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COMMENTARY

DETERRENCE AND DISTRIBUTION IN THE LAW OF TAKINGS

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Supreme Court decisions over the last three-quarters of a century have turned the words of the Takings Clause into a secret code that only a momentary majority of the Court is able to understand. The Justices faithfully moor their opinions to the particular terms of the Fifth Amendment, but only by stretching the text beyond recognition. A better approach is to consider the purposes of the Takings Clause, efficiency and justice, and go anew from there. Such a method reveals that in some cases there are good reasons to require payment by the government when it regulates property, but not to insist upon compensation to each aggrieved property owner. In other cases, the opposite is true — compensation to individuals makes sense, but payment by the responsible government agency does not. Uncoupling efficiency and justice would invigorate the law of takings.

INTRODUCTION

The law of takings couples together matters that should be treated independently. The conventional view, shared by courts and commentators alike, has been that any takings case can be resolved in one of two ways: either there is a taking and compensation is due, or there is no taking and no compensation is due. These results are fine as long as one holding or the other serves the two central concerns of the Takings Clause — efficiency and justice. But a problem arises when the two purposes behind the law of takings come into conflict, as they readily might. It happens, as we shall see, that in some takings cases there are good reasons to require *payment by* the government, but not *compensation to* the aggrieved property owners. In other cases the opposite is true — compensation to individuals makes sense, but payment by the responsible government agency does not. What is needed, then, is a set of four possible resolutions, instead of the conventional two; the two new resolutions become available when we uncouple efficiency considerations from justice considerations, or, put another way, when we uncouple "taking" on the one hand from "compensation" on the other. The resulting set of four helps smooth

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out some of the many wrinkles for which the law of takings is renowned.[1]

And new wrinkles keep turning up. In *Phillips v. Washington Legal Foundation*,[2] the Supreme Court considered the meaning of the phrase "private property" in the Constitution's injunction "[N]or shall private property be taken for public use, without just compensation."[3] The majority and dissenting opinions in *Phillips* took a range of interpretive approaches to the issue, each seemingly sensible but none fully faithful to the animating concerns of the just compensation requirement. The debate among the Justices ends up shedding little light on the ultimate takings question in the case, which remains to be resolved on remand. As the latest in a string of unsatisfying takings decisions, *Phillips* proves less interesting for the answers it provides than for the questions it provokes, at least in our minds. Despite all their differences, the Court's nine members implicitly agreed on one thing — the possibility of a taking without compensation. This seemingly novel notion has moved us to think anew about the conventional law of takings, and to consider the virtues of an expanded approach. We shall revisit *Phillips* at the end of our ruminations.

I. THE PURPOSES OF THE TAKINGS CLAUSE

Begin with the aims of the Takings Clause. In a vast and otherwise contentious literature, whether judicial opinions or scholarly books and articles, there appears to be virtual consensus that the purposes of just compensation are essentially two. Frank Michelman calls them "utility" and "fairness" in an article that remains, more than thirty years after its publication, the most significant piece of academic commentary on our subject.[4] He could just as well have called them "efficiency" and "justice," and in fact he later does.[5] Efficiency argues

[1] *See, e.g.*, Michael A. Heller, *The Boundaries of Private Property*, 108 YALE L.J. (forthcoming April 1999) (manuscript at 140 n.199, on file with the Harvard Law School Library) (collecting colorful quotations on the daunting messiness of takings law).

[2] 118 S. Ct. 1925 (1998). Throughout this essay, our discussion of *Phillips* draws from a companion piece that considers the case in closer detail than is necessary here. *See generally* Michael A. Heller & James E. Krier, *Making Something Out of Nothing: The Law of Takings and* Phillips v. Washington Legal Foundation, 7 SUP. CT. ECON. REV. (forthcoming 1999).

[3] U.S. CONST. amend. V; *see Phillips*, 118 S. Ct. at 1928. The Fifth Amendment is made applicable to the states through the Fourteenth Amendment. *See* Chicago, Burlington & Quincy R.R. Co. v. Chicago, 166 U.S. 226, 239 (1897).

[4] *See* Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165 (1967).

[5] *See id.* at 1219. It is unsurprising that most commentators think about the Takings Clause in terms of efficiency and justice, because for several decades now judges and scholars have regarded those two values as the criteria by which to evaluate just about any legal outcome. *See, e.g.*, Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1093 (1972) (suggesting that the reasons behind the settling of entitlements in one party or another are "economic efficiency, distributional preferences, and other justice considerations"). Michelman provides an analysis of efficiency and

for allocating resources among alternative uses in ways that maximize value; justice argues for distributing the costs and benefits resulting from particular allocations in ways that satisfy some equitable principle of rightness.

Efficiency, in short, is about the size of the pie, and justice is about who should get what piece. We prefer to think about these two concerns in terms of deterrence and distribution, because doing so lets us clarify some interrelationships that might otherwise be overlooked.

A. Deterrence — General and Specific

Richard Posner identifies one deterrence rationale for the government's obligation to pay compensation. "The simplest economic explanation for the requirement of just compensation," he says, "is that it prevents the government from overusing the taking power."[6] If the government were free to take resources without paying for them, it would not feel incentives, created by the price system, to use those resources efficiently. A likely consequence would be the movement of some resources from higher to lower valued uses. The aim to avoid this tendency we shall call *general* deterrence.[7]

Specific deterrence has a related but nonetheless different purpose: the obligation to pay compensation can constrain governmental inclinations to exploit politically vulnerable groups and individuals.[8] James Kent, in his *Commentaries*, captured the essence of both kinds of deterrence when he referred long ago to the compensation requirement as a "check" on government power.[9]

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justice in the particular context of takings. *See* Michelman, *supra* note 4, at 1181–82 (arguing that collective action must be judged in terms of allocative efficiency and distributive justice); *id.* at 1168 n.4 (arguing that allocation is judged in terms of efficiency and distribution is judged in terms of fairness). Other takings literature reflects a similar analytic posture. *See, e.g.*, WILLIAM A. FISCHEL, REGULATORY TAKINGS: LAW, ECONOMICS, AND POLITICS 216–17 (1995) (arguing that the takings issue "involves fairness as well as efficiency"); Stephen R. Munzer, *Compensation and Government Takings of Private Property*, 33 NOMOS 195, 199–200 (1991) (arguing that the theory of takings rests on a pluralist theory of property comprising principles of efficiency, justice, and desert).

[6] RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 58 (4th ed. 1992); *see also* William A. Fischel & Perry Shapiro, *Takings, Insurance, and Michelman: Comments on Economic Interpretations of "Just Compensation" Law*, 17 J. LEGAL STUD. 269, 269–70 (1988) (arguing that the compensation requirement serves the purpose of "disciplining the power of the state, which would otherwise overexpand unless made to pay for the resources that it consumes").

[7] *Cf.* A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869, 877–78 & nn.13–14 (1998) (discussing other uses of the terms "general" and "specific" deterrence and collecting citations).

[8] *See, e.g.*, Saul Levmore, *Just Compensation and Just Politics*, 22 CONN. L. REV. 285, 306–07 (1990).

[9] *See* 2 JAMES KENT, COMMENTARIES ON AMERICAN LAW 275 (Da Capo Press, 1971) (1827).

B. *Distribution — Specific and General*

The distributional function of just compensation is the one most readily acknowledged by the courts. A familiar statement of the idea appears in Justice Black's opinion in *Armstrong v. United States*:[10] "The Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."[11] As with deterrence, it proves useful to think about distribution in terms of the specific and the general. What we call *specific* distribution is simply the method of compensation that courts use in takings cases now: they determine and distribute the amounts due in terms of each aggrieved claimant *as an individual*.[12]

General distribution, on the other hand, is our own invention, different in method, and to some degree in purpose, from conventional (specific) compensation. As we have already suggested (and will explain more fully below), there are occasions when the Takings Clause, rightly considered, calls for payment of deterrence damages by the government, but not for specific distribution of compensation to claimants as individuals. Especially when a government regulation unduly burdens many parties, high transaction costs may make it infeasible to compensate each affected person through a specific distribution of individually tailored payments. At the same time, fairness might not require a specific distribution either. But it hardly follows that the responsible government agency should not have to pay, because considerations of efficiency might call for payment as a deterrent, a spur to appropriate incentives. When the government is required to pay deterrence damages, but not to make a specific distribution, we call the payment a *general distribution*. For example, the responsible government bureau could be required to pay deterrence damages into a special fund, or even into general revenues.[13] (For our approach to

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[10] 364 U.S. 40 (1960).

[11] *Id.* at 49.

[12] As Justice Souter said in *Phillips*, "[A] court seeks to place a claimant 'in as good a position pecuniarily as if his property had not been taken.'" Phillips v. Washington Legal Found., 118 S. Ct. 1925, 1936 (1998) (Souter, J., dissenting) (quoting United States v. 564.54 Acres Land, 441 U.S. 506, 510 (1979) (quoting Olson v. United States, 292 U.S. 246, 255 (1934))).

[13] Our development and application of uncoupling in the takings context is novel, but the general idea of separating two things ordinarily tied together has appeared before. For example, several states require defendants to pay part of punitive damages awards not to plaintiffs, but to state treasuries or to special funds (where the amounts become available for specific or general distributions). *See, e.g.*, BMW of North America, Inc. v. Gore, 517 U.S. 559, 614–18 (1996) (Ginsburg, J., dissenting) (collecting references to thirteen states that allocate part of punitive damage awards to general revenues or to special funds directed to victim assistance, public medical assistance, civil reparations, the state university system, a school for the deaf and blind, or low-income attorney services, among other uses); *see also* A. Mitchell Polinsky, *Detrebling Versus Decoupling Antitrust Damages: Lessons from the Theory of Enforcement*, 74 GEO. L.J. 1231 (1986) (discussing

work in practice, fiscal boundaries must not be too porous, or else damage payments could flow back to the responsible government bureau and undermine the intended deterrent effect.[14])

C. *Interrelationships of Deterrence and Distribution*

Deterrence and distribution are not always independent of one another. Take the case of general deterrence. If compensation of any kind is denied when justice would insist upon it, the result would not only be unfair but might be inefficient as well. First of all, to relieve the government of any obligation to pay is to forgo an opportunity to test whether the benefits of a government program are truly worth its costs, an important matter when the benefit-cost call is a close one. Second, a program that would be efficient if compensation were paid to burdened parties might be inefficient if compensation is withheld, as a consequence of the demoralization suffered by the uncompensated losers. Demoralization has to figure into the calculation of final costs and benefits, and thus into the question whether a government program enhances or diminishes net welfare. Specific deterrence implicates similar efficiency concerns. If compensation were not required, politicians would be inclined to support government projects that benefit the privileged at the expense of the vulnerable. If the latter lose more than the former gain, then this kind of singling-out promotes inefficiency and injustice alike.

Interrelationships like these have an important bearing on the choice between specific and general distributions, a point best explained by reference to Figure 1 below, which uncouples matters that are conventionally bound together. Conventional wisdom allows for a pairing of no taking/no compensation, the ordinary regulation that appears in Box 1, and for a pairing of taking/compensation, the ordinary taking that appears in Box 4. The familiar view overlooks an additional set of two, the pairing of taking/no compensation that appears in Box 2 and the pairing of no taking/compensation that appears in Box 3.[15]

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the idea of uncoupling the amount of antitrust damages paid by a defendant from the amount of damages paid to the plaintiff).

In some rather unusual instances, we might need variations on the standard method of general distribution, mechanisms that sidestep any actual payment by the government, yet still advance the purposes of the Takings Clause. *Phillips* could be a case in point, and we shall consider it in that connection later. *See infra* pp. 1018–22.

[14] *See* POSNER, *supra* note 6, at 64 (noting how hard budget constraints can discipline public officials).

[15] Long-standing scholarly tradition places theoretical innovations in Box 4, but surely they may appear, as they do here, in other boxes, like our Box 2 and our Box 3. *See* Calabresi & Melamed, *supra* note 5 (discovering Box 4); James E. Krier & Stewart J. Schwab, *Property Rules and Liability Rules: The Cathedral in Another Light*, 70 N.Y.U. L. REV. 440 (1995) (exploring Box 4).

Should there be specific distribution to claimants?	Should there be payment by the government? *No*	Should there be payment by the government? *Yes*
No	*Box 1* Ordinary Regulation	*Box 2* Taking/No Compensation
Yes	*Box 3* No Taking/ Compensation	*Box 4* Ordinary Taking

FIGURE 1: *Uncoupling Deterrence and Distribution, Taking and Compensation*

In Box 1 and Box 4 cases, efficiency and justice concerns can be harmonized by one or the other ordinary route. Box 1 refers to cases where neither efficiency nor justice calls for payment by the government or to any individual; Box 4 has in mind cases where efficiency and justice both call for the opposite.

Our new entries, Box 2 and Box 3, deal with purposes in conflict. When we speak in Box 2 of a taking without compensation, we mean a taking with no specific distribution, as opposed to a general one. A general distribution that forces the government to pay (into some special fund, for example) can advance general or specific deterrence, even though the amount paid is not specifically distributed to claimants. Beyond that, it is plausible to suppose that general distributions can be formulated in such a way as to ease demoralization (an efficiency concern) and promote a sense of fairness or justice, matters we save for further discussion in connection with the *Phillips* case.[16]

The idea behind Box 3 is more straightforward: there are occasions when justice calls for specific distributions to aggrieved parties, even though there is no taking (say because there is no reason to suppose that deterrence is a matter of concern). Notice that we have a source for such payments; among other possibilities, they could be drawn from the amounts paid in by a government agency as general distributions in Box 2 cases.

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[16] *See infra* p. 1022.

Our claim emerges from the foregoing. An expanded conception of the takings picture — a move from two alternative resolutions to four — can help resolve conflicts left unattended by current law. For a first example of the proposition, return to Frank Michelman's great article on takings.

II. A Classic Example of Cross-Purposes

As his title suggests,[17] Michelman examines utility and fairness, efficiency and justice, as they bear on the question of compensation. He develops a utilitarian (efficient) compensation rule and then goes on to consider an alternative rule based on fairness. To make a very long story very short, he defines the efficiency gains (call them E) of a government program as the excess of benefits produced by the program over losses inflicted by it.[18] Government programs that yield net efficiency gains look to be a good thing from a utilitarian standpoint, but Michelman sees that a thorough accounting must go further and consider what he calls "demoralization costs" and "settlement costs." Demoralization costs (D) consist of the sum of the dollar value of disutility that would be suffered if the losers in government programs and their sympathizers were to go uncompensated, plus the present dollar value of lost future production owing, say, to the impaired work incentives of demoralized people.[19] Settlement costs (S) are simply the transaction costs required to make compensation payments to affected individuals sufficient to avoid demoralization costs.[20]

Michelman's model shows that when a government program yields efficiency gains but entails capricious redistributions, it necessarily follows, if the program goes forward, that either demoralization costs or settlement costs will have to be paid. If each of these, considered separately, would exceed efficiency gains, the program should be rejected on utilitarian grounds. In other cases, since one cost or the other has to be paid, the lower of the two should be chosen.

The essence of this conclusion can be captured by using the notations introduced above. Efficiency concerns would suggest a veto of any program where $E < D$ and $E < S$. But if $E > D$ *or* S, then compensation is due when $D > S$, but not when $S > D$.

Notice the unsatisfactory results that can follow. If $S > D$ and a denial of compensation would not be unfair (in other words, distributional concerns do not call for payment by the government to each ag-

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[17] Recall that his title is *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*. *See* Michelman, *supra* note 4.

[18] *See id.* at 1214.

[19] *See id.*

[20] *See id.*

grieved party),[21] then there is no taking, no compensation, and no payment by the government. Suppose, however, that the size of E is sufficiently questionable that we want to test the responsible government agency's resolve by making it dip into its budget to pay for the negative effects of its program. Michelman's approach cannot provide this deterrent, but our approach can. Michelman's problem arises because he follows the conventional path, coupling payment *by* the government with specific distribution *to* the aggrieved parties. In the situation we are discussing, however, specific distribution is by definition out of the question because of high settlement costs. The shortcoming in Michelman's approach is significant, because high S and questionable E commonly go hand-in-hand.

We have no idea where Michelman would end up were he to consider the alternative of a general distribution. In large part, his concern is to find a harmony between utility and fairness in the rules of decision that the courts have developed for takings cases, and to identify circumstances in which the legislative branch might improve on what the courts are able to do. On the question of deterrence, he seems to be ambivalent. As William Fischel observes, Michelman does not say what should follow if the government decides to go ahead with an inefficient program.[22] Fischel, on the other hand, shares our view that compelling compensation in the case of a wasteful program "would, as a practical matter, discourage a budget-conscious government from doing it."[23] But Fischel, like Michelman, has in mind only specific distributions, whereas we want to consider, among other things, the virtues that uncoupling make possible. Once general dis-

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[21] When $S > D$, the question remains whether the absence of compensation is consistent with the demands of justice. Drawing on early work by John Rawls, Michelman concludes that the fairness of a denial of compensation turns largely on the same considerations that enter into a utilitarian calculation. An uncompensated taking is fair in any instance when a claimant "ought to be able to appreciate how such decisions might fit into a consistent practice which holds forth a lesser long-run risk to people like him than would any consistent practice which is naturally suggested by the opposite decision." *Id.* at 1223. As William Fischel has noted, "The conditions in which the landowner bites his lip and agrees that he should be able to see that noncompensation is in the interests of all people like himself turn out to be almost the same as the conditions in which settlement costs exceed demoralization costs . . . ." FISCHEL, *supra* note 5, at 199.

It is unnecessary for us to take any position on whether and when some view of justice and fairness might require compensation notwithstanding that $S > D$. Our aim, rather, is to accommodate conflicting purposes in ways that the conventional approach cannot.

[22] Fischel notes:

> Michelman's analysis does allow that demoralization rises as benefits fall relative to costs, and increasing demoralization is an argument for compensation. But the unstated presumption in that case is that the government will pay if that happens. The government is not deterred by compensation; it is not induced to reevaluate the merits of the project.

FISCHEL, *supra* note 5, at 151.

[23] *Id.* at 146; *see also id.* at 151 (noting that "governments required to pay for regulations can quickly change their minds about the need for regulation").

tributions are introduced, an array of subtle responses becomes available to courts and especially to legislators.[24]

III. THE VIRTUES OF UNCOUPLING

Here we address government regulatory programs that impose small (sometimes trivial) losses on aggrieved property owners. Under the conventional view, analysis of cases arising from such programs would no doubt begin (and quickly end) with Justice Holmes's opinion for the Court in *Pennsylvania Coal Co. v. Mahon*.[25] In deciding regulatory takings cases, Holmes said, a court has to consider, among other things, "the extent of the diminution" in value caused by the government program in question.[26] "When it reaches a certain magnitude, in most if not in all cases there must be an exercise of eminent domain and compensation to sustain the act."[27] Of interest to us is the implicit corollary to what Holmes said: in most cases in which losses are small, there is no taking and no compensation is due. Indeed, as the Court made clear a few years later in *Village of Euclid v. Ambler Realty Co.*,[28] even very substantial harms to property value can be insufficient to trigger the just compensation requirement.[29]

Holmes's statement in *Pennsylvania Coal* is unhelpfully abstract in any number of ways. For example, "diminution in value" of what? And what is the threshold of "a certain magnitude"? These are familiar criticisms, but we have a new one to add. A blanket excuse for small losses overlooks the difference between government programs that impose small losses on a large number of people and programs that impose small losses on only a small number of people. The two categories are analytically distinct, as we can see by considering them in light of Box 2 and Box 3 of the matrix we constructed earlier.[30]

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24 While Michelman focuses on specific distribution, he nevertheless does point out, in a little-discussed section of his article, the possibility of "settlement methods too artificial or innovative for judicial adoption." Michelman, *supra* note 4, at 1253–55. He continues: "A court, it seems, must choose between denying all compensation and awarding 'just' compensation.... Here is a situation in which a legislature can impose a useful fairness discipline which eludes the grasp of courts." *Id.*

25 260 U.S. 393 (1922).

26 *Id.* at 413.

27 *Id.*

28 272 U.S. 365 (1926).

29 *See id.* at 397 (finding no taking despite the plaintiff's allegation of a 75% reduction in property value). *But cf.* Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1027–31 (1992) (holding regulations that wipe out the value of real property to be takings per se unless the regulated uses amount to common law nuisances).

30 *See supra* p. 1002 fig.1. We will restrain ourselves from introducing yet another matrix at this point, but we should mention two other logically obvious possibilities. Where a regulation imposes large losses that are concentrated on a few people, both specific deterrence and fairness concerns point us toward a Box 4 ordinary taking. The analysis is more complicated when regulations impose large losses on a large number of people. Efficiency is obviously an issue because there are large total costs, and justice is obviously an issue because there are large individual

A. Box 2: Taking/No Compensation

1. *Taking, but No Specific Distribution.* — Imagine first a government program that has small negative effects on a very large number of property owners. The large number of affected parties means that efficiency gains might be questionable and that settlement costs would be high *if specific distribution were the remedy*. Specific distribution makes for high S because the compensation process involves so many transactions with so many parties. In contrast, general distribution requires only an estimation of average losses and does not entail the expense of claimant-by-claimant payments, so it is a much cheaper process. It is economical in another sense: compelling the responsible government agency to confront the burdens created by its program makes it feel the pressure of general or specific deterrence, and thus promotes efficiency. As long as the general distribution would be regarded as fair by fair-minded people, the method neatly sidesteps the sacrifices implicit in Michelman's approach to cases where $S > D$.[31]

Notice how the size of per capita losses is relevant to the fairness issue and also to the matter of deterrence. As individual losses become smaller, the argument for the fairness of a general distribution becomes greater, because each losing party is burdened only a little. In contrast, as individual losses diminish, the argument for deterrence becomes weaker, at least prima facie, because total costs are going down and thus are more likely to be outweighed by total benefits. In consequence, ultimate judgments about the need for general deterrence will turn on estimations of the number of parties adversely affected, the absolute size of the costs and benefits generated by the program in question, the degree to which the program is accompanied by implicit compensation (or a general distribution) to the burdened property owners (Holmes's "average reciprocity of advantage"[32]), and so forth. At least some of these inquiries are familiar ones in conventional analysis.

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losses. At the same time, high settlement costs are likely to rule out specific distributions. The next section suggests some of the factors that should inform our thinking about such cases. In any event, the cases are unlikely to arise as a practical matter, because ordinary political processes should tend to weed out programs that create a lot of misery for a lot of people.

[31] If burdened parties do not receive specific distributions, who will litigate to ensure appropriate levels of Box 2 deterrence payments by the government? At present, public interest law groups seem willing to bring suit in some cases of the type we have in mind, even when specific distributions are very improbable (*Phillips* is an example). Moreover, the opportunity to compel a general distribution should work as an incentive, often a sufficient one, for aggrieved parties to sue. Beyond that, judicial awards of contingency fees based on the size of (and paid from) the general distribution could provide powerful incentives to litigate, especially by way of class actions. Measures like the foregoing are unlikely to induce much litigation in cases involving losses that are small per capita and in the aggregate, but those are precisely the cases not worth judicial time and effort in any event.

[32] *Pennsylvania Coal*, 260 U.S. at 415 (considering regulations on property use that benefit property owners at the same time).

It is a nice question whether the Supreme Court would accept general distributions as the "just compensation" required by the Takings Clause. The chief cause for worry is the Court's decision in *Hodel v. Irving*,[33] invalidating the Indian Land Consolidation Act of 1983.[34] A century ago, Congress began allotting Indian reservation lands to individual Indians, with the constraint that the owners could not sell or partition the holdings. As the land passed down via intestacy or devise, ownership was fractionated among so many heirs and devisees that much of the land became unmanageable. The 1983 legislation aimed to solve this problem by providing that low-value allotment interests would escheat to the tribe, eventually consolidating the land for tribal use. The Court noted that the legislation had little impact on the expectations of the individual owners and produced benefits for the tribes (of which the allotment owners were members) that were "greater than the sum of the burdens imposed[,] since consolidated lands are more productive than fractionated lands."[35] It nevertheless held that the Act worked an unconstitutional taking of "the right to pass on property."[36]

We do not know whether today's Court would let formalism trump reason in this fashion. In our view, the Consolidation Act itself provided an acceptable method of general distribution. The government gained nothing from the measure, and, as the Court itself acknowledged, the Indians ended up with more than they had before.

2. Taking, but No Distribution at All. — It should be clear from all we have said thus far that in virtually any case involving a government program that imposes small losses on a small number of people, a court should regard the action as a Box 1 ordinary regulation. After all, in such cases concerns with justice and efficiency are both attenuated, so there is no need for any deterrence or any distribution. Yet the courts treat a significant category of these cases as Box 4 ordinary takings, thanks to the conventional per se rule that government programs imposing permanent physical invasions always call for compensation, period.

Loretto v. Teleprompter Manhattan CATV Corp.[37] is a familiar example. The dispute there arose from a New York statute requiring landlords to allow the installation of cable television equipment on their buildings.[38] To be sure, the statute did in a sense take something, a little space that belonged to landlords, but the taking was minuscule in terms of both physical dimension (about a cubic foot per building)

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[33] 481 U.S. 704 (1987); *see also* Heller, *supra* note 1, at 152–54 (analyzing *Hodel*).
[34] 29 U.S.C. §§ 2201–2210 (1994).
[35] *Hodel*, 481 U.S. at 715–16.
[36] *Id.* at 716–17.
[37] 458 U.S. 419 (1982).
[38] *See id.* at 421.

and monetary value (one dollar per building).[39] The de minimis nature of the taking, in the Court's view, mattered not at all. Permanent physical occupations authorized by the government are takings, even though they yield significant public benefits and have "only minimal economic impact" on property owners.[40]

The physical invasion rule is passing strange. It operates innocently (but unnecessarily) in cases that impose substantial economic burdens or affect large numbers of people, cases in which deterrence and distribution concerns already point in the direction of ordinary takings. The trouble is that courts also extend the rule to cases in which both the harm and the number of people affected are minimal, even though neither deterrence nor distribution considerations suggest any need for payment by the government or compensation to the claimants. Because the losses suffered by all the affected property owners are small in the aggregate, there is little reason to worry about efficiency. And since the per capita losses are also small, there is no reason to worry about justice either. Absent evidence that a politically vulnerable group has been singled out and mistreated, there is no occasion for specific or general deterrence, nor for specific or general distribution.

The thrust of our argument can be put another way. Cases like *Pennsylvania Coal* and *Euclid*, taken together, grant ordinary regulatory programs the benefit of an overly broad "de maximis" rule, according to which even very large individual losses might not trigger government liability (without regard to the magnitude of losses in the aggregate). Given that de maximis regulatory intrusions are to be regarded as unobjectionable, common sense suggests that there should be a de minimis rule as well, applicable to *all* cases involving small losses per capita (and in the aggregate).

And, of course, there is such a rule in conventional law, but it is not applied to permanent physical invasions because, it is said, the land-

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[39] The majority argued that one and a half cubic feet were at stake, while the dissent claimed it was only one-eighth of a cubic foot, *see id.* at 443 (Blackmun, J., dissenting), a pretty silly dispute. As for the monetary value, subsequent to the Supreme Court decision the New York courts noted that the victorious landlord had never shown that "just compensation" exceeded the one dollar the statute had specified and the Commission had found to be "reasonable compensation." Loretto v. Group W. Cable, 135 A.D.2d 444, 448 (N.Y. App. Div. 1987) (denying the landlord's claim for attorney's fees as the prevailing party).

[40] *Loretto*, 458 U.S. at 435. Temporary invasions, in contrast, are "subject to a more complex balancing process," *id.* at 435 n.12, though even then an actual physical intrusion is regarded as "an unusually serious" consideration, *id.* at 426. As one can see, the Court attempted, unsuccessfully in our view, to distinguish permanent physical occupations from temporary limitations on the right to exclude, such as the limitations in *PruneYard Shopping Center v. Robins*, 447 U.S. 74, 77–79 (1980), in which shopping mall owners were forced to admit picketers, and *Kaiser Aetna v. United States*, 444 U.S. 164, 166–69 (1979), in which property owners were forced to admit boaters.

owner's right to exclude deserves very special regard.[41] But this special consideration for physical intrusions overlooks the likelihood (or is it the certainty?) that the average landowner, given the choice, would rather suffer the small burden occasioned by a de minimis rule for physical invasions than the substantial burden of the conventional de maximis rule for ordinary regulations. The special importance of the right to exclude could be handled (if it needs to be handled at all) by establishing a diminution-in-value threshold substantially lower than the one now applied in the case of regulations that do not work permanent physical invasions. Notice, though, that this move would not be costless. Applying a lower threshold could replicate the bad incentives that the conventional law creates now: other things being equal, it is likely that government agencies prefer nonencroaching regulatory programs that impose substantial (but noncompensable) social harms, as opposed to more efficient alternatives that involve relatively minor physical encroachments (the costs of which the agencies have to bear).[42]

B. Box 3: No Taking/Compensation

Turn to cases in which justice calls for compensation even though efficiency does not. The conventional approach leaves no room for such instances, whereas our approach accommodates them readily.

Hadacheck v. Sebastian,[43] a standard entry on everyone's list of troubling takings decisions, provides a good example. The petitioner there had purchased land because it contained a bed of clay valuable for making high-quality bricks. Used for making bricks, the land was worth $800,000, but when the land was put to the next best use, its value plummeted to $60,000.[44] The tract was outside the city limits and far away from any residences, and for all anyone could have foreseen, that would always be the case. But progress intervened, the city

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[41] According to the Court, impinging on the right to exclude "is perhaps the most serious form of invasion of an owner's property interests." *Loretto*, 458 U.S. at 435. The Court explained: "The power to exclude has traditionally been considered one of the most treasured strands in an owner's bundle of property rights." *Id.*

[42] *See* FISCHEL, *supra* note 5, at 151 (noting that for regulators "regulations are often rational substitutes for the physical acquisition of property"). Fischel's observation about substitution suggests why there should be no compensation in a case like *Loretto*, even if transaction costs might be low because the number of landlords is relatively small. No matter how low transaction costs were in that case, they probably exceeded any demoralization costs occasioned by the absence of compensation. Beyond that, the New York legislation seems to be efficient (the benefits from network externalities exceed the aggregate burdens, which are trivial even if a large number of landlords are involved), and one could hardly suppose that landlords are a politically vulnerable group. Neither fairness nor efficiency calls for any deterrence, and the substitution observation argues against any distribution, which would create a perverse incentive for government agencies to choose less efficient regulatory alternatives.

[43] 239 U.S. 394 (1915).

[44] *See id.* at 405.

grew, and houses came to be built in the vicinity (perhaps they were *brick* houses).[45] The petitioner's operations had become a nuisance, and the city enacted an ordinance that put him out of business.[46] When the measure was challenged as a taking, the Supreme Court upheld it as a valid exercise of the police power.[47] No compensation was due.[48]

Hadacheck stands as a clear example of another per se rule in the law of takings: diminution in property value caused by nuisance-control measures never requires compensation. The rule has held rock-solid ever since *Hadacheck*, at least with respect to common law nuisances.[49] This is fine enough on the efficiency side of the ledger, because there is usually little reason to worry about general deterrence in cases like *Hadacheck*.[50] Nuisances, by definition, reduce the aggregate value of all the land they affect (the land that harbors them and the neighboring land affected by them); the burdens imposed on owners by government regulation of nuisances are outweighed by the benefits to neighbors. Nuisance law itself is best considered as an efficiency-enhancing measure.

Justice is another matter, however; the conventional takings law treatment of nuisances does not necessarily promote fair results. In *Hadacheck*, for instance, the neighbors had come to the nuisance, and their doing so had been unforeseeable by all concerned. Beyond this, the petitioner's activities involved not even the tiniest degree of moral culpability. Why, then, should he have to bear the necessary costs of admittedly worthwhile change? As far as we can tell, no commentator has ever thought the result in *Hadacheck* to be fair. The case is particularly galling because the brickmaker's operations had surely benefited the very community that later put him out of business.

Hadacheck does not stand alone, nor is the relevant category of cases limited to coming to the nuisance situations. In *Miller v. Schoene*,[51] for example, the Court upheld a Virginia regulation that required the uncompensated felling of ornamental red cedar trees infected with red cedar rust, a fungus that has no effect on cedars but can prove fatal to nearby apple trees.[52] "Apple growing," the Court

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45 *See id.*

46 *See id.* at 406–07.

47 *See id.* at 409–10.

48 *See id.* at 414.

49 The Court limited the rule to common law nuisances (at least in cases where the challenged regulation wipes out property value entirely) in *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1029–31 (1992), discussed below at p. 1012.

50 The specific deterrence point is more complex, in part because courts are reluctant to examine the motives behind legislation. Hadacheck asserted that the zoning ordinance put him and another brickyard owner out of business as a favor to competitors, who could then maintain a lucrative monopoly. *See Hadacheck*, 239 U.S. at 407.

51 276 U.S. 272 (1928).

52 *See id.* at 278–89.

noted, "is one of the principal agricultural pursuits in Virginia,"[53] so it was hardly surprising that the state opted to sacrifice the cedars. The choice, while no doubt efficient, was hardly fair — absent compensation (of which, we concede, there was a little: the owners of the cedars had "the privilege of using the trees when felled"[54]).

Just v. Marinette County[55] provides another illustration. There, the Wisconsin Supreme Court held that an ordinance regulating the development of wetlands did not work a taking, notwithstanding that wetlands development had been a standard practice in Marinette County for many years. Once again, the problem with *Just* is not efficiency; the very fact that wetlands were disappearing no doubt increased their value and justified their preservation. But because the Justs had done nothing more or worse than their neighbors before them, arguably they deserved compensation.[56]

Unforeseen circumstances can render inefficient a standard use or practice that once had economy on its side. There is no need to deter regulation in such instances (indeed, it should be encouraged); thus, the responsible government agency should not be compelled to pay damages. The fact remains, however, that the regulatory programs we have in mind often impose losses that should, as a matter of fairness, fall on broader shoulders than those of the unwittingly offending property owners.[57] Our approach provides for just compensation through specific distribution in these cases, yet it avoids the unwanted deterrence that would arise if the regulating agency were stuck with the bill. Box 3 compensation comes not from the agency budget, but rather from general revenues or from a special fund in which the general distributions made in Box 2 cases of taking/no compensation (in the sense of no specific distribution) have been banked.

Could courts require compensation in cases like these as a matter of constitutional law? The answer turns out to be rather complicated.

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[53] *Id.* at 279.

[54] *Id.* at 277. Fischel is of the view that high transaction costs would have made it infeasible to compensate the cedar tree owners in *Miller*. *See* FISCHEL, *supra* note 5, at 153–54. But he is hardly positive, and, reading his account, we are not so sure either. Of course, Fischel overlooks the possibility that a general distribution might have been devised — not for the sake of deterrence, but for the sake of fairness. Although our Box 3 no taking/compensation category calls for compensation by way of specific distribution, *see supra* p. 1002 & fig.1, there is no reason why a general distribution could not be used in appropriate instances instead. The point of our matrix is to expand the resolutions available for takings cases, so we are the last people who wish to be bound by our boxes.

[55] 201 N.W.2d 761 (Wis. 1972).

[56] And they probably would have received it in any number of states. *See generally* Charles C. Marvel, Annotation, *Local Use Zoning of Wetlands or Flood Plain as Taking Without Compensation*, 19 A.L.R.4TH 756 (1983) (noting a division among the states on the question whether wetlands regulation works a taking, and collecting cases).

[57] Recall Justice Black's admonition in *Armstrong* that individual property owners should not be forced to "bear public burdens which, in all fairness and justice, should be borne by the public as a whole." Armstrong v. United States, 364 U.S. 40, 49 (1960).

As the Supreme Court explained in *Lucas v. South Carolina Coastal Council*,[58] there is no property right entitling a landowner to commit or create nuisances, because "the proscribed use interests were not part of his title to begin with."[59] In this sense, then, regulatory measures that control nuisances do not *take property*. But the Court in *Lucas* went out of its way to limit its observation to activities amounting to nuisances at common law.[60] These the government is free to police without regard to any diminution in the value of the regulated land, even a diminution to zero. On the other hand, programs aimed at noisome uses that are not common law nuisances remain subject (we presume) to the standard diminution-in-value test.

The point is this: if it is the common law of nuisance that frames the situation, then it is appropriate to refer to the full body of nuisance principles in determining the entitlements of land-ownership. One such common law principle is the coming to the nuisance defense. Although the defense does not necessarily entitle landowners to commit nuisances unchecked, it has been held to entitle them to compensation for their losses when encroaching neighbors move next to the nuisance and then seek to abate it.[61]

Coming to the nuisance theory provides a basis for courts to award compensation in some nuisance control cases as a matter of constitutional law. But the argument is a tortured one, inapplicable to the majority of cases, in which the noxious uses in question do not amount to nuisances at common law.[62] Perhaps there is some basis for courts to award compensation without a taking simply as a matter of equitable jurisdiction; this seems to be the case in Germany.[63] Most likely,

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[58] 505 U.S. 1003 (1992).

[59] *Id.* at 1027.

[60] *See id.* at 1029–31.

[61] The standard example is *Spur Industries v. Del E. Webb Development Co.*, 494 P.2d 700 (Ariz. 1972), which held that a feedlot was a nuisance but that, as a matter of fairness, others who came to the nuisance should bear the costs of moving the operation or shutting it down, *see id.* at 708.

[62] Hence the coming to the nuisance doctrine might be of no avail in a case like *Miller v. Schoene*, in which the Court said: "We need not weigh with nicety the question whether the infected cedars constitute a nuisance according to the common law; or whether they may be so declared by statute." Miller v. Schoene, 276 U.S. 272, 280 (1928) (citing Hadacheck v. Sebastian, 239 U.S. 394, 411 (1915)).

[63] Gregory Alexander reports to us that the German system already offers a limited version of what we propose:

> In Germany, only the High Constitutional Court (*Bundesverfassungsgericht*) has jurisdiction to determine whether land-use measures are unconstitutional under Article 14, the property clause, of the German Constitution (*Grundgesetz*, or Basic Law). That Court has in several cases determined that a regulation does not violate Article 14 because it comes within the scope of the Article's "social obligation of ownership" (*Sozialbindung*) clause. That does not necessarily end the matter, however, for the Supreme Civil Court (*Bundesgerichtshof*) may subsequently determine that compensation is due as a matter of nonconstitutional law. . . . The first case in which this occurred (no constitutional violation, but compensation is due) is the famous "wet gravel" (*Nassauskiesung*) case.

though, our Box 3 no taking/compensation cases are best handled by appropriate legislative measures. Indeed, the legislature might be the appropriate forum to implement our suggestions generally, for it is not clear that courts have the authority — or, if they do, the administrative capacity — to carry out general distributions.

IV. THE *PHILLIPS* CASE

Now we want to go back to *Phillips v. Washington Legal Foundation*,[64] the case that provoked this essay. For generations, lawyers have pondered the question "What is private property?" The same issue is obviously latent in every takings dispute, yet it is seldom aired in any because the "propertyness" of the asset at stake in the litigation is usually uncontested. In *Phillips* it was not.

Briefly, the story behind *Phillips* is this.[65] Before 1980, the only checking accounts that federally insured banks could provide paid no interest. Lawyers used the accounts anyway for pooling and disbursing certain funds entrusted to them by or for clients, namely any funds too nominal in amount, or held for too short a term, to earn interest net of expenses in a savings account. (Savings accounts were usually used for large amounts held on behalf of individual clients.) Beginning in 1980, the rules were changed to permit federally insured interest-bearing checking accounts for some kinds of deposits; lawyer trust funds could earn interest if charitable organizations received the interest. States moved quickly to capitalize on the new rules by enacting Interest on Lawyer Trust Account (IOLTA) programs. The programs provide that any client funds otherwise incapable of earning interest (that is, nominal and short-term amounts) are to be pooled together in IOLTA accounts. The interest thereby earned by the aggregated funds is then distributed to nonprofit organizations that render legal services to the poor. Every state and the District of Columbia has such a program, and in over half of them attorney participation is mandatory.

The plaintiffs in *Phillips* challenged Texas's mandatory IOLTA program on several constitutional grounds, but the only question that reached the Court, and the only one that shall concern us here, was whether the interest on IOLTA accounts is private property for pur-

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E-mail message from Gregory Alexander, Professor of Law, Cornell University, to James E. Krier (Aug. 14, 1998) (on file with the Harvard Law School Library). On the "wet gravel" case, contrast BVerfGE 58, 300 with BGHZ 91, 20. *See generally* Gregory S. Alexander, *Constitutionalizing Property: Two Experiences, Two Dilemmas, in* PROPERTY AND THE CONSTITUTION: THE PUBLIC DIMENSION OF PRIVATE PROPERTY (Janet McLean ed., forthcoming 1999) (discussing these cases).

64 118 S. Ct. 1925 (1998).

65 *See generally* Heller & Krier, *supra* note 2 (manuscript at 1–4, on file with the Harvard Law School Library) (detailing the facts of *Phillips*).

poses of the Takings Clause.[66] The district court rejected the plaintiffs' claims on summary judgment.[67] Because the funds deposited into IOLTA accounts are only those incapable of earning interest net of costs, the judge reasoned that clients owning the principal lost nothing; indeed, they never really had any property in the interest in the first place. Given that there was no property, there could be no taking.[68] The same logic must have figured in the thinking of the hundreds of state judges who had previously considered the constitutionality of IOLTA programs in the course of adopting them,[69] and it supported decisions by federal courts of appeals in two earlier cases.[70]

A panel of the Court of Appeals for the Fifth Circuit nevertheless disagreed, choosing to apply a different but no less rigorous logic.[71] The principal amounts deposited into IOLTA accounts are obviously the property of the various clients who handed over the money. Under Texas law, the Court observed, the general rule is that "interest follows principal"; therefore, the interest must be the clients' property as well.[72] The Supreme Court, in an opinion by Chief Justice Rehnquist, affirmed, noting that it expressed no view as to whether the Texas IOLTA program worked a taking, or, if it did, whether any compensation was due.[73] Those were separate questions, to be decided on remand.[74] Four justices dissented.[75]

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66 *See Phillips*, 118 S. Ct. at 1928 In the lower courts, the plaintiffs also argued that the Texas IOLTA program deprived them of First Amendment rights of freedom of speech and association by forcing them "to financially support, and thereby associate with, various recipient organizations whose purported objectives [they] find objectionable." Washington Legal Found. v. Texas Equal Access to Justice Found., 373 F. Supp. 1, 9 (W.D. Tex. 1995). The district court ruled against the plaintiffs in part because "at least as far as the client is concerned, such a claim is necessarily predicated upon the Plaintiffs' claim that the funds generated from the IOLTA accounts are, in fact, the property of the client," *id.* at 9, a claim the court also rejected, *see id.* at 10.

67 *See Washington Legal Found.*, 873 F. Supp. at 11.

68 *See id.* at 7.

69 The highest courts of seven states expressly held that the program was not a taking; another thirty-seven state supreme courts, including that of Texas, used their rule-making authority to adopt IOLTA programs, while five states adopted the programs by legislation. *See* Brief of Amici Curiae Alabama Law Foundation, Inc. et al. in Support of Petitioners, *Phillips*, 118 S. Ct. 1925 (No. 96-1578), *available in* 1997 WL 476500, at *7–*8; *see also* ABA Comm. on Ethics and Professional Responsibility, Formal Op. 348 (1982) (endorsing the ethical propriety of IOLTA programs).

70 *See* Washington Legal Found. v. Massachusetts Bar Found., 993 F.2d 962, 976 (1st Cir. 1993) (upholding the Massachusetts IOLTA program against a challenge by the same public interest law foundation that brought *Phillips*); Cone v. State Bar, 819 F.2d 1002, 1006–07 (11th Cir. 1987) (upholding Florida's IOLTA program in a case where the client trust earned six cents per month, an amount insufficient to yield net interest for the client).

71 *See* Washington Legal Found. v Texas Equal Access to Justice Found., 94 F.3d 996, 1004 (5th Cir. 1996).

72 *Id.*

73 *See Phillips*, 118 S. Ct. at 1934.

74 *See id.*

75 *See id.* (Souter, J., dissenting) (joined by Justices Breyer, Stevens, and Ginsburg); *id.* at 1937 (Breyer, J., dissenting) (joined by Justices Souter, Stevens, and Ginsburg).

A. The Court's Approaches

Much of the disagreement among the Justices in *Phillips* turned on a question of interpretive method. How was the Court to determine the meaning of the words "private property" in the Fifth Amendment? The majority, following an approach we call *contextual severance*,[76] considered the meaning of the phrase in isolation from "taken" and "just compensation," the other operative words of the Takings Clause.[77] Then, perhaps realizing that "private property" cannot meaningfully be defined absent context,[78] the Justices let the law of Texas settle the point that IOLTA interest is the property of the owner of the principal.[79]

The majority's approach is hardly indefensible, at least from a legal (as opposed to a literary) point of view. The Constitution is thought to protect rather than create rights; the rights themselves are determined by reference to "existing rules or understandings that stem from an independent source such as state law."[80] This doctrine enabled the Court, like the court of appeals before it, to pass the buck to Texas and

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[76] *See* Heller & Krier, *supra* note 2 (manuscript at 7–9, on file with the Harvard Law School Library) (defining *contextual* severance and comparing the technique to the familiar move of *conceptual* severance). "Conceptual severance" refers to the technique of identifying the relevant property for constitutional analysis by severing particular property interests from other interests that could logically be considered in conjunction with them. *See* Margaret Jane Radin, *The Liberal Conception of Property: Cross Currents in the Jurisprudence of Takings*, 88 COLUM. L. REV. 1667, 1676 (1988) (defining "conceptual severance"); *see also* Frank Michelman, *Takings, 1987*, 88 COLUM. L. REV. 1600, 1601 (1988) (noting that the same phenomenon might also be called "entitlement chopping"). In the case of IOLTA programs, a judge could employ conceptual severance to find that the IOLTA interest is a discrete piece of property that was wholly taken, rather than a part of a larger principal that was reasonably regulated.

[77] The clause mentions "public use" too, but this requirement was not an issue in *Phillips* and is pretty much a throw-away in any event, at least in the federal courts. *See* JESSE DUKEMINIER & JAMES E. KRIER, PROPERTY 1112–16, 1214–15 (4th ed. 1998) (discussing "public use"); *cf.* Jed Rubenfeld, *Usings*, 102 YALE L.J. 1077, 1078–79 (1993) (arguing that the "public use" phrase is the key to understanding takings). Oddly, the remaining words of the Takings Clause, "nor," "shall," "be," "for," and "without," have not generated much analytical action.

[78] Private property is, as Jeremy Bentham said, nothing but "a basis of expectation[,] the expectation of deriving certain advantages from a thing," and that expectation "can only be the work of law." 1 JEREMY BENTHAM, THEORY OF LEGISLATION 137–38 (Boston, Weeks, Jordan & Co. 1840). Hence the problem facing the Court in *Phillips*: if the Court were to say that the interest is private property, then private property it would be; otherwise not. The resulting circularity can be avoided by at least two methods, one adopted by Chief Justice Rehnquist for the majority, the other by Justice Souter in dissent.

[79] The Court held that instances in Texas law in which interest does not follow principal were "insufficient to dispel the presumption of deference given the views of a federal court as to the law of a State within its jurisdiction." *Phillips*, 118 S. Ct. at 1931. That "two of the three judges" on the federal court of appeals panel were Texans, *id.*, apparently outweighed the inclinations of the Texas Supreme Court (the justices of the Texas Supreme Court were petitioners in *Phillips*) on this aspect of Texas law.

[80] Board of Regents of State Colleges v. Roth, 408 U.S. 565, 577 (1972), *quoted in Phillips*, 118 S. Ct. at 1930.

rely on its "interest follows principal" maxim.[81] Never mind that Texas itself had passed the buck earlier on, relying on English common law. And the English judges had not really thought the matter through either, at least not completely, instead satisfying themselves with the notion that interest follows principal "as the shadow [does] the body."[82] Not once did Chief Justice Rehnquist, writing for the majority, pause to consider why anything should rest, at bottom, on such shady reasoning.[83]

Justice Souter and the other dissenters disagreed with the majority's clause-chopping method of contextual severance. They argued that the words "private property" and "taken" and "just compensation" should be considered together, rather than in isolation from each other. Addressing the meaning of "private property" on its own had led the majority to ignore "the most salient fact" in the case: that without IOLTA, clients would never have received net interest in any event, thanks to the federal and state regulatory provisions underlying IOLTA programs.[84] Those provisions were relevant to the taking and compensation issues, and thus to the property issue as well, "because the way we may ultimately resolve the taking and compensation issues bears on the way we ought to resolve the property issue."[85] It could turn out that the Texas program had not taken the interest, or it could turn out that the just compensation for any such taking was zero. The dissent stressed that, in either event, the majority's holding would end up being little more than "an inconsequential abstraction."[86]

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[81] *Phillips*, 118 S. Ct. at 1931.

[82] Beckford v. Tobin, 27 Eng. Rep. 1049, 1051 (Ch. 1749), *quoted in Phillips*, 118 S. Ct. at 1930. In criticizing the majority's way of thinking about the meaning of "private property," Justice Breyer wrote, "The slogan 'interest follows principal' no more answers *that* question than does King Diarmed's legendary slogan, '[T]o every cow her calf.'" *Phillips*, 118 S. Ct. at 1938 (Breyer, J., dissenting) (citation omitted) (alteration in original); *cf.* Felix Cohen, *Dialogue on Private Property*, 9 RUTGERS L. REV. 357, 365–69 (1954) (elaborating on cows, calves, and the nature of private property).

[83] The balance of the majority opinion was devoted to dismissing counterarguments on the property issue made by the petitioners and by the United States as amicus curiae. In response to the argument that the "property" at issue had no value, the Court observed that "property is more than economic value." *Phillips*, 118 S. Ct. at 1933. Even if the value of the interest at stake were zero, then, the property right in that interest might still be deserving of constitutional protection, though how it would be protected is unclear. *See id.* Finally, the Court countered arguments that the government created the value of the interest by noting that it was the lawyers who pooled the funds. *See id.*

[84] *Id.* at 1934 (Souter, J., dissenting).

[85] *Id.* at 1935.

[86] *Id.* Accordingly, for Justice Souter, the best method would have been "to consider what is property only in connection with what is a compensable taking," *id.*, and since the court of appeals had done otherwise, the case should have been sent back to it for application of the correct approach, *see id.* at 1937. In the other dissenting opinion, Justice Breyer expressed agreement with Justice Souter's views but went on to say that even if one accepted, for the sake of argument, the majority's method of analyzing the property question, the majority had its substantive conclu-

The ultimate result in *Phillips* is unlikely to turn on the interpretive tussle between majority and dissenting Justices. After all, nothing in the majority's approach — analyzing each issue in isolation, seriatim — dictates that a taking will be found, or, if one is, that compensation will be awarded, just as nothing in the method of the dissenters — analyzing the issues as an integrated whole — necessarily forecloses such results. Notice also that one cannot even say which approach generally economizes on the time and expense of litigation.[87]

Whose views on contextual severance should be preferred? We do not know, and indeed, do not much care. The dispute is incapable of principled resolution and largely irrelevant in any event to the economic and ethical concerns that animate the Takings Clause. The majority and dissenters alike tried to pack too much into the phrase "private property"; they wanted the term to do more work than it can handle. Our view is that the debate among the Justices in *Phillips* probably amounts to little more than quibbling.

Yet method matters nonetheless, in a context larger than that framed by the Justices in *Phillips*. Both the majority and dissenters quite clearly acknowledged that while the Texas IOLTA program might have "taken" something that was "private property," it did not follow that "just compensation" was necessarily due. Though they disagreed about other matters, all nine Justices seemed to recognize a possible pairing of taking/no compensation. On the surface, their result looks like one of our unconventional alternatives, but we are confident that the Justices had something other than our Box 2 in mind. What the Justices must have been thinking is that IOLTA programs might work a taking calling for *conventional* compensation, but that, given the unusual nature of IOLTA programs, the *measure* of that compensation could well be zero.[88]

Recall that, in our terms, the taking/no compensation pairing in Box 2 of our matrix means a taking that does not call for a *specific* distribution. We would usually provide for deterrence by way of a *general* distribution in Box 2 cases, because in those cases, although fairness does not require individualized compensation, efficiency con-

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sions wrong. *See id.* at 1937–39 (Breyer, J., dissenting). Justice Souter agreed. *See id.* at 1937 (Souter, J., dissenting).

[87] Justice Souter was concerned to "avoid spending time on what may turn out to be an entirely theoretical matter," *id.* at 1935, but he failed to realize that the majority's approach actually saves time in any instance where it leads to a conclusion that no "private property" interest is at stake, just the result Justice Breyer would have reached in employing the majority's method, *see id.* at 1939 (Breyer, J., dissenting).

[88] The Takings Clause, after all, "measure[s] any required compensation by the claimant's loss," as Justice Souter reminded the Court in his dissenting opinion. *Id.* at 1936 (Souter, J., dissenting). Justice Breyer made a similar observation, noting that in takings cases the government is required to pay the current value of the property taken, not the added value that might result from what the government subsequently does with the property. *See id.* at 1939 (Breyer, J., dissenting).

siderations still call for the cost-internalization that a requirement of payment by the government can provide. The Justices in *Phillips* could not have been contemplating our idea of a general distribution in talking about taking/no compensation, because at the time of the case our idea did not yet exist. This hardly means, however, that *we* cannot think about how *Phillips* might be resolved in light of our model.

B. Phillips *in Our Model*

Phillips is a member of a class of cases concerned with government regulatory programs that impose trivial burdens per capita but, because a large number of people are affected, may involve substantial sums in the aggregate.[89] Our general reaction to such cases runs like this: the small burden per individual could support a conclusion that no specific distribution is required on fairness grounds or to ease any "demoralization" among risk-averse property owners. Moreover, given the large number of people affected, concerns about high settlement costs suggest that if any distribution at all is to be considered, it should be a general distribution. If deterrence concerns arise because of the large aggregate sums at stake, they could be addressed by making the responsible government bureau pay, as a general deterrent; the obligation to pay may also be a welcome specific deterrent in instances giving rise to suspicions that politically vulnerable groups are being exploited.

But *Phillips* calls for more particular analysis, in part because it involves a situation where the government program itself creates value by pooling property fragments, and in part because the value created arguably comes at no expense to property owners, meaning, among other things, that there is no case for general deterrence.

Pooling programs are common, but their analysis has been neglected, especially in connection with takings.[90] In this regard, notice that both specific and general distribution seem to be impossible in IOLTA cases, because there is nothing to distribute. The claimants

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[89] *See supra* note 30.

[90] Pooling cases arise when the government attempts to overcome a tragedy of the commons or of the anticommons by bundling fragmented property interests:

> In a commons, by definition, multiple owners are each endowed with the [right] to use a given resource, and no one has the right to exclude another. When too many owners have such [rights] of use, the resource is prone to overuse — a *tragedy of the commons*. . . . In an anticommons, . . . multiple owners are each endowed with the right to exclude others from a scarce resource, and no one has an effective [right] of use. When there are too many owners holding rights of exclusion, the resource is prone to underuse — a *tragedy of the anticommons*.

Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621, 623–24 (1998); *see also* Michael A. Heller & Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research*, 280 SCIENCE 698, 700 (1998) (arguing that patent policy may create too many fragmented rights and may require later government intervention to facilitate pooling).

suffered no loss by the conventional measure, and using an alternative measure — one that made the government pay back the interest earned by the pooled accounts — would amount to wiping out IOLTA programs altogether. *Phillips*, then, is a pooling case, but of an unusual sort, and unusual cases might call for measures that rely on some mechanism other than payment of money by and to the parties in the lawsuit. To put ourselves in a position to think about such measures, we first have to consider how pooling creates value generally, and how it does so in IOLTA programs in particular.

Property interests with little realizable value when owned individually often gain value when pooled, due to economies of scale. Pooling generates value whenever the addition of one more individual's assets marginally increases the gains from, or decreases the costs of, exploiting all the group's assets in the aggregate. IOLTA programs rely less on increasing gains than on decreasing costs. True, there might be increasing gains if banks pay slightly higher rates of interest as account balances go up: for example, a bank might pay 5.2% on a single pooled account of $2000 (for an annual yield of $104), but only 5% on ten individual accounts of $200 each (for a total annual yield of $100). But increasing gains of this sort are a minor factor in IOLTA programs, because accounts are pooled only within each lawyer's office, rather than on some wider basis, such as across the state. Each additional client dollar earns about what it could have before, so the marginal benefit curve is nearly flat and the cumulative interest increases at an approximately linear rate with each new client.

Decreasing costs, on the other hand, are a very salient feature of IOLTA programs, which realize substantial economies of scale in generating and distributing interest. (Recall that the programs apply only to funds incapable of earning net interest for individual clients.) By pooling client funds, lawyers avoid the trouble of opening, tracking, and closing separate accounts for each individual or corporation. Economies in the distribution of interest are even more significant. Payment is made to a single agency rather than to multiple clients, no tax identification numbers are needed, and accounting expenses (for tax and other purposes) are dramatically reduced.[91]

So the Court in *Phillips* was wrong when it said that the Texas IOLTA program "does nothing to create value."[92] To extend the example we introduced above, suppose it would cost a lawyer $20 to generate and distribute $10 in interest earned in a single client's ac-

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[91] *See* Brief of Amici Curiae Alabama Law Foundation, Inc. et al. in Support of Petitioners, *Phillips*, 118 S. Ct. 1925 (No. 96-1578), *available in* 1997 WL 476500, at *5–*6 (detailing the cost savings from pooling in the generation and distribution of interest earned on client funds) (citing ABA Task Force and Advisory Board on Interest on Lawyer Trust Accounts, Report to the Board of Governors 22–24 (July 26, 1982)).

[92] *Phillips*, 118 S. Ct. at 1933.

count. If instead ten accounts were pooled and earned $104, the costs of generating and distributing that amount would probably be much *less* than $104 if the whole sum were paid to a single agency, but well *over* $104 if the interest were distributed pro rata to each client.[93]

In deciding whether IOLTA interest was property, the majority in *Phillips* focused on the gross interest corresponding to a single client's principal. In contrast, the dissenters argued that if any interest-related number were relevant, it would be the net interest available for distribution in the unpooled case, by definition a negative amount. Neither approach addresses the novel takings issues that pooling raises; the most salient numbers are those more or less ignored in *Phillips*.

One of these is the net interest that a marginal client could deny to a mandatory IOLTA program if the client were allowed an "opt-out" option, say by directing that her principal not go into her lawyer's IOLTA account.[94] Justice Breyer probably had this in mind when he said that the "most that Texas law here could have taken from the client is . . . the client's right to keep the client's principal sterile, a right to prevent the principal from being put to productive use by others."[95] Notice, though, that Justice Breyer's observation is not quite correct. A marginal client's choice to opt out of an IOLTA program would not render the client's principal "sterile"; the money would remain productive, but the resulting interest would be enjoyed by depository banks. Essentially, IOLTA programs redistribute wealth from organizations that provide banking services for depositors to organizations that provide legal services for the poor.

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[93] Note that states can generate scale efficiencies more easily than can individual clients, but the cumulative net interest is not necessarily an overall efficiency gain for society. Just as IOLTA programs shifted $100 million in interest to states, so could the states have collected the same amount using targeted taxes on banks, lawyers, clients, or other consumers of the public goods that the legal system provides its users. Depending on the costs of these alternative methods of collecting and redistributing funds for legal services, IOLTA programs may or may not be socially efficient. This feature of IOLTA makes *Phillips* the odd pooling case; normally, pooling will result in efficiency gains.

Regulatory schemes that exploit scale economies will usually impose monetary harm on a number of people; each individual's burden shifts the marginal cost curve upward but does not affect its shape. The more each individual is harmed, the larger the pool necessary before cumulative benefits exceed total costs; at the extreme, per capita harms can be so high that the program in question will be inefficient no matter how large the pool of contributors becomes. At the same time, though, some regulatory programs may yield marginal benefits that increase at a faster rate than they do in, say, IOLTA programs. For example, the value of government provision of some goods may benefit from network effects, in which "the utility that a user derives from consumption of [the] good increases with the number of other agents consuming the good." Michael L. Katz & Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 AM. ECON. REV. 424, 424 (1985) (defining "network effects").

[94] This discussion pertains to mandatory IOLTA programs only. If lawyers can opt out, as many states now allow, then clients could indirectly opt out by choosing a nonparticipating lawyer. Voluntary and opt-out programs involve giving, not taking; with respect to them, just compensation is irrelevant.

[95] *Phillips*, 118 S. Ct. at 1938 (Breyer, J., dissenting).

The other salient number ignored by the majority in *Phillips* is the cumulative net interest that IOLTA programs earn from pooling, a sum by definition not capable of specific distribution (because such a distribution would make IOLTA pointless). While the majority deferred discussing it,[96] Justices Souter and Breyer happily noted that conventional just compensation doctrine would assign this new value to the government, because it was generated by the government program at issue.[97] Our approach opens up new possibilities for distributing the cumulative gains from pooling in ways that would better serve the purposes of the Takings Clause. For example, certain forms of general distribution could give clients just what mandatory IOLTA programs take away: the right to determine the uses to which the earnings from principal are put, or what we call "client-voice." Whereas conventional takings law focuses on unpooled gross and net interest, an approach based on deterrence and distribution rightly shifts attention to opt-out and client-voice alternatives.

D. Deterrence and Distribution in Phillips

A better approach to *Phillips* is to identify the deterrence and distribution issues at stake and to uncouple them in a way that makes matters more tractable. In this respect, however, the case is far from transparent to us. The path taken by all the Justices resulted in, among other things, a conventional factual record that is inadequate for our unconventional purposes. On the deterrence side, we need to know if IOLTA programs are likely to be so inefficient or oppressive as to require some sort of check on the government; with respect to distribution, we need more nuanced information about the plaintiffs' fairness claims and options for redressing them. In the absence of a more developed record, we can only offer some initial speculations.

Pooling programs can raise questions about inefficiency and general deterrence, but the particular kind of pooling involved in IOLTA programs seems untroubling. All IOLTA programs generate value, yet even the mandatory ones inflict no actual monetary harm on any individual. The degree of harm is clear, and clearly trivial, per capita and in the aggregate, making general deterrence a nonissue. So too for specific deterrence. Clients who deposit money in lawyers' trust fund accounts do not strike us as politically vulnerable. Though IOLTA programs may not be the least costly way to fund legal services for the

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[96] *See Phillips*, 118 S. Ct. at 1934 (deferring discussion of the taking and just compensation issues).

[97] Justice Souter explained that courts would "measure any required compensation by the claimant's loss, not by the government's (or the public's) gain." *Id.* at 1936 (Souter, J., dissenting). And, drawing an analogy to land valuation cases, Justice Breyer noted that "the government must pay the current value of condemned land, not the added value that a highway it builds on the property itself creates." *Id.* at 1939 (Breyer, J., dissenting).

poor, they are not egregiously inefficient and do not seem likely to have costly collateral consequences; for example, clients are unlikely to respond by underusing the legal system.

Fairness concerns are more troubling in *Phillips*, partly because conventional just compensation doctrine responds so poorly to the expressive and liberty interests at stake in the case.[98] In IOLTA programs, monetary losses are not the crux. Denial of client-voice is. In this light, the majority's position in the case seems more than a little odd. The Chief Justice's opinion separated interest from the principal to which it owed. The interest was a real thing that might quite literally have been taken (the takings issue, recall, was remanded); IOLTA's redistribution of the productive capacity of the principal, on the other hand, was regarded as "at most" a regulation of the "use of the property,"[99] the plain implication being that it would pass constitutional muster.[100] Yet the interest so captivating to the majority is worth absolutely nothing, zero, to clients depositing principal. At the same time, the denial of aggrieved IOLTA conscripts' ability to control the way in which their principal is used seems to have concerned the Court not at all. In short, the majority focused on a trivial injury, but ignored a substantial insult.

If considerations of justice were thought to require it, a court (assuming it has the authority) could instruct the responsible government agency to make a general distribution that gives clients a voice in the use of IOLTA funds (say by voting whether to support legal services for the richer instead of the poorer), or could allow clients or their lawyers to opt out of (or not opt into) the program.[101] But IOLTA programs do not seem to be a more oppressive means of raising funds than a straight tax on clients or other consumers of legal services would be, so such a move strikes us as unnecessary. We see the arguments for calling *Phillips* a Box 2 case, but we conclude, tentatively, that it ends up fitting best in Box 1. Mandatory IOLTA programs should probably be viewed as ordinary regulations.

V. Demolishing and Rebuilding the Takings Clause: Some Concluding Remarks

Presumably, more than a few of our readers will accuse us of demolishing the Takings Clause and building something else in its place. We (and many accessories before the fact) are guilty of the second

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98 *See supra* note 66 (noting the plaintiffs' First Amendment concerns).

99 *Phillips*, 118 S. Ct. at 1930 (quoting Yee v. Escondido, 503 U.S. 519, 522 (1992)).

100 *See id.*

101 Though the tax treatment of client-voice and opt-out options would differ, takings analysis should not be tied to such concerns. With a client-voice system, the Internal Revenue Service would probably impute IOLTA interest to clients as income; with an opt-out system, there would be no imputed income. *See id.* at 1933 (citing the relevant IRS interpretations).

charge, but not the first. The Supreme Court started the process of demolition seventy-five years ago. Before then, takings law was pretty simple and solid, if not particularly satisfying. When the government took title to property or actually occupied it, then just compensation was due; otherwise it was not. Matters started to get complicated in 1922, when the Court decided *Pennsylvania Coal.*[102] Suddenly, even the burdens worked by regulatory measures might amount to takings, unless the measures were intended to control nuisances. Developments since have only added to the muddle, but we shall refrain from a blow-by-blow description because even an abbreviated account would bore aficionados, and only a lengthy one would satisfy anybody else. Let an annotated inventory suffice. Supreme Court decisions over the last three-quarters of a century have obscured and bifurcated the nuisance exception to regulatory takings;[103] have waffled on the question of conceptual severance;[104] have distinguished inconsistently between permanent and temporary takings;[105] have suggested that what is not just compensation actually is just compensation, if only regulators are crafty;[106] have made little of large losses,[107] unless they are entire,[108] and much of small ones,[109] even when they are zero;[110] have become confused about what "private property" is for purposes of the Takings Clause;[111] have, in short, turned the words of the Takings Clause into

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[102] *See* Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922).

[103] *See, e.g.*, Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1022–28 (1992) (limiting the nuisance exception to common law nuisances); Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 491–93 (1987) (viewing as "tantamount to public nuisances" the very uses that were not regarded as nuisances in *Pennsylvania Coal*); Penn Central Transp. Co. v. New York City, 438 U.S. 104, 133 n.30 (1978) (questioning the distinctive character of the nuisance exception).

[104] *See, e.g.*, DUKEMINIER & KRIER, *supra* note 77, at 1157, 1165, 1177, 1208 (noting the Court's inconsistent application of conceptual severance).

[105] *See, e.g.*, First English Evangelical Lutheran Church v. County of Los Angeles, 482 U.S. 304, 318 (1987) (conflating temporary and permanent physical invasions); Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 428 (1982) (distinguishing between permanent and temporary physical invasions).

[106] *See, e.g.*, *Penn Central*, 438 U.S. at 137 (implying that transferable development rights cannot be, but on the other hand may be, just compensation); DUKEMINIER & KRIER, *supra* note 77, at 1167 (discussing the paradox in the Court's approach).

[107] *See, e.g.*, Village of Euclid v. Ambler Realty Co., 272 U.S. 365, 384, 397 (1926) (holding that a 75% diminution in the value of property is acceptable).

[108] *See, e.g.*, *Lucas*, 505 U.S. at 1019 n.8 (distinguishing between total deprivation of value and deprivations only slightly less than total).

[109] *See, e.g.*, *Loretto*, 458 U.S. at 434–35 (holding that permanent physical invasions are takings even when they have "only minimal economic impact on the owner").

[110] *See, e.g.*, *Phillips*, 118 S. Ct. at 1933 (observing that a taking may be found even when the property in question has no "positive economic or market value," and applying the observation to a zero amount of interest).

[111] *See, e.g.*, Eastern Enters. v. Apfel, 118 S. Ct. 2131, 2155 (1998) (Kennedy, J., concurring in the judgment and dissenting in part) (criticizing the Court's extension of takings doctrine to a situation involving no "specific property right or interest"); Hodel v. Irving, 481 U.S. 704, 716–17 (1987) (suggesting that the right to exclude and the right to devise are "essential sticks in the bun-

a cryptogram that only the Justices in a given case are able to decipher (and seldom do all of them agree).

So demolition has been the Court's doing, and the mess is hardly surprising: changing times, values, politics, and personalities result in new and different views among the members of the Court, yet our constitutional tradition requires that the Justices always moor their opinions to particular words. The tie has held, but only because the words have been stretched beyond recognition. To make sense of the Takings Clause, it is time to look behind its text to its purposes, and go anew from there. One such purpose is obviously fairness, but another is necessarily efficiency, thanks to *Pennsylvania Coal*. Whatever the Court's decision in that case left obscure, it made clear that regulations are often a substitute for eminent domain. There is abundant agreement that the power of eminent domain is justified and constrained for reasons having to do, in part, with efficient use of society's resources. It would be strange to suppose that the same is not true of regulatory substitutes.

A problem with this observation is that it calls up the ghost of substantive due process. If the courts are to review regulatory measures with efficiency in mind and the means for deterrence in hand, then arguably this is little different from empowering them to second-guess the legislature generally. But the Court does that now, at least in the context of takings. In its first exaction case, the *Nollan* majority established a practice of reviewing land-use regulations with unusually close attention to the connection between ends and means.[112] Then, in its subsequent decision in *Dolan*, the Court insisted upon rough proportionality between the thing exacted and the development permitted in exchange.[113] Dissenting in the latter case, Justice Stevens remarked on the majority's "application of what is essentially the doctrine of substantive due process."[114]

Seemingly, the Fifth Amendment's limitation to measures taking "private property" would constrain the judiciary's freedom to strike down regulatory programs, but that constraint has just recently been loosened considerably. In its decision last year in *Eastern Enterprises v. Apfel*,[115] the Court considered the constitutionality of legislation holding certain employers retroactively liable for employee retirement

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dle of rights that are commonly called property," whereas the right to sell is perhaps not); Heller, *supra* note 1 at 103–04, 139–40 (discussing conflicts in the Court's definition of private property).

112 *See* Nollan v. California Coastal Comm'n, 483 U.S. 825, 841 (1987) (closely scrutinizing the relationship between a regulatory measure and the ends it claims to advance).

113 *See* Dolan v. City of Tigard, 512 U.S. 374, 391 (1994) (announcing a "rough proportionality" test).

114 *Id.* at 410 (Stevens, J., dissenting).

115 118 S. Ct. 2131 (1998).

benefits.[116] The plurality invalidated the measure as a taking, even though it concerned no standard property interest.[117] The move prompted Justice Kennedy to caution that the Court must be "careful not to lose sight of the importance of identifying the property allegedly taken, lest all governmental action be subjected to examination under the constitutional prohibition against taking without just compensation, with the attendant potential for money damages."[118]

The question of appropriate limitations on the scope of judicial review is not our problem. Whatever the boundaries of the Takings Clause, we think there is much to be gained by analyzing takings in terms of the clause's underlying purposes, and by understanding that efficiency and justice are best served by uncoupling matters and methods of deterrence from matters and methods of distribution. Thus might we develop a body of law as supple as the challenges it confronts.

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116 *See* Coal Industry Retiree Health Benefit Act of 1992, 26 U.S.C. §§ 9701–9722 (1994 & Supp. II 1997).

117 *See Eastern Enters.*, 118 S. Ct. at 2146–53.

118 *Id.* at 2156 (Kennedy, J., concurring in the judgment and dissenting in part).