How to Solve (or Avoid) the Exactions Problem

Richard A. Epstein
How to Solve (or Avoid) the Exactions Problem

Richard A. Epstein*

I. INTRODUCTION

It is my great honor to deliver the Earl F. Nelson lecture for the year 2007. I have never met Mr. Nelson, but I have looked at the roster of distinguished people who have spoken in this lecture series, and I am pleased to have my name added to such an august list. I would also like to add my tribute to Dale Whitman, to whom this Conference has been dedicated. I regard him as a one-man version of Mr. Inside and Mr. Outside, a reference to – for those of you who remember – the old Army teams from the 1940s that sported a backfield with Glenn Davis and Doc Blanchard. In our context, the inside guy is the master of private law, in Dale’s case mainly the law of mortgages. The outside guy is the master of public law, who knows a great deal about takings, eminent domain and state regulation. I mention Dale’s combination of talents not only because they are relevant to his very distinguished career, but also because they are relevant to the problem that I shall tackle in this lecture: how to identify and then solve the exactions problem.

In dealing with a question of this sort, most public lawyers start with the original document, the Constitution. The tools of their trade are the interpretive ones associated with textual analysis in its historical context. The underlying subject matter of the particular transaction is a decidedly second-order concern. In contrast, I came into constitutional law quite by accident, and with a certain degree of regret, for at heart I remain very much a private lawyer. My starting points of reference are the routine transactions between ordinary individuals, none of whom have any of the special prerogatives of the state. From that baseline, I seek to figure out how those relationships should be altered when one of the parties is the state, with its own unique powers of coercion. That difference in starting point matters, for where you begin will, in large measure, tell you something about where you’re going to end up. Those scholars and judges who treat constitutional law as the quintessential public law subject always find ways to introduce huge degrees of discretionary power for the state in its dealings with ordinary, private interests. Those, relatively few of us who start from the private law perspective on property rights veer in exactly the opposite direction, by finding that these rights resist easy incursion by state regulation. Clearly, public lawyers have to yield

* James Parker Hall Distinguished Service Professor of Law, The University of Chicago; Peter and Kirsten Bedford Senior Fellow, The Hoover Institution. This article is a revised version of the Earl F. Nelson lecture delivered in honor of Dale Whitman at the University of Missouri-Columbia on April 13, 2007.
something to private lawyers in their calculations. Just as clearly, private lawyers have to yield something to the public lawyers who are also concerned with the effort to guard private rights from government regulation. Both sides will end somewhere in the middle, but not necessarily at the same place. By starting at opposite ends, the inevitable frictions of legal doctrine and its application make it unlikely that the two intellectual ventures will end up at the same middle position.

Given this private law perspective, I plan to start not with the Constitution, and not with the power of the state through its permit power to condition the use or disposition of property upon the willingness of a landowner to engage in certain kinds of actions or to refuse to engage in certain kinds of actions. Instead, I will start with the ideas of property which I then use as a basis for understanding constitutional doctrine. That approach is congenial to my own personal education in law, which began at Oxford in the fall of 1964. My first course at Oxford was Roman law, which is a subject that I teach to this day. My views on property law have been heavily influenced by the Roman conceptions, which in fact shaped the views of many great English and American writers at the time of the founding of our Constitution. So like a good Romanist or early common law lawyer, I shall start with the private law conception of property in order to explain how that framework lets us understand the sophistication of modern private transactions, in contrast to the crude conceptions of private property that dominate constitutional discourse.

II. THE COMPLETENESS OF PRIVATE PROPERTY REGIMES

Let us concentrate on the law of land. Although there will be some variations, the basic rule holds that the party who first takes possession of the surface owns the exclusive rights to the skies above the land and to the center of the earth below the land.1 Over that physical space, each owner enjoys a trinity of three key rights. The first is the right to (exclusive) possession; the second is the right to the use and the fruits of the land; the third is the right of disposition.2 The right to maintain exclusive possession gives the owner the shell, while rights of use and disposition give that person the fruit that lays inside of it, which can be either consumed, invested or traded. Quite simply, there is no point in excluding everybody else if the owner is not allowed to do anything with the land over which he has these exclusive rights.

One key in the land law question asks how any legal system allows for the transfer of ownership between parties. There are two such forms of transfer, the first of which is relatively unproblematic, and the second of which is vital for understanding takings law. The unproblematic form of transfer allows the owner to convey his land voluntarily to somebody else who steps

1. WILLIAM BLACKSTONE, 2 COMMENTARIES *18.
2. WILLIAM BLACKSTONE, 1 COMMENTARIES *134.
into his shoes. If a potential buyer values the property more than its current owner, the law devises forms that allow for the orderly shift in ownership. The key condition is that the gains from the transaction must exceed the cost of putting the transaction together. Accordingly, the basic mission for simple property transactions is twofold: to increase the security of the transaction and to reduce the cost of their execution; otherwise the frictions in the system will prevent the productive disposition of property. Early Roman lawyers, medieval English lawyers, and modern lawyers have all worked desperately to figure out what kind of combination of deeds, witnesses, and recording systems are best able to reduce those transactions costs. These outright transactions are not particularly problematic because the new buyer just stands in the shoes of the old seller, as the new donee stands in the shoes of the old donor. All relationships between transferor and transferee end the moment the transaction is completed.

The much more difficult challenge to any system of property law arises when the gains from trade and cooperation depend on the creation of *multiple* ongoing interests in the same thing. These new patterns of ownership can happen in any number of different ways. In the Roman system, for example, you could create a family settlement under which one person is entitled to a usufruct, that is the uses and fruits of the property during his or her life, and then afterward the property would go back to the original owner; in the American and the English law we call the analogous arrangement one of "interests" or "estates" instead of usufructs. Our system of multiple interests in property is in fact more complicated than the Roman, because we allow successive life estates in different people in the same piece of land, where the Romans, it appears, did not allow for successive usufructs.

These details to one side, the basic argument in both systems is that dividing the property between the two parties creates benefits which exceed the value of the property when kept in the hands of a single owner. That division is valuable not only in family planning – where it is tied to lives – but also in commercial cases, as in a simple lease of property that creates a landlord-tenant relationship. Once the two (or more) parties adopt one of these divided relationships, it is no longer possible to have a clean deal; now the law must figure out how to regulate the use of the party in possession of the property to make sure that his use does not prejudice those people who will take possession after him. This outcome can be accomplished by contract or by the law of waste.

The partition of property can also take place in at least two other ways. By the first method, rights over property are given not only to persons who are successive occupants of land, but also to neighbors. Accordingly, the law regulates what we call in English and American law easements and restrictive covenants, both of which were treated under Roman law as servitudes – a term adopted by the recent Restatement of Property, which goes out of its
way to abolish the distinction between easements and covenants. An easement allows one person to enter onto somebody else’s land in ways that would otherwise count as trespasses. These rights of way could be only for individuals to walk, or they could allow for the movement of animals and vehicles. Both the easement and its scope are created by voluntary transactions, which satisfy the usual mutual gain requirement. In contrast to easements stand restrictive covenants, which prohibit an owner from making uses of his own property that would be otherwise lawful. As a matter of general law, these uses are quite innocuous; yet your neighbor would prefer that you not do them. One of the most common covenants stipulates that an owner will not build a house above a certain height to protect a neighbor’s view.

What makes these servitudes difficult is that they are not just personal affairs between the two original parties, but often are intended to benefit and burden anyone who acquires either plot of land thereafter. The law therefore has to find ways to ensure that these arrangements bind not only the original transactors but also subsequent takers of both the dominant and the servient interests. Most critically, in terms of validity, all private law systems make no distinction whatsoever between the validity of easements and restrictive covenants. The only distinctions that survive are technical: do you identify, describe, and record these interests – all of which are second-order considerations. Thus the private law develops a comprehensive system of land use regulation that “internalizes externalities” between neighbors, such that the combination of the two parcels of land with these interests attached exceeds their value if both of these servitudes were forcibly invalidated.

A second variation on the theme of divided interests has to do with an area in which Dale Whitman has done extensive work, namely with liens and mortgages for acquiring secured credit. Nothing in the logic of land division requires that the division be between somebody who has the right of occupation today and somebody who has that right of occupation tomorrow. It is perfectly sensible to think about land as a security for the repayment of loans. So the law of mortgages adjudicates the relationships between creditor and debtor, which allow the creditor to have security in the land without forcing him to enter into possession of property which is better left in the hands of its owner, unless he defaults. The mechanics of this system, and its creation of multiple mortgages, is complicated, but the overarching theme follows the same logic used in other areas in which property is divided into multiple interests. As with other transactions, the rules have to govern relations not only between the immediate parties to the transactions, but also must govern relationships between the third parties to whom the mortgaged land might be

4. See id. § 1.2.
sold, or for that matter, mortgaged a second time. As with other divisions in property, the system of recordation, foreclosure and redemption has facilitated these transactions, and with it the gains from trade they generate, for quite often the borrowed funds are used to improve the property used to secure the loan. There is little doubt that these transactions are done more efficiently today than ever before.

In the modern law of real property, these separate devices are not used each in isolation from the others. They can all be used, and are commonly used, in combination to wring the last ounce of value out of the underlying asset. So our basic theorem holds. Today, people are able to slice property, if they so choose, thinner and thinner, and to track and protect the interests so created. Historically, the creation of a second mortgage required the ingenuity of the greatest conveyancers on the face of the globe. Today, we can easily combine and reconfigure mortgages in whatever way we like. In consequence, we can contribute thousands upon thousands of separate (but standardized) instruments into a given pool, where they are securitized, so that we can give different tranches to different investors who can then use them to balance or diversify their portfolio as they see fit. Here is one form of ingenuity. Five hundred years ago no one could create multiple interests in land, such that it goes to A on Mondays, and B on Tuesdays, and C on Wednesdays and so on: the law would say, “no grantor can do this, because the pattern of interests is too difficult to monitor.” Today timeshare agreements allow for just these divisions of property.

If you want yet another illustration on how multiple interests in property work together, you need look no further than to the rise of the planned unit development, or the complex condominium. Both are devices in which novel property interests are created to extract value from real estate. The ability to first create and then recombine interests in land is the dominant feature of the long-term evolution of land law. Put aside the occasional jagged edges, and the conclusion still holds. The complex system of property rights unlocks value in ways that generate an immense degree of prosperity for each and every person. The people who benefit the most never give a second thought as to the institutions that undergird it. They just exploit its desirable features in a simple and reliable fashion.

III. THE CONSTITUTIONALIZATION OF PRIVATE PROPERTY

The key question for this lecture is the reception that this system of property rights receives under our Constitution. Like most well-conceived social arrangements, the Constitution’s great object is to protect the liberty and the property of all the citizens who live under its terms. The reason why constitutions (and governments) are needed is because no group of disparate individuals can rely exclusively on clever voluntary mechanisms to allow the formation of a viable and just state. Sooner or later, responsible future citizens must resort to state coercion to prop up the system of property rights and the market transactions they spawn. At a minimum, these objectives require a
resort to state taxation, which creates the political and social infrastructure needed to allow voluntary arrangements to go forward. The most economical guide as to how that mission could be achieved is the Takings Clause to our Constitution, which in a dozen well-chosen words outlines the basic approach. "[N]or shall private property be taken for public use, without just compensation." 7 Unlike a purely voluntary system, it does not say that the state cannot take property for public use without the consent of its individual owner. Our Framers realized that they could never maintain a political order if the requirement of individualized consent could allow a single person to block the creation of a central government with its own police force. But the Constitution does not veer to the other extreme either, which would allow the state to do whatever it chooses to the citizens whom it is supposed to protect. So the compromise solution is that the state may take private property for public use so long as it provides just compensation to the individuals from whom that property is taken.

That sensible compromise need not only apply to cases where the government occupies land. It generates the same desirable incentives when applied to taxation and other forms of government regulation. And once it is so applied, the litmus test for valid government action is this: any person who is subject to a government exaction must get back from the state in-kind benefits that are worth more to him or her than the taxes that they paid to set up these arrangements. At all points the social objective is to use coercion to create win-win arrangements that will leave no individual worse off than before. The substitution of the full and perfect equivalent for the taxes taken means that no rational person ought, in principle, to be opposed to the institution of that regime. He might wish that others be taxed so that he can enjoy a free ride, but if put to the all-or-nothing question, he would prefer the regime of universal taxation with the associated public benefits to the prior state of affairs, i.e. the state of nature, in which he escapes all taxation only when all others do.

There is therefore a kind of logical completeness to the system of property rights which exhausts every useful attribute of every natural and, I might add, non-material thing in the world. Every time lawmakers start tinkering with that system, they should ask themselves whether they are changing things for the better or for the worse. There are, of course, all sorts of government exactions, taxes, liens, and controls that pass muster within this basic system. Nonetheless, the initial presumption properly holds that the more state regulation disrupts the operation of the system, the greater the justification it should have to put forward to defend that initiative against constitutional attack.

---

7. U.S. CONST. amend. V.
IV. EUCLID AND THE TRUNCATION OF PRIVATE PROPERTY

Nonetheless, under the current versions of constitutional law, this private law account of private property is simply, completely, thoroughly, and emphatically rejected in the Supreme Court and, I daresay, by way of imitation in virtually all state courts that address these same issues. How does this strange kind of bifurcation in the rules governing property arise, and what are its consequences? Under the current system, the common law system of property is given, largely, its due in cases of outright takings, in which the government simply substitutes itself, or even some third person, as the owner of land. These transactions are treated as a form of forced outright sale for which compensation is appropriate. Therefore, when the government steps into the shoes of a landowner to lay claim to some particular land for a fort, road, or post office, it is going to have to pay full market value to the owner of the property whom it has displaced. The logic behind this very commendable rule rests on the knowledge that it is very difficult for any court to figure out the relative values between the private and public use of any given parcel of land. Therefore, if the state is required to pay dollar-for-dollar compensation for the property that it is taking, so that the private owner is fully compensated, then the state is only going to take that land if it can give back to its taxpaying citizens something worth more to them than the tax revenues it expends. The theory is that full compensation not only prevents the state from singling out one individual for disparate treatment, but it also puts a cash check on government ambitions, so that it only selects those projects that make social or economic sense.

The central difficulty with the modern takings law is the failure of the courts to extend this approach to partial takings of land when the government appropriates only some of the incidents of ownership, but leaves some behind for the original owner. Recall the earlier discussion of how land can be divided into multiple interests: future interests, mortgages and liens, and rights over the land of another. At issue is whether, and if so how, the government is held to account when it takes some but not all of these interests from a given plot of land.

In my view, the term "private property" when used in the Constitution refers not just to the land itself as some single undifferentiated entity, but instead refers to each and every partial interest in the land that their owners can create by voluntary transactions. So if someone mortgages real property held in a fee simple, thereafter the mortgagee holds the mortgage and the original owner retains the equity interest in the mortgaged property. The same logic applies to leases, life estates, covenants, and easements. To put the proposition in a slightly different form, any private transaction that complicates the state of the title neither increases nor reduces the obligations of the government to compensate. Essentially the social objective is to allow people to structure their voluntary transactions in whatever form they see fit and only thereafter to let the government decide whether or not the fractional interests so created are ones that are worth acquiring by paying compensation.
This approach does not, however, describe how the law works today. My next objective is to explain how the law approaches these partial interests in land, and then to tie that approach to the exaction problem, which is the ultimate focus of this lecture. To simplify the history somewhat, the first and most important case for these purposes is a zoning case called Village of Euclid, Ohio v. Ambler Realty Co., 8 which was decided by Justice Sutherland, a Republican railroad lawyer, who was in my view both well-intentioned and wholly misguided. Euclid involved an integrated 68-acre plot of land located between two railroad tracks that its owner had planned to develop as a factory. The local city council planners, however, concluded that they had a better idea for how this property ought to be used, so they divided it into three separate zones: one commercial, one residential for apartments, and one residential for single-family homes. The planners, however, did not quite figure out how to compute value: once those land use restrictions were imposed, the value of the plot dropped, in rough terms, from $800,000 as an integrated plot to around $200,00 as a zoned one. So, by placing the restrictive covenant on the land, the planners thus imposed a $600,000 loss on the owners, for which the obvious question to ask is this: "for what particular social benefit do you wish to create this private loss?" That question was neither asked nor fully answered in Euclid, which held that the zoning ordinance did not run afoul of the prohibitions contained either in the Takings or Due Process Clauses. Of course, the new zone would have some effects upon the owners of neighboring plots of land, but there is no uniform direction to those economic effects. Some people would be better off if Ambler Realty could have built its plant; other people would be worse off. If you are trying to net out these positives and negatives, chances are you would not find too much going on, except for the general effect that the increase in the wealth of land on balance produces additional opportunities for jobs, goods and services for other individuals.

In making this observation I have often been subjected to this reply: "Professor Epstein, you are, as usual, an intellectual primitive because you fail to understand that allowing people to make whatever use of their property utterly disrespects the rights of other individuals." And my interlocutors are right insofar as their observation is meant to say to a landowner "you cannot pollute, you cannot poison the atmosphere, and you cannot send filth and noise unto your neighbor." The law of nuisance, which again has its origins in Roman times, and which has been universally adopted in English law, makes actionable and unlawful all these "non-trespassory" invasions of the space of another individual. 9 But now track this understanding against the particulars of Euclid and ask yourself whether this zoning ordinance was designed in any way, shape, or form to combat any kind of nuisance-like behavior? And the answer is, if you are building a factory on a 68-acre plot of land,

complete with set-backs, and walls, and dead-silence, there's nothing that looks remotely like a common law nuisance unless and until the smoke spews or the water turns foul. *Euclid* is not a case where the state acts to restrict the building of a charnel house whose very operation is going to pollute the rivers and poison your neighbors.

This traditional law of nuisance did not organize the analysis, for what Justice Sutherland did was to relativize the concept by noting that "[a] nuisance may be merely a right thing in the wrong place, like a pig in the parlor instead of the barnyard." Even that observation is wrong, for the pig can be a nuisance in the barnyard if it inconveniences outsiders. But for our purposes, the more decisive objection is that the Sutherland approach represents part of the decline of modern American constitutional law. By professing complete ignorance about concepts that are perfectly clear within a private law framework, the judges acquire greater freedom to regulate free of constitutional constraint. This pattern of putting words like *nuisances, takings*, and *property* in quotation marks is a conscious effort to undermine the coherence of a private law system whose boundary conditions maximize the value of the multiple properties which are subject to the common regime of nuisance law. Nonetheless, *Euclid* marks the creation of a constitutional chasm between cases in which the state takes possession of the land as opposed to "merely" imposing restrictive covenants upon its use. Any private person could only acquire a restrictive covenant by purchase. The state, which has the power of compulsory purchase, however, is allowed to take the identical interest without paying so much as a dime. On the other hand, if the State had wanted to subject this integrated plot of land to the right of the public to walk across the property, then its claim of an easement is said to trigger the payment of compensation just as if it had occupied the land outright. So that the central feature of modern American constitutional law of property has always been the conscious bifurcated treatment between two types of property interests that have equal dignity and receive equal protection under the private law, to wit, the restrictive covenant and the easement.

V. **NOLLAN AND THE EXACTION GAME**

The question that next arises is, how does this game play itself out over time? The answer is that it clearly leads to immense advantages for the State, which opens up the field of exactions that we were talking about before. Let me skip huge swaths of American constitutional law and fast-forward now sixty years from the *Euclid* to a case that poses a genuine puzzle to standard


constitutional theorists, Nollan v. California Coastal Commission.\textsuperscript{12} Its facts are so beautiful that surely some very learned law professor made them up. Here is the situation in a nutshell: along the California coast stands a whole line of houses in various states of disarray between the Pacific Coast Highway, which is about 100 or 150 yards off the coast, and the coast itself. Accordingly, the people who drive down the Pacific Coast Highway are subject to the constant indignity of looking at the backs of these houses instead of being able to look out over the ocean beyond it. As with all activities near the coast, the State would like to improve the view of the people who are driving down the Pacific Coast Highway. Actually, it is more concerned for its own interests, because this is the deal that it offers:

Oh, landowner, you would like to build a bigger house, which would create arguably a bigger visual blockade for people driving down the Pacific Coast Highway. Of course we can stop you from building that larger blockade simply by placing a land use restriction on your property. The restriction will cost you a great deal, but under current law, we do not have to compensate you for that loss unless we wipe out all the value of the property, which cannot happen so long as we leave your current dilapidated shack in place. So let's make a deal. We would much rather have a lateral easement going in front of your house than the viewing rights from the road: so if you give us the easement, we will give you a permit to build a larger house, for two reasons. One is that we would love to collect the tax money that comes from you building a larger home on your current site. And secondly, it turns out, there are public beaches north and south of your property, and it would be very nice for our citizens to be able to walk from one beach to the other along the ocean front, which means through your front yard. So we are very entrepreneurial and we believe in markets, and we believe in freedom of contract. Here's the deal, you give us the easement, we will give you the building permit. OK? It is as simple as that.

And you look at it and you say, "Oh my God, I have to take this deal." Well, why do you have to take it? First you do a quick back-of-the-envelope calculation. As an owner, you will not fall for any rhetorical ploy that says that non-possessory interests are not worth very much; they can be worth a fortune. In fact, a restrictive covenant on new construction, even when imposed by regulation, can, as it did in Euclid, knock down the value of land by eighty, ninety percent or more. So, hypothetically, assume that if an owner can now substitute the good new for the bad old house on the land, the land value goes from say, $200,000 to $1 million. That's not a bad number, $800,000 in gain. But that pesky little easement in front of the land may be a real bother that reduces the value of the land, but one can price that cost at only $100,000, maybe $150,000. Landowners can add and subtract. Each can determine that he is better off with the new house subject to the lateral easement than with neither the new house nor the new easement. The deal

\textsuperscript{12} 483 U.S. 825 (1987).
gets made, and if the landowner tries to build thereafter, the state planner is in the ironic position of being able to correctly defend the transaction with a plea for freedom of contract on the ground that the deal makes both parties better off than they were before.

Accordingly, Mr. and Mrs. Nollan saw their neighbors cave and accept the offer, but they had a better idea: they built the bigger house without the permit. Duly outraged, the State asserted that it was now entitled to that lateral easement free of charge. Justice Scalia heroically refused to allow the easement, which he condemned as a form of "out-and-out... extortion."\(^\text{13}\) His position was, sort of, that the state could not obtain a lateral easement free of charge by holding up the building permit. Why is a big question that I shall address momentarily. But at least for the moment Scalia allowed the landowners to get away with it in this particular circumstance. The state could not demand the exchange.

Now how do you start to figure out why this stated-mandated deal, to which all the Nollans' neighbors surrendered, is so troublesome? To do so it is only necessary to return to the world of complete property rights that I described in the initial portion of this lecture. In that world—a real and not a utopian world, moreover—restrictive covenants and possessory easements are cut from the same cloth. Both are property rights. Thus in the exact case, the State comes along and says, "Hey, we'll give you a choice between either keeping people off your front lawn or building a house, but you can't have both." Anyone steeped in the system of private property would yell in protest: "Wait a second. I was entitled to both." This offer is not the embodiment of the state of affairs that Milton and Rose Friedman summarized in the phrase "Free to Choose."\(^\text{14}\) That phrase produces long term social gains by allowing each owner to exchange what he owns for what he does not have but values more. It is not as though this deal called for me to exchange a covenant over my land for an easement over yours. The more of those transactions, the better.

Yet note the difference between the legitimate exchange and the state's Nollan stratagem. A Nollan-type offer allows the state to go up to the person who owns two entitlements in the same parcel of land and to insist that the owner is free to choose which of those two he would like to retain. By way of analogy, it is as if I went up to the worthy Professor Whitman on some dark street and I said, "I'll either take your watch or your wallet but I won't take both so you've got a freedom of choice." That's classically known as the case of duress of goods, which only works because the state can back its threat, suitably disguised as an offer, with the use of force, even if it never asks one police officer to remove his gun from its holster. So this revised

\(^{13}\) Id. at 837 (citing J. E. D. Assocs., Inc. v. Town of Atkinson, 432 A.2d 12, 14 (N.H. 1981).

\(^{14}\) MILTON FRIEDMAN & ROSE FRIEDMAN, FREE TO CHOOSE: A PERSONAL STATEMENT (Harcourt Brace Jovanovich 1980).
offer operates in a very different kind of world from the conventional world of barter where I offer my wallet for his watch.

But let us suppose that I can make just this offer; what would our friend Whitman do in response? Well, he would look at his watch and he would look at his wallet and he would figure out which happens to be worth more at the time and he would hand over the thing which was worth less. But why would I make that offer instead of simply urging a command that required Whitman to give over the wallet? Here is one explanation: if the idea of freedom of choice could distract the judges, then I am doing very well because by giving Whitman a choice between two things, one of which costs him $100 and the other $500, I can now get the former for free.

In fact the situation is in a context more devious than this. Let us suppose that I know the market value of the watch and the wallet, where the former is worth $100 and the latter is worth $500. But suppose I also know that Whitman has a deep attachment to this particular watch so that the distinctive watch, for which no market substitute will do, is worth $600 to its owner for powerful subjective reasons. Now I can make the same offer of choice and still get the $500 in cash that I prefer, so that we are both left, after a fashion, better off because he is allowed to retain his treasured watch. It is just this last condition that holds with the exaction in Nollan. I have already indicated that there is every reason to posit that the landowner would much prefer the new house with the loss of the lateral easement to the status quo. There is also every reason to think that the Coastal Commission attaches a higher value to the lateral easement. So presto, by giving the choice, the Commission gets the property right that it values most while the Nollans get to keep that right that they value most, which is the source of the mutual gain—ignoring the illegitimacy of the initial threat. This is just the logic that dispenses with all the niceties of the situation when I, as a robber, give Whitman the choice between his watch and his wallet. And so we preserve the conceit that these choices set up mutually beneficial exchanges.

At this point the puzzle is solved. Even if the state’s receipt of a lateral easement in exchange for the building permit is mutually beneficial when taken in isolation, it is deeply coercive because the state cannot give the landowner his original choice in a legal universe in which all rights in real property have equal dignity. Once we distribute the initial rights correctly, then the paired choices will be different because the state can never set the lateral easement up against the restrictive covenant. Instead, no matter what choices it offered, it would have to pay for the interest that it ultimately received. If the state gave you the choice between the easement and the covenant, and you chose to surrender the easement, it would have to pay you for that. If you yielded the covenant on new construction, the state would have to pay you for that. The moment that consequence becomes clear the state will no longer choose to offer any landowner the ostensibly option that it extended to Nollan. Let us suppose that the state values the easement more than the cost of it to the owner, but the reverse is true for the covenant. What state would take the risk that the owner who is happy with his current structure would surren-
der the covenant to which the state attaches far less value? No, the moment
the state has to pay both ways then it will revert to the same kind of behavior
with covenants that it now adopts with respect to condemnation. No free
options. Rather, the government will prefer to identify the interests that are
worth more to it than to the private owner and those it condemns. If the state
really wanted the easement, it would just take the easement, and pay for it. If
the state wanted the restriction on building, it would make the restriction.
The illusion of choice only comes in by virtue of the fact that every set of
constitutional property rights turns out to be incomplete given the initial error
in Euclid. It is that incomplete nature of the constitutional rights system that
allows for the differential treatment between easements and covenants.

So the great puzzle for Justice Scalia is the converse of what was previ-
ously stated. Once we have accepted the Euclid framework that strips most
restrictive covenants of their constitutional protection, why doesn’t the logic
of mutual gain through exchange continue as its proponents claim? After all,
what is his reply to the war-cry that runs: “Since the state can really impose
draconian sanctions on land use without giving the land owner any option,
why in the world should Justice Scalia want to restrict further the set of
choices available to the beleaguered owner?” In a system of avowedly in-
complete constitutional property rights, it is exceedingly difficult to come up
with a principled answer to that challenge.

Faced with this question, Justice Scalia gave an ingenious answer that
stressed that the activities in question were a form of out-and-out extortion
because there was no match between the exaction that was demanded and the
peril to be avoided. In his view, the state’s legitimate interest was solely to
protect the “viewing spot” for those who wish to look over the landowner’s
property. Unfortunately, the lateral interest was not related to that objec-
tive; and therefore it could be counted as an impermissible limitation on the
building permit, even though it was less onerous than the restrictive covenant
that the state sought to impose. There is, of course, no private law conception
of germaneness with respect to the terms of a contract, for the entire purpose
of an agreement is to get the parties to decide what they choose to surrender
(from their own assets) and what they hope to receive from the assets of an-
other. The linkage is internal to the exchange and imposed by the party.
There is no external test which establishes the relationship in question. In the
end therefore, Justice Scalia’s ingenious effort to establish some kind of
“germaneness” condition is only a judicial deus ex machina, made necessary
by the decision to relegate restrictive covenants to second-class rights. The
tsimpler solution is that if one wants to have a viewing spot to overlook pri-
ivate lands, then by all means one should buy it, or in the case of the govern-
ment condemn it for compensation.

15. Nollan, 483 U.S. at 836.
VI. **Dolan** and the Relatedness Question

Yet once we start down this road, there is really no turning back for courts now have to address this relatedness question that **Nollan** poses. On that score, there was a moment of comparative lucidity seven years later in **Dolan v. City of Tigard**, where the City had both good and bad reasons to play the exaction game. Untangling its various motivations depends closely on the law of nuisance referred to above. In **Dolan**, the owner of a plumbing and electric supply store requested the right to expand her facility and to pave the parking lot she provided for her customers. Now, business expansion is not an issue to which a small-government classical liberal can take a simple “let the state drop dead” attitude. One key point is that every time a landowner paves over bare ground, it changes the patterns of runoff, which by reducing the absorptive ability of the land carries with it real dangers of flooding, which in turn could lead to the degradation of sensitive environmental areas. One such place is the pure blue waters of Lake Tahoe. So even if runoff is not treated as a tort under the rule of **Rylands v. Fletcher**, no one should be indifferent about the external consequences of the landowner’s private decisions. Similarly, whenever a landowner increases the traffic going in and out of its site, it places an additional burden on the common highways that service the business. These burdens could vary largely, and it would be most unwise to insist on funding a public highway by charging an equal front-footage exaction on landowners when one person has built a 100 story office building while everybody else lives in a single-family home. The use of an equal front footage charge surely results in the small landowners being forced to subsidize their more highly-developed neighbor.

So the question that Chief Justice Rehnquist faced in **Dolan** was what kind of exactions could a government impose to counter this dangerous combination of potential nuisances and excessive use of infrastructure. In a nutshell, his position was that the state could use “rough[ly] proportiona[te]” means to achieve “legitimate” public ends. His instincts are respectable on both parts of this test. Thus with respect to the runoff, the initial question is whether this is the sort of activity that the state could punish after the fact, to which I think that the answer should be yes. If so, then it is surely the kind of activity that could be enjoined before the fact, so we do not face the problem of illegitimate ends that loomed so large in **Nollan**. Turning next to the question of means, the rough proportionality test asks whether the prohibition in question fits the wrong in question, which is the same question that the judges in private lawsuits address when the plaintiff seeks injunctive relief against a nuisance.

---

17. See id. at 378, 382.
Now how do these principles play out in the *Dolan* case? The answer is that the case is one that is afflicted with the common difficulty of joint causation. Although the Court does not address this point, it seems highly likely that water that runs over the Dolan land comes from three sources: the reduced absorption capability of his own land; natural runoff from other places; and runoff that comes from the activities of other landowners who have covered their own properties. The culvert that the City wanted collected water from all three locations, not only the run-off from Dolan’s land. Accordingly, some division of the cost of construction to take into account the multiple origins seems like the right answer, where the term “rough proportionality” means that we cannot demand mathematical precision on an issue which lends itself to approximate answers: so any reasonable estimate of the fraction attributable to each should suffice.

With respect to the increased road traffic, the connection between the source of the harm and the state response is far weaker because it is highly unlikely that the patrons of Dolan’s store count as only a tiny fraction of the people who use the bike path. So here we have the kind of mismatch that was evident in *Nollan*. The right governmental response is to make sure that whatever taxes are placed on other adjacent landowners are used to determine the restrictions placed on Dolan. The one pitfall here is to be sure that Dolan is not given either a greater or lesser obligation by virtue of the time that she expanded her use. The highway is a public resource open to all, and the best way to prevent excessive development is not to privilege those who have developed their property first. So it looks as though the bike path should be acquired by condemnation. But if it turns out that we can compute the legitimate exaction that falls on Dolan, then there is no harm in allowing further trades whereby the City of Tigard could say that ‘we will relieve you of these valid obligations so long as you agree to provide us with some in-kind benefit that we prefer.’ The reason that this does not count as an illicit exaction is that the concern with the traffic increase justified the imposition of proportionate restrictions on the landowner, a feature wholly absent in *Nollan*.

One way we know that Rehnquist was working like a good lawyer is that he sought to replicate in constitutional terms the complex doctrines of special assessments developed under state law. Local communities must always figure out whether to charge the cost of common improvements either to the immediate neighbors or to the community at large. Indeed, all rules he cited were from state courts that had to address just these issues. He re-

20. See *id.* at 388.
21. *Id.* at 389-91 (citing Pioneer Trust & Sav. Bank v. Mount Prospect, 176 N.E.2d 799, 802 (Ill. 1961) (requiring the local government to demonstrate that its exaction is directly proportional to the specifically created need, deemed the “specif[c] and uniquely attributable” test); Billings Properties, Inc. v. Yellowstone County, 394 P.2d 182, 188 (Mont. 1964) (requiring general connection between the required dedication and the proposed development); Collis v. City of Bloomington,
jected at one extreme a test that allows the special assessment to be imposed on some generalized statement of public need. At the other extreme he thought that it was too strict to require that the state show that the exaction was "specific and unique" to the site.\(^\text{22}\) Hence the rough proportionality standard was the midpoint between the two extremes that translates into a form of intermediate scrutiny for various forms of exaction, which is not a bad place to be in light of the difficulties of the program.

VII. THE AFTERMATH OF NOLLAN AND DOLAN

The hard question is whether there is an intermediate standard of review that is sustainable in the long run. On this score, I shall just make a couple of points. The first of these is that the Supreme Court itself seems to have been determined to limit the scope of Nollan and Dolan by taking the position that they do not extend "beyond the special context of exactions—land-use decisions conditioning approval of development on the dedication of property to public use."\(^\text{23}\) The lower courts, both state and federal, have been more than eager to follow this lead, and to construe the scope of Nollan and Dolan as narrowly as possible.

Let me offer in this context just three illustrations of how the subsequent cases have played out. Two of these involve environmental disputes and the last concerns the quintessential problems of urban development.

**Conservation Easements.** Smith v. Town of Mendon involved landowners who wished to build on one portion of their ten acre plot of land that the township had not designated as environmentally sensitive.\(^\text{24}\) The Town was prepared to grant that building permit only if the landowners accepted a conservation easement that operated in perpetuity over portions of their land that were not being developed. The Smiths' land had already been placed into an environmental protection overlay district (EPOD), which meant that they could not develop within that region without first gaining clearance under the arduous local procedures.\(^\text{25}\) As is often the case in environmental regulation, there was no evidence in the record that the local designation of the EPOD was keyed to prevent any kind of nuisance to nearby land, although on some other occasions that might have happened. Instead, its major purpose was to preserve the land in its pristine condition for its own sake, which is one example of how the modern police power purpose of "environmental protection" cuts far more broadly than the traditional common law approach of

\(^{22}\) N.W.2d 19 (Minn. 1976) (requiring a showing of a reasonable relationship between the planned subdivision and the municipality's need for land).

\(^{23}\) Id. at 389-90.


\(^{25}\) 822 N.E.2d 1214, 1215 (N.Y. 2004).

\(^{25}\) Id. at 1215.
“nuisance prevention.” There is no doubt in my mind that this objective counts as a legitimate public use, even if we do not go down the unfortunate road of well-nigh unlimited public use that commended itself to a bare majority of the Supreme Court in *Kelo v. City of New London.*

For the purposes of this case, however, the landowners accepted the validity of the overlay scheme and only protested the decision of the Town of Mendon to condition the grant of the building permit on the acceptance of a conservation easement over the properties that were situated in the overlay district. The conversion of the regulatory apparatus into an explicit easement is not, it should be noted, a mere change in words. Within the regulatory framework, there are still procedures that aggrieved landowners can follow to obtain development rights, subject (needless to say) to fairly onerous conditions which go far beyond those which would be required to meet the normal requirements of nuisance law. But once the conservation easement is put into place, then the State no longer acts as a regulator, but as an owner that can obtain an automatic injunction against any proposed use within the designated area that does not conform with the scope of the easement so created. Under the regulatory scheme, it could only seek citations for violations, and would be subject to any change in the general law which weakened the restrictions imposed.

There is, to be sure, a real question of whether we should treat these conservation easements as possessory, given that they do not allow the state or the public to enter the property at will, as was the case with the lateral easement in *Nollan.* Predictably, the New York court refused “to extend the concept of exaction where there is no dedication of property to public use and the restriction merely places conditions on development.” At this point, the odd logic of exactions plays out. The loss of some development rights (uncertain because of the environmental overlays) is small relative to the gains to the property owner from building on another portion of the land right now. Without the recognition that restrictions on land use should not be prefaced with the word “merely” the entire case tumbles down the wrong direction. There is never a straight-up judgment as to whether the state would find it worth while to acquire that conservation easement if they had to pay for it with cash on the barrelhead. Rather, the New York state court applied the low-level standard of review associated with ordinary regulatory takings cases, and upheld the restrictions in question as “legitimate,” without finding this a particularly interesting or troublesome case.

There was a dissent by Judge Read (of the University of Chicago) which fought the decision on grounds that worked (as she had to) within the framework of the existing case law. As a doctrinal matter she was right to note that

27. *Smith,* 822 N.E.2d at 1216.
28. *Id.* at 1219.
29. *Id.* at 1220-21.
under New York law a conservation easement is classified as an easement, and not as a restrictive covenant. And she also noted that there was a clear lack of an essential connection between the permit that was granted and the restriction that was imposed. Alas, I think that her objections are wrong within the framework of the established law, dreadful as it might be. Even if state law calls the conservation interest a negative easement, in truth it operates as a restrictive covenant because it prevents use by the current owner rather than authorize entry to the public at large. But as a matter of first principle, none of this should matter. What really counts in these circumstances is the conscious separation of the treatment of private property in private law from its treatment in the constitutional setting. There is nothing about the incentive structures that govern public or private behavior that turn on the distinction between the two kinds of easements. The objection to this decision does not arise from some mystical attachment to public property. It relates to the inability to get any principled revelations as to how much weight the state attaches to the interest it claims. And that information is never available if the state can bundle the acquisition of the conservation easement in with the approval of the construction of the new home.

**Bag Limits.** Here is a second case that cuts in the same direction. The common law rules on wild animals allowed each person to be the owner of whatever wild animals he first reduced to possession, especially from his own land. The adoption of this particular rule carries with it a real deficit that state regulation can and should address, namely, the risk of overhunting of fish and game that results in the premature destruction of the stock. It is therefore perfectly appropriate to create some legal regime that limits the amount of the catch today, in order to preserve it for future generations. But the question then arises, when "surplus" wildlife (i.e., animals beyond those necessary to sustain the size of the herd) are available for capture, is there any limitation on their allocation, or may the state just distribute its permits and licenses as it sees fit?

That question came to the fore in *Clajon Production Corp. v. Petera*, where the owners of large ranches received hunting licenses whose quotas did not reflect their share of the game that they could catch in an unregulated environment. In effect, their position was that their superior ability to capture game should be reflected in a larger allotment of permits so that they could be left at least as well off as they were before they lost their right of capture. The situation was made still more complex by the fact that the ranches in question catered to out-of-state individuals, whose interests were necessarily slighted. Since the regulations on their face did not contain an

---

30. *Id.* at 1225 (Read, J., dissenting).
31. *Id.* at 1228.
33. *See* 70 F.3d 1566, 1574, 1576 (10th Cir. 1995).
34. *Id.* at 1571.
explicit distinction between local and out-of-state hunters, the Commerce Clause challenge failed and the case rested on the ability to mount a takings challenge to the restrictions in question. But here, as before, the usual low level of scrutiny for police power regulations meant that the claimants could succeed only if they could bring themselves into the framework of *Nollan* and *Dolan*, which they could not, for the reasons noted earlier: the restrictions on use were not possessory interests that triggered any form of heightened scrutiny. The net effect of that decision is that the allocation of permits is not anchored in any way to the prior use of the various lands, and the state has an increased scope of discretion, which necessarily injects a larger element of politics in its allocation decisions. At this point, the outcome is exactly what one would predict: votes carry greater weight than land, so that the ranchers come out on the short end of the distribution.

**Tenant Relocation.** The last example that I shall offer, *Garneau v. City of Seattle*,\(^\text{35}\) shows that the same analysis of exactions that applies in the country also holds in the city. During its economic boom, the City of Seattle adopted, pursuant to Washington state law, a Tenant Relocation Assistance Ordinance that required developers of new projects to pay $2,000 to help cover the relocation costs of sitting tenants who were evicted from their units. There was, of course, no claim that the tenants were ousted in violation of their property rights. Indeed, as a common law matter, the holdover tenant who does not leave receives virtually no legal protection at all.\(^\text{36}\) Nonetheless, the divergence between private and constitutional law took its toll, and the Court held that the law was a rational response to the larger building boom, and the only question was whether the City could require the landlord to pay for the costs of relocation in the absence of any contractual obligation to do so.

At this point, I think that there is much to be said that no compensation should be coming from either private or public sources. The tenants who had the benefit of short term leases could be asked to provide for their own relocation expenses, just as other tenants do when their leases are not renewed. But for these purposes, I shall not press that point, for the case itself only asked the question of whether the developers were required to make that payment, instead of the public at large. Here the developers conceded that the restrictions in question did not relate to the loss of their possessory interest, which I find somewhat mystifying, since they had to force the tenants out of possession in order to obtain the undivided possession of their land, needed to begin their own demolition project.\(^\text{37}\) But once that concession was made, it was easy enough to hold that the lax standards of review that apply to ordinary regulatory takings case allowed this particular statute to pass muster.

\(^{35}\) See 147 F.3d 802 (9th Cir. 1998).


\(^{37}\) *Garneau*, 147 F.3d at 806-07.
Yet, the real question here is why this burden should be placed on the developers. It seems quite clear that no private person could engage in this type of conduct in order to prevent the development or sale of property. I could not, for example, go to Dale Whitman and announce that he is only entitled to sell his house if he pays $1,000 to me. Nor could I tell him, if he were my landlord, that I would leave at the end of the lease only if he paid me that same sum of money. So why the difference? One argument is that the developer caused the loss in question, by insisting that the tenants vacate. But that form of causation which follows the full exercise of one’s right of exclusive possession and use has never generated any liability under the private law, so why should it generate a huge obligation because the legislature decrees otherwise? The better approach here is not to condition the building permit on the payment of cash to departing tenants, but to make those payments a public expense, at which point it is far less likely that the ordinance would pass at all. As it is, the Seattle rule poses a development tax which will retard the development of the property in question by raising the costs of development. It is again a manifestation of a covert political agenda that hardly lines up with any measure of social welfare. As in other cases, the Takings Clause is so important precisely because it does prevent political efforts to saddle discrete groups with the benefit of so-called public programs.

Well, who is this hurting? It is certainly hurting the developer, but who is the developer? The developer represents its shareholders, its contractors, and the future residents of the projects that are going to be built only at higher prices, if at all. Why these dislocations to other individuals is ignored is left unexplained. We have a situation in which the takings laws allows the state to take into account all the beneficiaries of its plans while the indirect losers are wholly ignored. The irony here should be palatable. The rationale for the ability of the state to ignore ordinary property rights and to impose a full range of exactions is to better serve the public at large. Yet the practice has exactly the opposite effect. It benefits those who have access to the local political process, chiefly because of the power of the vote, but hurts all those individuals who would be left better off if the full system of common law property rights are preserved. And the question here is not purely distributional. There are real net losses from the operation of a constitutional system that makes a hash out of the coherent principles of law that govern transactions over private property among ordinary citizens. The only way that we can solve the exaction problems created by current Supreme Court doctrine is to junk the anemic constitutional definitions of private property tied to possession in favor of the more robust system of property rights, including use and disposition, developed with such care in the private law.