

INTERGOVERNMENTAL LIABILITY RULES

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INTRODUCTION

The domain of externalities continues to present pressing issues of efficiency and distribution. Owing much to Professor Ronald Coase,¹ the polluter-pollutee standoff has become the seminal illustration of the quest to achieve optimal resource allocation in the face of conflict, while addressing considerations of justice and fairness in establishing the parties' rights and duties.² Correspondingly, the voluminous literature following Guido Calabresi and Douglas Melamed's property rule/liability rule framework³ has focused on designing the proper legal mechanisms to redress different forms of externalities—pollution again constituting a prime example—resulting from involuntary, extra-market encounters between private actors.⁴

Within this setting, the role of governments is largely conceived as that of a third party, charged with resolving the conflict.⁵ To be sure, there is continuous disagreement over the proper choice of legal tools, with policymakers and commentators vacillating, in the case of environmental externalities, between different forms of regulation (land use controls,⁶ emission-based and technology-based standards),⁷ corrective taxes,⁸ tradable environmental allow-

¹ Ronald H. Coase, *The Problem of Social Cost*, 3 *J.L. & Econ.* 1 (1960).

² For a partial list of the subsequent academic discussion of pollution in the law and economics tradition, see Henry E. Smith, *Exclusion and Property Rules in the Law of Nuisance*, 90 *Va. L. Rev.* 965, 966 n.2 (2004). The spatial impacts of pollution have also triggered critical schools of thought, most prominently the "environmental justice" movement, which argues that environmentally undesirable facilities are sited deliberately in minority neighborhoods, or at least have a disproportionate impact on minority groups. See generally Clifford Rechtschaffen & Eileen Gauna, *Environmental Justice: Law, Policy, and Regulation* (2002); Edwardo Lao Rhodes, *Environmental Justice in America: A New Paradigm* (2003).

³ Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 *Harv. L. Rev.* 1089 (1972).

⁴ For an efficient review of the property rule versus liability rule literature, see Henry E. Smith, *Property and Property Rules*, 79 *N.Y.U. L. Rev.* 1719, 1731–48 (2004).

⁵ See, e.g., Steven Shavell, *Foundations of Economic Analysis of Law* 92–101 (2004).

⁶ See *infra* Section I.A.

⁷ See generally Zygmunt J.B. Plater et al., *Environmental Law and Policy: Nature, Law, and Society* 469–711, 743–885 (3d ed. 2004).

⁸ These taxes are designed to make the polluter pay for the marginal harms that it causes. For a supportive analysis of such taxes, see Shavell, *supra* note 5, at 94–97.

ances,⁹ shared ownership or management,¹⁰ statutory-based responsibility for harms,¹¹ and the common law.¹² Yet the common conception which regards these public entities as performing their genuine governmental capacities in exogenously controlling the problem of externalities created by the direct parties to the conflict remains intact.

This description, however, presents only a partial picture of the role governments actually play in such standoffs. This Article, which examines land use controls, and pro-development zoning in particular, posits that governments may often coalesce in the creation of externalities and conflicts by legitimizing activities that, while beneficial to some, are harmful to others. When a local government makes a land use decision whose positive and negative effects remain within its own jurisdiction, political checks as well as existing legal mechanisms may curb at least some instances of allocative inefficiencies or gross deviations from prevailing notions of fairness. Conversely, when such a decision has substantial implications on private and public actors outside its territory, the local government has no apparent political motive to consider these effects in advance, let alone to consciously forego intrajurisdictional benefits to prevent interjurisdictional harms. Despite the risk of harm to external parties that are unable to hold decisionmakers accountable for the adverse effects of their policies, the law in most

⁹ See Daniel H. Cole, *Pollution and Property: Comparing Ownership Institutions for Environmental Protection* 58–59 (2002); J.H. Dales, *Pollution, Property & Prices: An Essay in Policy-Making and Economics* 93–97 (1968).

¹⁰ See Carol M. Rose, *Common Property, Regulatory Property, and Environmental Protection: Comparing Community-Based Management to Tradable Environmental Allowances*, in *The Drama of the Commons* 233 (Elinor Ostrom et al. eds., 2002) [hereinafter Rose, *Common Property*] (analyzing the pros and cons of common resource management vis-à-vis tradable environmental allowances in controlling externalities).

¹¹ The federal Comprehensive Environmental Response, Compensation, and Liability Act (“CERCLA” or “Superfund” law), imposes stringent liability on polluters for costs associated with cleaning up sites contaminated by hazardous wastes. Pub. L. No. 96-510, 94 Stat. 2767 (1980) (codified as amended at 42 U.S.C. §§ 9601–75 (2000)). For a recent evaluation of this act, see Martina E. Cartwright, *Superfund: It’s No Longer Super and It Isn’t Much of a Fund*, 18 *Tul. Envtl. L.J.* 299 (2005).

¹² See Robert C. Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Use Controls*, 40 *U. Chi. L. Rev.* 681, 719–60 (1973) [hereinafter Ellickson, *Alternatives*].

states does not provide increased procedural and substantive protection to adversely affected outsiders.

A recent example illustrates the dynamics of such cross-border externalities. In November 2004, the Zoning and Land Regulation Committee in Dane County, Wisconsin, approved a conditional use permit allowing the Payne & Dolan Company to mine sand and gravel from a thirty-acre site in the town of Oregon for a period of ten years. The site is located near the border of the village of Brooklyn, in close proximity to Brooklyn Commons, a subdivision in the process of construction. It is also located in Brooklyn's designated growth area according to the village's master plan. In January 2005, after the county board denied an appeal by the village, one of Brooklyn's residents expressed his frustration: "The village gains nothing from this This is a town of Oregon pit, an eighth of an inch from the village and we have nothing to say about this."¹³

Moreover, as this Article will show, the government often stands to gain directly from regulatory decisions, mainly in the form of incremental taxes and other types of public revenues based on property values (property taxes) or on the level of economic activity within its territory (sales taxes, business taxes, personal income taxes, user fees, etc.). A zoning decision that draws in new retail businesses in a previously undeveloped area may translate into additional local sales tax or income tax revenues, which could supersede the marginal public expenditures that the local government would face (for example, a provision of infrastructure or services). Yet in making such decisions, the local government ignores not only cross-border environmental externalities, but also other types of economic effects that it would have considered had such effects occurred within its boundaries. In other words, while a local government would consider the negative impact that a new shopping mall would have on existing businesses in its own old commercial district, because this may correspondingly adversely affect its internal fiscal tradeoff, the local government would too often disregard similar cross-border costs.

¹³ Bill Novak, *No Stopping Pit: County Board Fails to Halt Project near Brooklyn*, *The Capital Times* (Madison, WI), Jan. 7, 2005, at 1C.

This Article stems from the above observations, which more genuinely portray local governments not as aloof problem-solvers, but rather as directly interested parties that are making land use decisions which are largely based on their marginal public revenue calculus. These insights also pave the way for an innovative solution, which seeks to create strong incentives to promote overall social welfare, without wholly upsetting local political and legal powers.

To achieve this balance in a normatively desirable and administratively feasible manner, I adopt a liability rule framework, in which the litigants would be the respective local governments and the remediable damages would be the expected loss of public revenues that the plaintiff local government would incur because of the adverse cross-border effects of the land use decision. For example, if the plaintiff local government demonstrated that a recently approved land use project across the border would likely create extraterritorial environmental spillovers, resulting in devaluation of properties located within its territory and a consequent decline in its ad valorem property tax revenues, the plaintiff generally would be entitled to monetary compensation.

This Article will spell out the substantive and procedural aspects of this suggested right to intergovernmental compensation for lost public revenues, including a statutory *de minimis* principle, a limit on the time period for compensation, incorporation of a self-assessment mechanism that holds the plaintiff responsible for strategic over-estimation or under-estimation of expected costs, and employment of sampling and aggregating techniques. This Article will further demonstrate the superiority of liability rules over property rules in the context of intergovernmental externalities in view of liability rules' ability to harness private information and genuine evaluations, hence allowing an otherwise imperfectly informed court to advance overall efficiency as well as fairness.

The significant potential of the intergovernmental liability rule scheme lies in its ability to serve as a proxy for the overall social balance through public plaintiffs and a public cost-benefit calculus, without incurring the enormous costs of a full-scale, multi-party litigation that would have involved all positively and negatively affected private parties. Moreover, as I will show, this distinction between public and private claims has independent normative merits

besides administrative feasibility. In addition, the liability rule framework would be efficacious in controlling intergovernmental competition by making governments internalize the overall effects of their policies, hence stimulating such competitive measures toward positive sum scenarios.

The public litigants/public revenue model may also offer a fresh approach to addressing cross-border *positive* effects of land use decisions. As I will show, although it is regularly normatively desirable to deny restitution-based remedies in cases of unsolicited benefits on others that are incidental to self-serving activities, it may make sense to allow such types of remedies in the unique intergovernmental setting.

Beyond the land use context, which is largely the province of interlocal disputes, the intergovernmental liability rule model may aid in establishing a new agenda for a host of intergovernmental conflicts and dilemmas on the local, state, and national levels. Identifying the currently underappreciated virtues of a liability rule regime not only as an enhancer of efficiency, but also as a workable compromise in the face of political constraints, might prove essential in the reshaping of legal institutions in the intergovernmental setting.

This Article is structured as follows: Part I will focus attention on pro-development zoning decisions, explaining why local governments tend to disregard extraterritorial costs, what role fiscal considerations play in such decisions, and why current legal doctrines inadequately address the problem of parochialism. Part II will present the new intergovernmental liability rule model and its various built-in mechanisms to ensure efficiency, fairness, and administrative practicability. Part III will look at the positive cross-border effects of land use decisions. I will conclude by denoting the broader potential of my model to enrich legal policy on intergovernmental relationships beyond the land use context, establishing an agenda for future research.

I. INTERJURISDICTIONAL EXTERNALITIES: THE CASE OF ZONING

A. Zoning and Localism

Land use controls are primarily the province of general-purpose local governments.¹⁴ Since the 1920s, states have expressly granted power to such local governments through an almost uniform adoption of the Standard State Zoning Enabling Act (“SZE A”)¹⁵ and the Standard City Planning Enabling Act (“SCPEA”).¹⁶ Over the years, several states have changed their zoning and planning enabling statutes,¹⁷ and calls for further reform abound.¹⁸ Yet the focus of these statutes on general-purpose local governments remains intact. Home rule grants have been an additional source of power for local governments,¹⁹ although state legislation can usually preempt local power in matters of “statewide concern”—a term broadly in-

¹⁴ See Robert C. Ellickson & Vicki L. Been, *Land Use Controls* 29–30 (3d ed. 2005); Gerald E. Frug, *City Making: Building Communities Without Building Walls* 143–45 (1999).

¹⁵ A Standard State Zoning Enabling Act (Advisory Comm. on Zoning, U.S. Dep’t of Commerce, rev’d ed. 1926).

¹⁶ A Standard City Planning Enabling Act (Advisory Comm. on City Planning and Zoning, U.S. Dep’t of Commerce 1928).

¹⁷ SZE A-based state legislation has changed over the years in many states, but it is still in effect, in various forms, in forty-seven states. See 1 Norman Williams, Jr. & John M. Taylor, *American Land Planning Law* § 19:01 (1974 & Supp. 2005). A 1997 study revealed that twenty-four states had not updated their planning statutes since 1928. Rodney L. Cobb, *Toward Modern Statutes: A Survey of State Laws on Local Land-Use Planning*, in 2 *Modernizing State Planning Statutes: The Growing Smart Working Papers* 21, 22–23 (Planning Advisory Service Report, Nos. 480/481, 1998); see also Edward J. Sullivan & Matthew J. Michel, *Ramapo Plus Thirty: The Changing Role of the Plan in Land Use Regulation*, 35 *Urb. Law.* 75, 77 (2003).

¹⁸ See American Planning Association, *Growing Smart Legislative Guidebook: Model Statutes for Planning and the Management of Change* (2002).

¹⁹ For the history of the home rule movement, see David J. Barron, *Reclaiming Home Rule*, 116 *Harv. L. Rev.* 2255, 2277–86 (2003). The legal implementation of home rule takes many forms and variations, even within a given state, and avoids clear classifications. Richard Briffault, *Home Rule for the Twenty-first Century*, 36 *Urb. Law.* 253, 253–56 (2004). Somewhat counter-intuitively, home rule provisions do not necessarily translate to greater local autonomy. This is because home rule provisions may often coexist with the nineteenth-century-based Dillon’s Rule, according to which courts should narrowly interpret any powers that a state has conferred to local governments. According to a recent study, thirty-nine states still employ this interpretative rule for some or all types of local governments. Jesse J. Richardson, Jr. et al., *Is Home Rule the Answer? Clarifying the Influence of Dillon’s Rule on Growth Management* 17–18 (Brookings Inst. on Urb. & Metro. Pol’y, Working Paper, 2003), available at <http://www.brookings.edu/es/urban/publications/dillonsrule.pdf>.

terpreted by the courts.²⁰ Indeed, many states, as well as the federal government,²¹ have launched theme-specific land use programs dealing with issues such as environmental protection²² and affordable housing,²³ and several states have shifted broader regulatory authority to regional and state bodies.²⁴ It would be fair to con-

²⁰ See, e.g., *Town of Telluride v. Lot Thirty-Four Venture*, 3 P.3d 30, 37 (Colo. 2000) (upholding state prohibition on rent control); *Wambat Realty Corp. v. State of New York*, 362 N.E.2d 581, 582–85 (N.Y. 1977) (upholding constitutionality of statute preempting local land use powers in the Adirondack Park region).

²¹ The role of the federal government in land use decisions is generally non-interventional, and is based on creating incentives for state and local governments. See John R. Nolon, In Praise of Parochialism: The Advent of Local Environmental Law, 26 *Harv. Envtl. L. Rev.* 365, 366–68 (2002). For a criticism of this approach, see William F. Pedersen, Using Federal Environmental Regulations To Bargain for Private Land Use Control, 21 *Yale J. on Reg.* 1 (2004).

²² One prominent example is the promulgation of “Little NEPAs,” statutes adopted by several states following the Federal National Environmental Policy Act of 1969, 42 U.S.C. §§ 4321–47 (2000). For a list and synopsis of these state statutes, see Daniel R. Mandelker, *NEPA Law and Litigation* § 12.2 (2d ed. 2005).

²³ A notable example is the New Jersey program, codified in the Fair Housing Act of 1985, N.J. Stat. Ann. §§ 52:27D-301 to 329 (West 2002), which allows local governments to submit “fair share plans” to the Council on Affordable Housing (“COAH”). *Id.* §§ 52:27D–305, 309. If the COAH certifies the plan, the local government is immunized for six years from further state litigation and potential judicial remedies. *Id.* § 52:27D–313. This legislation followed the famous Mount Laurel litigation, in which the New Jersey Supreme Court invalidated on state constitutional grounds zoning measures excluding affordable housing. *Southern Burlington County NAACP v. Twp. of Mount Laurel*, 336 A.2d 713, 724–25, 730 (N.J. 1975), cert. denied 423 U.S. 808 (1975) [Mount Laurel I]; *Southern Burlington County NAACP v. Twp. of Mount Laurel*, 456 A.2d 390, 410 (N.J. 1983) [Mount Laurel II]. For a discussion of affordable housing programs, see Stuart Meck et al., *Regional Approaches to Affordable Housing* 31–105 (2003) and Rusty Russell, *Equity In Eden: Can Environmental Protection and Affordable Housing Comfortably Cohabit In Suburbia?*, 30 *B.C. Envtl. Aff. L. Rev.* 437 (2003).

²⁴ See 3 Arden H. Rathkopf et al., *The Law of Zoning and Planning* §§ 36:12–36:20 (4th ed. 1975 & Supp. 2005). These steps, which started in the early 1960s, were fueled by the position that local control creates serious inefficiencies and inequities, as was vividly expressed in a 1971 report titled “The Quiet Revolution,” calling for displacement of the traditional “feudal system” of land use controls. Fred Bosselman & David Callies, *The Quiet Revolution in Land Use Control* 1 (1972). Many states authorize, but do not mandate, regional cooperation in land use issues. For a list of these states, see Dale Krane et al., *Home Rule in America: A Fifty-State Handbook* 489, tbl.A13 (2001). For a list of regional councils and metropolitan planning organizations, see National Association of Regional Councils, <http://www.narc.org/links/cogslst.html> (last visited Apr. 8, 2006).

clude, however, that the states still leave the overwhelming majority of land use regulation to general-purpose local governments.²⁵

Land use regulations, and zoning in particular, generally enjoy considerable judicial deference. Courts deem them to be presumptively valid, and place the burden of proof on those making substantive due process claims to show that the regulation is arbitrary and unreasonable.²⁶ While federal courts usually only require “minimum rationality” for a zoning ordinance to pass constitutional muster, state courts generally require a “real and substantial relationship” between the regulation and the public purpose when examining the validity of the regulation both on its face and “as applied” to a specific case.²⁷ Yet, a regulation is ultimately upheld even if its reasonableness is “fairly debatable,” since it still enjoys the presumption of validity.²⁸

Courts have been more suspicious of rezoning schemes, especially when they apply to individual tracts.²⁹ Yet, although courts may scrutinize such decisions more closely, they still examine these acts under either the “minimum rationality” or the “real and substantial relationship” umbrellas.³⁰ Moreover, most state courts seem to have rejected the Oregon Supreme Court’s holding in *Fasano v. Board of County Commissioners*, which differentiated between legislative land use acts (that is, the development of a general land use policy applicable to a large portion of the public),

²⁵ Hence, the abovementioned “quiet revolution” failed to create a comprehensive state and regional land use regime. See John R. Nolon, *Golden and Its Emanations: The Surprising Origins of Smart Growth*, 35 *Urb. Law.* 15, 16–17 (2003). But see David L. Callies, *The Quiet Revolution Revisited: A Quarter Century of Progress*, 26 *Urb. Law.* 197, 211–13 (1994).

²⁶ This standard was set in a 1926 landmark case, in which the Supreme Court validated zoning as a constitutional exercise of police power. *Vill. of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 397 (1926).

²⁷ See 1 Rathkopf, *supra* note 24, §§ 3:12, 3:14–16. State courts may look at, *inter alia*, whether the regulation is “unduly restrictive or excessive” or if the burdens imposed by the regulation far exceed its benefits. *Id.* § 3:17.

²⁸ See *Zahn v. Bd. of Pub. Works of City of L.A.*, 274 U.S. 325, 328 (1927). In some cases, this standard is termed “at least debatable.” See *Dodd v. Hood River County*, 59 F.3d 852, 865 (9th Cir. 1995). Accordingly, the ancillary “balancing of interests” test, looking at the regulation’s costs and benefits, is usually conducted in very general terms rather than through accurate quantification. 1 Rathkopf, *supra* note 24, § 3:18.

²⁹ Such regulations may be attacked by either the landowner (in the case of “down-zoning”) or neighbors (in the case of “up-zoning”).

³⁰ Rathkopf, *supra* note 24, § 40:7.

which are due the full presumption of validity, and “quasi-judicial” zoning decisions aimed at “specific individuals, interests, and situations.”³¹ In so doing, the majority of courts settle for what is in effect a deferential review of rezoning classification decisions.³²

In addition, the relatively limited applicability of the regulatory takings doctrine to land use measures that do not amount to elimination of “all economically beneficial use”³³ of the adversely affected land further contributes to local governments’ broad powers.³⁴ Consequently, legally authorized piecemeal zoning and rezoning decisions aimed at specific projects are a frequent reality in most jurisdictions.

Leaving land use decisions with the local government has long aroused the suspicion of commentators, even absent negative cross-border externalities. Professors Daniel Mandelker and Dan Tarlock criticize local government decisions as sloppy and ad hoc.³⁵ Others, writing in either the process theory³⁶ or public choice³⁷ traditions, attribute an internal logic to such decisions, but nonetheless see the inherent biases of the local political process as a source

³¹ *Fasano v. Bd. of County Comm’rs*, 507 P.2d 23, 26–27 (Or. 1973) (en banc); see also *Bd. of County Comm’rs v. Snyder*, 627 So. 2d 469, 474 (Fla. 1993).

³² See, e.g., *State v. City of Rochester*, 268 N.W.2d 885, 889–90 (Minn. 1978); *Hampton v. Richland County*, 357 S.E.2d 463, 465 (S.C. Ct. App. 1987); *Quinn v. Town of Dodgeville*, 364 N.W.2d 149, 157 (Wis. 1985). For a more extensive list, see 1 Rathkopf, *supra* note 24, § 5:7 n.2.

³³ *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1027 (1992).

³⁴ When the loss of value is not absolute, in order to determine whether the regulation affects a taking under the federal constitution, current doctrine adopts an ad hoc test originally phrased in *Penn Cent. Transp. Co. v. City of N.Y.*, 438 U.S. 104, 124 (1978). Some states, however, have gone beyond that to protect landowners from regulatory takings. A notable example is Oregon’s recently approved Measure 37, which requires local governments to compensate landowners for a land use regulation that “has the effect of reducing the fair market value of the property.” See *State of Oregon, Voters’ Pamphlet: Volume 1—State Measures 103* (2004), available at <http://www.sos.state.or.us/elections/nov22004/guide/pdf/vpvol1.pdf>.

³⁵ Daniel R. Mandelker & A. Dan Tarlock, *Shifting the Presumption of Constitutionality in Land-Use Law*, 24 *Urb. Law.* 1, 2 (1992).

³⁶ See John Hart Ely, *Democracy and Distrust* 6–7 (1980) (explaining that process theory aims at legitimizing the countermajoritarian authority of unelected judges to review decisions made by legislatures and other elected officials).

³⁷ See e.g., Daniel A. Farber & Phillip P. Frickey, *Law and Public Choice: A Critical Introduction* 1 (1991) (demonstrating that the public choice literature explores political institutions and outcomes based on the assumption of selfish and rational actors).

of concern. Writers such as Professors Robert Ellickson,³⁸ William Fischel,³⁹ Einer Elhauge,⁴⁰ and Neil Komesar⁴¹ have analyzed the conditions under which either a majoritarian⁴² or minoritarian⁴³ bias will likely dominate and skew local land use decisions. In response, authors such as Professors Carol Rose⁴⁴ and Vicki Been⁴⁵ point to

³⁸ Robert C. Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 *Yale L.J.* 385, 399–409 (1977) (explaining that while in smaller suburban communities the majoritarian interests of existing homeowners are likely to prevail, in larger and more diverse jurisdictions, entrepreneurs may employ superior organizational skills to gain disproportionate influence).

³⁹ William A. Fischel, *Regulatory Takings: Law, Economics and Politics* 297–98 (1995) [hereinafter *Fischel, Regulatory Takings*] (arguing that the advantages of concentrated economic interest groups are greatly diminished in small-scale local governments).

⁴⁰ Einer R. Elhauge, *Does Interest Group Theory Justify More Intrusive Judicial Review?*, 101 *Yale L.J.* 31, 39 (1991) (focusing on the problem of minoritarianism).

⁴¹ Neil K. Komesar, *Law's Limits: The Rule of Law and the Supply and Demand of Rights* 60–64 (2001) (arguing that the type of political malfunction in local zoning decisions depends on a number of variables, including the size and type of the local government, the distribution of the per capita stakes within it, and the costs of political participation).

⁴² A majoritarian bias hypothesis could be based on (at least) two theories: First, an extension of interest group theory to circumstances in which the majority is able to prevail in the political market, as is the case with Komesar's model. *Id.* at 114. Second, a median voter model, according to which the zoning issue is decided by special election ("ballot box zoning"), in which a popular majority must approve the measure. For the median voter model, see Neil Bruce, *Public Finance and the American Economy* 131–36 (2d ed. 2001). For "ballot box zoning," see Ellickson & Been, *supra* note 14, at 401–09.

⁴³ See Mancur Olson, *The Logic of Collective Action* (1971) (presenting the theory of interest group politics, according to which small concentrated, well-organized interest groups have substantially greater political influence).

⁴⁴ Carol M. Rose, *Takings, Federalism, Norms*, 105 *Yale L.J.* 1121, 1131–35 (1996) (reviewing William Fischel, *Regulatory Takings: Law, Economics, and Politics* (1995)) (criticizing process theory's "localism bashing" and arguing that exit and voice options constrain local government no less than they do state or federal governments).

⁴⁵ Vicki Been, "Exit" as a Constraint on Land Use Exactions: Rethinking the Unconstitutional Conditions Doctrine, 91 *Colum. L. Rev.* 473, 525–27 (1991) (explaining that the possibility of exit is an empirical question, the answer for which differs between municipalities, based on local conditions such as size and political structure); see also Melvyn R. Durchslag, *Forgotten Federalism: The Takings Clause and Local Land Use Decisions*, 59 *Md. L. Rev.* 464, 486 (2000) (arguing that the smaller the community, the greater the number of opportunities for informal political participation to give voice to affected dissenters).

exit and voice mechanisms as potentially disciplining local land use regulation.⁴⁶

B. Interlocal Zoning Externalities

When a zoning decision has considerable extraterritorial impacts, the local government's power raises an additional set of concerns. Many critics consider exclusionary zoning patterns, aimed at generally limiting growth,⁴⁷ or specifically at keeping out low-revenue, high-expenditure residents,⁴⁸ to be the epitome of local government parochialism. The usual suspects are affluent suburbs in metropolitan areas allegedly free riding the benefits of proximity to big cities, while ignoring regional needs and burdens.⁴⁹

⁴⁶ But see Stewart E. Sterk, *Competition Among Municipalities as a Constraint on Land Use Exactions*, 45 *Vand. L. Rev.* 831, 859 (1992) (arguing that residents in highly developed localities may lack the opportunity to exit because the specific location may provide opportunities that do not exist elsewhere).

⁴⁷ The New York Court of Appeals famously upheld a growth control plan aimed at limiting land development over an eighteen-year period by coordinating growth with the provision of adequate capital improvements. *Golden v. Planning Bd. of Town of Ramapo*, 285 N.E.2d 291 (N.Y. 1972). In doing so, however, the court criticized the locally based structure of land use law as "pronounced insularism." *Id.* at 299–301. For an analysis of *Ramapo* and of subsequent growth control techniques, see Nolon, *supra* note 25.

⁴⁸ The term "exclusionary zoning" refers to various methods employed by high-income suburbs to keep out low- and moderate-income families. Exclusionary zoning is undertaken chiefly for fiscal reasons: admitting families who purchase homes with a value below the community average will lower the tax incident per family, forcing communities to raise taxes to maintain current spending levels. See, e.g., Richard Briffault, *Our Localism: Part I—The Structure of Local Government Law*, 90 *Colum. L. Rev.* 1, 21–22, 39–64 (1990) [hereinafter Briffault, *Localism I*] (discussing *Golden* and other noteworthy exclusionary zoning cases); Robert P. Inman & Daniel L. Rubinfeld, *The Judicial Pursuit of Local Fiscal Equity*, 92 *Harv. L. Rev.* 1662, 1685–89 (1979). For state legislative attempts to curb exclusionary zoning, see *supra* note 23.

⁴⁹ See, e.g., Frug, *supra* note 14, at 76–85, 143–45; Richard Briffault, *Our Localism: Part II—Localism and Legal Theory*, 90 *Colum. L. Rev.* 346, 365–74, 382–84 (1990) [hereinafter Briffault, *Localism II*]; see also Sheryll D. Cashin, *Localism, Self-Interest, and the Tyranny of the Favored Quarter: Addressing the Barriers to New Regionalism*, 88 *Geo. L.J.* 1985, 1993–95 (2000) (pointing to the ever-present, even if currently implicit, racial motives for exclusionary zoning); Richard Thompson Ford, *The Boundaries of Race: Political Geography in Legal Analysis*, 107 *Harv. L. Rev.* 1841, 1894–97 (1994) (same).

This Article focuses on a slightly different version of local parochialism—designating and siting *pro-development* land uses.⁵⁰ Zoning an area for light or heavy industry, outlet shopping malls, car dealerships, discount retailers, or for high-density affluent housing may create a rich source of tax revenue and generate social benefits, such as new employment. This type of zoning, however, may also generate environmental costs such as pollution, noise, and congestion, alongside economic costs such as reduced commercial activity at adjacent competing sites.⁵¹

To reduce internal environmental costs, a local government is often motivated to site such land uses at its fringe to “share” the environmental costs with its neighbors.⁵² Similarly, to reduce internal economic losses, the local government will consider whether the new development is expected to decrease activity in competing projects within its jurisdiction, especially to the extent that this would adversely affect local public revenues. Local governments, however, are less likely to consider whether a new development project will have similar adverse economic effects outside their borders.⁵³

⁵⁰ See, e.g., Bradford C. Mank, Environmental Justice and Discriminatory Siting: Risk-Based Representation and Equitable Compensation, 56 Ohio St. L.J. 329, 421 (1995); Michael Wheeler, Negotiating NIMBYs: Learning from the Failure of the Massachusetts Siting Law, 11 Yale J. on Reg. 241, 284–88 (1994); Robert B. Wiygul & Sharon Carr Harrington, Environmental Justice in Rural Communities—Part One: RCRA, Communities, and Environmental Justice, 96 W. Va. L. Rev. 405, 437–48 (1993).

⁵¹ See Susan M. Wachter & Man Cho, Interjurisdictional Price Effects of Land Use Controls, 40 Wash. U. J. Urb. & Contemp. L. 49 (1991). See generally Shelley Ross Saxer, Local Autonomy or Regionalism?: Sharing the Benefits and Burdens of Suburban Commercial Development, 30 Ind. L. Rev. 659 (1997).

⁵² This may also be the case with waste disposal facilities and similar sites, in which the developer is willing to pay generous host fees above regular taxes to switch the local dynamics from NIMBY (“Not-In-My-Backyard”) to YIMBY (“Yes-In-My-Backyard”). See Daniel Mazmanian & David Morell, The “NIMBY” Syndrome: Facility Siting and the Failure of Democratic Discourse, in *Environmental Policy in the 1990s* 125, 139–41 (Norman J. Vig & Michael E. Kraft eds., 1990) (discussing the YIMBY approach of the Southern California Hazardous Waste Management Authority); John A. Barnes, Learning to Love the Dump Next Door, *Wall St. J.*, June 25, 1991, at A22.

⁵³ For a discussion of the regional effects of local zoning decisions allowing “big box” retail, see Patricia E. Salkin, Supersizing Small Town America: Using Regionalism to Right-Size Big Box Retail, 6 Vt. J. Envtl. L. 9, 52–54 (2005).

The politics of zoning cross-border externalities are easy enough to understand. Whenever adversely influenced outsiders have no right to vote in municipal elections or do not otherwise possess political power in the deciding jurisdiction,⁵⁴ local government officials have no incentive to refrain from engaging in “fiscal illusion,”⁵⁵ through pushing costs outside the border.⁵⁶

There are divergent opinions regarding how frequently the cross-border externalities phenomenon influences local zoning decisions. Professor William Fischel, writing in the context of environmental externalities, argues that empirically, this phenomenon is virtually non-existent in the interlocal context, as opposed to, perhaps, the interregional or interstate context.⁵⁷ Since neighboring local governments and their respective residents are engaged in long-term relationships, he argues, they can issue reciprocal credible threats for retaliation should one side engage in offensive, unbalanced acts. This forces local governments to respect their

⁵⁴ To be clear, the type of interjurisdictional conflicts discussed are those in which neither party can threaten the other with unilateral annexation under the relevant state law, nor is either party able to employ extraterritorial zoning or other land use powers over the other. For a discussion of state annexation laws, see Gerald E. Frug et al., *Local Government Law* 386–405 (3d ed. 2001). For a discussion of state legislation authorizing extraterritorial land use powers, see Rathkopf, *supra* note 24, § 35:6. For example, the city of Mequon, Wisconsin has recently frozen, for a period of two years, the town of Grafton’s plan to zone an area near the border for three auto dealerships, employing its authority under Wisconsin law to take temporary zoning measures over unincorporated land lying within one and a half miles of the city’s border. See Lawrence Sussman, *Unhappy Residents Explore Annexation*, *Milwaukee J. Sentinel*, Apr. 22, 2004, at 5B. Similarly, vertical interjurisdictional land use disputes, in which the state or a federal agency wishes to site a facility that does not conform to the local land use regulations of the hosting local government, are not discussed in the article. See generally Laurie Reynolds, *The Judicial Role in Intergovernmental Land Use Disputes: The Case Against Balancing*, 71 *Minn. L. Rev.* 611 (1987).

⁵⁵ “Fiscal illusion” is the systematic underevaluation of costs by decisionmakers whenever the government is not obligated to compensate for losses, especially when such costs are borne by members of a different constituency for whom the decisionmakers are not politically accountable. See Lawrence Blume et al., *The Taking of Land: When Should Compensation be Paid?*, 99 *Q.J. Econ.* 71, 72 & n.5 (1984); see also Hanoch Dagan, *Just Compensation, Incentives, and Social Meanings*, 99 *Mich. L. Rev.* 134, 138 (2000) (arguing that fiscal illusion is likely to occur when the affected group members have little political influence).

⁵⁶ *City of Del Mar v. City of San Diego*, 183 *Cal. Rptr.* 898, 903 n.4 (Ct. App. 1982).

⁵⁷ William A. Fischel, *The Homevoter Hypothesis: How Home Values Influence Local Government Taxation, School Finance, and Land-Use Policies* 184–206 (2001) [hereinafter Fischel, *Homevoter*].

neighbors, enabling them to achieve their own spatial “order without law.”⁵⁸

Yet, there are several reasons to believe that Fischel may have been overly optimistic. First, the reality of uncoordinated local zoning for industry, and for large-scale commercial and residential developments with significant extraterritorial externalities, is well documented in various court cases,⁵⁹ scholarly research,⁶⁰ and in many news reports.⁶¹ Second, Fischel’s general contention about neighboring municipalities’ mutual respect for each other implies that local governments would refrain from inflicting *all types* of major land use externalities. This, too, is unsupported by the comprehensive evidence of “defensive” patterns of unilateral anti-growth measures and exclusionary zoning.⁶²

Empirical evidence further indicates that local governments usually deal with each other on a more short-term, subject-specific ac-

⁵⁸ Id. at 202–04. As the term indicates, Fischel bases his argument on Robert Ellickson’s seminal work, Robert C. Ellickson, *Order without Law: How Neighbors Settle Disputes* (1991) [hereinafter Ellickson, *Order without Law*].

⁵⁹ See *infra* Section I.D.

⁶⁰ See *Minor Myers III, Obstacles to Bargaining Between Local Governments: The Case of West Haven and Orange, Connecticut*, 37 *Urb. Law.* 853, 872–75 (2005) (describing the town of Orange’s decision to approve a variance extending its commercial zone so as to allow a Target department store along with 500 parking spaces on a plot bordering the town of West Haven; such a decision was expected to increase Orange’s annual tax revenue by \$180,000 but to create negative ancillary impacts to the nearby West Haven residential neighborhood); see also Rae Zimmerman, *Issues of Classification in Environmental Equity: How We Manage Is How We Measure*, 21 *Fordham Urb. L.J.* 633, 650 (1994) (finding that a number of the most hazardous waste sites in the nation are within a few miles of counties other than the one ascribed to the site location).

⁶¹ For one such example, see the text accompanying note 13, *supra*. Another recent example concerns the Vulcan Materials Company’s plan to expand by eighty acres its mining operations in the Azusa Rock Quarry in California. The expansion site is located in the foothills above the city of Azusa, near the border with the city of Duarte. Duarte residents and officials contend that the expansion would fill the city with dust, noise and particulate pollution, and would lower property values. One Duarte resident expressed his frustration with Azusa’s unneighborliness about the mine’s activity, saying: “Azusa takes care of Azusa only . . . and to heck with others.” Emanuel Parker, *Vulcan Draws Duarte’s Ire*, *Pasadena Star-News*, Apr. 27, 2005.

⁶² See *supra* note 49. Some commentators have suggested that these measures are not only defensive, but may also be predatory in nature. Municipalities employing exclusionary techniques deflect fiscally undesirable developments to neighboring localities, thereby decreasing that locale’s attractiveness to homebuyers. See, e.g., Robert W. Helsley & William C. Strange, *Strategic Growth Controls*, 25 *Reg. Sci. & Urb. Econ.* 435 (1995).

countancy basis than the order without law approach would suggest. Interlocal agreements are prevalent for contracts for services,⁶³ joint provision of services,⁶⁴ and the creation of single-purpose special districts.⁶⁵ These agreements are driven by the mutual desire to pool resources in order to achieve the benefits of economies of scale and to spread risks. These dealings, however, do not naturally spill over into other areas of cooperation. In fact, service agreements may achieve the opposite effect of seclusion by allowing wealthy enclaves to incorporate without having to face the full costs associated with producing services, thus leaving them free to employ exclusive policies elsewhere, mostly in land use issues.⁶⁶

There is an obvious reason for this subject-based distinction. In the case of burden- or revenue-sharing scenarios, as opposed to service agreements, one of the parties often does not stand to gain from cooperation. This is the case when a homogenous suburb enjoys the fruits of exclusionary zoning while deflecting the burdens

⁶³ See Advisory Comm'n on Intergovernmental Relations, *State and Local Roles in the Federal System* 327 (1982). Under such contracts, a local government purchases a service, such as transportation or a certain utility, from another local government, because it is less expensive than producing the service itself. See Laurie Reynolds, *Intergovernmental Cooperation, Metropolitan Equity, and the New Regionalism*, 78 *Wash. L. Rev.* 93, 124 (2003) [hereinafter Reynolds, *Intergovernmental Cooperation*].

⁶⁴ These mutual aid agreements usually involve provision of services such as police, fire, and emergency back-ups. Such agreements may also involve implementation of a jointly articulated program or regulatory goal, such as a county-wide drunk driving reduction effort. Reynolds, *Intergovernmental Cooperation*, *supra* note 63, at 132–34.

⁶⁵ These special districts usually provide a single service such as transportation, sewage, water, or flood control. Special districts may also be created by top-down state legislation or following a citizen petition. See Fischel, *Homevoter*, *supra* note 57, at 21–22; Reynolds, *Intergovernmental Cooperation*, *supra* note 63, at 137–40.

⁶⁶ See Gary J. Miller, *Cities By Contract* (1981). Miller analyzes a series of intergovernmental contracts for services known as the Lakewood Plan, in which Los Angeles County became the provider of many services to newly incorporated municipalities. He shows that the county priced the services at such a low level that other parts of the county actually subsidized the Lakewood Plan incorporated municipalities. *Id.* at 20–33. Professor Richardson Dilworth argues more broadly that suburban infrastructural development providing the means for suburban autonomy was facilitated largely by central city infrastructural development in at least two ways. First, the large pool of engineers and contractors who had been trained on large infrastructure projects in central cities could sell their expertise to suburban communities. Second, the technological advancement of infrastructure systems resulting from large public works in these cities decreased the systems' costs and thus made them available to smaller communities. Richardson Dilworth, *The Urban Origins of Suburban Autonomy* 25–35 (2005).

of affordable housing on others, or when a wealthy school district reserves its high tax base for its residents.⁶⁷ The same rationale applies to pro-development zoning, where the deciding local government has no apparent incentive to consider extraterritorial costs. When the local government conceives its uncoordinated act to be a better alternative to negotiation, it may also be initially more reluctant to accept a neighboring government's offer to resolve the conflict by consent.⁶⁸

Moreover, in the case of pro-development zoning decisions, the strategic quarrel over costs and benefits may be even more burdensome than in other scenarios.⁶⁹ For instance, in many cases, *both* local governments may be candidates for hosting the specific project at the background of the zoning decision, and hence compete directly for the fixed demand for the new land use. When governments engage in tax-driven competition for zoning-in businesses and commercial developments, this phenomenon is particularly acute, as documented in academic studies⁷⁰ and in news reports.⁷¹

⁶⁷ See *supra* note 49.

⁶⁸ See Myers, *supra* note 60, at 875–82, 890–92 (attributing Orange and West Haven's failure to reach an agreement in a series of conflicts to rent dissipation, as well as bottom-up animosity); see also Richard G. Lorenz, *Good Fences Make Bad Neighbors*, 33 *Urb. Law.* 45, 77–80 (2001).

⁶⁹ For the systematic failures of neighbors to reach agreements over use of land, see Stewart E. Sterk, *Neighbors in American Land Law*, 87 *Colum. L. Rev.* 55 (1987).

⁷⁰ See, e.g., Jonathan Schwartz, Note, *Prisoners of Proposition 13: Sales Taxes, Property Taxes, and the Fiscalization of Municipal Land Use Decisions*, 71 *S. Cal. L. Rev.* 183, 209–13 (1997) (analyzing the Oxnard-Ventura “sales tax war” in Ventura County, California as driving local development decisions). In 1999, the California legislature passed a law aimed at discouraging retailers from creating competition between local governments, by prohibiting government from providing financial assistance to a big box store larger than 75,000 square-feet relocating from one community to another in the same market area. *Cal. Gov't Code* § 53084 (West 2006). For a criticism of this statutory intervention, and an argument that interlocal competition did not have an independent effect on local development policies prior to this legislation, see Max Neiman et al., *Local Economic Development in Southern California's Suburbs: 1990–1997* (2000). But cf. Paul G. Lewis, *Retail Politics: Local Sales Taxes and the Fiscalization of Land Use*, 15 *Econ. Dev. Q.* 21 (2001) (arguing that sales tax competition is detrimental to balanced land use development). Location incentives are discussed in more detail in note 178, *infra*.

⁷¹ See, e.g., Paul Foy, *Walker Unveils Sweeping Tax Reform Plan*, Associated Press, Nov. 22, 2004; Chris Lester, *Sales Taxes Inflicting Pressure*, *Kan. City Star*, Feb. 9, 1999, at D10; Dean Mosiman, *Bauman Exploring Ways to Share Metro Tax Money, Services*, *Wis. State Journal*, Apr. 4, 2002, at B3; Frank Reeves, *In Twin Cities, Tax-*

This state of affairs makes each local government's claim for its right to enjoy the lion's share of the net benefits allegedly more "legitimate," further increasing the negotiation gap compared to scenarios in which there is only one potential "buyer" that is able to implement the utility-enhancing project.⁷²

Professor Clayton Gillette, rejecting the self-conscious isolation thesis, attributes the relative rarity of interlocal agreements over revenue- or burden-sharing to misjudgment of the benefits of cooperation, agency costs inflicted by public officials, and most prominently to contracting costs.⁷³ As for the latter, bearing in mind potential quarrels over the surplus in project-specific bargaining, Gillette considers the possibility of broad-based relational contracts for revenue- or burden-sharing, but then points to the problems of observability and verifiability in monitoring and formally enforcing such agreements.⁷⁴ He concludes that local governments should utilize informal contracts that focus on discrete, salient acts of cooperation, which the parties can more closely observe and enforce through self-help sanctions.⁷⁵

At this point, however, Gillette faces the same unresolved dilemma as does Fischel. Consider Gillette's own example of two adjoining localities each deliberating whether to develop a shopping mall on the fringe of their common boundary that would displace existing stores in both localities.⁷⁶ One is left to wonder why so many uncoordinated development projects of this type go ahead if

Sharing Gives Everyone Slice of Development Pie, *Pittsburgh Post-Gazette*, Feb. 13, 2004, at D1.

⁷² The symmetry between competing local governments superficially resembles Ayres and Talley's discussion of how divided entitlements might facilitate bargaining. Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement To Facilitate Coasean Trade*, 104 *Yale L.J.* 1027, 1072-82 (1995). However, this theory would be irrelevant here unless the parties agree in advance that the two zoning scenarios are symmetrical or that they are able to formulate a pro-rata key to evaluate the two scenarios' respective costs and benefits. See also Rachel Croson & Jason Scott Johnston, *Experimental Results on Bargaining Under Alternative Property Rights Regimes*, 16 *J.L. Econ. & Org.* 50, 50-52 (2000) (demonstrating that when entitlements are not clearly allocated, successful bargaining is less likely to occur).

⁷³ Clayton Gillette, *Regionalization and Interlocal Bargains*, 76 *N.Y.U. L. Rev.* 190 (2001) [hereinafter Gillette, *Regionalization*].

⁷⁴ *Id.* at 257-60.

⁷⁵ *Id.* at 263-69.

⁷⁶ *Id.* at 247.

local governments are able to effectively retaliate against previous-round egocentricity through informal measures.

One possible explanation is that unlike the stylized Axelrodian game,⁷⁷ or some real-life settings involving closely-knit neighbors⁷⁸ or owners-in-common of small-scale resources,⁷⁹ the payoffs in future rounds of local government relationships may not be certain or high enough to allow for retaliation. The gains from developing a shopping mall may be too tempting if the rival local government has no similar project in its canon and it is otherwise unknown when or how it would be able to retaliate.⁸⁰ Another reason may be that unlike private property owners, local governments might not pursue retaliation as strongly. A recently elected mayor of a city that was a victim of past neighbor egocentricity may just blame her predecessor rather than actively engage in an interlocal vendetta.⁸¹ A wealthy suburb's proposal for a joint provision of services may help county officials forget about the suburb's ongoing reluctance to share the regional burdens of affordable housing.⁸²

In summary, local governments are not constantly inflicting harm on others, and cooperation or effective monitoring and threatening are sometimes attainable,⁸³ but it is fair to state that the

⁷⁷ Robert Axelrod, *The Evolution of Cooperation* 27–54 (1984).

⁷⁸ Ellickson, *Order without Law*, supra note 58, at 177–83, 208–19.

⁷⁹ See Rose, *Common Property*, supra note 10, at 237–38.

⁸⁰ Cf. Douglas G. Baird et al., *Game Theory and the Law* 173–74 (1994) (discussing high discount rates in repeated games in the face of uncertain future payoffs).

⁸¹ But see Myers, supra note 60, at 890–92 (describing the way in which long-standing popular enmity between the towns of Orange and West Haven is driving current political decisions). I obviously do not aim to offer a universal thesis about intergovernmental strategic games, which would also be applicable, for example, in the international arena. Issues such as discount factors in valuations of future payoffs, effective time horizons and “patience,” and the frequency within which governments change in certain types of political regimes as affecting governmental choices of retaliation, reciprocity, or cooperation must be examined in the context-specific setting to have any analytical or predictive value. For such a study in the international context, see George Norman & Joel P. Trachtman, *The Customary International Law Game*, 99 *Am. J. Int'l L.* 541 (2005).

⁸² See supra note 66 and accompanying text.

⁸³ A notable example for a voluntary revenue-sharing scheme is the sales tax agreement between the City of Modesto and Stanislaus County. See *Theory in Action, City & County Encourage Good Land Use Through Tax Sharing* (1998), available at <http://www.abag.ca.gov/planning/theoryia/cmprmodesto.htm>. See infra note 223 for a discussion of statutory tax-base and revenue-sharing schemes.

problem of zoning cross-border spillovers is far from being negligible.

C. The Problem Restated: Fiscalization of Zoning

Assessing the phenomenon of intergovernmental externalities requires a more in-depth understanding of the nature and scope of the fiscalization of local zoning decisions.

To finance their expenditures, local governments continue to rely heavily on revenues from their own resources, mostly property taxes, local sales taxes, local income taxes, and business taxes, as well as on non-tax revenues such as user charges.⁸⁴ The distribution of local taxes between the different types of local governments—the county itself or its subdivision, the incorporated municipality (if any), the school district, and special districts—that have overlapping jurisdiction and taxing power over local assets is a complicated, state-specific issue.⁸⁵ Taking the property tax as an example, the allocation pattern of property tax revenues between the relevant local governments having taxing power varies between the different states.⁸⁶ In most states, each local government separately sets its own tax rate,⁸⁷ subject usually to state limits on the maximum tax rate or on the local government's overall growth rate of annual tax levies.⁸⁸ Only in relatively few states, post-Proposition 13 Cali-

⁸⁴ In 1996–97, for all types of local governments, 62% of their general revenues were derived from their own sources. Out of the locally generated general revenues, the property tax generated 45%, sales and gross receipts tax 10%, local income tax 4%, and user charges 26%. For municipalities, general revenues from own resources counted for 72% of their general revenues. Out of these locally generated general revenues, the property tax generated 29%, sales and gross receipts tax 17%, local income tax 9%, and user charges 27%. 4 U.S. Census Bureau, 1997 Compendium of Government Finances, No. 5, tbl.4 (1997), available at <http://www.census.gov/prod/gc97/gc974-5.pdf> [hereinafter Compendium of Government Finances]. Data from the 2002 Census of Governments indicate that this trend remains largely unchanged. See 4 U.S. Census Bureau, Finances of Municipal and Township Governments: 2002, No. 4, tbl.1 (2002), available at <http://www.census.gov/prod/2005pubs/gc024x4.pdf>.

⁸⁵ See generally Ronald Fisher, *State and Local Public Finance* (3d ed. 2007); Jerome R. Hellerstein et al., *State and Local Taxation: Cases and Materials* (8th ed. 2005).

⁸⁶ See Joan Youngman, *Legal Issues in Property Valuation and Taxation: Cases and Materials* 15–21 (2d ed. 2006).

⁸⁷ See, e.g., Wash. Rev. Code Ann. § 84.52.010 (West 2004).

⁸⁸ For these two types of limits, as well as for limits on the annual growth rate of assessed value and on the property tax rate for overall local spending, see Arthur

fornia being a notable example, does the state limit the overall tax rate for all relevant local governments combined and accordingly set up a mechanism for allocating the pie.⁸⁹ The local sales and income taxes are even more “localized” in the sense that they are usually levied by only the relevant municipality and the county.⁹⁰ Local non-tax charges are naturally the most specific.⁹¹

Since the general-purpose local government relies heavily on such revenues to finance its activities, what follows is a fiscalization of its zoning decisions. In considering whether to approve a new zoning scheme, the local government will compare its expected marginal expenditures for the project (provision of roads, parks, police and fire services, etc.) vis-à-vis its expected marginal public revenues.⁹² Besides permissible exactions,⁹³ such revenues include, as discussed, potential additional taxes—property tax, sales tax, and local business tax and income tax—as well as non-tax revenues

O’Sullivan, Limits on Local Property Taxation: The United States Experience, *in* Property Taxation and Local Government Finance 177, 177–78 (Wallace E. Oates ed., 2001).

⁸⁹ See Cal. Const. art. XIII A, § 1. Another form of top-down property tax redistribution concerns school finance in some states. See Melissa C. Carr & Susan H. Fuhrman, The Politics of School Finance in the 1990s, *in* Equity and Adequacy in Education Finance: Issues and Perspectives 136 (Helen F. Ladd et al. eds., 1999). For the role of the property tax in education finance, see generally William N. Evans et al., The Property Tax and Education Finance, *in* Property Taxation and Local Government Finance, *supra* note 88, at 209.

⁹⁰ For example, in 1996–97, school districts relied on local income tax and on sales tax for less than one percent each of their general revenues derived from local funding, while special districts did not tax income and relied on the sales tax for only two percent of their general revenues derived from local funding. Compendium of Government Finances, *supra* note 84.

⁹¹ This also explains why special districts, which are single-purpose local governments, rely so heavily on user charges. In 1996–1997, special districts relied on charges for sixty percent of their general revenues derived from local funding. *Id.*

⁹² See generally Robert W. Burchell et al., Development Impact: Assessment Handbook 11–12 (1994).

⁹³ Exactions are typically a requirement for dedication of land or for financial or in-kind provision of amenities aimed at balancing the project’s anticipated negative impacts. The Supreme Court set relatively strict qualitative and quantitative boundaries for land dedications in *Dolan v. City of Tigard*, 512 U.S. 374, 388–96 (1994), and *Nolan v. California Coastal Commission*, 483 U.S. 825, 837–39 (1987).

such as user charges.⁹⁴ The zoning power, therefore, becomes a primary fiscal tool for local governments.⁹⁵

Revenue-generating motives are especially dominant in state-mandated development schemes such as Tax Increment Financing (“TIF”).⁹⁶ In such a scheme, a redevelopment agency, which is usually a body of the general-purpose local government, gets to keep the post-redevelopment incremental property tax revenues in return for its redevelopment activity until the full repayment of the bonds issued by the agency.⁹⁷ During that time, the agency does not have to share these incremental revenues with all the jurisdictions that normally share the area’s property taxes. It is therefore not surprising that general-purpose local governments use their land use powers to engage extensively in fiscally motivated redevelopments of “blighted” areas through these agencies.⁹⁸

The ability of public officials to pursue such fiscal agendas depends on what could be termed the “transparency” of tax adjustment mechanisms; that is, the extent to which changes in home values and in other assets resulting from land use decisions correlatively influence periodical tax assessments and tax levies. If, for ex-

⁹⁴ See Ellickson & Been, *supra* note 14, at 755–56.

⁹⁵ See, e.g., Helen F. Ladd, *Land Use Regulation as a Fiscal Tool*, in *Local Government Tax and Land Use Policies in the United States: Understanding the Links* 55 (Helen F. Ladd ed., 1998); see also Arthur O’Sullivan, *Urban Economics* 503–36 (4th ed. 2000).

⁹⁶ See, e.g., Gary P. Winter, *Tax Increment Financing: A Potential Redevelopment Financing Mechanism for New York Municipalities*, 18 *Fordham Urb. L.J.* 655 (1991).

⁹⁷ See, e.g., Todd A. Rogers, Note, *A Dubious Development: Tax Increment Financing and Economically Motivated Condemnation*, 17 *Rev. Litig.* 145, 162–64 (1998); see also *In re Request for Advisory Opinion on Constitutionality of 1986 PA 281*, 422 N.W.2d 186, 191–96 (Mich. 1988) (rejecting the argument that TIF is a constitutionally impermissible diversion of school districts’ tax funds). A study in California found that most redevelopment agencies did not generate enough growth in assessed property values to account for the tax increment diverted to the redevelopment agencies. Michael Dardia, *Subsidizing Redevelopment in California* (1998), available at http://www.ppic.org/content/pubs/R_298MDR.pdf.

⁹⁸ Redevelopment of “blighted” areas is a hotly debated issue primarily because redevelopment agencies or the general-purpose local government often acquire the land through eminent domain and eventually pass it on to private developers. While redevelopment to remove blight has already been recognized as meeting the federal constitution’s Fifth Amendment “public use” requirement in *Berman v. Parker*, 348 U.S. 26, 33 (1954), the Supreme Court has recently extended the scope of fiscally motivated takings by upholding the constitutionality of eminent domain for “economic development.” See *Kelo v. City of New London*, 125 S. Ct. 2655, 2664–69 (2005).

ample, homeowners are well aware of the adverse environmental effects from zoning an adjacent area for industry, and can readily enforce lower ad valorem property tax assessments through the legal system,⁹⁹ the local government would consider such expected outcomes *ex ante*, for its own fiscal sake.¹⁰⁰ In addition, tax transparency also helps to alleviate, even if to a limited extent, problems of intrajurisdictional political biases.¹⁰¹ When residents whose political clout is disproportionately low can at least enjoy lower tax levies (if, for example, a zoning decision decreases their home val-

⁹⁹ See, e.g., *Boekeloo v. Bd. of Review of City of Clinton*, 529 N.W.2d 275, 278 (Iowa 1995); *Reliable Elec. Finishing Co. v. Bd. of Assessors*, 573 N.E.2d 959, 960–61 (Mass. 1991); *Westling v. County of Mille Lacs*, 512 N.W.2d 863, 866 (Minn. 1994); *Inmar Assocs., Inc. v. Borough of Carlstadt*, 549 A.2d 38, 41 (N.J. 1988); *B.P. Oil Co. v. Bd. of Assessment*, 633 A.2d 1241, 1243 (Pa. Commw. Ct. 1993); see also Youngman, *supra* note 86, at 35–36.

¹⁰⁰ Within the limited framework of this Article, I do not offer a general theory about what chiefly motivates governments in their regulatory decisionmaking. Politically based theories assume that the chief motivation for local governments in their regulatory decisionmaking is satisfying the marginal private preferences of politically influential resident-voters or of other significant actors. Under this framework, a new industrial zone would be allowed only to the point that the marginal private costs of the expected environmental degradation equals the marginal benefits of a potential new job or of a decrease in the tax burden on its residential property. Whether the intrajurisdictional results of this decision would be optimal depends on whether the community is homogeneous or heterogeneous. See Wallace E. Oates & Robert M. Schwab, *Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?*, 35 *J. Pub. Econ.* 333, 342–49 (1988). Other models for local government decisionmaking yield different results. See, e.g., William A. Niskanen, Jr., *Bureaucracy and Representative Government* 38–42 (1971) (discussing a bureaucratic model where public decisionmakers promote personal agendas to enhance their power and personal status); Dennis Epple & Allan Zelenitz, *The Implications of Competition among Jurisdictions: Does Tiebout Need Politics?*, 89 *J. Pol. Econ.* 1197, 1197–99 (1981) (analogizing local governments to private sector actors in the market and assuming the government's desire to maximize tax revenues as the primary motivator). For a criticism of the private sector model, see, e.g., William W. Bratton & Joseph A. McCahery, *The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World*, 86 *Geo. L.J.* 201, 237–39 (1997) (explaining that government actors would act entrepreneurially to advance tax revenues only when such actions would also yield appropriate electoral benefits).

¹⁰¹ Hence, the practical difference between the politically based model and the bureaucratic model, discussed *supra* in note 100, narrows substantially as tax transparency increases. If more and more private effects of the zoning decision translate into changes in tax revenues that are legally enforced, then even a bureaucratic-type calculus becomes more comprehensive than intuitively expected.

ues), the effect on them would be taken into account, albeit indirectly.¹⁰²

Local governments also consider the negative and positive tax effects on government-owned local public goods, such as parks and roads. Although taxes are not levied on the properties themselves,¹⁰³ a decrease in productivity and enjoyment of these assets might influence the public coffers through a derivative effect on property values and economic activity. For example, increased traffic congestion on a public road or a noise disturbance in a formerly peaceful park will adversely influence the market values of private assets, as well as the net present value and flow of income from businesses, translating in turn into lower taxes. Similarly, when a public resource such as a public park is financed through user fees, and the demand for the public park is decreased because of unneighborly adverse effects, the social costs are indirectly translated to a net loss of public non-tax revenues.

If the aforementioned factors are indeed taken into account, then the fiscal calculus might become a rough proxy for evaluating the overall balance of the effects of zoning. This means, therefore, that the public revenue-expenditure marginal balance can indicate at least the general trend of the jurisdictional social balance, which is comprised of the marginal balance of both public and private costs and benefits resulting from the land use decision. As I will show in Part II, this insight holds the key to structuring the appropriate legal remedy for land use parochialism, so that the intergovernmental realm will similarly fulfill the potential of the public calculus as a proxy to the overall social balance when cross-border effects are involved.

¹⁰² This is definitely not to argue that the marginal public revenue-expenditure balance would always perfectly fit the overall marginal social balance. Consider a hypothetical community with a ten percent local sales tax and a two percent annual property tax (based on the property's full market value). In such a scenario, a zoning decision which increases annual local sales in the jurisdiction by \$200 but decreases property values by \$900 will be considered fiscally desirable (10% of 200 – 2% of 900 = 2), while it is inefficient from a social welfare viewpoint. Although such deviations may occur, the value-based fiscal calculus has the advantage of making the local government at least weigh interests it would have otherwise ignored.

¹⁰³ See John A. Swain, *The Taxation of Private Interests in Public Property: Toward a Unified Theory of Property Taxation*, 2000 *Utah L. Rev.* 421, 421–22.

*D. Why the Current Property Rules Menu Is Insufficient**1. Present Doctrine's Indecisive Response*

Currently, the most comprehensive measure for combating local egocentricity is found in Oregon's state land use act,¹⁰⁴ which requires that local zoning decisions comply with statewide goals,¹⁰⁵ including the duty to "take into account the regional, state and national needs."¹⁰⁶ The Act enforces the attainment of such goals through the process of state-based "acknowledgement."¹⁰⁷

As for the remaining states, the ability of neighboring local governments and their residents to oppose local zoning decisions involves a number of procedural and substantive aspects. Some states, either statutorily or judicially, award property owners residing in neighboring local governments the right to receive notice on pending zoning matters, to appear in the public hearing, and to voice their opinions.¹⁰⁸ States generally award standing to attack local zoning decisions in court to allegedly aggrieved property owners living outside the deciding jurisdiction, especially in rezoning cases.¹⁰⁹

Neighboring local governments' attainment of standing is conditioned on a showing of specific "aggrievement" or injury to the local government in its corporate capacity.¹¹⁰ The local government does not obtain standing merely as a representative of its allegedly

¹⁰⁴ Comprehensive Land Use Planning Coordination, 1973 Or. Laws 80 (codified as amended at Or. Rev. Stat. §§ 197.005–.860 (2003)).

¹⁰⁵ These statewide goals were adopted by the Land Conservation and Development Commission ("LCD"), set up by the Act. Land Conservation and Development Commission, Statewide Planning Goals & Outlines, <http://www.lcd.state.or.us/LCD/goals.shtml> (last visited Apr. 10, 2006).

¹⁰⁶ See Oregon's Statewide Planning Goals & Guidelines, Goal 2: Land Use Planning at 3, available at <http://www.lcd.state.or.us/LCD/docs/goals/goal2.pdf>.

¹⁰⁷ Or. Rev. Stat. § 197.251 (2003).

¹⁰⁸ See, e.g., N.Y. Town Law §§ 264–65 (McKinney 2004) (granting a right to receive personal notice for property owners within a 500-foot radius of the relevant site); see also *Scott v. City of Indian Wells*, 492 P.2d 1137, 1141–42 (Cal. 1972); *Roosevelt v. Beau Monde Co.*, 384 P.2d 96, 100–03 (Colo. 1963).

¹⁰⁹ See James D. Lawlor, Annotation, Standing of owner of property adjacent to zoned property, but not within territory of zoning authority, to attack zoning, 69 A.L.R.3d 805 (2006).

¹¹⁰ See John J. Michalik, Annotation, Standing of municipal corporation or other governmental body to attack zoning of land lying outside its borders, 49 A.L.R.3d 1126 (2006).

affected residents,¹¹¹ or when its contentions for specific injury are merely generalized and speculative.¹¹² Prominent among the various categories of specific aggrievements recognized for standing purposes are reduction in tax revenue due to decreased property values,¹¹³ depreciation in value of the local government's property,¹¹⁴ and other environmental or economic effects impinging on the affected local government's ability to fulfill its statutory obligations.¹¹⁵

Underlying these procedural rights is a basic substantive viewpoint that a local zoning scheme must consider the interests of all those it significantly affects; however, a closer look reveals state courts' varying devotion to this principle. Only a minority of jurisdictions, New Jersey being a notable example, seem fully committed to curbing local zoning parochialism by creating a coherent body of law aimed at implementing and enforcing substantive norms for both "defensive" exclusionary zoning¹¹⁶ and "offensive" pro-development zoning. In *Borough of Cresskill v. Borough of Dumont*,¹¹⁷ the New Jersey Supreme Court invalidated Cresskill's decision to rezone a one-block parcel bordering on three other boroughs from residential use to a shopping center, calling it illegal

¹¹¹ See, e.g., *Greenbelt v. Jaeger*, 206 A.2d 694, 698 (Md. 1965). But cf. *Wende v. Bd. of Adjustment of City of San Antonio*, 27 S.W.3d 162, 167 (Tex. App. 2000), rev'd on other grounds, 92 S.W.3d 424 (Tex. 2002) (stating that a city located near a stone quarry was a "person aggrieved," where the mayor testified to his personal experience and noted complaints from residents about the effects of blasting on their properties).

¹¹² *Vill. of Riverwoods v. Vill. of Buffalo Grove*, 511 N.E.2d 184, 186 (Ill. App. Ct. 1987); see also *Vill. of Franklin v. City of Southfield*, 300 N.W.2d 634, 635 (Mich. Ct. App. 1980) (denying standing by mere proximity in the absence of alleged "special damages").

¹¹³ See, e.g., *Twp. of River Vale v. Town of Orangetown*, 403 F.2d 684, 686-87 (2d Cir. 1968); *Vill. of Barrington Hills v. Vill. of Hoffman Estates*, 410 N.E.2d 37, 40 (Ill. 1980). But cf. *City of Carbondale v. City of Marion*, 569 N.E.2d 290, 293 (Ill. App. Ct. 1991) (rejecting Carbondale's standing to attack a regional shopping mall included in Marion, in spite of the potential loss of sales tax revenues in Carbondale's own mall).

¹¹⁴ *Twp. of River Vale*, 403 F.2d. at 685.

¹¹⁵ See 4 Rathkopf, *supra* note 24, §§ 63:27-63:28; *City of Brentwood v. Metro. Bd. of Zoning Appeals*, 149 S.W.3d 49, 58-59 (Tenn. Ct. App. 2004) (examining an objection to a construction of a billboard near the boundary line); *Town of Mesilla v. City of Las Cruces*, 898 P.2d 121, 124 (N.M. Ct. App. 1995) (extending government standing for aesthetic injuries).

¹¹⁶ See *supra* note 23.

¹¹⁷ *Borough of Cresskill v. Borough of Dumont*, 104 A.2d 441 (N.J. 1954).

“spot zoning.”¹¹⁸ In so doing, the court held that a municipality is not only obligated to hear outsiders, but it must also give at least as much consideration to the rights of adversely affected residents of adjoining municipalities as it does to those of its own residents.¹¹⁹ This approach, later expressed in New Jersey’s Municipal Land Use Law,¹²⁰ does not formally drop the presumption of validity in favor of the deciding local government, but it does require courts to closely examine the evidentiary basis on which the zoning decision was made.¹²¹ Additionally, it imposes a duty on the local government to consider neighboring jurisdictions’ comprehensive plans.¹²²

California courts also apply a substantive rule. They require that the land use decision bear a “real and substantial relationship” to the region’s general welfare.¹²³ This rule is applied to both exclusionary¹²⁴ and inclusionary zoning cases.¹²⁵ Once a court is satisfied that a project is “benign,” however, it seems to abandon a searching review of costs and benefits and instead defers to the local government’s judgment about the project’s location and scope.¹²⁶ This

¹¹⁸ Id. at 447–48.

¹¹⁹ Id. at 445–46.

¹²⁰ See N.J. Stat. Ann. § 40:55D–2(d) (West 2005), which states that one of the purposes of the Act is “[t]o ensure that the development of individual municipalities does not conflict with the development and general welfare of neighboring municipalities, the county and the State as a whole.”

¹²¹ See also *Quinton v. Edison Park Dev. Corp.*, 285 A.2d 5, 9 (N.J. 1971) (holding that there was no rational basis for denying buffer protection to neighbors in the adjoining municipality).

¹²² *Ferraro v. Zoning Bd. of Adjustment*, 574 A.2d 38, 44 (N.J. 1990); cf. *Town of Weldon Springs v. Andor, Inc.* 764 S.W.2d 734, 736 (Mo. Ct. App. 1989) (holding that Plaintiff locality did not demonstrate special damages sufficient for standing, despite having a contiguous boundary and inconsistent zoning plan).

¹²³ *Associated Home Builders, Etc., Inc. v. City of Livermore*, 557 P.2d 473, 489 (Cal. 1976).

¹²⁴ Id. at 488–89 (upholding the City of Livermore’s decision to condition issuance of further residential building permits on development of new and adequate educational, sewage disposal, and water supply facilities).

¹²⁵ *City of Del Mar v. City of San Diego*, 183 Cal. Rptr. 898, 903–07 (Ct. App. 1982) (upholding San Diego’s multi-phase development plan of a new community, North City West).

¹²⁶ Hence, the court states that “San Diego considered and reasonably rejected the project alternatives suggested by Del Mar as infeasible in view of the social and economic realities in the region,” without further specifying the evidence on which this consideration was based. Id. at 908–09.

dynamic is even more typical of other state¹²⁷ and federal¹²⁸ courts that simply opt for the “fairly debatable” standard originally conceived of in intralocal zoning disputes.¹²⁹

2. When Would Property Rules Work?

Deferential judicial review ignores the lack of effective political counterbalances across jurisdictional lines. In so doing, it stimulates further parochialism in zoning decisions, with attendant inefficiencies and distributional inequities. These inefficiencies are exacerbated by the inadequacy of the private law of nuisance, which forces developers to internalize only a fraction of the adverse costs of intensive development. Thus, both local governments and developers are inadequately deterred from advancing sub-optimal zoning plans.¹³⁰ In practice, the current legal regime imposes no liability for the adverse consequences of intergovernmental zoning externalities. This outcome is equivalent to Calabresi and Melamed’s Rule 3.¹³¹

¹²⁷ See, e.g., *Town of Bedford v. Vill. of Mount Kisco*, 306 N.E.2d 155, 156, 159–160 (N.Y. 1973) (upholding Mount Kisco’s decision to rezone an area near the border from one-family residence to multiple six-story residence, based on the “fairly debatable” standard).

¹²⁸ See, e.g., *Constr. Indus. Ass’n of Sonoma County v. City of Petaluma*, 522 F.2d 897, 908–09 (9th Cir. 1975), cert. denied 424 U.S. 934 (1976) (upholding Petaluma’s plan to fix the yearly housing development rate at 500 dwelling units). As the court explains: “[i]f the present system of delegated zoning power does not effectively serve the state interest in furthering the general welfare of the region or entire state, it is the state legislature’s and not the federal courts’ role to intervene and adjust the system.” *Id.* at 908.

¹²⁹ See *supra* note 28 and accompanying text.

¹³⁰ See *infra* notes 158–66 and accompanying text.

¹³¹ According to this taxonomy, in the factory versus resident standoff, under Rule 1, the factory may not pollute unless he buys the resident’s entitlement for an agreed price (property rule in favor of resident). Under Rule 2, the factory may pollute but must compensate the resident for damage caused as determined by the court (liability rule in favor of resident). Under Rule 3, the factory may pollute at will and can only be stopped if the resident buys out his entitlement at an agreed price (property rule in favor of factory). Under Rule 4, the resident may stop the factory from polluting but if he does so, he must compensate the factory at a price determined by the court (liability rule in favor of factory). See Calabresi & Melamed, *supra* note 3, at 1115–17. However, as Henry Smith aptly notes with respect to Rule 3, the doctrinal expression of siding with a polluter is that the polluter exercises a “privilege,” not a “right,” to pollute, such privilege being correlated with a “no right” of the other party to stop it. The polluter cannot positively force the pollutee to accept the pollution, but if in prac-

However, a stringent approach scrutinizing local decisions with extraterritorial consequences, exemplified by the *Cresskill* case ending in injunctive relief,¹³² creates its own costs. A default rule giving an adversely affected local government, or its residents, property rule protection (Calabresi and Melamed's Rule 1)¹³³ may sometimes block an overall efficient land use decision¹³⁴ if the parties cannot cheaply negotiate an agreement in the shadow of injunction.¹³⁵

As I explained earlier, pre-zoning bargaining often fails, especially when the two local governments compete to provide the same land use.¹³⁶ Even if only one of the parties could feasibly receive the entitlement at the outset, the party likely to prevail will still engage in strategic behavior during bargaining under the current legal rule. Moreover, since there are good reasons to assume that post-litigation bargaining may prove equally unsuccessful,¹³⁷ the currently limited spectrum of property rules means that the court's decision between Rule 1 and Rule 3 (that is, whether to abolish the zoning decision or to give it the go ahead, respectively) may very well determine the final allocation of the entitlement.¹³⁸

This outcome would not be troublesome if we were generally confident that courts are able to accurately predict the effects on

tice the pollutee cannot stop the pollution, the court shall not intervene in favor of the pollutee. Smith, *supra* note 2, at 1011–16.

¹³² See *supra* notes 117–19 and accompanying text.

¹³³ See *supra* note 131.

¹³⁴ See Gillette, *Regionalization*, *supra* note 73, at 207–08 (arguing that stringent judicial review which fails to accurately measure costs and benefits may thwart effective zoning schemes).

¹³⁵ But cf. Shavell, *supra* note 5, at 83–87 (discussing the feasibility of resolving externalities through bargaining in the shadow of legal rules).

¹³⁶ See *supra* Section I.B.

¹³⁷ Ward Farnsworth, *Do Parties to Nuisance Cases Bargain After Judgment? A Glimpse Inside the Cathedral*, 66 *U. Chi. L. Rev.* 373, 381–84 (1999) (examining twenty nuisance cases and finding post-litigation negotiation infrequent and consummated sales of rights nonexistent).

¹³⁸ A. Mitchell Polinsky, *Controlling Externalities and Protecting Entitlements: Property Right, Liability Rule, and Tax-Subsidy Approaches*, 8 *J. Legal Stud.* 1, 10–13 (1979). But see Louis Kaplow & Steven Shavell, *Property Rules Versus Liability Rules: An Economic Analysis*, 109 *Harv. L. Rev.* 713, 735–37 (1996) [hereinafter Kaplow & Shavell, *Property Rules*] (arguing, cautiously, that because property rules are generally less efficient than liability rules, the parties have relatively more to gain from bargaining in the shadow of property rules and hence are more likely to conclude beneficial bargains).

the respective local governments and choose between Rule 1 and Rule 3 after comparing the decision's expected public benefits with its costs.¹³⁹ Moreover, if courts had good (not to say perfect) knowledge, they could even more finely tailor their choice between the two property rules, taking into account not only the current zoning scheme, but also the ability of the parties to prevent or mitigate the conflict. Since zoning precedes development, courts could seek to identify the party that is the least cost avoider of the conflict, and by directing injunctive relief in favor of the other party, force the least cost avoider to carry out mitigating measures.¹⁴⁰

It is unrealistic, however, to expect courts to make accurate assessments of the costs and benefits of intergovernmental zoning and externalities. First, courts almost always face the inherent difficulty of overcoming problems of private information and subjective evaluations. Second, a full-scale evaluation of costs and benefits, even in "objective," probabilistic terms, is a daunting task, especially if the legal rule requires courts to closely consider on-site or off-site alternatives. The time, effort, and resources required to learn the facts in detail, acquire expert knowledge, and eventually come up with an analysis of the expected values of the various interests affected by the scheme or its alternatives impose a high—if not prohibitive—burden on the courts.¹⁴¹

The difficulty that courts have in making such valuations is vividly demonstrated by the judicial oversight of environmental impact statements, the mainstay of the federal National Environmental Protection Act ("NEPA") and of subsequent state legislation.¹⁴² In California, for example, the California Environmental Quality Act ("CEQA") decrees that "it is the policy of the state that public agencies should not approve projects as proposed if there are feasible alternatives or feasible mitigation measures available which would substantially lessen the significant environmental effects of such projects."¹⁴³

Probably not surprisingly, the standard of review for the Environmental Impact Reviews ("EIR") that should contain such fea-

¹³⁹ Kaplow & Shavell, *Property Rules*, supra note 138, at 724–25.

¹⁴⁰ Calabresi & Melamed, supra note 3, at 1096–97.

¹⁴¹ See Komesar, supra note 41, at 35–45, 70–86, 165–70.

¹⁴² See supra note 22.

¹⁴³ See Cal. Pub. Res. Code § 21002 (West 2005).

sible off-site and on-site alternatives is that of “abuse of discretion.”¹⁴⁴ California courts seem content with this lax substantive standard, reasoning that “the reviewing court does not pass upon the correctness of the EIR’s environmental conclusions, but only upon its sufficiency as an informative document.”¹⁴⁵ While this respect for elected officials’ decisionmaking can be explained from a separation of powers viewpoint, the California courts could have narrowed it in the intergovernmental context, given courts’ own emphasis on local officials’ lack of political incentives to consider regional perspectives.¹⁴⁶ It seems likely that high administrative costs are largely responsible for courts’ reluctance to engage in a detailed quantitative investigation of alternatives and mitigation measures.¹⁴⁷

Matters become even more complicated if courts are asked to review not only environmental effects, but also economic and social ones, as is often the case with pro-development projects entailing potential loss of revenues and jobs in existing businesses, which in turn translate into lower tax revenues for the plaintiff local government. Concern over administrative costs and imperfect knowledge in these cases is an alternative explanation for the state courts’ general reluctance to construe social and economic effects not directly accompanied by environmental changes as falling within the ambit of environmental impact statements.¹⁴⁸

¹⁴⁴ Id. § 21168.5.

¹⁴⁵ See *Citizens of Goleta Valley v. Bd. of Supervisors of the County of Santa Barbara*, 801 P.2d 1161, 1167 (Cal. 1990) (quoting *Laurel Heights Improvement Ass’n v. Regents of the Univ. of Cal.*, 764 P.2d 278, 283 (Cal. 1988)).

¹⁴⁶ See *supra* note 56 and accompanying text.

¹⁴⁷ Consider again *City of Del Mar v. City of San Diego*, 183 Cal. Rptr. 898 (Ct. App. 1982), in which Del Mar asked the Court of Appeals to evaluate the nine-phase North City West development project covering 4,286 acres and designed to accommodate 40,000 people, to scrutinize San Diego’s consideration of on-site and off-site alternatives, and to further consider additional alternatives not formally discussed by San Diego in its EIR. Id. at 900–01. It is clear that a detailed cost-benefit evaluation of all the alternatives would have been impracticable, even if normatively desirable. Hence, the court had no sensible option but to settle for a bird eye’s view of the project, noting that San Diego’s projections must “await the passage of time and the impact of social, political and economic forces.” Id. at 905.

¹⁴⁸ See *Friends of Davis v. City of Davis*, 100 Cal. Rptr. 2d 413, 424–26 (Ct. App. 2000).

3. *The Need for Liability Rules*

Given such imperfect information by courts, liability rules may often be superior and should be added to the menu of interjurisdictional remedies.

The liability rule framework has been re-conceptualized as an option mechanism, in which the party found liable may choose either to receive the entitlement against payment of the other party's court-evaluated harm, engage in harm-prevention measures that will resolve the conflict, or simply waive the entitlement altogether. With the pollutee-polluter scenario as a prime example, Calabresi and Melamed's Rules 2 and 4¹⁴⁹ have been redefined as "call options," the former making the polluter the option-holder, and the latter granting such option to the pollutee.¹⁵⁰

As Professors Louis Kaplow and Steven Shavell have shown, liability rules may actually serve as a sophisticated mechanism for capitalizing on the litigants' private information whenever the court has imperfect information.¹⁵¹ For example, if the court can estimate the pollutee's "average" or typical harm, Rule 2 allows the court to harness the private information that the polluter naturally possesses about his prevention costs, so that the latter would take the entitlement by paying compensation only if prevention is unfeasible and its genuine benefits outweigh the pollutee's court-estimated costs. This means that, at least with respect to cases of harmful externalities in which the benefits and harms are generally uncorrelated, a liability rule is on average more efficient than a property rule regime.¹⁵²

Professors Ian Ayres and Paul Goldbart further build on the information-harnessing effect of liability rules by calling for placement of the option in the hands of the litigant for whom the court's estimate is more speculative, that is, the party who has the greater

¹⁴⁹ For the Calabresi & Melamed four-rule taxonomy, see *supra* note 131.

¹⁵⁰ See, e.g., Ian Ayres & J.M. Balkin, *Legal Entitlements as Auctions: Property Rules, Liability Rules, and Beyond*, 106 *Yale L.J.* 703, 729–33 (1996); Richard A. Epstein, *A Clear View of The Cathedral: The Dominance of Property Rules*, 106 *Yale L.J.* 2091, 2093 (1997); Lee Anne Fennell, *Revealing Options*, 118 *Harv. L. Rev.* 1399, 1414–18 (2004) [hereinafter Fennell, *Options*].

¹⁵¹ Kaplow & Shavell, *Property Rules*, *supra* note 138, at 724–28.

¹⁵² *Id.*

variance of potential private evaluation.¹⁵³ Following this important insight, the liability rule option taxonomy has been further developed by complementing “call options” with “put options” (“Rule 5” and “Rule 6”).¹⁵⁴ This expansion enables the decoupling of allocative efficiency from distributive concerns, meaning that the court’s decision about which party would be the more efficient chooser need not dictate its judgment about the most just distribution of side payments.¹⁵⁵ In other words, the decision whether to grant the more efficient chooser a call option (forcing her to pay to receive the entitlement) or a put option (entitling her to receive payment to forego it) could be based on distributive preferences.

In the intergovernmental zoning context, the deciding local government (“Alpha”) could generally be seen as the efficient chooser, since it typically possesses relatively more private information. This is especially true with respect to potential prevention and mitigation measures, including both on-site and off-site alternatives, which are usually more varied and feasible for Alpha than for its neighbor (“Beta”).¹⁵⁶ The distributive choice between Rule 2

¹⁵³ Ian Ayres & Paul M. Goldbart, *Optimal Delegation and Decoupling in the Design of Liability Rules*, 100 Mich. L. Rev. 1, 21–26 (2001); see also Ronen Avraham, *Modular Liability Rules*, 24 Int’l Rev. L. & Econ. 269, 289–90, 296 (2004).

¹⁵⁴ In the polluter-pollutee scenario, under Rule 5, the court permits pollution to continue and also grants the polluter the option to stop polluting and to receive court-determined damages from the pollutee. Under Rule 6, the court enjoins the pollution and grants the resident an option to waive the injunctive right in return for court-determined damages from the polluter. Ayres & Goldbart, *supra* note 153, at 6–9. Some authors have reversed the order of Rules 5 and 6. See, e.g., Saul Levmore, *Unifying Remedies: Property Rules, Liability Rules, and Startling Rules*, 106 Yale L.J. 2149, 2163 (1997). Of course, these are not the only additional options. Ayres and Goldbart have also offered “dual chooser rules” in which both parties have a say about reallocating the entitlement. Ayres & Goldbart, *supra* note 153, at 34–43. This is in effect what Ronen Avraham terms “modular liability rules.” Avraham, *supra* note 153, at 278–82.

¹⁵⁵ Ayres & Goldbart, *supra* note 153, at 33–34, 39–40. The potential for decoupling efficiency considerations from distributive ones is not unique to the externalities setting. See, e.g., Michael A. Heller & James E. Krier, *Deterrence and Distribution in the Law of Takings*, 112 Harv. L. Rev. 997, 1025 (1999) (advocating decoupling the considerations of deterring governments from taking inefficient public measures and the distributive justification for compensation in the law of takings); David Rosenberg, *Decoupling Deterrence and Compensation Functions in Mass Tort Class Actions for Future Loss*, 88 Va. L. Rev. 1871, 1875–1879 (2002).

¹⁵⁶ This is definitely not to say that Beta can never take effective measures to mitigate the adverse effects. Accordingly, Beta’s legal entitlement, as elaborated *infra* in Part II, should be subject to the general principle of mitigation of damages. See Rich-

(forcing Alpha to pay Beta's court-estimated damages to allow the zoning scheme to go forward) and Rule 5 (granting Alpha the initial entitlement, plus a put option to abolish the zoning scheme and to receive damages for its foregone incremental public revenues) does not seem too difficult to me. As I show in detail in the following Part, holding Alpha responsible for employing its monopolistic-like regulatory powers within its territory would curb regionally inefficient land use more appropriately. Moreover, in view of the preliminary nature of a zoning decision (as opposed to a conflict following the actual development), a "put option" scheme might often turn land use regulation into a mere tactical device for cross-border rent capturing. Alpha would be motivated to threaten Beta with a harmful zoning decision for which it has no genuine need—such as the designation of an undeveloped area at its fringe for heavy industry, even if no current private demand for such a land use exists—provoking Beta into futile, "virtual" zoning retaliation.

II. INTERGOVERNMENTAL LIABILITY RULES

This Part offers an outline for a statutory intergovernmental liability model.¹⁵⁷ First, it defines and justifies the proposed cause of action and remediable damages. It then identifies the relevant parties, timing of litigation, period of compensation, de minimis bar, and employment of self-assessment mechanisms, as well as sampling and aggregating techniques. It later explains why this model may be better than the current legal regime at encouraging parties to negotiate in its shadow, and why we should be hesitant to convert this intergovernmental litigation into a full-scope class action dealing directly with the entire scope of the public and private balance.

ard A. Epstein, *Cases and Materials on Torts* 790–91 (8th ed. 2004). Interestingly, while it is theoretically possible to examine Beta's ability to offset the damage, such a focus may often prove impracticable or incoherent. Consider a hypothetical case in which Alpha decides to zone an area near its border with Beta for industrial use. Beta in response decides to zone the area on its side of the border for an environmentally sensitive land use, such as a public park. On the one hand, Beta's decision intensifies the conflict, but on the other hand, Beta has designated a neighbor-friendly land use, which under regular circumstances might create positive externalities for Alpha's residents.

¹⁵⁷ In this Part, I assume that the entire set of costs and benefits is confined to a specific state.

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*A. Designing the Liability Mechanism**1. Defining the Cause of Action and Remediable Damages*

The intergovernmental liability model seeks to compensate adversely affected local governments for expected public revenue losses arising from cross-border effects of land use decisions, mainly zoning ones. Public losses usually follow private losses; for example, decreased property tax revenues follow diminution in property values. These two types of costs are analytically and normatively different, however, and there are good reasons to remedy public monetary damages, while rejecting many allegedly parallel claims of adversely affected private parties.

Consider the loss of ad valorem property taxes. Currently, a neighboring local government, Beta, has no recognized cause of action to recoup present or future lost revenues following a zoning decision in Alpha that devalues properties located within Beta. I argue that the statutory recognition of remediable damages in the intergovernmental context of property tax revenues should be broader than with private causes of action over property damages generally, and devaluation in particular.

To appreciate the differences, consider, first, that in private law, landowners adversely affected by what they deem to be unneighborly conduct may employ various common law causes of action, such as private nuisance, public nuisance, negligence, or strict liability for ultra-hazardous activities.¹⁵⁸ Liability, however, is not regularly established merely by demonstrating damage or interference with the use and enjoyment of land. To prevail in private nuisance, for example, the plaintiff usually has to show that the activity is somehow “subnormal” in relation to its geographical

¹⁵⁸ For a doctrinal survey of these causes of action, see 37 Am. Jur. 3d Proof of Facts 439 (2005). In some cases, the computation of permanent damages can be based not only on depreciation in the property's market value, but also on diminution in its rental or usable value. Most jurisdictions allow an affected owner or occupant of real estate to recover damages not only for depreciation in value of property or for diminution in its rental or usable value, but also for personal inconvenience, emotional distress, sickness, etc. See Tracy A. Bateman, Nuisance as Entitling Owner or Occupant of Real Estate to Recover Damages for Personal Inconvenience, Discomfort, Annoyance, Anguish, or Sickness, Distinct From, or in Addition to, Damages for Depreciation in Value of Property or its Use, 25 A.L.R.5th 568 (1994 & Supp. 2004).

vicinity.¹⁵⁹ In public nuisance, liability is imposed upon showing that the damaging activity is in itself unreasonable¹⁶⁰—for instance, when the action is otherwise “proscribed by a statute, ordinance, or administrative regulation.”¹⁶¹ In an era of extensive land use regulation, zoning plays a major role in establishing these standards of reasonableness and normalcy. Although the fact that an activity conforms to a zoning ordinance is not conclusive against the existence of nuisance,¹⁶² the local government’s regulatory approval is a major factor to consider.¹⁶³ While private defendants should generally be able to rely on zoning conformity as a shield from at least some types of nuisance claims, a local government should not benefit from such relief when its standard-setting was designed to create internal benefits while simultaneously imposing extraterritorial burdens.

Second, in private law, liability for devaluation of land is usually confined to permanent adverse market effects of physical pollution and other forms of non-trespassory invasion, and occasionally to marketplace stigma due to proximity to environmental hazards.¹⁶⁴ In contrast, private law usually does not provide a remedy for market devaluation due to, for example, an off-site aesthetic disturbance, or the mere increase in traffic congestion resulting from a

¹⁵⁹ See Plater et al., *supra* note 7, at 114; Ellickson, *Alternatives*, *supra* note 12, at 731–33. As the Supreme Court famously stated in *Village of Euclid v. Ambler Realty Company*, 272 U.S. 365, 388 (1926): “A nuisance may be merely a right thing in the wrong place,— like a pig in the parlor instead of the barnyard.”

¹⁶⁰ See Restatement (Second) of Torts § 821B (1979 & Supp. 2004).

¹⁶¹ *Id.* § 821B(2)(b). Historically, the primary purpose of public nuisance has been to enable public authorities to terminate conduct found to be harmful to the public health, welfare, or morals based on community standards. Recent years have seen, however, increasing attempts to extend the scope of public nuisance by focusing on the harm, rather than on the nature of conduct, as a sufficient basis for liability. For a criticism of this approach, see Donald G. Gifford, *Public Nuisance as a Mass Products Liability Tort*, 71 U. Cin. L. Rev. 741, 774–813 (2003).

¹⁶² See, e.g., *Fendley v. City of Anaheim*, 294 P. 769, 771 (Cal. Dist. Ct. App. 1930); *Weltshe v. Graf*, 82 N.E.2d 795, 796 (Mass. 1948); *Bowers v. Westvaco Corp.*, 419 S.E.2d 661, 665–66 (Va. 1992).

¹⁶³ See 8 Eugene McQuillin, *The Law of Municipal Corporations* § 25.11 (3d ed. rev. 2000 & Supp. 2005). Moreover, if the court ignores current zoning regulations, it actually engages in its own judicial zoning. Plater et al., *supra* note 7, at 133–34.

¹⁶⁴ See *Bradley v. Armstrong Rubber Co.*, 130 F.3d 168, 175–76 (5th Cir. 1997) (discussing various state and federal courts’ approaches to the compensability of stigma-based devaluations).

new project.¹⁶⁵ While such limits have merits in the private law context, there is sense in including such foreseeable market effects in the calculus of public revenue litigation, since the deciding local government is generally expected to take into account such broader considerations when making a decision on a new land use.¹⁶⁶

Third, even in jurisdictions that do not grant a local government sovereign immunity when it creates a nuisance in managing its properties¹⁶⁷—including when the action is filed by the state or one of its subdivisions¹⁶⁸—the substantive scope of liability is generally derived from conventional tort doctrine and does not reflect a heightened standard.¹⁶⁹ More importantly, since zoning is considered a quintessential example of a “governmental” rather than a “proprietary” function for the purpose of defining the scope of sovereign immunity from tort actions,¹⁷⁰ “negligent zoning” that does not otherwise constitute a taking or a violation of substantive

¹⁶⁵ See Robert D. Dodson, *Rethinking Private Nuisance Law: Recognizing Aesthetic Nuisances in the New Millennium*, 10 S.C. Envtl. L.J. 1, 1–2 n.13 (2002); *Dunaway v. City of Marietta*, 308 S.E.2d 823, 824 (Ga. 1983) (finding a mere increase in traffic insufficient to sustain a claim challenging the rezoning). But see, e.g., *Foley v. Harris*, 286 S.E.2d 186, 190–91 (Va. 1982) (enjoining collection of junked automobiles on lot in subdivision).

¹⁶⁶ Cf. *Roberts v. Planning and Zoning Comm’n*, No. CV010379911S, 2003 WL 21235343, at *3–5 (Conn. Super. Ct. May 15, 2003) (highlighting the centrality of the traffic congestion factor in deciding certain types of land use projects); Daphna Lewinsohn-Zamir, *Compensation for Injuries to Land Caused by Planning Authorities: Towards a Comprehensive Theory*, 46 U. Toronto L.J. 47, 76–87 (1996) (arguing that compensation for damages caused by land use decisions should not be confined by the boundaries of nuisance law); Georgette C. Poindexter, *Light, Air, or Manhattanization?: Communal Aesthetics in Zoning Central City Real Estate Development*, 78 B.U. L. Rev. 445, 483–88 (1998) (discussing the legitimacy of aesthetic zoning in the absence of recognition for aesthetic nuisance).

¹⁶⁷ See, e.g., *City of Columbus v. Barngrover*, 552 S.E.2d 536, 545 (Ga. App. 2001); *Li v. Feldt*, 487 N.W.2d 127, 129 (Mich. 1992).

¹⁶⁸ See, e.g., *Bd. of Educ. v. Mayor and Common Council of Riverdale*, 578 A.2d 207 (Md. 1990) (denying the sovereign immunity defense to a municipality in a suit brought by a school district for alleged damages caused by leak of gasoline from municipality’s underground tank).

¹⁶⁹ See, e.g., *City of Little Falls v. State*, 190 N.Y.S. 807, 809–810 (App. Div. 1921).

¹⁷⁰ For a discussion of this taxonomy, see 18 McQuillin, *supra* note 163, §§ 53.23, 53.24. For a classification of zoning as a “governmental” function, see, e.g., *Video Int’l Prod., Inc. v. Warner-Amex Cable Commc’ns, Inc.*, 858 F.2d 1075, 1085 (5th Cir. 1988).

due process is outside the realm of private remedies.¹⁷¹ Hence, to the extent that we view intergovernmental liability for zoning as normatively desirable, liability for harmful zoning should be spelled out in a specific statutory scheme.

The discrepancy between current private law and the intergovernmental liability scheme is even more substantial with respect to prospective loss of sales tax and other revenues, such as local income tax, resulting from declining economic activity within the territory of the affected local government. In a free market economy, it is inconceivable to hold a private party liable for taking away business from a competitor, absent unfair methods of competition, antitrust violations, or other exceptionally predatory or malicious conduct. Adverse effects on other market actors resulting from the employment of pricing mechanisms or related business practices are part of the ordinary working of markets, not externalities that the law should redress through remedies.¹⁷²

Conversely, competition for public revenues between local governments and the employment of zoning powers for that purpose raises an entire array of additional social, economic, and political considerations that justify increased statutory and judicial intervention according to the tenets of public law, while preserving the core of local government autonomy. This increased involvement is especially warranted because intergovernmental competition for economic activity, job creation, high-income residents, and businesses, and consequently for public revenues, is often criticized as inefficient and wasteful,¹⁷³ resulting at times in an environmental¹⁷⁴ and

¹⁷¹ See *supra* notes 26–34 and accompanying text.

¹⁷² See *Ala. Power Co. v. Ickes*, 302 U.S. 464, 478–80 (1938) (reasoning that damages to an existing business from lawful competition is a case of *damnum absque injuria* (damage without injury) not remediable at law).

¹⁷³ For a general evaluation of intergovernmental competition, see, e.g., Advisory Comm'n on Intergovernmental Relations, *Interjurisdictional Tax and Policy Competition: Good or Bad for the Federal System?* (1991); Albert Breton, *Competitive Governments: An Economic Theory of Politics and Public Finance* 235–48 (1998); *Competition Among States and Local Governments* (Daphne A. Kenyon & John Kincaid eds., 1991).

¹⁷⁴ See, e.g., Daniel C. Esty, *Revitalizing Environmental Federalism*, 95 *Mich. L. Rev.* 570, 627–38 (1996) (arguing that states and local governments engage in an environmental “race to the bottom” by offering developers lax environmental regulation); Peter P. Swire, *The Race to Laxity and the Race to Undesirability: Explaining Failures in Competition Among Jurisdictions in Environmental Law*, 14 *Yale L. & Pol’y*

economic¹⁷⁵ “race to the bottom.” Without going into an elaborate discussion about whether and when this conception of intergovernmental competition holds true, it is clear that land use controls, and zoning in particular, are probably the quintessential example of local government spatial monopoly in which the government has a direct fiscal stake beyond its political interests. Since antitrust law does not apply to local governments,¹⁷⁶ and would in any case seem inappropriate in the land use context, a normatively modest, yet economically effective, mode of intervention would be to hold local governments financially liable for failing to consider regional effects in making zoning decisions, even if in a limited manner.

2. Identifying the Parties

Litigation revolving around the public revenue balance generally requires that all relevant local governments (counties, incorporated municipalities, school boards, and special districts) that can expect either positive or negative effects of the zoning scheme be represented in the litigation.¹⁷⁷ Consider the following illustration:

Rev. 67 (1996). But cf. Richard L. Revesz, *Federalism and Interstate Environmental Externalities*, 144 U. Pa. L. Rev. 2341 (1996); Fischel, *Homevoter*, supra note 57, at 162–83 (both challenging this general thesis); see also supra note 99.

¹⁷⁵ A 1997 nationwide survey found that all fifty states continuously increased the level and variety of tax and other financial incentives to attract newly established projects, or to have existing ones relocate into their territory. Keon Chi & Drew Leatherby, *State Business Incentives: Trends and Options for the Future* (1997). Prominent examples include investment tax credit schemes that allow businesses to reduce their income tax liability by a specified percentage of the cost of new in-state facilities or equipment, job-creation credits based on a firm’s incremental in-state employment or payroll, property tax exemptions for business plant and machinery, and sales tax exemptions for purchases of equipment. See Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 Harv. L. Rev. 377, 382–89 (1996) [hereinafter Enrich, *Saving the States*]. This means that in many cases, states and local governments are willing to forego major public revenues in the present with the hope of regaining those public revenues through a future consequential increase in local income tax, sales tax, property tax, etc.

¹⁷⁶ Local Government Antitrust Act of 1984, 15 U.S.C. §§ 34–36 (2000). See generally Phillip Areeda & Louis Kaplow, *Antitrust Analysis: Problems, Text, and Cases* 133 (5th ed. 2004).

¹⁷⁷ While the state itself also has a public revenue stake in the zoning decision, it should refrain from joining in the litigation, bearing in mind that it could always intervene directly in land use decisions of “statewide concern.” See supra note 20.

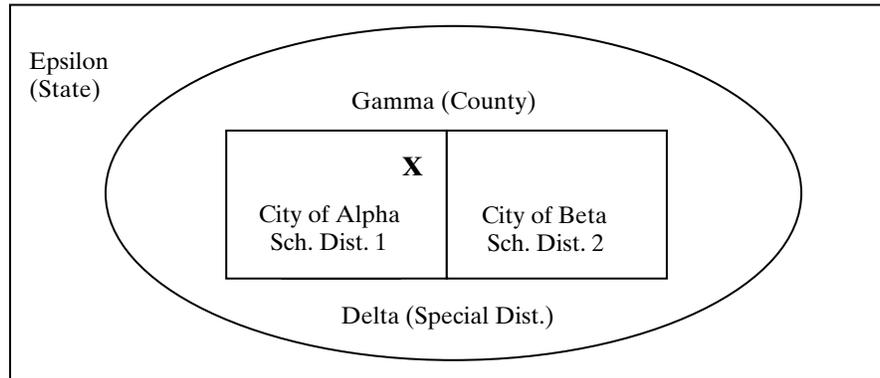


Illustration 1: Parties to Intergovernmental Litigation

In this scenario, Alpha, an incorporated city, decides to zone site X, near its border with Beta, another incorporated city, for shopping centers and large discount retailers. The borders of School Districts 1 and 2 conform, respectively, to the borders of Alpha and Beta. Alpha and Beta are located in the same county, Gamma. Delta, a Special District providing a certain infrastructure, serves the entire county, including the incorporated cities. The zoning decision is expected to generate sales for new businesses in site X, but may also decrease property values in one of Beta's peaceful residential neighborhoods, and reduce the volume of business in Beta's old commercial district.

The key to identifying the correct parties to the litigation lies in understanding which local governments stand to gain from the zoning decision and which stand to lose from it, and in dividing both the liability and the entitlement to compensation pro rata to the respective public revenue share of the parties on each side of the litigation. Simply put, the liability regime should be based on the state-specific statutory scheme of the taxing powers of the different local governments and the tax rates for each local government.¹⁷⁸

¹⁷⁸ See supra notes 85–91. Assume, for example, that in the State of Epsilon, a city enjoys a four percent sales tax on retail businesses, while the county levies a two percent sales tax. For residential properties within an incorporated city, the city takes a one percent property tax, as does the school district. Assume further that special district revenues are based strictly on user fees, and that these would be largely unaffected by such zoning decisions. In this scenario, the plaintiffs are Beta and Gamma for the loss of sales tax (sharing the compensation at a 2:1 ratio), and Beta and School

While the potential multitude of overlapping local governments complicates the picture, the number of parties still seems tolerable enough to render the intergovernmental liability scheme feasible from an administrative viewpoint. Pro-development zoning decisions, which are the basis of this Article, may typically involve a limited number of parties, as the cases surveyed in Part I demonstrate.¹⁷⁹ Contrarily, exclusionary zoning decisions may be inappropriate for compensation-based litigation, since the burden of “defensive” zoning falls on the shoulders of many local governments because each one must contribute its share to meeting the regional demand for affordable housing. In these latter cases, a state regulatory program may be more appropriate.¹⁸⁰

For the sake of simplicity, I will henceforth refer to Beta as a sole plaintiff and to Alpha as a sole defendant, but obviously state-specific adjustments regarding the relevant parties are necessary to make the model workable.

3. Timing of Litigation

The true potential of intergovernmental zoning litigation lies in its *ex ante* approach. In accident law, where the act in question usually cannot be undone, damages (actual and punitive) aim at deterring *future* potential tortfeasors from engaging in harmful conduct that they can efficiently prevent.¹⁸¹ In typical nuisance cases, injunctive relief or permanent damages encourage the liable party to take feasible preventive measures to stop future damages. However, in the typical *ex post* nuisance litigation where no feasi-

District 2 for the loss of property tax (sharing the compensation at a 1:1 ratio). The defendants are Alpha and Gamma (sharing the liability at a 2:1 ratio). The justification for including Gamma on both sides of the litigation lies in the fact that the types of costs are not symmetric to the types of benefits. While Gamma both profits and loses from the changes in sales tax revenues, it does lose from the decrease in property tax revenues, so its respective share cannot simply be deducted from the litigation. This statutorily-based alleged deviation from the general principle that “a person cannot sue himself” should not be jurisprudentially troublesome, however, given the *sui generis* nature of the litigation as an intergovernmental accounting mechanism aimed at internalizing public costs and benefits, and the existence of other parties on both sides of the litigation that would be willing to make their case.

¹⁷⁹ See supra Subsection I.D.1.

¹⁸⁰ See supra note 23.

¹⁸¹ Guido Calabresi, *The Costs of Accidents: A Legal and Economic Analysis* 73–75 (1970).

ble on-site prevention options exist, relocation and other costs often hamper otherwise potentially efficient off-site mitigation, such as moving to a different location.¹⁸²

In contrast, litigation over a governmental zoning decision that *precedes* actual development and private conflicts has the unique advantage of both creating incentives to mitigate the potential conflict and allowing local governments more flexibility in implementing such measures in advance. Threatened with the potential costs of compensation, the liable local government would reconsider its zoning policy and choose the most efficient solution from its entire range of feasible on-site and off-site alternatives.¹⁸³ It is in such context that the liability rule seems to reveal its full potential as an option device.

This example demonstrates why litigation should be held as closely as possible to the date of the zoning decision, although this timing has the disadvantage of making the court estimate expected costs rather than calculating actual damages.¹⁸⁴ Although the payment structure could be designed to allow for judicially-mandated

¹⁸² See Richard R.W. Brooks, *The Relative Burden of Determining Property Rules and Liability Rules: Broken Elevators in the Cathedral*, 97 *Nw. U. L. Rev.* 267, 306 n.154 (2002) (explaining that relocation costs might include not only moving costs, but also start-up costs in the new location, as well as loss of goodwill).

¹⁸³ To make sense of this *ex ante* choice, the abandonment of a zoning decision following such litigation should not be considered as a “regulatory taking” from the landowner, whose land and its up-zoning has been the subject of litigation.

¹⁸⁴ Under this scenario, the remediable costs—to borrow from personal injury tort terminology—would fall somewhere between inchoate losses and future losses. Inchoate losses relate to cases in which the plaintiff has been exposed to a substance (e.g. asbestos) linked to certain types of diseases which, if occurring, would require medical treatments and inflict other types of physical, emotional, and economic losses. Yet at the time the plaintiff sues, the disease has not yet erupted. Future losses relate to cases in which the plaintiff has already sustained a physical injury expected to impose future costs alongside present ones. See George C. Christie, *Cases and Materials on the Law of Torts* 736–37 (3d ed. 1997); Symposium, *Liability for Inchoate and Future Loss*, 88 *Va. L. Rev.* 1625 (2002). Generally, evidentiary rules for establishing inchoate losses are stricter than the rules for future losses. Compare *Potter v. Firestone Tire & Rubber Co.*, 863 P.2d 795, 816 (Cal. 1993) (requiring plaintiff to demonstrate that it is more likely than not that he will develop cancer in the future due to the toxic exposure), with *Pearson v. Bridges*, 524 S.E.2d 108, 112–13 (S.C. Ct. App. 1999) (reasoning that an expert opinion about potential future complications from gallbladder surgery may be a sufficient basis to calculate future costs without the need to meet the “more probable” standard).

periodic payments,¹⁸⁵ this should not be accompanied by a periodic judicial *reassessment* of public costs and benefits. Transforming the one-time, ex ante litigation into a series of periodic judicial re-evaluations of the court's original assessment might prove to be an administrative nightmare. Moreover, a limit on the period of time for which compensation will be due, which I suggest in the following Section, should alleviate the problem of a potential mismatch with ex post consequences, and further tip the scales in favor of genuine ex ante litigation.

4. Compensation Period and Minimum Damage Limits

Two important limits on intergovernmental liability are necessary to offset potential undesirable consequences of the new legal regime.

First, Alpha should not be liable to Beta for lost revenues ad infinitum. Alongside the administrative difficulties of judicially estimating the net permanent implications of a zoning measure, there is independent normative merit in restricting the period of compensation in the intergovernmental context of public revenues. While Alpha's land use decisions sometimes influence property values and economic activity levels within Beta, it is obvious that Beta's current and future regulatory measures are the prime generator of governmentally-caused changes, including changes in tax policies. Granting Beta a perpetual right to compensation may very well skew Beta's incentives to engage in future schemes that positively affect public and private interests, constituting a type of moral hazard problem.¹⁸⁶ Therefore, the optimal solution would be to limit the entitlement to intergovernmental compensation for a fixed period, for example five or ten years, based on a one-time ex

¹⁸⁵ This payment structure has become prevalent in many jurisdictions, especially in the medical malpractice liability context. See Roger C. Henderson, *Designing a Responsible Periodic-Payment System for Tort Awards: Arizona Enacts a Prototype*, 32 *Ariz. L. Rev.* 21, 26–28 (1990); Ellen S. Pryor, *After the Judgment*, 88 *Va. L. Rev.* 1757, 1170–74 (2002).

¹⁸⁶ Moral hazard generally refers to the greater tendency of people protected from the consequences of risky behavior to engage in such behavior or to exercise a lower level of care. See 2 *The New Palgrave Dictionary of Money and Finance* 304 (Peter Newman et al. eds., 1992).

ante evaluation of the expected public revenue effects of the zoning decision for that time period.

Second, to avoid the administrative costs of spite-motivated political litigation for relatively negligible claims, there should be a minimum loss requirement for intergovernmental liability claims. Such a *de minimis* rule would require the plaintiff local government to pass at least one of two statutorily designed bars: a minimum total sum, or a minimal percentage of decrease in tax revenues from each relevant asset within the claim. The minimum total sum alternative would cover situations in which Alpha's zoning scheme imposes small per asset burdens that fall on a large number of assets in Beta, even though the asset-specific percentage bar would not be reached. Beta, as the sole plaintiff whose legal interest expands to all taxable assets in its territory, could readily manage such a claim, which would require a class action mechanism in the private party setting.¹⁸⁷ Settling for the total sum alternative in such a scenario also makes sense from a normative viewpoint. In an intrajurisdictional setting, it is often undesirable to compensate a large number of persons each incurring a relatively modest burden, at least when political checks are sufficient to curb exaggerated or unbalanced burdens.¹⁸⁸ These considerations do not apply, however, in interjurisdictional conflicts, in which no such extralegal mechanisms regularly apply.¹⁸⁹

5. Self-assessment as Ceiling and Floor

In evaluating Beta's expected loss of public revenues, the court cannot rely merely on a comparative study of similar past zoning schemes, but must also consider the affected area's unique characteristics to obtain an accurate estimate of the expected damages. As Beta has an intimate knowledge of the allegedly affected assets, based, *inter alia*, on its current periodic assessments for its own tax

¹⁸⁷ See *infra* Section II.C.

¹⁸⁸ See Lee Anne Fennell, *Taking Eminent Domain Apart*, 2004 Mich. St. L. Rev. 957, 968–71 [hereinafter Fennell, *Eminent Domain*]; see also Hanoch Dagan, *Takings and Distributive Justice*, 85 Va. L. Rev. 741, 771–77 (1999) (arguing that land use law, regulating social relationships of members in geographic and political localities, should be based on concepts of long-term reciprocity rather than on short-term accounting).

¹⁸⁹ See *supra* Section I.B.

purposes (records that the court could examine in estimating before-the-harm values), it has every incentive to inflate its claimed future losses and manipulate its privately-known data for that purpose. Interestingly, however, in some instances Beta might deliberately *underestimate* its losses or hide them altogether in order to avoid high-profile litigation that might motivate affected residents to pursue reassessment proceedings vis-à-vis Beta, or at least to diminish residents' success in these proceedings.¹⁹⁰

Academic interest in self-assessment has proliferated in the past few years, with authors noting the disparity between this mechanism's potential to provide superior information and decrease administrative costs, compared to utilization in current law.¹⁹¹ The major challenge in shaping reforms that incorporate a self-assessment mechanism into the law lies in making the self-assessing party bear the true negative and positive consequences of its declared evaluation.¹⁹² Professor Saul Levmore, in a similar context, has suggested that landowners be able to self-assess the value of their properties for property tax purposes, provided that this stated value would also be the price at which the government, or any willing buyer, would be able to purchase the property.¹⁹³

Public revenue litigation offers a unique opportunity to narrow the opportunism of self-claimed damages, although a judicial determination is still necessary. To fulfill this potential, the intergovernmental liability model should hold the plaintiff local government responsible for its claimed estimates of decreased tax

¹⁹⁰ This latter option assumes an agency problem on the part of the local government in representing its residents' interests given its own fiscal considerations. See *supra* notes 99–102 and accompanying text.

¹⁹¹ See, e.g., Saul Levmore, *Self-Assessed Valuation Systems for Tort and Other Law*, 68 Va. L. Rev. 771 (1982).

¹⁹² See, e.g., Michael Abramowicz, *The Law-and-Markets Movement*, 49 Am. U. L. Rev. 327, 364–73, 389–93 (1999); Richard A. Epstein, *Holdouts, Externalities, and the Single Owner: One More Salute to Ronald Coase*, 36 J.L. & Econ. 553, 582–84 (1993); Fennell, *Options*, *supra* note 150, at 1433–43.

¹⁹³ Levmore, *supra* note 191, at 778–79; see also Abraham Bell & Gideon Parchomovsky, *Takings Reassessed*, 87 Va. L. Rev. 277, 300–06 (2001) (suggesting the application of self-assessment mechanisms in takings cases and the use of probabilistic enforcement measures aimed at deterring exaggerated assessments); Fennell, *Options*, *supra* note 150, at 1464–68 (advancing the idea of “entitlements subject to self-made options” as a basis for creating “callable call” mechanisms that may be appealing not only in bilateral standoffs, but also in dynamic, multiparty commons settings).

revenues vis-à-vis its residents for the entire period for which it claims compensation, regardless of the actual outcome of the trial. For example, if Beta argues that the property of Jane, Beta's resident, will be devalued by five percent during the statutory intergovernmental compensation period because of Alpha's zoning scheme, Beta will be unilaterally obligated to decrease Jane's property tax levies by five percent for this entire period. This obligation would persist even if the court later holds, in establishing Alpha's liability, that Jane's property will not be devalued at all, or only at a fraction of Beta's argued amount.

Making Beta take on such a credible commitment will deter it from abruptly inflating its argued losses. Accordingly, to prevent Beta from strategically *underestimating* its losses, a complementing rule is necessary. This rule would state that if the court estimates Jane's property devaluation at a *higher rate* than that argued by Beta, Beta will only be able to collect the lower amount from Alpha, while Jane will be entitled, vis-à-vis Beta, to a bigger decrease in its property tax levies according to the court's estimate for the entire period. While, theoretically, there may be instances in which Beta may be somewhat undeservedly punished for making honest, yet too low, evaluations of expected damages, I believe that this will be quite rare, as opposed to cases in which the court will judicially correct strategically undervalued claims. Given this symmetrical floor-ceiling rule, Beta would be strongly motivated to direct its claim only at genuine, reasonably observable and verifiable expected damages.

6. *Sampling and Aggregating*

Intergovernmental litigation over lost public revenues may typically involve dozens, if not hundreds, of properties or businesses, the potential devaluation of which serves as the basis for the claim. Obviously, an asset-by-asset analysis would entail substantial administrative costs, threatening to undermine the prospective advantages of one plaintiff, one defendant litigation. In other words, while the intergovernmental claim naturally enjoys the benefits of

aggregation on both sides of the litigation, a detailed asset inspection might result in wasteful disaggregation.¹⁹⁴

To avoid this drawback, the court should complement aggregation with sampling techniques. The unique circumstances of intergovernmental litigation enable courts to employ such techniques with much fewer concerns about statistical validity, due process, and individual justice, concerns that have made these techniques a source of controversy in mass torts cases.¹⁹⁵

First, from a technical standpoint, Beta, in its statement of claim, may often divide the assets into categories, based on parameters such as geographical distance, type of residence, etc., as this very simple example illustrates:

¹⁹⁴ The benefits of aggregation are the *raison d'être* of collective actions, and class actions in particular. See *Amchem Prods. v. Windsor*, 521 U.S. 591, 617 (1997). The potential of aggregation should not, however, be an independent reason for imposing substantive liability on a defendant. It is merely an administrative device to implement otherwise normatively justified liabilities.

¹⁹⁵ The Ninth Circuit approved the district court's use of sampling in a class action seeking damages for human rights abuses committed by the Philippine regime of Ferdinand Marcos. Out of 9541 facially valid claims, the district court randomly chose 137 claims, based on an expert opinion that the examination of the random sample would achieve a ninety-five percent statistical probability that the same percentage determined to be valid among the examined claims would be applicable to the totality of examined claims. Out of the claims selected, sixty-seven were for torture, fifty-two were for summary execution, and eighteen were for "disappearance." Following an individual determination of compensatory damages for the sample group in each of the three subclasses, the remaining members in the relevant subclass were granted the average award for the sampled claims in that subclass. See *Hilao v. Estate of Marcos*, 103 F.3d 767, 782, 787 (9th Cir. 1996). Conversely, the Fifth Circuit invalidated the use of extrapolation based on sample verdicts in an asbestos-related injuries class action, holding, inter alia, that this violates due process and the Seventh Amendment's guarantee of a trial by jury. See *Cimino v. Raymark Indus.*, 151 F.3d 297, 311 (5th Cir. 1998). For the virtues of aggregation of sampling, see Michael J. Saks & Peter David Blanck, *Justice Improved: The Unrecognized Benefits of Aggregation and Sampling in the Trial of Mass Torts*, 44 *Stan. L. Rev.* 815 (1992).

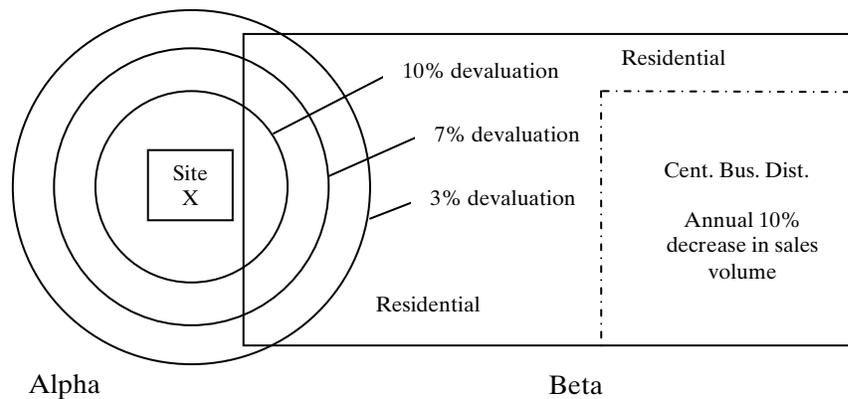


Illustration 2: Sampling Assets to Evaluate Lost Public Revenues

In such a case, the court, basing its findings on expert knowledge of similar past projects, should also sample assets to examine their specific attributes to arrive at a combined individual asset assessment of expected loss resulting from Alpha's zoning decision. Next, the court should adjust its sample findings, pro rata, to non-sample assets. If, for example, the court concludes that the value of a residential property, designated by Beta to be within the ten percent devaluation range, is expected to decrease by only six percent, it would proportionately apply this finding to all assets in Beta's self-proclaimed ten percent range.¹⁹⁶ The pro rata adjustment of non-sample assets would also work if Beta resorts to strictly specific asset evaluations. Here also, the court, selecting a random sample for which it has a sufficiently high confidence interval of the sample's means and proportions, would adjust its sample findings, pro rata, to non-sample assets.¹⁹⁷

Second, from the parties' procedural and substantive rights perspective, the implementation of aggregation and sampling techniques in intergovernmental public revenue litigation seems well

¹⁹⁶ A prevalent technique for determining individual compensatory awards in toxic materials class actions is to divide adversely affected properties into groups based on factors such as their geographical vicinity to the damaging source. See, e.g., Debora R. Hensler et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* 328–32 (2000).

¹⁹⁷ See Saks & Blanck, *supra* note 195, at 841–44.

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balanced. Beta, as a single plaintiff (as well as Alpha as a single defendant) is chiefly interested in the aggregated result, and not in the internal asset distribution. Moreover, unlike a plaintiff in the class action scenario whose interest may be adversely affected by relatively low-value co-plaintiffs randomly selected for the sample, Beta is in full control of the various specific asset estimates and is in the best position to avoid inflating individual asset devaluations that later turn out to be much more modest. Moreover, the floor-ceiling scheme also ensures that the interests of Beta's residents vis-à-vis Beta are properly preserved, since Beta alone bears the risk of overestimation and underestimation.

B. Bargaining in the Shadow of Litigation

I explained earlier why intergovernmental bargaining in the shadow of the current doctrine is often unattainable, making liability rules necessary in the face of the court's imperfect information about respective costs and benefits.¹⁹⁸ Although liability rules, on average, work better than property rules in such scenarios, they cannot guarantee the most efficient result. There are instances in which the parties may be interested in bargaining following the liability rule judgment. Moreover, parties may often be motivated to reach a pre-litigation bargain in the shadow of liability rules when they have a good estimate of the prospective judicial allocation of the entitlement and of the side payments, thereby saving the wasteful administrative costs involved in litigation.¹⁹⁹

It is still largely unclear whether, all other things being equal, bargaining in the shadow of liability rules is more feasible than with property rules.²⁰⁰ The very limited empirical research so far does not support the position that liability rules are supreme,²⁰¹ but

¹⁹⁸ See supra Section I.D.

¹⁹⁹ See Kaplow & Shavell, Property Rules, supra note 138, at 741–43.

²⁰⁰ Compare Ayres & Talley, supra note 72, at 1029–32 (arguing that liability rules facilitate more efficient trade), with Louis Kaplow & Steven Shavell, Do Liability Rules Facilitate Bargaining? A Reply to Ayres and Talley, 105 Yale L.J. 221 (1995). See also James E. Krier & Stewart J. Schwab, Property Rules and Liability Rules: The Cathedral in Another Light, 70 N.Y.U. L. Rev. 440, 464 (1995) (arguing that liability rules remove the incentives for parties to bargain cooperatively).

²⁰¹ See Farnsworth, supra note 137, at 421.

the unique context of intergovernmental liability rules might be a stimulus to out-of-court bargaining.

In the conventional bilateral scenario—assuming both parties realize, even if they do not openly admit it, that the entitlement should change hands—the clash over the bargaining surplus itself is a zero sum game, inducing both parties to hold back genuine information.²⁰² This is not the case with Alpha and Beta in the public revenue litigation. Both sides have a good reason to fear that actually pursuing litigation may put them at risk vis-à-vis their respective residents and businesses. Given the aforementioned floor-ceiling cap, Beta may fear that litigation would leave it bearing more obligations to lower tax levies for its residents than covered by Alpha. Alpha, on its part, is exposed not only to Beta's claims, but also to the increased likelihood that landowners residing in Alpha will become aware of the adverse effects of the zoning decision on their properties and initiate their own property tax reassessment proceedings against Alpha.²⁰³

With the prospect of a negative sum game in mind, Alpha and Beta may be inclined to avoid litigation and reach an agreement. While officials could attempt to betray their agency to their constituents by quietly agreeing to leave the zoning intact for a side payment, the Damocles' sword of third party liability might have Alpha and Beta search for the most cost-reducing solution in most cases.

C. Should the Suit Extend to a Government-led Class Action?

Creating the intergovernmental litigation framework naturally raises the question of why we should settle for the public revenue proxy, rather than try to remedy the full range of private and public costs. In other words, instead of litigating only its own affairs, Beta could also lead a statutorily crafted class action on behalf of its residents and businesses for their respective property devalua-

²⁰² See Fennell, *Eminent Domain*, supra note 188, at 965–66. But see Daphna Lewinsohn-Zamir, *The Choice Between Property Rules and Liability Rules Revisited: Critical Observations from Behavioral Studies*, 80 *Tex. L. Rev.* 219, 232–33 (2001) (arguing that parties would typically be able to reach an agreement about dividing a given pie).

²⁰³ Think, for example, of the residents living in the eastern parts of Alpha in Illustration 2.

tion and reduction in economic activity. Moreover, to the extent that at least some of Beta's residents may have a viable cause of action under current law, a one-shot-catch-all litigation could conceivably save time and resources.

Robert Ellickson advanced a similar idea in his article on "Public Property Rights."²⁰⁴ Building on the potential benefits of a small number of parties, Ellickson, writing chiefly in the environmental context, suggested creating vicarious intergovernmental rights and duties that would later be passed on to individual group members, except where the administrative costs of the pass-through outweighed the benefits.²⁰⁵

While I do not wholly rule out this possibility, a switch to government-led class actions raises substantial administrative and normative concerns. First, from an administrative viewpoint, such an extension could hinder the possibility of out-of-court bargaining between the local governments in the shadow of the liability rule regime. Although bargaining is attainable in the class action context, it is administratively more complicated and costly. Even if we were to preclude opting out,²⁰⁶ settlement in this context requires class certification and court approval, which may be difficult to obtain and would consume both time and resources.²⁰⁷ While the certification stage could be statutorily resolved in the intergovernmental context, an overall waiver of the need for court approval seems more problematic from a due process perspective, making the possibility of pre-litigation bargaining unlikely.

Second, and more importantly, there is normative merit in keeping this kind of litigation limited to the intergovernmental realm, rather than effectively creating a new private cause of action merely mediated by public authorities. I explained earlier why forcing Alpha to compensate Beta for a decrease in sales tax revenues is sensible, and why the same standard should not apply to a

²⁰⁴ See Robert C. Ellickson, *Public Property Rights: A Government's Rights and Duties When Its Landowners Come into Conflict with Outsiders*, 52 S. Cal. L. Rev. 1627 (1979) [hereinafter Ellickson, *Public Property*].

²⁰⁵ See *id.* at 1632–43.

²⁰⁶ See David Rosenberg, *Mandatory-Litigation Class Action: The Only Option for Mass Tort Cases*, 115 Harv. L. Rev. 831, 831 (2002).

²⁰⁷ See 4 Alba Conte & Herbert B. Newberg, *Newberg on Class Actions* § 11:25 (4th ed. 2002); Myron S. Greenberg & Megan A. Blazina, *What Mediators Need to Know about Class Actions: A Basic Primer*, 27 Hamline L. Rev. 191, 217–18 (2004).

private firm that takes business away from competitors.²⁰⁸ Similarly, in the environmental context, creating a new catch-all private cause of action that would practically exceed the current boundaries of nuisance law and other private law mechanisms may have over-reaching implications on the general context of private conflicts, in which there are good reasons to refrain from such a broad-based liability.²⁰⁹ In addition, focusing on intergovernmental compensation would create less of an unnecessary upheaval for related doctrines such as sovereign immunity.²¹⁰ Finally, limiting litigation to the intergovernmental realm would be more likely to result in the confinement of inverse condemnation takings claims to direct regulatory effects, rather than derivative ones.²¹¹

Moreover, if Beta's residents were entitled to statutory compensation for the entire devaluation of their properties, the legal regime would simply replace one distortion for another by encouraging Alpha to systematically over-burden its own politically inferior residents. This is because Alpha would not be liable to compensate its own residents for the entire devaluation, but would only bear the costs of the marginal decrease in its ad valorem public revenues resulting from such devaluation. Hence, the legal focus on Alpha's liability for public revenues on both sides of the border ensures a symmetric correction of the political bias.

²⁰⁸ See *supra* Subsection II.A.1.

²⁰⁹ See *id.* It should be emphasized that the exclusion of private parties from the new statutory regime would not affect their ability to pursue current private causes of action against the developer during the stage of implementation, including through the mechanism of class action.

²¹⁰ See Timothy M. Hall, Annotation, Right of One Governmental Subdivision to Sue Another Such Subdivision for Damages, 11 A.L.R.5th 630, 650 (1993) (showing that state courts dealing with the applicability of sovereign immunity in damages litigation between governmental entities within a state have reached different results). It seems, however, that a political subdivision cannot assert the defense of sovereign immunity in a claim filed by the state, which is "the very source of that immunity." *State v. City of Bowling Green*, 313 N.E.2d 409, 412 (Ohio 1974).

²¹¹ The law has not yet recognized "derivative takings," which are adverse externalities on surrounding properties produced as a result of either a physical or a regulatory taking of a certain tract. See Bell & Parchomovsky, *supra* note 193, at 279. Clearly, recognizing a broad cause of action for *private parties* in our context would effectively result in establishing a derivative takings doctrine.

D. The Political Merits of the Model

The intergovernmental liability model may prove to be superior to other institutional and legal mechanisms, not only because of efficiency considerations, but also because of its potential political advantages, especially in comparison to the long-proposed structural switch to regional- or state-level land use regulation. The regionalism/localism debate has come in waves, one extending from the 1950s to the 1970s, much inspired by Professor Charles Tiebout's famous depiction of local governments as providing a marketplace for local public goods and taxes,²¹² and revolving around the issues of the efficiency of fragmented public goods provision and of interjurisdictional inequality.²¹³ In the early 1990s, a new wave of writing, typically labeled "New Regionalism,"²¹⁴ began to offer a fresh series of arguments in favor of regionalism, focusing on the economic benefits that both inner cities and suburbs can enjoy from regional reforms given their interdependence, as well as on the inefficiency of intergovernmental externalities.²¹⁵ Many New Regionalists regard proposals for general-purpose regional governments, made by writers such as Professor Richard Briffault²¹⁶ and David Rusk,²¹⁷ to be unrealistic, and they instead endorse a

²¹² See Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 *J. Pol. Econ.* 416 (1956). Bruce Hamilton later introduced zoning into Tiebout's model by arguing that local governments could use zoning to indirectly set the values of new developments and the respective ad valorem taxes that such developments would pay to finance local goods and services. See Bruce W. Hamilton, *Zoning and Property Taxation in a System of Local Governments*, 12 *Urb. Stud.* 205, 205–06 (1975).

²¹³ For support of localism, see, for example, Robert L. Bish, *The Public Economy of Metropolitan Areas* 35–62 (1971); Wallace E. Oates, *On Local Public Finance and the Tiebout Model*, 71 *Am. Econ. Rev. (Papers & Proc.)* 93, 96 (1981). For criticisms, see, for example, Richard Child Hill, *Separate and Unequal: Governmental Inequality in the Metropolis*, 68 *Am. Pol. Sci. Rev.* 1557, 1567 (1974); Kenneth T. Jackson, *Crabgrass Frontier: The Suburbanization of the United States* (1985).

²¹⁴ For a description of the New Regionalism movement, see Cashin, *supra* note 49, at 207–28; Todd Swanstrom, *What We Argue About When We Argue About Regionalism*, 23 *J. Urb. Aff.* 479 (2001).

²¹⁵ See, e.g., Anthony Downs, *New Vision for Metropolitan America* 52–59 (1994); Neal R. Peirce, *Citistates: How Urban America Can Prosper in a Competitive World* 131–32 (1993).

²¹⁶ See Richard Briffault, *The Local Government Boundary Problem in Metropolitan Areas*, 48 *Stan. L. Rev.* 1115, 1122 (1996); Briffault, *Localism II*, *supra* note 49, at 426–30.

²¹⁷ See David Rusk, *Cities Without Suburbs* 89 (3d ed. 2003); David Rusk, *Inside Game, Outside Game: Winning Strategies for Saving Urban America* 327–33 (1999).

more modest establishment of limited-purpose regional governments or execution of intergovernmental agreements.²¹⁸

While this debate lingers, prevailing extra-economic, political conceptions seem to have limited the adoption of calls for regional reforms, particularly in land use issues. The arguments in favor of local governments as promoters of genuine participatory democracy and citizen liberty date back at least to Thomas Jefferson's "ward republics,"²¹⁹ and have been the backbone of the home rule ethos ever since.²²⁰ Within this framework, zoning is traditionally considered a quintessential form of democratic local control,²²¹ as is allegedly proven by the relative frequency of "ballot box zoning."²²² New Regionalism arguments holding that fragmented local governments diminish democratic values have not gained sufficient currency to initiate a bottom-up pressure for structural reforms in land use governance.²²³

In contrast, a liability rule regime would be less objectionable politically than a wholesale switch to regional- or state-based land use regulation. This change would be less controversial because a liability rule regime preserves incentives for local governments to

²¹⁸ See John J. Harrigan & Ronald K. Vogel, *Political Change in the Metropolis* 288–90 (7th ed. 2002); Reynolds, *Intergovernmental Cooperation*, supra note 63, at 111–13.

²¹⁹ See Anwar Hussain Syed, *The Political Theory of American Local Government* 38–40 (1966). For the currently most prominent articulation of such arguments in favor of local government powers, see Frug, supra note 14, at 19–24. But see Briffault, *Localism II*, supra note 49, at 405–10; Cashin, supra note 49, at 1998.

²²⁰ See Richardson et al., supra note 19, at 7 (arguing that in many respects, the home rule ethos seems distinct from and more powerful than actual home rule legal state mandates).

²²¹ See Fischel, *Homevoter*, supra note 57, at 57; Briffault, *Localism II*, supra note 49, at 366–75. But see Bernard H. Siegan, *Property and Freedom: The Constitution, the Courts, and Land-Use Regulation* 179–201 (1997) (arguing that zoning can be anti-democratic).

²²² For an evaluation of direct democracy in land use decisions, see Ellickson & Been, supra note 14, at 464–73; Daniel P. Selmi, *Reconsidering the Use of Direct Democracy in Making Land Use Decisions*, 19 *UCLA J. Envtl. L. & Pol'y* 293 (2001/2002).

²²³ See Harrigan & Vogel, supra note 218, at 350–62. For a survey of the current instances of regional governments and metropolitan tax base sharing, see Cashin, supra note 49, at 2028–29; Salkin, supra note 53, at 55–61. The most notable example of a state-imposed metropolitan tax base sharing is that of the Twin Cities in Minneapolis. See Thomas Luce, *Regional tax base sharing: the Twin Cities experience*, in *Local Government Tax and Land Use Policies in the United States*, supra note 95, at 234. For the relatively rare *voluntary* revenue sharing agreements, see supra note 83.

innovate and to enhance economic activity by allowing them to keep the net social gains of their initiatives. This type of regime also leaves the local government with the final authority to pursue a project against payment of its external costs, to redesign it to mitigate the conflict, or to abandon it altogether. In this respect, the option framework, which was initially conceived in purely economic terms, contains an intrinsic added value of preserving a significant degree of political autonomy and liberty, and thus enjoys better prospects for actual implementation.²²⁴

The wisdom of intergovernmental liability rules is further adduced from the doctrine of intergovernmental takings, which typically deals with cases in which the federal government employs its power of eminent domain to take state or local government-owned properties.²²⁵ The Supreme Court has long held that the federal government must compensate for such a taking, even though the Fifth Amendment's Takings Clause does not explicitly refer to publicly owned properties.²²⁶

Although this Article chiefly addresses externalities rather than permanent physical occupation, there is an important conceptual similarity between the current field of intergovernmental takings and the proposed regime of intergovernmental liability for land use

²²⁴ But see Kaplow & Shavell, *Property Rules*, supra note 138, at 745–48 (doubting that non-instrumental justifications for rights should play an independent role in deciding on the type of the entitlement, especially if such considerations could be taken into account in calculating damages).

²²⁵ For a comprehensive analysis, see Michael H. Schill, *Intergovernmental Takings and Just Compensation: A Question of Federalism*, 137 U. Pa. L. Rev. 829 (1989).

²²⁶ See *United States v. 50 Acres of Land*, 469 U.S. 24, 31 (1984) (“When the United States condemns a local public facility, the loss to the public entity, to the persons served by it, and to the local taxpayers may be no less acute than the loss in a taking of private property.”). Conversely, the authorities are less clear as to whether a state must compensate for condemnation of property owned by one of its political subdivisions. See Brian P. Keenan, Note, *Subdivisions, Standing and the Supremacy Clause: Can A Political Subdivision Sue Its Parent State Under Federal Law?*, 103 Mich. L. Rev. 1899, 1902–03 (2005) (noting disagreement among the circuits on when a political subdivision may sue its parent state under the Constitution). See generally A.S. Klein, Annotation, *Power of Eminent Domain as Between State and Subdivision or Agency Thereof, or as Between Different Subdivisions or Agencies Themselves*, 35 A.L.R.3d 1293, § 3 (1971) (stating that the question of compensation depends on state law and the particular circumstances). The ability of one governmental subdivision of a state to condemn “horizontally” the property of another subdivision requires express authorizing legislation or a necessary implication of such power from general powers granted to the particular governmental subdivision. See id. § 11.

decisions. In both cases, the defendant government, acting within its formal powers, is required to pay for its otherwise legitimate exercises of those powers whenever it inflicts specific types of harm on other jurisdictions. In other words, the defendant government is not conceived as committing a wrong or as exceeding its powers, but it is nevertheless made to internalize the costs of its actions to ensure both efficiency and fairness.²²⁷ This proposed framework, therefore, constitutes an adequate compromise between maintaining the defendant's powers that explicitly or implicitly supersede those of the plaintiff, while mitigating the undesirable, yet often unavoidable, consequences of this political and economic conflict.²²⁸

III. COLLECTING ON INTERGOVERNMENTAL LAND USE BENEFITS

Intergovernmental public revenue litigation offers a unique framework for addressing the issue of *positive* land use externalities. Just as monetary public litigation may justify establishing statutory substantive norms that depart from conventional tort law, crafting an intergovernmental entitlement to collect on cross-border incremental public revenues resulting from zoning decisions need not necessarily adhere to the normative and doctrinal framework of the law of restitution.

²²⁷ This is not to say that making governments internalize their costs is the only relevant theory justifying compensation for takings, or that the use of the expropriation power is a trivial extension of sovereign power. For the historic roots of the takings power and its relation to principles of sovereignty, see William Michael Treanor, Note, *The Origins and Original Significance of the Just Compensation Clause of the Fifth Amendment*, 94 *Yale L.J.* 694, 695–98 (1985).

²²⁸ This type of compromise is also found at times in international law. The most prominent example is probably the U.S.-Canada arbitration over transboundary air pollution caused by a Canadian smelter. *Trail Smelter Arbitration (U.S. v. Can.)*, 3 R. Int'l Arb. Awards 1905, 1965–66 (1938, 1941). In the Tribunal's final decision, following earlier decrees ordering Canada to compensate the U.S. for past damages, see *Trail Smelter Arbitration (U.S. v. Can.)*, 3 R. Int'l Arb. Awards 1905, 1911 (1938), the Tribunal prescribed a permanent regime to prevent future cross-border damage, but simultaneously held that in the event of future damage, Canada is to indemnify the U.S. for such damage and also compensate it for reasonable costs of investigation at U.S. \$7500 per year. *Trail Smelter Arbitration (U.S. v. Can.)*, 3 R. Int'l Arb. Awards 1905, 1980 (1941). Hence, what appeared to be an injunction left open the possibility for Canada to redeem itself of its obligations subject to monetary liability. For the basis of transboundary liability for harmful externalities, see Xue Hanquin, *Transboundary Damage in International Law* 134–36, 184–87, 312–16 (2003).

Local zoning decisions creating extraterritorial net benefits may take many forms. For example, Alpha may designate undeveloped land at its fringe for a public park, endowing both use and non-use benefits on approximate residents.²²⁹ While Alpha could normally collect user fees for actual visits to the park in an administratively feasible manner,²³⁰ and could perhaps even set up a constitutionally valid differential price scale for residents and non-residents,²³¹ off-site benefits pose a more substantial obstacle.²³² Although property owners in Beta may enjoy increased market values resulting from the mere proximity to a peaceful, aesthetically pleasing park (especially since such a land use also prevents intensive development of that land), Alpha lacks taxing power over Beta residents' share in the benefits. Similarly, Alpha's decision to designate an area as a historic district and to invest public monies for its preservation may promote the economic interests of non-residents by increasing tourism and sales in adjacent cross-border businesses.²³³

The law of restitution would usually bar a benefit-based accounting in the private law realm, such as when a developer carries out a

²²⁹ For use and non-use benefits of public spaces, see Amnon Lehari, *Property Rights and Local Public Goods: Toward a Better Future for Urban Communities*, 36 *Urb. Law* 1, 26–33, 44–48 (2004).

²³⁰ See *id.* at 20–24.

²³¹ The ability of a local government to limit access to its publicly owned resources or otherwise to favor residents over outsiders is an intricate, context-specific question. The Supreme Court has approved the federal constitutional validity of limiting access to schools and of restricting tuition waivers to residents. See, respectively, *Martinez v. Bynum*, 461 U.S. 321, 333 (1983) and *Milliken v. Bradley*, 418 U.S. 717, 741–44 (1974). Similarly, the Court has ruled that a local ordinance limiting parking to local residents does not violate the Fourteenth Amendment's Equal Protection Clause. *County Bd. of Arlington County, Va. v. Richards*, 434 U.S. 5 (1977). State law may, however, lead to different results. See, e.g., *Borough of Neptune City v. Borough of Avon-By-The-Sea*, 294 A.2d 47, 55 (N.J. 1972) (applying the public trust doctrine to a municipal beach dedicated to public use, and striking down an ordinance that required nonresidents to pay a higher fee for the use of the beach).

²³² See Ellickson, *Public Property*, *supra* note 204, at 1664–68.

²³³ Non-use spillover benefits of preservation of a historic district are a public good in themselves, making it difficult to charge derivative beneficiaries for their enjoyment. For current legal and economic approaches to preservation of historic districts, see Daphna Lewinsohn-Zamir, *The "Conservation Game": The Possibility of Voluntary Cooperation in Preserving Buildings of Cultural Importance*, 20 *Harv. J.L. & Pub. Pol'y* 733 (1997); Francois Quintard-Morenas, *Preservation of Historic Properties' Environs: American and French Approaches*, 36 *Urb. Law* 137 (2004).

project that provides unsolicited positive externalities.²³⁴ Courts generally have been reluctant to hold a neighbor liable in restitution following a self-serving activity by a landowner that incidentally improves the neighbor's land, even when such a benefit is readily translatable into objective monetary benefits.²³⁵ Considerations of autonomy and encouragement for pre-activity agreements traditionally weigh heavily against restitution, especially to the extent that the activity is sufficiently profitable for its doer, so that the potential "free riding" on the part of the beneficiary will not undermine it altogether.²³⁶ This principle might also apply when the benefiting element stems from a specific land use regulation.²³⁷

Similarly, in the context of restitutionary claims between local governments or other state subdivisions, courts have generally held the defendant liable when acceptance of a service or improvement gives rise to an implied contract,²³⁸ or when the subject matter of the service or improvement provided is otherwise governed by a state-based fiat imposing a special duty on the recipient.²³⁹ Conversely, absent such a statutory duty, *ex ante* solicitation, or *ex post*

²³⁴ See, e.g., *Green Tree Estates v. Furstenberg*, 124 N.W.2d 90 (Wis. 1963) (holding that a developer was not entitled to recover from a neighbor for voluntary construction of street improvement, curbs, and gutters).

²³⁵ See, e.g., *Ulmer v. Farnsworth*, 15 A. 65 (Me. 1888) (rejecting the plaintiffs' claim for recovery after their pumping of water from their own quarry unavoidably drained water from the defendant's quarry). See also Restatement (Third) of Restitution and Unjust Enrichment § 2(e) (Discussion Draft 2000).

²³⁶ See Hanoch Dagan, *The Law and Ethics of Restitution* 130–45 (2004) (stressing the importance of restitution in solving free riding scenarios when the respective parties' interests are genuinely locked in).

²³⁷ See *Dinosaur Dev., Inc. v. White*, 265 Cal. Rptr. 525, 526 (Ct. App. 1989) (rejecting the restitution-based claim of a plaintiff for constructing an additional road that would ensure the neighboring landlocked property's access to the nearest thoroughfare, as required by the local government as a condition on approving his subdivision map).

²³⁸ See, e.g., *Bd. of County Comm'rs v. Bd. of Twp. Trs.*, 445 N.E.2d 664 (Ohio Ct. App. 1981) (allowing a county to recover in quasi-contract for the reasonable value of hydrant services accepted by a township in the period following the termination of the formal contract between the parties).

²³⁹ See, e.g., *Town of Montebello v. Lehr*, 309 N.E.2d 231, 234–35 (Ill. App. Ct. 1974) (holding that a county could recover from a township on an implied contract theory for costs of assessment of town property, in view of the primary duty statutorily imposed on townships in this matter).

acceptance of benefits, the plaintiff governmental subdivision has no contract- or restitution-based cause of action.²⁴⁰

With this background in mind, the intergovernmental litigation framework may be normatively and administratively suitable for creating statutory-based monetary incentives for local governments to consider the interests of their neighbors. Specifically, the framework would award benefit-conferring local governments a time-fixed entitlement to collect on specific zoning schemes, while preserving the basic political structure of local autonomy for both the benefactor and beneficiary.

To achieve these simultaneous goals, an intergovernmental benefit rule model would be most appropriate in scenarios in which Beta, following a cross-border benefiting zoning decision by Alpha, is able to gain from a significant increase in property values or in economic activity levels within its territory through a corresponding increase in its public revenues. The case for imposing liability on Beta for spillover tax benefits is especially strong for governmental schemes that create local public goods (either pure or mixed), for example, where zoning decisions necessitate substantial governmental financing to implement the project, as is the case with open spaces and historic preservation.²⁴¹ Ultimately, the efficiency-promoting rationale of cross-border accounting would be validated effectively through the intergovernmental realm of public revenues, without unnecessarily upsetting otherwise justified limits on restitution in private law or forcing the neighboring local governments to engage in a universal tax base sharing.

²⁴⁰ See, e.g., *County of Cook v. City of Chicago*, 593 N.E.2d 928, 931 (Ill. App. Ct. 1992) (holding that the county could not recover from the city for treating the city's tuberculosis patients at a county hospital, because the city was under no specific statutory duty to maintain tuberculosis sanitation, so any benefit that the city received from the county hospital in performing its independent duty to treat all of its patients was merely incidental).

²⁴¹ The economic traits of these projects are such that they are typically inadequate for pure private provision, primarily because a private instigator of such a project cannot readily internalize many of its benefits. See Bruce, *supra* note 42, at 64–81; Richard Cornes & Todd Sandler, *The theory of externalities, public goods, and club goods* (2d ed. 1996).

CONCLUSION

With 87,525 local governments in the fifty states, 38,967 of which are general-purpose local governments,²⁴² no one-size-fits-all legal formula can effectively encompass and control the host of problems and dilemmas associated with the operation of these bodies. Accordingly, the intergovernmental liability rule model designed in the context of pro-development land use decisions does not purport to be a panacea for all these issues. The liability rule framework does, however, demonstrate broad potential for properly addressing ex ante and ex post efficiency, just distribution of costs and benefits, and considerations of political autonomy.

Probably the most important jurisprudential contribution of a more extensive application of liability rules lies in recognizing that some types of governmental actions that are otherwise legally valid require an intervention in the form of compensatory liability rules when political checks and other extra-legal mechanisms are insufficient. While it might otherwise be justified to award broad land use regulatory powers to local governments and to leave at least a certain level of intrajurisdictional adverse effects on private interests without a substantive remedy, the same cannot be said for interjurisdictional spillovers in the face of the lack of political accountability. These insights about the workings of the political arena and the proper role of law in addressing them may pave the way for a more subtle and sophisticated craft of legal regimes and remedies. In so doing, the intergovernmental compensation model presented in this Article may be extended not only to land use conflicts at the interstate and international levels, but also to other subject areas of intergovernmental externalities, such as tax incentives²⁴³ or crime deflection.²⁴⁴ I leave the detailed inquiry about this potential broader application of the model for future work.

²⁴² 1 U.S. Census Bureau, 2002 Census of Governments, No. 1, tbl.3 (2002).

²⁴³ For the current debate about the appropriate legal policy towards tax incentives programs, compare Enrich, *Saving the States*, supra note 175, at 433–40 (advocating restrictions on such programs through application of the Dormant Commerce Clause), with Clayton P. Gillette, *Business Incentives, Interstate Competition, and the Commerce Clause*, 82 *Minn. L. Rev.* 447, 471–74 (1997) (arguing that these programs are generally beneficial and that, at any rate, local opposition is sufficient to curb inefficient measures).

²⁴⁴ See Doron Teichman, *The Market for Criminal Justice: Federalism, Crime Control, and Jurisdictional Competition*, 103 *Mich. L. Rev.* 1831, 1836–39 (2005) (analyz-

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Finally, the positioning of the respective governments on both sides of the litigation, focusing on public revenues as the watermark for compensation, is desirable from more than just a case-specific efficiency perspective. Perhaps more importantly, it serves the purpose of reinvigorating and better informing the debate regarding the *raison d'être* of local and state governments in a federal society, and the way in which these political entities, in both their proprietary and governmental capacities, can claim a comparative advantage in identifying, promoting, and implementing the will of the people.

ing crime displacement policies as deriving from an interjurisdictional competition to become crime-unfriendly, attract economic investments, and increase property values).