ("The general rule . . . is that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking.").

To be more precise, suppose a property owner holds a property interest worth V_i before the passing of the regulation, which is worth only V_t afterwards, and the government offers partial compensation, C_p. Further suppose that, in light of all of the facts and circumstances of the case, a taking will be found if the property owner realizes an economic loss of L_t (a positive number). Finally, let the just compensation due if a taking is found be C_j.

Then, under a takings analysis in which the just compensation question is analytically distinct from the takings question, a taking will be found when $V_i - V_t > L_t$, and the just compensation due can be defined by the formula, $C_j = V_i - V_t - C_p$. If, however, $V_i - V_t \leq L_t$, no taking will be found, and no additional compensation will be due.

Conversely, under the alternative method, in which the just compensation question is conflated with the takings question, a taking will be found when $V_i - V_t > L_t + C_p$, and the just compensation due can again be defined by the formula given above.

Thus, the significance of the difference in analytic method is not in the extreme cases, when both methods find a taking or both find no taking. Instead, in the realm where $L_t + C_p \geq V_i - V_t > L_t$, as in the example above, the difference in analytic method means the difference between a taking being found and compensated at $C_j = V_i - V_t - L_t - C_p$, and no taking being found. Under the alternative method, the government could use partial compensation to avoid *ever* having to pay *just* compensation, provided that it accurately selected the value of C_p such that $V_i - V_t \leq L_t + C_p$.

76. *See* MacDonald, Sommer & Frates v. Yolo County, 477 U.S. 340, 350 (1986) ("[A] court cannot determine whether a municipality has failed to provide 'just compensation' until it knows what, if any, compensation the responsible administrative body intends to provide."). *But see* Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 137 (1978) (holding that certain partial compensation rights "nevertheless undoubtedly mitigate whatever financial burdens the law has imposed on appellants and, for that reason, are to be taken into account in considering the impact of regulation"). For further application of this critical distinction in light of the Buyout, see *infra* Part III.C.

77. Stuart Miller, *Triple Ways to Take: The Evolution and Meaning of the Supreme Court's Three Regulatory Taking Standards*, 71 TEMP. L. REV. 243, 245 (1998).

the "famously incoherent" regulatory takings analysis to the Buyout.[78] Discussion of the other two categories, eminent domain and physical occupation,[79] are inapposite to a takings analysis of the Buyout, and are thus beyond the scope of this Note.

A. Identifying the Property Interest

Notably, the property interest of quota rights is not an interest in land or tangible property. The Court has exhibited a willingness, however, to extend takings protection to any property interest, not merely those that may be physically taken.[80] Even so, defining a property interest's "functional dimension,"[81] that is, identifying the property interest in question among the various rights a property owner may possess, is only the first step in delineating the precise property interest alleged to be taken.[82] Although the functional dimension of a particular property interest has been identified, the specific property interest allegedly taken must be defined, both temporally and spatially, before proceeding to determine whether just compensation was provided.[83]

As recently explained by the Supreme Court:

> Property interests may have many different dimensions. For example, the dimensions of a property interest may include a physical dimension (which describes the size and shape of the property in question), a functional dimension (which describes the extent to which an owner may use or dispose of the property in

78. Holly Doremus, *Takings and Transitions*, 19 J. LAND USE & ENVTL. L. 1, 1–2 (2003).

79. Miller, *supra* note 77, at 245.

80. Property interests are not confined in the "vulgar and untechnical [sic] sense [to] the physical thing with respect to which the citizen exercises rights recognized by law." United States v. Gen. Motors Corp., 323 U.S. 373, 377 (1945). Instead, in the context of takings analysis, property interests include "every sort of interest the citizen may possess." *Id.* at 378. This expansive definition of "property" has been limited, however, to exclude abstract economic interests unless "they are legally protected interests." United States v. Willow River Power Co., 324 U.S. 499, 503 (1945).

81. *See* Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 216 F.3d 764, 774 (9th Cir. 2000) (defining "functional dimension" as "the extent to which an owner may use or dispose of the property in question"), *aff'd*, 535 U.S. 302 (2002).

82. *See* Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 130 (1978) (identifying the precise property interest at issue, namely, the airspace above New York's Grand Central Station before proceeding with the takings analysis).

83. *Tahoe-Sierra*, 535 U.S. at 318.

question), and a temporal dimension (which describes the duration of the property interest).[84]

Because it is often critical in a takings analysis to "compare the value that has been taken from the property with the value that remains in the property,"[85] the question arises as to "whose value is to furnish the denominator of the fraction."[86] That is, to determine the extent of a reduction in value of a property interest, one must first decide the bounds of the property interest being taken. The significance of selecting the "denominator" cannot be overstated because "[t]o the extent that any portion of property is taken, that portion is always taken in its entirety."[87] The Court, however, has "consistently rejected . . . an approach to the 'denominator' question" that establishes the denominator to be precisely the size or duration that was taken.[88]

Instead, the physical dimension of the property interest must be considered to be coterminous with the boundaries of the functional property interest in question.[89] Thus, when the Court considered

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84. *Id.* (quoting *Tahoe-Sierra*, 216 F.3d at 774); s*ee also* RESTATEMENT (FIRST) OF PROPERTY §§ 7–9 (1936) (defining various property estates in terms of such dimensions).

85. Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 497 (1987).

86. *Id.* (citing Michelman, supra note 69, at 1192). To illustrate, suppose that a quota holder has a certain allotment to grow flue-cured tobacco, and a certain allotment to grow burley tobacco. If a new regulation deprives the quota holder of all value of the flue-cured quota, but does not affect the burley quota, then the "denominator question" asks whether to consider only the flue-cured quota or the overall quota in determining if a taking has occurred. Defining the "denominator" as *just* flue-cured would mean that the quota holder was left with the fraction *0 / flue-cured quota*, or zero. Defining the denominator instead as *both* flue-cured and burley would mean that the quota holder was left with *burley quota / (flue-cured + burley quota)*, or a figure larger than zero.

87. Concrete Pipe & Prods. of Cal., Inc. v. Constr. Laborers Pension Trust for S. Cal., 508 U.S. 602, 644 (1993).

88. *Tahoe-Sierra*, 535 U.S. at 331. *But see* Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1016 n.7 (1992) ("[I]t is unclear whether we would analyze the situation as one in which the owner has been deprived of all economically beneficial use of the burdened portion of the tract, or as one in which the owner has suffered a mere diminution in value of the tract as a whole."). Fortunately for parsimony, this dictum has not modified lower courts' rejection of conceptual severance. *E.g.*, Broadwater Farms Joint Venture v. United States, 35 Fed. Cl. 232, 238–40 (1996); Bauer v. Waste Mgmt. of Conn., Inc., 662 A.2d 1179, 1196 (Conn. 1995). The Court itself has since retreated from such stringent conceptual severance. *See* Palazzolo v. Rhode Island, 533 U.S. 606, 630–31 (2001) (considering the affected wetlands property in light of the claimants entire land interest, including the portion that remained developable after the regulation).

89. *See* Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 130 (1978) ("'Taking' jurisprudence does not divide a single parcel into discrete segments and attempt to determine whether rights in a particular segment have been entirely abrogated . . . . [The] Court focuses . . . on . . . the parcel as a whole.").

whether a New York City regulation depriving the owners of Grand Central Station of their right to develop the airspace above the terminal was an unjust taking, it defined the physical dimension of the property interest as "the parcel as a whole," extending above and below the ground in accordance with title and state law.[90]

Similarly, the temporal dimension[91] of the property interest must be considered to be coterminous with the boundaries of the functional property interest in question.[92] Thus, for example, a fee simple estate has an indefinite temporal dimension,[93] whereas a life estate would have a temporal dimension coincident with the lifetime of the life-estate holder.[94] Similarly, a moratorium on the development of a particular parcel of land for a thirty-two-month period does not constitute a taking of the owner's *entire* property interest.[95]

B. Determining Whether a Taking Has Occurred

Although the rules for delineating the dimensions of the property interest in question appear to be fairly well settled after *Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency*,[96] the rules for determining whether a taking has occurred remain "a problem of considerable difficulty."[97] The takings issue has been called "[b]y far the most intractable constitutional property

90. *See id.* at 130–31 ("In deciding whether a particular governmental action has effected a taking, this Court focuses rather both on the character of the action and on the nature and extent of the interference with rights in the parcel as a whole—here, the city tax block designated as the 'landmark site.'").

91. Defining the temporal dimension of the property interest includes assessing the duration or longevity of the interest and affixing the point in time at which to value the interest.

92. *See Tahoe-Sierra*, 535 U.S. at 332 ("[A] permanent deprivation of the owner's use of the entire area is a taking of 'the parcel as a whole,' whereas a temporary restriction that merely causes a diminution in value is not.").

93. *See, e.g.*, *id.* ("Logically, a fee simple estate cannot be rendered valueless by a temporary prohibition on economic use, because the property will recover value as soon as the prohibition is lifted.").

94. RESTATEMENT (FIRST) OF PROPERTY § 117 (1936).

95. *Tahoe-Sierra*, 535 U.S. at 332. Nevertheless, such interference may yet constitute a taking if it "goes too far." Pa. Coal Co. v. Mahon, 260 U.S. 393, 415 (1922). For a discussion of the "too far" test, as well as the situations in which a per se taking may be found, see *infra* Part II.B.2.

96. 535 U.S. 302, 318 (2002).

97. Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 123 (1978).

issue."[98] As one commentator observes, "[T]akings doctrine is a mess."[99]

As a threshold matter, regulatory takings analysis does not measure what is gained by the government, but rather, what is lost by the property owner.[100] Nevertheless, three separate standards have been developed by the Court to analyze regulatory takings claims.[101] One of the three, the "essential nexus" test, has recently been limited to cases involving exactions and is thus irrelevant to the Buyout context.[102] Each of the other two standards presents a sufficient basis for a regulatory takings claim, and thus both should be evaluated in a given case.[103] The first test entails a categorical standard by which a per se taking occurs. The second test involves a balancing of the facts and circumstances of a given case. Each of these two standards will be examined in turn.

1. *The Categorical Standard*. Throughout the history of the takings doctrine, a categorical standard by which a per se taking may be found has evolved.[104] The essence of the modern categorical

98. Carol M. Rose, Mahon *Reconstructed: Why the Takings Issue Is Still a Muddle*, 57 S. CAL. L. REV. 561, 561 (1984); *see also* Jed Rubenfeld, *Usings*, 102 YALE L.J. 1077, 1078 n.2 (1993) (citing some of the more colorful descriptions of the confused state of takings jurisprudence).

99. Daniel A. Farber, *Public Choice and Just Compensation*, 9 CONST. COMMENT. 279, 279 (1992).

100. *See* United States v. Gen. Motors Corp., 323 U.S. 373, 378 (1945) ("[T]he deprivation of the former owner rather than the accretion of a right or interest to the sovereign constitutes the taking.").

101. Miller, *supra* note 77, at 245; *see, e.g.*, Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1014, 1016, 1019 (1992) (recognizing that a taking may occur by lack of an adequate state interest, by a categorical rule, and by a balancing test); Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 485, 492 (1987) (same).

102. Lingle v. Chevron U.S.A. Inc., 125 S.Ct. 2074, 2086 (2005).

103. Miller, *supra* note 77, at 245. Of course, in certain cases one or more of the three categories will merit little discussion. For example, the categorical rules may be clearly inapposite to the analysis of a particular case.

104. Miller, *supra* note 77, at 287. One of the early manifestations of a categorical standard arose in *Hadacheck v. Sebastian*, 239 U.S. 394 (1915). Under *Hadacheck*, a use may be prohibited entirely without triggering the need for compensation if the prohibited use constitutes a public nuisance. *Id.* at 408. Elimination of the tobacco quota system, however, does not curb a public nuisance. Smoking tobacco may indeed constitute a public nuisance in certain circumstances, s*ee, e.g.*, R.I. GEN. LAWS § 23-20.6-2(a) (2001) ("Smoking tobacco in any form is a public nuisance and dangerous to public health . . . ."), *repealed by* Public Health and Workplace Safety Act, Pub. L. No. 2004, ch. 198, § 1. Here, however, the productive use of a quota property interest, namely, growing tobacco (or leasing property for tobacco growing), is not likely to create a public nuisance.

standard—as developed in *Lucas v. South Carolina Coastal Council*[105]—is that a regulatory taking of *all* of the economic value of a property interest must be compensated.[106] The categorical standard embraced by *Lucas* is difficult to meet, however.[107] For example, even a reduction in value from $3,150,000 to $200,000 has been held not to constitute a taking of *all* of the economic value of the property.[108] As a result, much scholarly criticism has been levied against *Lucas*.[109] Nevertheless, *Lucas* remains controlling authority.[110]

2. *The Balancing Standard*. Absent a categorical taking,[111] most regulatory claims are "a question of degree—and therefore cannot be disposed of by general propositions."[112] Thus, there is no "set formula to determine where regulation ends and taking begins."[113]

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105. 505 U.S. 1003 (1992).

106. *Id.* at 1027. When undertaking a takings analysis, it is critical to first define the functional, spatial, and temporal dimensions of the property interest in question. *See supra* Part II.A. Otherwise, *any* regulatory taking could meet the categorical standard of *some* property interest. *See supra* note 34 and accompanying text.

107. 505 U.S. at 1036 (Blackmun, J., dissenting) ("[T]he Court imagines that [the categorical standard] will arise 'relatively rarely' or only in 'extraordinary circumstances.'").

108. *See* Palazzolo v. Rhode Island, 533 U.S. 606, 630–31 (2001) (holding that a regulation precluding the development of a seventy-four-lot subdivision on a particular plot did not constitute a "total taking" because the property owner could still "build a substantial residence" on the parcel).

109. *See, e.g.*, Richard Epstein, Lucas v. South Carolina Coastal Council: *A Tangled Web of Expectations*, 45 STAN. L. REV. 1369, 1371 (1993) ("The Supreme Court's inability to understand the role of reasonable expectations in generating entitlements paves the way for the rapid elimination of all perceived entitlements by simply claiming that the enactment of a single government regulation reasonably creates an expectation that further regulations will follow."); Donald Large, Lucas: *A Flawed Attempt to Redefine the* Mahon *Analysis*, 23 ENVTL. L. 883, 886 (1993) ("The primary flaw I see in the majority's opinion is that having established the principle that you have to pay the land owner for a total wipe-out of value, and having eliminated the 'noxious use' exception to the principle, they dragged the exception right back in again."); Laura McKnight, *Regulatory Takings: Sorting Out Supreme Court Standards After* Lucas v. South Carolina Coastal Council, 41 U. KAN. L. REV. 615, 615 (1993) ("Unfortunately, the Court in *Lucas* did not pin down a standard that eliminates the confusion regarding regulatory takings.").

110. *See Palazzolo*, 533 U.S. at 630–32 (applying the categorical standard from *Lucas* to the facts before the Court).

111. *See supra* Part II.B.1.

112. Pa. Coal Co. v. Mahon, 260 U.S. 393, 416 (1922).

113. Goldblatt v. Town of Hempstead, 369 U.S. 590, 594 (1962).

Certainly, not every regulatory action by a state should result in a taking.[114] On the contrary, the Takings Clause "preserves governmental power to regulate, subject only to the dictates of 'justice and fairness.'"[115] Unfortunately, the Court has "been unable to develop any set formula for determining when justice and fairness require that economic injuries caused by public action be compensated by the government."[116] Thus, "[t]he inquiry into whether a taking has occurred is essentially an 'ad hoc, factual' inquiry."[117]

Instead, a balancing standard controls, by which a regulatory taking occurs when a regulation "goes too far" to limit the property interest in question.[118] In "certain circumstances . . . a particular exercise of the State's regulatory power is so unreasonable or onerous as to compel compensation."[119] Of course, under such a standard, "[t]here is no abstract or fixed point at which judicial intervention under the Takings Clause becomes appropriate."[120] A court must "rely 'as much [on] the exercise of judgment as [on] the application of logic.'"[121]

Despite the vagaries of the Court's approach to the balancing standard, two factors are of particular significance: (1) "the economic impact of the regulation on the claimant"; and (2) "the extent to which the regulation has interfered with distinct investment-backed expectations."[122] Often, the Court has characterized the second factor

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114. *See Mahon*, 260 U.S. at 413 ("Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law.").

115. Andrus v. Allard, 444 U.S. 51, 65 (1979) (quoting Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978)).

116. *Penn Cent.*, 438 U.S. at 124 (internal quotations omitted).

117. Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1005 (1984) (quoting Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979)).

118. *Mahon*, 260 U.S. at 415.

119. Palazzolo v. Rhode Island, 533 U.S. 606, 627 (2001).

120. *Andrus*, 444 U.S. at 65.

121. MacDonald, Sommer & Frates v. Yolo County, 477 U.S. 340, 349 (1986) (quoting *Andrus*, 444 U.S. at 65).

122. Penn Cent. Transp. Co. v. City of NewYork, 438 U.S. 104, 124 (1978). *Penn Central* actually lists three factors as critical for takings analysis. *Id.* The third, however, "the character of the government action," *id*., is synonymous with the distinction among eminent domain, physical occupation, and regulatory action. *See, e.g.*, *id.* (citing "physical invasion by the government" as an example of the "character of government action"); Miller, *supra* note 77, at 248–53 (noting the standards applicable to takings claims for eminent domain and physical occupation); *see also supra* notes 77–79 and accompanying text.

as probative of, or as an example of, the first.[123] Nevertheless, it is helpful to analyze the two factors separately.[124]

The Court first articulated the economic-impact factor in *Agins v. City of Tiburon*.[125] A regulation effects a taking when it "denies [a property] owner economically viable use" of property.[126] The economic-impact test relies on an infringement of a property owner's right to "use" the property.[127] Of course, not every regulation economically impacting a property owner will constitute a taking.[128] Rather, the government may "adjust[] the benefits and burdens of economic life" for property owners.[129]

The Court created the distinct investment-backed expectations test in *Penn Central Transportation Co. v. City of New York*.[130] Although the Court did not explicitly define the test in *Penn Central*, distinct investment-backed expectations are referred to as "interests that [are] sufficiently bound up with the reasonable expectations of the claimant to constitute 'property' for Fifth Amendment purposes."[131] As an example, the Court cited *Pennsylvania Coal Co. v.*

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123. *See, e.g.*, *Penn Cent.*, 438 U.S. at 124 ("The economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are, of course, relevant considerations."); *cf.* Michelman, *supra* note 69, at 1229–34 (considering the distinct investment-backed-expectations test as part of an analysis of the economic-impact test).

124. Several cases list the two tests as separate factors for purposes of a balancing analysis. *E.g.*, Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979).

125. 447 U.S. 255, 260 (1980).

126. *Id.*

127. *See* Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1017 (1992) ("[T]otal deprivation of beneficial use is, from the landowner's point of view, the equivalent of a physical appropriation."); *see also* Lynda J. Oswald, *Cornering the Quark: Investment-Backed Expectations and Economically Viable Uses in Takings Analysis*, 70 WASH. L. REV. 91, 119 (1995) (noting in light of *Lucas* that "the right to 'use' property has long been viewed as a fundamental characteristic of property").

128. *See, e.g.*, Pa. Coal Co. v. Mahon, 260 U.S. 393, 416 (1922) (holding that government interference with the ground under respondent's property, although causing subsidence of the surface, did not constitute a taking).

129. Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978).

130. *Id.* The Court sometimes refers to this test as the "reasonable investment-backed expectations test." *E.g.*, Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 535 U.S. 302, 342 (2002); Palazzolo v. Rhode Island, 533 U.S. 606, 617 (2001). Regardless of its precise form, the shared term "investment-backed expectations" appears to have been coined in one commentator's famous work on takings. *See* Michelman, *supra* note 69, at 1213 ("The problem, then, is to show that utilitarian property theory, applied with utmost consistency, does not require payment of compensation in every case of social action which is disappointing to justified, investment-backed expectations.").

131. *Penn Cent.*, 438 U.S. at 125.

Mahon,[132] noting that although the claimant had sold the surface rights of his property, he had "expressly reserved the right to remove the coal thereunder."[133]

Nevertheless, a distinct investment-backed expectation "must be more than a 'unilateral expectation or an abstract need.'"[134] Moreover, an expectation in the "most profitable use of" a property interest is not dispositive.[135] Instead, there are many distinct investment-backed expectations "embodied in the concept of 'property.'"[136] When such expectations are "sufficiently important, the Government must condemn and pay for" the property interest before taking it.[137]

Further, the Court has never explained what is required for an expectation to be "investment backed."[138] One approach would be to examine investments forgone by the property owner in order to initially obtain the property interest alleged to be taken.[139] It is not always possible, however, to identify the initial transaction in which the property owner obtained the property interest in question. Even if it were possible, the property owner often did not sacrifice much value at the time of acquisition, but nevertheless might reasonably

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132. 260 U.S. 393 (1922).

133. *Penn Cent.*, 438 U.S. at 127 (citing *Pa. Coal*, 260 U.S. at 414).

134. Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1005–06 (1984) (quoting Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980)).

135. Andrus v. Allard, 444 U.S. 51, 66 (1979).

136. Kaiser Aetna v. United States, 444 U.S. 164, 179 (1979).

137. *Id.*

138. *See, e.g.*, Philip Morris, Inc. v. Reilly, 312 F.3d 24, 36 (1st Cir. 2002) (noting the widespread "struggle to adequately define this term"). Of course, the term "investment" is not limited to money proffered by "investors." Instead, it appears that most expenditures by the challenging party are considered "investment backed." *See, e.g.*, Palazzolo v. Rhode Island, 533 U.S. 606, 611 (2001) (assuming that private purchase of parcel of land is "investment backed"); Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1008 (1992) (same).

139. Under such an approach, "investment-backed expectations" embody something akin to the tax concept of "basis." *See* 26 U.S.C. § 1012 (2000) (detailing the tax rules for calculating basis). Basis is a placeholder for the investment that a property owner originally spent to obtain the property in question. *Id.* Typically, "[t]he basis of property [is] the cost of such property." *Id.*

An analogy may also be made to contract law. For example, when the future property owner enters into an agreement with the government, providing good consideration in exchange for the creation of a regulatory right, later deregulation might effect a taking. *See* J. Gregory Sidak & Daniel F. Spulber, *Deregulatory Takings and Breach of the Regulatory Contract*, 71 N.Y.U. L. REV. 851, 862 (1996) ("[T]he regulatory contract represents a meeting of the minds no more ambiguous than typical commercial contracts between private parties.").

invest in future growth of the property interest.[140] Instead, the Court has inquired as to the significance of the property owner's expectations relating to the property taken.[141]

Similarly, the property owner need not show that the challenged regulation was enacted after the property interest was obtained.[142] For example, when an unconstitutional regulation was passed prior to the property owner receiving title, the property owner could nevertheless assert a takings claim in light of the regulation.[143]

Nevertheless, part of doing "business in [a] regulated field" is that a property owner "cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end."[144] Thus, as in the rest of regulatory takings analysis, a court must examine each case on its own peculiar facts.

C. Just Compensation

Once a court has established that a taking has occurred, the court then examines whether the government has provided "just compensation."[145] In most instances, "just compensation" is merely the fair market value of the property interest,[146] or the amount that "a willing buyer would pay in cash to a willing seller."[147] The fair market value "term is 'not an absolute standard nor an exclusive method of

140. *See, e.g.*, *Kaiser Aetna*, 444 U.S. at 165–69, 180 (holding that the government had to compensate a property owner for "taking" the right to exclude, even though there was scant evidence of what consideration had been provided by the property owner to acquire the property initially).

141. *See, e.g.*, Hodel v. Irving, 481 U.S. 704, 715 (1987) (considering the right to devise certain Indian lands as insufficient for a distinct investment-backed expectation when the lands were held in trust by the government and generally only leased to the property owner).

142. *See Palazzolo*, 533 U.S. at 629–30 (rejecting the argument that regulations cannot be challenged by those who acquire title to property after such regulations are passed).

143. *See id.* at 627 (reasoning that otherwise, "[a] State would be allowed, in effect, to put an expiration date on the Takings Clause and that [f]uture generations, too, have a right to challenge unreasonable limitations" on property interests).

144. Concrete Pipe & Prods. of Cal., Inc. v. Constr. Laborers Pension Trust for S. Cal., 508 U.S. 602, 645 (1993) (citing Fed. Hous. Admin. v. The Darlington, Inc. , 358 U.S. 84, 91 (1958)).

145. U.S. CONST. amend. V; *see also supra* note 75.

146. *E.g.*, United States v. Reynolds, 397 U.S. 14, 16 (1970).

147. Almota Farmers Elevator & Warehouse Co. v. United States, 409 U.S. 470, 474 (1973) (quoting United States v. Miller, 317 U.S. 369, 374 (1942)); *see also* James Geoffrey Durham, *Efficient Just Compensation as a Limit on Eminent Domain*, 69 MINN. L. REV. 1277, 1285 (1985) (reiterating this common test).

valuation,'" however.[148] For example, in some instances, the value lost by the property-interest holder far exceeds the value gained by the government. In such a case, "[i]t is the owner's loss, not the taker's gain, which is the measure of the value of the property taken."[149] Moreover, "[t]he constitutional requirement of just compensation derives as much content from the basic equitable principles of fairness as it does from technical concepts of property law."[150]

The Court has provided conflicting guidance on whether the taking of a property interest *created by government itself* may be considered in just compensation analysis. For example, the Court in *United States v. Fuller*[151] held that "the Government as condemnor may not be required to compensate a condemnee for elements of value that the Government has created."[152] In the same opinion, however, the Court cautioned that "[w]e do not suggest that such a general principle can be pushed to its ultimate logical conclusion."[153]

III. APPLYING THE TAKINGS FRAMEWORK TO THE TOBACCO QUOTA BUYOUT

A. The Quota Holders' Property Interest

A proper takings analysis begins with identification of the specific property interest allegedly taken.[154] In the case of the tobacco quota holders, the entire analysis turns on proper identification of the property interest in question. Here, the property interest is *not* the land on which tobacco is farmed; similarly, the property interest is *not* the right to produce a defined amount of tobacco per year. Instead,

148. United States v. Fuller, 409 U.S. 488, 490 (1973) (quoting United States v. Va. Elec. & Power Co., 365 U.S. 624, 633 (1961)); *cf.* Laura H. Burney, *Just Compensation and the Condemnation of Future Interests: Empirical Evidence of the Failure of Fair Market Value*, 1989 B.Y.U. L. REV. 789, 820–21 (arguing that just compensation analysis should consider "demoralization costs and fiscal illusion").

149. United States v. Causby, 328 U.S. 256, 261 (1946) (citation omitted).

150. *Almota*, 409 U.S. at 478 (quoting United States v. Fuller, 409 U.S. 488, 490 (1973)) (internal citation omitted).

151. 409 U.S. 488 (1973).

152. *Id.* at 492.

153. *Id.* In *Fuller*, landowners claimed that their permits to use nearby government land should be considered part of the value taken when their land was condemned. They argued that if sold on the free market, the land would fetch a higher price because of the associated use permits. *Id.* at 489. The Court held, however, that the taking of the now-worthless use permits should not impact the amount of compensation owed the landowners. *Id.* at 492.

154. *See supra* Part II.A.

the property interest taken by FETRA is the right to produce and sell a certain proportion of the tobacco prescribed by the secretary for a given year.[155]

It remains critical to delineate all dimensions of the property interest in question.[156] In particular, the issue remains of *when in time* to affix the value of property interests. Because the property interests fluctuate in value due to the ever-changing tobacco quota market, selection of the year in which the property interests will be valued may be dispositive of the takings analysis.

The Court has never squarely faced a takings claim in such a time-affected case.[157] One natural selection for the time dimension might be 2004, which would allow an accurate comparison of the value of the quota-property interests immediately before the enactment of FETRA[158] and immediately afterward (zero). The year of the MSA and the sudden increase in cigarette prices—1998—might appear to be an attractive choice also[159] because quota holders experienced a significant decline in the actual poundage of tobacco associated with their quota rights beginning in that year.[160] Nevertheless, this decline, if attributable to the MSA, is not attributable to state action, and thus is inapposite to a takings analysis.[161] Moreover, the lease price of the quota rights increased after the MSA to compensate for this decline.[162] Thus, the most logical selection is 2004, just prior to the passage of FETRA.[163]

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155. *See supra* note 38 and accompanying text.

156. *See supra* Part II.A.

157. *But see* Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 535 U.S. 302, 306, 332 (2002) (considering whether temporary moratoria on development are per se takings). In *Tahoe-Sierra*, however, the temporal dimension in question was not the selection of a particular moment in time, but rather how broadly to define the *time span* for the property interest to determine whether the moratorium effected a taking of all economic value, as in *Lucas*, or (alternately) if the balancing standard of *Mahon* applied.

158. Since FETRA was signed into law on October 22, 2004, this selection would simply be the 2004 quota levels.

159. *See* Capehart, *supra* note 4 (noting that the amount of compensation due would vary depending on the selection of "base period," or time dimension).

160. Tiller, *supra* note 8, at 7.

161. *See supra* note 69 and accompanying text.

162. *See* Capehart, *supra* note 4, at 18 ("As the national quota shrinks . . . , competition for rental quota further inflates the cost of growing tobacco . . . .").

163. *Cf.* United States v. Miller, 317 U.S. 369, 374 (1943) ("[V]alue is to be ascertained as of the date of taking."). Notably, the actual point in time chosen by FETRA is the 2002 quota level; however, the 2002 level was nearly identical to the 2004 level. Tiller, *supra* note 8, at 7.

In sum, the property interest taken under FETRA is the quota holders' right to produce a certain proportion of the nation's domestic-grown tobacco, valued in 2004 prior to the passage of the buyout legislation.

B. The Taking of the Quota Holders' Property Interest

Having carefully defined the property interest, the next step in a takings analysis is to focus on whether such property interest has been taken. As discussed in detail in Part II.B, two pertinent standards are used to determine whether a taking has occurred: the categorical[164] and the balancing.[165]

1. *Taking under the Categorical Standard.* The Court affirmed in *Lucas* that the taking of *all* economic value of a property interest constitutes a taking.[166] Had the property interest been the land itself, or the right to produce tobacco, FETRA would not constitute a taking under *Lucas*. The value of the quota-property interest in the FETRA context, however, lies in the exclusive right to produce tobacco in a regulated market.[167] With the elimination of the regulated market, this interest is worth nothing. Former quota holders and former non–quota holders are on equal footing post-FETRA with respect to the production of tobacco because each can participate in the newly freed tobacco market.[168] Therefore, because the quota holders can no longer extract any value from their extinguished quota rights, FETRA represents a taking of *all* economic value of the property interest and constitutes a categorical taking under *Lucas*.

2. *Taking under the Balancing Standard.* Even if a court found that *Lucas* was inapplicable here, a taking could still be found under

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164. *See supra* Part II.B.1.

165. *See supra* Part II.B.2.

166. Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1028 (1992).

167. *See supra* Part III.A.

168. At least one commentator has argued that the elimination of regulatory price supports does not form sufficient basis for a takings claim. Sidak & Spulber, *supra* note 139, at 995–96. Professors Sidak and Spulber argue that a regulatory contract must first exist before a takings claim may lie; otherwise, the deregulation is the elimination of "mere statutory gratuities." *Id.* at 996. However, Sidak and Spulber's argument focuses solely on "the jurisprudence of network industries" and fails to squarely address the takings issue presented by a quota system. *Id.* at 856.

the balancing standard.[169] A taking may be found under the balancing standard if either of two "particular[ly] significan[t]" factors weighs heavily: (1) "[t]he economic impact of the regulation"; or (2) "the extent to which the regulation . . . interfere[s] with distinct investment-backed expectations."[170] In the case of the tobacco quota holders, there is no question of "economic use" that is affected by the regulation in the sense in which such term is used in the case law.[171] Thus, the critical inquiry is whether FETRA interferes with distinct investment-backed expectations.

To the extent that distinct investment-backed expectations are acquired based on an initial bargained-for exchange, quota holders who have possessed their rights since 1938 might not be able to show that their expectations are investment backed.[172] Such quota holders gave no consideration for their original quota rights.[173] The initial distributions were targeted to those who already farmed tobacco.[174] Thus, in one respect, farmers merely traded their 1938 market share for the quota rights. On the other hand, if such an exchange is considered equitable, then the quota holders arguably regain their market share after FETRA and are justly compensated anyway.

Regardless, several other considerations make it clear that the quota holders' property interest is investment backed. First, present quota holders who are also growers find themselves with farm equipment lying idle due to the ever-decreasing demand, with significant debt remaining on such equipment.[175] Such equipment was purchased with the expectation that their quota rights would continue to be valuable.[176] With the passage of FETRA, many such farmers have ceased or will soon cease farming, yet these farmers still possess

169. Kaiser Aetna v. United States, 444 U.S. 164, 179 (1979).

170. Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978).

171. This factor has been applied to more concrete property interests, such as the development of a parcel of land. *See supra* note 127 and accompanying text.

172. *See supra* note 122 and accompanying text.

173. *See* 7 U.S.C. § 1311 (2000) (repealed 2004) (issuing tobacco quotas without requiring consideration in return).

174. *See id.* (noting the statute's application to those who already produced tobacco).

175. *See Necessity*, *supra* note 3, at 22 (statement of Todd Haymore, director, Universal Leaf Tobacco Company) ("You've made the capital investments and have the equipment to produce a crop twice the size you are today . . . .").

176. *See id.* (implying that such investments and purchases were made because the farmers believed they would be profitable).

heavily financed equipment.[177] Further, this idle equipment cannot be used in the service of any crop but tobacco.[178] Moreover, many present quota holders purchased their rights in the secondary market.[179] Thus, their expectations are surely investment backed, given that they indeed paid fair consideration for the rights with the expectation that they would continue to have value. Therefore, under the "'ad hoc, factual' inquiry"[180] of the balancing test, a court would likely find that the dissolution of the quota holders' investment-backed property interest constituted a taking.

Thus, certain quota holders may present compelling arguments that FETRA effected a taking of their property interest under either the categorical standard or the balancing standard.

C. FETRA Does Not Provide Just Compensation

Having determined that FETRA gives rise to valid takings claims, the final analytical step is to determine whether FETRA's payment provisions constitute just compensation. The Court's usual test for just compensation is simply the market value of the property interest.[181] Here, the market value for the quota rights was approximately $3.50 per pound in 1998.[182] Because the quota total established by the secretary decreased by approximately 50 percent between 1998 and the last year of the quota program, 2004, a reasonable price for quota rights in 2004 would be about $7.00 per pound.[183] This figure matches exactly the compensation offered by the Buyout Payments.

Market value, however, is "not an absolute standard nor an exclusive method of valuation."[184] In the Buyout context, the

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177. *See id.* at 13 (statement of Sam Crews, president, North Carolina Tobacco Growers Association) ("Sadly, [many former tobacco farmers] remain indebted and completely out of the tobacco farming business.").

178. *Id.* at 17.

179. *See Quota*, *supra* note 13, at 22 (statement of Donald L. Wright, owner and operator, Wright Farm) (noting that quota property interests have "been bought, sold, inherited, married and the whole prospect").

180. Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1005 (1984) (quoting Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979)).

181. United States v. Reynolds, 397 U.S. 14, 16 (1970).

182. *Quota*, *supra* note 13, at 24 (statement of Donald L. Wright, owner and operator, Wright Farm).

183. *Id.* at 25.

184. United States v. Va. Elec. & Power Co., 365 U.S. 624, 633 (1961).

"assessment of market value involves the use of assumptions, which make it unlikely that the appraisal will reflect true value with nicety."[185] When legislation affecting an industry is pending, market value within the industry may be an inadequate measure of compensation. In the case of tobacco, the turmoil in the years preceding the passage of FETRA depressed quota prices. Further, because the market prices for quota rights are the market's best guess as to the present value of the right over the lifetime of the quota system, the very uncertainty in the quota system makes a market value definition of just compensation inappropriate.

Instead, a shorter time scale should be employed, then compounded over the projected (pre-FETRA) lifetime of the quota system. In 2003, the one-year-lease price for quota rights was approximately $0.60 per pound.[186] Much less uncertainty is programmed into this figure because quota holders could be more certain that their quota rights would retain their value for one year than indefinitely. Thus, a proper valuation of the quota rights would proceed by compounding the $0.60 per pound price over the (indefinite) lifetime of the quota rights, discounted to present value.[187] At a discount rate of 5 percent, the value of the quota rights is thus $12.60 per pound.[188] From this calculation, whether FETRA's partial compensation of $7.00 per pound is "just" is a much closer question.

One might argue that this calculation is flawed because it compounds the one-year-lease rate of the quota rights *indefinitely*

185. United States v. Miller, 317 U.S. 369, 374 (1943).

186. *Quota*, *supra* note 13, at 24 (statement of Donald L. Wright, owner and operator, Wright Farm).

187. *See id.* at 88 (statement of Rep. Ernie Fletcher (Kentucky)) (noting that payment levels were "the estimated present value of the quota-asset, approximated by compounding the rental-value of the quota-right . . . over the lifetime of the quota"). The one-year-lease price is also appropriate because it responds to the prices in the global market for tobacco. That is, the domestic market for a quota right reflects global tobacco demand and price; if tobacco were fetching a higher price on the global market, for example, the domestic quota market would respond by bidding up the price of quota rights.

188. This figure is based on author's own calculations. Supposing that V_p is the present value of the quota rights, V_l is the value of the yearly lease, and r is the discount rate, then $V_p = V_l / (1 - (1 + r)^{-1})$. Setting V_l at sixty cents per pound and r at 0.05, V_p = $12.60. This calculation assumes that the value of the quota right would remain constant over time indefinitely. Of course, prices fluctuate over time, making this calculation an approximation. The downward-price trend pre-FETRA might be offset by a future price increase if worldwide supply decreased to more adequately match demand, or the downward-price trend might be offset by controlling for uncertainty in the ongoing viability of the domestic quota system. In either case, the simple present-value calculation might still be a valid method for calculating the compensation due.

despite the reality that the quota system was politically unstable and likely to be eliminated by legislation sooner rather than later. Such an argument fails, however, because the threat of government elimination of property rights does not render those rights worth less for purposes of takings analysis.[189] Otherwise, Congress could reduce the amount of compensation that would be "just" simply by threatening to eliminate a right created by statute. The secondary market for the right would become depressed, and thus the compensation due for the ultimate elimination of the right would similarly decrease.

Importantly, the takings analysis here does not ask whether the taking of $5.60 per pound (the present value calculation that yielded a price of $12.60 per pound minus the offered compensation of $7.00 per pound) constitutes a taking requiring just compensation. Such a calculation would conflate the taking and just compensation inquiries, an analytical approach never embraced by the Court.[190] Instead, a taking was first found, then the question of what compensation is "just" follows.[191] Thus, the final question in the analysis is whether the compensation offered by FETRA (56 percent of the value of the quota rights) is "just." Because the Court has held that "'just compensation' means the full monetary equivalent of the property taken" and "[t]he owner is to be put in the same position monetarily as he would have occupied if his property had not been taken,"[192] it is clear that just compensation requires payment of $12.60 per pound, which is 100 percent of the value of the property taken.

Therefore, FETRA effects a taking of the quota holders' property interest in their quota rights and does not provide just compensation.

CONCLUSION

In conclusion, the passage of FETRA effects a taking of private property without just compensation in its elimination of the tobacco

189. *Cf.* Almota Farmers Elevator & Warehouse Co. v. United States, 409 U.S. 470, 477–78 (1973) ("The Government must pay just compensation for those interests 'probably within the scope of the project from the time the Government was committed to it.' It may not take advantage of any depreciation in the property taken that is attributable to the project itself." (quoting *Miller*, 317 U.S. at 377 (internal citations omitted))).

190. *See supra* note 69.

191. *See supra* note 75.

192. United States v. Reynolds, 397 U.S. 14, 16 (1970).

quota holders' property interest, under either the categorical standard of *Lucas* or the balancing standard of *Mahon*. The property interest in question is properly identified as the exclusive right to produce tobacco in a certain proportion to the total domestic production figure chosen by the secretary of agriculture. The Buyout does include partial compensation for quota holders, in the amount of $7.00 per pound of tobacco- quota right; this Note, however, contends that just compensation would be $12.60 per pound. Because a proper takings analysis calculates just compensation independently of whether a taking has occurred, the Buyout does not justly compensate quota holders.

The ramifications of this finding are costly for the government. Many crops remain heavily regulated. The deregulation of those markets may create a regulatory taking for which just compensation must be provided.