WINDFALLS, WIPEOUTS, AND NUISANCE LAW: STRICT LIABILITY WITH OR WITHOUT RESTRICTED DAMAGES*

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In *Windfalls for Wipeouts*[1] (*WFW*), authors Hagman and Misczyn-ski address the issue of recapturing the benefits and compensating the losses to landowners that flow from certain public and private activi-ties. The authors' principal analysis consists of a proposal for the enactment of a windfalls for wipeouts plan. This scheme, in either its omnibus format or controls format,[2] provides for the recapture of benefits through taxation and the compensation of loss through direct payment. Hagman and Misczynski's text also includes, however, a discussion of existing windfall recapture and wipeout mitigation de-vices. In chapters 8 and 9, for example, Davis D. Thompson evalu-ates the role nuisance law plays as a wipeout mitigation device.

1. D. HAGMAN & D. MISCZYNSKI, WINDFALLS FOR WIPEOUTS: LAND VALUE CAPTURE AND COMPENSATION (1978) [hereinafter cited as WFW].

2. WFW, *supra* note 1, at 31-71. The primary distinction between the omnibus proposal and the controls proposal is that the former treats all windfalls and wipeouts whatever the cause while the latter addresses only those caused by governmentally instituted land use controls.

Thompson concludes that current applications of nuisance law produce inefficient results and advocates the adoption of a "Strict Liability with Restricted Damages" rule (SL/RD) to make nuisance law more efficient. Acceptance of Thompson's SL/RD approach would require courts to abandon the present "best-user" approach characteristic of American nuisance law and eschew the traditional measure of compensatory damages.

Thompson presents his analysis in a manner which is only superficially attractive. On a first reading, Thompson's analysis does seem to "work"; SL/RD appears to maximize total welfare. Thompson's analysis, however, ignores the buzz of Meade's storied bees.[3] The ever present problem of externalities[4] casts considerable doubt on the otherwise persuasive quality of Thompson's analysis. The value of beneficial externalities, although a product of an individual's land use decision, can neither be captured by the individual nor reflected in the individual's calculus of the impact of his or her action. Other analysis by Thompson raises additional unanswered questions.

The issue addressed here is not whether Thompson's analysis will ultimately prove sound. Rather, this Article proposes that Thompson's analysis provides inadequate support for his conclusion. The points made are neither new nor startling to individuals familiar with welfare economics. The points merit repetition, however, because *WFW's* audience will undoubtedly include many who are unfamiliar with economic analysis and who are otherwise apt to find Thompson's analysis, or that in favor of other strict liability proposals, convincing.

The relationship of nuisance law, whatever its precise parameters, to Hagman and Misczynski's proposed omnibus scheme, raises a subsidiary issue. The incorporation of nuisance law into the windfall for wipeout proposals poses issues that deserve emphasis. Given the magnitude of Hagman's and Misczynski's undertaking, however, readers should not be surprised to find some slippage in the incorpo-

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3. *See* Johnson, *Meade, Bees, and Externalities,* 16 J. LAW & ECON. 35 (1973). *See also* Gould, *Meade on Externalities: Should the Beneficiaries be Taxed?,* 16 J. LAW AND ECON. 53 (1973).

4. An externality is the amount by which social cost diverges from private cost. *See* Dahlman, *The Problem of Externality,* 22 J. LAW & ECON. 141 (1979). Externalities result because of the presence of transaction costs. *See* Coase, *The Problem of Social Cost,* 3 J. LAW & ECON. 1 (1960). *See also* Calabresi, *Transaction Costs, Resource Allocations and Liability Rules: A Comment,* 11 J. LAW & ECON. 67, 68 n.5 (1966).

ration of in-place mitigation schemes into the author's omnibus proposal. The proposed incorporation is, nevertheless, somewhat odd and deserves discussion.

I.   STRICT LIABILITY WITH RESTRICTED DAMAGES—THE PROPOSAL

Thompson's general proposition posits that American nuisance law does not ensure the "best" use of land. He proposes a strict liability with restricted damages (SL/RD) rule as an alternative to the present balancing system, or "best user" rule.[5] The major difference between a strict liability system (regardless of how damages are measured) and a best user system is that the former divests the decision maker of much of the discretion inherent in the best user approach. Once a court determines that a particular invasion is of the category that constitutes a nuisance, its only remaining duty is to calculate the damages caused by that invasion. The court need not consider the desirability of either the nuisance creating activity or the victim's land use. In theory, the nuisance maker, not the court, determines

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5   WFW, *supra* note 1, at 194-95. Thompson's characterization of American nuisance law as best user is accurate as a generalization. Most nuisance actions are based on either an intentional tort or a negligence theory. To be actionable under the intentional tort theory, defendant's action must be both intentional *and* unreasonable. RE-STATEMENT (SECOND) OF TORTS § 822 (1979). Roughly speaking, conduct is unreasonable or negligent only when the gravity of the harm outweighs the utility of the conduct. *Id.* § 8. *See* W. PROSSER, THE LAW OF TORTS § 89 (4th ed. 1971) [hereinafter cited as PROSSER]. Since the essence of a nuisance action is a conflict between land uses, a decision for either party is a decision that the victorious party is the "better or best" user of the land.

There are hints that American courts are moving away from "best user" towards a strict liability approach. In Boomer v. Atlantic Cement Co., 26 N.Y.2d 219, 257 N E 2d 870, 309 N.Y.S.2d 312 (1970), the court permitted defendant to continue to operate so long as it was willing to pay damages determined by the court. While the precise basis of the opinion is unclear, it is arguable that *Boomer* reflects the policy of § 829A of the RESTATEMENT (SECOND) OF TORTS (1979), which provides for recovery of damages by plaintiff if the harm he suffers is "severe and greater than the plaintiff should be required to bear without compensation." *See* "James-Keeton Proposals," RESTATEMENT (SECOND) OF TORTS, Explanatory Notes § 822 (Tent. Draft No. 17, 1971) for a discussion of the policy of § 829A. Judicial acceptance of *Boomer* and § 829A has not been rapid, however, and "best user" still appears to be the dominant approach of American courts.

Thompson somewhat incorrectly describes "best user" as assigning the right to use property "to the party who values it most highly." WFW, *supra* note 1, at 188. In fact, under the best user approach, the court assigns the right to the party whom it believes "ought" to value it most highly. The essence of "best user" is that the court, not the parties, is the decision maker.

whether the continued use of the property in the offensive manner is worthwhile. A market determination is substituted for a judicial decision.

In addition to proposing a shift from "best user" to a strict liability theory, Thompson proposes a reformulation of the method of measuring plaintiff's damages. Rejecting the traditional measure of damages as the difference in the value of plaintiff's land and buildings with and without the nuisance,[6] Thompson suggests that plaintiff's recovery be limited solely to the decline in the value of his land.[7] Defendant's liability, however, would continue to be measured by the court as the total decline in the value of plaintiff's land and buildings. The difference between the amount for which defendant would be liable (the decline in value of plaintiff's property) and the amount to be recovered by plaintiff (the decline in value to his land) would accrue to the government.[8] Although Thompson never provides a precise definition of "land," he apparently means only raw land.[9] The central thesis underlying his proposal to modify the measure of recovery is that so limited, nuisance law would encourage the plaintiff to make the most efficient use of his land in light of the limitation. So long as plaintiff devotes the use of his land to its best use, Thompson posits, the entire decline in the market value of his property will represent a decline in land value.[10] If a plaintiff inefficiently uses his land, the decline in value caused by defendant's action will reflect diminished value to both plaintiff's land and his buildings.

Thompson's major contribution to nuisance literature is his proposal for restricted damages.[11] Other commentators have advocated strict liability as the appropriate theory of liability.[12] Nevertheless,

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6. PROSSER, *supra* note 5, § 90.

7. WFW, *supra* note 1, at 194-95.

8. *Id.* at 195, 201.

9. In describing restricted damages, Thompson states that the defendant pays for damages to B's land and buildings, but B only recovers for the reduction in value to his land. Thompson discusses the value of the "land undeveloped." WFW, *supra* note 1, at 195. He thus seems to be speaking in classic Georgist terms. *See* WFW, *supra* note 1, at 33.

10. WFW, *supra* note 1, at 195.

11. Thompson had earlier made the same point. *See* Thompson, *Land Use Allocation and the Problem of Wipeouts from Private and Government Land Use: A Suggested Rule,* 6 ENVT'L L. REV. 431 (1975).

12. *See* Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules and Fines as Land Use Controls,* 40 U. CHI. L. REV. 681 (1973); Epstein, *Nuisance Law: Corrective Justice and Its Utilitarian Constraints,* 8 J. LEGAL STUD. 49 (1979). Nuisance law has

the major portion of Thompson's work in *WFW* is his defense of the proposition that strict liability is superior to a "best user" approach.

II. THE EVALUATION SCHEME

To support his call for a SL/RD system of nuisance law, Thompson adopts the evaluative scheme popularized by Michelman. Thompson states that "the general purpose of nuisance law . . . is to see to it that goods are produced efficiently and distributed fairly."[13] He then defines an efficient nuisance policy as one in which the various costs associated with nuisances, evaluated in dollars, are minimized.[14] The law is efficient, in other words, if it effects a result from which there is no change creating a potential Pareto improvement.[15]

In insisting upon a "monetizable" measure of costs, Thompson departs from the general pattern of recent nuisance law analysis. Michelman, for example, defines an efficient policy as one "which maximizes the total amount of welfare, of personal satisfaction, in society, *and not all satisfaction is material.*"[16] Calabresi and Melamed, like Thompson, define efficiency as minimizing costs. They define "costs," however, to include all disutilities includng those which are not monetary or even "monetizable" in some rough sense.[17] Thompson limits his definition to monetizable costs, but offers no real explanation other than to suggest that the restricted definition is traditional in nuisance literature.[18] Economic analysis of

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generated a considerable wealth of recent thoughtful literature. *See, e.g.,* Calabresi & Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral,* 85 HARV. L. REV. 1089 (1972); Polinsky, *Controlling Externalities and Protecting Entitlements: Property Rights, Liability Rules and Tax-Subsidy Approaches,* 8 J. LEGAL STUD. 1 (1979); Rabin, *Nuisance Law: Rethinking Fundamental Assumptions,* 63 VA. L. REV. 1299 (1977); Note, *Efficient Land Use and the Internalization of Beneficial Spillovers: An Economic and Legal Analysis,* 31 STAN. L. REV. 457 (1979).

13. WFW, *supra* note 1, at 184. Michelman popularized the notion of efficiency and equity analysis in land use control. *See* Michelman, *Property, Utility and Fairness. Comments on the Ethical Foundation of "Just Compensation" Law,* 80 HARV. L. REV. 1165 (1967).

14. WFW, *supra* note 1, at 185.

15. A potential Pareto improvement is an economic rearrangement in which gains can be so distributed as to make everyone in the community better off. *See* E. MISHAN, COST-BENEFIT ANALYSIS 132, 316-17 (1976). *See also* Calabresi & Melamed, *supra* note 12, at 1094.

16. Michelman, *supra* note 13, at 1173. (Emphasis added)

17. Calabresi & Melamed, *supra* note 12, at 1094 n.11.

18. WFW, *supra* note 1, at 185.

nuisance law is, however, hardly traditional. Thompson refers to Misczynski's comments on *Efficiency and Equity*[19] elsewhere in *WFW* but they offer little support for his position.[20] Misczynski's justification for using market-derived values is largely pragmatic. He accepts market-established values because they can be measured while "there is no way to go out and measure welfare."[21]

Of course, it is not necessarily intellectually dishonest to proffer a definition primarily for pragmatic reasons; such an approach is convenient. The difficulty is that the definition simply does not fit. Thompson himself notes that the definition "has the considerable disadvantage of assuming that [costs] are properly weighed by their market value in dollars."[22] Thompson's determination that a system is efficient is correct, in other words, only to the extent that no nonmonetizable costs exist and to the extent that those costs which have monetary values have been accurately valued. Neither proposition is ever true. The error is particularly glaring when a proposed system depends upon encouraging an individual to make decisions that reflect only market valuation.

Thompson categorizes costs along the general lines suggested by Ellickson and Michelman.[23] He suggests that the costs of a nuisance include nuisance costs,[24] prevention costs,[25] administrative costs,[26] and demoralization costs.[27] Thompson notes that administrative costs include negotiation costs and litigation costs.[28] He divides demoralization costs into demoralization costs and risk costs.[29] Finally,

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19. *Id.*

20. *Id.*

21. *Id.* at 145.

22. *Id.* at 185. As Calabresi and Melamed note, one problem with insisting on a monetary valuation is that some matters are never entered into the calculation. *But see* Fischel, Windfalls for Wipeouts in a Coasion Property Rights Perspection, (August, 1979) (paper presented at Windfalls for Wipeouts Conference at Vermont Law School), in which Fischel argues that all things have a monetary value.

23. *See* Ellickson, *supra* note 12, at 688-89; Michelman, *supra* note 13, at 1214.

24. WFW, *supra* note 1, at 185.

25. *Id.* Thompson subdivides prevention costs into prevention (physical cost, or out-of-pocket) costs and opportunity costs. The distinction is often significant to prevent opportunity costs from being ignored. For our purposes, however, the two can be lumped together.

26. *Id.* at 186.

27. *Id.*

28. *Id.*

29. *Id.*

Thompson introduces the concept of "misallocation costs." Misallo-cation costs occur "when the sum of nuisance and prevention costs which would occur under a given assignment of rights is greater than the sum which would occur if administrative costs were zero."[30]

Thompson's definition of damages requires comment. He assumes damages equal the lesser of nuisance costs and prevention costs,[31] thus incorporating the doctrine of avoidable consequences.[32] For ex-ample, if a smoke belching factory causes a $75,000 house to be unin-habitable unless a $5,000 air filtration system is installed, Thompson would value the damages to the house at $5,000, not $75,000. This issue might be moot, however, if a court computes the damages as the difference between the market value of plaintiff's land with and with-out the nuisance; the market probably will reflect the presence of pre-vention costs as a floor to market value diminution.[33] A court might also, however, take into account peculiarities of the plaintiff, such as inability to tolerate the side effects of the most efficient preventive measure; *e.g.*, if the owner of the $75,000 house could not tolerate the filtered air unless it were further treated at the cost of an additional $20,000. If it did so, plaintiff's recovery might exceed the otherwise market-determined decline in value. The extent to which courts are willing to tolerate a plaintiff's special needs or preferences is not clear.

Thompson also ignores the distinction between market value and personal value suggested by Ellickson[34] as being too difficult to meas-ure and somewhat insignificant.[35] He further assumes that the amount A would be required to pay B to buy a right from B to pol-lute is the same as B would pay to have A cease polluting if he were otherwise entitled to pollute.[36] The identity of these amounts may be

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30.   *Id.* at 188.

31.   *Id.* at 191.

32.   For example, the rose garden in Section IV *infra*.

33.   There appears to be some doubt about whether the doctrine of avoidable con-sequences applies to nuisance law. *Compare* PROSSER, *supra* note 5, at 391, *with* WOOD ON NUISANCES (5th ed. 1875). As discussed in the text, the issue becomes moot if the courts use decline in market value as the measure of damages.

34   Ellickson, *supra* note 12, at 735-37. Ellickson has suggested that plaintiff be entitled to recover an additional amount of damage in addition to market decline to compensate him for the loss of his homestead and the disorientation and discomfort he would suffer in changing his life style.

35.   WFW, *supra* note 1, at 191-92.

36.   *Id.*

assumed only if A's and B's values are wealth indifferent. Mishan suggests that such is not the case.[37] If Mishan is correct, Thompson errs in failing to recognize that what is Pareto-optimal would vary depending upon the allocative effects of the various liability rules he uses.

Thompson's evaluative scheme virtually ignores the issue of fairness. Unlike his attempt to define efficiency, he offers no concrete definition of fairness. Fairness, he states, is an ill-defined concept.[38] Undeniably, he is correct. The inability to define fairness does not, however, diminish its importance. Yet, that inability tempts one to ignore it. Thompson does so, stating: "It is without question that fairness is and ought to be an important goal of nuisance law. But we have little to recommend as an objective guide for determining the fairness of suggested revisions of that law."[39] The concept of fairness plays virtually no further role in Thompson's evaluation. He concentrates solely on developing and applying efficiency criteria. Unfortunately, Thompson's approach runs afoul of Misczynski's admonishment in *WFW* that economic analysis often shortchanges discussions of equity (fairness) because economists have useful observations about efficiency but only opinions about equity.[40] As Misczynski, and probably Thompson recognizes, the danger is "that equity and efficiency strategies may become inextricably interlocked, and a policy which simultaneously deals with both of them may be required."[41]

Efficiency is dependent upon a given distribution of wealth. By ignoring fairness Thompson assumes a given distribution. Yet nuisance law appears to have often functioned as a vehicle for redistributing wealth.[42] For example, a decision that recognizes a right to be

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37. *See* MISHAN, COST BENEFIT ANALYSIS, *supra* note 15, at 132-34. *See also* R. POSNER, ECONOMIC ANALYSIS OF LAW, 35 n.1 (2d ed. 1977); Calabresi & Melamed, *supra* note 12, at 1095. Unlike firms, individuals' preference curves, that is, the amount they would pay for various goods, are variable and dependent upon wealth. Therefore, if the initial assignment of entitlements makes individuals wealthier, they may value the entitlement more or less highly than they would were they required to buy it. The initial entitlement may thus serve to redefine the Pareto optimal point. This phenomenon, sometimes termed "wealth elasticity," is a significant check on the Coase theorem. *See* Coase, *supra* note 4.

38. WFW, *supra* note 1, at 184.

39. *Id.* at 185.

40. *Id.* at 142.

41. *Id.* at 143.

42. The demand for the recognition of aesthetic nuisances is to some extent

free from a type of invasion previously permissible serves to make plaintiff and others like him richer. Conversely, defendant and others in the same situation become poorer. Although such a decision might arguably be the "efficient" result in the long run, it remains true that for reasons other than efficiency one group has been favored at the expense of another by affording that group a right it could not or might not have cared to purchase.

That nuisance law may act as a device to permit courts to redistribute wealth may be objectionable to some, particularly those perceiving the proper role of law to be solely that of removing barriers that stifle the operation of the market, does not justify ignoring that role. Thompson's failure to consider the equity issue is especially disturbing in that he silently undercuts the equity power of the court by advocating adoption of strict liability. Perhaps courts make poor benevolent dictators and ought to be stripped of that power, but advocates of systems that would do so have a duty to address the equity issue. Since Thompson fails to make the argument in terms of the efficiency criteria he considers, analysis of the relative merits of various systems on equity grounds is unnecessary. Should Thompson prove correct in his theory that SL/RD is more efficient than "best user," one must determine whether the loss of the court's equity power is a loss worth bearing.

III. STRICT LIABILITY WITH RESTRICTED DAMAGES— PRELIMINARY COMMENTS

After applying various liability/remedy combinations to a series of hypothetical cases,[43] Thompson concludes that the best single ap-

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designed solely as a device for internalization of unsightly diseconomies. It will, however, also have a redistributive effect upon wealth which may or may not be intended. *See generally* Note, *Aesthetic Nuisance: An Emerging Cause of Action*, 45 N.Y.U. L. REV 1075 (1970). Certainly anyone who advocates that right must recognize that among those who are most likely to be directly affected are the employees of plants that are deemed to be aesthetically unappealing.

43   Thompson's methodology is to compare the efficiency of various liability/remedy combinations in three hypothetical cases. The combinations used are best user/injunction, best user/damages, strict liability/injunction, strict liability/damages, no liability/inverse damages, strict liability/damages/contributory negligence, and strict liability/restricted damages. Case 1, the simple case, is the classic smoke spewing factory/affected residence case. Difficult Case I is the situation confronting the landowners in the simple case *before* either had built. Difficult Case II, the "Making the Nuisance Go Away" case, involves the situation in which the factory, built at a time when it represented the efficient use, becomes inefficient.

proach to nuisance law is to adopt a strict liability with restrictive damages rule (SL/RD). Thompson suggests five reasons for adopting SL/RD:

1) a defendant, being liable for the full measure of damages, must determine the utility of his use;

2) a plaintiff, being limited to recovery of decreases in land value, will attempt to use his property for its most efficient use;

3) administrative costs are minimized because there is less uncertainty about the result of litigation, thereby facilitating negotiations. In addition, should litigation be necessary, the court's role is limited to determining the extent of defendant's liability and the amount of plaintiff's recovery;

4) risk costs are reduced because the threat of certain wipeouts would be eliminated; and,

5) demoralization costs are decreased because entitlements would be clearly stated.[44]

To clarify the parties' respective rights, Thompson rejects Ellickson's attempts[45] to attach strict liability to certain uses. Instead, he assigns strict liability for certain types of physical invasions.[46] He considers any general "aesthetic right" to be undefinable but permits the courts to create exceptions for certain designated uses such as funeral parlors, cemeteries, and nuclear plants.[47] Thompson's belief

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Throughout the analysis, Thompson posits the efficient result which does not vary despite variations in entitlements. He initially assumes that administration costs are zero but relaxes that assumption as he develops his argument. WFW, *supra* note 1, at 189-96.

44. *Id.* at 199.

45. Ellickson, *supra* note 12, at 728-33.

46. WFW, *supra* note 1, at 196-201.

47. WFW, *supra* note 1, at 200. The reader should note the irony of Thompson's decision. Although purporting to adopt a strict liability system (such as a system in which the market determines outcomes) Thompson is compelled to make the grandest choice of all. He must decide what is or is not a nuisance. This choice is necessary since the market cannot answer what Calabresi refers to as the "what is a cost of what" question. G. CALABRESI, THE COST OF ACCIDENTS 133-34 (1970). Were that question not answered, there would be a plethora of nuisance actions in which plaintiffs could argue that they had suffered damage by foregoing using their property in a way we commonly think of as a nuisance. For a discussion of the reciprocal nature of damages, see Coase, *supra* note 4, at 2. In arriving at his categorical definition of "nuisance," Thompson may be showing his true motive. He is more concerned with who makes the crucial decision (the courts or him) than how that decision is implemented. Of course, the market cannot function unless initial entitlements are decided. It is ironic that those who argue for strict liability and decision making by the impersonal market must ultimately make (or accept choices made by others) the most crucial decision of all—whose position is to be the valued one?

that SL/RD will give useful market information to both plaintiffs and defendants may ultimately prove to be the weak link in his analysis. His remaining reasons for preferring SL/RD, however, raise three distinct concerns.

A. *Administrative Costs*

Thompson's assumption that the administrative costs associated with administering a SL/RD system would be lower than administering other systems[48] is unsupported. In a strict liability system the determination of what is a nuisance is generally easier than in a balancing system like the "best user," although so long as courts are permitted to create exceptions for particular uses, the definition can never be certain. It is unclear, however, whether uncertainty about the definition of "nuisance" deters or encourages claims. One might speculate that uncertainty, by increasing litigation expenses, deters small claims and encourages larger ones. Strict liability, by clarifying the definition, might therefore encourage the prosecution of small claims and discourage larger claims. That result, however, is far from clear and might well be erroneous depending upon the identity of the claimant, his relevant economic position, his beliefs and even the deductibility of his litigation expenses.[49] Though Thompson notes that ordinary strict liability might be more expensive than "best user,"[50] he never addresses the issue.

Thompson implies, however, that restricted damages tip the balance decidedly towards strict liability. Given SL/RD, a court need not determine whether a plaintiff was "contributorily negligent," a step which Thompson believes is otherwise necessary in a strict liability system to assure efficient results.[51] Furthermore, Thompson asserts that the additional step of determining plaintiff's recovery is less expensive than determining contributory negligence.[52] Assuming that Thompson is correct, he has proven only that SL/RD is less ex-

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48. WFW, *supra* note 1, at 198.

49. An individual's decision to litigate is highly dependent upon such matters as his risk tolerance, the deductability of litigation expenses, the ability to obtain necessary data (or to conceal it) and the relative resources of his opponent. The decision to litigate, for example, might represent a decision that litigation is the least expensive way to delay. *See generally* R. POSNER, *supra* note 37, at 434-41.

50. WFW, *supra* note 1, at 198.

51. *Id.* at 194. Thompson uses "contributory negligence" in a Posnerian sense. *See* Posner, *Strict Liability: A Comment,* 2 J. LEGAL STUD. 205, 207 (1973).

52. WFW, *supra* note 1, at 198.

pensive than strict liability with contributory negligence (SL/CN); he never addresses the question of whether SL/RD is cheaper than the best user rule. Consideration of that issue is left to the reader.

Surprisingly, Thompson never addresses two elements of administration costs peculiar to his SL/RD system. First, he fails to consider the difficulty of determining the amount of damages plaintiff receives or the measure of restricted damages. Any measure of damages here must begin with the value of the plaintiff's land. Thompson, however, never defines land. Presumably, he means only raw land.[53] He suggests that determining plaintiff's site value would not be easy but gives no indication of how difficult it might be. Hagman and Misczynski, on the other hand, indicate elsewhere in *WFW* that site valuation is quite costly and administratively difficult.[54] Some commentators even suggest that measuring site value is infeasible in a theoretical, as well as practical, sense.[55]

Secondly, Thompson tends to ignore the costs that individuals would incur to determine the effective use of their respective lands. He recognizes that "in the real world determining the efficient use of property is a very difficult and costly task."[56] Yet in his discussion of administrative costs, he considers only the costs of resolving disputes; he ignores the information gathering costs imposed on parties deciding how to act.[57] On this point, Thompson acts more as an advocate than an analyst.

B. *Risk Costs*

Thompson states that strict liability might be expected to reduce risk costs by limiting the number of instances in which plaintiff is totally wiped out. He contends that risk reduction is socially desirable, relying "on the widely accepted assumption that individuals are risk adverse."[58] In so contending, Thompson falls victim to a fallacy of composition—the assumption that what is true for the individual

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53. *See* note 9 *supra.*

54. WFW, *supra* note 1, at 35.

55. *See* Oldman and Teachout, *Some Administrative Aspects of Site Value Taxation: Defining Land and Value; Designing a Review Process,* in TAXATION OF URBAN PROPERTY IN LESS DEVELOPED COUNTRIES 207 (R. Bahl ed. 1979). *See generally* THE ASSESSMENT OF LAND VALUE (D. Holland ed. 1970).

56. WFW, *supra* note 1, at 193.

57. *Id.* at 197-98.

58. *Id.* at 198.

or part is necessarily true for the group or whole. It might be that risk and the potential benefit of undertaking it is a vital component of the macroeconomy. Society might benefit more from encouraging risk takers to act than from reducing risks. The reduction in risk costs associated with strict liability is not clearly a desirable result in the macroeconomic sense. Any contention that it is needs more support than an illogical generalization of the experience of the individual.

C.   *Demoralization Costs*

Thompson concludes that strict liability is likely to reduce demoralization costs because it creates "clearly assigned rights which the members of society can understand and learn to expect."[59] Individuals would thus experience fewer frustrations of their expectations. Best user, on the other hand, relies on individualized balancing to determine "reasonableness" and, therefore, does not produce results as predictable as those under strict liability.

Thompson confuses predictability with fairness. His assumption that clearly assigned rights shape expectations and thereby define "equitable" is true only if society perceives those rights as naturally ordained. If, on the other hand, society perceives law as a social tool, the assignment of entitlements will coincide with expectations about equity only so long as it appears to produce results consistent with those expectations. History is replete with examples of clearly defined rules which promoted revolution, not satisfaction. It is possible, therefore, for strict rules to produce results which are frequently arbitrary or inconsistent with expectations and thus demoralizing.

"Best user," by emphasizing reasonableness, tends to appeal to one's sense of fairness. Though "best user" also produces results inconsistent with expectations, the results do not appear to be as arbitrary as strict liability results. Although not everyone will concur as to what is "reasonable" in a given situation, everyone can agree that "reasonableness" is an appropriate test. Results inconsistent with one's expectations need not be recognized as evidence of bad law but can be rationalized as evidence of poor judging or lawyering. Moreover, given that in any "reasonable" system presumptions, generalizations and rules of thumb decide a great number of cases, it cannot be assumed that the number of cases in which expectations are denied is significantly greater in a best user system than under strict

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59.   *Id.* at 199.

liability.[60] It is unclear, therefore, which system would produce higher demoralization costs.

Additionally, Thompson's proposal does not call for adopting strict liability in a vacuum, but for replacing the present system. A dynamic element is thus introduced. Nowhere does Thompson address the vital question of whether the savings to be gained from his system would adequately compensate for the demoralization costs associated with both the changeover and the realization by affected people that a system which has abruptly changed once may at some future date do so again.

The problem of abrupt change and its attendant demoralization costs raises yet another question about the validity of Thompson's assumption that SL/RD reduces demoralization costs.[61] Even if we assume that the system is implemented and that clearly defined rights are assigned, we must recognize that change will constantly occur and will create pressure for recognition of new societal preferences. A best user system permits recognition of that change in a way that does not dramatically contradict existing rules. In fact, a major benefit of a best user system is that it facilitates relatively painless recognition of change.[62] Strict liability draws hard lines. Departures, therefore, tend to be more apparent. As one would expect, recognized changes are more demoralizing than those which might be perceived as correcting adjustments in one's expectations.

Whether implementation of SL/RD can be justified as reducing demoralization costs is a far more complex subject than Thompson's brief discussion suggests. He may well be correct in his conclusion. His basis, however, is purely speculative.

In sum, Thompson advances SL/RD in part because it would lessen administration costs, demoralization costs, and risk costs. He does not adequately support his conclusions about the former two costs. It is quite possible that SL/RD might increase both. Even if one grants Thompson his point about risk costs, it is not clear whether that reduction is socially desirable. Again, his argument is

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60. *See* PROSSER, *supra* note 5, § 35 for a discussion of the common law courts' attempts to formulate rules of law to govern negligence cases. For an illustration of the difficulties of doing so, *compare* Baltimore & Ohio Ry. v. Goodman, 275 U.S. 66 (1927) *with* Pakora v. Wabash Ry., 292 U.S. 98 (1934).

61. *See* WFW, *supra* note 1, at 199.

62. *See* Bischoff, *The Dynamics of Tort Law: Court or Legislature?*, 4 VERMONT L. REV. 35 (1979).

unsupported. SL/RD may in fact be a "better" system, but before we subject ourselves to the costs of overhauling our present system, Thompson must provide clearer reasons.

IV.   INTERNALIZING EXTERNALITIES[63]

The main thrust of Thompson's SL/RD proposal is an attempt to apply principles of strict liability to resolve land use disputes. The basic premise of strict liability systems is that, if required to internalize the harmful externalities created by his land use, an individual acting in his own best interest effects an efficient result. Thus, assume that A owns land which as a factory site has a value of $100,000. Alternatively, A's land is worth $75,000 as a residential site. Based on that data, A would build the factory site and capture the $25,000 excess. Assume, however, that the factory generated $30,000 in nuisance costs for which A would be liable in a strict liability situation. What would A do? He would either develop his land as a residential site or pay prevention costs if the prevention costs and administration costs associated with their payment were less than $25,000. If the nuisance costs consisted of smoke damage to B's rose garden and B were willing to do without his garden for less than $25,000, A could "buy out" the garden and develop a factory site. If the garden could not be relocated, protected or purchased for less than $25,000, A would develop a residential site.

Can it be said that any of the above results are efficient? No! The basic assumption in the analysis is that the values assigned to A's land and B's garden accurately reflect their social worth. The assumption is only partially true. The $100,000 valuation assigned to A's land if developed as a factory site represents the discounted value of A's land for that use. That is, the present value of all rentals that A would receive if he were to develop a factory site would be $100,000. If, under a strict liability system, he were assigned liability for the nuisance costs to B's garden, the present value of which is $30,000, the value of A's land as a factory site would decline by the lesser of nuisance costs or prevention costs plus administration costs. Likewise, the value of B's land, were A entitled to operate his factory with impunity, would decrease by the lesser of nuisance or prevention costs plus administration costs. Thus the value of both A's and

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63. *See* Note, *Efficient Land Use and the Internalization of Beneficial Spillovers: An Economic and Legal Analysis*, 31 STAN. L. REV. 457 (1979), for a recognition of the problem of internalizing external benefits.

B's lands depends upon the gross value of all benefits for which the owner could charge less the value of all diseconomies for which he is liable. Excluded from the calculus are the value of beneficial externalities generated by a land user but for which he cannot charge and diseconomies for which he is not liable. Restated in Hagman/Misczynski terminology, land values reflect externalities only to the extent that their owners must pay for "wipeouts" and may collect for "windfalls."

The significance of the exclusion of uncompensated wipeouts and nonliability windfalls can be illustrated by returning to the hypothetical. Recall that if liable for the damage to B's garden, A would build a house if prevention/administration costs exceeded $25,000. By doing so he would maximize his wealth. Might not the factory, however, generate "windfalls" as well as "wipeouts?" The answer intuitively is yes. Some benefits, of course, are captured. For example, if A's building of a nearby factory is advantageous for those who use its output, A could expect to extract some payment for that advantage. That externality would be recaptured in the form of higher prices. The higher than normal profits increase the value of the land as a plant site. In our hypothesis the $100,000 valuation would reflect this result.

All beneficial externalities are not, however, recaptured. Those not recaptured fall into two categories. One includes those economies which would, in a purely competitive system, be recaptured but are not because of rigidities existing in our system. Thus, if the building of a factory increases the value of nearby residences (at least those upwind) because it would substantially lessen the commuting costs of the workers who inhabit them, one might anticipate that A could recapture some of that benefit through wage reductions. Even if one were talking about a mill town, however, which might present a somewhat homogeneous worker population, it is unlikely that A could recapture the externalities. Rigidities introduced by minimum wage legislation, union pay scales, and welfare legislation are only some of the factors which might prevent A from realizing the benefits which are theoretically available to him because he contracts with those upon whom the benefits are bestowed. The $100,000 valuation of A's property does not reflect this benefit. Instead, the benefit is captured by the mill workers. For the purpose of later consideration, we will refer to this noncaptured benefit as Re (beneficial externalities caused by rigidity in the economy).

A second category of noncompensated externalities are those

which represent incidental externalities (Ie). An example is increased
value for local homeowners who are not employed by A but who
could sell to those who would be, or for local business which would
sell to either A or his workers. A's inability to collect the incidental
benefits results from the failure of the law to vest A with an entitle-
ment to do so. Absent a contractual relationship, A's claim to the
value of the benefit is not legally protected.[64]

What then exists are two quite different calculi. From A's view-
point, the issue is one of deciding between L_R and L_F -D_{CL} in which
L_R is the value of his land as a residential site, L_F its value as a fac-
tory site, and D_{CL} the costs of diseconomies associated with the fac-
tory for which he is liable. In every case D_{CL} is the lesser of (N_C +
A_C) (nuisance costs plus administration costs of their payment) or
(P_C + A_C) (prevention costs plus associated administrative costs). If
$L_R > L_F - D_{CL}$, A develops his land as a residential site; if $L_R < L_F$
$- D_{CL}$, he develops it as a factory site; if $L_R = L_F - D_{CL}$, he is
indifferent.

From society's standpoint, that is, macro as opposed to micro, the
calculus is considerably more complex. Society's choice is between
$[L_R + Re_R + Ie_R - (D_{CLR} + D_{CNR})]$ and $[L_F + Re_F + Ie_F - (D_{CLF}$
$+ D_{CNF})]$. $Re_R + Ie_R$ and $Re_F + Ie_F$ represent the noncaptured ben-
eficial externalities created by A's developing his land for residential
and factory use respectively. $D_{CLR} + D_{CNR}$ and $D_{CLF} + D_{CNF}$ are
the costs of diseconomies of residential and factory use for which A is
and is not liable respectively.

To A the choice is between $75,000($L_R$) and $100,000($L_F$) minus
the lesser of $30,000($N_C$ + A_C)[65] or (P_C + A_C). If P_C + A_C >
$25,000, A develops his land for residential use. From society's posi-
tion, however, the preferred solution depends upon the magnitude of
noncaptured and nonliability externalities that are not relevant to A.
Therefore, even if P_C + A_C > $25,000, it is not clear that A's use of
his land as a residential site is most efficient. Nevertheless, under a
strict liability system, A builds a residence whenever (P_C + A_C) ex-
ceeds $25,000. The inability of the nuisance maker to capture all ex-
ternal benefits generated by his land use undercuts the comfortable
notion that by acting in his self-interest he will make the socially de-
sirable decision.

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64. *See generally* E. MISHAN, *supra* note 15, at 111.

65. A_C is assumed to be zero although in reality A_C is always greater than zero
and might often be considerable.

The problem of uncompensated beneficial externalities likewise arises in calculating prevention costs. If in our initial hypothesis B were willing to forego the beauty and pleasure of his garden for $20,000, then A would build his factory, buy out (or condemn) B's garden for $20,000, and maximize his land's value at $80,000 ($100,000 − $20,000). Even if we assume zero Re, Ie, and D_{CN}, that result is efficient only if the destruction of B's garden did not itself create diseconomies by destroying benefits that the garden generated but for which B was not compensated. Assume, for example, that the serenity of B's garden increased the value of adjacent lands by $15,000. In that case the social measure of prevention costs is $35,000, not the $20,000 that B demands or is awarded as damages. If Re_F, Ie_F, and D_{CN} were zero, A's land is most efficiently used as a residence. Again, in a strict liability system A makes an inefficient decision because the measure of damages reflects understated prevention costs.

Although it is clear why Re's, Ie's, and D_{CN}'s exist, the reason should be emphasized. Simply stated, if transaction costs were zero, the amounts externalized would be accounted for in every transaction. For example, returning to our hypothesis, B would correctly measure prevention costs because the adjacent land owners would offer him a $15,000 "bribe"[66] to continue his garden. He would include that amount in the costs of discontinuing his gardening. Administration costs, however, are never zero and, if the effects of the garden are diffuse, the costs to adjacent landowners of determining and assessing the amount of the bribe might well exceed the benefits of the garden. Thus, as one relaxes the assumption of zero administration costs, the assumption that A's cost-benefit analysis mirrors society's becomes untenable.

The central premise of Thompson's strict liability system, that A will necessarily act efficiently when maximizing his wealth, is erroneous. Efficiency results only if 1) A and B (and all other parties) are permitted to capture all benefits and are liable for all externalities *or* 2) a third party decision-maker capable of social calculus is substituted for A.[67] Pressing the latter point, we must ask: Does the best

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66. The term *bribe* is used non-pejoratively to refer to the amount one will pay another to secure an advantage to which he is not initially entitled. *See generally* Coase, *supra* note 4.

67. If A is asked to engage in cost-benefit analysis from a social viewpoint, he would, of course, be acting as a third-party decision maker.

user rule employ such a decision-maker? A court using the best user rule can consider externalities in deciding the appropriate remedy. The best user approach, in fact, dictates a social calculus which includes consideration of beneficial externalities and nonliability diseconomies. In that respect, it is superior to the strict liability rule.

While the best user rule dictates a social calculus, it does not necessarily insure that the balancing is accurate. One must ask whether the courts are competent decision-makers. The ability of courts to decree efficient results is hampered, if not defeated, by the difficulties they face in attempting to obtain the necessary data. Returning to our hypothesis, A and B will each be represented at the proceedings and can be expected to present information favorable to their respective positions. Furthermore, liberal discovery rules generally will enable each to obtain information in the possession of his opponent. Neither party, however, is in a particularly advantageous position to evaluate the externalities favorable to his position (such as beneficial externalities created by their use, diseconomies created by others).

It is tempting to suggest that those who benefit but pay no compensation would intervene to explain their positions. The suggestion, however, seems unrealistic First, the impact of incidental benefits may be so diffuse as to be inseparable, and thus not recognized as distinct from other influences on the value of the benefited party's land. Second, even if recognized, the benefit may be so insignificant, as compared to the costs of intervention, as to prevent the benefited party from going forward. Third, even if the benefits are significant, intervention is apt to be forestalled by the free rider problem. Finally, the costs of intervention in judicial resources may foreclose the opportunity to intervene.[68] All of these make it unlikely that the court will obtain the data necessary to render an efficient decision.

The identity of the decision-maker—be it judge or juror— also decreases the likelihood that a decision will be the most efficient. Unlike the strict liability system, the decision-maker does not make decisions that affect him directly. Instead, he attempts to decide what *ought* to be the result. He attempts to achieve a balancing of interests that is appropriate from a societal rather than a personal standpoint. But what the court believes the correct balance to be might often reflect ill-considered biases. Better decisions might be reached if the decision-maker were affected directly. Because the strict liability sys-

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68. *See generally* Shapiro, *Some Thoughts on Intervention Before Courts, Agencies and Arbitrators,* 81 HARV. L. REV. 721 (1968), for a discussion of intervention rules.

tem does not ask or rely upon altruistic action, the system has some appeal.

What then is the final result? The strict liability rule does not depend upon unselfishness or unbiased decision-making. It does not insure consideration of all relevant data. It relies for its vitality upon the decision-maker excluding from consideration all data that does not affect him regardless of its social significance. The best user approach presents the contrary situation. It dictates that the decision-maker act unselfishly, but unrealistically assumes that he will receive the relevant data and will act upon it from a societal viewpoint rather than one of personal bias. In sum, neither system can guarantee efficient results; neither is clearly preferable when judged by efficiency criteria.

The dilemma so far developed can be stated thus: Are courts, operating with the broad discretion afforded them by the best user system, sufficiently bad Pigouvian decision-makers to warrant the abandonment of that system and the adoption of an admittedly defective market system under the rubric of strict liability? Is the cost of market failure greater or less than the cost of nonmarket failure?[69] The answer is a somewhat unsatisfyng "no one knows." Selection of either system entails a gamble that the decision-maker must take. He cannot submit it to a market test. The litmus test is only a personal decision of whether the chosen system produces "good" results.

V. NUISANCE LAW AND THE OMNIBUS PROPOSAL FOR A WINDFALLS FOR WIPEOUTS SYSTEM

One subject that receives little consideration from Thompson or Hagman and Misczynski is the role that nuisance law plays in the omnibus proposal for a windfalls for wipeouts system. To be sure, recoveries of nuisance damages are considered by Hagman and Misczynski in the omnibus proposal. There they define a wipeout as "any decrease in the value of property, less . . . [d]amage [p]ayments."[70] They define damage payments to include amounts received in nuisance actions.[71] The interfacing of the omnibus proposal and Thompson's SL/RD nuisance system, however, is odd.

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69. *See* Wolf, *A Theory of Nonmarket Failure: Framework for Implementation Analysis*, 22 J. LAW & ECON. 107 (1979).

70. WFW, *supra* note 1, at 44.

71. *Id.*

In the omnibus proposal an individual who suffers a wipeout receives a mitigation payment of approximately fifty percent (actually somewhere between thirty percent and seventy percent).[72] Under Thompson's proposal, on the other hand, a wiped out landowner recovers one hundred percent—less litigation expenses—of the decrease in the value of his land, and zero percent of the decrease in the value of buildings.[73] (Presumably the latter would qualify for a mitigation payment.) Likewise, if a nuisance maker benefits from creating a diseconomy, that betterment is a windfall to him. Yet one who receives a nuisance windfall must repay it all plus administration costs, whereas ordinarily one is entitled to keep fifty percent of any windfall.

Neither Thompson nor Hagman/Misczynski offers any explanation for distinguishing between nuisances and other forms of windfalls and wipeouts. If all nuisances were intentional, the surcharge on nuisance makers might be thought of as a deterrent against unnecessary wipeouts. Nuisances, however, can result from negligent behavior, and even those which are intentional need be so only in the sense that one could foresee with reasonable certainty that one's land use will affect another's interest in the private use and enjoyment of land.[74] One need not intend harm for the nuisance to be "intentional." It is not so clear that the distinction can be justified in terms of deterring undesirable behavior.

The distinction between recovery for wipeouts caused by nuisance and other wipeouts is even more difficult to understand. If one is wiped out, one is wiped out. It is unlikely that one is particularly offended if it results from a nuisance as opposed to a governmental plan. Why then does one recover more if the wipeout is caused by a physical invasion of the type denominated by Thompson to be a nuisance? No explanation is offered.

Hagman and Misczynski are also at odds with Thompson in choosing the appropriate basis for determining mitigation payments. Thompson permits a successful plaintiff to recover only damages to the value of his land.[75] Denying a plaintiff recovery for the decline in the value of his buildings is, according to Thompson, vital in prompt-

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72.   *Id.* at 48.

73.   *Id.* at 195.

74.   RESTATEMENT (SECOND) OF TORTS §§ 8A, 825 (1979). *See also* RESTATEMENT (SECOND) OF TORTS Comment e (1979).

75.   WFW, *supra* note 1, at 195.

ing him to make the most efficient use of his land. Is the same reasoning not applicable to wipeouts resulting from other causes? Apparently, the answer is no. Hagman and Misczynski reject a "raw land" definition of property for either the "improved land" or "real estate" definition.[76] (They do not decide between the two.) Once again nuisance wipeouts are treated differently for no discernible reason.

The reason for the failure of Hagman and Misczynski and Thompson to coordinate the omnibus proposal and the SL/RD proposal might be that for Hagman and Misczynski nuisance law represents a minor component of a very large problem. Moreover, it is a component with which the courts have wrestled for nearly a thousand years. Hagman and Misczynski clearly intend to offer Thompson's analysis primarily as a proposal to improve that mitigation technique. That, however, does not explain fundamental differences such as the percentage of payment or basis of calculating damages.

VI. Conclusion

Like most of the recent nuisance literature, Thompson's analysis raises perplexing questions that cannot be answered by talismatic invocation of "right" and "wrong." The dilemma is as old as the issue of welfare economics itself. Those diseconomies that lawyers speak of as nuisances are inevitable byproducts of conflicting land uses that cannot be "corrected" without consideration of both the efficiency and the equity effects of the law. Thompson's proposal is an interesting sketch of how we might deal with nuisances. He admits his recommendations are tentative and formulated on the basis of "guesstimates."[77] His analysis should not be rejected for that reason. Although flawed by erroneous assumptions, SL/RD may nonetheless be a better system of nuisance law. Whether that is so requires further analysis.

From an overall perspective, neither Thompson nor Hagman and Misczynski has fully considered the role of nuisance law as part of the windfalls for wipeouts proposals. That loose end is understandable given the magnitude of Hagman's and Misczynski's undertaking. It is disturbing, however, because it suggests that *WFW* is itself but a rough sketch of an approach to resolving the problem of land use

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76. *Id* at 32-35.
77. *Id* at 201-02.

externalities. An enormous amount of detailed work obviously remains; neither the omnibus nor controls format of *WFW* is ready for enactment. In supplying the detail, however, we may find ourselves faced with problems of theory and implementation not readily apparent from the overall view. Upon reflection one is left with the disquieting question of whether in *WFW* Hagman and Misczynski have shown us the long sought after Northwest Passage or merely Alice's rabbit hole.