U.S. Court of Appeals Docket No. 06-56306
Lower Court Docket No. CV 02-02748 FMC (RZx)

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DANIEL GUGGENHEIM, SUSAN GUGGENHEIM
AND MAUREEN H. PIERCE
Petitioners-Appellants,

vs.

CITY OF GOLETA
Respondent-Appellee.

APPELLANTS' RESPONSE TO PETITION FOR REHEARING BY THE PANEL OR EN BANC

Appeal From Of the United States District Court
for the Central District of California
The Honorable Florence-Marie Cooper, District Judge

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1. Introduction

Plaintiffs' facial challenge to Goleta's rent control ordinance arises directly out of the 2002 decision of the City of Goleta to adopt rent control. The direct, immediate effect of the City choosing to adopt rent control was to impose space rents at 20 percent of fair market and to enable residents who own mobile homes to sell them for 10 times their value as personal property. (Slip Opinion ("SO") 13848.) Because there was a gap in time when no rent control was in effect (SO 13815), the adoption of the ordinance was the equivalent of adopting an 80 percent rent roll back. The City chose to adopt the ordinance without even the pretense of study or analysis.

The Panel found that the adoption of this unusually confiscatory rent control ordinance imposed the burden of an affordable housing program improperly on one property owner and enabled an enormous wealth transfer. The Panel undertook an exhaustive analysis of a well developed factual record, applying the three prong balancing test established in *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104 (1978). Weighing these factors, the Panel concluded the adoption of this ordinance simply went too far, resulting in a compensable taking.

The Petition asserts the Panel applied *Penn Central* in an unprecedented manner. That simply is not true. The Supreme Court has repeatedly found takings despite the absence of substantial harm to the investment-backed expectations of property owners. The central thrust of the Petition and the Amicus briefs is an indefensibly narrow interpretation of the Supreme Court's assurance in *Palazzolo v. Rhode Island*, 533 U.S. 606 (2001) that "[f]uture generations, too, have a right to challenge unreasonable limitations on the use and value of land." *Id.* at 625. They argue *Palazzolo* should be limited to its narrow facts, where the property owner

who acquired the property subject to regulation was really the same party, with a technical change of ownership. Such a view would render the broad promise of *Palazzollo* meaningless.

The Petition overstates the impact of the decision, which is an outgrowth of the unique economic facts of the case. The City chose to adopt an extreme form of rent control which unfairly imposed the burden of an affordable housing program on an individual property owner, implicating a concern central to the purpose of the Fifth Amendment. *Armstrong v. United States,* 364 U.S. 40, 49 (1960)

The Panel found, in this case, the regulation went too far. The Petition for rehearing is, in reality, a thinly veiled "Petition for re-weighing" of the *Penn Central* factors, sought in the hope that a different panel will reach a different conclusion.

2. <u>Rehearing Is Not Warranted Under FRAP Rule 35</u>

The Petition argues the Panel "improperly" applied the ad hoc balancing test for takings established by *Penn Central*. In substance, the City disagrees with how the Panel weighed the three factors. The Petition does not establish a conflict within the Circuit or issues of legal importance. The Petition extrapolates the application of a decision which arises out of the unique economic facts of this case. It is hardly remarkable that rent control, at some point, can become so confiscatory it will result in a regulatory taking.

The Panel correctly applied the standard for considering a facial challenge. It determined a taking was caused immediately on adoption of the ordinance by its basic operative features, which established space rents at 20 percent of fair market value. Because the operative provisions of the ordinance caused the taking, that taking can only be avoided by not adopting the ordinance.

City asserts the Panel abandoned the distinct investment-backed expectation as a "key" factor in the *Penn Central* analysis. The City advocates a rule that would bar any taking claim whenever a property owner has bought a property subject to regulation. This putative rule has never existed and is plainly inconsistent with *Palazzolo.*

The Petition focuses on the asserted possibility that Plaintiffs may be able to earn a "fair return on investment." This is a restatement of the flawed assertion that the "investment-backed expectations" of the property owner are always determinative. This argument also conflates the substantive due process analysis, which establishes the legal limits of rent control, with the takings analysis, which determines whether the legal application of rent control is a compensable taking. The "fair return on investment" analysis, which does not consider the impact of the challenged regulation on the property's value, is irrelevant to determining a taking.

City complains it has been denied the right to defend its regulation "on the merits" by the Panel. City had that opportunity. The Panel observed the record had been fully developed through three rounds of trial court litigation, including a motion for summary judgment that resulted in factual findings which were the basis for the Panel's decision. There is nothing left to adjudicate. City simply wants a "second bite" at the apple. Notably, City fails to offer any additional or different facts it would "develop" below if given the choice.

3. Factual Background

Plaintiffs Daniel and Susan Guggenheim and Maureen Pierce ("Parkowner") purchased the park in 1997, which was then located in unincorporated Santa Barbara County. (SO p. 13814) The park had been subject to rent control in the County since 1987. *Id.*

The City incorporated in February 2002. (SO 13811) City was required to temporarily adopt (120 days) the County's ordinances under California Government Code Section 57376. City chose to adopt rent control after the temporary mandate elapsed. (*Id*) However, there was a gap in time when the Park was not subject rent control. (SO 13815) City adopted an ordinance which, on its face, imposed space rents at 20 percent of fair market rent and enabled tenants to sell their manufactured homes for 10 times their value. (SO 13848) The Panel described the City's action as a "naked transfer" of wealth. (*Id*)

The Panel recognized that the ordinance served the purpose of affordable housing, but disproportionately imposed the burden of that program on Plaintiffs. (SO 13864-66) It also noted that the City did not impose the burdens of affordable housing in this fashion to any other property owners in the City. (SO 13865) Indeed, the burden imposed on Plaintiffs is far greater than for new developers in the City, who are only required to make 20 percent of their housing available at below market rates. (*Id*, fn. 27) The Panel concluded the adoption of the ordinance confiscated the vast majority of the value of the property for a public purpose. (*Id*)

4. The Panel Properly Applied the Standard For Facial Takings Claims

The Panel concluded mere adoption of the ordinance caused a taking by establishing rents at 20 percent of fair market levels and enabling the huge wealth transfer resulting from the sale of homes. (SO 13841-43)

The Supreme Court has affirmed that in order to establish a facial taking claim, the plaintiff must show that "mere enactment" of the legislation established the taking. *Suitum v. Tahoe Reg'l Planning Agency*, 520 U.S. 725, 736 (U.S. 1997); *Hodel v. Virginia Surface Mining & Reclamation Assn., Inc*., 452 U.S. 264,

297 (1981).

The Panel recognized the "uphill battle" presented by such a test, but that is the test the Panel applied. (SO 13842-13843) It analyzed the impact of the enactment of the ordinance, based on the District Court's core factual findings. (SO 13843) The Court applied these core factual findings to the *Penn Central* balancing test analysis. (SO 13846-66) The Panel found the adoption of the rent control ordinance in 2002 resulted directly and immediately in the confiscation of the vast majority of the value of Plaintiffs' property.[1]. (SO 13841-43)

City asserts Plaintiffs must show there is no set of circumstances under which the ordinance will not cause a taking pursuant to *United States v. Salerno*, 481 U.S. 739 (U.S. 1987). This burden was met by establishing the enactment of the ordinance has caused the taking. The only way for the City to avoid the taking was to either not adopt the law or change the ordinance. The Petition notably fails to suggest any set of circumstances that could lead to a different result.

5. Property Owners Who Purchase Property Subject To Regulation Can Establish a Taking Claim

City argues that Parkowner may earn a "fair return on investment" based on the assertion that the purchase price reflected the impact of rent control and argues that fact bars a taking claim as a matter of law. In substance, City proposes a modification of the *Penn Central* analysis which would make the "investment backed expectations" determinative of regulatory taking claims. City conflates the substantive due process analysis for determining whether the government has a

[1] The Panel recognized the Ordinance allows for rent increases based on a percentage of the CPI or to address increased expenses. (SO 13869-72) The potential for future adjustments to account for future inflation and future cost increases could not avoid the taking resulting from the adoption of the ordinance.

right to set rents at a particular level, with the takings question of whether compensation is necessary.

A. The "Investment Backed Expectations" Are Not Determinative

The Panel stated that the regulation did not strongly interfere with Parkowner's investment-backed expectations, but balanced against the other two *Penn Central* factors, found the regulation went "too far.'" (SO 13867) This is hardly remarkable under a balancing test. The Court recognized that under *Palazzolo*, Parkowner took possession with at least some hope it could challenge the ordinance under the Takings Clause. (SO 13862) Given the extreme form of rent control imposed by the City, this was a reasonable expectation.

The Supreme Court has found certain kinds of regulations are regulatory takings without considering investment-backed expectations. It was explicit on this point in *Hodel, supra*. *Hodel* held a regulation designed to address a problem with fractionalizing Indian lands to be a facial taking. The Court acknowledged:

> . . . None of the appellees here can point to any specific investment-backed expectations beyond the fact that their ancestors agreed to accept allotment only after ceding to the United States large parts of the original Great Sioux Reservation.

Id at 715. The Court nonetheless found there was a taking based on the character of the governmental regulation which effectively amounted to a physical confiscation. *Id.* *Hodel* is particularly salient because it arose in the context of a *Penn Central* takings claim. The Court found there was a taking based on what it considered the "extraordinary" character of the government action. *Id*

The Panel cited *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987), which found a taking despite the fact that the plaintiff bought property subject to coastal regulations. The Panel noted the dissent of Brennan and Marshall in

Nollan who complained the ". . . landowners who can make no claim that their reasonable expectations have been disrupted." 483 U.S. at 842 (U.S. 1987)

This Circuit has also recognized, under *Palazzolo*, a purchaser may have a valid takings claim even though the purchase price was discounted to reflect existing land-use regulations. *Daniel v. County of Santa Barbara*, 288 F.3d 375, 383 (9th Cir. 2002), *Equity Lifestyle Props., Inc. v. County of San Luis Obispo*, 548 F.3d 1184, 1190 (9th Cir. 2008).

The City and Amici urge rehearing based on a mistaken view of the primacy of investment-backed expectations as a factor under *Penn Central*. Justice O'Conner explained this was precisely the error of the Rhode Island Supreme Court that led to reversal in *Palazzalo*:

> The court erred in elevating what it believed to be "[petitioner's] lack of reasonable investment-backed expectations" to "dispositive" status. Ibid. Investment-backed expectations, though important, are not talismanic under *Penn Central*. Evaluation of the degree of interference with investment-backed expectations instead is one factor that points toward the answer to the question whether the application of a particular regulation to particular property "goes too far." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415, 67 L. Ed. 322, 43 S. Ct. 158 (1922).

Unfortunately, this is an error that has persisted after *Palazzolo*. See R.S. Radford and J. David Breemer, *The (Less?) Murky Doctrine of Investment-Backed Expectations After Palazzolo, and the Lower Courts' Disturbing Insistence on Wallowing in the Pre-Palazzolo Muck* (2005) 24 SW. U. L. Rev 351.

The Panel correctly weighed the nature of the government regulation and the economic impact of the regulation against the investment-backed expectations of the Parkowner to find a taking.

B. The City Conflates the Substantive Due Process "Fair Return"

Analysis With Takings Analysis

The possibility of Parkowner earning a "fair return on investment" based on the artificially depressed purchase price of a the property is not relevant, much less dispositive of a regulatory taking claim. The City has confiscated 80 percent of the value of the property and argues, in effect, a taking can be determined by assuring that Parkowner earns a "fair return" on the remaining 20 percent that has not (yet) been confiscated.

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The "fair return on investment" standard arises out of substantive due process rights. It is designed to determine the right to regulate under a rational basis standard. *Sierra Lake Reserve v. Rocklin*, 938 F.2d 951, 957-958 (9th Cir. 1991), quoting *Sinaloa Lake Owners Association v. City of Simi Valley* 882 F.2d at 1407 (other citations omitted).

The question of whether a regulation has a rational basis, *i.e.*, a means-ends analysis, is not relevant to determining whether there is a compensable taking. The Supreme Court in *Lingle v. Chevron U.S.A., Inc.* 544 U.S. 528 (US 2005) explained:

> The [takings] Clause expressly requires compensation where government takes private property '*for public use*.' It does not bar government from interfering with property rights, but rather requires compensation 'in the event of *otherwise proper interference* amounting to a taking.'

Id at 537 (emphasis in original) quoting *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304 (1987)

California courts applying this standard have recognized the "fair return" analysis arises out of substantive due process protections against arbitrary

government regulation. See, e.g., *Kavanau v. Santa Monica Rent Control Bd.*, 16 Cal.4th 761, 771 (Cal. 1997), *Galland v. City of Clovis*, 24 Cal.4th 1003 (Cal. 2001). Applying this standard, California courts have repeatedly rejected the need to consider the market value of the property to determine a "fair return on investment." See, e.g. *Fisher v. City of Berkeley*, 37 Cal.3d 644, 682 (Cal. 1984), *Kavanau, supra* at 778. In fact, under this standard, California courts have even found regulating bodies can disregard the actual investment made by the property owners. See *Fisher* and *Kavanau, supra*.

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The Panel properly analyzed the impact of rent control on the value of the property in analyzing the economic impact factor under *Penn Central*. (S0 13848) A "fair return on investment" analysis, which rejects the consideration of the market value of the property, is not relevant to, much less dispositive of even one of the three *Penn Central* factors, yet City argues it is dispositive of a regulatory taking claim.

The Panel upheld the right of the City to adopt the rent control ordinance, but found, in this case, the adoption resulted in a compensable taking because the property had effectively been conscripted for the public's use. (SO 13852) In other words, the fact that the City has a right to impose rents at 20 percent of market under a substantive due process standard, begs the question of whether such regulation must be compensated as a taking.

6. Rehearing Is Not Proper To "Re-Weigh" Under *Penn Central*

The Petition asserts alternatively that the Court improperly focused on: (1) the "wealth transfer theory," (2) the similarity to a physical takings analysis, and (3) "forcing park owners to rent space at below market value." This laundry list of

objections itself demonstrates the Court did not improperly focus on any particular factor. The Panel properly weighed these factors to conclude there was a regulatory taking.

The City argues the decision would convert any governmental action which is "almost a physical taking" into the equivalent of a "per se" taking. The City mischaracterizes the decision. The Panel properly *weighed* this factor. The Court in *Penn Central* observed a taking "may more readily be found when the interference with property can be characterized as a physical invasion by government . . ." (438 US at 125).

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Because a physical occupation of property is deemed a "per se" taking, it is hardly remarkable that regulation which is highly similar to a physical taking would be more likely to be deemed a taking. The *Penn Central* analysis was designed to identify regulatory actions that are functionally equivalent to a classic taking in which government directly appropriates private property or ousts the owner from his domain." *Lingle*, 544 U.S. at 539

City argues the Panel has done an "end run" around the holding of *Yee v. City of Escondido,* 503 U.S. 519 (1992). As the Panel points out, the Court in *Yee* specifically contemplated the possibility that mobilehome rent control, though not a physical taking, could give rise to a regulatory taking claim. 503 US at 530.

City also argues that the Panel erred and departed from precedent by focusing only on one element of Parkowner's interest in the property, i.e. potential profits. Again, City mischaracterizes the decision. The Panel considered the similarity to physical invasion, noting the fact that the ordinance effectively eviscerated Parkowner's right of exclusion. (SO 13863) See also *Cienega*

Gardens v. United States, 331 F.3d 1319, 1338 (Fed Cir. 2003) (government affordable housing program "eviscerated the Owners' right to exclude...").

In addition, the Panel recognized the regulation gave tenants the right to transfer the underlying value taken from the owner to new tenants when they moved. (SO at 13863) The City's argument begs the question of what, if any, valuable remaining property right should have been considered, based on the record before the Court? The Panel was required to make its decision based on the record, not based on the potential for residual property rights never identified and thus never weighed under *Penn Central*.

The Petition chastises the Panel for considering the fact that the impact of the ordinance is to impose rents at 80 percent below market, but ignores the reason this fact is critical to a takings analysis: it disproportionately imposes a burden of affordable housing on Parkowner. (See SO 13865-13866) The Supreme Court has recognized that one of the central functions of the Fifth Amendment is to prevent a small group of private property owners from bearing burdens that should be borne by the community as a whole. *Armstrong*, *supra*, at 49 (1960). *Lingle, supra* at 2080.

City identifies two purported "flaws" with the Panel's consideration of this factor. First, City claims it ignores the fact that mobile home parks are different from typical rental housing because the purported status of mobile home owners as "captive ownership" therefore subject to a "monopolistic market." This argument is the focus of the brief of Amicus Curie Golden State Manufactured-Home Owners League ("GSMOL") The argument may be relevant to a substantive due process or equal protection claim, but has no bearing on a regulatory taking claim.

Even if a valid regulatory purpose of protecting against predatory rent

practices could somehow "mitigate" against finding a taking, it is impossible to see how this particular ordinance could serve that purpose by establishing rents at 20 percent of fair market rents resulting in sales of personal property at 10 times its value. The unstated logic seems to be so long as there is any justification for regulating rents, there is no limitation on how confiscatory that regulation can become without becoming a taking. Is a rent level of 1% of market a taking? If the goal is to protect against "overcharging," adopting a rent control ordinance imposing rents at 20 percent of fair market is overkill, to put it mildly.

7. The City is Not Entitled To a Second Trial On the Merits

The City complains it has been denied the right to defend its regulation on the merits by the Panel. Not so. The City had several opportunities to defend the regulation on the merits in the District Court. The Panel relied on the extensive record that was developed in a case that reached the eve of trial. In particular, the Panel relied on the "core findings" made by the District Court in the course of ruling on the motion for summary judgment and the District Court's *sua sponte* motion for judgment. (See SO 13837-13843) Parkowner's facial challenge to the Ordinance was fully developed at the District Court level and the Panel rendered its decision based on undisputed facts. There is nothing left to adjudicate at the district court level.

8. The Pane Properly Found the "State Compensation" Requirement of *Williamson* to Be Prudential

Amicus Curiae League of California Cities, California State Association of Counties, and APA California ("League") argue the Panel was not correct in unanimously deciding that the state compensation ripeness requirement of *Williamson County Regional Planning Commission v. Hamilton Bank*, 473 U.S.

172 (1985) is prudential. League ignores the core rationale for determining whether ripeness is jurisdictional, whether there is a genuine "case or controversy" under Article III. (See SO 13826-27, citing *Suitum, supra.*) "Its basic rationale is to prevent the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements.") *Abbott Lab. v. Gardner*, 387 U.S. 136, 148 (1967). The prudential concern is whether resolution of the dispute should be postponed in the name of '"judicial restraint from unnecessary decision of constitutional issues,'" *Reg'l Rail Reorganization Act Cases*, 419 U.S. 102, 138 (1974).

The Panel correctly found this dispute has been sufficiently developed through three full rounds of litigation at the trial court level. (SO 13833) Pursuing additional "state compensation" will not render the dispute any less hypothetical.

League argues *Suitum, supra*, did not address the state compensation requirement. This conclusion ignores the Court's holding that:

> There are **two independent prudential hurdles** to a regulatory taking claim brought against a state entity in federal court. . . . a plaintiff must demonstrate that she has both received a . . . [final decision] and sought "compensation through the procedures the State has provided for doing so," *Id*., at 194.

(520 U.S. at 734, emphasis added)

League argues *San Remo Hotel, L.P. v. City & County of San Francisco*, 545 U.S. 323 (U.S. 2005) compels the conclusion that *Williamson* creates an Article III barrier to Parkowner's takings claim. As the concurring opinion of Rehnquist points out, *San Remo* did not directly address the question of whether the ripeness requirement was prudential. *Id* at 352, fn. 2[2].

[2] However, Rehnquist concluded the Court impliedly found the ripeness

Williamson is itself instructive on this issue. *Williamson* does not address or refer to the state compensation requirement as jurisdictional. The fact that *Williamson* explicitly allows for a "futility exception" is consistent with the prudential nature of the requirement. 473 US at 195. If there was no Article III "case or controversy," the fact that a state had an "inadequate" state remedy would not convert an abstract dispute into a concrete dispute ready for federal court adjudication.

League simply sees no role for the federal courts to decide federal questions, even where years of litigation in state court provided no meaningful remedy. The Panel carefully determined it was correct to exercise its prudential jurisdiction based on the unique procedural facts of this case. That conclusion should not be revisited via rehearing.

9. Guggenheim Has Standing

League's argument that Parkowner suffered no "injury in fact" is a reiteration of its argument that the majority did not properly weigh the investment-backed expectations of Parkowner. The Panel's analysis fully addresses standing. The adoption of the ordinance by the City in 2002 certainly caused an "injury in fact" to Parkowner. League points out that the City was "obligated" to adopt the ordinance when the City was formed, but neglects to mention that this obligation was temporary (120 days). The ordinance would have not remained in effect if the City had not affirmatively voted to adopt the rent control ordinance. (See Gov't Code § 57376)

10. The City Misstates and Exaggerates the Impact of the Decision

GSMOL paints a picture of allegedly dire consequences of the Panel's

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requirement is prudential. *Id*

decision. In reality, the decision will have no impact on mobile home rent control ordinances which function consistently with the interests GSMOL claims it is trying to protect, i.e. residents purportedly "held hostage" by park owners. The Panel's decision is not a threat to any bona fide equity of mobile home owners. GSMOL's real concern is that those cities which have been applying rent control in a confiscatory fashion will begin to apply their ordinances consistent with the purpose of protecting against overcharging of rents.

11. Conclusion

The City fails to identify any interest of "uniformity" of decisions or any novel legal issues that must be addressed by en banc review. Rather, the City seeks a re-weighing of the *Penn Central* balancing analysis in the hope that a

different panel of judges will weigh the three *Penn Central* factors differently. That is not a valid purpose for rehearing, en banc or otherwise.

Dated: November 5, 2009 HART, KING & COLDREN

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CERTIFICATE OF COMPLIANCE

Counsel of Record hereby certifies that pursuant to FRAP Rule 32(a)(7), the enclosed brief of Daniel Guggenheim, Susan Guggenheim and Maureen H. Pierce is produced using 14-point Times New Roman type including footnotes and contains 4,150 words, which is less than the total words permitted by the Rules of Court. Counsel relies on the word count of the computer programs used to prepare this brief.

Dated: November 5, 2009

/s/ Robert S. Coldren_____
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CERTIFICATE OF SERVICE

DANIEL GUGGENHEIM, et al. v. CITY OF GOLETA
USCA DOCKET NO. 06-56306
Lower Court Case No. CV 02-2478 FMC (RZx)

I hereby certify that I electronically filed the foregoing **APPELLANTS' RESPONSE TO PETITION FOR REHEARING BY THE PANEL, OR EN BANC** with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on November 5, 2009.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system

By: /s/ Sandy Moore_____