

Property Rights After *Palazzolo*: When What You Know Can Hurt You

By David L. Callies

In *Palazzolo v. Rhode Island*, 121 S. Ct. 2448 (2001), the U.S. Supreme Court addressed the effect that “notice” of an existing land-use regulation has on the two principal classes of regulatory takings: partial and total. The Court held that acquisition of title after the effective date of a regulation does not automatically bar either one. The Court also lowered the ripeness barrier to bringing regulatory takings claims and clarified the meaning of “economically viable use.” Equally important are the issues that the Court foreshadowed but left undecided: the denominator, or relevant parcel, issue; the meaning

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of investment-backed expectations in partial takings cases; and the application of its notice rule in such partial takings situations.

Palazzolo's significance is particularly clear when read against the background of the law of takings up until now. It is divided into two principal parts: physical and regulatory. The first—eminent domain, compul-

ples) as part of his bundle of property rights in the first place. The *Palazzolo* decision deals with the background principles exception as well.

Far more common is the partial regulatory taking, in which the owner retains some beneficial use of the land. Here, the Court in *Lucas* (and ultimately in *Palazzolo*) refers for guidance back to its 1978 decision

the Council, a state agency charged with the duty of protecting the state's coastal property. To qualify for an exemption, the statute provides that "the proposed activity must serve 'a compelling public purpose which provides benefits to the public as a whole as opposed to individual or private interests.'" *Palazzolo*, 121 S. Ct. at 2456.

In 1978, Shore Gardens's corporate charter was revoked for failure to pay income taxes, and title to the property passed to Palazzolo alone as the sole shareholder. Palazzolo then resumed development efforts and filed an application in 1983 to dredge and fill 18 acres. When the Council denied that application as being too substantial, Palazzolo submitted a new—and significantly smaller—development proposal two years later. The Council rejected the second application as well, concluding that the proposed development could not proceed under any circumstances because it did not serve a "compelling public purpose" and, therefore, was inconsistent with the regulatory standard for a special exemption.

Finding no relief in his appeal of the administrative decision, Palazzolo filed a takings claim, alleging that the regulation had deprived him of all economically viable use of his property. This allegation brought his claim within one of the two discrete categories of regulatory actions that *Lucas* recognized as compensable takings without a case-specific inquiry: (1) regulations that compel the property owner to suffer a physical "invasion" of the property and (2) regulations that deny all economically beneficial or productive use of the land. 505 U.S. at 1015.

The Rhode Island Supreme Court rejected Palazzolo's claim on three grounds: (1) that the takings claim was not ripe; (2) that Palazzolo was precluded from challenging any regulations that existed before he acquired title to the property; and (3) that *Lucas* was inapplicable because the parcel retained economically viable use despite the restric-

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sory purchase, or condemnation—occurs when government physically takes an interest in land. There is no "notice" rule here (what a landowner knew or should have known has nothing to do with his entitlement to compensation under the Fifth Amendment). This is important because in the second category, regulatory takings, the U.S. Supreme Court compares total, or per se, takings to physical takings. In all regulatory takings, if a land-use regulation goes "too far" in reducing the use or value of a parcel of land, it is a taking in accordance with the rule of *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922). In *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992), the Court set out its per se or categorical rule for total regulatory takings: if a regulation leaves an owner without economically beneficial use of the land, then the owner is entitled to compensation as if the property were physically taken, with two exceptions. If the offending (in a constitutional sense) regulation either seeks to eliminate a nuisance or reflects a background principle of a state's law of property, then the regulation is valid regardless of its effect on the landowner's parcel, because the landowner did not have these rights (to perpetrate a nuisance or act contrary to such background princi-

in *Penn Central Transp. Co. v. New York*, 438 U.S. 104 (1978). There, according to the Court, it is necessary to engage in a multi-factor inquiry into the nature of the governmental action and the economic effect of the regulation on the landowner, particularly the extent to which the regulation interferes with the distinct, investment-backed expectations of the landowner. As discussed below, the Court in *Palazzolo* leaves partial takings for another day.

Palazzolo's Claim

In 1959, Anthony Palazzolo and some associates formed Shore Gardens, Inc., to purchase and hold three undeveloped parcels on Winnapaug Pond in Westerly, Rhode Island. Much of the land was salt marsh, requiring considerable fill to stabilize the land for development. Beginning in 1962, Shore Gardens submitted several proposals to the Rhode Island Division of Harbors and Rivers, all of which the Division rejected. As a result, the parcel sat idle for more than a decade after its purchase.

In 1971, Rhode Island designated all salt marshes as "coastal wetlands," significantly limiting the scope of permissible development. Any filling of or building on Winnapaug Pond or adjacent lands required a "special exemption" from

tion. On appeal, the U.S. Supreme Court agreed that Palazzolo's claim failed to meet the test for a per se taking under *Lucas*, but the Court held that the claim could still be considered under the multi-factored *Penn Central* analysis. In so holding, the Court concluded that Palazzolo's claim was ripe and that he was not barred from challenging the regulation even though it pre-dated his acquisition of the property. Accordingly, the case was remanded for the state courts to make the *Penn Central* determination.

Ripeness

In ruling on the ripeness question, the U.S. Supreme Court rejected the state court's application of the standards enunciated by the Court in *Williamson County Regional Planning Comm'n v. Hamilton Bank*, 473 U.S. 172 (1985), and *MacDonald, Sommer & Frates v. Yolo County*, 477 U.S. 340 (1986). Under the *Williamson County* test, a regulatory takings claim is not ripe until "the government entity charged with implementing the regulations has reached a *final* decision regarding the application of the regulations to the property at issue." 473 U.S. at 186 (emphasis added). The *MacDonald* case held that a takings claim was unripe when the claimants had submitted only a single grandiose plan for development and had not demonstrated that less ambitious plans also would be rejected. 477 U.S. at 351. Applying these standards, the Rhode Island Supreme Court held that Palazzolo's claim was premature because he had not demonstrated that a more modest proposal also would have been rejected.

The U.S. Supreme Court found the *MacDonald* standard inapplicable in Palazzolo's case. The Court noted that cases like *MacDonald* "arose when an owner challenged a land-use authority's denial of a substantial project, leaving doubt whether a more modest submission or an application for a variance would be accepted." 121 S. Ct. at 2459. Conversely, the Court stated that a

takings claim is likely to have ripened "once it becomes clear that the agency lacks the discretion to permit any development, or the permissible uses of the property are known to a reasonable degree of certainty . . ." Id.

Applying this test, the Court found that the Council had in fact made a final decision regarding the development of Palazzolo's property. The Court based this decision on the "unequivocal nature of the wetland regulations at issue and . . . the Council's application of the regulations to the subject property." Id. at 2458. The regulation provides that no development would ever be permitted on or near Winnapaug Pond—or any other "Type 2 water"—without a special exemption from the council, and the council refused to grant such an exemption unless a "compelling public purpose" would be served. Given the council's clear ruling that neither of the proposed developments qualified for the exemption, the Court easily concluded that Palazzolo's claim was ripe for

and the denial reasonably final. In making ripeness determinations, the Court said, it is important to bear in mind the basic purpose of the final decision requirement:

Our ripeness jurisprudence imposes obligations on landowners because "[a] court cannot determine whether a regulation goes 'too far' unless it knows how far the regulation goes." Ripeness doctrine does not require a landowner to submit applications for their own sake. [A claimant] is required to explore development opportunities on his upland parcel only if there is uncertainty as to the land's permitted use.

Id. at 2460.

Pre-acquisition Regulations

The most significant aspect of the *Palazzolo* decision was the Court's analysis of the effect of regulations that pre-date the claimant's acquisition of the property. Before *Palazzolo*, a number of lower courts had barred

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review. The Court further concluded that the evidence established that the council had interpreted its regulations as prohibiting fill for any purpose. Without fill, no development could proceed and, consequently, further applications would have been pointless.

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regulatory takings claims when the property owner had notice that the property was subject to the regulation. In *Good v. United States*, 189 F.3d 1355, 1361 (Fed. Cir. 1999), for example, the court said that "[o]ne who buys with knowledge of a restraint assumes the risk of economic loss." See also *Gazza v. New York State Dep't*, 679 N.E.2d 1035, 1037-41 (N.Y. 1997) (no taking occurred because *Gazza* purchased the property with the knowledge that he would need a variance, and thus he had no right to build anything and no

cognizable property interest); *Grant v. South Carolina Coastal Council*, 461 S.E.2d 388, 391 (S.C. 1995) (no taking because a permit to fill tidelands was required when claimant acquired the property).

Following the reasoning of these courts, the Rhode Island Supreme Court held that the post-regulation acquisition of title was fatal to Palazzolo's takings claim, whether

law simply because the regulation pre-dated the claimant's acquisition of title. "A regulation or common-law rule cannot be a background principle for some owners but not for others[.]" the Court stated. *Id.* This is the most important holding in the case. Many commentators and several courts had engrafted such a "notice" rule on regulatory takings jurisprudence, particularly per se

Although Palazzolo's claim was not categorically barred by the existence of the regulation pre-dating his acquisition of the land, there was dissension on the Court as to whether that knowledge was a relevant fact to be at least considered under the *Penn Central* partial taking analysis. In a concurring opinion, Justice O'Connor stated that "[t]oday's holding does not mean that the timing of the regulation's enactment relative to the acquisition of title is immaterial to the *Penn Central* analysis. Indeed, it would be just as much error to expunge this consideration from the takings inquiry as it would be to accord it exclusive significance." 121 S. Ct. at 2465. Justice O'Connor reasoned that a landowner's knowledge of a regulation has a bearing on the landowner's "investment-backed expectations" under the *Penn Central* inquiry. "[T]he regulatory regime in place at the time the claimant acquires the property helps to shape the reasonableness of those expectations." *Id.* at 2466. Justice Breyer agreed, adding: "Ordinarily, such expectations will diminish in force and significance—rapidly and dramatically—as property continues to change hands over time." *Id.* at 2477.

Justice Scalia, in contrast, reasoned that the existence of a regulation before the landowner's acquisition of title had no bearing, except as a background principle of property law or nuisance. In his view, "[t]he 'investment-backed expectations' that the law will take into account do not include the assumed validity of a restriction that in fact deprives property of so much of its value as to be unconstitutional." *Id.* at 2468.

The upshot of this debate is that the state courts, on remand, must make an educated guess as to whether Justice O'Connor's or Justice Scalia's viewpoint will prevail with respect to partial takings. Although Justice Stevens's dissenting opinion suggests that he might side with Justice O'Connor, the views of the remaining five Justices are unclear. Accordingly, litigants must tread with

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total (categorical or per se under *Lucas*) or partial (under *Penn Central*). The state court reasoned that a purchaser is deemed to have had notice of a regulation that was in effect at the time of acquisition. The regulation, therefore, had become a background principle of state law, which constituted an exception to the takings claim under *Lucas*. 505 U.S. at 1028–32.

Lucas provided an exception for regulations that merely duplicate land-use prohibitions that already exist under background principles of state law of property. As the Court in *Palazzolo* observed, "a landowner's ability to recover for a government deprivation of all economically beneficial use of property is not absolute but instead is confined by limitations on the use of land which 'inhere in the title itself.'" *Palazzolo*, 121 S. Ct. at 2464 (citing *Lucas*, 505 U.S. at 1029). The Court rejected the application of this exception in Palazzolo's case, however, stating that a regulation does not become a background principle of law merely by its enactment. *Id.* Similarly, a regulation that is otherwise unconstitutional absent compensation is not transformed into a background principle of the state's

takings under the *Lucas* rule. There is, of course, no such language in *Lucas*, nor could there be, given the direct analogy of the rule there to the law of eminent domain.

This addendum to the "notice" rule issue emphasizes, but does not resolve, the importance of the categorical exceptions in *Lucas*. The Court signals in *Palazzolo* that wetlands protection is not a nuisance but leaves untouched the increasing use of the public trust doctrine and customary law as potential "background principles," as found in some state court decisions. See, e.g., *In re Water Use Permit Applications*, 9 P.3d 409, 494 (Haw. 2000) (asserting that the state holds water rights in public trust and, therefore, denial of water permit was not a taking); *Stevens v. City of Cannon Beach*, 854 P.2d 449, 456–57 (Or. 1993) (holding that "the doctrine of custom as applied to public use of Oregon's dry sand areas" is a background principle of the state property law). The Court's decision in *Palazzolo* also leaves the door open to some—but not all—legislative enactments, such as those codifying existing public trust rights previously recognized as limitations on private land titles.

caution in this area until a more definitive ruling emerges.

The Denominator Issue

Turning to the merits of Palazzolo's claim, the Supreme Court concluded, as did the state court, that Palazzolo could not establish a *Lucas* taking because he had not been deprived of all economically beneficial use of his property. The Court noted that Palazzolo had conceded that his parcel retained at least \$200,000 in development value because it could be used for construction of a residence on the upland part of the property. The Court observed that "[a] regulation permitting a landowner to build a substantial residence on an 18-acre parcel does not leave the property 'economically idle.'" *Id.* at 2465.

Palazzolo also argued that the upland parcel was distinct from the wetlands and, therefore, it should not be considered when determining whether the property retains economically viable use. Common to both total and partial takings analyses, this raised the redoubtable "denominator issue": what is the extent of the landowner's property interest to be considered in deciding whether the interest allegedly damaged is partially taken—is it just the part of the property affected by the regulation or is it the entire parcel owned by the claimant? If Palazzolo were correct, he could have avoided the Court's conclusion that there was no total per se taking of his property as a whole because part of it—the upland portion—could be used to construct a \$200,000 residence. Thus, the property as a whole would not be devoid of economically beneficial use.

In *Penn Central*, the Court held that the denominator included the entire value of the company's holdings in the area. 438 U.S. at 130–31. *Lucas*, however, expressed discomfort with this rule, referring to it as "an extreme—and, we think, unsupported—view of the relevant calculus. . . ." 505 U.S. at 1016 n.7. Legal commentators have since

echoed this comment. See *Palazzolo*, 121 S. Ct. at 2465.

The Court declined to decide the denominator question in *Palazzolo* because the issue had not been raised in the state courts. The tenor of the Court's opinion suggests, however, a willingness to revisit *Penn Central*'s "entire parcel" theory when that issue is properly before the Court. Meanwhile, the law with respect to this issue is therefore still best stated by the Federal Circuit, which discussed the denominator issue in the context of denials of dredge and fill permits by the Army Corps of Engineers under the Clean Water Act. See *Loveladies Harbor, Inc. v. United States*, 28 F.3d 1171 (Fed. Cir. 1994). Out of 250 acres owned by the claimant, the court was willing to consider only the devaluation of 12.5 acres for which the Corps had denied a permit. *Id.* at 1180–82. With the difference being \$2.7 million before the permit denial and \$12,500 thereafter, the trial court awarded the \$2.7 million, which the Federal Circuit affirmed. *Id.* at 1173–75, 1182–83; see also *Palm Beach Isles v. United States*, 208 F.3d 1374 (Fed. Cir. 2000) (holding that the relevant parcel for takings analysis purposes was 50.7 acres rather than 311 acres, then later separating out a 1.4 acre parcel in a subsequent decision).

A Partial Taking

Although Palazzolo was unsuccessful in his total taking claim under *Lucas*, the Court concluded that Palazzolo still had a potentially viable claim under *Penn Central*. The Court was unable to reach the merits of that claim, however, because the state courts had rejected both the *Lucas* claim and the *Penn Central* claim on the notice issue and, therefore, had not engaged in the requisite factual inquiry to determine whether a partial takings had occurred. Having reversed the state court on the notice issue, the U.S. Supreme Court remanded the case for further proceedings, consistent with its opinion, to address the partial taking

issue. On remand, the Supreme Court of Rhode Island must balance these *Penn Central* factors to determine whether denying all construction—except for a single family home on an 18-acre parcel—is indeed a partial taking of property without compensation.

Conclusion

Palazzolo gives property owners and their attorneys a sharper image of the U.S. Supreme Court's regulatory takings jurisprudence. The Court's ripeness ruling relieves claimants from the burden of submitting repeated applications for scaled-back development plans when it is clear that the regulatory agency would not approve such plans. The Court also held that claimants are not categorically barred from bringing an action when the disputed regulation predates the claimant's acquisition of the property. The decision also casts considerable doubt on the broad application of a statutory exception to per se takings under *Lucas* as background principles of a state's law of property. Left unresolved, however, is the precise role of custom and public trust as such background principles. Also, whether the landowner's knowledge of the regulation has an impact on the landowner's "investment-backed expectations," and, therefore, should be considered as at least one element of a partial takings inquiry. How the Court resolves these questions will have considerable effect on the manner in which takings jurisprudence is applied to regulatory disputes between government and landowner. ■

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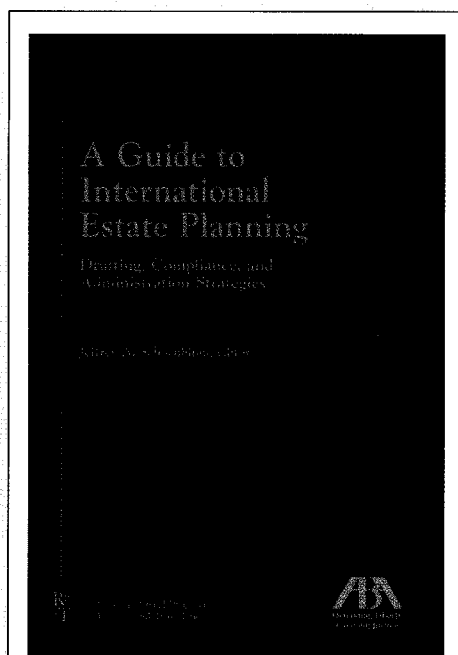
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Linux for Lawyers

Although most columns are devoted to software written for the Microsoft Windows operating system, there are alternatives, such as the Apple Macintosh and Linux. Unfortunately for Apple devotees, this column will not be about the Macintosh, but about the newer kid on the block, Linux.

What Is Linux?

Linux (pronounced "lih-nuhcks," not "lye-necks") is a somewhat stripped-down version of Unix, one of the oldest and most popular multi-tasking, multi-user operating systems. The Linux kernel (the central component of the operating system) was developed by a Finnish graduate student, Linus Torvalds, in 1991. The Free Software Foundation and Project GNU ("GNU" is a recursive acronym meaning "GNU is Not Unix") had been working to develop the other components needed for a complete operating system, and they added the Linux kernel in 1992 to release what is now known as GNU/Linux or just plain Linux.

One of the things that makes Linux unique is the licensing agreement under which it is distributed. Under the terms of the GNU General Public License developed by the Free Software Foundation, Linux and its source code (the instructions that were compiled to create the operating system) are distributed for free and can be modified and redistributed, subject to two very important restrictions. These restrictions are that any redistributed software must include the source code and must be subject to the same licensing agreement. For example, I can buy a distribution of Linux, add my own modifications, and legally resell the resulting product, including the components originally purchased from someone else. Linux has been described as the first operating system written as a chain letter, with each programmer adding two or three lines of code before passing it along to five friends.

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Linux is therefore available for free and can be downloaded from a number of different web sites. Many Linux applications are also free (or very inexpensive). In fact, many of the applications described in this column can be downloaded for free or purchased on a CD for less than \$50.

Distributions and Desktops

Linux comes in different flavors, referred to as "distributions," each of which will include a number of utilities not included in the original Linux operating system, such as utilities for installing the system and software applications. The most popular distributions include Red Hat Linux from Red Hat Software (www.redhat.com), Caldera OpenLinux from Caldera Systems, Inc. (www.caldera.com), SuSE Linux from SuSE Inc. (www.suse.com), Debian/GNU sponsored by a nonprofit organization, Software in the Public Interest, Inc. (www.debian.org), and Corel Linux (which is based on the Debian distribution), previously available from Corel (www.corel.com) but recently transferred to Xandros Corporation (www.xandros.net).

There are also a number of different desktop environments available for Linux, all of which are based on the "X Windows" graphical user interface. These X Windows desktops can appear to be very similar to Microsoft Windows, with pull-down menus and icons, and the most popular desktops are based on GNOME ("GNU Network Object Model Environment"), KDE ("K Desktop Environment"), and Motif. To further confuse matters, different Linux distributions may come with different desktop environments. So, for example, Red Hat Linux comes with both GNOME and KDE (with GNOME as the default), but Corel Linux comes with only KDE (although GNOME can be added by the user).

These choices may lead to confusion and concern about software compatibility, but for most users and most applications the decisions are not that critical. Most Linux applications will run under each of the different distributions and desktops, although some modifications may be needed in some cases.

Red Hat Linux is the most popular distribution and has become something of an industry standard, but lawyers and law firms wanting to try Linux might prefer the Corel distribution, which is easy to install and is designed for desktop applications (and not server applications) and provides support for WordPerfect and other Corel applications.

Basic Office Software

For basic office tasks (word processing, spreadsheets, databases, e-mail, etc.), there is a surprising variety of choices.

Corel WordPerfect Office 2000 is still available for Linux and includes not only WordPerfect 2000 but also Quattro Pro, Corel Presentations, the Paradox database, and CorelCentral for managing information such as tasks, calendars, and contact information.

Although Microsoft Word is not available for Linux, there is a something of a work-alike in the form of StarOffice from Sun Microsystems (www.sun.com), which provides word processing (reported to have 80% of the functionality of MS Word), spreadsheets, presentation applications, graphics, calendar, Internet browser, e-mail, and scheduler. StarOffice is also available for Microsoft Windows and other operating systems.

A relatively new release is Ximian Evolution from Ximian Inc. (www.ximian.com), which functions like Microsoft Outlook and provides integrated e-mail, task and contact lists, scheduling, and calendars. Ximian is also promoting a software link to allow its Evolution application to share information with Microsoft Exchange servers. The Ximian desktop can also provide word processing, spreadsheets, and graphics-editing applications.

Estate Software

For estate-specific software, the choices are much more restricted. There are only two estate administration software applications that might run under Linux, although the vendors admit that they do not yet know of any users actually running Linux with their applications. Because these applications are not written from Linux source code, they are not subject to the GNU general public license described above, and the costs will be the same as for MS Windows applications.

6-in-1 from the Lackner Group, Inc. (www.lacknergroupp.com) can provide fiduciary accountings, federal estate tax returns (Form 706), and fiduciary income tax returns (Form 1041), as well as many other state tax returns and state filings. Lackner's 6-in-1 should be able to run under Linux because the applications are written using Filemaker Pro, and Filemaker Inc. (www.filemaker.com) supports Red Hat Linux, as well as the Mac OS and other operating systems.

In a similar fashion, the FASTER system from FASTER Systems LLC ((508)347-0195) should be able to provide fiduciary accountings, federal estate tax returns, fiduciary income tax returns, and other returns and filings under Linux, because the FASTER system is written in Progress. Progress Software (www.progress.com) supports Linux, as well as other operating systems.

For other essential programs, such as estate tax planning or other estate applications, that are available only as MS Windows software, it may be possible to run the applications under Linux using an emulator such as Wine

(www.winehq.com) that supports many (but not all, or even most) Win32 software. The developers of Wine, however, admit that it is developmental software that is not suitable for general use.

Conclusion

Working with MS Windows is not always easy, is sometimes maddeningly difficult, and is usually mysterious. Working with Linux should be less mysterious and less maddening but, except for the simplest installations, will require a higher order of knowledge about the operating system and how to install and maintain applications. If you think of owning a computer like owning a house, then MS Windows usually requires no more than some simple repairs with pliers and a screwdriver. Linux, on the other hand, often requires the ability to install new plumbing or wiring.

Linux is therefore not for the technologically timid or the faint of heart, but can provide a stable, efficient, and inexpensive computing environment for those willing to work on the "bleeding edge" of technology.

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