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PALAZZOLO V. RHODE ISLAND: THE SUPREME COURT'S EXPANSION OF SUBSEQUENT OWNERS' RIGHTS UNDER THE TAKINGS CLAUSE

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Palazzolo v. Rhode Island[2] is an important case that significantly impacts New York and its existing standards for challenging a taking of property by governmental regulation. The prevailing doctrine relative to taking by regulatory rules, zoning regulations or environmental regulations is well known.[3] The New York rule, which is also the nationwide rule, provides that if a regulation or ordinance deprives the owner of all productive use or reasonable return from the owner's land, this constitutes a taking and is therefore unconstitutional.[4] In a declarative judgment proceeding, in addition to arguing that an ordinance is a taking for which the government must compensate, a party can claim that, in enacting the ordinance, the legislative body exceeded its authority to regulate private property, and therefore

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[1] The Honorable Leon D. Lazer is a graduate of the City College of New York, and received his LL.B from New York University Law School. Judge Lazer served as an Associate Justice of the Appellate Division, Second Department, from 1979 to 1986 and was a New York State Supreme Court judge from 1973 to 1986. He was a partner in the New York law firm of Shea & Gould; Town Attorney for the Town of Huntington, New York; member of the Temporary State Commission to Study Governmental Costs in Nassau and Suffolk Counties; Chair of Pattern Jury Instructions Committee of the New York State Association of Supreme Court Justices; author of many published judicial opinions; member of the American Law Institute; member of the American and New York State Bar Associations and the Association of Supreme Court Justices of New York State. Judge Lazer retired from the bench in 1986.

[2] 533 U.S. 606 (2001).

[3] *See* Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922).

[4] U.S. CONST. amend. V. states: "[n]or shall private property be taken for public use without just compensation"; N.Y. CONST., art. I, § 7(a) states: "Private property shall not be taken for public use without just compensation"; Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1015 (1992); Gazza v. New York Dep't of Envtl. Conservation, 89 N.Y.2d 603, 616-17, 657 N.Y.S.2d 555, 561 (1997), *cert. denied*, 522 U.S. 813 (1997).

the ordinance is unconstitutional.[5] This is law with which we are all familiar.

The impact of Palazzolo in New York flows from its effect on recent holdings of the New York Court of Appeals. In 1997, the Court decided Gazza v. New York State Department of Environmental Conservation.[6] Gazza owned wetland property and applied to the Department of Environmental Conservation ("DEC") for setback variances in order to build on the uplands of the parcel. His application was denied.[7] He then brought an action claiming a taking by the DEC. On appeal, the Court of Appeals made what for many observers was a surprising determination. The Court held since the wetland restriction was in effect when Gazza acquired the title, the restriction merged into the title and could not be challenged by him.[8] The Court of Appeals ruled on three similar cases the same day, arriving at the same conclusions.[9]

According to the Gazza Court, if a party buys property subject to a zoning regulation or an environmental regulation, that party cannot challenge the regulation under the so-called 'Lucas rule' of a complete taking.[10] In Anello v. Zoning Board of Appeals,[11] one of the other three cases decided the same day as Gazza, the Court handed down a similar decision relative to a steep-slope ordinance.[12] Similar holdings were issued in Kim v. City of New York,[13] a lateral support case and in Basile v. Town

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[5] *See Mahon*, 260 U.S. at 415 ("while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking").

[6] 89 N.Y.2d at 603, 657 N.Y.S.2d at 555.

[7] *Id.* at 608-09, 657 N.Y.S.2d at 556.

[8] *Id.* at 615-16, 657 N.Y.S.2d at 560-61.

[9] The three other "takings" cases decided by the Court of Appeals on the same day as *Gazza* are: Anello v. Zoning Bd. of Appeals, 89 N.Y.2d 535, 656 N.Y.S.2d 184; Basile v. Town of Southampton, 89 N.Y.2d 974, 655 N.Y.S.2d 877, *cert. denied*, 522 U.S. 907 (1997); Kim v. City of New York, 90 N.Y.2d 1, 659 N.Y.S.2d 145, *cert. denied*, 522 U.S. 809 (1997).

[10] *Gazza*, 89 N.Y.2d at 615-16, 657 N.Y.S.2d at 560-61.

[11] 89 N.Y.2d 53, 656 N.Y.S.2d 184.

[12] *Id.* at 538, 656 N.Y.S.2d at 184.

[13] 90 N.Y.2d at 8, 659 N.Y.S.2d at 148-49.

of Southampton,[14] another wetlands case. So in four cases, the Court of Appeals established the rule that if property is acquired subject to a restriction, the buyer is stuck with the restriction with respect to a claim of a taking.

The leading United States Supreme Court case on the issue of taking by regulation is Lucas v. South Carolina Coastal Council,[15] where the Court held that in order for the regulation to be a taking, there must be a complete extinction of productive use of the property.[16] Justice Stevens, in his dissent, noted that the Court's rule was "wholly arbitrary", and would mean that landowners deprived of 95 percent of use of their property could not recover. However, a landowner who lost 100 percent of its property use could recover the complete value as compensation for the taking.[17] Complete extinction is the requirement for a taking under Lucas, as written by Justice Scalia.[18]

Is a showing of complete extinction of productive use of property the only way to challenge a zoning regulation under the takings clause? There is another way, which is outlined in the case of Penn Central Transportation Company v. New York City, decided in the late 1970's.[19] Penn Central entered into an agreement to lease the airspace over the magnificent Grand Central Terminal on 42nd Street, for which it was to receive $3,000,000 a year.[20] Jackie Kennedy[21] was among the many who fought to save the unique facade of the terminal. As a result of efforts like hers, Grand Central Terminal was designated a landmark under New York City's Landmark ordinance,[22] and the City refused to allow the proposed development of a 55 story

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[14] 89 N.Y.2d at 976, 655 N.Y.S.2d at 878-79.

[15] *Lucas*, 505 U.S. at 1015-16.

[16] *Id.*

[17] *Id.* at 1064 (Stevens, J., dissenting).

[18] *Id.* at 1015-16.

[19] 438 U.S. 104 (1978).

[20] *Id.* at 115-16 (describing Grand Central Terminal as "one of New York City's most famous buildings").

[21] Jacqueline Kennedy Onassis (1929-1994), widow of John F. Kennedy, the 35th President of the United States and also widow of Aristotle S. Onassis, a Greek businessman, at http://gi/grolier.com/presidents/es/first/35PW.html.

[22] *Penn Central*, 438 U.S. at 115-116.

tower on top of the existing structure.[23] The challenge to the ordinance went all the way up to the United States Supreme Court, which ultimately sustained it. The Court's decision sustaining the ordinance was partly based on the provision that permitted Penn Central to sell or transfer some of the development rights on nearby property that it owned.[24] Therefore, the United States Supreme Court reasoned there was no complete taking. Transfers of development rights are not worth very much, but in that era this fact was not well known.

Thus, there are two ways for an owner to approach a takings case. One way is to follow the Penn Central route and the other is to follow the Lucas case; but the Lucas route requires total extinction of productive use.[25] In Palazzolo v. Rhode Island,[26] Justice Kennedy, writing for the majority, looked back at Penn Central and observed that the case has always been a mystery. According to Justice Kennedy, even where the regulation falls short of eliminating all beneficial use, under Penn Central a taking may have occurred depending on a number of factors.[27] The factors include the character of the government action, the extent to which it interferes with distinct investment backed expectations, and the economic impact on the property owned.[28] What "investment backed expectations" means has eluded clarity for a number of years. In Gazza, because of the upland, the property in question had some residual value, but Gazza had argued a complete extinction of use. To the extent that he argued the applicability of Penn Central, the Court of Appeals did not accept his contentions. It found that his "reasonable expectations were reflected by his consideration of the inherent limitations on the property when he made the purchase offer for thousands less than its worth without the

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[23] *Id.* at 116-17.

[24] *Id.* at 137. The Court found that the transferable development rights mitigated the financial burden of the terminal's landmark designation, and therefore, had to be considered in the analysis.

[25] *Lucas,* 505 U.S. at 1015-16.

[26] 533 U.S.at 606.

[27] *Id.*

[28] *Id.*

restrictions. Thus, his 'reasonable' expectations were not affected when the property remained restricted."[29]

Palazzolo v. Rhode Island[30] dealt with a situation similar to the one in Gazza because it also involved ownership of wetlands and a denial of variances for 18 acres of property. The corporation that originally owned the property had its charter revoked in 1971,[31] the same year the Rhode Island Coastal Resources Management Council enacted very stringent provisions regarding development of wetland property.[32] In 1978, Palazzolo became successor-in-interest to the corporation's rights in the property as sole shareholder,[33] and later challenged the 1971 environmental regulations as a complete taking. The Rhode Island Supreme Court rejected his attack on the regulations, holding 'a la Gazza', that when Palazzolo bought the property, he took title to it subject to the environmental regulations, therefore, he could not now attack those regulations.[34] Furthermore, in response to Palazzolo's Penn Central argument, the Rhode Island Supreme Court questioned the kind of distinct investment-backed expectation Palazollo could have had when he obtained the property, subject to the regulations.[35] The Court dismissed the complaint and ultimately the United States Supreme Court found the Rhode Island rule to be unconstitutional.[36]

The issue before the United States Supreme Court was whether a purchaser or successive titleholder is deemed to have notice of an earlier enacted restriction, and is therefore barred from claiming that it affects a taking.[37] Writing for the six to three majority, Justice Kennedy wrote this dispositive language:

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[29] *Gazza,* 89 N.Y.2d at 619, 657 N.Y.S.2d at 564.
[30] 533 U.S. at 606.
[31] *Id.* at 614.
[32] *Id.*
[33] *Id.*
[34] *Id.* at 616.
[35] *Id.*
[36] *Palazzolo,* 533 U.S. at 616.
[37] *Id.*

> [w]ere we to accept the State's rule the post-enactment transfer of title would absolve the State of its obligation to defend any action restricting land use no matter how extreme or unreasonable. A State would be allowed in effect to put an expiration date on the Takings Clause. This ought not be the rule. Future generations have a right to challenge unreasonable limitations of the land.[38]

The majority opinion went on to reason that if the Rhode Island rule were followed, distinctions would develop between old owners and new owners and between owners that have wealth and can litigate and owners that have the need to immediately sell.[39] Justice Kennedy's opinion established a bright line rule that any holding that provides that an owner who acquires title subject to certain restrictions cannot challenge the restrictions is unconstitutional.[40]

Concurring, Justice O'Connor cautioned that this rule might paint too bright a line.[41] She hypothesized a situation where a person would buy a restricted-use property at an already reduced price and proceed to achieve a windfall by successfully litigating a takings claim.[42] Justice O'Connor believed that it would be more prudent to consider the timing of a purchase and a claim without a bright line rule.[43] Then, she took a strong swipe at Justice Scalia's opinion. I do not know what is going on between these two folks. But in a footnote Justice O'Connor asserted that Justice Scalia's "inapt government as thief simile is symptomatic of the larger failing of his opinion."[44] Justice Scalia responded, and referred to Justice O'Connor's previously mentioned hypothetical as the "polar horrible," and made other

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[38] *Id.* at 625.
[39] *Id.* at 627.
[40] *Id.*
[41] *Id.* at 634 (O'Connor, J., concurring).
[42] *Palazzolo,* 533 U.S. at 634.
[43] *Id.* at 633.
[44] *Id.* at 634.

references to the error of her opinion.[45] He joined the majority's holding that the timing of the regulation should have no effect on whether the taking is unconstitutional.[46]

There are dissenting opinions in Palazzolo, written by Justices Ginsburg, Souter and Breyer. Justices Ginsberg and Breyer believed the case was not ripe for review, therefore, they took issue with the majority's proceeding to decide the case on its merits.[47] Justice Stevens, although concurring with the majority that the case was ripe, agreed with the Rhode Island Supreme Court on the merits that Palazzolo could not challenge the regulation.[48]

As a result of Palazollo, Gazza has been overruled.[49] The timing of the regulation relative to the owner's title does not preclude a takings claim.[50] Incidentally, although Palazzolo won on the principal issue, he lost the case under the 'Lucas' claim because his property had at least a $200,000 value. He had argued total extinction of productive use, but two acres of the twenty-acre parcel was upland property and could be developed, which left him only the Penn Central claim to be determined on remand.[51]

So we are back to where we were before Gazza. Gazza and its progeny are now gone in New York. Furthermore, a property owner does not have to establish total extinction of use when arguing that a taking has occurred, Penn Central is still waiting in the wings.

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[45] *Id.* at 637 (Scalia, J., concurring).

[46] *Id.*

[47] *Id.* at 646 (Ginsberg, J. dissenting); *id.* (Breyer, J., dissenting).

[48] *Palazzolo,* 533 U.S. at 637-645 (Stevens, J., concurring in part, dissenting in part).

[49] *Id.*

[50] *Id.* at 630.

[51] *Id.* On remand to the Rhode Island Supreme Court, the case was further remanded to the trial court for the necessary findings of fact. *Palazzolo v. Rhode Island*, 785 A.2d 561 (R.I. 2001).

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