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HOW TO CREATE—OR DESTROY—WEALTH IN REAL PROPERTY

*Richard A. Epstein**

PROPERTY RIGHTS—PRIVATE PROPERTY AND CONSTITUTIONAL RIGHTS

It is a commonplace observation among writers, like myself, in the classical liberal tradition that strong and well-defined property rights are an indispensable precondition for the creation of wealth, and through it human happiness and satisfaction. In most contexts, this proposition is stated as a universal truth, which is not dependent on the particular circumstances of any given culture. A more popular version of this proposition is attributable to Sophie Tucker, who said (rightly): “I’ve been rich, and I’ve been poor. Believe me, honey, rich is better.”¹ Her vivid generalization, which is attacked by many on the grounds that the crude obsession with material wealth pays insufficient attention to the critical variations among cultures, strikes me as about right. Writ large, the concern with wealth makes pretty good sense, even though on particular issues—such as the care of impoverished infant children—it does not furnish a suitable guide for decision.² To be sure, it is easy to note that different forms of natural resources may well require different systems of property rights, as with water. But that proposition holds true only with respect to the physical variations in natural resources, whereby a riparian regime that works for gentle English rivers will not do well on the raging Colorado River. In the end, the same physical

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1. Carole Goldberg, *The Red-Hot Mama*, HARTFORD COURANT, Aug. 14, 2003, at D1.

2. For the medical parallel, see RICHARD A. EPSTEIN, MORTAL PERIL: OUR INALIENABLE RIGHT TO HEALTH CARE? 31-37 (1997). For the leading economic defense of wealth maximization, see Richard A. Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103 (1979), and for the criticism, see Ronald M. Dworkin, *Is Wealth a Value?*, 9 J. LEGAL STUD. 191 (1980).

environment is likely to give rise to the same solutions in all sorts of different cultures. What is needed is some basic understanding of how property rights foster the creation of wealth.

In this Essay, I propose to offer a general account of property rights in *land*,³ which starts from first principles and builds up from there to the complex property arrangements that can work in the modern state. But just as there is growth, there is also pathology, so it is equally critical to understand how modern legal regulation all too often destroys wealth by inhibiting the rights of use and disposition that were part of the common law bundle of rights. The central thesis of this Essay runs as follows: The common law tradition, broadly conceived, did a good job in dealing with the development of property rights in land.⁴ The constitutional protection of property rights consciously departs from that system and creates a weak, inconsistent, gap-ridden system that opens up vast opportunities for political intrigue. Note these key contrasts.

The backbone of the common law system of property rights is the rule of first possession, which allows individuals to acquire property over which they enjoy rights of use or disposition. Thereafter, the rules governing conflicts of use between neighbors tended to maximize the value of all plots of land subject to the common regime. It achieved this result by a system of successive approximations.⁵ Law started off with a system of strong boundary conditions between neighbors and then allowed for the emergent system to vary in two ways. One of these was coercive, whereby the state added or subtracted rights from the initial bundle for all holders equally. The key condition was to deviate from the hard-edged boundaries under circumstances where it produced gains shared equally by all parties. In addition, the open rules on disposition allowed for voluntary transactions that combined property interests in ways that further facilitated mutual gains in wealth. Over time, a combination of factors has made that system ever more versatile: sophisticated drafting by private counsel to get rid of default terms that did not quite work out;⁶ judicial decisions that tend to increase the flexibility of covenants and easements;⁷ and legislation that allows for the creation of new forms of property interests, such as time-shares in real estate.⁸ All of these features tend to strengthen a system with robust, well-defined, and consistent property rights in land.

3. For a general discussion, see Robert C. Ellickson, *Property in Land*, 102 YALE L.J. 1315 (1993).

4. For an exposition of this system, see RICHARD A. EPSTEIN, *SIMPLE RULES FOR A COMPLEX WORLD* 53-70 (1995).

5. For my more detailed account and a discussion of the variations on the basic rules, see Richard A. Epstein, *Nuisance Law: Corrective Justice and its Utilitarian Constraints*, 8 J. LEGAL STUD. 49 (1979).

6. For example, the standard deed provisions on the rule against perpetuities or on the allocation of rights between tenants for life and remainderman.

7. See, e.g., *Neponsit Prop. Owners' Ass'n v. Emigrant Indus. Sav. Bank*, 15 N.E.2d 793 (N.Y. 1938).

8. See, e.g., FLA. STAT. §§ 721.01-.32 (2006).

These private rules were in turn supplemented by a system of state takings for public use, with a built-in compensation requirement that essentially allowed for further corrections in any distribution of property rights under a rule that, if properly applied, left no one worse off than they were prior to the invocation of public force. The receipt of just compensation was meant to leave the landowners who lost their property as well off as before. The new public property use—the creation of a highway for the benefit of all landowners—generated gains that were shared equally across society. Sticking to these principles tended to avoid shipwrecks in legal innovation while moving wealth, and doubtless utility, to ever higher levels. While the standard of wealth is not the be all and end all of social welfare, it works especially well with land use transactions, where market values are useful proxies to social welfare.

The modern constitutional treatment of property rights consciously deviates from these common law rules.⁹ Today's systems of land use regulation, from zoning to environmental protection, are marred by the same flaws. First, the "bundle of rights" within the system of property—exclusion, possession, use, development, and disposition¹⁰—are thought to be arbitrary and hence worthy of no particular respect if the state should think it appropriate to "redefine" property rights without compensation.¹¹ Under the revised version of the world, "the" property right is the right to exclude from occupation.¹² All the other standard incidents of ownership are left in constitutional limbo. To use a simple analogy: The common law rules sought to give clear rights over both the rind of the orange and its fruity contents. The constitutional law uses hard rules to govern the external side of matters but insists that the ownership structures do not govern the contents, which are left wholly indeterminate: the state cannot use them at all, but the individual cannot use them without the consent of the state. The common law prided itself on the unity of ownership. The constitutional law allows the government to fractionate the unity at will and without financial repercussions.

The doubts about property were matched by movements on other fronts. The just compensation requirement is systematically loosened so that many elements of value—loss of good will, appraisal fees, and legal fees—are kept out of the compensation formula, even when takings are allowed. At the same time, the police power definitions are systematically expanded so

9. For my extended critique, see RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* (1985).

10. For the usual account of ownership, see A.M. Honoré, *Ownership*, in *OXFORD ESSAYS IN JURISPRUDENCE* 107, 114-18 (A.G. Guest ed., 1961). See also Wesley Newcomb Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 *YALE L.J.* 16 (1913).

11. For an elaboration of this theme, see Eric Claeys, *Takings: An Appreciative Retrospective*, *WM. & MARY L. REV.* (forthcoming 2007).

12. See, e.g., Thomas W. Merrill, *Property and the Right to Exclude*, 77 *NEB. L. REV.* 730 (1998). For the internal complexities of that right, see Lior Jacob Strahilevitz, *Information Asymmetries and the Rights to Exclude*, 104 *MICH. L. REV.* 1835 (2006), where the plural, "rights," is meant to convey different senses in which rights to exclude are protected.

that any effort to improve the general welfare can suffice, even if not tied to the common law conception of nuisance. Taken together, both these developments substantially weaken property rights, such that the state gains both the power to initiate new land use restrictions—which don't touch the right to exclude—without taking into account the harm these restrictions inflict on the private owners, who bear the brunt of their losses, all without compensation.

Clearly there is something amiss in this constitutional reformulation. A voluntary market would have ample demand for any property at zero price, but no supply. That imbalance works out quite differently in the public sphere because the eminent domain law now grants the state the enforceable option to purchase at a zero price those incidents of property that do not involve the right to exclude. Now the want of a voluntary supply no longer matters. All that counts is the demand side. Let any one party gain the unilateral right to acquire property at zero price and, lo and behold, he or she consumes too much of the good relative to the costs inflicted. That simple observation explains the fatal flaw in the modern law, for governments are subject to the same temptations. The removal of any need to compensate for the taking of restrictive covenants in land (always a property interest in the private law) offers a massive subsidy for government regulation which leads to its excessive utilization. No longer is there any built in check in the system that insures each authorized government move has some strong possibility of leading to an overall social improvement. The new rule maximizes state discretion, not social welfare. It is important to outline both systems in some detail.

STATE OF NATURE THEORY

Classical and Modern

The classical literature on property rights approached the topic of property rights and state power from state of nature theory. Let us assume that all individuals are plunked down on earth in some disorganized array. What principles are then appropriate to decide which persons own which external resources, and why? It also asks what is the “bundle of rights” that are implicated in the notion of ownership of land or a particular thing. As one moves forward into modern times, the question of state of nature theory takes on a different coloration as individuals are increasingly worried about the preservation of the built heritage and the environment for all inhabitants of the world.¹³

In practice, these two topics, one old and recurrent and the other one new and pressing, are more closely related than is commonly supposed. Any accurate account of how property rights emerge from a state of nature car-

13. See, e.g., PRESERVING THE BUILT HERITAGE: TOOLS FOR IMPLEMENTATION (J. Mark Schuster et al. eds., 1997).

ries with it strong implications on what *use* rights any property owner may have vis-à-vis both his neighbors and the public at large. It also speaks to the rights of *disposition* of that same property. Once these attributes of property are fully understood, the role of state enforcement becomes much more delimited on such tough questions as zoning and environmental protection. A strong property rights framework also allows us to answer some key questions of institutional design, including the vexed issue of which restrictions on the use of property may be imposed as of right, and which require the payment of compensation.

That said, we must be aware of the illusion of progress. Progress is nonproblematic in science and math, where once a problem is solved, that solution will not be undone by future events. But there is no similar unidirectional feature with respect to the creation and protection of property rights, such that societies evolve inexorably in the right direction. Sometimes that is true, as the potential for the division and recombination of property rights through voluntary transactions, for example, is well accepted in the marketplace. But on other occasions, especially on matters of state regulation, the directional signals are much more mixed. There is, alas, a constant sentiment in practical and academic circles that older conceptions of property rights cannot meet the challenges of a new age.¹⁴ Unfortunately, the novel views of property rights and the regulations put forward to implement this position are in my view usually counterproductive. All too often they result in the destruction of wealth by undermining the old, but hardy, common law systems of rights. Unfortunately, I see much of modern intellectual and political life as a tension between two strong tendencies. We continue to prosper because the improvements of technology offset much of the decline of institutional wisdom stemming from the spate of ill-considered social reforms. But over the long haul, we would do far better if we married traditional conceptions of property rights to innovative uses of technology.

Here is one suggestion as to how this might have happened. Eric Claeys has argued forcefully that this disintegration of property rights stems from the use of the bundle metaphor.¹⁵ I have no doubt that the “bundle” phrase has lent itself to that purpose—after all, the term “bundle” suggests an arbitrary collection of rags (or “sticks”) contained in a single package. The argument is that using this language made it easier for realists and relativists to jettison one version of property rights in favor of another. This arresting hypothesis is hard to test. The causal explanation is always clouded because the bundling notion has been around for a long time. The Roman law often spoke of ownership in terms of the *ius utendi, fruendi abutendi*—the rights

14. See, e.g., BRUCE A. ACKERMAN, PRIVATE PROPERTY AND THE CONSTITUTION (1977) (discussing outmoded conceptions of layman's property, as opposed to the scientific conception).

15. Claeys, *supra* note 11. For the phrase “disintegration of rights,” see the highly influential essay of Thomas C. Grey, *The Disintegration of Property*, in NOMOS XXII: PROPERTY 69, 69-85 (J. Roland Pennock & John W. Chapman eds., 1980).

of use, enjoyment, and abuse. The latter seems a bit out of place here, although the right to destroy does raise important property conceptions,¹⁶ but in fact the term *abutendi*—abuse—has been long commonly read to include the right of alienation of property as well, just as in the modern law.¹⁷ Indeed, this emphasis on the bundle of rights has been used by the advocates of strong property rights, like myself, to say that each stick in the bundle is entitled to equal protection,¹⁸ so perhaps, conceptual issues influenced the transformation in attitudes. On balance, however, I think that, in the end, deep social unhappiness about the perceived consequences of private property combined with strong political movements to undo the classical legal synthesis led to this result.¹⁹ That temptation should be stoutly resisted in the property area, for the set of rights found in the traditional bundle of property rights was far from arbitrary, as each stick in that bundle is needed to enhance the value of the whole.

Bottom-Up or Top-Down

But how to defend this position as a matter of principle? The first question that one asks in state of nature theory is how it is that any person has any rights in land at all. That problem is more difficult than is sometimes supposed, given that any account of property rights has to explain how one person ever comes to obtain rights good against the rest of the world.²⁰ In dealing with this question, there are really only two basic approaches to the problem, both of which have been used on different occasions. The first of these approaches holds that all property is unowned in a state of nature, so any individual keeps what he can take on the simple ground that no one else has standing to stop him. The system usually works best when there is a slow migration of populations into new territories. In the beginning, these individuals may space their holdings in order to minimize conflict (but not too far lest they undermine the possibilities of cooperation), but with time, the remaining land is slowly occupied, so in the end, all persons have *neighbors*, some of whom are *strangers* with whom they share no ongoing consensual arrangements.

The second approach works in the opposite way. It assumes that all property is held in common so that some decision by either unanimous consent or, more realistically, a central authority is needed to convert any, indeed every, parcel to private property. It is abundantly clear that unanimous

16. See Lior Jacob Strahilevitz, *The Right to Destroy*, 114 YALE L.J. 781 (2005).

17. See BARRY NICHOLAS, AN INTRODUCTION TO ROMAN LAW 154 (1962) (pointing out that, in a Roman conception of ownership, "'abuse' has been construed to include alienation").

18. See Richard A. Epstein, *Weak and Strong Conceptions of Property: An Essay in Memory of Jim Harris*, in PROPERTIES OF LAW: ESSAYS IN HONOUR OF JIM HARRIS 97 (Timothy Endicott et al. eds., 2006). For criticism of this view, see J.W. HARRIS, PROPERTY AND JUSTICE (1996).

19. For my account, see RICHARD A. EPSTEIN, HOW PROGRESSIVES REWROTE THE CONSTITUTION (2006). For the unhappiness, see Louis D. Brandeis, *The Living Law*, 10 ILL. L. REV. 461 (1916).

20. See RESTATEMENT (FIRST) OF PROPERTY § 1 (1936) (defining "right" as "a legally enforceable claim of one person against another, that the other shall do a given act or shall not do a given act").

consent is not possible under any configuration of social life. Yet the approval of central authority will work, if at all, only when societies are already formed. The gated community and condominium association have elaborate governance mechanisms that stem from a common landlord whose function is, to paraphrase Harold Demsetz, to internalize the externalities that are associated with land use.²¹ But even these property arrangements—subdivisions, condominiums—start with unanimous consent, which is obtained by the contracts that allow matters into the group in the first place. Understanding how these various regimes work gives us a window into dealing with our modern system of government regulation as it relates to both traditional zoning and modern environmental objectives.

This lack of any social organization in primitive times effectively ruled out a top-down creation of a system of property rights. Locke makes that point most vividly when he observes that the acorn belongs to him who takes it from the tree.²² The father of the proposition that the state rules only with the consent of the governed was sensitive to the limitations on the role of consent in establishing property rights when he asks: “[W]as it a robbery thus to assume to himself what belonged to all in common? If such a consent as that was necessary, man had starved, notwithstanding the plenty God had given him.”²³ Locke understood that a system of common consent is so unfeasible that people take the acorn first and ask questions later. It seems clear that the problem of coordination rules out in the early stages of social development any top-down system of property rights. A decentralized system of bottom-up rights was a historical necessity that cannot be denied or readily undone one thousand years later. A more technical way to put the basic point is that to require coordination in a primitive state of affairs is to usher in an era of mass starvation, which is hardly evidence of an efficient allocation of scarce resources. The somber implication of this process is that the rule of unilateral possession is strictly necessary, from which hardly follows that the mechanism is perfect, notwithstanding its ubiquity in primitive cultures. The better implication is that the creation of new systems of property rights may eliminate some major problems but will also introduce smaller ones in their stead. Imperfections are always a brute fact of life. So the challenge is now set: How does one set out the contours of private property to deal with the allocation issues so necessary for wealth creation and preservation?

21. Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347, 348 (1967) (“A primary function of property rights is that of guiding incentives to achieve a greater internalization of externalities.”).

22. JOHN LOCKE, *TWO TREATISES OF GOVERNMENT AND A LETTER CONCERNING TOLERATION* 112 (Ian Shapiro ed., Yale Univ. Press 2003) (1690).

23. *Id.*

Temporal Externalities

The first question is surprisingly simple but is one that was the source of extensive legal disputation, with profound social implications. To start with the simplest case, suppose that one takes the acorn, what bundle of rights does that possession give? And, then, in the age of agriculture, to occupy land, what does that occupation give? In line with the Demsetzian view (and long before it was formalized), the answer was that possession gave ownership of an indefinite duration, for both chattels and land. One explanation for this result is that it meant that people did not have to keep their acorns in hand, in order to preserve their rights, and prowl the boundaries of their land. They kept possession of what they owned until they either consumed it, sold it, or evinced some clear and unambiguous sign of abandonment, which could not be lightly inferred for assets of positive market value.

This rule of permanent ownership for land had powerful consequences. By giving people the long time horizons, it allowed individuals to make intelligent choices on investment, consumption, and saving. The person who sowed the plants could harvest the crops, which meant that they would put seeds into the ground in the first place. Yet since that party kept both the crops and the land, any decision that compromised the value of the land to increase the yield of the crops was fully internalized, so the single owner would get the upside and downside of all decisions on whether to keep crops or timber on land. To anticipate modern concerns, the environmental soundness of that temporal decision is evident when one looks at the harvesting programs that take place today on government owned land. There is a built-in incentive for commercial firms to clear-cut land because they do not bear the costs in the reduction in value, in large measure because governments, given political pressures, do not enter into contracts that force these costs back on the cutters. It is yet another instance in which the modern preference for public ownership creates the dangerous negative externalities that one feature of the traditional system of property law avoids. The proof of the pudding is in the eating. The same timber companies operate in very different fashion on their own private lands because the needed internalization does take place. It is sobering to realize how a debate over the meaning of possession that dates back to Roman law has such powerful implications for modern political discourse.

Spatial Externalities

The temporal dimension is one dimension over which externalities may take place. But it is not the only dimension over which these conflicts matter. The question of negative spillovers to neighboring lands and waters, both public and private, is also a part of the overall situation that a sound system of private property rights has to address. Within the traditional legal system, this question is often encompassed in three heads of law: trespass

(i.e., unlawful entrance) onto the land of another; cattle trespass (unlawful entrance by one's animals); and nuisance (creation of noxious conditions—discharges, odors, noise, and the like) that starts on the property of one owner and migrates over to that of another. The mere fact that these bodies of law are of very ancient lineage should be sufficient to dispose once and for all of the common misconception that ancient and medieval systems of ownership were deficient because they rested on some naïve assumption that all property owners should be able to do exactly what they will with what they own, no matter what consequences their actions have on others.²⁴ Yet there never was a time when the ownership of land gave one the right to use it in ways that damage others: *sic utero tuo ut alienum non laedas* (therefore use your own so that you do not harm others) is a maxim of very old and honorable lineage.²⁵ To be sure, the maxim has to be refined to give an account of what counts as a harm, as for example, in cases that deny rights of recovery to persons who claim harm when others build on nearby land in ways that block light or air.²⁶ But no matter how those refinements are made, it becomes clear from the outset that the common law system of property rights was conscious of the correlative harms that the actions of one individual could have on another. The loss internalization norm was at work in these cases, and understanding its role in private disputes is critical to set the stage in figuring out the appropriate scope of government regulation in more modern contexts.²⁷

To attack this problem, it is useful to look at matters in two separate states of the world. There are a few important complications that arise when the parties are not in symmetrical positions with each other, as when one is uphill to the other (where local customs may pick up the key variations). But for these purposes, the basic arguments can be understood by ignoring those complexities and assuming a perfect symmetry between the positions of two or more landowners. In its most exacting conditions, this involves landowners that have the same kind of land use patterns. Solving this problem gives a window into explaining how zoning and environmental law should operate when the complexities of multiple parties (as in pollution cases) preclude the obvious use of private litigation to adjudicate the differences. The overarching theme is that the substantive principles that aid in wealth creation in private disputes work in more modern contexts.

24. For one modern recognition of the point, see J.W. Harris, *Who Owns My Body*, 16 OXFORD J. LEGAL STUD. 55, 60 (1996), noting that with property-independent prohibitions, “[i]t is criminal to commit assault or homicide with a weapon, but it is completely irrelevant whether the accused owned the weapon or not.”

25. See NICHOLAS, *supra* note 17, at 154 (“[N]o enjoyment can ever be absolute in the sense that it is free from any restrictions whatever. At the very least the use, enjoyment, and abuse of his property by one owner must be reconciled with the equal use, enjoyment, and abuse by all other owners of their property.”).

26. See, e.g., *Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc.*, 114 So. 2d 357, 369-70 (Fla. Dist. Ct. App. 1959).

27. On this problem generally, see Epstein, *supra* note 5.

The question then is how do we decide the boundary conditions between two neighbors? Their status as neighbors means that one brute fact of nature limits their flexibility in resolving disputes. Neither party can just move away, for avoiding the dispute means abandoning the property. It is for good reason that rules of trespass and nuisance, whether by custom or law, form the oldest branches of tort law. The rules governing harms arising out of contracts, such as malpractice, occupier's liability, and (even most of) product liability, can wait for a later day. People can protect themselves in how they choose their trading partners. They cannot, before planned unit developments, protect themselves by choosing their neighbors.

How, then, is it best to shape trespass and nuisance law? The first binding constraint, which remains applicable in other contexts dealing with wealth creation, is generalizability. No one can say, consistent with rule of law values, that I can harm you in ways that you cannot harm me: persons have equal rights in the state of nature. This equality constraint is widely understood to be a fairness norm, but it is one that has powerful benefits from an efficiency standpoint. There is only one position of parity and countless variations, running in both directions, on the theme of relative privilege. By foreclosing all these dangerous alternatives among neighbors (and indeed all strangers), it is hard for any person to game the system, as their own personal welfare will be better off only to the extent that the liability rules that they embrace benefit everyone else as well.

So the question is, if "n" persons each own identical plots of land, what rules would they choose if high transaction costs make it impossible for them to bargain to maximize the joint value of their respective holdings? In each case, they are, given the symmetrical assumptions of this model, behind a perfect Rawlsian veil.²⁸ Any effort they have to expand their rights as land users will hurt them when they suffer the fall out from the parallel uses by others. So their incentives are for honest revelations on institutional choices to maximize that gap between benefit and cost.

This assumption explains why tort protection against trespasses to land enjoys such universal support. If each person could enter the land of a neighbor at will, then each person could disrupt the gains that come from clearing the land, planting crops, or building structures. Good fences turn out to make good neighbors. The clear empirical prediction is that even if we take into account the (relatively low) costs of enforcement, each neighbor will be better off with the injunction than without it, save in rare cases where one enters the land of another to escape some imminent peril to

28. For his classical exposition, see JOHN RAWLS, *A THEORY OF JUSTICE* (1971). Note that Rawls thought that his formula was most valuable in figuring out nonutilitarian reasons for doing certain kinds of actions. But its great strength lies in its ability to elicit honest preferences about how legal institutions should be arranged precisely because it puts people in a position whereby, with the knowledge that they have at their disposal, the only way they can do well by themselves is to do well by others at the same time. A test of this sort may go astray in some cases, but when applied consistently, it will get very close to some social optimum.

life or limb.²⁹ This looks to be true even in the odd case when there are only two neighbors. But since this discussion focuses on real property, it is critical to remember that most people will have multiple adjacent neighbors, in addition to having other nonadjacent landowners in the vicinity who may be affected by their actions. The multiple threats of entry are forestalled by this rule, which produces even larger gains than we might expect. The rule therefore obviates the need for thousands of voluntary transactions, all of which could flounder in the absence of a true competitive setting. It hardly will do to get 99% of your neighbors to sign a noninterference policy if the remaining few can savage the land. Neighbors are determined by geography, and unlike suppliers, you can't get another one because you don't like the one you have. Once again, the rules that carry the greatest moral urgency are easiest to defend by some simple utilitarian calculations. The reason why socially these moral intuitions play such an enormous role is that they spare everyone the need to rework the social calculations from the ground up each time the problem comes up.³⁰ For repetitive situations, habit and custom are cheaper and more reliable than conscious deliberative computation. So we have clear reasons why this boundary matters.

It is more difficult to deal with nuisance cases, where no single answer is sufficient to cover the full range of situations. The first point to note is that nuisances—smells, noise, gases, toxins—come in all sizes and shapes. In this context, the central truth is that the magnitude and distribution of the harms really matters and forces the kind of differentiation in legal response that is generally resisted in the law of trespass, where all entries tend to be treated alike.³¹ But in nuisances we shift course. Start with the major cases and it is clear that runoff that fouls soil and blocks agriculture is a big deal. The same is true of stench and sledgehammers. The usual legal rule treats these high-intensity nuisances as though they were trespasses and subjects them to a per se prohibition, which carries with it the right to damages for past harms and an injunction against future harms.

At this point, however, the path of nuisance law tends to diverge from that of trespass for reasons that again reflect physical circumstances, not cultural differences. The typical injunction could demand a complete cessation of harm so that not one single drop of pollution could make it on a neighbor's land. But at some point the precautions needed to stop that last tiny bit of harm dwarf the gains that they achieve. The situation here is

29. See, e.g., *Vincent v. Lake Erie Transp. Co.*, 124 N.W. 221 (Minn. 1910); *Ploof v. Putnam*, 71 A. 188 (Vt. 1908).

30. Jonathan Haidt, *The Emotional Dog and Its Rational Tail: A Social Intuitionist Approach to Moral Judgment*, 108 PSYCHOL. REV. 814 (2001).

31. For an early expression of this view, see *Dougherty v. Stepp*, 18 N.C. 371, 371 (1835), stating: The amount of damages may depend on the acts done on the land, and the extent of injury to it therefrom. But it is an elementary principle that every unauthorized, and therefore unlawful, entry into the close of another, is a trespass. From every such entry against the will of the possessor the law infers some damage; if nothing more, the treading down the grass or the herbage, or as here, the shrubbery.

unlike the prohibition on actual entry, which is sensibly subject to a strong on/off switch.

This treatment of the residual harms in major nuisance cases gives some insight as to the treatment of the second half of the problem: how to treat minor nuisances? Recall that the standard definitions of a nuisance are insensitive to the magnitude question: any smell, noise, or discharge qualifies. But by that definition, no one could talk on his front patio or engage in any farming. It is therefore instructive that the recognition of a live-and-let-live principle has developed in these cases to allow low-level nuisances to continue by all parties, without compensation. The point of this large/small distinction is to correct the overprotection of land that comes from an uncritical carryover of the law of trespass to nuisance.³²

The above logic explains that these deviations from the hard boundary conditions in the law of trespass count as Pareto improvements that should be welcomed in the *ex ante* position as yet another small means for wealth creation. The material from Baron Bramwell's decision in *Bamford v. Turnley*³³ shows that this was clearly perceived when the rule received its most sophisticated articulation in 1862.³⁴ Hence courts require, *on a reciprocal basis*, that an injured party absorb, without compensation, damages for small levels of harm in ways that benefit all parties from behind the Rawlsian veil of ignorance. The rule increases land values for both parties

32. See Thomas W. Merrill, *Trespass, Nuisance, and the Costs of Determining Property Rights*, 14 J. LEGAL STUD. 13 (1985).

33. [1862] 122 Eng. Rep. 27 (Exch. Div.).

34. *Id.* at 32-33. I quote the passage in full because it represents the most prescient judicial analysis of the economic and philosophical issues ever penned:

The instances put during the argument, of burning weeds, emptying cess-pools, making noises during repairs, and other instances which would be nuisances if done wantonly or maliciously, nevertheless may be lawfully done. It cannot be said that such acts are not nuisances, because, by the hypothesis, they are; and it cannot be doubted that, if a person maliciously and without cause made close to a dwelling-house the same offensive smells as may be made in emptying a cesspool, an action would lie. Nor can these cases be got rid of as extreme cases, because such cases properly test a principle. Nor can it be said that the jury settle such questions by finding there is no nuisance, though there is. . . . There must be, then, some principle on which such cases must be excepted. It seems to me that that principle may be deduced from the character of these cases, and is this, viz., that those acts necessary for the common and ordinary use and occupation of land and houses may be done, if conveniently done, without subjecting those who do them to an action. . . . 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.

to a dispute from the *ex ante* perspective, which obviates any distributional concerns that might otherwise arise. In addition, its requirements easily generalize to cover multiple parties.

Thus far the analysis has covered only those cases in which there are physical invasions of the property of another. Often times there are other kinds of disputes that involve conduct on one piece of land that does not invade the property of another but which nonetheless causes serious dislocations. Here are two examples that tend to require different solutions. The first case involves the problem of lateral support. Dig out your land and the nearby land will fall over. The same logic that governs the live-and-let-live cases takes over, only now we speak of background restrictions on land use so that both, or indeed, all landowners on level land cannot dig out to the boundary line if the nearby land will fall. The strong obligation, however, does not extend to cases where the support is required for structures built close to the boundary—for here the fear is that some unilateral preemptive action of the first-to-build will result in the gain of rights over a neighbor who is, for all practical purposes, powerless to stop them. The weaker alternative requires each landowner to give notice to neighbors before the work begins so that, if need be, they can shore up their own foundations. And knowing of the rules, one option for the first-to-build owner is to avoid the problem by building back from the boundary line. We have here yet another instance where the recognition of *noninvasive* nuisances improves overall social welfare.

The second instance deals with claims for an easement of light or view, already alluded to in connection with the discussion of the *sic utero maxim*. Should building so as to block light or view be treated as a nuisance for any loss it causes to land values? That argument has been widely rejected in the judge-made law tradition of most countries and for good reason—namely that it encourages premature development to perfect one's right to build. The point here is that the first-to-build gets to stop the second from building. If that were allowed, then why could the second not stop the original builder to protect his own options? The risks here show the importance of parity in the initial position: parity can only be preserved if either both or neither have the right to build, independent of what the other does first. In general, both plots of land are worth more with development rights. And what is true here with two neighbors applies with many neighbors. Could the first-to-build stop twenty nearby owners from exercising the like privilege? Clearly the answer has to be no. Even if we allow for Pareto improvements that alter the original real estate balance, this proposed easement of view or light does not qualify for that treatment.

Variation by Contract

The overall situation, however, has still not drawn to a close. It may well be that parties are in identical positions at the outset. But with differential investment strategies, they could easily alter that balance. One addi-

tional benefit of the relatively clear rules for governing boundary disputes is that they set a robust baseline for further negotiations where one party wants to buy out rights from another. In the simplest case, one person can simply purchase outright the land of a neighbor. Now being a sole owner of both, all losses are internalized: Any runoff or pollution from one part of the land only harms another part of land owned by the same person. The purchase option allows for the internalization of the externality.

Most often, however, the outright purchase is not feasible because the neighbor has undertaken some investments in his land that are of more value to him than a potential purchaser. Fortunately, the overall system of property law allows for the partition of assets by permitting the purchase of limited interests in land, which could include the right to walk or ride over the land (an easement to commit what would otherwise be a trespass); to have runoff on the land in question (ditto for pollution); or to impose height or setback conditions to preserve light and view. These transactions do not allow either party separately, or the two jointly, to increase the burdens on third persons, so the mutual gain between the parties counts in fact as a social benefit. And since land use arrangements are of long duration, the law in virtually all societies holds that the easements or covenants so created will, with an observation of minimum formalities, benefit and bind subsequent parties on both sides of the transactions.³⁵ The bottom line here is that a system of voluntary contract is available to correct any misallocations of resources that are introduced by the basic system of land law.

In most cases among strangers, however, these arrangements are hard to negotiate. In some cases, getting a right of view or light over one's neighbor's property, for example, may not matter much unless others join in. It seems clear that most parties are generally not able to negotiate this transaction voluntarily, which explains why use rights and disposition rights must be coupled together in any systematic understanding of a sound property rights regime. There is, however, one critical area in which extensive reassignment of rights does take place: planned unit developments. In these cases, the bargaining difficulties are obviated because we start with the single owner of a large parcel of land who is able to divide property among all purchasers in ways that create an elaborate network of easements and covenants among them.

There are several key features about this system. First, once the system of recordation is in place, it is no longer necessary to preserve any legal difference in treatment between easements (that allow entry) and covenants (which impose additional restrictions) on property. Both are properly governed by the unified set of rules which insure that their benefits and burdens run for all persons, regardless of when they buy into the common scheme.

35. For a convenient compilation of the rules, see *RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES* (2000). For my own views on how recordation and notice increase the scope of contractual freedom in the domain of servitudes, see Richard A. Epstein, *Notice and Freedom of Contract in the Law of Servitudes*, 55 S. CAL. L. REV. 1353 (1982).

Second, the common owner has the right incentives to get the correct mix of servitudes over the property. Any benefit he gives to one party increases the market value of the relevant parcel of land. Any burden he imposes on one party reduces that market value. The only way to maximize private gains is to develop and elaborate a reciprocal network of benefits and burdens that produces the largest net gains for customers. The internalization of all benefits and losses thus solves the Demsetz externality problem. The upshot is that the system of voluntary transfers functions well because it respects the full range of property rights and thus allows for their accurate valuation in all sorts of transactions.

Third, these planned unit developments are capable of having a variation that no background rules of common law could supply. The particular choice of covenants can properly reflect the income and taste preferences of the prospective members in the restrictions that they place on private use and on the organization of the common areas. In general, the higher the income levels of association members, the more critical the soft amenities. More generally, these agreements almost never cut down on the protection between neighbors that are included in the background rules of the legal system. Yet they typically do much to impose reciprocal easements and covenants; they typically add common areas as well; and they almost always put in place governance structures, which often resemble corporate or nonprofit boards, to deal with changes that need to be made down the road.

The explanation for all these developments relates to one powerful theme: valuable property for high income individuals offers real opportunities to use private information to improve on overall performance. Relying on the initiatives of a single owner cuts down on the transaction costs needed to implement the system that aligns the incentives of all players for the reasons noted above. In addition, the external effects of these arrangements on third persons are likely to be *positive*; after all, any nuisance-like activity will be quickly enjoined within the association, and no alteration of rights among its members improves their collective position as against strangers to their transaction. The substantive provisions of these agreements therefore give some sense of how public arrangements ought to be made, a topic to which we shall turn later.

MOVEMENT INTO THE PUBLIC SPHERE

A Modest Transformation

One implicit assumption of my basic argument, so critical for understanding the destruction of wealth in the public sphere, is that the rules of engagement developed in the private law should in principle shape our understanding of the full range of public law problems dealing with these land use conflicts. Most critical to this argument is that the set of rights developed through the private law are complete, consistent, and well-defined, and work relentlessly toward the optimization of land values. One might assume

therefore that no improvements were possible, but that conclusion is itself incorrect for two reasons. The first of these is that the private rules themselves do not address enforcement issues for violations, for which private rights of action are often inappropriate for severe nuisances (not caught by the live-and-let-live rules) from multiple sources that impact on large numbers of persons. Second, in cases of initial separate ownership, high transaction costs could often block the adoption of a new set of covenants and easements (often reciprocal) that could improve overall land values. The first issue here is how the public law should deal with these questions. The second issue is whether the current framework of takings law works well on these matters, which, as will become evident from a discussion of a few key Supreme Court cases, it does not.

A convenient place to start this analysis is with the obvious parallel to cases of public nuisance, a well-developed head of law, in which a private party pollutes, say, a river or lake. Here, one possibility is that all riparians could join together in a class action to deal with the situation, which creates immense procedural complexities. Or the state could sue to enjoin the nuisance. The emphasis here is on the substance, and the key rule of transformation from the private to the public space is this: *the state has the same rights, no more no less, as any private owner under the law of trespass and nuisance*. The efficient rules for dealing with private/private interactions set the stage for private/ public interactions.

The same argument could apply to subjects like air pollution, which involve the creation of many simultaneous nuisances that do harm to many private individuals. Again the choice in these cases is often between class actions and direct systems of enforcement, which may well involve complex schemes of direct regulation. But again, the procedural issues, so vital in practice, only raise second order questions. The first order considerations involve the interaction between damages and injunctions, and on this issue, the point to stress is that total elimination of all pollution makes no more sense in the public arena than in the private, for live-and-let-live is the operative principle in both settings. The trick is to reduce the pollution to acceptable levels, which are positive and not zero. What level is optimal will often be a subject of disputation. As the discussion of private real estate developments in gated communities and subdivisions indicated, the higher the level of affluence, the lower the level of pollution.

That same principle should apply in the public sphere, as it is generally the case that people at the margin prefer to equate the last dollar that they spend on private comfort with the last dollar that they spend on shared amenities that they can only acquire by public means. Put in its simplest form, no one wants to build a mansion on a public road filled with potholes, located in a region permeated with stench. And they will pay for controlling both if given the opportunity to do so, which makes it all the more imperative that systems of taxation be used in the first instance to provide public goods and not to secure covert redistribution of wealth between interest groups, each of which is intent to pass on to others a disproportionate share

of common burden. The actual operation of the scheme need not place a straightjacket on the behavior of state and local governments. In principle, regional variations in allowable pollution levels make sense if they lead to intelligent groups of high- and low-intensity activities in separate districts. The basic contours of environmental law are an outgrowth of the correct understanding of the private law rules.

A similar analysis could apply to the restrictive covenants between strangers that are blocked by high transaction costs. The state here imposes the applicable rule on all parties, subject to this constraint. It seeks to adopt only those rules which improve overall value, which obviates any need to consider cash compensation for losers. That result could be achieved, for example, with various rules that regulate exterior appearance, where all parties benefit because signs, walls, or exteriors adhere to common schemes, as in planned unit developments. One simple expedient is to keep signs flush on walls, which improves both appearance and visibility. These rules prevent a destructive prisoner's dilemma game by making it impossible for first one, and then all, to build perpendicular signs that frustrate both objectives. In general, however, these opportunities for constructive restraints are likely to be hard to come by given that the differences in initial positions among the various landowners raise the prospect that what works for some will be a detriment to others. This theme of disproportionate impact should, but often does not, play a critical role in the analysis of various land use regulations.

The Modern Approach: The Disintegration of Property Rights

Zoning

The above paragraphs sketch out in brief form how modern forms of regulation should build on the older system of common law rights. All of these moves are surely legal under current law, which cannot be reproached on the grounds that it affords insufficient flexibility to achieve the objectives of the private law system. But modern doctrines now go far beyond these well-specified parameters in deciding on the permissible scope of government regulation. The initial impulse in this direction arose in connection with zoning cases that had to ask this simple question: when the state had a vision of proper land use allocation that did not fit the earlier model, did it have to pay compensation to those landowners whose property values were reduced by the restrictions on use that the state imposed? To the good private lawyer, there is no principled distinction between the property status of restrictive covenants and the property status of easements. To be sure, the former allows one or more persons to prevent people from making the kinds of use of their property that the common law system allowed. The second allows landowners to use other people's property in ways that the common law prohibited. A height restriction is an illustration of the first kind of restriction, and an easement to walk over land, or to move vehicles over land,

is an instance of the second. Within a voluntarist universe, both of these kinds of relationships are welcomed on the simple ground that so long as all parties to the transaction have given their sense, there are likely to be gains from trade that improve overall wealth.

The United States Supreme Court rejected the unity of covenants and easements starting with its decision in *Village of Euclid, Ohio v. Ambler Realty Co.*,³⁶ which held that a local decision to divide a unified tract of land suitable for industrial development into three separate zones—industrial, apartment houses, and single homes—did not require any compensation even though it reduced the value of the property by between 75%-80%.³⁷ It is critical to dispense with the false rationales that have been used to defend this result. One is that the losses sustained in these cases are no different from those which involve losses from competition or from blocking views and rights of way. Hence these cases are sometimes treated as though they involve only the “mere diminution” in value. Thus Justice Brennan’s influential remark in *Penn Central*, “the decisions sustaining other land-use regulations, which, like the New York City [landmark preservation statute], are reasonably related to the promotion of the general welfare, uniformly reject the proposition that diminution in property value, standing alone, can establish a ‘taking,’” links explicitly back to *Euclid*.³⁸ But his point is surely wrong because the diminution in value stems not merely from what other people do with their rights under the common law framework, as by building a house next door, but explicitly from stripping out use rights from the initial bundle that inhered in the landowner. The claim here is for damages attributable to the fractional interest in rights, which is denied on the ground that one cannot “take” property rights that are nonpossessory in nature.

A second argument in these cases is that the regulations here, by relying on these zones, should be understood as a way to prevent various kinds of nuisances. But at this point, the term “nuisance” is a metaphor, for we do not have anything that looks like a physical invasion from the ordinary development. Nor is the case one that falls within the class of reciprocal nuisances under the live-and-let-live rules. Put otherwise, a factory, unlike a rancid cesspool, is not a nuisance per se. One waits until it emits some harmful odor, noise, or filth and then enjoins that noxious behavior. Most critically, the law should show little, if any, sympathy for the argument that the shut down would cause major disruptions. The simple answer is that the strong ex post sanction means that in a prior stage, the developer will be sure not to stray too close to that line. But once we start to say, as does Justice Sutherland, that “[a] nuisance [could] be [the] right thing in the wrong place,—like a pig in the parlor,”³⁹ then we have lost the war of analogies, for a factory on a large plot of land that emits no odors and no filth cannot

36. 272 U.S. 365 (1926).

37. *Id.* at 396-97.

38. *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 131 (1978).

39. *Euclid*, 272 U.S. at 388.

in good conscience be treated as though it were somehow a nuisance. The expansion of the category of wrongs can proceed without limit so that in the end, we feel ourselves collectively entitled to enjoin just about any development in a particular location if we can muster the political will to do it.

How, one might add, does this relate to the question of wealth creation? It relates simply because of the established numbers. We know that a *social* loss is necessarily tied to the reduction in value of the land. And there is no reason why that private loss should be kept off the social ledger solely because it is concentrated on a single person and not shared by other members of the community. The effect on overall social wealth is the same, regardless of its incidence. And in political terms, the situation is worse because the ability to isolate a single person increases the likelihood that political factions will repeat the tactic in the future. The simple question, therefore, we have to ask is, where are the systematic gains that offset this loss? The only place we can look is to the gains from neighbors. The large gains from the prevention of common law nuisances are by assumption not there, so we have to look to what I like to call “soft” externalities—the improvement in the amenities of people nearby.⁴⁰ But these are hard to determine without knowing the composition of the nearby properties and the actual operations of the plant that is no longer built. It could easily be that many neighbors could prefer to have a plant that offers employment opportunities and does not put pressure on other forms of local infrastructure, like schools. So even if we thought that the amenities from no plant were positive, it is highly unlikely that they are equal in magnitude to the losses concentrated on the single person (even if we put all the political costs to one side).

In any event, there remains a simple and effective way for government to deal with those difficulties should they crop up. Just buy the land and then resell it subject to restrictive covenants that remove the obnoxious features and preserve those which are desired. These are not fanciful possibilities, for preservation societies do this all the time when they take preservation servitudes over private properties in order to preserve, for example, their facades for public benefit. Now the state through eminent domain (or a private society through contract) is internalizing the externalities in the fashion that Demsetz thought was appropriate for the creation of property rights, so the original logic of the system holds through its modern variations. Decide *Euclid* the other way, and the nuisance law remains if the factory gets out of hand, and the condemnation power remains if it does not. The efficiency of the zoning system was not investigated by Justice Sutherland or, regrettably, by any Justices who have unthinkingly followed that fateful decision.

40. For discussion in connection with the morals heading of the police power, see Richard A. Epstein, *Externalities Everywhere?: Morals and the Police Power*, 21 HARV. J.L. & PUB. POL'Y 61 (1997).

Just Compensation

We can now address the fatal disjunction in takings law between the public law and private conceptions of private property. The private law recognizes no viable distinction between acquiring easements (to cause nuisances to neighbors) or acquiring covenants (to enjoin conduct, such as that pertaining to air and light). Following this one principle shapes the entire field of takings law by radically truncating the situations where state regulation may proceed without some compensation to the aggrieved owner. Some examples follow.

Ask first whether the state should be able to impose height and setback restrictions on individuals in order to improve the views of others. Start with this simple situation. Assume that *A* owns land worth \$100,000, which is free and clear of all encumbrances. He then sells for \$30,000 a restrictive covenant to his neighbor *B* that binds him not to build over thirty feet. We will assume that the covenant increases the value of *B*'s land by \$35,000 and reduces that of *A*'s by \$25,000 so that both benefit from the deal. The state now condemns *A*'s land and offers to pay \$75,000, the market value of the land, to *A*. It offers nothing to *B* on the ground that it has not taken her property. Surely something is deeply amiss about this rule. The assignment of a partial interest in property should not increase or decrease the rights and duties that both *A* and *B* have against the world. The right answer therefore requires the state to condemn the covenant from *B* at its fair market value so that it has to pay her \$35,000. It would be utterly indefensible to assume that the state has not taken her restrictive covenant because it cannot go into possession of a covenant, given that it has rights over the land of another. One may as well say that all intellectual property is deprived of constitutional protection for the same reason. The obvious answer is that the state has a choice. If it condemns *A*'s land alone, then it takes it subject to the covenant. If it wants the land free and clear, then it condemns both. It would be the height of folly to say that the state only triggers its obligations under the Takings Clause when it enters into possession of the land. A possessory takings doctrine has no application to *ius in re aliena*, rights in the land of another, when these are, as with covenants, nonpossessory.

The situation involved with zoning is not radically discontinuous because these use restrictions should be regarded as a network of restrictive covenants. In dealing with these cases, the burden of covenants in all situations is a taking of property. But the question is whether cash compensation is owed. To answer that question, we have to distinguish between two pure types, recognizing that some intermediate cases will occur. The first situation is that of so-called average reciprocity of advantage, where each party benefits in like fashion from the restrictions imposed on others. At that point, the regulation contains, as I am fond of saying, *implicit-in-kind* compensation. All members of the group are better off than before, so the regulation overcomes the transactional obstacles that separate the parties without taking advantage of some for the benefit of others. The prospect of uniform

improvement across a class thus reduces the danger of factional struggle. It also means when property values increase for both sides that no cash compensation is owing. That conclusion does not depend on any supposed conceptual obstacle to the taking of nonpossessory interests. Rather, the result comes from a consistent application of the rules on implicit-in-kind compensation, which in this context point to the compensation embedded in the regulation. And in those cases where the compensation is partial, cash should be used to top off the state's obligation.

The second situation involves use restrictions that differentially hurt some landowners *on net* and help others. These dangerous situations allow dominant interest groups to achieve through regulation, while paying nothing, covenants that they would have to purchase if acquired privately. No one person can tell his neighbor not to build in ways that block his view of the sea. But allowing a zoning ordinance to achieve that result without compensation pushes conflict into the public arena, where the absence of clear property rights—the development rights of one party are now up for grabs—manifestly invites the waste of public resources. The no-compensation rule also aggravates all the temporal issues by giving the first-to-build an advantage over the second, which the private law has systematically denied, and for good reasons. It also leads to the odd conclusion that you have to pay in voluntary transactions but may confiscate in involuntary ones. The unmistakable impact is to give huge incentives to depart from the voluntary market for private advantage. To counter these deep pathologies, the basic rule should be that cases of *disproportionate* impact should be enjoined unless compensation is paid so that the losers are not hurt by the social initiative. The compensation requirement has more than distributional effects. It sets prices and creates incentives for beneficial political behavior, here by applying rules that work in the private sector.

This general approach suggests the dominant view that allows regulations—without compensation—to restrict the ability to build ordinary homes in coastal areas, to require habitat to be set aside for endangered species, to limit construction in or drainage of wetlands, or to require no growth or development zones are all in profound error. The point here is not the *Kelo*⁴¹ question of whether these activities should be allowed to go forward at all. We can freely concede that the regulations are for public use. But the want of compensation means that government regulators will also push for regulations that have any positive value to them because they will perceive the cost to the owner as carrying with it a zero price. Yet no social calculus is correct if it counts the benefits to the winners but ignores the costs to the losers. But this is what this form of regulation does.

The point here is not just theoretical, but after this theoretical discussion, a real life story helps put matters into context. In the famous American

41. *Kelo v. City of New London*, 545 U.S. 469 (2005).

decision, *Lucas v. South Carolina Coastal Council*,⁴² the question was whether a regulation that prohibited a landowner from building on coastal dunes counted as a taking when it reduced the value of a plot from \$250,000 to zero (a real social loss).⁴³ The Supreme Court held that it did, even if it did not embrace the view that any lesser reduction in price should receive the same treatment (which it should if marginal incentives are to be preserved).⁴⁴ The case was graphic because in consequence the Coastal Council was required to purchase the land outright, for its market value. It now had to internalize the full costs of its decision. What did it do? It sold the land of course. And to whom? Not to the neighbor who would pay \$150,000 because he could use it as a side yard, but to an outsider, for the full \$250,000, who was allowed to build just like Mr. Lucas. The moral: Talk here is cheap. People will talk about benefits they get from quiet and solitude but not when they have to pay for them. And that is what takings law, even on sensitive environmental issues, is about—getting the right incentives. How? By following the patterns developed with care and sensitivity in private disputes.

Let me give one further illustration of how the breakdown in private law conceptions leads to genuine quandaries in the public law. In *Nollan v. California Coastal Commission*,⁴⁵ the landowner owned a small dilapidated property on the beach between the Pacific Ocean to the west and the Pacific Coast Highway (PCH) to the east.⁴⁶ He requested permission to build a larger home in keeping with the neighborhood, which the commission was prepared to grant only if he ceded to the public a lateral easement across the front of his property that allowed people to walk across his land⁴⁷—a clear public use, obviously. He balked and built the house anyhow, and the question was whether the state could attach the condition to its permit.⁴⁸ Justice Scalia held that it could not within the modern framework of takings law.⁴⁹ In his view, the state had a legitimate interest under the police power to preserve a “viewing spot” that would allow people on the PCH to see the water. But it was a form of out-and-out-extortion for him to insist that he surrender his lateral easement when he sought to block that view spot. The great difficulty in the case is associated with the doctrine of unconstitutional conditions: if the state has the absolute right under the police power to block the new construction of the house, why can’t it grant it on the condition that Nollan cede the lateral easement? Thus, the critics of *Nollan* point out, quite sensibly, that the effect of the rule is to block gainful exchanges.⁵⁰ The

42. 505 U.S. 1003 (1992).

43. *Id.* at 1003.

44. *Id.* at 1031-32.

45. 483 U.S. 825 (1987).

46. *Id.* at 827.

47. *Id.* at 828.

48. *Id.* at 829-30.

49. *Id.* at 841-42.

50. See Lee Anne Fennell, *Revealing Options*, 118 HARV. L. REV. 1401 (2005).

landowner values the right to build a new home at \$100,000 and the loss of the easement at \$20,000. The state values the viewing spot at \$5,000 and the easement at \$10,000. So both are better off with the switch than without it. The great risk, therefore, is that this tough rule will make these bargains unenforceable so that the state will just stick with blocking the new construction, which is an inferior result.

Whether that prediction will play out is open to speculation: The state might decide to allow the permit because it wants, for example, increases in taxes. But the deeper point here is that a better understanding of the rights structure obviates the need to go through this analysis in the first place. Recall that the private law of servitudes treats covenants and easements as part of a comprehensive whole. The state can claim a public easement only on payment of just compensation. So too it can claim the benefit of a public covenant for the same reason. At this point, there is no police power justification that allows it by decree to wipe out the \$100,000 in development rights. Nor does this strategy of choice work in this case, for it is just tantamount to the standard form of coercion that gives a person the choice between her money or her life. Clearly, if forced to choose, she will surrender the former. But the law does all that it can to resist allowing this choice in the first place. So it is here. The Coastal Commission has given the landowner a choice between the surrender of a covenant and the surrender of an easement, when the landowner is entitled to both. So if she elects to surrender the lateral easement, then the state has to pay for the \$20,000, as Scalia required. So these options strategies are effectively blunted, and in this case, we can now see what happens given the numbers. The state backs off the covenant because it does not wish to pay the \$100,000 in private losses. It also backs off the lateral easement because it does not wish to pay \$20,000 for the \$10,000 benefit. Knocking out the bundling strategy thus improves resource allocation because both interests are given their highest values. What Scalia missed was the importance of a complete set of property rights. What the critics missed was that their favored bargains induce all sorts of strategic behavior by government that seeks to exploit the weakness in the constitutional protection of private property. What the reader should not miss is that the strong system of private rights is the only way to make the takings law more coherent than it is. So long as the Justices think that there are two sets of rules—one for ordinary transactions and another for state transactions—they will flounder in this area. What is so desperately needed is an understanding of the deep conceptual unity of the public and private law.

