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Uncoupling the Law of Takings

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Uncoupling the Law of Takings

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

BY MICHAEL A. HELLER AND JAMES E. KRIER
two; the two new resolutions become available when we uncouple efficiency considerations from justice considerations, or, put another way, when we uncouple "taking" on the one hand from "compensation" on the other. The resulting set of four possible resolutions helps smooth out some of the many wrinkles for which the law of takings is renowned. And new wrinkles keep turning up. In Phillips v. Washington Legal Foundation, 118 S. Ct. 1925 (1998), the Supreme Court considered the meaning of the phrase "private property" in the Constitution's instruction "[N]or shall private property be taken for public use, without just compensation." The majority and dissenting opinions in Phillips took a range of interpretive approaches to the issue, each seemingly sensible but none fully faithful to the animating concerns of the just compensation requirement. The debate among the justices ends up shedding little light on the ultimate takings question in the case, which remains to be resolved on remand. As the latest in a string of unsatisfying takings decisions, Phillips proves less interesting for the answers it provides than for the questions it provokes, at least in our minds. Despite all their differences, the Court's nine members implicitly agreed on one thing — the possibility of a taking without compensation. This seemingly novel notion has moved us to think anew about the conventional law of takings, and to consider the virtues of an expanded approach.

### The purposes of the Takings Clause

Begin with the aims of the Takings Clause. In a vast and otherwise contentious literature, whether judicial opinions or scholarly books and articles, there appears to be virtual consensus that the purposes of just compensation are essentially two. Frank Michelman calls them "utility" and "fairness" in an article that remains, more than 30 years after its publication, the most significant piece of academic commentary on our subject ("Property, Utility, and Fairness: Comments on the Ethical Foundations of 'Just Compensation' Law," 80 Harvard Law Review 1165 [1967]). He could just as well have called them "efficiency" and "justice," and, in fact, he later does. Efficiency argues for allocating resources among alternative uses in ways that maximize value; justice argues for distributing the costs and benefits resulting from particular allocations in ways that satisfy some equitable principle of rightness.

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

#### A. Deterrence — general and specific

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

Specific deterrence has a related but nonetheless different purpose: the obligation to pay compensation can constrain governmental inclinations to exploit politically vulnerable groups and individuals. James Kent, in his Commentaries (1827; reprinted by Da Capo Press, 1971), captured the essence of both kinds of deterrence when he referred long ago to the compensation requirement as a "check" on government power.

#### B. Distribution — specific and general

The distributional function of just compensation is the one most readily acknowledged by the courts. A familiar statement of the idea appears in Justice Black's opinion in Armstrong v. United States (364 U.S. 40 [1960]): "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." As with deterrence, it proves useful to think about distribution in terms of the specific and the general. What we call specific distribution is simply the method of compensation that counts use in takings cases now: they determine and distribute the amounts due in terms of each aggrieved claimant as an individual.

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

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

Interrelationships like these have an important bearing on the choice between specific and general distributions, a point
**FIGURE 1: Uncoupling Deterrence and Distribution, Taking and Compensation**

<table>
<thead>
<tr>
<th>Should there be payment by the government?</th>
</tr>
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<tbody>
<tr>
<td><strong>Yes</strong></td>
</tr>
<tr>
<td><strong>Box 1</strong></td>
</tr>
<tr>
<td>Ordinary Regulation</td>
</tr>
<tr>
<td><strong>Box 3</strong></td>
</tr>
<tr>
<td>No Taking/Compensation</td>
</tr>
</tbody>
</table>

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

Our claim emerges from the foregoing. An expanded conception of the takings picture — a move from two alternative resolutions to four — can help resolve conflicts left unattended by current law.

**The Phillips case**

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

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

The plaintiffs in *Phillips* challenged Texas' mandatory IOLTA program on several constitutional grounds, but the only question that reached the Court, and the only one that shall concern us here, was whether the interest on IOLTA accounts is private property for purposes of the Takings Clause. The district court rejected the plaintiffs' claims on summary judgment. Because the funds deposited into IOLTA accounts are only those incapable of earning interest net of costs, the judge reasoned that clients owning the principal lost nothing; indeed, they never really had any property in the interest in the first place. Given that there was no property, there could be no taking. The same logic must have figured in the thinking of the hundreds of state judges who had previously considered the constitutionality of IOLTA programs in the course of adopting them, and it supported decisions by federal courts of appeals in two earlier cases.

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

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**Phillips in our model**

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

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

Pooling programs are common, but their analysis has been neglected, especially in connection with takings. In this regard, notice that both specific and general distribution seem to be impossible in IOLTA cases, because there is nothing to distribute. The claimants suffered no loss by the conventional measure, and using an alternative measure — one that made the government pay back the interest earned by the pooled accounts — would amount to wiping out IOLTA programs altogether. *Phillips*, then, is a pooling case, but of an unusual sort, and unusual cases might call for measures that rely on some mechanism other than payments of money by and to the parties in the lawsuit.

In deciding whether IOLTA interest was property, the majority in *Phillips* focused on the gross interest corresponding to a single client's principal. In contrast, the dissenters argued that if any interest-related number were relevant, it would be the net interest available for distribution in the unpooled case, by definition a negative amount.

Neither approach addresses the novel takings issues that pooling raises; the most salient numbers are those more or less ignored in *Phillips*.

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

The other salient number ignored by the majority in *Phillips* is the cumulative net interest that IOLTA programs earn from pooling, a sum by definition not capable of specific distribution (because such a distribution would make IOLTA pointless). While the majority deferred discussing it, Justices Souter and Breyer happily noted that conventional just compensation doctrine would assign this new value to the government because it was generated by the government program at issue. Our approach opens up new possibilities for distributing the cumulative gains from pooling in ways that would better serve the purposes of the Takings Clause. For example, certain forms of general distribution could give clients just what mandatory IOLTA programs take away: the right to determine the uses to which the earnings from principal are put, or what we call "client-voice." Whereas conventional takings law focuses on unpooled gross and net interest, an approach based on deterrence and distribution rightly shifts attention to opt-out and client-voice alternatives.
A better approach to Phillips is to identify the deterrence and distribution issues at stake and to uncouple them in a way that makes matters more tractable. In this respect, however, the case is far from transparent to us. The path taken by all the justices resulted in, among other things, a conventional factual record that is inadequate for our unconventional purposes. On the deterrence side, we need to know if IOLTA programs are likely to be so inefficient or oppressive as to require some sort of check on the government; with respect to distribution, we need more nuanced information about the plaintiffs' fairness claims and options for redressing them. In the absence of a more developed record, we can only offer some initial speculations.

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

Fairness concerns are more troubling in Phillips, partly because conventional just compensation doctrine responds so poorly to the expressive and liberty interests at stake in the case. In IOLTA programs, monetary losses are not the crux. Denial of client-voice is. In this light, the majority's position in the case seems more than a little odd. The Chief Justice's opinion separated interest from the principal to which it owed. The interest was a real thing that might quite literally have been taken (the takings issue, recall, was
just compensation was due; by regulatory measures in 1922, the Takings Clause and building something else in its place. We (and many accessories before the fact) are guilty of the second charge, but not the first. The Supreme Court started the process of demolition 75 years ago. Before then, takings law was pretty simple and solid, if not particularly satisfying. When the government took title to property or actually occupied it, then just compensation was due; otherwise it was not. Matters started to get complicated in 1922, when the Court decided Pennsylvania Coal Co. v. Mahon, 260 U.S. 191. Suddenly, even the burdens worked by regulatory measures might amount to takings, unless the measures were intended to control nuisances.

Demolishing and rebuilding the Takings Clause

Presumably, more than a few of our readers will accuse us of demolishing the Takings Clause and building something else in its place. We (and many accessories before the fact) are guilty of the second charge, but not the first. The Supreme Court started the process of demolition 75 years ago. Before then, takings law was pretty simple and solid, if not particularly satisfying. When the government took title to property or actually occupied it, then just compensation was due; otherwise it was not. Matters started to get complicated in 1922, when the Court decided Pennsylvania Coal Co. v. Mahon, 260 U.S. 191. Suddenly, even the burdens worked by regulatory measures might amount to takings, unless the measures were intended to control nuisances.

Developments since have only added to the muddle, but we shall refrain from a blow-by-blow description because even an abbreviated account would bore aficionados, and only a lengthy one would satisfy anybody else. Let an inventory suffice: Supreme Court decisions over the last three-quarters of a century have obscured and bifurcated the nuisance exception to regulatory takings; have waffled on the question of conceptual severance; have distinguished inconsistently between permanent and temporary takings; have suggested that what is not just compensation actually is just compensation, if only regulators are crafty; have made little of large losses, unless they are entire, and much of small ones, even when they are zero; have become confused about what "private property" is for purposes of the Takings Clause; have, in short, turned the words of the Takings Clause into a cryptogram that only the aficionados, and only a lengthy one would make sense of the Takings Clause, it is time to look behind its text to its purposes, and go anew from there. One such purpose is obviously fairness, but another is necessarily efficiency, thanks to Pennsylvania Coal. Whatever the Court's decision in that case left obscure, it made clear that regulations are often a substitute for eminent domain. There is abundant agreement that the power of eminent domain is justified and constrained for reasons that have to do, in part, with efficient use of society's resources. It would be strange to suppose that the same is not true of regulatory substitutes.

A problem with this observation is that it calls up the ghost of substantive due processes of demolition. The move prompted Justice Kennedy to caution that the Court must be "careful not to lose sight of the importance of identifying the property allegedly taken, lest all governmental action be subjected to examination under the constitutional prohibition against taking without just compensation, with the attendant potential for money damages."
process. If the courts are to review regulatory measures with efficiency in mind and the means for deterrence in hand, then arguably this is little different from empowering them to second-guess the legislature generally. But the Court does that now, at least in the context of takings. In its first exaction case, Nollan v. California Coastal Commission, 483 U.S. 825, 841 (1987), the majority established a practice of reviewing land-use regulations with unusually close attention to the connection between ends and means. Then, in its subsequent decision in Dolan v. City of Tigard, 512 U.S. 374, 391 (1994), the Court insisted upon rough proportionality between the thing exacted and the development permitted in exchange. Dissenting in the latter case, Justice Stevens remarked on the majority's "application of what is essentially the doctrine of substantive due process."

Seemingly, the Fifth Amendment's limitation to measures taking "private property" would constrain the judiciary's freedom to strike down regulatory programs, but that constraint has just recently been loosened considerably. In its decision in Eastern Enterprises v. Apfel, 118 S. Ct. 2131 (1998), the Court considered the constitutionality of legislation holding certain employers retroactively liable for employee retirement benefits. The plurality invalidated the measure as a taking, even though it concerned no standard property interest. The move prompted Justice Kennedy to caution that the Court must be "careful not to lose sight of the importance of identifying the property allegedly taken, lest all governmental action be subjected to examination under the constitutional prohibition against taking without just compensation, with the attendant potential for money damages."

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

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