APPLICATION OF THE *PENN CENTRAL* TEST

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There are many different types of regulatory takings, each with their own unique rules and body of Supreme Court jurisprudence. Although the Supreme Court has articulated different inquiries based on the type of taking, each of the tests "aims to identify regulatory actions that are functionally equivalent to the classic taking in which government directly appropriates private property or ousts the owner from his domain. Accordingly, each of these tests focuses directly upon the severity of the burden that government imposes upon private property rights."[1]

In *Penn Cent. Transp. Co. v. City of New York*, the Court acknowledged it had been "unable to develop any 'set formula' for determining when 'justice and fairness' require" compensation for a taking and instead created a flexible standard of review.[2] The *Penn Central* test is an ad hoc determination based upon all facts and circumstances but with particular attention paid to a set of three factors: (i) "economic impact of the regulation on the claimant"; (ii) the extent to which the regulation interferes with "distinct investment-backed expectations"; and (iii) the character of the government action.[3] Since then, the Court has provided little guidance on the application of these factors.

Economic impact

Economic impact is a factual determination that is relatively simple to measure: an expert appraiser determines the fair market value of the property at its highest and best use before the regulation was enacted, as compared to the fair market value at its highest and best use after the regulation was enacted.

There is, however, an argument to be made that the extent of the economic impact should not be as important. Property rights are defined by state law, not the economic value attached to them. And although property rights do not magically vest at certain price points or certain percentage losses, courts require a significant diminution in value to constitute a taking. For example, in New York, 82 percent is enough of a loss to constitute a taking,[4] but 64 percent is not enough.[5] How does constitutionality turn on 18 percentage points of value? The answer is that it doesn't. The difference between those two cases was whether the owner could still use the property for economic benefit.

The reality is that constitutional regulations can sometimes cause large degrees of economic suffering and unconstitutional regulations can sometimes cause very little. The Constitution is about rights; economics are about damages. And thus, what a market buyer will pay for a property that is restricted by a regulation reflects the extent of the regulation (i.e., damages), not whether there was a vesting of a property right.

Reasonable investment-backed expectations

Reasonable investment-backed expectations are an objective determination, not a subjective one. It is not about the impact to a specific person, disconnected from market realities. Rather, it is about the regulation's impact upon the property, regardless of individual preferences, and grounded in what a reasonable market participant would have expected.[6]

The determination of reasonable investment-backed expectations is also a before-and-after comparison. The court evaluates the investment-backed expectations of market participants before the regulation was enacted as compared to those same expectations after the regulation was enacted. Thus, reasonable market participants have investment-backed expectations of utilizing a property to its maximum economic potential at its maximum permitted use. Any use other than that is not objectively reasonable. For example, if a regulation precluded all development on a valuable piece of land, the fact that the owner only intended to use it to tend sheep and grow grass does not make that regulation constitutional.

Prior to *Palazzolo v. Rhode Island*, owners that took title *after* a regulation was passed often had difficulty in claiming that the regulation was a taking since they had notice of the limitation before the purchase. Courts often found that they had notice of the regulation at the time of purchase.[7] However, *Palazzolo* held that the potential regulatory takings claim runs with the land and is transferable from owner to owner:

> Were 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 to be the rule. Future generations, too, have a right to challenge unreasonable limitations on the use and value of land.
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> Nor does the justification of notice take into account the effect on owners at the time of enactment, who are prejudiced as well. Should an owner attempt to challenge a new regulation, but not survive the process of ripening his or her claim (which, as this case demonstrates, will often take years), under the proposed rule the right to compensation may not be asserted by an heir or successor, and so may not be asserted at all. The State's rule would work a critical alteration to the nature of property, as the newly regulated landowner is stripped of the ability to transfer the interest which was possessed prior to the regulation.[8]

However, Justice O'Connor's concurrence differentiated between the right to bring a regulatory takings claim and the ability to win that claim. In accord with the majority opinion, she confirmed that a post-enactment purchaser can bring a takings claim,[9] but suggested that with notice of the regulation, a claimant's reasonable investment-backed expectations may not have been negatively impacted.

> Today's holding does not mean that the timing of the regulation's enactment relative to the acquisition of title is immaterial to the *Penn Central* analysis. Indeed, it would be just as much error to expungåe this consideration from the takings inquiry as it would be to accord it exclusive significance. If existing regulations do nothing to inform the analysis, then some property owners may reap windfalls and an important indicium of fairness is lost.[10]

While Justice O'Conner also stated that investment-backed expectations are "not talismanic,"[11] and are not to be given exclusive significance,[12] the damage was done.

Justice O'Connor's interpretation is both contrary to the majority opinion in *Palazzolo* and unworkable in practice. If someone buys property with notice of a pre-existing unconstitutional regulation, either the owner can bring a claim, or he can't. Notice cannot be both a non-factor and a penalizing factor at the same time. Yet, that would seem to be the end result of Justice O'Connor's concurrence.

Evaluating investment-backed expectations under Justice O'Connor's view is also endlessly circular. Let's start with an owner who buys property with notice of a pre-existing unconstitutional regulation. What are the owner's investment-backed expectations? They are to bring a regulatory takings action based on the regulation, the success of which will depend upon an evaluation of reasonable investment-backed expectations. Thus, the owner's reasonable investment-backed expectations are based on reasonable investment-backed expectations.[13]

In contrast, the concurrence of Justice Scalia determined that the proper approach was not to consider the unconstitutional regulation:

> In my view, the fact that a restriction existed at the time the purchaser took title (other than a restriction forming part of the "background principles of the State's law of property and nuisance," *Lucas v. South Carolina Coastal Council,* 505 U.S. 1003, 1029, 112 S.Ct. 2886, 120 L.Ed.2d 798 (1992)) should have no bearing upon the determination of whether the restriction is so substantial as to constitute a taking. The "investment-backed expectations" that the law will take into account do not include the assumed validity of a restriction that in fact deprives property of so much of its value as to be unconstitutional. Which is to say that a *Penn Central* taking, see *Penn Central Transp. Co. v. City of New York,* 438 U.S. 104, 98 S.Ct. 2646, 57 L.Ed.2d 631 (1978), no less than a total taking, is not absolved by the transfer of title.[14]

Justice Scalia's interpretation is a truer analysis and comports with the principal holding in *Palazzolo* (i.e., that the original owner's right to bring a regulatory takings claim is transferable). If the analysis of reasonable investment-backed expectations is different for the subsequent purchaser than it would be for the original owner, then it alters the analysis and impacts the transferability of the claim.[15] It also follows the Supreme Court's decision in *Nollan v. Cal. Coastal Comm.* in which the Court rejected the argument that notice of a regulation stripped an owner of reasonable investment-backed expectations.[16]

As the focus of the inquiry is the regulation and the subsequent purchaser is simply stepping into the original owner's shoes to make that same determination, the court must compare the reasonable investment-backed expectations before the regulation versus how they were impacted as result of the regulation.

Lastly, investment-backed expectations do not require any development effort or expenditure of money by the owner. To require otherwise is

tantamount to a pay-to-play scheme wherein the takings claim must be purchased via money spent on architects, engineers, plans, and permit applications. Whether a regulation is constitutional or unconstitutional cannot be based upon how much money someone spends.[17] Furthermore, the result of such development efforts would be a valid building permit. But a permit is a vested property right and a separate and distinct property from the fee.[18]

Character of the regulation

Character is more than an either/or determination about whether the regulation is a physical invasion or an adjustment to the property's use in the name of police power. Rather, it is what the regulation does, whom it impacts, how it affects the owner's reasonable expectations of "property," and how the burden is distributed as between the individual owner and the public.[19]

The severity of the regulation's impact can have a substantial determination upon the takings inquiry.[20] Character is best evaluated in accord with the central tenet of *Lingle*, that "a valid public purpose standing alone may not justify an otherwise problematic regulation."[21]

Police power is what provides the government with the authority to take action.[22] However, simply because a regulation is a valid exercise of police power does not also mean that it is not a taking contrary to the Fifth Amendment. "A claim that action is being taken under the police power of the state cannot justify disregard of constitutional inhibitions."[23]

Consider all three factors…and more

Many courts fail to consider all of the *Penn Central* factors.[24] In this regard, the Supreme Court is not always helpful, sometimes also failing to fully consider all of them. And indeed, *Penn Central* is an ad hoc test, with no set formula, based only on "the concepts of justice and fairness." Nonetheless, all *Penn Central* factors must be considered to give effect to the test.[25] The polestar for this approach is *Hodel v. Irving*. In this *Penn Central* case, two of the three factors weighed against the property owner. Had the Court stopped there, the case would have been over. Yet, the Court found a taking based upon its examination of the third factor, character of the regulation, and the weight that was assigned to it.[26]

Conclusion

As evident from the above, both the right to use itself and what can be subtracted from the right to use without it being an unconstitutional taking have been defined by the circumstances of each case. There is no one universal determination. But at the same time, the legal principles that can arise from these ad hoc cases can substantially impact the landscape of regulatory takings cases around them. For the benefit of property owners and government actors alike, care must be given in these cases to adhere to the principles that underlie the core Supreme Court determinations.

Notes

1 Lingle v. Chevron U.S.A. Inc., 544 U.S. 528, 539 (2005).

2 438 U.S. 104, 124 (1978).

3 Id.

4 In re New Creek Bluebelt, Phase 4, 997 N.Y.S.2d 447, 451 (N.Y. App. Div. 2014).

5 Adrian v. Town of Yorktown, 920 N.Y.S.2d 411, 412 (N.Y. App. Div. 2011).

6 See, e.g., Ruckelshaus v. Monsanto, 467 U.S. 986, 1005–06 (1984) ("A 'reasonable investment-backed expectation' must be more than a 'unilateral expectation or an abstract need.'") (citing Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980) ("a mere unilateral expectation or an abstract need is not a property interest entitled to protection")).

7 Palazzolo v. Rhode Island, 533 U.S. 606, 626 (2001) ("[T]he theory underlying the argument that post enactment purchasers cannot challenge a regulation under the Takings Clause seems to run on these lines: Property rights are created by the State. So, the argument goes, by prospective legislation the state can shape and define property rights and reasonable investment-backed expectations, and subsequent owners cannot claim any injury from lost value. After all, they purchased or took title with notice of the limitation.").

8 Id. at 627-628.

9 Id., at 632 (O'Connor, concurring).

10 Id. at 635.

11 Id. at 634.

12 Id. at 635.

13 See Anello v. Zoning Bd. of Appeals of the Vill. of Dobbs Ferry, 89 N.Y.2d 535, 540 (N.Y. 1997) (implicitly overruled on other grounds by Palazzolo) ("Furthermore, if property

owners were permitted to assert compensatory takings claims based on enforcement of preexisting regulations, the traditional takings analysis articulated in Penn Cent., and its inquiry into 'the extent to which the regulation has interfered with distinct investment-backed expectations,' would be rendered hopelessly circular. To illustrate based on the facts of this case: If petitioner's title was defined without regard to the steep-slope restriction, then her investment-backed expectations would include the possibility of winning a compensatory takings lawsuit as a result of the Village's enforcement of the ordinance. However, the success of her compensatory takings lawsuit would depend largely on the extent to which the ordinance interferes with her investment-backed expectations, which would in turn depend on the possible success of the compensatory takings claim, and so on. This inevitable circularity points up the analytical flaw in permitting a subsequent purchaser to assert a compensatory takings claim based on a property interest that has already been defined out of the owner's title.").

14 Palazzolo, 533 U.S.at 636–37 (Scalia, concur); see also Arkansas Game & Fish Comm'n v. United States, 568 U.S. 23, 38 (2012) ("The determination whether a taking has occurred includes consideration of the property owner's distinct investment-backed expectations, a matter often informed by the law in force in the State in which the property is located.").

15 Id. at 628 ("The State's rule would work a critical alteration to the nature of property, as the newly regulated landowner is stripped of the ability to transfer the interest which was possessed prior to the regulation. The State may not by this means secure a windfall for itself.").

16 Nollan v. Cal. Coastal Comm., 483 U.S. 825, 833, fn.2 (1987) ("Nor are the Nollans' rights altered because they acquired the land well after the Commission had begun to implement its policy. So long as the Commission could not have deprived the prior owners of the easement without compensating them, the prior owners must be understood to have transferred their full property rights in conveying the lot.").

17 See Palazzolo, 533 U.S. at 634-635 (O'Connor, J., concurring) ("We also have never held that a takings claim is defeated simply on account of the lack of a personal financial investment by a post enactment acquirer of property, such as a donee, heir, or devisee.").

18 See John J. Delaney & Emily J. Vaias, Recognizing Vested Development Rights as Protected Property in Fifth Amendment Due Process and Takings Claims, 49 Wash. U. J. Urb. & Contemp. L. 27 (1996) (should an owner obtain a vested right to develop a particular project, that right is, of course, a *separate* "property" right also protected from uncompensated takings, and that owner has unassailable proof of expectations).

19 See Lingle, 544 U.S. at 539–40 ("[T]he *Penn Central* inquiry turns in large part, albeit not exclusively, upon the magnitude of a regulation's economic impact and the degree to which it interferes with legitimate property interests"); Penn Cent. Transp. Co., 438 U.S. at 149–50 (Rehnquist, dissenting) ("A taking does not become a non compensable exercise of police power simply because the government in its grace allows the owner to make some 'reasonable' use of his property. It is the character of the invasion, not the amount of damage resulting from it, so long as the damage is substantial, that determines the question whether it is a taking"); see also *Palazzolo*, 533 U.S. at 633–34 (O'Connor, concurring) ("the purposes served, as well as the effects produced, by a particular regulation inform the takings analysis").

20 See Hodel v. Irving, 481 U.S. 704, 716–17 (1987) (finding a Penn Central taking because of the extraordinary character of the regulation); see also Arkansas Game & Fish Comm'n, 568 U.S. at 39 ("Severity of the interference figures in the calculus as well."); Portsmouth Harbor Land & Hotel Co. v. United States, 260 U.S. 327, 329–330 (1922) ("while a single act may not be enough, a continuance of them in sufficient number and for a sufficient time may prove [a taking]. Every successive trespass adds to the force of the evidence.").

21 Michael Lewyn, Character Counts: The "Character of the Government Action" in Regulatory Takings Actions, 40 Seton Hall L. Rev. 597, 599-600 (2010) ("This rule is perfectly consistent with the proposition that courts may balance a public purpose against the harm to a takings plaintiff. Second, the "private harm/public interest" balancing test is easier to apply than alternative interpretations of the *Penn Central* "character" factor… Accordingly, courts should treat the public interest favoring regulation as part of the 'character' factor.").

22 Nollan, 483 U.S. at 843 (Brennan, dissenting) ("There can be no dispute that the police power of the States encompasses the authority to impose conditions on private development."); Nashville, C. & St. L. Ry. v. Walters, 294 U.S. 405, 429 (1935) ("It is true that the police power embraces regulations designed to promote public convenience or the general welfare, and not merely those in the interest of public health, safety, and morals.").

23 Panhandle E. Pipeline Co. v. State Highway Comm'n of Kansas, 294 U.S. 613, 619 (1935); Lingle, 544 U.S. at 536–37 ("As its text makes plain, the Takings Clause does not prohibit the taking of private property, but instead places a condition on the exercise of that power. In other words, it "is designed not to limit the governmental interference with property rights per se, but rather to secure compensation in the event of otherwise proper interference amounting to a taking.").

24 See Adam R. Pomeroy, Penn Central After 35 Years: A Three Part Balancing Test or A One Strike Rule?, 22 Fed. Circuit B.J. 677, 704 (2013) ("on average, the circuit courts of appeals utilized three factors only slightly more than one-third of the time (37.8%)…[and] applying *Penn Central* as a balancing test is statistically rare... As an average percentage of cases applying all three *Penn Central* factors (cases that themselves are less than half of all cases reaching the merits), courts applied it as a balancing test less than 14% of the time.").

25 Palazzolo, 533 U.S. at 636 (O'Connor, concur) ("the Takings Clause requires careful examination and weighing of all the relevant circumstances in this context. The court below therefore must consider on remand the array of relevant factors under Penn Central before deciding whether any compensation is due.").

26 Hodel, 481 U.S. at 716–17; Babbit v. Youpee, 519 U.S. 234 (1996).