ValpoScholar Valparaiso University Law Review

Volume 32
Number 3 *Summer 1998*

*pp.*833-853

*Summer 1998*

# Protecting Property with Legal Remedies: A Common Sense Reply to Professor Ayres

Richard A. Epstein

# Commentary

# PROTECTING PROPERTY RIGHTS WITH LEGAL REMEDIES: A COMMON SENSE REPLY TO PROFESSOR AYRES

RICHARD A. EPSTEIN*

## I. INTRODUCTION

During its twelve-year history, the Monsanto Lecture has become a major outlet for torts scholarship in the United States. Professor Ayres's current contribution to this series—*Protecting Property with Puts*[1]—continues in that worthy tradition by bringing his economic acumen to the tricky question of finding the optimal legal regime to redress wrongs to property. In this lecture, he continues his recent elaboration[2] on the path-breaking article of Guido Calabresi and A. Douglas Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*,[3] which itself was the object of an enormous outpouring of scholarship on the twenty-fifth anniversary of its publication.[4]

One recent trend in that literature is to explain how the original insights of Calabresi and Melamed can be better understood by resorting to the standard tools of financial economics:[5] hence the reference to puts—an option that gives its holder the right to sell an entitlement at a fixed price—which thus protects the holder against a downturn in price. A put is often understood in opposition to a call—an option that gives its holder the right to buy an entitlement at a fixed

---

* James Parker Hall Distinguished Service Professor of Law, The University of Chicago. I should like to thank Ian Ayres and Saul Levmore for their helpful comments on an earlier version of this paper. I should also like to thank Michael Maimin, class of 1999 for his energetic research assistance and Daniel Sommers (Yale College) for his careful review of the manuscript.

1. Ian Ayres, *Protecting Property with Puts*, 32 VAL. U. L. REV. 793 (1998).

2. See Ian Ayres & Jack M. Balkin, *Legal Entitlements as Auctions: Property Rules, Liability Rules, and Beyond*, 106 YALE L.J. 703 (1996); Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 YALE L.J. 1027 (1995).

3. Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

4. *See, e.g.*, Symposium, *Property Rules, Liability Rules, and Inalienability: A Twenty-Five Year Retrospective*, 106 YALE L.J. 2083-2214 (1997).

5. *See* Madeline Morris, *The Structure of Entitlements*, 78 CORNELL L. REV. 822 (1993).

price—and thus allows the purchaser to take advantage of an upturn in the market. The metaphor of puts and calls has been pursued eagerly by a number of writers on the subject, whose work Ayres seeks to consolidate and extend.[6] If Ayres is to be believed, I am the one voice that holds out against this apparent integration of legal theory and financial economics. In the course of elaborating on his own views, Professor Ayres has taken me to task for my recent contribution to this topic, in which I defended the dominance of property remedies except in circumstances of necessity.[7] I am therefore most appreciative to the editors of the *Valparaiso University Law Review* for offering me the opportunity to respond briefly to some of Professor Ayres's criticisms and to elaborate on my own skepticism about the current vogue.

This brief Comment is organized as follows. In Section II, I comment on what I have termed the "subversive" organization of rights and remedies first proposed by Calabresi and Melamed in 1972.[8] In Section III, I comment on what I think to be the weaknesses of the efforts of Professor Ayres and others to use financial economics to extend and elaborate on the basic two-by-two matrix of Calabresi and Melamed. In Section IV, I comment on Ayres's specific examples of put options in connection with conversion, confusion, encroachment, and holdover tenant situations. A brief conclusion follows.

## II. CALABRESI AND MELAMED'S VOYAGE OF DISCOVERY

Calabresi and Melamed's 1972 article was a highly sophisticated effort to integrate substantive rights with legal remedies. To develop their typology, they used as their central example a simple pollution case between Taney, a polluter, and Marshall, a nearby resident. In line with traditional common law approaches, Calabresi and Melamed recognized that it was critical first to specify who has what entitlement, and then to determine what remedy, if any, should be granted to protect that entitlement so defined.[9]

Applied in the pollution context, the law first had to decide whether to protect Marshall against Taney's pollution. Then, if it decided to protect Marshall, it had to decide whether it should award him damages or grant him an injunction. Calabresi and Melamed called the damage remedy a "liability

---

6. *See, e.g.*, Carol M. Rose, *The Shadow of* the Cathedral, 106 YALE L.J. 2175 (1997); Saul Levmore, *Unifying Remedies: Property Rules, Liability Rules, and Startling Rules*, 106 YALE L.J. 2149 (1997); James E. Krier & Stewart J. Schwab, *Property Rules and Liability Rules: The Cathedral in Another Light*, 70 N.Y.U. L. REV. 440 (1971).

7. Richard A. Epstein, *A Clear View of* The Cathedral: *The Dominance of Property Rules*, 106 YALE L.J. 2091 (1997) [hereinafter Epstein, *Clear View*].

8. *Id.* at 2103.

9. Calabresi & Melamed, *supra* note 3, at 1090-93.

rule" because it implies that Taney may take Marshall's entitlement (to the quiet enjoyment of his own property) so long as he is prepared to compensate Marshall for his loss. To use their precise definition: "Whenever someone may destroy the initial entitlement if he is willing to pay an objectively determined value for it, an entitlement is protected by a liability rule."[10] Calabresi and Melamed call the injunction a property rule because it allows Marshall to stop Taney from polluting. In its precise form: "An entitlement is protected by a property rule to the extent that someone who wishes to remove the entitlement from its holder must buy it from him in a voluntary transaction in which the value of the entitlement is agreed upon by the seller."[11]

That injunction can, however, be dissolved by consensual means so long as Taney is prepared to meet Marshall's price, however high it might be set. Awarding injunctive relief therefore allows Marshall to "hold out" against Taney even when his own losses are small and Taney's gains from the activity that causes the pollution are large. So while the traditional legal position granted the innocent plaintiff in Marshall's position injunctive relief, at least where his damages were substantial, many recent commentators have urged the superiority of liability rules as a way of compensating the pollution victim for his losses while allowing the polluter to gain, when appropriate, from the continuation of his activities.[12] That result is at variance with the traditional legal approach that usually granted injunctive relief when the plaintiff's harm was substantial,[13] and denied it only when losses were trivial in comparison to the gains from the defendant's operation.[14] But in the famous case of *Boomer v.*

---

10. *Id.* at 1092.

11. *Id.*

12. *See, e.g.*, Louis Kaplow & Steven Shavell, *Property Rules Versus Liability Rules: An Economic Analysis*, 109 HARV. L. REV. 713 (1996).

13. *See, e.g.*, Whalen v. Union Bag & Paper Co., 101 N.E. 805 (N.Y. 1913):

> Although the damage to the plaintiff may be slight as compared with the defendant's expense of abating the condition, that is not a good reason for refusing an injunction. Neither courts of equity nor law can be guided by such a rule, for if followed to its logical conclusion it would deprive the poor litigant of his little property by giving it to those already rich. It is always to be remembered in such cases that "denying the injunction puts the hardship on the party in whose favor the legal right exists, instead of on the wrongdoer." (Pomeroy's Eq. Juris. vol. 5, § 530.) In speaking of the injustice which sometimes results from the balancing of injuries between parties, the learned author from whom we have just quoted sums up the discussion by saying, "The weight of authority is against . . . issuing an injunction."

*Id.* at 806. Note that the clear emphasis in this passage is on the protection of the rights of little people against large corporate wrongdoers. In ordinary cases of substantial damage, the holdout concern does not dominate.

14. *See* Madison v. Ducktown Sulphur, Copper & Iron Co., 83 S.W. 658 (Tenn. 1904) (denying an injunction for the destruction of scrub vegetation when defendant's operation was the economic source of life for a small Tennessee town). However, the injunction was granted at the instance of the state of Georgia, first after allowing the plant a reasonable time to introduce measures to abate the fumes (Georgia v. Tennessee Copper Co., 206 U.S. 230 (1907)), and then permanently,

*Atlantic Cement*,[15] the court showed some willingness to limit plaintiff's remedy to damage actions even when he suffered substantial harms.

The analysis thus far has focused on those cases in which the legal system decided to award Marshall some relief for the pollution. But perhaps the legal system could take the opposite position and deny all legal relief. Here the conventional analysis took the sensible position that we need not worry about the nature of the remedy in those cases where the plaintiff has established no wrong. The novel twist of Calabresi and Melamed is found in their now famous fourth rule, which purports to be a mirror image of the damage remedy referred to above: "Marshall may stop Taney from polluting, but if he does he must compensate Taney."[16] The excitement over this rule was marked by a rare intersection between academic speculation and legal practice when the Arizona Supreme Court in *Spur Industries, Inc. v. Del E. Webb Development Co.*,[17] a coming to the nuisance case, appeared to follow just that rule.

In my previous article on the *Cathedral*, I argued that Calabresi and Melamed had subverted the traditional categories of property rights by introducing Rule 4 into the mix of possible solutions.[18] In my view, the standard definition of property sets the stage for the analysis that follows, and it requires that the holder of land (just to keep matters simple) has the exclusive rights to possession, use, and disposition of that piece of land.[19] The pollution that comes from a neighbor necessarily interferes with that right and thus requires that the plaintiff be given some relief. In those circumstances, it is odd to say to the owner that he must purchase back the quiet enjoyment that he had in the original position. Indeed, if he must purchase back that right once, why can he not be required to do so again and again? Each individual has many neighbors, and they are capable of engaging in repeated interferences with his property. A legal rule that allows one to protect himself from pollution only by way of purchase opens up the possibility that the beleaguered owner will have to shell out cash on multiple occasions to purchase peace. The want of coordination among the various polluters may make this the optimistic scenario. The owner may find it better simply to allow the destruction of his land rather

---

unless pollution control standards were met (State of Georgia v. Tennessee Copper Co. & Ducktown Sulphur, Copper & Iron Co., 237 U.S. 474 (1915)). *See* JOHN W. WADE ET AL., PROSSER, WADE AND SCHWARTZ'S TORTS, CASES AND MATERIALS 834 (9th ed. 1994).

15. 257 N.E.2d 870 (N.Y. 1970).

16. Calabresi & Melamed, *supra* note 3, at 1116.

17. 494 P.2d 700, 708 (Ariz. 1972) (Cameron, V.C.J.).

18. Epstein, *Clear View*, *supra* note 7.

19. All this is not to say that we should ignore water pollution, but it is to note that the complex system of entitlements makes it difficult to identify the single plaintiff (or even small group of plaintiffs) who should bring the action, and thus tends to move the inquiry in favor of state actions to control the discharge.

than engage in futile sequential purchases of the defensive right. We would never tolerate a world in which individuals were open targets to physical aggression, which they could escape only by purchasing out the demands of all would-be aggressors. Why introduce that regime in pollution cases?

Ayres pays some attention to the long-term consequences of choosing one legal rule over the other when he notes that it is often important to give the resident protection—he is speaking here of his Rule 6[20]—when "lawmakers think that it is particularly important to give the Resident an incentive to invest in her land."[21] But what is lacking from his analysis is any dynamic explanation as to how anyone uncovers the truth of this initial assumption. It is hardly self-evident that a court, or even a legislature, could find out whether it is more important for *A* or *B* to invest in real property, and, if so, whether those investments optimally should include polluting the property of others. Yet it would be very unwise to convert courts into miniature zoning boards that are required to make initial factual investigations of where the proper incentives lie before deciding which rule to use in each case.

Ayres rightly stresses that there are no free lunches, in that the increased stability of expectations for one side always comes at a diminution of expectations for the other. But unless we have very strong *a priori* information as to the relative terms of trade, the prudent course of action is to favor the stability of general legal rules and to avoid the administrative costs (and political intrigue) of trying to pick in practice the winners that we know must exist in theory. Assuming that expected values are uniformly distributed over closed intervals makes the mathematics tractable, but it hardly gives any sense of how estimating the actual distributions of values will play out in practice—especially if the parties themselves are likely to find it difficult to attach precise monetary values to, say, the inconvenience and health hazards of pollution.

Even if that difficulty can be surmounted, I am somewhat uneasy about Ayres's implicit premise that treats the option as though it is always exercised at the expected value that the non-optionee attaches to the interest taken. Clearly that expected figure will not correspond with the actual value that the non-optionee attaches to the property. The usual approach on damages makes an *ex post* examination of the actual loss and thus avoids an issue raised here because the actual loss suffered by the property holder could be either greater or smaller than the stipulated judicial price. Giving a windfall to the other guy by paying what turns out in retrospect to be too much is something that few people are likely to protest; indeed, the person who collects will be quiet about his good

20. See *infra* text accompanying note 28.

21. Ayres, *supra* note 1, at 807.

fortune. But I suspect that Ayres's proposal will run into more difficulty if it turns out that the person whose property is taken attaches a higher subjective value to it than the court awards. Ayres is rightly sensitive to the variance question in deciding where options should be placed under his scheme.[22] But it is a mistake to ignore that issue in setting the option price equal to the expected value, when the variance in values of the coerced party is high, even if it is lower than the variance of the party who holds the option. The Ayres proposal thus amounts to a covert attempt to fine-tune the system, which is surely at variance with one who thinks that simple rules generally function best in a complex world.

For all these reasons, there is a lot to praise in the traditional rule that protects the individual landowner against pollution with injunctive relief backed up by damages. As that is the case, one should question on normative grounds the ability of a court simply to choose willy-nilly to award the aggrieved plaintiff no remedy at all. The best way to state that no court could defend in principle Rule 4 is to say that it could not defend Rule 3 either—the simple refusal to grant remedy for admitted pollution. What is so subversive about the Calabresi and Melamed approach is that it makes the assignment of property rights appear arbitrary, empowering social czars to place individual cases first in one box and then in another. It almost makes us pine for the simpler days when natural law theories of property rights were thought to dictate the results.

What makes the problem so difficult is that the above analysis misses those cases where the no-liability of Rule 3 might be defensible. Here it is important to differentiate among various types of pollution cases, as neither Calabresi and Melamed nor Ayres do. The visual image of pollution that comes forward when Marshall and Taney do battle is massive amounts of emission coming from Taney's plant into Marshall's flower gardens. And many cases surely fit that description, which is why the moral condemnation of pollution is so strong. But the simple constraint that all pollution be discharged from one plot of land to another systematically underestimates the diversity of cases found in the law. In my own early writing on the law of nuisance, I reverted to a pattern of cases in which each of many parties emits small quantities of pollution (noise, filth, or whatever) that damage his neighbor's property, only to have his own property damaged in turn by similar conduct.[23] Under those circumstances, I defended the traditional common law rule of "live-and-let-live," which holds that each person was required to put up with the pollution of his neighbor in exchange for

22. Ayres, *supra* note 1, at 819-23.

23. Richard A. Epstein, *Nuisance Law: Corrective Justice and Its Utilitarian Constraints*, 8 J. LEGAL STUD. 49 (1979).

the right to commit similar low-levels of pollution himself, as explicated brilliantly in Baron Bramwell's decision in *Bamford v. Turnley*.[24]

The defense of this rule was that all sides were better off under this relaxation of the usual liability rules than they were with their enforcement. The key point to recognize is that the shift from the standard version of entitlements to the version of newer entitlements (with reciprocal easements to pollute) did not take place arbitrarily but rested on the strong likelihood that everyone would be better off surrendering some of their rights to exclude and receiving in exchange greater freedom of action. Then, once this shift in rights is made, we can clearly envision a set of remedies and adjustments that could follow. In ordinary cases, damages and injunctions are inappropriate. And in some circumstances (a point that Calabresi and Melamed did not mention), the self-help remedy of abatement should be available to the nuisance victim. But once the nuisance is authorized under the live-and-let-live rule, then no remedies are available. In particular, abatement is no longer a possibility, and the person who enters the land of another thus loses the privilege to commit what would otherwise be a trespass. Similarly, individuals who do not like to suffer low-level nuisances can indeed follow Rule 4 and stop the pollution, but only so long as they are willing to pay for it. The arbitrariness of the typology is thus diminished, and its usefulness enhanced, with the restoration of the strong sense of property rights that Calabresi and Melamed have undermined. Imposing some discipline on the choice of categories also enriches our understanding of their uses and their limitations.

---

24. 122 Eng. Rep. 27 (Ex. 1863). There the court said:

> There is an obvious necessity for such a principle as I have mentioned. It is as much for the advantage of one owner as of another; for the very nuisance the one complains of, as the result of the ordinary use of his neighbour's land, he himself will create in the ordinary use of his own, and the reciprocal nuisances are of a comparatively trifling character. The convenience of such a rule may be indicated by calling it a rule of give and take, live and let live.
>
> . . . .
>
> . . . The public consists of all the individuals of it, and a thing is only for the public benefit when it is productive of good to those individuals on the balance of loss and gain to all. So that if all the loss and all the gain were borne and received by one individual, he on the whole would be a gainer. But whenever this is the case,—whenever a thing is for the public benefit, properly understood,—the loss to the individuals of the public who lose will bear compensation out of the gains of those who gain. It is for the public benefit there should be railways, but it would not be unless the gain of having the railway was sufficient to compensate the loss occasioned by the use of the land required for its site; and accordingly no one thinks it would be right to take an individual's land without compensation to make a railway.

*Id.* at 33. For a longer analysis of this decision, see Richard A. Epstein, *For a Bramwell Revival*, 38 AM. J. LEGAL HIST. 246, 269-83 (1994).

The above analysis applies not only to pollution but to other torts as well. The usual rules of property give individuals exclusive possession of their own land, and thus condemn entries by others as trespasses unless consent is purchased. It would, as a general matter, be quite absurd to defend a legal regime that adopted Rule 3 (or Rule 4) for trespasses, so that individuals could commit deliberate entry, or destruction, of their neighbor's property at will. The traditional view is that trespass is a wrong; all that is then left for the court to decide is whether damages, injunctions, or self-help in defense of property is appropriate under the circumstances, just as the conventional analysis has it.

In some cases, however, we can find situations that might call for a principled relaxation of the traditional rules of exclusion. The most famous illustration of rules of this sort are the open-range rules for cattle.[25] The usual rules of "closed range" require each owner to fence in his cattle lest they commit a trespass on the land of another. The open-range rules reverse the presumption and hold that the isolated individual who wants to keep cattle out has to fence them out in order to prevail. The only remedy that is allowed for trespass, as it were, is an expensive form of self-help.

The hard question is this: why that switch in entitlements? And the best answer is that cattle have a tendency to wander when they graze, and an open-range rule benefits all cattle owners within a given region by allowing their cattle freedom of movement. So long as they are prepared to let other cattle graze on their own land, they have a similar freedom for their own—yet another instance of reciprocal benefits found under the live-and-let-live rule. But the moment that mixed uses take place in a given region, that rule loses its sway. It is no accident that in developed areas the closed-range norms prevail even when the applicable law has not returned to the traditional view that requires cattle owners to prevent trespass, while allowing land owners to hold cattle (another self-help remedy) as security for payment of the damage caused.[26]

The upshot is that we have a strong presumption in favor of warding off strangers, whether they pollute or trespass. The typology of Calabresi and Melamed is alert to the range of logical possibilities, but it offers nothing substantive to explain the patterns of general use and occasional deviation. Only a substantive analysis of the overall situation can explain which substantive rule should be preferred when, and why.

---

25. For the now obligatory citation, see ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES 42-48 (1991).

26. Marshall v. Welwood, 38 N.J.L. 339 (1876).

## III. AYRES AND THE CHOICE OF REMEDIES

Professor Ayres seeks to build on the basic analysis of Calabresi and Melamed by explaining why we should consider not only the four possibilities mentioned above, but also two additional possibilities, both of which assume the form of financial puts (which give their holder the right to sell at a given price). At the formal level, I have little to critique about his mathematical analysis. He is surely right to stress the importance of the variation in output in analyzing the choice of legal rules, and as a matter of financial analysis, it is correct "to give the option to the decision-maker who has a higher variance of potential values,"[27] assuming that we know who that person is.

Nonetheless Ayres is so enraptured by the information-forcing properties of options that he underplays the important differences in institutional settings as we move from financial markets to nuisance situations. Indeed, it is his affection for the financial side of matters that leads him to take issue with much of what I have just written in defense of the dominance of property rights against the claims of many that liability rules allow private parties to harness information, and thus to generate gains from trade that are not possible under the traditional legal regime. To see where Ayres has misstepped, it is best to begin by noting the subtle reformulation that he makes of the traditional distinction between property rights and liability rules.

He writes in ways that capture the potential arbitrariness of the choices:

> Rule 1: a court might issue an injunction against a Polluter; or
> Rule 2: a court might find a nuisance but permit pollution to continue if the Polluter chose to pay damages; or
> Rule 3: a court might find the pollution not to be a nuisance and permit the Polluter to continue without paying damages; or
> Rule 4: a court might permit a Polluter to continue unless the Resident chose to pay the Polluter damages in order to enjoin further pollution; or
> Rule 5: a court might allow a Polluter to continue polluting, but also give the Polluter the choice to stop polluting and to receive damages from the Resident; or
> Rule 6: a court might allow a Resident to enjoin pollution, but also give the Resident the option of waiving his injunctive rights in return for damages from the Polluter.[28]

---

27. Ayres, *supra* note 1, at 819.
28. *Id.* at 794-97.

The key point here is to note the subtle transformation in the content of the rules that is worked by Ayres. Rule 1 no longer uses the definition of property rights favored by Calabresi and Melamed. Instead, it simply focuses on its remedial correlate and announces baldly that the plaintiff is entitled to an injunction. To those of us who remember the traditional property law, that statement carries with it the following meaning. The ordinary remedy traditionally given by common law courts is damages, but the courts of equity intervened with specific relief when the remedies at law were not deemed "adequate"—that is, when damages were not capable of providing full and complete relief to the plaintiff, and bringing him back, to the extent the law could do so, to the position that he enjoyed before the defendant's wrong. In nuisance cases, the losses to the plaintiff could be difficult to calculate, especially if personal amenities and health were at stake and if valuation of future uncertain harms is otherwise difficult. The situation is only made worse because there is no ready market in which the plaintiff could pay someone else to assume its full losses. The plaintiff of course was not obligated to seek an injunction but could settle for damages for the harms committed and for those which would be committed in the future—a point that raises genuine measurement complications of its own. The plaintiff who obtained an injunction could, of course, waive any benefit he received by agreeing to have the injunction dissolved for a price—which is why the holdup problem exists.

Ayres's cryptic statement of Rule 1—that a court might issue an injunction against a polluter—carries with it a very different meaning. In his autarkic universe, the *only* remedy available to the aggrieved landowner is an injunction. Damages are not available, and the parties are not allowed to contract around the legal rule even if they find it in their interest to do so. Not surprisingly, Ayres finds that this rule is inefficient, which is why no court in the history of the common law has adopted it.

Ayres has a reason to give this odd definition of Rule 1. It is to make a place for his Rule 6. Rule 6 says that the resident is entitled to the injunction but can waive it in exchange for damages, which of course he will not set at any figure below his actual cost as known to him. Ayres regards this as an important refinement because he now has a place for "puts" in the legal analysis. The choice between damages and injunctions now gives the innocent resident the right to sell his entitlement of quiet enjoyment to the polluter—the very definition of a put. Who could take exception to this legal regime? No one, because it more closely captures what Calabresi and Melamed meant by a property rule in their original paper and more closely follows the common law approach which in serious cases gives the plaintiff the election of remedies—that is, the choice between damages and injunctive relief.

But again, we have to be more careful about what is going on. One important element of the remedial picture in nuisance cases is overlooked first by Calabresi and Melamed and then by Ayres. In allowing damages, a court must decide whether to award temporary or permanent damages.[29] That distinction is not required in the case of the ordinary destruction of a simple chattel because, once the chattel is gone, the total amount of damages is fixed. But with pollution, the level of future damages depends in part on the level of future activity that the defendant undertakes—which is why an injunction matters in this case even if it is totally irrelevant for the destruction of a chattel. In practice, the choice between permanent and temporary damages is tricky, because there are advantages and disadvantages both ways. Temporary relief allows for periodic computation of damages, so that the level of the award can vary with the level of pollution. But at the same time it forces the plaintiff to bear the costs of multiple suits in order to vindicate his rights. Permanent damages eliminate those legal costs, but at the same time raise the possibility that the defendant will increase the level of pollution beyond the accepted amounts given that he has paid a lump sum for the right to pollute and does not therefore have to internalize the marginal costs of the higher pollution rates. A good legal system has to find some way to decide which form of damage award to use in the face of these alternative perils. As a rough guess, the presumption is in favor of permanent damages, but it can be displaced in cases that contain a high, irreducible variability in the expected levels of pollution.

By excluding a discussion of temporary damages, Ayres makes it appear as though the Resident can force the Polluter to buy his right of quiet enjoyment in the future. But in fact no legal system has ever adopted quite so bizarre a rule of imposing, as it were, a duty to pollute. To make it look like a put, the legal remedy has to provide that the Resident can force the Polluter to pay $\$X$ in exchange for the right to pollute $Y$ amount for some period of time. But suppose the damage award is not to the Polluter's liking. Puts be damned, he generally has the option to *mitigate* pollution levels and thus to reduce the level of damages he must pay the Resident. The Resident is only entitled to damages up to the level of pollution caused. He is not entitled to *collect* for some level of harm and insist that the Polluter continue to pollute at this level. If it helps to say that the Polluter has a reverse put (the right to resell the pollution rights to the Resident), then so be it. It seems a lot easier to say that he has the right to mitigate damages by cutting pollution in the face of a future damage remedy. The plaintiff has the right to demand a return to the status quo *ante*, and so in a sense does the defendant.

---

29. For a discussion, see RICHARD A. EPSTEIN, CASES AND MATERIALS ON TORTS 712-13 (6th ed. 1995).

The mysteries of Ayres's dubious terminology go still deeper, for Rule 5 is a piece of work as well. Here we have the inverse to Rule 6, in situations in which all the options are held by the Polluter, as if he were the holder of the property. Now the Polluter has the right to pollute, but he also has a put option of sorts, which is to stop polluting and receive damages from the Resident, presumably equal to whatever gains he got from polluting that are no longer his—e.g., the costs of new abatement technology. But note the perverse incentives that this rule creates. No one is a polluter by nature. You have to engage in some action to pollute. Now Rule 5 gives a real incentive to take up that cause. After all, you can start to pollute and then stop and claim money damages for the difference. It looks to me like a clear case of profiting from your own wrong. And it is a game that anyone can play. The law could give me the right to steal from you, and then require you to pay me damages when I return that particular right to you. Ayres is right to say that his Rule 5 shares with Rule 6 the feature of giving "the initial entitlement holder a put option—the option to force a non-consensual purchase on the other side."[30] What he neglects to say is why anyone on earth would choose to adopt this particular rule.

The reason why Ayres makes this error is the limited choice of his example. He has only two parties playing a one-period game; under those circumstances, any rule that allows the two parties to contract out of the presumptive legal solution could facilitate efficient renegotiation. But in all real world settings, the legal rules must work over many periods and must be resistant not only to the machinations of the two parties to the original dispute, but also to third parties who might come in. These difficulties come into play when we consider a variation on the nuisance prevention rules—namely, whether the government is entitled, when no nuisance has been committed, to decree, without paying compensation, that owners are not allowed to develop their land if that development will interfere with the eating, breeding, and sheltering of endangered species.[31]

Let there be two parties and a single period, and the choice of initial entitlement does not much matter.[32] But it surely matters when many parties play the game over many periods. The rule which denies the owner compensation could induce him to destroy valuable habitat lest his lands be frozen by government action. A decision to allow the government to designate land as habitat makes renegotiation of property rights impossible. The owner

30. Ayres, *supra* note 1, at 796.

31. Babbitt v. Sweet Home Chapters of Oregon, 515 U.S. 687 (1995).

32. For a longer discussion of these issues, see Richard A. Epstein, Babbitt v. Sweet Home Chapters of Oregon: *The Law and Economics of Habitat Preservation*, 5 SUP. CT. ECON. REV. 1, 37-40 (1997).

who buys back the rights faces the risk that a second designation (for a different reason) will result in another loss of these rights to the government. The traditional regimes that allow owners to keep off polluters and trespassers—the role government takes when it insists that its animals be sheltered on private lands—lead to far more efficient results. When lands are needed for habitat, they can be acquired by voluntary purchase or eminent domain.

Just the same difficulties plague the creation of the open range.[33] The owner who wants peace for his property without having to erect a fence does not know whom to buy that peace from: if one cattle owner cedes his right to trespass, another will take his place. But when the property rights run in the opposite direction, renegotiation is possible. The landowner who allows one cattle owner to graze his animals on his land need not permit others as well. The formation of property rights is driven by a powerful transaction cost logic which is not illuminated by the addition of Rules 5 and 6, or the reliance on the language of puts.

## IV. PUTS AGAINST DESIGNATED PERSONS: OF CONVERSION, CONFUSION, ENCROACHMENT, AND HOLDOVER TENANTS

These illustrations should put us on guard against our willingness to indulge in additional permutations of the original two-by-two matrix offered by Calabresi and Melamed. But Ayres is undaunted in his effort to show the key role that puts play in the overall operation of the legal system. In order to do this, he stresses the common law theme that allows plaintiffs a choice of remedies against defendants in a variety of situations in which the defendant has committed some wrong against the plaintiff. The illustrations that he uses are surely important ones, and it is important to understand both their use and their limitation.

The first case involves the possibility that the plaintiff will be allowed to require the defendant to purchase some product that has been innocently (that is, mistakenly) converted by the defendant. Here the common law rule allowed the plaintiff to complete the sale or, more accurately, to force the converter to purchase a good over which he had claimed ownership. This situation is not the same as forcing a put on a total stranger because it never contemplates that the owner of a chattel has the option to pick someone out of a crowd to purchase the property in question. Rather, the argument is that once the defendant has committed this particular wrong, then he should be subject to this remedy. The potential realm of puts is limited to wrongdoers.

---

33. For discussion, see Kenneth R. Vogel, *The Coase Theorem and California Animal Trespass Law*, 16 J. LEG. STUD. 149, 175-77 (1987).

Ayres is surely correct when he says that the forced purchase remedy in conversion cases is not the result of a consensual transaction. But the clear force of my remarks was to explain why the remedy would not be tolerated in the stranger cases and to indicate its limited use as a remedy in the conversion cases as well. On that last point, Ayres disagrees with the position I took when I wrote, "The 'forced sale' rule has come under constant attack especially in cases of innocent takings, where it is usually rejected today. What possible reason is there to believe that I want the ill-fitting galoshes that I took by mistake from the opera cloakroom?"[34]

Ayres's main point is to argue that this forced sale rule is not "under constant attack"[35] in the cases I mentioned in my article. Ayres is right to note that I did not cite any law for this proposition, so here is a somewhat fuller examination of the issue. The law of conversion has a certain schizophrenic quality. Historically, its major premise is draconian: "The normal and usual measure of recovery in trover is the value of the goods at the time of conversion. . . . "[36] Indeed, the essence of conversion is often said to depend on this choice of remedy: "The entire theory of conversion is that by his tortious act the defendant has repudiated the plaintiff's property in the chattel, and, by appropriating it to his own use, has treated it as his own."[37] But that same passage immediately shows the high threshold that must be crossed before this tough measure of damages can take hold:

> All tortious intermeddlings with personal property are not conversions. There is many a tortious intermeddling that is not a conversion. To be a conversion the tortious intermeddling must be so serious that it is fitting to require the defendant to pay the full value of the property. There is a special rule of damages for *such* a tortious intermeddling as is a conversion. It is in that special rule of damages that conversion moves and lives and has its being.[38]

The hard question then concerns the tipping point on the choice of remedies. To get a sense of the modern view, the most obvious place to look is at the Restatement (Second) of Torts § 922, which reads as follows.

---

34. Epstein, *Clear View*, *supra* note 7, at 2099, *discussed in* Ayres, *supra* note 1, at 814 n.64.
35. Epstein, *Clear View*, *supra* note 7, at 2099.
36. 1 FOWLER V. HARPER ET AL., THE LAW OF TORTS 256 (2d ed. 1986).
37. *Id.* at 237.
38. *Id.* at 237-38 (quoting EARL WARREN, TROVER AND CONVERSION 3 (1936)).

§ 922. RETURN OR TENDER OF RETURN OF CONVERTED CHATTEL

(1) The amount of damage for the conversion of a chattel is diminished by its recovery or acceptance by a person entitled to its possession.

(2) The amount of damages may, in the discretion of the court, be diminished by the tender of return of the chattel to one entitled to its possession if

(a) it was converted in good faith and under reasonable mistake, and

(b) its value to the one entitled to possession is not substantially impaired, and

(c) the tender is made promptly after the discovery of the mistake and is kept open.[39]

The comments to this provision stress the discretion that is left in the hands of the court, so that the "privilege of mitigation of the damages by return of the chattel is equitable in its nature."[40] This Restatement Rule has also been endorsed in these terms:

> This [Restatement] rule has much to commend it. The standard measure of damages for conversion (the chattel's full value) is a harsh burden to impose on a more or less innocent converter who offers to restore the chattel in question as soon as he has discovered his mistake. And the limitations on the rule seem well adapted to protect the plaintiff's legitimate interests.[41]

The footnote qualification then shows some of the conditions that can be used to guide discretion: the remedy will not be awarded in cases of deliberate conversion by the defendant (that is, with full knowledge of the plaintiff's title); it will not be awarded in cases of undue prejudice against the plaintiff, or to deprive the plaintiff of any element of special damages that would otherwise be recoverable. The citations to all predate the publication of the Restatement of Torts in 1979. A Restatement illustration shows the limits of that discretion:

> 3. A innocently buys from B a new suit of clothes that has been stolen from C. A wears the suit for a month. At the end of that time C sues A for conversion. A tenders return of the suit but C refuses to accept it. Since the suit has become second-hand clothing, its value

39. RESTATEMENT (SECOND) OF TORTS § 922 (1979).
40. *Id.* § 922 cmt h.
41. HARPER ET AL., *supra* note 36, at 170.

> is substantially impaired and the tender does not mitigate the damages for the full value of the new suit, for which A is liable.[42]

Who could quarrel with this result? Indeed, the question should be asked whether the court should exercise its discretion on the return of the chattel where the change in condition is real but the impairment may not be substantial. Here the obvious point of comparison is the perfect tender rule in the law of contracts, which allowed rejection of goods that deviate from the contractual specification without any showing of impairment, substantial or otherwise.[43] That rule did receive some outspoken nineteenth century support,[44] even in those cases where its exercise was driven solely by the collapse in market conditions, and not by any dissatisfaction with the goods as such.[45] The rigors of that rule have been altered so that now the rejection of the goods is possible only upon showing that the "non-conformity substantially impairs" the value of the goods in shipment.[46] The goods may also be kept, allowing an action for damages for the difference.[47]

Within this framework, my modest example about the galoshes was designed to cover only the strongest possible case for denying the forced sale, where the goods are promptly returned in their unchanged condition after their innocent conversion. I think it would be a clear abuse of discretion for any court to order the purchase in the limiting case that I described. I have not done an exhaustive review of the case law, and authority on the Restatement provision is, to say the least, scant.[48] But by the same token, I have found no court that has allowed the plaintiff to insist on a forced sale where the defendant has promptly returned goods in their unchanged condition. In part, this outcome has nothing to do with the law. Conversion actions are often brought by secured creditors who claim that purchasers/debtors have acted in ways that undermined the value of their lien. First and foremost, secured creditors want repossession of the property in question because the right of a damage action for conversion

---

42. RESTATEMENT (SECOND) OF TORTS § 922 cmt. f, illus. 3.

43. For the comparison, see Epstein, *Clear View*, *supra* note 7, at 2099.

44. *See* Norrington v. Wright, 115 U.S. 188 (1885) (allowing rejection of late shipment old iron T rails after stipulated time); Filley v. Pope, 115 U.S. 213 (1885) (allowing rejection of goods shipped from wrong port).

45. For explanation, see FRIEDRICH KESSLER & GRANT GILMORE, CONTRACTS: CASES AND MATERIALS 831-33 (2d ed. 1970).

46. U.C.C. § 2-608(1) (1977).

47. *Id.* Official Comment 1.

48. *See, e.g.*, Plymouth Fertilizer Co. v. Balmer, 488 N.E.2d 1129, 1140 (Ind. Ct. App. 1986) (involving the conversion of natural gas and stating that "We have not been shown any authority for the proposition . . . that Indiana has adopted the Restatement of Torts, 2d, § 922. . . . Assuming, *arguendo*, that Indiana had adopted § 922, Plymouth conceded that its motion may not be granted because in this case the necessary good faith may be lacking.").

is largely worthless.[49] We should therefore hardly expect this issue to arise in its most common context. In other cases, the question is whether the plaintiff can recover damages to property that has been returned belatedly and in a damaged condition. Both risks are fully accounted for: interim damages are awarded for the delay, and additional damages for the diminution in value of the goods in question.[50]

Ayres says that my reluctance to order the forced sale is a mistake because the inadvertent taker was negligent relative to the owner. But surely some cases of innocent mistake are not negligent, which is why conversion is often referred to as a strict liability tort. And even if some negligence goes undetected in a strict liability system, the prompt return makes that negligence one of harmless error, because the plaintiff has suffered no damage. Undaunted, Ayres sees the creation of this put option as a way to deter potential takings and, thus, to shore up the operation of property rules. But this approach misstates the relevant role that security of possession plays in a system of private property. The point of the legal rules is to minimize the level of *systemwide* insecurity, which takes into

---

49. *See, e.g.*, McQuillan v. Mercedes-Benz Credit Corp., 961 S.W.2d 729 (Ark. 1998). The *McQuillan* court wrote:

> The market value of the property is not, however, the only measure of the damages recoverable in an action for conversion; the circumstances of the case may require a different standard, including a measure of the expenses incurred as a result of the conversion. Moreover, the fact that the items were eventually returned to the owners does not necessarily bar recovery of damages for their conversion, but may mitigate the damages. Generally, the law permits evidence of the return of the property to its owner in mitigation of damages only when certain circumstances are present: (1) that the owner must have accepted the return of the goods; (2) that the original conversion occurred by mistake; and (3) that the return of the goods occurred promptly after the discovery of the mistake and before the commencement of the action for conversion.

*Id.* at 733 (citations omitted). The case showed no hint of a seller unwilling to retake the goods.

50. *See* Vetter v. Browne, 85 S.W.2d 197, 199 (Mo. Ct. App. 1935):

> Where an automobile has been converted by another and the vehicle has thereafter been returned and accepted by the owner thereof, the measure of damages is the difference between the value of the car at the time of the conversion and the value of the car at the time of the return, plus the reasonable value for the loss of the use of such vehicle during the period of time that the owner has been deprived thereof.

*Id.* (citations omitted). *See also* Welch v. Kosasky, 509 N.E.2d 919 (Mass. App. Ct. 1987):

> Where, as here, the rightful owner elects to receive back the converted goods, the rule of damages, as the defendant correctly observes, is still based on value at the time of the conversion, but the converter is (1) credited with the value of the returned goods at the time of their return, and (2) charged with damages for loss of use of the goods during the period of the detention.

*Id.* at 921 (citations omitted). The court then allowed plaintiff to recover damages for the reduction in value attributable to the alteration of the goods. Once again, a defendant's solvency appears in practice to be a serious obstacle to the forced purchase remedy.

account the position of both parties to the transaction.[51] Here the effort to increase the security of the property owner by allowing the option to sell necessarily reduces the security that the innocent converter has in her wealth and possession by exposing her to the risk of the forced purchase, and for no good reason. Assume that defendant takes plaintiff's fur coat out of a checkroom. Does she really have to purchase a second coat when she already has a perfectly serviceable one? That is an awfully high price to exact from someone who makes a prompt return, and the known application of this odd rule could have the perverse consequence of encouraging the innocent converter to simply leave the goods where she finds them and flee the scene, which works to no one's benefit. Right now, the innocent converter still has to pay the modest price of actually tendering the goods to the original owner, which should deter any casual errors. Anything more counts as overdeterrence given the losses involved.

Finally, there is the gnawing requirement that the legal system has to set the price for this put. Ayres has stated: "Kaplow and Shavell suggest that the optimal exercise price should be set at the court's best estimate of the non-option holder's value. In the galoshes example, this might be a relatively small number, so that most original owners would prefer the galoshes back rather than to exercise their put."[52] Once again, the "positive" theory of law and economics takes a real drubbing, for the proposed measure of damages bears *no* relation to the market value of the goods at the time of conversion, a figure that has been universal in all conversion cases when the goods have not been returned. It seems perfectly obvious why courts would refrain from getting into such muddy waters, for who has any idea as to what that hypothetical option price would be? And why should a court and the parties haggle over that number when the return option is available? And what should be done if the strike price (which is necessarily an expected value) differs from the actual subjective value of the hapless purchaser?

The usual case in which the forced sale is ordered is one in which the chattel is not only taken, but damaged or altered, in line with the Restatement rule. The legal position makes perfectly good sense. Once the chattel is damaged, it is tricky to figure out what damages are needed to make the plaintiff whole, so that the long-established election of remedy allows the plaintiff simply

---

51. For the philosophical account, see FRIEDRICH A. VON HAYEK, THE ROAD TO SERFDOM 132-47 (50th Ann. ed. 1994): "What is constantly being done is to grant this kind of security piecemeal, to this group and to that, with the result that for those who are left out in the cold the insecurity constantly increases." *Id.* at 137. Hayek meant to apply his statements to the grand politics of welfare economics. Here we only have innocent conversions that are as likely to be made by the one party as the other. But the net effect of Ayres's rule is to make both sides worse off *ex ante*, the kind of Pareto Pessimal outcome that should have no place in ordinary private law transactions.

52. Ayres, *supra* note 1, at 815 n.64 (citation omitted).

to liquidate his original investment for cash. The remedy of forced purchase requires the defendant, quite simply, to pick up the pieces when the chattel is destroyed and to take the up and down of its value when the chattel is taken. As the return of the chattel no longer gets us close to the status quo *ante*, the legal remedy is shifted to the plaintiff's benefit.

To see how these cases really work, it is best to look less to the law of simple conversion, than to the rich body of case law that deals with accession, confusion, and specification, all of which decide who should own a particular chattel that by mistake is made out of the inputs of two separate individuals.[53] The standard example has *A* making a fine sculpture out of *B*'s marble, which *A* believes innocently but mistakenly to be his own. In these cases, it is quite impossible to give the thing to each party separately, and the question involves the division of rights and duties under the circumstances. In these circumstances, the sheer physical necessity of the situation prevents each person from retaining sole ownership of his own input. The Roman answer was quite ingenious. It allowed one person to keep the thing but gave the other a lien equal to the value of the materials or labor added to the process. In the case of the marble slab, the sculptor could satisfy his obligation by offering an unused slab of marble of equal quality.

One key feature of this solution was that the law refused consciously to make the two parties co-owners of the thing, for the sufficient reason that joint owners are necessarily partners with extensive fiduciary obligations to each other. Generally speaking, unrelated individuals should not be cast involuntarily into that mutual trust relationship. The lien relationship allows one person to sever the connection with the other unilaterally by compensating him for the value of the input. It is yet another early illustration of a taking with just compensation. I suppose that this relationship could be described as giving one party a "call option," but that description only obscures what is illumined by the traditional account of the subject.

The encroachment cases that Ayres addresses offer a similar story.[54] As before, these cases offer no support for the proposition that individual owners have put options against strangers. In these situations, the usual danger is that the plaintiff will demand that the defendant vacate the land at great expense in order to return the status quo *ante*. That danger of waste has led many courts and commentators to deplore the common law rule and to favor a rule that requires the defendant to pay damages only and, thus, to complete the purchase

53. Epstein, *Clear View*, at 2106-07. *See also* RICHARD A. EPSTEIN, SIMPLE RULES FOR A COMPLEX WORLD 116-18 (1995).

54. I discuss encroachment at length in Richard A. Epstein, *Holdouts, Externalities, and the Single Owner: One More Salute to Ronald Coase*, 36 J. LAW & ECON. 553, 567-72 (1993).

of the land in question. Here too, we do not have a put option against a stranger, but only a put option against a self-selected wrongdoer who has already occupied the property and claimed it as his own. Given the tiny sliver of property that is taken, most defendants would be thrilled if forced to complete the purchase of property that they have already taken, without having to face the holdout risk that arises when asked to rip down their encroaching structure.

The situation with holdover tenants is exactly the same: the remedy is available only against a wrongdoer and has never been extended to allow a landlord to designate some hapless stranger as the proud tenant of the landlord's own land. Even with these cases, we have sharp limitations on the period of time in which the landlord can hold the tenant to the lease. The tenant who holds over on a twenty-year lease cannot be made to stay for another twenty years but at most for a single year.[55] In dealing with these examples, the critical point to note is the enormous protection that is offered all individuals by limiting the forced purchase (or lease) arrangements to admitted wrongdoers. The basic point of the conventional wisdom remains good. There is never a case to require strangers to purchase any property (land, chattels, patents, or whatever) from its owner for cash. The use of the forced exchange is limited to those cases of necessity, as I urged in my original *Yale Law Journal* article,[56] and there is never a case where a necessity exists to sell something to a particular purchaser, even if there may well be reasons why one has to purchase (or rent) a particular thing from its owner. That asymmetry remains in the law, and the discussion of puts does nothing to displace it.

## V. CONCLUSION

There is a curious tension in Ayres's article between his claims for novelty and his claims for tradition. On the novelty side, he stresses the gains from using the economic language of puts and calls to help explain the appropriate remedial structure for a wide array of conventional wrongs. At other times, he claims that his purported solutions track the traditional election of remedies that has long been allowed by common law courts. I think that he is largely misguided on both counts. Rather than set sail on dangerous waters, he would have done better to note that the initial mistake in the Calabresi and Melamed article was its implicit and heretical rejection of the proposition that remedial choices should be made only after a violation of legal right is established. On that view of the world, there is really no reason to concoct additional options,

55. As to the basis for the length of the period or term, on one view, it is the way the rent is reserved in the original lease, and on another view, the length of the original term or period—but the maximum length in each case is limited to one year. *See* 1 AMERICAN LAW OF PROPERTY § 3.35, at 244-46 (1952 & Supp. 1977); RESTATEMENT (SECOND) OF PROPERTY § 14.4 cmt. f (1977).

56. Epstein, *Clear View*, *supra* note 7.

such as the famous Rule 4, when it has already been concluded that the substantive rights lie with the plaintiff.

His effort to expand and elaborate on the famous four-fold classification of Calabresi and Melamed only leads Ayres to substantive conclusions that are at odds with common sense, just as they are at odds with any systematic economic approach. It often leads him to propose modifications of common law rules, such as the measure of damages for innocent conversions, that bear no relationship to the case law and none to common sense. In my own view, his article shows a common flaw in much recent writing about the common law, which is the effort to rationalize the system from the top-down in light of some very abstract propositions. I have no desire to attack the use of economic theory, but only to see that it is applied with greater sensitivity to institutional context and social arrangements. Toward that end, I think that the program of law and economics should be reoriented to at least this degree: start with the common law decisions, and then ask how their results are defective in light of economic theory, and what legal changes would lead to the desired improvements. That simple bottoms-up approach will not remove all error from the legal system, and it might well miss some grand insight derivable from pure theory alone. But it does offer a necessary corrective against flights of fancy that too often lead us astray. The law of remedies does contain elections and options. But understanding their shape and efficiency is not advanced by invoking the economics of puts and calls as much as it is by accepting the simple proposition that the plaintiff might often need to have an election of remedies in order to secure full relief against the defendant's wrong.