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Article

Positive and Negative Externalities in Real Estate Development

Richard A. Epstein[†]

INTRODUCTION

Externalities of all sorts and descriptions are a fixed feature of all real estate development in advanced societies, for much of the value of owning and using land derives from the simple fact that everyone has neighbors.¹ But having neighbors is a two-edged sword, as they are welcomed on some occasions and scorned on others. To deal with inevitable appearance of neighbors, legal systems have developed a wide range of land-use control devices that have worked their way into the fabric of modern law.² Thus modern legal systems contain techniques to regulate the use of land, such as private restrictive covenants and easements on the one side and elaborate local zoning codes and regional growth-control regimes on the other. These same legal systems often develop devices from rent control to affordable housing regimes to regulate the price at which real estate can be sold or rented.³

The use of these various devices has long been a source of intellectual disagreement and institutional conflict. What is needed in many cases is a single mode of analysis that tries to

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1. Stephen Malpezzi, *Affordable Housing: Supply Side Innovation?*, RUTGERS CTR. FOR REAL EST.: BLOG•RE (Mar. 8, 2018), <http://rutgersrealestate.com/blog-re/affordable-housing-supply-side-innovation>.

2. See *generally id.* (listing a wide range of land-use control devices that are used in the modern law).

3. *Id.*

figure out which of these systems should be welcomed for the improvements that they generate and which should be condemned for the discord they sow.

In order to achieve that goal, it is necessary to identify which real estate innovations from behind a veil of ignorance generate overall social improvements and which tend to result in redistributive struggles that tend to undermine both political stability and economic growth. In order to achieve that end, it is necessary to take a systematic look at the various devices that are used to identify and control both the negative and positive externalities in real estate markets.

This Article take up that challenge by examining the existence and control of negative and positive externalities in real estate markets from a comparative perspective, with special emphasis on English and American law. These externalities are present everywhere but assume their greatest importance in regions with high population densities,⁴ where high land values make it essential to allow multiple claimants to create overlapping interests in the same parcel of real estate.⁵ But how should these common interests be coordinated? One approach is top down, where centralized state authorities make the allocative decisions. The alternative approach is decentralized. The state simply sets and enforces boundaries between strangers, and then it lets multiple parties decide privately whether to pool or to separate their activities. The first approach is marked by noble ambition and backed by claims of dispassionate expertise. Yet the results are usually disappointing. It is much easier for governments to keep people apart than to bring them together. As a rule, voluntary arrangements tend to work better than zoning laws or other compulsory land-use arrangements.

In order to explain and defend this thesis, I shall proceed as follows. Part I examines the various meanings of the term externality as it is used in law and economics. Part II then launches a conceptual attack on the externality problem by examining the idealized conditions in which it cannot exist—namely those in which all persons obtain their full bundle of rights and obligations from a single owner, so that they wholly consent to the full

4. See generally JOHN P. BLAIR, LOCAL ECONOMIC DEVELOPMENT: ANALYSIS AND PRACTICE 30 (1995) (stating the “externality problem increases rapidly as urban density increases”).

5. See, e.g., GOH Yihan, *Tort Law in the Face of Land Scarcity in Singapore*, 26 ARIZ. J. INT’L & COMP. L. 335, 340 (2009) (discussing the effects of high population densities and land value on legal property rights in Singapore).

package of benefits and burdens they receive. In these settings, any controls over both positive and negative externalities follow identical paths, given that the owner has every incentive to maximize total revenues from his project, which necessarily requires the minimization of future negative externalities and allowing, but not requiring, the creation of future positive ones. Part III then explores the differing treatments of positive and negative externalities when neighboring landowners do not acquire property from a single owner. It explains why it is both easier and more critical to control negative externalities than to create positive ones. It also rejects the provocative proposal of Professor Ariel Porat to recognize a private-restitution remedy for unrequested benefits.⁶ Part IV then illustrates the perils of moving from the decentralized private law models generated by the single ownership paradigm to various forms of public intervention in land-use settings, such as zoning laws and affordable-housing mandates. The contrast is clear. The private models do not allow for redistributive objectives to weaken productive decisions. The public models, which operate over a far greater scope, necessarily use coercive power to enforce both land-use regulations and transfer payments. These interventions are far more vulnerable to political influences, especially when their exercise is not hedged in by a requirement to compensate parties who have suffered disproportionate losses of their property rights.

I. EXTERNALITIES, BROAD AND NARROW

In its broadest formulation, an externality covers any impact that one party's activities have on the welfare of another party.⁷ In a normal situation we measure externalities by their effects on other human beings. But often those individuals organize themselves into groups, be they commercial arrangements or social organizations. It is therefore often sensible to short-circuit the analysis of each person's individual position by treating the legal entity as a stand-in for the individual members whose fortunes have been altered by the activities of another person. The relevant impacts can be positive or negative, and

6. See *infra* note 83 and accompanying text.

7. THEORY AND MEASUREMENT OF ECONOMIC EXTERNALITIES 1 (Steven A. Y. Lin ed., 1976) ("Generally, effects on persons not directly privy to the decision leading to an activity are termed *externalities* . . .").

refer not just to real estate transactions, but to all human affairs.⁸ Under that definition, all actions by all persons and firms, however innocuous, necessarily generate both sorts of externalities, often to different people. Taken seriously, this definition implies that private markets will inevitably fail because they cannot, in Professor Harold Demsetz's famous phrase, "internalize the externalit[ies]"⁹ of human action. Government regulation, which generates its own positive and negative externalities, can never be categorically ruled out.¹⁰ Thus the system of state control snowballs, under the same broad definition, creating massive externalities, positive or negative, of its own.¹¹

Clearly something is amiss in this grand formulation that uses a definition of externality that, whatever its intuitive appeal, is too broad for legal or policy work. Any serious examination of the externality problem thus starts by narrowing the class of externalities for which legal intervention is justified, that is, to what traditional lawyers called cognizable or actionable harms. The folly, moreover, of any broad definition is that it treats any refusal to deal in a competitive market as a negative externality, which would mean that any action that leaves anyone else worse off may count as an *actionable* harm that justifies government intervention.¹² On this expansive view of the world, *A* cannot marry *B* because of the disappointment of *C*, a rival suitor. But if the situation were reversed, *C*'s successful courtship could be blocked by *B*. Under this definition, there are always overlapping and crippling externalities. Disappointed suitors in competitive markets can always complain of losing one sale to a rival at which all sales are suspect. The correct view, therefore, declines to provide compensation for all *competitive* losses.

8. See *Externality*, INVESTOPEDIA, <http://www.investopedia.com/terms/e/externality.asp> (last visited Apr. 26, 2018) ("An externality is a consequence of an economic activity experienced by unrelated third parties; it can be either positive or negative.").

9. Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347, 357 (1967).

10. Cf. Christopher Serkin, *Big Differences for Small Governments: Local Governments and the Takings Clause*, 181 N.Y.U. L. REV. 1624, 1689–97 (2006) (discussing cascading, intergovernmental externalities).

11. See *id.*

12. See Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470 (1923), for the most famous development of this concept. For my critique, see Richard A. Epstein, *Hayek's Constitution of Liberty—A Guarded Retrospective*, 30 REV. AUSTRIAN ECON. 415, 424–26 (2017), <https://link.springer.com/article/10.1007%2Fs11138-016-0367-7>.

Economic losses, however, need to be taken into account for common carriers and public utilities, whose duties to serve in a potential monopoly position generate a correlative duty to offer service at fair, reasonable, and nondiscriminatory rates.¹³ Note that these duties are not symmetrical: potential customers need not avail themselves of the services supplied by common carriers or public utilities, but are free to seek or create alternative services to undercut the monopoly power position of the common carrier or public utility. More generally, the scope of this common carrier exception contracts whenever new technologies convert formerly monopolistic markets into competitive ones, so that nondiscrimination duties are no longer needed (as is the case with net neutrality in the provision of telecommunications services).¹⁴

The treatment of these abundant externalities arises with far greater urgency in real estate markets where close proximity among neighbors invariably gives rise to both positive and negative externalities, from either consistent or inconsistent land uses. Coase's analysis of the problem of social cost anticipates just that problem in his discussion of *Sturges v. Bridgman*, where a physician sought to enjoin a neighboring confectioner from operating machinery whose vibrations interfered with the doctor's examination of patients.¹⁵ That interaction had a second, temporal dimension because the confectioner began his noisy operations before the physician set up his more sensitive practice near their party wall.¹⁶

The law has two mechanisms for addressing these types of externalities. It can use legal intervention to control the negative externalities or to encourage the positive ones. Or it can rely on private ordering, whereby the parties sort themselves in ways that minimize the negative externalities and enhance the positive ones. The challenge is to figure out how these two systems work best together to encourage both efficient sorting and effec-

13. See Epstein, *supra* note 12, at 436–38.

14. Cf. Press Release, FCC, Chairman Kevin J. Martin Comments on Commission Policy Statement (Aug. 5, 2005), http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-260435A2.pdf (stating that competition decreases necessity of regulation).

15. Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 8–10 (1960) (analyzing *Sturges v. Bridgman* [1879] 11 Ch D 852 (C.A.) at 853).

16. *Sturges*, 11 Ch D at 853–54; Coase, *supra* note 15, at 8; see also William F. Baxter & Lillian R. Altree, *Legal Aspects of Airport Noise*, 15 J.L. & ECON. 1, 3–4 (1972) (discussing the first-in-time rule).

tive behavioral limitations, whether through centralized planning, private initiative, or collective action.¹⁷ Typically, a mixed solution that combines zoning and other land-use restrictions, and private associations offers the best results.

At this stage in the inquiry, it is best to be agnostic as to both the ultimate distribution of various activities and the devices used for locational and temporal sorting. But the key challenge is to explain why legal systems everywhere give far greater protection against negative externalities through tort, most notably the law of trespass and nuisance, than they offer compensation through the law of restitution for positive externalities that are given to someone who supplies an unrequested benefit to another person.¹⁸ Put otherwise, the law of trespass and nuisance are in general more robust than the law of restitution, whose application is sharply restricted to cases where a tangible benefit or service is supplied under conditions of necessity to someone who has not, and could not, have taken precautions on his own behalf.¹⁹ At one level, this difference presents a bit of a puzzle because it looks inconsistent with the famous Coasean agnosticism of causation—one that does not sharply distinguish between conferring a benefit and inflicting a harm.²⁰

Indeed, this inability to precisely identify which of two interacting parties is “responsible” for the externality has spread from the private law into American constitutional law, in ways that doubtless echo in other jurisdictions. In *Miller v. Schoene*,

17. See Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. Chi. L. Rev. 947, 947 (1984) (“The persistent tension between private ordering and government regulation exists in virtually every area known to the law.”).

18. See, e.g., RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 2(3) (AM. LAW INST. 2011) (“There is no liability in restitution for an unrequested benefit voluntarily conferred, unless the circumstances of the transaction justify the claimant’s intervention in the absence of contract.”). For a discussion of the limiting principles of restitution outlined in the Restatement, see Michael Traynor, *Unjust Enrichment: Some Introductory Suggestions*, 68 WASH. & LEE L. REV. 899, 900 (2011).

19. See Richard A. Epstein, *The Ubiquity of the Benefit Principle*, 67 S. CAL. L. REV. 1369, 1383–88 (1994) (analyzing the categories of necessity as they pertain to the law of restitution); Saul Levmore, *Obligation or Restitution for Best Efforts*, 67 S. CAL. L. REV. 1411, 1421 (1994) (describing restitution as available when a party unambiguously benefits and could not be said to have preferred another option).

20. See Coase, *supra* note 15, at 13 (“If we are to discuss the problem in terms of causation, both parties cause the damage. If we are to attain an optimum allocation of resources, it is therefore desirable that both parties should take the harmful effect (the nuisance) into account in deciding their course of action.”).

the Supreme Court, speaking through Justice Harlan Fiske Stone, expressed its inability to decide whether the owner of cedar trees that harbored a pest that attacked apple trees was causally responsible for the harm, as the harm was the product of the joint activities of both parties.²¹ If the tests for causation are weak, it becomes difficult in any private dispute to assign responsibility between the parties. Then, by extension, the same difficulties arise in constitutional law, where, in the mistaken words of Justice Antonin Scalia, “the distinction between ‘harm-preventing’ and ‘benefit-conferring’ regulation is often in the eye of the beholder.”²² This supposed insight into causation is in fact a ruinous form of intellectual relativism that kills off general analysis by endlessly expanding the actionable classes of positive and negative externalities. The building that blocks the view of *A* is the same building that enhances the view of *B*. The bell which causes earsplitting sounds to *C* may provide sweet music to *D*. It is therefore necessary to craft workable limits on the cognizable claims from both positive and negative externalities.²³

II. THE SINGLE-OWNER PARADIGM IN THEORY

The first conceptual step in this inquiry is to conduct, both theoretically and practically, an intellectual exercise that makes all externalities in both directions magically disappear. Start by imagining a single largish plot of land that has a single owner, and then asking how that owner will dispose of that land over time to multiple parties in order to maximize his own position through gains from trade. His initial parceling takes into account all of the downstream imperfections that arise in the definition and enforcement of rights, not only immediately, but over time.²⁴ He does this because he knows full well that the initial sale of any particular unit is not the final transaction. The property can be resold, mortgaged (and foreclosed), bequeathed, or otherwise given away, and it is necessary that all these takers,

21. *Miller v. Schoene*, 276 U.S. 272, 278–79 (1928). For the history and an analysis of the case, see WILLIAM FISCHER, *REGULATORY TAKINGS: LAW, ECONOMICS AND POLITICS* 151–57 (1995).

22. *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1024 (1992). For my most recent criticism of this passage, see Richard A. Epstein, *Missed Opportunities, Good Intentions: The Takings Decisions of Justice Antonin Scalia*, 6 *BRIT. J. AM. LEGAL STUD.* 109, 129 (2017).

23. For a case that rejects the noise claim for extrasensitive plaintiffs, see *Rogers v. Elliot*, 15 N.E. 768 (Mass. 1888).

24. For an analogy to the so-called durable monopolist, see generally Ronald H. Coase, *Durability and Monopoly*, 15 *J.L. & ECON.* 143 (1972).

without differentiation, step into the shoes against all other claimants as holders of rights who are subject to reciprocal burdens. The entire law of easements and covenants starts with the premise that at some distant point, the initial units will either be sold, foreclosed, or transferred by way of gift or will, so that some mechanism has to be put into place to ensure that the relationships that work for the original buyers, will also persist for any subsequent transferees.²⁵ These contingencies are routinely provided for, even in the absence of any precise knowledge as to when these events are likely to take place, for the simple reason that all that matters for the initial design is the certainty that such transfers will occur. The exact patterns of events is unknown, which proves to make the task somewhat easier because people are behind a (partial) veil of ignorance. Because the problem is permanent and the exact pattern of events is always unknowable, the legal rules governing easements and covenants are of great durability.²⁶

The reason all externalities disappear in this paradigm is that all initial parties *consent* to the harms that they suffer, just as they are empowered to enjoy certain benefits.²⁷ Subsequent parties are then bound and entitled so long as they receive notice of the terms of the arrangement, which can be effectively provided both from the chain of title and by recordation.²⁸ This knowledge allows them to set a sensible price that reflects both their benefits and burdens. This single-owner approach also helps explain rights and responsibilities in other collective endeavors, including corporations and partnerships, and even charitable organizations. The dual protections of consent and notice apply to all transactions at all times, and thus supply an effective response to the problems of externalities and sorting.

25. See generally JAMES C. SMITH ET AL., PROPERTY: CASES & MATERIALS 641 (2d ed. 2008) (discussing the development of the law of servitudes and covenants running with the land).

26. See Epstein, *supra* note 12, at 426–27 (discussing the constancy of basic institutions of property law and attributing that constancy to the law's ability to facilitate transactions in the face of uncertainty).

27. See TERRY L. ANDERSON & GARY D. LIBECAP, ENVIRONMENTAL MARKETS: A PROPERTY RIGHTS APPROACH 2 n.2 (2014) (noting that it is not entirely proper to consider externalities when all costs and benefits are captured and available for decisions by parties).

28. For a basic discussion of how notice improves marketability of land by permitting purchasers to make informed assessments of the burdens on a parcel, see Susan F. French, *Toward a Modern Law of Servitudes: Reweaving the Ancient Strands*, 55 S. CAL. L. REV. 1261, 1284 (1982).

Practical implementation of this approach is found in planned unit developments (PUDs), which in general have proven highly successful precisely because, over time, they learn to package the right mix of benefits and burdens.²⁹ Understanding the private approach offers a template for government regulation in the common situation in which separate property owners do not obtain their titles from a single owner. The differences between the private and public situation matter as well, so that it is only with caution that one can determine which of the standard PUD rules can work in the public sector. Further, the process is also dynamic, for as neighborhoods change, the same risk of obsolescence that takes place with covenants can happen with public restrictions as well, which suffer various rigidities for which individual variances, often hard to obtain, can offer only limited relief.³⁰ It is therefore necessary to think of private associations as a combination of charters and constitutions, which contain a mixture of strong vested rights and an elaborate governance structure endowed with the power to tax and spend for the general welfare of the community.³¹ The key constraint in these voluntary associations is that each decision, whether collective or private, should seek to obtain some Pareto improvement—that is leave at least one person better off and no one worse off.³²

In this paradigmatic system, there is *no coercive redistribution whatsoever*, as all charitable activities—and there are

29. Much of the success in post–World War II development took place through this vehicle, including the well-known Levittown project. For an early discussion, see ROBERT W. BURCHELL WITH JAMES W. HUGHES, *PLANNED UNIT DEVELOPMENT: NEW COMMUNITIES AMERICAN STYLE* (1972) (exploring the impact and potential of PUDs, which allow the same land tracts to be used for residential, commercial, and industrial purposes). For a general discussion of group ownership of land, see Robert C. Ellickson, *Property in Land*, 102 *YALE L.J.* 1315, 1322–44 (1993) (analyzing the costs and benefits to both individual and group land ownership).

30. For an example of the rigidities of covenants, see *Western Land Co. v. Truskolaski*, 495 P.2d 624, 627 (Nev. 1972) (rejecting a changed circumstances claim). For an example of the difficulty of obtaining variances, see *Commons v. Westwood Zoning Board of Adjustment*, 410 A.2d 1138, 1143 (N.J. 1980) (remanding denial of variance for further consideration, with the burden of proof placed on the applicant seeking the variance).

31. See generally Richard A. Epstein, *Covenants and Constitutions*, 73 *CORNELL L. REV.* 906 (1988) (observing the transition of covenants from conveyances to governance devices).

32. RICHARD A. EPSTEIN, *BARGAINING WITH THE STATE* 8 (1993) (“[I]f no person in state A is worse off than he was in state B, and at least one person is better off in state A than he was in state B, then state A must be judged as superior to state B.”).

many—are left to separate organizations specifically dedicated to that purpose.³³ Indeed, in these collective situations, the frequent use of pro rata rules suggests that an even stronger constraint than a Pareto improvement should be satisfied—namely, that the gains generated by these actions track the level of initial investment to the greatest extent possible.³⁴ That equalization condition is intended to maximize the size of the gain at each decisive step by eliminating the factional conflict over the division of surplus.³⁵ It is this simple insight that explains, for example, why the fraction of benefits and duties assessed for each unit is set at the outset of a common unit development, proportionate to the measure assigned in the original agreement.³⁶ Yet some future interventions will necessarily have a disproportionate impact—for example, one unit might be particularly impacted by the installation of a drainage or ventilation system that enhances the value of the entire development. So, at that point, the same basic model addresses the use of cash or in-kind compensation for extraordinary losses, in order to ensure that these impositions do not leave any one person or minority group unambiguously worse off when the membership as a whole prospers.³⁷

This sentiment is not just a principle of abstract justice, but one of intense practical importance. It explains why one of the single most influential sentences in American takings law reads, quite simply: “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.”³⁸ The point here is

33. *Id.* at 8–9.

34. *Id.* at 98–103 (using six different scenarios to illustrate that pro rata gains and collective solutions are preferred).

35. *Id.* at 98.

36. For an agreement that assigns per lot, see The Reserve at Frisco LLC, Declaration of Covenants, Conditions, Easements and Restrictions of The Reserve at Frisco, Article IV Section 5 (Sept. 9, 1997), <http://www.thereserveatfrisco.com/documents/declarations.pdf> [hereinafter Frisco Declaration].

37. See FISCHER, *supra* note 21, at 77 (discussing the history of just compensation).

38. *Armstrong v. United States*, 364 U.S. 40, 49 (1960). The statement was made so that the materialmen who supplied work on U.S. naval boats did not have to foot the bill when these boats were shipped out to sea, thus dissolving the materialmen’s liens. *Id.* at 48–49.

that this general proposition is not some abstract truth that applies only to public takings. If these thought experiments and PUD rules are correct, they embrace both present and future decisions. Our Coasean experiment lets us do the conceptual work as if we live in a zero-transaction-cost world when we try to gain insights on how to organize future transactions in the high-transaction-cost world of real estate markets.³⁹ All rights and all correlative duties are thus strictly specified between any and all pairs of individuals (and of course larger groups) within the system.⁴⁰ These rights are well-specified on substantive rights and governance structures, for both initial participants and their successors in title.⁴¹

This complete contingent-state system reduces the risk of strategic behavior—that is, trying to guess the optimal time to acquire or dispose of any property interest by the simple expedient of equalizing rights between any two random pair of owners regardless of when they acquire their respective positions.⁴² The pricing decisions made in any given transaction therefore are solely responsive to changes in market value of the various properties, and remain so whether other properties are held by their original purchaser or some subsequent taker.⁴³ The rules govern all matters of property possession, disposition, and use. Most critically, in this universe there is *no distinction whatsoever between positive and negative externalities*, given the web of consent and notice that binds all present and future participants.⁴⁴ These rules are content-free. Hence, it is permissible to insist that future owners respect aesthetic concerns equally with those of health and safety in whatever proportions that the original

39. I have used this methodology before. See Richard A. Epstein, *Holdouts, Externalities and the Single Owner: One More Salute to Ronald Coase*, 36 J.L. & ECON. 553 (1993) [hereinafter Epstein, *Holdouts*] (discussing the central role transaction costs play in organizing legal responses to many private-law problems); Richard A. Epstein, *Notice and Freedom of Contract in the Law of Servitudes*, 55 S. CAL. L. REV. 1353 (1982) [hereinafter Epstein, *Notice and Freedom*] (showing how the touch-and-concern requirement frustrates freedom of contract with respect to private property).

40. Epstein, *Notice and Freedom*, *supra* note 39, at 1365–66.

41. *Id.*

42. For an example of just this result, see Frisco Declaration, *supra* note 36. The Frisco Declaration's preamble holds that all parties and their successors are both bound and burdened by these covenants. *Id.*

43. Epstein, *Holdouts*, *supra* note 39, at 555 (explaining the Coasean idea that in a world of zero transaction costs, parties can “move resources to their highest-valued use”).

44. *Id.* at 560 (explaining how universal consent offers the best way to avoid externality problems).

single owner thinks will maximize the total value to all property owners.

The ideal system must not only address matters when they go well, but also when they go badly. Knowing that litigation costs are always positive, the astute system designer is likely to avoid specifying unduly complex formulations of legal rights that reduce value by adding uncertainty in the definition and enforcement of rights.⁴⁵ By the same token, the first owner has only limited ability to predict future changes in technology and circumstances, so that vested rights in a buyer's exclusive occupation of a designated unit are combined with a governance structure capable of dealing with problems that cannot be solved in advance, such as the governance of common areas or the need for future repairs and improvements. To make matters more complex, different developers are likely to target different classes of potential buyers, which means that rules ideal for one organization may not be so for another.⁴⁶ Thus the degree of quiet and separation in a luxury PUD may be far greater than that required in one that is tailored to a lower income group. And the amenities and services that are supplied by developments dedicated to senior citizens will surely differ from those offered in a PUD aimed toward households with young families.⁴⁷

In addition to these temporal demands, there is an insistent spatial dimension. What is the optimal size of a single PUD subject to common management? There is little doubt that the increase in the number of parties governed by any arrangement can lead to greater stresses on the governance dimension, especially if the tastes of the individual members diverge on key issues.⁴⁸ At this point, it may make perfectly good sense to divide some initial single development into two separate ones, sepa-

45. See generally RICHARD A. EPSTEIN, *SIMPLE RULES FOR A COMPLEX WORLD* (1995) (concluding that complex legal rules hamper efficiency and productivity).

46. See generally French, *supra* note 28, at 1308–09 (explaining the promissory undertakings must be devised to benefit subsequent owners in a common unit scheme).

47. For an example of the kinds of restrictions imposed, see *Nahrstedt v. Lakeside Village Condominium Ass'n, Inc.*, 878 P.2d 1275, 1277–78 (Cal. 1994) (en banc) (upholding restrictions against pets).

48. See generally Richard A. Epstein, *The Role of Exit Rights: What the Theory of the Firm Says About the Conduct of Brexit Negotiations*, 39 *CARDOZO L. REV.* (forthcoming 2018) (manuscript at 108) (showing how divergent preferences led to the breakdown of the European Union).

rated by physical boundaries and governed by different organizations.⁴⁹ In effect, what happens is that rules governing trespass and nuisance will be used to keep the two PUDs separate, allowing, where appropriate, more specific joint ventures limited to particular aspects of governance (e.g., dealing with common issues, such as power supply or flood protection, that could crop up). The point here is that the single owner has every incentive to properly divide management in these situations, just as a complex corporation constantly considers whether it should engage in new acquisitions or divestments in order to better align its asset portfolio.⁵⁰ Note that divestment should be regarded as a form of decentralized control that can be either repeated or reversed, as the case may be.

All of these variations can arise from the initial single-owner position. That said, it still becomes critical to know exactly how, and why, these various decisions on management and separation are made. Indeed, the question has real urgency because, in most common situations, neighbors do not derive their title from a common owner, and hence need to articulate in the context of an initial unified development an ex-post set of workable boundary conditions, which should ideally be modeled on the partition processes that a single owner voluntarily adopts ex ante. What works well in voluntary arrangements should create, in my view, a presumption for how the legal system should operate between strangers—namely any persons who obtain ownership through separate chains of title, which is the common case in a world in which first possession is the root of title for each separate parcel of land.⁵¹ Indeed, the same logic will apply even to cases of individuals who derive ownership by way of outright conveyances from a single owner with no reserved interests or conditions, who are generally treated as strangers, subject to rules that stress separation and not cooperation.

In designing these rules, one further question is whether some extrinsic substantive requirement for servitudes should limit the freedom-of-contract approach based on consent and notice. In my view, the answer to that question is no, so that the

49. See *id.* at 105 (discussing how flexible rules could help “relationships to morph from one form to another”).

50. See *id.* at 104 (explaining that in reality, partnerships that overcome conflicts of interests are rare).

51. See Richard A. Epstein, *Possession as the Root of Title*, 13 GA. L. REV. 1221, 1221–22 (1979) (stating “the common and civil law . . . [contain] the proposition that . . . taking possession of unowned things is the only possible way to acquire ownership of them”).

only limitations on these arrangements are those that address defects in the contracting process, remedying fraud, misrepresentation, concealment, and nondisclosure, mistake, and incapacity. In general, in real estate transactions, these issues are secondary because the high level of formality surrounding both inspection of title and examination of the physical premises prior to sale reduces the relevant risks.⁵² Land transactions contain multiple checkpoints against these unfair practices.⁵³

Yet other concerns arise. The first involves the application of the antitrust law to landowners that have real market power. The second involves the application of housing discrimination laws. The former tends to have only modest application to land-use arrangements. The latter has an enormous one. I favor the former restriction, and tend to oppose the latter.⁵⁴ But for these purposes, the key point is that in both cases the laws apply with equal force to both the original parties and to all successors in title.

On the other hand, the law of covenants has tended to adopt a set of recondite restrictions on privity, touching and concerning the land, and the performance of affirmative covenants.⁵⁵ But none of these doctrines has been allowed to block the PUD initiated by a single developer.⁵⁶ The requirement of privity was ignored in ways that let a condominium association enforce all of its pertinent agreements.⁵⁷ The touch-and-concern requirement covered all essential operations of the association; and affirmative covenants were allowed to collect condominium assessments.⁵⁸ In principle, the law could go further. Thus the *Restatement (Third) of Property: Servitudes* questions all of these

52. Richard A. Epstein, *The Use and Limits of Self-Valuation Systems*, 81 U. CHI. L. REV. 109, 128 (2014).

53. *Id.*

54. See RICHARD A. EPSTEIN, FORBIDDEN GROUNDS: THE CASE AGAINST EMPLOYMENT DISCRIMINATION LAWS 63–64 (1995) (arguing that “reducing the level of variance in tastes among group members” complicates collective decision-making, which in turn decreases consumer satisfaction); see also Richard A. Epstein, *Public Accommodations Under the Civil Rights Act of 1964: Why Freedom of Association Counts as a Human Right*, 66 STAN. L. REV. 1241, 1291 (2014) (concluding that Title II of the Civil Rights Act of 1964 has “become an instrument of repression”).

55. See, e.g., *Neponsit Prop. Owners’ Ass’n v. Emigrant Indus. Sav. Bank*, 15 N.E.2d 793, 795 (N.Y. 1938) (discussing restrictions on covenants).

56. See, e.g., *id.* at 798 (disallowing the covenant restrictions to block a PUD).

57. *Id.* at 797–98.

58. *Id.* at 795–98.

restrictions and takes the sensible view that all rights over the land of another—covenants, easements, licenses, and profits of all sorts and descriptions—should be subject to uniform rules.⁵⁹ This is a welcome return to the Roman tradition of servitudes writ large, which I have long championed.⁶⁰ Professor Susan French has long taken the position that my view ignores the “negative impact of servitudes on patterns of land use,” without exactly explaining which unacceptable externalities take place and why.⁶¹ Nonetheless, her final outlook, which has received little judicial acceptance, resembles my own.

III. POSITIVE AND NEGATIVE EXTERNALITIES IN THE PRESENCE OF HIGH TRANSACTION COSTS

It is now important to apply this theory to positive and negative externalities outside the context of PUDs created by single owners, who, as noted, have strong incentives to impose the right set of restrictions to maximize the value of all units after sale.⁶² The best approach is to conduct a thought experiment, coupled with an examination of the various types of agreements for these PUDs. The correspondence between the two approaches is virtually complete. On the one side are powerful prohibitions against common-law nuisances, subject to some predictable variations.⁶³ On the other side lie a large number of affirmative obligations dealing with matters such as architecture and landscaping, which show far higher variation, usually dependent on wealth effects and custom.⁶⁴ If it is correct to respect these features in voluntary transactions, then it is also correct to take a cue from these practices in establishing relationships between strangers. The resulting bottom line resembles the common law of nuisance, rationalized on efficiency grounds.

Start with negative externalities. The typical PUD has no patience with any of the traditional large-scale nuisances routinely actionable at common law. I know of no residential or commercial arrangements that allow for persons to freely emit odors

59. RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 7.12 cmt. a (AM. LAW. INST. 2000).

60. See *supra* note 39 and accompanying text.

61. Susan F. French, *Tradition and Innovation in the New Restatement of Servitudes: A Report from Midpoint*, 27 CONN. L. REV. 119, 123 (1994).

62. See *supra* Part II.

63. Epstein, *Holdouts*, *supra* note 39, at 573–76.

64. See, e.g., *Maher v. City of New Orleans*, 516 F.2d 1051, 1059–60 (5th Cir. 1975) (illustrating that wealth and custom play a part in deciding to preserve historical architecture).

or smells into the common areas. Yet the broad definition of nuisance reaches all “nontrespassory invasions” of the property of another that interfere with the use and enjoyment of that property.⁶⁵ The great difficulty that arises in this area is that this definition covers a huge number of activities that vary along two key dimensions: the severity of the harm and the number of people who suffer from that harm.⁶⁶

These variances in scale and intensity of harm are of great conceptual importance in any closed environment, where the possibility of reciprocal harms from parallel behaviors is enormous. In these environments, the repetition of low-level nontrespassory invasions usually generates *no* legal remedy, so that people are allowed to talk in hallways and to play music in their apartments.⁶⁷ But the question of intensity is never far from the center of the inquiry; there are often disputes as to whether cell phones may be used in lobbies, or when workmen can start repairs in one unit that will cause some inconvenience to others.⁶⁸ Here, there is some sensitivity to changes in settings and severity: any differences with cell phone use is not matched by the common rules that limit heavy construction to weekday hours, roughly between 9:00 AM and 5:00 PM.⁶⁹ The motivation behind these rules is to work a sensible accommodation between the need for improvements and the present comfort of all residents. The greatest noise and activity takes place during working hours when the disruptions are likely to be lower. But when more people are at home during the evenings and on weekends the restrictions are put back into place.⁷⁰ Given that these are all done by analysis behind a relative veil of ignorance, the regulations will tend to be efficient. But there will be stress on the exact lines

65. See *Morgan v. High Penn Oil Co.*, 77 S.E.2d 682, 689 (N.C. 1953).

66. For a discussion of the movement from small numbers of persons to large numbers, see Richard A. Epstein, *Nuisance Law: Corrective Justice and Its Utilitarian Restraints*, 8 J. LEGAL STUD. 49, 82–84 (1979) [hereinafter Epstein, *Nuisance Law*].

67. For the most famous expression of this live-and-let-live rule for low-level interactions, see *Bamford v. Turnley* (1862) 122 Eng. Rep. 27, 33 (Ex.) (“The convenience of such a rule may be indicated by calling it a rule of give and take, live and let live.”).

68. See, e.g., *Noise from Construction*, CITY OF NEW YORK, <http://www1.nyc.gov/nyc-resources/service/2090/noise-from-construction> (last visited Apr. 26, 2018) (demonstrating that New York City requires a permit be obtained for noise created after 6:00 PM on weekdays and on the weekend during all times).

69. Cf. ST. PAUL, MN, NOISE REGULATIONS tit. 28, ch. 293, § 293.07 (1987) (limiting construction noise between certain hours).

70. See, e.g., *Noise from Construction*, *supra* note 68.

of demarcation when and if certain individuals know that they are likely to make extensive renovations where others are not.

It is critical to note that these observed patterns can easily be carried over to transactions among strangers.⁷¹ In this instance, one huge advantage is that, in many cases, the increase in physical separation tends to reduce conflicts between neighbors, as many nuisances, especially noise and odors, tend to rapidly dissipate over distance.⁷² Yet in the cases that do remain, the basic rules follow the voluntary pattern very closely, with the more severe offenses meriting the strongest responses. The usual rule is that injunctive relief is routinely allowed against substantial nuisances on a more or less categorical basis.⁷³ As there are few cases of repetitive and accidental nuisances, disputes over the basis of liability—the choice between intentional harms, negligence, and strict liability—are relatively subdued in this area.⁷⁴ In some cases of enormous benefit, the actions may go forward. But, unlike the oversimplified model of damages *versus* injunctive relief developed by Professors Guido Calabresi and Douglas Melamed,⁷⁵ the use of injunctions and damages are more often complements than substitutes.⁷⁶ The injunctive side of the equation allows for conditional injunctions, bound by levels and time of emissions.⁷⁷ The damage side picks up the slack where the injunctive relief backs off. By starting with the former and moving cautiously to the latter, the total level of dislocations is far lower than moving to a corner position in which one of these remedies is adopted to the exclusion of the other. The exact

71. For a more complete account of these variations, see Epstein, *supra* note 66, at 67.

72. *Cf.* ST. PAUL, MN, NOISE REGULATIONS tit. 28, ch. 293, § 293.06 (1987) (establishing that a noise violates the ordinance if it can be heard fifty feet outside of a building).

73. See Mark P. Gergen et al., *The Supreme Court's Accidental Revolution? The Test for Permanent Injunctions*, 112 COLUM. L. REV. 203, 244 (2012).

74. For the official statement, see RESTATEMENT (SECOND) OF TORTS § 822 cmt. a (AM. LAW INST. 1979).

75. See generally Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972) (developing a framework to deal with legal problems).

76. See A. Leo Levin, *Equitable Clean-Up and the Jury: A Suggested Orientation*, 100 PENN. L. REV. 320, 320 (1951) (“It is familiar law that a litigant in equity may ask and receive damages or other relief normally awarded in a court of law. The chancellor was not deterred from adjudication such ‘legal’ issues, for they were thought of as incidental and their disposition was necessary to the effective termination of the entire matter in dispute.”).

77. *Id.* at 338.

remedial mix is not easy to determine, but the traditional locality rule in nuisance cases suggests where levels of interference from similar activities are reciprocal, higher levels of pollution are allowable, so long as the emissions are confined to a particular area.⁷⁸ But for lower-level nuisances, a more universal live-and-let-live rule takes over, so that *neither* damages nor injunctive relief is allowed, given the freedom of action that arises from allowing these low-level nuisances is universally beneficial, especially since everyone saves on administrative costs.⁷⁹ The public law follows quite closely the patterns seen in PUDs, with one obvious difference: private parties have greater flexibility to negotiate workable comprehensive schemes than tort litigation, which is more difficult to fine tune. But the parallels are close. As will become clear later, modern state regulation often strays from these salutary principles.

The question then arises as to how positive externalities are coordinated. In this regard, the key insight is that the level of variation in rules, whether by design or operation, is far greater here than in the harm-prevention realm. Virtually every adjacency has some potential to either create or undermine these positive interactions, and it takes a huge amount of local knowledge to specify such matters as, for example, the precise standards governing the conformity of exterior design. Of equal importance are the adjacencies between various units in the larger whole. Thus, for ordinary developments, it need not be the case that common facilities work best if all individuals have identical sets of uses and preferences. Indeed, it is perfectly commonplace in most buildings to have units of different sizes, but of the same general quality. This differentiation has the hidden advantage of lowering the stress on common unit facilities that come from peak load usage. If all persons had the same work and lifestyle patterns, concentrated periods of high demand could easily overwhelm communal resources.⁸⁰ Yet on the other side of the issue, it may well be that having persons of similar tastes and income could support larger investments in common facilities, knowing that tenants or owners in all groups will be willing to pay rent to obtain use of the common elements and fees can capture the various elements of value. There is no way to know

78. Epstein, *Nuisance Law*, *supra* note 66, at 87–89.

79. *Id.* at 84 (noting the administrative cost associated with low-level nuisances is high).

80. See JANE JACOBS, *THE DEATH AND LIFE OF GREAT AMERICAN CITIES* 152–58 (1961).

a priori which effects are greatest in what setting. But the developer's local knowledge puts him in the best position to maximize the cooperative surplus.

In some cases, the adjacencies involve radically different uses at different levels. A walk down Broadway in New York City shows one dominant pattern. The ground floor is occupied by retail space, for which street access is essential. The space generally goes below ground—in part because of a regulation that does not count that space against the Floor-Area Ratio (FAR) that limits volume above ground,⁸¹ and also because retail customers often do not need natural light. Above the retail area is often office space, close to street level and easily accessible. Hotel space may form a third layer, above which are a range of residential units, topped off perhaps by a restaurant with a panoramic view. In some cases, the various activities are interrelated, as patrons in the hotel eat at the restaurant, as do many of the local residents. Such cross-fertilization is most important where land values are greatest, so that any zoning system that specifies single uses—residential, commercial and the like—in dense neighbors will undercut these synergies, a point noted by Jane Jacobs in the classic book *The Death and Life of Great American Cities*, which attacked the reign of Robert Moses for its sharp segregation of uses.⁸²

The next question, however, is whether it is possible to capture this system of private benefits through litigation similar to that on the nuisance side of the ledger. The answer has both theoretical and practical sides. On the former, it is difficult to identify how a principle maps onto the private rules developed by PUDs. To fill that gap, Professor Ariel Porat argues in favor of an “expanded duty of restitution” to fill the asserted gap in the current law.⁸³ The basic assumption of the Porat thesis is that, “ideally,” negative and positive externalities should be subject to the same treatment, namely one of full internalization, so that injurers and benefactors alike are subject to the same set of ideal incentives (as happens within the PUD).⁸⁴ The purpose here is

81. See N.Y. ZONING RESOLUTION art. VII, ch. 7, § 77-22 (2016). For a summary of the rules, see *Glossary of Planning Terms*, CITY OF NEW YORK, <https://www1.nyc.gov/site/planning/zoning/glossary.page#floor> (last visited Apr. 26, 2018).

82. See JACOBS, *supra* note 80, at 131–32.

83. See Ariel Porat, *Private Production of Public Goods: Liability for Unrequested Benefits*, 108 MICH. L. REV. 189, 205–09 (2009).

84. *Id.* at 190 (“Ideally, from an economic perspective, both the negative and positive effects should be internalized by those who produce them, for

to align incentives for the optimal creation of public goods, which individual people have insufficient incentive to create or maintain by themselves.⁸⁵ There is a well-known inequality that drives the analysis of public goods: social benefits are greater than private costs, which in turn, are greater than private benefits. Unless some coercive mechanism is introduced, the private party will only look at the last inequality so that the improvement will not be made. Porat instances the failure to create a private park that improves amenities in the neighborhood.⁸⁶ Porat is aware of the many pitfalls that stand in the way of this expanded duty in particular cases: some activities produce both benefits and harms; sometimes transaction costs can exceed the gains from organizing the activity; sometimes the rules will infringe on individual autonomy; and sometimes valuation problems will be daunting.⁸⁷

What this catalogue of particulars misses, however, is the systematic disabilities that doom this approach. Start with this simple difference: returning to our PUD framework, the response to these externalities differs radically from case to case,⁸⁸ so that there is no set of uniform practices to serve as a template to evaluate the role of positive externalities in interactions among strangers. Porat acknowledges the risks of heterogeneity when some individuals are left worse off by actions that benefit others, to which he says his restitution duty does not apply.⁸⁹ Yet these situations are more common than is usually suspected; the introduction of the manufacturing plant in *Village of Euclid v. Ambler Realty Co.*,⁹⁰ for example, may diminish amenities to some while providing increased job opportunities for others. These cases of multiple effects are so pervasive that this one exception may well swallow the rule, even if it were possible in theory to design a compensation scheme to cover all losers if the aggregate gains are sufficiently large. Indeed, the problem of heterogeneity goes further, because any set of diffuse benefits

with full internalization, injurers and benefactors alike will behave efficiently.”).

85. *Id.* at 226.

86. *See id.* at 191.

87. *See id.*

88. Compare *Nahrstedt v. Lakeside Vill. Condo. Ass'n, Inc.*, 878 P.2d 1275 (Cal. 1994) (upholding restrictions against pets), with *Anderson v. City of Issaquah*, 851 P.2d 744 (Wash. Ct. App. 1993) (reversing denial of a building permit by city development commission on aesthetic grounds).

89. Porat, *supra* note 83, at 220.

90. 272 U.S. 365, 380–81 (1926).

will be valued differently by different people—assuming that they know how to value them at all. After all, there are differences in location, view, and preferences that make it hard to treat all individual takers within any geographical region as though they were the same. The distribution of benefits differs sharply from the distribution of nuisances. The latter are relatively infrequent, in part because the first person to be inconvenienced by noises and odors is often the party who generates them, which operates as an implicit (if imperfect) deterrent to these harms.⁹¹

But there is no similar bit of self-constraint on the benefit side of the equation. Quite the opposite: there is a real risk of moral hazard, inviting people to gin up benefits for some large and undefined class of persons for which they then can claim compensation. The parallel behavior in nuisance cases is that of the eager plaintiff who puts himself into harm's way—a risky strategy to say the least, and one that presupposes the existence of some nuisance-like behavior.⁹² The transaction-cost dynamics therefore are wholly different in the two cases, even if, as Porat rightly observes, the standard theory is moved to treat positive and negative externalities in the same fashion.⁹³

In addition, the remedial structure is not equal to the institutional challenge. Most critically, there is no parallel on the benefit side to injunctive relief that plays such a central role in nuisance cases. There is no way to enjoin persons from taking advantage of benefit for which they have made no request.⁹⁴ Nor is there any method whereby the supposed beneficiaries could disclaim the benefit in advance, even if they knew where and when it was likely to take place. The magnitude of these remedial difficulties is minimized by limiting the inquiry to the creation of a public park. But the logic of the expanded duty of restitution could apply to routine activities like people landscaping their own properties, removing old shacks, or painting their

91. Cf. Epstein, *Nuisance Law*, *supra* note 66, at 100 (reasoning that a party who creates a traffic jam will have to take into account his own delays).

92. Cf. Marina Galperina, *Why Russians Are Obsessed with Dash-Cams*, JALOPNIK (Feb. 15, 2013), <https://jalopnik.com/why-russians-are-obsessed-with-dash-cams-5918159> (describing Russian insurance fraud whereby drivers deliberately create traffic accidents in an effort to sue others).

93. See generally Porat, *supra* note 83 (arguing that while the law treats positive and negative externalities differently, they should be treated identically).

94. See RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT, § 2(3) (AM. LAW INST. 2011) (“There is no liability in restitution for an unrequested benefit voluntarily conferred.”).

houses. The scope of the benefit cannot be traced out by watching physical interactions, as is the case with noises and smells. It is thus always difficult to figure out how wide to draw the circle of benefits in complex neighborhoods characterized by different types of land uses, because some, like nuisances, have intensely local effects while others, like regional growth, may have neighborhood-wide effects.⁹⁵ Indeed, the high frequency of these beneficial interactions will likely lead to situations where changes in market value are attributable to the combined activities of multiple parties, posing general brainteasers under the law of joint-and-several liability.

As the frequency of these beneficial interactions increases, the valuation problems become more acute and the gains from legal intervention necessarily diminish. This accumulation of difficulties matters. In some cases, where there are systematic benefits to be gained, it is possible to rely on informal social pressures to get sloppy neighbors to bring their properties up to standard.⁹⁶ Yet in general it would be disastrous to offer subsidies to individuals to mow their own lawns or to paint their shutters a nice shade of green. There will be no agreement as to which activities should receive that subsidy, how much they should be paid, who should be required to bear the brunt of the costs, or underwrite the public costs of administering such a system. Still, some direct public investments (in contradistinction to payments to individual landowners) could work in connection with positive amenities like the creation of parks. Thus it is common today to allow for various tax breaks for the creation of preservation easements for either wildlife or historic structures, which uses a system of matching grants to achieve the needed subsidy at far lower costs.⁹⁷ Occasionally, legislative or administrative standards may help fill the gap, although these schemes

95. *Compare* *Shore v. Maple Lane Farms, LLC*, 411 S.W.3d 405 (Tenn. 2013) (holding that amplified music concerts on a farm could constitute a nuisance), *with* *Hood River Cty. v. Mazzara*, 89 P.3d 1195 (Or. Ct. App. 2004) (interpreting a county ordinance regarding barking dogs).

96. See ANDREW JAY KAUFMAN, *WHERE THE LAWN MOWER STOPS: THE SOCIAL CONSTRUCTION OF ALTERNATIVE FRONT YARD IDEOLOGIES* 3–4 (2000), <https://lib.dr.iastate.edu/cgi/viewcontent.cgi?article=18351&context=rtd> (explaining how informal social norms help ensure all neighbors maintain their lawns).

97. For a primer, see TECH. PRES. SERVS., NAT'L PARK SERV., *EASEMENTS TO PROTECT HISTORIC PROPERTIES: A USEFUL HISTORIC PRESERVATION TOOL WITH POTENTIAL TAX BENEFITS* (2010), <https://www.nps.gov/tps/tax-incentives/taxdocs/easements-historic-properties.pdf>.

themselves can easily get carried away by excessive enforcement.⁹⁸ In the end, it may well be that in a world of imperfect administrative enforcement it is appropriate to provide no legal mechanism for the creation of certain positive externalities. This last discussion thus paves the way for a more synoptic overview of the strengths and pitfalls of various schemes for land-use regulation.

IV. PUBLIC LAND-USE REGULATION: ZONING AND AFFORDABLE HOUSING MANDATES

This analysis of housing markets generates what I have called in other contexts the “separability thesis.”⁹⁹ The basic insight is that covert wealth transfers of all sorts should not be allowed to cloud appropriate judgments for the efficient use of resources in light of the lessons learned from the single-owner hypothesis.¹⁰⁰ In the current legal environment of extensive land-use regulation, however, political forces often seek major redistributive objectives, so that land-use regulation takes on the role of creating transfers across different groups under the guise of dealing with various positive and negative externalities.¹⁰¹ The point here is not that there are no schemes of regulation that serve legitimate functions, for, in principle, it is always possible that some system of land-use regulation can overcome coordination problems for private owners in a way that leaves all regulated parties better off than they were before. I will mention two such opportunities here. The first is a sign ordinance that requires all signs to be of a certain size and flush against their buildings. This ordinance gets rid of sign clutter and reduces the probability that one sign will block another from view. In those cases, where the ordinance improves the value of all properties, regulation should be welcome because it provides, in the form of restriction against like abuses by others, in-kind compensation for the loss of total freedom in mounting signs on property. Similarly, an ordinance that requires uniform archi-

98. See, e.g., *Anderson v. City of Issaquah*, 851 P.2d 744, 755 (Wash. Ct. App. 1993) (reversing the denial of a building permit by a city development commission based on aesthetic concerns).

99. See generally Richard A. Epstein, *Innovation and Inequality: The Separability Thesis*, 39 HARV. J.L. & PUB. POLY 1 (2016) (applying the phrase to intellectual property).

100. See *supra* Part II.

101. See Amnon Lehavi, *Zoning and Market Externalities*, 44 FORDHAM URB. L.J. 361, 383 (2017).

ecture in historical districts can also pass that test, if the exterior creates additional value for its owners as a tourist destination.¹⁰² When necessary, this scheme can be supplemented by a real estate tax abatement if the benefits generated go to parties outside of the regulated district. Unfortunately, most systems of land-use regulation do not resemble these well-tailored interventions. Below are three important examples—*Euclidian* zoning,¹⁰³ affordable housing, and the *Mount Laurel* “fair share” rule¹⁰⁴—of how matters can go awry.

The use of zoning in American life began in the first three decades of the twentieth century with efforts to control a wide range of land-use problems dealing with high density and the adjacency of inconsistent land uses.¹⁰⁵ The use of the single-owner model indicates some of the rich complexities that arise in this area. All of these zoning plans seek to take into account the height, the placement, and the bulk of buildings and other structures, both because of the interdependences among them, and because of the enormous impact that buildings have on light and views (where the question is not whether these views are ever blocked, but rather the manner in which they block those views).¹⁰⁶ In dealing with this issue, it would be dangerous to dismiss all zoning regulations that go beyond the scope of the nuisance law as unwise, but it is very difficult to come up with a metric that allows for good regulations to be sorted out from bad ones.

The first zoning laws were relatively modest in their scope, dealing with such matters as height restrictions,¹⁰⁷ on the one hand, and setback restrictions on the other.¹⁰⁸ The court decisions upholding these regimes often rested on a mixture of two

102. See, e.g., *Maher v. City of New Orleans*, 516 F.2d 1051, 1060, 1060 n.45 (5th Cir. 1975) (upholding an ordinance intended to preserve historic buildings in New Orleans’ French Quarter).

103. *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926).

104. *S. Burlington Cty. NAACP v. Twp. of Mount Laurel (Mount Laurel I)*, 336 A.2d 713, 724 (N.J. 1975).

105. For a concise summary of the various issues, see ROBERT C. ELLICKSON ET AL., *LAND USE CONTROLS*, 57–68 (4th ed. 2013).

106. See *Euclid*, 272 U.S. at 379–81 (describing the zoning plan); *Mount Laurel I*, 336 A.2d at 719–20 (describing the zoning plan); *Anderson v. City of Issaquah*, 851 P.2d 744, 746–47 (Wash. Ct. App. 1993) (describing the zoning plan).

107. See, e.g., *Welsh v. Swasey*, 214 U.S. 91, 100 (1909) (upholding building height restrictions in certain areas of Boston).

108. See, e.g., *Gorieb v. Fox*, 274 U.S. 603, 610 (1927) (sustaining setback restrictions on public health and safety grounds).

dominant themes in takings law. The first is that there is a police-power justification for preventing disease from overcrowding and distress from dark areas.¹⁰⁹ The second is that the general scope of the ordinance means that there are reciprocal benefits to all the parties subject to it.¹¹⁰ I will not go into the difficulties in these cases, which are close,¹¹¹ but it is important to note that zoning ordinances often take on a far more corrosive position, and consequently survive only because of the high level of deference that, starting with *Euclid*,¹¹² judges give to the legislators and administrators who put these laws into effect.

Euclid is the most conspicuous illustration of this dangerous trend; a case in which, the United States Supreme Court upheld a comprehensive zoning scheme for the development of land in the Cleveland suburb of Euclid.¹¹³ At issue in that case was the zoning for a single contiguous sixty-eight-acre plot of land located between a major thoroughfare on the one side and a railroad on the other.¹¹⁴ The applicable zoning ordinance broke this plot up into three horizontal bands.¹¹⁵ U-2 was suitable for two-family homes, and U-3 for apartment houses.¹¹⁶ Finally, U-6, located only 130 feet away from U-2, was zoned to “include plants for sewage disposal and for producing gas, garbage and refuse incineration, scrap iron, junk, scrap paper and rag storage, aviation fields, cemeteries, crematories, penal and correctional institutions, insane and feeble minded institutions, storage of oil and gasoline (not to exceed 25,000 gallons).”¹¹⁷

This zoning scheme was a recipe for land-use disaster, because it undid the benefits for land-use planning created by the single owner who could account for all externalities, positive or negative, from the development of the entire plot, which, given its size and access, was ideal for an integrated manufacturing plant. Its large size made it possible for self-imposed setbacks to

109. See, e.g., *Maier v. City of New Orleans*, 516 F.2d 1051, 1058–64 (5th Cir. 1975).

110. See, e.g., *Rose v. Chaikin*, 453 A.2d 1378, 1384 (N.J. Super. Ct. Ch. Div. 1982) (“[P]laintiff must show . . . that he has been denied the reciprocal benefits of a common zoning plan.”).

111. For a discussion of these difficulties, see Richard A. Epstein, *Disappointed Expectations: How the Supreme Court Failed To Clean Up Takings Law in Murr v. Wisconsin*, 11 N.Y.U. J.L. & LIBERTY 151 (2017).

112. *Vill. of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926).

113. *Id.* at 397.

114. *Id.* at 379.

115. *Id.* at 380.

116. *Id.*

117. *Id.* at 381.

reduce any nuisance-like complications with neighbors. Why then introduce new unnecessary territorial divisions that create unwanted land-use conflicts by forcing the physical coexistence of incompatible uses? Indeed, the ordinance allegedly reduced the plot value by about seventy-five percent without generating any offsetting benefits to nearby neighbors.¹¹⁸ Yet *Euclid* allowed the government to impose heavy disparate burdens without using the compensation devices that are common for this purpose in PUDs.¹¹⁹ Freed therefore from any kind of price constraint, it is not surprising that the ordinance blocked all construction on that plot until the property was ultimately used for a defense plant during World War II, disregarding the zoning plan.¹²⁰ The signaling function of a price system is systematically ignored when government officials are given discretion to use regulations to transfer wealth from one party to another.¹²¹

The larger significance of *Euclid* derives from two separate reasons. The first is that it enshrined a highly deferential rational-basis test that allowed all sorts of zoning schemes to be validated even when they resulted in systematic losses in land value in all sorts of other contexts.¹²² In effect, the rules permitted the imposition of zoning restrictions with a conspicuous disparate impact, directed chiefly toward anticompetitive ends that had little or nothing to do with the control of nuisances. The shift itself is marked by the adoption in 1961 of a much-expanded New York City zoning ordinance that shifted attention away from external effects on light and air toward the use that took place within the walls, which made it difficult to repurpose various buildings when economic conditions occurred, including the conversion of old manufacturing facilities into artist lofts.¹²³ Second,

118. See *id.* at 384 (stating that the complaint alleged the prezoning value of the land was \$10,000 and that the postzoning value was only \$2500).

119. *Euclid* denied recovery for the substantial devaluation of the property at issue. See *id.* For a state law covering PUD compensation, see Bert J. Harris, Jr., Private Property Rights Protection Act, FLA. STAT. § 70.001 (2017).

120. See ELLICKSON ET AL., *supra* note 105, at 96.

121. Cf. Kim Jung-kwan, *Energy Not a Political Issue*, KOREA JOONGANG DAILY (Jan. 18, 2013), <http://koreajoongangdaily.joins.com/news/article/Article.aspx?aid=2965687> (arguing that government energy price subsidies undermine corporate confidence in market institutions).

122. See *Euclid*, 272 U.S. at 392 (describing possibilities that would satisfy the rational-basis test).

123. See Norman Marcus, *New York City Zoning—1961–1991: Turning Back the Clock—But with an Up-to-the-Minute Social Agenda*, 19 FORDHAM URB. L.J. 707, 710–11 (1992) (discussing a 1961 New York City ordinance revision that severely limited flexibility in updating property uses).

Euclid's model of separate zones for different kinds of activities ignored the huge positive externalities that can come from mixing different kinds of uses in the same zone.¹²⁴ In this regard, the model of the modern multiple-use building is one example. Indeed, it was just this theme that Jane Jacobs hammered home back in 1961: single-use districts create dead zones in uses that multiple-use districts can fill.¹²⁵ To be sure, the question is always empirical, for heavy manufacturing may well not fit in with various forms of residential and commercial use. But it bears noting that the failure of modern zoning schemes is that they rest on what Friedrich Hayek termed the “fatal conceit” that central planners can move quickly and accurately to create the necessary synergies and separations.¹²⁶ It turns out that all too often they cannot, for the reasons that always stand in the path of central planning: ignorance and bias.

The second major mistake in modern *Euclidian* zoning law is its constant effort to create some major form of wealth redistribution through regulation that has a differential effect on different participants. As argued earlier, the use of the single-owner theory does not seek to create redistribution between various groups but rather to ensure through competition that all these arrangements economize both the internalization of externalities and the creation of common public goods.¹²⁷ In dealing with these issues, it often, but by no means always, suggests that individual PUDs will have a membership that best reduces conflicts, increases cooperation, and allows for the efficient uses of common spaces. This austere model does not survive well in situations where the ability to use the permit power allows the state to force selected groups to change the mix of residents in PUDs.¹²⁸ Two common ways in which this can be done is through affordable housing mandates, often called inclusionary zoning, and through state mandates that local communities provide

124. See *Euclid*, 272 U.S. at 389–90 (describing the impact and legality of having separate zones for different kinds of activities).

125. See JACOBS, *supra* note 80, at 152–77.

126. See generally F.A. HAYEK, *THE ROAD TO SERFDOM* 113 (Bruce Caldwell ed., Univ. of Chi. Press 2007) (discussing the restrictions on speed and efficiency of government action when hindered by numerous considerations); F.A. HAYEK, *THE FATAL CONCEIT: THE ERRORS OF SOCIALISM* 21 (W.W. Brantley III ed., Univ. of Chi. Press 1991) (stating the “fatal conceit” concept rests in the collective overconfidence in the belief “that the ability to acquire skills stems from reason”).

127. See *supra* Part II.

128. Cf. *Wilson v. Borough of Mountainside*, 201 A.2d 540, 541, 453 (N.J. 1964) (upholding decision of planning review for land-use control).

their “fair share” of low- and moderate-income housing. Both of these popular programs run into major difficulties because the obligations in question, following on the tradition of *Euclid*, are imposed on developers and local communities without payment of just compensation.

The standard view of an affordable housing program is that local and state governments require a developer to reserve a certain fraction of new housing for tenants or buyers who are members of protected classes.¹²⁹ The developer is allowed to offset the losses that come from these obligations by raising, to the extent that the market will allow, the rents or sale prices on the market-rate units. In the United States, these programs are often defended as a way to offset the serious shortage of decent, safe, and sanitary housing for persons and families of low or moderate income given “an absolute present and future shortage of supply in relation to demand.”¹³⁰ At no point do the defenders of these ordinances explain why supply and demand are perpetually out of equilibrium, for which the obvious answer is that the massive regulation of these housing markets—through a combination of zoning laws, rent-control ordinances, building codes, permit restrictions, disability-access rules, special permits, and taxes—drives up the cost of low- and moderate-income housing.¹³¹ But instead of seeking to remove the obstacles that block market activity, they impose restrictions on landlords and sellers that result in costly and often counterproductive behaviors.¹³² Unfortunately, these systems are a clever form of price controls, for the

129. For my analysis of these issues, see Richard A. Epstein, *The Unassailable Case Against Affordable Housing Mandates*, in EVIDENCE AND INNOVATION IN HOUSING LAW AND POLICY 64 (Lee Fennell & Benjamin Keys eds., Cambridge Univ. Press 2017) [hereinafter Epstein, *The Unassailable Case Against Affordable Housing Mandates*].

130. CAL. HEALTH & SAFETY CODE § 50003(a) (West 2018). The San Jose affordable housing program, which “requires all new residential development projects of 20 or more units to sell at least 15 percent of the for-sale units at a price that is affordable to low or moderate income households,” was sustained against constitutional challenge on *Euclid*-like grounds in *California Building Industry Ass’n v. City of San Jose*. 351 P.3d 974, 978 (Cal. 2015). For my critique, see Epstein, *The Unassailable Case Against Affordable Housing Mandates*, *supra* note 129, at 65.

131. See Robert C. Ellickson, *The False Promise of the Mixed-Income Housing Project*, 57 UCLA L. REV. 983, 997 (2010) (discussing the higher production costs of subsidized housing).

132. See Laura L. Westray, *Are Landlords Being Taken by the Good Cause Eviction Requirement?*, 62 S. CAL. L. REV. 321, 323 (1988) (discussing the systematic risk that landlords will be deprived of their right to exclude, which is

limitations of price on some units necessarily limits the total revenue that can be obtained from the entire production run, leading to chronic shortages. To make matters worse, the mandates for affordable housing often work badly because they require interactions among different income groups that would not normally choose to live in the same project, even if they are quite happy to live in the same general neighborhood.¹³³ These costs come from two sources. First, the need to rent or sell to two or three classes of occupants in a single building drives up the cost of construction by requiring different materials and layouts that must be spread uniformly throughout the project.¹³⁴ It also drives up the cost of marketing by requiring separate and specialized brokerage staffs (common throughout all markets from land to cosmetics) to rent or sell separately to members of each group.¹³⁵ And for the subsidized groups, potential tenants must be prescreened to determine eligibility for inclusion in the various programs.¹³⁶ On the demand side, the mixing of different income groups tends to drive away wealthier clienteles who want extensive services and amenities (e.g. twenty-four-hour doorman service) that other occupants cannot afford.¹³⁷ In some cases, developers have sought to beat back the force of these restrictions

“one of the most essential sticks in the bundle of rights that are commonly characterized as property” (quoting *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 433 (1982))).

133. See Naomi J. McCormick et al., *The New Stigma of Relocated Public Housing Residents: Challenges to Social Identity in Mixed-Income Developments*, 11 CITY & COMMUNITY 285, 289 (2012) (“The development of mixed-income housing was an intentional effort to counteract public housing stigma, but produced countervailing forces.”); Jarred Schenke, *Is HUD’s \$6B Mixed-Income Housing Strategy to Blame for Housing Shortage*, BISNOW (Mar. 10, 2017), <https://www.bisnow.com/national/news/construction-development/huds-funding-faces-uncertainty-for-mixed-income-players-71491> (stating there is “little evidence that people with higher incomes mingle in any meaningful way with lower-income families in the same project”).

134. See ROBERT HICKEY, CTR. FOR HOUS. POLICY, AFTER THE DOWNTURN: NEW CHALLENGES AND OPPORTUNITIES FOR INCLUSIONARY HOUSING 9 (2013) (discussing the increase in costs of infill sites for inclusionary housing developments).

135. AARON GORNSTEIN & ANN VERRILLI, MIXED-INCOME HOUSING IN THE SUBURBS: LESSONS FROM MASSACHUSETTS 19 (2006) (discussing affirmative marketing requirements).

136. See, e.g., Mark Joseph & Robert Chaskin, *Living in a Mixed-Income Development: Resident Perceptions of the Benefits and Disadvantages of Two Developments in Chicago*, 47 URB. STUD. 2347, 2357 (2010) (discussing the increased screening of mixed-income developments).

137. See Patrick Bayer et al., *Separate When Equal?: Racial Inequality and Residential Segregation* 30 (Yale Working Papers on Econ. Applications & Policy, Discussion Paper No. 9, 2005), <https://economics.yale.edu/sites/default/files/>

by creating separate lobbies and elevators for the two groups.¹³⁸ But that in turn provokes a fierce legislative response against the “poor door,” which can easily derail the project in its entirety.¹³⁹ The correct way to handle this situation is for the state to compensate (in cash) the developer for the losses attributable to these multiple impositions, costs that are likely to prove so expensive that they will not be borne as the price is too high. A simpler scheme uses more efficient separation to provide low-income persons with payments that allow them to receive subsidized housing without disrupting the general practices, whose efficiency rationales regulators often fail to understand.

The same difficulties arise with larger efforts to create balanced communities outside of any single development. The most dramatic illustration of this practice comes from the endless litigation in the *Mount Laurel* saga, beginning with the 1975 decision of the New Jersey Supreme Court in *Southern Burlington County NAACP v. Township of Mount Laurel*.¹⁴⁰ The court managed to find a right to sufficient levels of low- and moderate-income housing in a Blackstone-like constitutional provision that reads: “All persons are by nature free and independent, and have certain natural and unalienable rights, among which are those of enjoying and defending life and liberty, of acquiring, possessing, and protecting property, and of pursuing and obtaining safety and happiness.”¹⁴¹ The intellectual transformation from a system of limited government to a comprehensive positive entitlement to government financial support on a state-wide basis was made without any explanation. But that result differs massively from the single-owner paradigm used to organize land-use

files/Working-Papers/wp000/ddp0009.pdf (“We motivated our hypothesis by documenting that middle-class black neighborhoods are in short supply given the current black sociodemographic structure in many U.S. metropolitan areas, forcing high-SES blacks either to live in predominantly white neighborhoods with high levels of neighborhood amenities or in more black neighborhoods with lower amenity levels.”).

138. See, e.g., Emily Badger, *When Separate Doors for the Poor Are More than They Seem*, WASH. POST: WONKBLOG (July 31, 2014), <https://www.washingtonpost.com/news/wonk/wp/2014/07/31/when-the-poor-want-their-own-door/> (discussing the proposal for an apartment with different amenities for its “affordable units”).

139. See, e.g., S. 6012, 2015–2016 Reg. Sess. (N.Y. 2015) (amending housing and rent control law).

140. 336 A.2d 713 (N.J. 1975). For one account of the decisions, see the New Jersey Digital Legal Library, which has collected many of the primary materials. N.J. DIG. LEGAL LIBRARY, <http://njlegallib.rutgers.edu/mtnlaurel/aboutmtnlaurel.php> (last visited Apr. 26, 2018).

141. N.J. CONST, art. I, § 1.

issues insofar as it requires that each unit of local government provide its fair share of low- and moderate-income housing.¹⁴² It is now over forty years since the New Jersey Supreme Court announced this basic fair-share obligation. Yet the imbroglio is still unresolved.¹⁴³ It is critical to understand why.

New Jersey, like many states, has authorized comprehensive zoning codes that go far beyond the requirements of the law of nuisance and far beyond the requirements that are found in any PUD, all of which favor growth over redistribution.¹⁴⁴ These government codes are often passed to advance the lofty goals of safe and balanced communities that hearken back to *Euclid*.¹⁴⁵ At this point, the first-best solution is to knock down the initial restrictive land-use regulation that blocked all low- and moderate-income housing. On that view, developers could have constructed adequate housing projects located in places where their targeted customers wanted to live without creating any local nuisances. From this perspective, there would be no need for state subsidies, and there would be no need to adopt special rules for forcing these projects into particular communities under an ambitious statewide plan. But that ship has sailed. Now that the zoning laws are set in legal stone, local communities, acting in response to judicial pressure, have to concoct ad hoc exceptions to them.¹⁴⁶ Since the notion of fair share cannot be operationalized, the basic scope of the obligation has to be determined for hundreds of separate communities, all of which have different

142. See, e.g., William W. Merrill III & Robert K. Lincoln, *Linkage Fees and Fair Share Regulations: Law and Method*, 25 URB. LAW. 223, 229 (1993) (describing Florida's Planning Act that requires local governments to plan for affordable housing).

143. For round two of the litigation, see *Southern Burlington County NAACP v. Township of Mount Laurel (Mount Laurel II)*, 456 A.2d 390 (N.J. 1983). For the arguments up through 1987, see John M. Payne, *Rethinking Fair Share: The Judicial Enforcement of Affordable Housing Policies*, 16 REAL EST. L.J. 20 (1987) (highlighting the problematic *Mount Laurel* decision and proposing a new approach to fair share). For a 2010 reprise, see generally MARCIA A. KARROW ET AL., HOUSING OPPORTUNITY TASK FORCE, FINDINGS AND RECOMMENDATIONS (2010) (recommending changes to New Jersey's affordable housing practices).

144. See, e.g., N.J. ADMIN CODE § 5:43-1.1 (2018) ("The purpose of the Neighborhood Preservation Balanced Housing Program is to provide municipalities, for-profit and non-profit developers with financial assistance needed to spur the development of affordable housing across the State . . .").

145. *Mount Laurel I*, 336 A.2d at 725–26 (citing *Vill. of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926)).

146. See *Banville v. Los Angeles*, 4 Cal. Rptr. 458, 569 (Cal. Dist. Ct. App. 1960) (discussing an ordinance providing the Regional Planning Commission the authority to grant a zoning exception).

population bases and different commercial and industrial activities.¹⁴⁷ No ordinary mortal can discharge this Herculean task with any degree of certainty. But it is certain that local governments will use all the resources at their disposal to keep out low-income families, often because of the additional tax burden that it will place on other landowners to fund the public education required for the influx of families with school-age children.¹⁴⁸ It is impossible to describe in a short paper the vitriol and intrigue that has beset this program at every stage. But it is possible to note that these programs, like those for affordable housing mandates, all involve efforts to impose patterned principles—some externally desired end—on communities that are not consistent with the single-owner models developed here.¹⁴⁹ Again, it is worth repeating that the situation would work far better if the government were authorized to use eminent domain power to purchase lands on which the various housing could be located. In that case, the state could organize a budget, and determine how to allocate it across communities. It could also exercise that power without local consent, and buy off the resistance of key landowners by offering full compensation. None of this was done. It is not therefore appropriate to dwell on the pathologies that were built into the program as early as 1975, as such defects can never be removed. The limits of coercion, the dangers of faction, and the want of coherent knowledge all doomed the plan to failure.

CONCLUSION

The purpose of this paper is to offer a conceptual explanation of how to make sound land-use development decisions in the face of the pervasive positive and negative externalities caused by all human actions. The key move is to start with a universe in which no externalities are possible, namely those in which all persons take either directly or by way of succession from a single owner who has the proper incentives to internalize all gains and losses from future productive activity. The gains that are given to one person generate the prospect of additional revenues, but

147. See Payne, *supra* note 143, at 26 (describing the complexity of the proposed fair-share formulas).

148. Cf. GORNSTEIN & VERRILLI, *supra* note 135, at 7 (discussing the increase in families with school-aged children in communities with reputable school systems).

149. For the notable critique of patterned principles, see ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 149–231 (1974).

the correlative losses generate offsetting revenue losses. All decisions therefore involve the correct form of netting out gains and losses so that the socially optimum result is obtainable whenever the single owner maximizes that gain.

In dealing with these issues, one discovers, both in theory and in practice, that the control of nuisance-like activities generates a more or less uniform set of responses that serve as a template to set boundary arrangements between two or more parties that do not derive their ownership rights from a common source. Hence the law of trespass and nuisance turns out to be relatively easy to impose and, in general, can be made to work well. But the set of positive benefits from gainful interactions varies widely across different projects, especially given the mix of parties who buy into the scheme, so that it is far harder to generate a set of rules for paying restitution for unrequested benefits between strangers. The effort to use private-law remedies generally fails because the benefits are too numerous and ill-defined. Sometimes a legal regulation might work, although there is risk of overregulation. Often social pressures may be the best system for dealing with these lost opportunities.

What is clear, however, is that any system of public law magnifies the risks of major economic dislocations. The private logic of the single owner does not afford any support for efforts to create extensive zoning schemes that not only separate parties but also specify particular uses for particular locations, or which require extensive cross-subsidies for affordable or fair-housing programs. Often these goals are unattainable, even if the state offers compensation for the parties whose property is taken for some allegedly larger social objective. It is therefore necessary to learn once again the limits of law in solving all social problems. A system of decentralized property rights controls most of the negative externalities. A system of private regulation can capture most of the positive externalities. It is always necessary to remind ourselves that the effort to push legal controls into uncharted territories often does more harm than good.