Strategic Land Use Litigation: Pleading Around Municipal Insurance

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STRATEGIC LAND USE LITIGATION: PLEADING AROUND MUNICIPAL INSURANCE

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Abstract: Municipal insurance policies inevitably contain a curious exclusion of coverage for regulatory takings claims. Many courts have interpreted this exclusion broadly, applying it to all land-use litigation. Other courts have interpreted the exclusion narrowly. Both interpretations are problematic. The former is at odds with policy language and the normal rule that insurance policies are to be construed against the insurer. The latter creates an opportunity for plaintiffs to craft their pleadings explicitly to trigger or to avoid triggering the municipality’s insurance coverage. Plaintiffs seeking a quick settlement are well advised to plead around the exclusion so as to settle with the insurer. But plaintiffs seeking to have the local government capitulate should avoid the insurance coverage, forcing the local government to bear its own litigation costs and the risk of an adverse judgment. The possibility of such pleading arbitrage is problematic, and this Article argues that states should find ways to extend insurance to cover Fifth Amendment regulatory takings claims.

INTRODUCTION

Municipalities deal with litigation risk in a variety of ways.¹ Large cities typically self-insure, retaining the risk of liability themselves.² Smaller municipalities, however, usually shift risk to a third party, either by purchasing private insurance from an insurance company or by joining a municipal risk pool.³ In either case, a municipality can insure itself against costs asso-

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¹ For a survey, see Christopher Serkin, Insuring Takings Claims, 111 N.W. U. L. REV. (forthcoming 2016) (draft on file with author).

² JOHN MARTINEZ, 4 LOCAL GOVERNMENT LAW § 27:31, Westlaw (database updated Oct. 2015) (“Risk management plays a significant role in the practical world of local government administration, particularly in large cities which are often self-insurers.”).

³ See id.; see also Jason E. Doucette, Note, Wading in the Pool: Interlocal Cooperation in Municipal Insurance and the State Regulation of Public Entity Risk Sharing Pools—A Survey, 8 CONN. INS. L.J. 533, 536 (2002) (“A public entity pool is a risk financing mechanism whereby a group of public entities contribute to a shared fund that in turn pays claims for and provides services to the participating entity.”) (internal quotation marks omitted).
associated with all manner of litigation, whether arising out of alleged police misconduct, employment discrimination, car accidents, or other sources of liability. One risk that local governments cannot insure, however, is the risk of regulatory takings liability and the litigation costs associated with such takings claims. Municipal insurance policies contain an exclusion of coverage for claims arising out of inverse condemnation. In a forthcoming article, I explore this lacunae in municipal insurance, and argue that the unavailability of regulatory takings insurance may lead smaller local governments to under-regulate and to under-enforce existing regulations.

The absence of regulatory takings insurance creates another problem, however, that has so far gone unrecognized in the scholarly literature. In at least some jurisdictions, insurance is available for other land use litigation, like § 1983 claims for due process or equal protection violations, administrative challenges, and other state law causes of action. Where that is true, plaintiffs challenging land use regulations have an important strategic advantage in choosing whether or not to trigger the municipality’s insurance coverage. A plaintiff seeking damages is well advised to plead a claim that triggers municipal insurance. The insurance company will be obligated to defend the action and will often settle claims so long as they are at least colorable (and sometimes even if they are not). But if a plaintiff instead wants the government to capitulate and withdraw the offending regulation, then the better course of action is to plead a regulatory takings claim alone. In that case, the government will be faced with paying both litigation costs and any resulting liability out of its general operating funds. For many local governments, the potential costs are sufficiently high that they will quickly

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4 See Serkin, supra note 1, at 17–23 (describing coverage provided by private insurance).
5 See id. at 25–29 (discussing the exclusion for regulatory takings claims). The only exception appears to be Minnesota, where the municipal risk pool explicitly provides coverage for regulatory takings litigation. See id.
7 See Serkin, supra note 1, at 34–39 (describing distributional consequences of the regulatory takings exclusion).
withdraw the challenged regulation rather than face the risk of liability and associated litigation costs.

These dynamics are increasingly important because local governments are often at the front lines of climate change adaptation—hence this Article’s inclusion in the excellent symposium on insurance and climate change.9 Local regulatory responses to sea level rise, for example, can include increased set-backs, preservation of wetlands and other soft armoring, as well as imposition of tough new building codes focusing on resiliency.10 All of these can burden property and give rise to takings claims.11 Property owners seeking exemptions from new regulatory burdens can—at least in some circumstances—take advantage of these strategic opportunities by pleading around insurance.

Whether this strategic decision is available to plaintiffs depends upon how courts—and insurance companies themselves—interpret the breadth of the inverse condemnation exclusion. Courts that interpret the exclusion broadly deny insurance coverage for all land use claims, taking away the opportunity for strategic pleading. In the process, however, those courts stretch and distort the policy language. This Article explores courts’ competing interpretations of the inverse condemnation exclusion that is standard across municipal insurance policies.12 Each interpretation presents its own problems.13 This Article then proposes that insurance should be more readily available for regulatory takings claims.14

I. COMPETING INTERPRETATIONS OF THE INVERSE CONDEMNATION EXCLUSION

A. The Inverse Condemnation Exclusion

Municipal insurance—and risk management practices more broadly—have received very little scholarly attention. For a brief period during an insurance crisis in the 1980s, scholars focused on the problem of municipal

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12 See infra notes 15–107 and accompanying text.
13 See infra notes 108–145 and accompanying text.
14 See infra notes 146–155 and accompanying text.
risk, but that attention waned once insurance markets opened up again.\textsuperscript{15} As a result, important gaps in coverage have gone largely if not entirely unnoticed in academic literature. Among the most important is the exclusion for regulatory takings claims. To understand its impact, however, one must first understand at least the basic outlines of insurance coverage generally.

Insurance policies provide coverage for pre-specified losses, subject to certain pre-specified exclusions. Where a loss falls within a policy’s coverage, the insurance company is obligated both to defend the litigation and to pay any resulting judgment in accordance with the policy limits.\textsuperscript{16} An insurance company’s duty to defend is, in fact, broader than its duty to indemnify, and is generally governed by the aptly-named “eight-corners rule.”\textsuperscript{17} The four corners of the complaint are compared with the four corners of the policy.\textsuperscript{18} If the complaint sets forth claims that fall within a covered loss, the insurer must defend.

Municipal insurance policies can take a number of forms and can provide coverage for many different kinds of risks. Most importantly here, a municipality’s general liability policy insures against occurrences resulting in bodily injury or property damage, while an errors and omissions (“E&O”) policy insures against harms resulting from decisions by municipal officials and employees.\textsuperscript{19} The latter might include, for example, liability arising out of the adoption of a discriminatory hiring policy. Land use litigation can implicate both types of polices. But both types of policies also contain an important exclusion for condemnation and inverse condemnation. Language varies by policy, but typically excludes coverage for “any injury or damage arising out of or resulting from a taking that involves or is in any way related to the principles of eminent domain, [or] inverse condemnation . . . .”\textsuperscript{20}


\textsuperscript{16} LEE R. RUSS & THOMAS F. SEGALIA, COUCH ON INSURANCE § 200:3 (3d ed. 2007).


\textsuperscript{18} Nutmeg Ins. Co., 229 F. Supp. 2d at 674.


\textsuperscript{20} See, e.g., SUSAN J. MILLER, I MILLER’S STANDARD INSURANCE POLICIES ANNOTATED § 14b, GL-116 (7th ed. 2013).
Inverse condemnation—referenced in the exclusion—is the state law cause of action for vindicating regulatory takings claims. It amounts to an eminent domain action triggered by the property owner instead of by the government, and it is a prerequisite for suing in federal court. Where a party brings a state inverse condemnation action, however, issue preclusion applies to prevent subsequent litigation in federal court. As a result, inverse condemnation is, for all intents and purposes, the exclusive means of vindicating regulatory takings claims against the state or subdivisions of the state. The exclusion of insurance coverage for inverse condemnation is, therefore, an exclusion of insurance coverage for regulatory takings claims against municipalities.

The absence of insurance for regulatory takings is not widely known in land use literature. This absence can have profound consequences for local governments’ regulatory incentives, as I argue in another article. It can also affect plaintiffs’ strategic pleading decisions, depending on how broadly the exclusion is interpreted. As it turns out, courts have adopted two very different interpretations of the inverse condemnation exclusion.

B. Judicial Interpretations of the Exclusion

When it comes to interpreting insurance policies, most courts have held that ambiguities are to be construed against the insurer. But that is not, in fact, the approach most courts have taken when it comes to interpreting the inverse condemnation exclusion. Indeed, instead of limiting the exclusion to claims for inverse condemnation, many courts have held that the exclusion applies to all claims arising out of land use litigation, includ-

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21 Cynthia J. Barnes, Comment, Just Compensation or Just Damages: The Measure of Damages for Temporary Regulatory Takings in Wheeler v. City of Pleasant Grove, 74 IOWA L. REV. 1243, 1246–47 (1989) (“The cause of action is inverse because it is brought by the landowner rather than by the condemnor.”).


25 See Serkin, supra note 1, at 31–34.

26 See infra notes 108–145 and accompanying text.

27 See infra notes 31–97 and accompanying text.

28 See Kenneth S. Abraham, A Theory of Insurance Policy Interpretation, 95 MICH. L. REV. 531, 531–32 (1996) (“The first principle of insurance law is captured by the maxim contra proferentem, which directs that ambiguities in a contract be interpreted ‘against the drafter,’ who is almost always the insurer.”) (internal citations omitted) (emphasis added).

29 See infra notes 31–97 and accompanying text.
ing due process and equal protection claims, Fair Housing Act claims, and beyond. This approach represents anything but a conservative interpretation of the policy language.

Consider the following two examples. In *Nutmeg Insurance Co. v. Clear Lake City Water Authority*, four real estate developers built out sewer and drainage facilities for new residential developments, and entered into contracts with Clear Lake City Water (“Clear Lake Water”), a water control district, to purchase those facilities. Clear Lake Water failed to obtain funding for the acquisition—allegedly because it undermined a series of bond elections—and so did not complete the acquisition. The facilities nevertheless continued to provide water and sewer service to the developments. The developers sued, alleging breach of contract, unjust enrichment, and inverse condemnation for accepting the ongoing use of the facilities. They won a jury award of $1.5 million. In a subsequent suit by Clear Lake Water against its insurer, however, the United States District Court for the Southern District of Texas ruled that the inverse condemnation exclusion applied. It reasoned: “Claimants’ breach of contract and quantum meruit claims do logically arise out of the unconstitutional taking claim.” As a result, the insurance company did not have to provide a defense against any of these claims, nor indemnity for the loss.

In *Columbia Casualty Co. v. City of St. Clairsville*, the United States District Court for the Southern District of Ohio refused to apply *Nutmeg* quite so broadly, but nevertheless extended the inverse condemnation exclusion to both due process and equal protection claims. There, a third party

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32 Id.
33 Id.
34 Id. at 677–78.
35 Id. at 678.
36 Id.
37 Id. at 696. The district court rejected other aspects of the plaintiff’s claim under different exclusions relating to bond elections. Id.
38 See id.
owned land that the City of St. Clairsville (the “City”) wanted to acquire to build a welcome center. When the property owner refused to donate the land, the City allegedly engaged in a “pattern of harassment” to reduce the value of the property and induce him to sell at a discounted price. Specifically, according to the property owner, the City fraudulently inflated water and electricity bills on the property, filed fraudulent liens, and downzoned the property, interfering with his plans to sell the property. The property owner sued, alleging tortious interference with contract, inverse condemnation, violations of due process and equal protection, conspiracy, and others. The City’s insurer brought a declaratory judgment action, seeking a determination that it was not obligated to defend or to indemnify the City because the underlying litigation fell entirely within the inverse condemnation exclusion.

The district court distinguished *Nutmeg*, and found that the tortious interference claim (as well as a “wrongful annexation” and civil conspiracy claim) did not fall within the inverse condemnation exclusion because the property owner would not need to “show the existence of a taking to prevail.” The insurance company therefore had a duty to defend the underlying litigation because of those claims. But the district court also held that the inverse condemnation applied not only to the regulatory takings claim itself, but also to the equal protection and due process claims. The district court focused on the fact that the complaint did not clearly articulate the bases for the alleged equal protection and due process violations, and ultimately concluded that these claims and the regulatory takings claim were “functionally equivalent.”

Even in the absence of more detailed allegations, this is not an obvious conclusion. After all, these other claims are very different causes of action that implicate fundamentally different analyses than inverse condemnation. Consider, first, the inverse condemnation claim. The Takings Clause prohibits government regulations that impose too great a burden on private property rights—those that “go too far” as defined by the United States Supreme

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40 Id. at *1.
41 Id.
42 Id. at *1–2.
43 Id. at *1.
44 Id. at *12.
45 Id. at *10–11. Although there needs to be only one basis for the insurance company’s duty to defend, the breadth of the exclusion is still important because if some claims in the underlying action are dismissed pre-trial, the insurance company’s duty to defend could disappear.
46 Id. at *11.
Court—unless just compensation is paid. For land use regulations, the resolution of a takings claim will turn on the extent to which the regulation interferes with the developer’s investment-backed expectations, and the resulting diminution in value of the property. This will require analyzing how much the developer has already spent on its plans to develop the property, whether the developer’s expectations were reasonable considering both the parcel of land and the neighborhood more generally, and what other uses remain available for the property after the regulation.

The substantive due process inquiry is fundamentally different. While successful economic substantive due process claims remain vanishingly rare in most contexts, land use regulations are occasionally—if still uncommonly—invalidate on substantive due process grounds. The background test, familiar from other regulatory contexts, asks whether the challenged regulation is rationally related to a legitimate government purpose. In application, many courts treat this as a kind of de facto cost-benefit analysis. Although the review is deferential, courts ask whether the regulation generates more benefits to the public than harm to the burdened property owner.

The focus on the harm to the burdened property owner is, of course, similar to the takings test. The extent of the burden is reflected in the diminution in value of the property. But takings analysis does not explicitly include consideration of the benefits to the public, which is a central com-

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51 See, e.g., ROBERT C. ELLICKSON ET AL., LAND USE CONTROLS 102 (2014) (citing cases in which the rational basis test for land use regulation was applied).

52 See, e.g., Coniston Corp. v. Village of Hoffman Estates, 844 F.2d 461, 464–65 (7th Cir. 1988) (weighing the costs and benefits of the regulation in question).

53 Id.


55 Coniston Corp., 844 F.2d at 466 (measuring a deprivation by diminution in value).
ponent of due process review.\textsuperscript{56} In mounting a defense to a due process claim, the City of Clairsville could have argued that it had good reasons for downzoning the subject property—perhaps traffic congestion, burdens on infrastructure, and the like—while the property owner could have argued that the reasons were either pretextual or insufficient to justify the substantial burden on his land.\textsuperscript{57} Importantly, again, due process involves a balancing of burdens and benefits, while inverse condemnation focuses only on the extent of the burden in absolute terms.\textsuperscript{58}

Equal protection claims in the land use context can take various forms. If a suspect classification is implicated—within the meaning of the Fourteenth Amendment—then the regulation may trigger heightened scrutiny, and the regulation must be necessary for a compelling government purpose.\textsuperscript{59} As interpreted by the Supreme Court of the United States, however, the Equal Protection Clause prohibits only \textit{de jure} and not \textit{de facto} discrimination.\textsuperscript{60} As a result, many property and housing-related claims implicating suspect classifications are much more frequently litigated under the Fair Housing Act than under the Equal Protection Clause itself.\textsuperscript{61}

Even where a suspect classification is not at issue—as with the plaintiff property owner who claims that he was singled out because he owned property that the City of Clairsville wanted to acquire—the Equal Protection Clause still prohibits irrational and arbitrary line-drawing.\textsuperscript{62} Again, this inquiry is different from both the takings and due process inquiries.\textsuperscript{63} In fact, the substance of each of these claims is demonstrably different from

\textsuperscript{56} See Lingle v. Chevron U.S.A. Inc., 544 U.S. 528, 545 (2005) (rejecting the argument that takings claims require evaluating whether the regulation substantially advances a government interest).

\textsuperscript{57} There are more specialized tests that still sound in due process but trigger more searching review, like the test for spot-zoning, or review for adjudicative versus legislative actions. See, e.g., Griswold v. City of Homer, 925 P.2d 1015, 1017 (Alaska 1996) (discussing spot zoning); Bd. of Cty. Comm’rs v. Snyder, 627 So. 2d 469, 470–71 (Fla. 1993) (discussing judicial review for legislative acts as opposed to quasi-adjudicative decision-making).

\textsuperscript{58} Compare Coniston Corp., 844 F.2d at 464–65 (weighing costs and benefits to the private property owner), with Pa. Coal Co. v. Mahon, 260 U.S. 393, 418 (1922) (considering the burden imposed on private property owners by regulatory takings that “go too far”).


\textsuperscript{63} Pa. Coal Co., 260 U.S. at 418 (considering the burden imposed on private property owners by regulatory takings that “go too far”); Coniston Corp., 844 F.2d at 464–65 (weighing costs and benefits to the private property owner).
the substance of an inverse condemnation claim. It is therefore very difficult to see why the inverse condemnation exclusion should ever be stretched to cover them.

Some might object to the specificity of this analysis. Courts’ expansive reading of the inverse condemnation exclusion may be based on a broader concern about insurable risks. Courts may at least implicitly assume that policy decisions, like land use regulations, are not covered by insurance because they are not fortuitous events. Extending the inverse condemnation exclusion makes good sense if the underlying purpose is to exclude coverage for affirmative government decision-making. But this proves too much. Recall that most land use litigation implicates a municipality’s E&O policy. Those policies are explicitly designed to provide coverage for affirmative policy decisions (whether actions or omissions). If a local agency adopts a discriminatory hiring policy, for example, resulting litigation can trigger the municipal E&O policy. Likewise, if a schoolteacher abuses a student, or a police officer violates someone’s rights, municipal insurance is available. There is no principled reason to distinguish land use decisions from these other insurable municipal actions.

Ultimately, the inverse condemnation exclusion is not usually phrased as an exclusion for land use regulations. It is not an exclusion for all liability arising out of zoning decisions or the decisions of zoning officials. It is, instead, an exclusion for inverse condemnation claims. Given that language and the rule that ambiguities in policy language are to be construed

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64 See Lingle v. Chevron U.S.A. Inc., 544 U.S. 528, 539 (2005) (describing the exclusive focus of regulatory takings claims as the “burden that government imposes upon private property rights”).
66 See supra notes 19–20 and accompanying text.
67 See supra notes 19–20 and accompanying text.
68 See, e.g., Indep. Sch. Dist. No. 697, Eveleth v. St. Paul Fire & Marine Ins. Co., 515 N.W.2d 576, 578–79 (Minn. 1994) (finding that the insurer had a duty to indemnify the school district for altering the duties of a secretary based on a theory of age discrimination because the E&O policy coverage for “wrongful acts” included intentional age discrimination absent an express exclusion).
70 See Serkin, supra note 1 (comparing regulatory takings claims with other claims for which municipal insurance is available).
against the insurer, courts’ extremely broad interpretations of the inverse condemnation exclusion appear unjustifiable.\textsuperscript{72}

Not all courts adopt such a broad reading of the inverse condemnation exclusion. In \textit{Town of Cumberland v. Rhode Island Interlocal Risk Management Trust, Inc.}, property owners sought permission to subdivide their property.\textsuperscript{73} The town planning board denied the subdivision applications, erroneously applying new stricter standards.\textsuperscript{74} In the underlying litigation, the Rhode Island Supreme Court held that the town tortuously interfered with the property owners’ economic advantage, and also violated the property owners’ substantive and procedural due process rights under 42 U.S.C. § 1983.\textsuperscript{75} The parties settled for $1.6 million.\textsuperscript{76} In subsequent litigation by the town seeking indemnification from its insurer, the Rhode Island Supreme Court rejected the insurer’s argument that the policy’s inverse condemnation exclusion applied.\textsuperscript{77} The court held that the lower court clearly found a violation of the Due Process Clause and not the Takings Clause.\textsuperscript{78}

The recent case, \textit{City of College Station, Texas v. Star Insurance Co.}, is another example.\textsuperscript{79} A developer, Weingarten Realty Trust (“WRI”), sued the City of College Station (the “City”) for various zoning decisions regarding property that it acquired in 2006 for fourteen million dollars in order to develop a Wal-Mart.\textsuperscript{80} WRI’s plans for the property required a rezoning for commercial use.\textsuperscript{81} WRI claimed that such a rezoning was consistent with the City’s comprehensive plan, and indeed the City’s planning staff recommended the rezoning.\textsuperscript{82} Nevertheless, the City denied WRI’s rezoning request, allegedly because of animus towards Wal-Mart.\textsuperscript{83} WRI submitted additional zoning requests and found new anchor tenants to replace Wal-Mart.\textsuperscript{84} The City continued to deny the rezoning and imposed additional

\textsuperscript{72} See \textit{supra} note 28 and accompanying text.
\textsuperscript{73} 860 A.2d 1210, 1212 (R.I. 2004).
\textsuperscript{74} \textit{Id}.
\textsuperscript{76} \textit{R.I. Interlocal Risk Mgmt. Tr.}, 860 A.2d at 1213.
\textsuperscript{77} \textit{Id}.
\textsuperscript{78} \textit{Id} at 1217. The Court also observed that “the claim against the town alleging inverse condemnation was withdrawn before trial.” \textit{Id}.
\textsuperscript{79} 735 F.3d 332 (5th Cir. 2013).
\textsuperscript{80} \textit{City of College Station v. Star Ins. Co.}, No. 11-2023, 2012 WL 4867568, at *1 (S.D. Tex. Oct. 12, 2012), \textit{rev’d}, 735 F.3d 332 (5th Cir. 2013). The facts were more developed in the trial court decision, and so are taken from there.
\textsuperscript{81} \textit{Id} at *1–2.
\textsuperscript{82} \textit{Id} at *1.
\textsuperscript{83} \textit{Id} at *2.
\textsuperscript{84} \textit{Id}.
conditions on the use of the property. Finally, in 2009, the City revised its comprehensive plan, designating a significant amount of WRI’s property for much less intensive commercial and suburban use.

WRI successfully sued, alleging that the City’s zoning decisions were arbitrary and capricious in violation of substantive due process, amounted to unequal treatment in violation of the Equal Protection Clause, should have been estopped due to WRI’s detrimental reliance, intentionally interfered with WRI’s contracts and business relations, and violated the Takings Clause in the Texas Constitution. The City settled the litigation for $1.6 million after incurring approximately $2 million in defense costs. The City then sought indemnification from Star Insurance Company, which underwrote an applicable E&O policy that contained an inverse condemnation exclusion. On cross-motions for summary judgment, the United States District Court for the Southern District of Texas held that the inverse condemnation exclusion precluded coverage for all of the claims, including the tortious interference with contract, equal protection, and substantive due process claims. Even though each of these different claims implicated fundamentally different legal analyses, the district court read the inverse condemnation exclusion as applying to all of them.

On appeal, however, the United States Court of Appeals for the Fifth Circuit reversed. The appellate court went through the various claims in the complaint and concluded that they were independent of—and did not arise out of—the inverse condemnation claim. As the court reasoned, the equal protection claim did not depend upon the inverse condemnation claim:

Suppose that a municipality has a policy or custom of imposing zoning restrictions on properties purchased by racial minorities—restrictions that do not physically intrude on the properties and reduce their value by only about 1%. No one would argue that such restrictions amount to regulatory takings; however, the mu-

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85 Id.
86 Id.
87 Id.
88 Id. at *9 n.7.
89 The policy excluded claims: “[A]ctually or allegedly arising out of or caused or contributed to by or in any way connected with any principle of eminent domain, condemnation proceeding, inverse condemnation, dedication by adverse use or adverse possession, by whatever name called.” Id. at *1 (emphasis added).
90 Id.
91 Id.
93 Id. at 338–39.
nicipality would still be liable for violating the Equal Protection Clause. To say that the municipality's liability in such circumstances “arises out of” an “inverse condemnation” action is untenable—the liability arises out of the city’s constitutional malfeasance. And the same general logic applies here.94

This was true of the substantive due process, and tortious interference claims as well.95 The Fifth Circuit observed that the relevant policy language did not exclude coverage for all actions arising out of zoning decisions, but only actions arising out of inverse condemnation, and that is necessarily a narrower exclusion and inapplicable to these other claims.96 Some other courts have similarly limited the inverse condemnation exclusion.97

While this interpretation is convincing as an interpretive matter and appears much more consistent with the policy language, it raises its own interesting and less obvious problem. By creating a specific and narrowly defined hole in municipal insurance coverage—for regulatory takings claims alone—it creates an opportunity for plaintiffs to choose whether or not to trigger the municipality’s insurance. This, in turn, can dramatically affect litigation dynamics and in many cases can all but determine remedies and outcomes.98

Uninsured regulatory takings litigation presents a substantial risk to municipal governments. Even if most regulatory takings claims ultimately fail, litigation costs alone can be substantial.99 Moreover, not all claims fail,
and the impact of a successful claim can be devastating. If the municipality is small enough, and the judgment large enough, regulatory takings liability can even manifest as an existential threat. The result—at least for smaller municipalities that typically buy insurance—is a predictable aversion to the risk of uninsured takings litigation. A developer that even threatens takings litigation over some regulatory action or inaction can often induce a small local government to back down. Therefore, a developer who wants the government to capitulate to his or her demands is well advised to bring only a regulatory takings claim. Adding additional insured claims to the mix will at least require the insurer to defend the litigation and make it easier for the government to stick to its guns.

On the other hand, if a developer is seeking a quick financial settlement instead of regulatory capitulation, he or she should seek to trigger the municipality’s insurance coverage. Faced with the costs of defending the action, and any potential liability, an insurer is more likely to offer to settle. This is no get-rich-quick scheme for developers since sophisticated insurers are good at pricing claims and evaluating litigation costs and risks. Nevertheless, there is at least a good chance that an insurer will make a meaningful settlement offer early in any litigation to avoid all of the costs associated with defending the action.

This dynamic only exists, however, where courts have interpreted the inverse condemnation exclusion narrowly. It also only exists where developers can, in fact, choose between different causes of action. As discussed above, the substance of the various legal protections for property


100 See, e.g., John Coté, Half Moon Bay Grapples with $36.8 Million Judgment Against It, SFGATE (Dec. 18, 2007, 4:00 AM), http://www.sfgate.com/bayarea/article/Half-Moon-Bay-grapples-with-36-8-million-3234399.php [https://perma.cc/8GC9-DT6K] (quoting a county supervisor as saying: “One of the options, candidly, is . . . to dissolve . . . . That’s an extreme. But when you get a judgment of $36 million plus legal fees . . . even if you were able to finance it and stretch it out over a period of time, you would need significant reductions in your level of service to pay that off.”).


102 See Pryor, supra note 17, at 6 (“Plaintiffs’ lawyers often plead lawsuits in a way designed to trigger a duty to defend even when there is quite likely no ultimate indemnity coverage. The hope is that . . . the insurer will cover at least part of the tort liability.”).

103 See, e.g., Pryor, supra note 98, at 1732 (discussing settlement pressures on insurers).

104 See supra notes 73–103 and accompanying text.

105 See supra notes 73–103 and accompanying text.
owners differs considerably from the substance of takings protection. Nevertheless, developers often have the ability to pick and choose among a host of claims through artful pleading and creative construction of legal protections. This dynamic is easiest to see by looking closely at some different regulatory contexts in which diverse claims might arise.

II. THE VARIOUS CLAIMS ARISING OUT OF LAND USE ACTIONS

Land use litigation takes many different forms and arises in many different regulatory contexts. It is frequently the case, however, that a property owner or developer could fashion a claim that either does or does not trigger the municipality’s insurance, depending on the desired litigation outcome. Every case is different, and facts supporting a claim in one case may not arise in another. This Part therefore does not purport to canvass the range of potential claims in any comprehensive way. It seeks, instead, to capture, through a stylized example, the typical claims that may arise.

Imagine, then, a developer who owns a parcel of undeveloped beach-front land. She is seeking to build a significant number of residential units for sale. Imagine further, for the moment, that the property is currently zoned to permit the density of development she is planning. The municipality, however, decides that the property is particularly susceptible to flooding due to sea level rise, and that the development would dramatically increase the economic costs of such flooding. In this case, the municipality might downzone the property, reducing—perhaps dramatically—the number of units that can be developed on the parcel. A change, for example, from quarter-acre to two-acre minimum lot sizes will reduce the number of units eight-fold while also preserving permeable land and, perhaps, soft armor. The municipality might even impose new setbacks, all but eliminating the parcel’s development potential.

Confronted with a downzoning, the developer in this example has a number of possible legal claims. The most obvious is a regulatory takings claim. As William Fischel has argued, undeveloped land is particularly susceptible to regulatory burdens because the property owner is unlikely to have significant political power and exit from the jurisdiction is impossible. For that reason, Fischel believes that regulatory takings protection should be at its greatest when it comes to protecting undeveloped property. Takings claims are in fact a commonplace response (or threatened re-

106 See supra notes 73–103 and accompanying text.
107 See infra notes 108–145 and accompanying text.
109 Id.
sponse) to downzonings. While they rarely win, they are frequently colorable, especially if the downzoning is significant.

But the developer has other possible claims to pursue in addition or in the alternative. In this example, the downzoning applies to the developer’s property only, as sometimes happens when the zoning action is in response to a particular development pressure. This can give rise to a reverse spot zoning claim, or a substantive due process claim more generally.

Reverse spot zoning sounds fundamentally in due process, although it has taken on a kind of life of its own. A reverse spot zoning claim challenges the validity of a zoning decision that singles out too small a piece of land for adverse treatment, especially when the zoning action is inconsistent with the comprehensive plan or appears otherwise unjustified by anything innate to the regulated parcel. By labeling a zoning action spot zoning, a court will apply a more searching review than would otherwise apply to a substantive due process claim.

Even where reverse spot zoning is not at issue—perhaps because the downzoning affects too great an area—a developer can still bring a substantive due process claim, arguing that the downzoning is arbitrary or irrational. That claim is more likely to survive in the context of land use than in other areas of the law. In fact, as noted above, property owners can sometimes actually win as applied substantive due process claims, even when courts apply rational basis review. Furthermore, given the political controversy surrounding sea level rise, not all courts may view climate-based regulatory justifications favorably. While successful cases are undoubtedly rare, they are not unknown.

In addition to these claims, the developer may also have an equal protection claim, arguing that she has been singled out for disfavored treat-

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110 Jesse J. Richardson, Jr., Downzoning, Fairness and Farmland Protection, 19 J. LAND USE 60, 63 (2003).
111 Id. at 65.
114 See ELLICKSON ET AL., supra note 51, at 100–05, 395–400 (describing and collecting cases discussing spot zoning and reverse spot zoning).
115 See id.
116 See id.
117 See supra notes 50–53 and accompanying text.
118 See supra notes 50–53 and accompanying text.
119 See supra notes 50–53 and accompanying text.
ment.121 Here, she might argue that other similarly situated property was not
downzoned.122 If she was attempting to build affordable housing—a com-
monplace context for land use litigation—she might also bring a discrimina-
tion claim under the Fair Housing Act or, at least in New Jersey, a claim pur-
suing to Southern Burlington County N.A.A.C.P. v. Township of Mount Lau-
rel, on the grounds that the municipality was impermissibly pursuing its
own parochial interests at the cost of its neighbors.123 In addition to all of
these, the developer might also have procedural due process claims, and
state statutory claims under the state zoning enabling act or coastal zone
management plan, if there is one.

All of these kinds of claims could also arise in many other regulatory
contexts. If, instead of downzoning the property, the municipality refused to
upzone the property to permit the development, this could also generate the
same list of claims.124 Likewise, the denial of a subdivision permit, variance,
or other necessary regulatory approval could trigger the same kinds of claims.

Notice, then, that the plaintiff in this example, like in so many land use
examples, has a range of options she could pursue.125 In the typical course,
she will pursue all of them. But the municipality’s insurance coverage might
affect that choice. Now, if she wants to force the municipality to pay its own
litigation costs and face the prospect of uninsured liability, she can bring
only the regulatory takings claim, filing exclusively an inverse condemna-
tion action in state court.126 However broadly or narrowly the inverse con-
demnation exclusion is interpreted in the jurisdiction, it will certainly apply
in this case.127 This, in turn, can create substantial leverage for the develo-
per; it is conventional wisdom that municipalities will often withdraw of-
fending regulations rather than pay compensation to enforce them.128 In the
example here, the municipality may withdraw the downzoning, issue the
subdivision permit, or otherwise capitulate to the developer’s regulatory

121 See supra note 79–94 and accompanying text.
“class of one” equal protection claims do not require showing of animus).
123 See 336 A.2d 713, 728 (N.J. 1975) (striking down a local zoning ordinance that did not
take account of regional needs).
124 See Serkin, supra note 10, at 376 n.147 (collecting cases).
125 See infra notes 146–155 and accompanying text.
126 MILLER, supra note 20, at GL-116 (stating that municipal insurance policies typically
exclude injuries arising from inverse condemnation).
127 See id.  
128 Bethany R. Berger, What Owners Want and Governments Do: Evidence from the Oregon
Experiment, 78 FORDHAM L. REV. 1281, 1284 (2009) (discussing the government response to the
statutory choice in Oregon that governments either pay or withdraw the offending regulation, and
observing that governments always chose to withdraw instead of pay).
demands. A municipality will of course not always cave in, but the financial pressure to do so may be acute, especially for smaller local governments.

If, however, the developer wants to trigger the insurance coverage, perhaps to induce a quick settlement, she needs only to include one of the other possible claims, at least where courts have narrowly construed the inverse condemnation exclusion. 129 The presence of the insurer increases the possibility of a quick settlement offer, allowing the developer to obtain some money even if it does not make her whole. 130

Some might wonder why a developer would ever seek settlement money instead of the increased leverage that comes with a takings claim. After all, this is not a context in which insurance provides the only source of funds to pay an adverse judgment. 131 Local governments have the ability to pay, even if they do not want to. 132 Obtaining repeal of the offending regulation might always seem better than a cash settlement that is likely to represent less than the full diminution in value of the property. 133 But this overlooks the dynamics around land development. Time is often of the essence when it comes to developing property. 134 The carrying costs associated with owning land, and especially of construction loans and the financing of development projects, means that delays can kill off projects as surely as anything. 135 An adverse regulatory action may therefore stop a development in its tracks. Even if the municipality ultimately changes its mind—perhaps due to the threat of takings litigation—the damage to the development project may already have been done; market conditions may have changed, competitors may have obtained an insurmountable advantage, and so forth. 136 In that case, the developer may actually prefer to take some money and get out.

129 See supra notes 73–97 and accompanying text.
130 John Dwight Ingram, Essay, Why Aren’t More Cases Settled?, 45 S.D. L. REV. 94, 96 (2000) (“Many insurers also employ staff counsel to handle routine defense work. Since their compensation is assured, they are likely to seek out satisfactory early settlements so they can handle a high volume of cases.”).
131 The ability to access insurance money is one reason plaintiffs in tort actions might underlitigate their claims to allege only negligent instead of intentional harm. See Pryor, supra note 98, at 1736.
132 Lawrence Rosenthal, A Theory of Governmental Damages Liability: Torts, Constitutional Torts, and Takings, 9 J. CONST. L. 797, 832 (2007) (stating that local governments can raise taxes or take on debt to cover takings liabilities).
134 See id.
135 See, e.g., id.
136 See id.
Indeed, the dynamics here are interestingly different from the few other contexts in which scholars have addressed the possibility of strategic pleading by plaintiffs to trigger insurance. For tort claims, and even shareholder class actions, plaintiffs will often craft their pleadings to avoid an exclusion. In those cases, the insurer may have the deepest pockets, and so triggering insurance is necessary in order to get paid. That is not a problem for plaintiffs suing local governments, which can raise taxes or issue debt to fund takings liability. Of course, developers will often prefer to have the government withdraw a burdensome regulation than to receive damages. The pure financial benefits of having an adverse land use decision reversed may be much greater than the damages available under the Takings Clause. The point here is simply that developers may sometimes prefer damages.

The resulting dynamic is counterintuitive. The constitutional remedy for a takings violation is damages, and specifically just compensation measured by the diminution in value resulting from the regulation. The typical remedy for a substantive due process or equal protection violation, however, is injunctive relief, striking down the regulation. Likewise, a Mount Laurel claim can give rise to a builder’s remedy, allowing the development to proceed as of right. These claims may also come with damages, especially through 42 U.S.C. § 1983. But plaintiffs pursuing these

137 See Pryor, supra note 98, at 1732–34 (describing reasons why plaintiffs sometimes prefer triggering insurance coverage).
138 See id. at 1726 (“If a defendant has insufficient noninsurance assets to satisfy the potential tort judgment, then plaintiffs, quite naturally, will have an incentive to evade an intentional-harm exclusion.”).
139 See Rosenthal, supra note 132, at 832.
141 See id.
142 See Robert C. Ellickson, Suburban Growth Controls: An Economic and Legal Analysis, 86 YALE L.J. 385, 490–93 (1977) (describing and criticizing the assumption that remedy for due process violation is injunctive relief); cf. Warren v. City of Athens, 411 F.3d 697, 709, 711–12 (6th Cir. 2005) (finding shop owners were entitled to permanent injunctive relief removing barri cades blocking their drive-through that the city installed because the city violated their procedural due process rights); Layman Lessons, Inc. v. City of Millersville, 636 F. Supp. 2d 620, 651–52, 656 (M.D. Tenn. 2008) (granting summary judgment after finding the city violated a religious organization’s substantive due process rights by relying on the city planner’s representation that adjacent property was residential to enforce an inapplicable “buffer strip” regulation, but denying permanent injunction for failure to show irreparable harm).
claims are, in general, mostly interested in obtaining property rule protection. Municipal insurance coverage, however, reverses the wires. A developer seeking damages will be well advised to bring claims primarily for injunctive relief in order to induce a settlement offer from the insurer, while a developer seeking a favorable regulatory outcome should bring an action exclusively for just compensation under the Takings Clause, thereby avoiding insurance and pressuring the government to capitulate.\footnote{One limitation to this argument is that a claim for purely injunctive relief is likely to fall within a different exclusion in a municipality’s insurance. See Columbia Cas. Co. v. City of St. Clairsville, No. 05-898, 2007 WL 756706, at *16 n.5 (S.D. Ohio Mar. 8, 2007) (noting that the policy contains a provision excluding “from coverage any action for declaratory or injunctive relief”); XXL of Ohio, Inc. v. City of Broadview Heights, 341 F. Supp. 2d 825, 831, 841 (N.D. Ohio 2004) (citing the policy exclusion for “actions seeking relief or redress in any form other than monetary damages,” which the court found validly excluded coverage); Nutmeg Ins. Co. v. Clear Lake City Water Auth., 229 F. Supp. 2d 668, 679 n.6 (S.D. Tex. 2002) (referencing a reservation of rights letter the insurer sent the city that advises the city that claims for injunctive relief are not covered under the policy at issue). For a due process claim to trigger insurance, it must also seek at least some damages, presumably under § 1983. 42 U.S.C. § 1983.}

III. EXPANDING INSURANCE FOR TAKINGS LIABILITY

These dynamics around municipal insurance for land use litigation are provocative, but what should happen? Courts could—and many courts do—eliminate the ability to plead around municipal insurance by simply expanding the inverse condemnation exclusion to cover all land-use related claims.\footnote{See supra notes 31–72 and accompanying text.} But this is no solution.\footnote{See Serkin, supra note 1, at 31–32 (arguing that the absence of regulatory takings insurance leads risk-averse local governments to under-regulate).} It requires interpretive gymnastics, and it then leaves local governments without insurance for an even broader category of claims, potentially transferring even more power into the hands of developers and private property owners, and leading to under-regulation and under-enforcement of land use and environmental regulations.\footnote{See id.} The ability of plaintiffs to plead strategically to avoid insurance puts municipalities in a tough spot, but it is even worse if insurance is never available.\footnote{See id.}

The opposite approach is also problematic. The asymmetry in insurance coverage for different kinds of claims arising out of fundamentally the same underlying acts allows for pleading arbitrage by creative plaintiffs’ lawyers. This problem is not unique to land use litigation, nor to insurance. Pleading decisions are often affected by considerations outside the merits of

money damages to any person who has been deprived by another acting under color of state law of any right, privilege or immunity granted by the Constitution or federal law.”).
Plaintiffs, for example, choose whether to include a federal claim in state court partly to control whether a defendant can remove to federal court. Such strategic choices are at least in tension with the goals of a genuinely merits-based resolution of the dispute. It may be, for example, that equal protection is the most serious constitutional challenge to some government action, but that the plaintiff avoids it purely to avoid the municipality’s insurance coverage.

Such pleading arbitrage comes with potentially serious consequences to property owners, as well. Ignoring some claims for the purpose of avoiding insurance coverage waives those claims. More generally, it risks leaving potentially meritorious constitutional claims unresolved. While such gamesmanship occurs frequently, it is not to be lauded. Structural pressures away from merits-based litigation should be viewed skeptically.

The best response may then be to fill the hole in the municipal insurance coverage by extending insurance to regulatory takings claims. In other work, I argue that private insurance markets should be able to provide this coverage once certain information barriers are overcome. That is, there are no insurmountable impediments to a private market for regulatory takings claims. But even if that is wrong, or if the market fails to provide insurance for a variety of reasons, the state can step in to provide this insurance as a kind of subsidy for local land use and environmental regulations. Upstreaming takings risk from small risk-averse local governments to large risk-neutral states is welfare-enhancing, and can be structured in a way that avoids or at least minimizes the risk of moral hazard. It would fundamentally change the opportunity for pleading arbitrage. If the state is defending local governments and indemnifying them for liability, it will be more difficult for plaintiffs to use the threat of takings litigation to strong-arm local officials.

This is particularly attractive when it comes to climate change. A state wanting to incentivize local regulatory responses to climate change could offer grants or other direct state funding, but local risk aversion means those

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150 See Debra Lyn Bassett & Rex R. Perschbacher, The Roots of Removal, 77 BROOK. L. REV. 1, 39 (2011) (indicating that a plaintiff can attempt to avoid federal subject matter jurisdiction by suing under state law); Scott R. Haiber, Removing the Bias Against Removal, 53 CATH. U. L. REV. 609, 652 (2004) (noting that a plaintiff can avoid removal by disguising “a claim based on federal law as a state law claim”); see also Okla. Tax Comm’r v. Graham, 489 U.S. 838, 841 (1989) (refusing to view a claim pled under state law as arising under federal law even if the tribe would have immunity under federal law).

151 See Serkin, supra note 1, at 31–32

152 See id. at 49.

153 See id.

154 See id.
grants will be discounted. A better response—or at least an additional one—would include the state indemnifying local governments for any resulting takings litigation. This might have more of an impact on local regulatory incentives than even direct grants, and could also prove to be much cheaper for states.

CONCLUSION

Land use law too often ignores the impact of municipal insurance. The absence of insurance for regulatory takings claims, in particular, has the potential to distort regulatory incentives. But, as this Article argues, it also generates interpretive challenges for courts. How broadly should the regulatory takings exclusion be applied? Courts that expand it to include almost all land use litigation do so at the risk of flouting basic interpretive canons. Those that read the exclusion narrowly create the possibility of pleading arbitrage and strategic litigation choices that may be in tension with the goal of resolving legal claims on the merits. Whatever the resolution, shining additional light on this lacuna in municipal insurance helps to explain and problematize strategic choices in land use litigation.

155 For a full exploration of this proposal, see generally Serkin, supra note 1.