INDIVIDUAL RELIANCE AND GOVERNMENT FORBEARANCE: A TALE OF FIVE CASES

LAURA S. UNDERKUFFLER*

INTRODUCTION

The topic for this panel of the conference is government forbearance: when government must—or should—refrain from changing previously existing individual entitlements.

There are many reasons why one might argue that government should forbear. It could be argued, for instance, that government should forbear because of the need to encourage individual investment, something that might erode if there is no certainty in property entitlements. Or it might be argued that government should forbear because continually changing rules can cause individual frustration and social instability. Or it could be argued that government should forbear because property is earned, or a necessary and natural entitlement, or is justified by some other theory of property rights.

In this Essay, I will focus on one particular forbearance argument: that government should forbear because of an individual's *justified reliance* on previously existing legal entitlements. This argument is not rooted in consequentialist theory; it is not rooted in the argument that government should forbear because—if it does not—certain negative consequences will follow. Rather, it is the common and intuitively powerful argument that government should forbear in certain situations because the individual *deserves to be protected* against change in the rules of the game. To put it in common legal form, the individual has a *contract* or *property right* that can be asserted against government. Individuals, in these situations, are believed to have a right to rely on the legal status quo.

The idea that there are situations in which individuals can rely on the existing rules of the game—and resist their change—is not a novel one in law. There are many situations in which this phenomenon is recognized by law. For instance, if the government enters into

* J. DuPratt White Professor of Law and Associate Dean for Academic Affairs, Cornell Law School.

an express contract with a supplier, the terms of that contract generally cannot be unilaterally changed by government without consequence.[1] From another direction, we are familiar with the idea that property rights are created by the established rules of the legal game. The proposition that property includes the "'existing rules or understandings that stem from an independent source such as state law'"[2] is a very familiar one. And changes in these rights, through government action, can lead to a justified claim of unlawful deprivation.[3]

Such ideas mask difficulties, however. The universe of express contracts with government might be limited because of the necessity of government consent; however, the universe of background laws on which an individual might rely is not. The idea of reliance on existing rules or legal understandings opens a Pandora's box of possibilities. Statutes, regulations, ordinances—enacted by federal, state, and local governments—all articulate rules of existing law. Indeed, virtually any individual act or omission that we can imagine is dealt with somehow by the legal status quo: it is either expressly or impliedly permitted or prohibited. Does this mean that an individual can rely on any proposition that is expressed or implied by law, with the possibly justified cry of "foul" if that power or immunity is eliminated?

To put it another way, from the universe of possibilities, *when* can an individual estop government—because of his or her reliance—from changing the rules of the game?

To explore this question, we will consider six settings, represented by six famous cases in this area of law. In each case, claims of justified reliance on previously existing law were made—with demands for payment of damages as a consequence for change. These cases are rooted in two different legal theories that are rarely juxtaposed: reliance and forbearance rooted in contract, and reliance and forbearance rooted in property rights in land. My goal is to see what this

1. *See* Lynch v. United States, 292 U.S. 571, 579 (1934) ("When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to private individuals."); Clearfield Trust Co. v. United States, 318 U.S. 363, 369 (1943) ("'The United States does business on business terms.'") (quoting United States v. Nat'l Exch. Bank of Balt., 270 U.S. 527, 534 (1926)).

2. *See* Phillips v. Wash. Legal Found., 524 U.S. 156, 164 (1998) (quoting Bd. of Regents of State Coll. v. Roth, 408 U.S. 564, 577 (1972)).

3. *See* U.S. CONST. amend. V ("No person shall be . . . deprived of . . . property, without due process of law; nor shall private property be taken for public use without just compensation.").

comparison illuminates, in the way of underlying ideas of reliance and forbearance, and to sketch some ideas as food for further thought.

I. CLAIMED RELIANCE SETTINGS: "CONTRACTS WITH GOVERNMENT"

A. Fletcher *and the Express Government Contract*

We will begin with an old chestnut, the case of *Fletcher v. Peck*.[4] *Fletcher* dealt with a change of heart by the Georgia legislature in the conveyance of land. In 1795, the legislature conveyed particular land to private parties. Subsequently, it passed an act which annulled the law under which the conveyances had been made.[5] The reason asserted for the rescission of the grants was that members of the legislature who had approved the sale had operated with corrupt and illicit motives.[6]

The question before the United States Supreme Court was whether "the State itself [could] . . . vacate a contract thus formed," and be "absolved from those rules of property which are common to all the citizens of the United States."[7] Citing the federal Contract Clause, the Court held that it could not. "Conveyances have been made," Justice Marshall wrote, "[and] those conveyances have vested legal estate . . . ."[8] "When . . . a law is in its nature a contract, [and] when absolute rights have vested under that contract, a repeal of the law cannot devest those rights . . . ."[9] Legislative power must have limits; and "where are they to be found if the property of an individual, fairly and honestly acquired, may be seized without compensation?"[10]

This rings true. Surely, if there is ever a situation in which an individual might be able to estop government change in his entitlements, it is when those entitlements are claimed under an express contract. If the government has expressly agreed to perform in a particular way, with this particular individual, and the individual

---

4. 10 U.S. (6 Cranch) 87 (1810).
5. *See id.* at 127, 132.
6. *See id.* at 129–30.
7. *Id.* at 130, 134.
8. *Id.* at 135.
9. *Id.*
10. *Id.*

has relied upon that promise, government must be accountable if it later—unilaterally—changes the rules of the game.

Consider, for instance, the government procurement contract. If the government agrees to purchase a number of ships from a military contractor, and the contractor builds the ships, the government will be liable for damages (under ordinary contract principles) if it later simply refuses payment or delivery. In such a case, the government is acting like any private party in the procurement of goods. Accordingly, the law—and common sense—holds government to the responsibilities that any private party in a similar situation would incur. As was stated in a recent case, "ordinary government contracts are typically governed by the rules applicable to contracts between private parties."[11] Indeed, any other rule would "produce the untoward result of compromising the Government's practical capacity to make [such] contracts."[12]

What about the age-old idea that one legislature cannot bind the legislative authority of its successors? Could a later repudiation of an express contract by government be authorized by this rule? To put it abstractly, how are the obligations of contract incurred by government, and the need to protect the sovereign powers of government, reconciled?

In a series of cases, the United States Supreme Court has recognized the "reserved powers" doctrine, which addresses this question. Under this doctrine, certain substantive powers of sovereignty cannot be given up by government, through contact or otherwise. One example is the exercise of the police power;[13] another is the power of eminent domain.[14] However, sovereign powers protected by this doctrine are limited. Beyond those powers, government is not absolved of damage claims when an individual has express contract rights to government performance, and government has failed to perform as promised. In such cases, the individual is entitled to rely on the government's promises, and sue for breach of contract if the

11. United States v. Winstar Corp., 518 U.S. 839, 914 (1996) (Breyer, J., concurring).

12. *Id.* at 884 (plurality opinion). *See also id.* at 913 (Breyer, J., concurring) ("This [rule] . . . is unsurprising, for in practical terms it ensures that government is able to obtain needed goods and services from parties who might otherwise, quite rightly, be unwilling to undertake the risk of government contracting.").

13. *See* Stone v. Miss., 101 U.S. 814, 817 (1879).

14. *See* W. River Bridge Co. v. Dix, 47 U.S. (6 How.) 507, 531–32 (1848).

government defaults. As explained by the Court, government has the capacity "to [bind] . . . future [legislatures] . . . by creating vested rights."[15]

So far, then, the rules are clear. Express contracts made with government, and property acquired under them, support individual reliance and require government forbearance. The question which remains is this: do these conclusions extend beyond this context?

B. Charles River Bridge *and* Winstar*: The Question of Implied Terms*

An express contract between an individual and government, which is complete as it stands and is accepted as operative "fact" by both parties, is—in a sense—the easy case for individual reliance and government forbearance. What about a contract which is express in some ways, but with open or possibly implied terms in others? Can an individual claim an enforceable reliance interest in this case?

The seminal case of this kind is *Charles River Bridge v. Warren Bridge*,[16] decided by the United States Supreme Court in 1837. In 1785, the Massachusetts legislature enacted a law that empowered a private company to erect a bridge over the Charles River, and to collect tolls from those who traversed it. The bridge was built and for more than fifty years tolls were collected. In 1828, a later session of the legislature passed an act which authorized the building of a competing, publicly owned bridge very near to the other. This public bridge was built, and travelers paid nothing for passage.[17]

The owners of the Charles River Bridge brought suit, claiming that the chartering and construction of the second bridge impaired their contractual rights with the State of Massachusetts. They claimed that the first legislative act "necessarily implied, that the [L]egislature would not authorize another bridge, and especially, a free one, by the side of [theirs] . . . , whereby the franchise granted to [them] . . . should be rendered of no value . . . ."[18] They argued

15. *See Winstar*, 518 U.S. at 876 (plurality opinion).
16. 36 U.S. (11 Pet.) 420 (1837).
17. *See id.* at 536–38.
18. *Id.* at 539.

that their charter was—in fact—a contract with the State, and that the later act impaired the obligation of this contract.[19]

The Court first remarked that the language of the contract must govern—the contract must "be interpreted by its own terms."[20] In addition, contractual obligations must be interpreted in light of the truism that "the object and end of all government is to promote the happiness and prosperity of the community."[21] This power should not "be presumed to [have been] surrender[ed]" if that surrender does not appear in explicit terms.[22] "While the rights of private parties are sacredly guarded, we must not forget that the community also [has] . . . rights, and that the happiness and well-being of every citizen depends on their . . . preservation."[23] In this case, the Court observed, the protection sought was not stated in the contract. As a result, there was no justified reliance by Charles River Bridge on the pre-existing status quo, and no justified claim for government forbearance.[24]

Justice Story dissented. "Is the charter to receive a strict or liberal construction? Are any implications to be made beyond the express terms?"[25] "No one doubts," he wrote, "that the charter is a contract and a grant . . . ," and that "this franchise is . . . fixed, determinate property."[26] "I put it to the common sense of every man . . . [. If] the legislature had said to the proprietors: you shall build the bridge; you shall bear the burdens; . . . and yet . . . we reserve to ourselves the . . . power and authority to erect other bridges . . . [and] destroy your profits, . . . is there a man living, of ordinary discretion and prudence, who would have accepted such . . . terms?"[27] "The prohibition arises by natural, if not necessary, implication."[28]

Justice Story's argument was rejected, however, and the doctrine espoused by the majority in *Charles River Bridge* has become known as the "unmistakability doctrine," or the idea that no sovereign power

19. *See id.*
20. *See id.* at 544.
21. *See id.* at 547.
22. *See id.*
23. *Id.* at 548.
24. *See id.* at 549–53.
25. *Id.* at 588 (Story, J., dissenting).
26. *Id.* at 588, 638 (Story, J., dissenting).
27. *Id.* at 615 (Story, J., dissenting).
28. *Id.* at 616–17 (Story, J., dissenting).

of government will be deemed surrendered unless done so in unmistakable terms.[29] After *Charles River Bridge*, the unmistakability doctrine became a staple of Supreme Court jurisprudence, limiting the ability of individuals to rely on claims of implied terms in otherwise express government contracts. For individuals claiming a contractual right to the maintenance of existing law—something that is rarely provided by explicit agreement with government—the unmistakability doctrine presents a very serious, or near-fatal, impediment.

Recently, however, the United States Supreme Court refused to apply this doctrine, in a widely publicized case. *United States v. Winstar Corporation*[30] dealt with government-facilitated takeovers of failing "thrifts" (savings and loan institutions) by healthy banks in the 1980s. The combination of high interest rates and inflation in the United States in the late 1970s and into the 1980s caused a rising tide of thrift failures.[31] If an institution failed, the Federal savings and Loan Insurance Corporation ("FSLIC") was required to indemnify depositors for losses incurred as the result of the failure of these federally insured institutions. In an attempt to forestall further losses, Congress tried a deregulatory scheme that weakened thrifts' capital reserve requirements. Also adopted were generous accounting principles for thrifts, for purposes of determining their compliance with capital reserve requirements.[32]

Failures of thrifts continued, however, and the FSLIC was faced with deposit insurance liabilities that exceeded the amount of its insurance fund. By 1988, the FSLIC was insolvent by over $50 billion.[33]

"Realizing that FSLIC lacked the funds to liquidate all of the failing thrifts, the [federal] Bank Board chose to avoid the insurance liability by encouraging healthy thrifts and outside investors to take over ailing institutions in a series of 'supervisory mergers.'"[34] Because such transactions were not intrinsically attractive to healthy institutions, "the principal inducement for these supervisory mergers

29. *See, e.g.*, Bowen v. Pub. Agencies Opposed to Soc. Sec. Entrapment, 477 U.S. 41, 52 (1986) ("'Sovereign power . . . governs all contracts subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms.'") (quoting Merrion v. Jicarilla Apache Tribe, 455 U.S. 130, 148 (1982)).

30. 518 U.S. 839 (1996).

31. *See id.* at 845 (opinion of Souter, J.).

32. *See id.* at 845–46 (opinion of Souter, J.).

33. *See id.* at 846–47 (opinion of Souter, J.).

34. *Id.* at 847 (opinion of Souter, J.).

was an understanding that the acquisitions would be subject to . . . particular accounting treatment that would help the acquiring institutions meet their reserve capital requirements imposed by federal regulations."[35]

Ultimately, this regulatory response was also unsuccessful in stemming the crisis in the thrift industry. In a change of direction, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA") in 1989. This law made substantial changes in the regulation of thrifts, including the imposition of new—and more stringent—capital reserve and accounting requirements. Once this law was passed, many institutions—including institutions that had acquired failed thrifts—were immediately rendered noncompliant, and subject to seizure by federal regulators.[36] Believing that the Bank Board and FSLIC has promised them the continuation of the prior capital and accounting rules, three merged institutions filed suit against the United States, seeking money damages on contractual and constitutional theories.[37]

Before the United States Supreme Court, the first question was whether the FSLIC had made express contracts with the plaintiff banks, including a promise that the banks could continue the use of the challenged practices if the law changed. Justice Souter, writing for the plurality, treated this question as a matter of interpretation of the individual merger agreements negotiated by the banks and government regulators. The government denied that the agreements contained such terms and argued that the statements in the documents that referred to generous reserve and accounting rules were simply statements of then-existing policy.[38]

The plurality rejected this interpretation. For instance, discussing the merger documents for one bank, the plurality observed:

> Although one can imagine cases in which the potential gain might induce a party to assume a substantial risk that the gain might be wiped out by a change in the law, it would have been irrational in this case for [the cooperating bank] . . . to stake its very existence upon continuation of current policies without seeking to

35. *Id.* at 848 (opinion of Souter, J.). *See also id.* at 850–56 (opinion of Souter, J.).
36. *See id.* at 857–58 (opinion of Souter, J.).
37. *See id.* at 858 (opinion of Souter, J.).
38. *See id.* at 862 (plurality opinion).

> embody those policies in some sort of contractual commitment. This conclusion is obvious from both the dollar amounts at stake and the regulators' proven propensity to make changes in the relevant requirements. . . . Under these circumstances, we have no doubt that the parties intended to settle regulatory treatment of these transactions as a condition of their agreement.[39]

A finding that the parties' agreement *should be interpreted* to assign the risk of regulatory change to the government, however, did not dispatch all questions that the case presented. In particular, even if such a finding would be binding on a private party under general contract principles, it was not at all clear—as a matter of law—that it could be binding on government. In short, there was the problem of the unmistakability doctrine and its application to this case.

The plurality, after a lengthy discussion of the doctrine and its policies, rejected its application. That doctrine, the plurality held, is rooted in the concern that a "contractual obligation [not] . . . block the exercise of a sovereign power of the Government."[40] That concern was—in turn—not involved in this case, because the plaintiffs sought only "insur[ance] . . . against . . . losses, arising from future regulatory change"; they did not seek "to bind . . . Congress from enacting [new] regulatory measures."[41]

The plurality acknowledged that "while agreements to insure private parties against the costs of subsequent regulatory change do not directly impede the exercise of sovereign power, they may indirectly deter needed government regulation" by increasing the cost of its enforcement.[42] However, the plurality finessed this issue on the ground that "Congress itself expressed a willingness to bear the costs at issue . . . when it authorized the FSLIC to 'guarantee [acquiring thrifts] against loss' that might occur as a result of a supervisory merger."[43] Applying the unmistakability doctrine in this case would also have harmful practical consequences, undermining the reputation of the government as a reliable contracting party.[44]

---

39. *Id.* at 863–64 (plurality opinion).
40. *See id.* at 879 (plurality opinion).
41. *See id.* at 887 (plurality opinion).
42. *Id.* at 883 (plurality opinion).
43. *Id.* (plurality opinion) (quoting 12 U.S.C. § 1729(f)(2) (1988 ed.) (repealed 1989)).
44. *See id.* at 883 (plurality opinion).

If one is honest, neither asserted reason for the non-application of the unmistakability doctrine in this case is particularly convincing. The distinction between payment of damages and regulatory power is artificial at best; presumably, in most if not all cases of this type, the plaintiffs will be suing for damages. If critical terms can be implied in such cases, because of the remedy sought, the principle that such terms must be explicitly stated in contracts of this type will have little practical application. As for the argument that application of the will impair the government's ability to contract with individual parties in a reliable or meaningful way, we must remember that we are dealing with the "unmistakability"—not the "prohibitory"—doctrine. The issue is not whether a government *can insure* a contracting partner against change; it is whether such insurance must be done in unequivocal terms—a point on which the dissenting justices forcefully elaborated.[45]

So what accounts for the result in the *Winstar* case? The roots, I would argue, can be found in the fact that the "supervisory merger" deals that government pushed in this case were so clearly and unabashedly pursued for the government's own financial benefit. Government agencies induced healthy banks to take over ailing thrifts in order to avoid FSLIC deposit insurance liability. In addition, Congress was aware—when debating FIRREA—that it would have the substantial effect of releasing the government from its contractual obligations.[46] As Justice Souter stated, "[t]he statute not only had the purpose of eliminating the very accounting gimmicks that acquiring thrifts had been promised, but the specific object of abrogating enough of the acquisition contracts as to make that consequence of the legislation a focal point" in its passage.[47]

Reconciling *Charles River Bridge* and *Winstar* appears to be difficult, as an initial matter. In a broad-brush way, the cases are very similar. In both, there were express contracts between government and private business interests. In both, the contracts lacked express, unmistakable language that protected the private parties from later, adverse government action. In both cases, it can be said that the protection that the private parties sought was something that could reasonably be presumed, as a practical and commercial necessity,

45. *See, e.g.*, *id.* at 929–30 (Rehnquist, C.J., dissenting).
46. *See id.* at 900 (opinion of Souter, J.).
47. *Id.* (opinion of Souter, J.) (footnote omitted).

for any private party entering such contracts. Yet, when the bottom line was reached, the Court was willing to supply this protection in *Winstar*, and in *Charles River Bridge* it was not.

What distinguishes these cases, in my view, is the taint of self-dealing. The take-away—as *Charles River Bridge* enduringly illustrates—is that courts are reluctant to imply substantial, protective terms in government contracts. This is true even when the contract without those terms can be seen as an improbably foolish bargain. However, this interpretive approach might succumb to another more generous account in cases of government's blatant and acknowledged self-dealing. In *Winstar*, government induced reliance not only for an articulated public purpose—and the kind of general public benefit that government actions presuppose—but also to implement an explicit and calculated strategy to save itself billions of dollars that it would otherwise have owed. The later legislative change was also, explicitly, tailored to that end. Granted the line between general protection of the public fisc and the sharpness of government self-dealing might not always be clear. But in the latter case, the disputed protection against government action might well be implied. And forbearance on the part of government—from changing the rules of the game vis-à-vis those parties—might well be required.

C. "Deregulatory Takings": The Case of the Implied Contract

For many years, state and federal governments heavily regulated certain industries. Interstate trucking, air transport, telecommunications, electric and gas utility companies, and others were subject to strict government rulemaking controls and government controls on new entry. The private businesses that flourished under these regimes were, essentially, government-protected and government-regulated monopolies.

These industries, in turn, invested on the basis of business and earnings that were generated by their status. They invested in specialized and durable assets that seemed necessary, or at least justified, under the regulated-monopoly regime. For example, utility companies operated under a model of self-sufficiency; they assumed the need to produce their own power, and invested in excess power capacity for periods of unusually high demand. Costs incurred under this regime were charged to their "captive" clientele.

In the 1990s, political winds shifted. As one author expressed it, "Americans . . . turned their backs on one of the New Deal's most important legacies by deregulating nearly every market to which regulation ha[d] been applied."[48] Industries which had previously enjoyed regulated-monopoly status suddenly found themselves competing with new entrants and new models for service. In the utilities market, for instance, previously regulated monopolies suddenly found the models of "self-sufficiency" and "captive customers" obsolete. Electricity could now be freely purchased from low-cost sources, rendering the model of higher-cost, "self-sufficient" sources obsolete. In addition, customers suddenly had a choice among competing telecommunications, electric, and gas providers. Firms that had been regulated monopolies suddenly found themselves with what they called "stranded costs"—costs incurred in monopoly-status investment that were now difficult or impossible to recover in a market-based environment.[49]

The nature and extent of so-called stranded costs varied greatly from industry to industry.[50] Some industries, such as airlines, experienced a boom in business as the result of deregulation and few assets in those segments were stranded.[51] However, other industries—such as the electric utility industry—cited large losses, and claimed foul.[52] The core of their claims was reliance: that they had relied on their regulatory monopoly status, and government had—unfairly—changed the rules of the game. They sought billions of dollars in compensatory damages.[53]

There might have been a political argument for some of these claims; indeed, one study points out that regulated utilities persuaded regulatory and state legislative bodies to provide more than $100 billion in relief (with the costs, in most cases, passed on to

---

48. Herbert Hovenkamp, *The Takings Clause and Improvident Regulatory Bargains*, 108 YALE L.J. 801, 801 (1999).

49. *See, e.g.*, Ass'n of Pub. Agency Customers, Inc. v. Bonneville Power Admin., 126 F.3d 1158, 1180 (9th Cir. 1997).

50. *See* Hovenkamp, *supra* note 48, at 803–04.

51. *See id.*

52. *See, e.g.*, *id.* at 804; Susan Rose-Ackerman & Jim Rossi, *Disentangling Regulatory Takings*, 86 VA. L. REV. 1435, 1457–60 (2000); J. GREGORY SIDAK & DANIEL F. SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES (1997).

53. *See* Rose-Ackerman & Rossi, *supra* note 52, at 1458–59.

consumers as "transition costs").[54] Whatever the political outcomes at the time, what is more interesting for our purposes is the *legal* argument that was made by these industries. The assertion was that deregulation violated the government's "regulatory contract" with these firms, and that compensation was required on that basis. They—and their advocates—argued that they had a tacit or implied understanding with government: that they would invest their resources in the running of the regulated/monopolistic enterprise, and the state would guarantee a particular rate of return. By engaging in deregulation, the state reneged on its side of the bargain. This deprived the firms of their "investment-backed expectations"—and was a taking of property without compensation.[55]

In other words, the firms were entitled to rely on a continuance of the legal status quo.

In light of our prior investigations and derived principles, is this a case in which the costs of the regulatory change should fall on the individual firms, or on government? Is this a case in which individual reliance was justified, and government forbearance required?

This case is clearly the weakest so far examined. To impose a duty of forbearance (or the payment of costs) on government, in this case, one must infer not only particular contract terms, dealing with risks of regulatory change, *but also the existence of the contract itself*. As commentators have observed, there is little legal support for viewing the relation between private firms and the regulatory agencies that govern them as establishing enforceable, contractual relations.[56] If there is some justified individual reliance in these cases, it is rooted in something far more insubstantial and uncertain than an explicit, executed contract.

In addition, *even if* the regulatory relation could be deemed a "contract" of sorts, there is nothing in that relation that would provide the desired contract term, i.e., the shifting of the costs of regulatory change from the firms to the public. Nothing in the history of regulatory dealing can be cited in these cases for such an "implied contract term." Arguments rooted in claims for general

---

54. *See id.* at 1458–59 (discussing studies).

55. *See, e.g.*, SIDAK & SPULBER, *supra* note 52, at 213–72.

56. *See, e.g.*, Rose-Ackerman & Rossi, *supra* note 52, at 1463; William J. Baumol & Thomas W. Merrill, *Deregulatory Takings, Breach of the Regulatory Contract, and the Telecommunications Act of 1996*, 72 N.Y.U. L. REV. 1037, 1045–46 (1997).

economic protection, or in the idea that a prudent investor would insist upon such terms, have not (as discussed above) been successful in the courts. Nor does public policy somehow demand such a result. No sharp self-dealing by government is present in this case, as it was in *Winstar*; and there are cogent arguments that regulated firms were well aware of the risks of regulatory change that they ran if the political winds shifted. There is, in short, little legal reason to rescue these industries from the risks that they chose—as many choose—as entrepreneurs, little *legal* ground for claiming individual reliance or requiring government forbearance.

***

In summary, the existence of a "contract" with government is one way to conceptualize when an individual is entitled to rely on an existing legal state of affairs, and government is—therefore—required to forbear. However, the idea of a "contract" with government as answering the question is superficial. The case might be a situation in which a government agent has signed an agreement with a private party, with express terms covering the issue of future legal change; but in most cases in which this theory is asserted, the facts will not be so simple.

In all of the other—more difficult—cases, our intuition and the cases above suggest the following principles:

> *(1) For individual reliance to be justified, there must be more than the simple existence of law. There must be some kind of personal transaction between the individual and government to set the stage for a reliance claim.*

This principle can be illustrated by a simple example. Let us say, for instance, that an individual wishes to open a bar in a college town. He heavily invests in the enterprise, in reliance on a state law that establishes a legal drinking age of 18. If the state thereafter increases the drinking age to 21, the individual—I believe we would all agree—has no legal claim to redress, even if his business is severely impacted by the change. The mere existence of a law that is addressed to the general public—without more—is not enough to create justified individual reliance, or to require government indemnification if the law is changed. Rather the individual most have

some personal, negotiated relationship with government to present a colorable reliance claim.

This principle is illustrated by the cases that we have examined. In *Fletcher*, there were express, negotiated understandings between individuals and government, governing the conduct of the parties. In *Fletcher* this understanding was the consummated sale of government land, and in *Charles River Bridge* it was the construction of a bridge in response to explicit, particular state authorization to do so. This principle was also met in *Winstar*: the federal government entered into negotiations, and executed agreements, with solvent banks to take over ailing thrifts. Its presence is far more tenuous, if it is present at all, in the regulated utilities cases. In those cases, government regulated certain industries, providing a legal environment for private operation; however, the degree to which there were particular, negotiated transactions or agreements between private firms and the regulating governments is much less clear. As a result, our intuition—and legal precedent—signal that this situation presents a weaker case.

This brings us to the second principle:

> *(2) A rule that law cannot change would present a serious problem in a dynamic society, in which changes in knowledge and the occurrence of exigencies continually challenge existing law. As a result, claims of reliance on previous law, and for indemnification for its change, must be cautiously granted.*
>
> *For individual reliance to be justified, there must be some kind of explicit understanding between the individual and government that the risk of change is something that the public (government) has undertaken. Absent evidence of government exploitation or overreaching, "implicit" or "implied" understandings of this sort will not be recognized.*

In our case of the disappointed bar-owning businessman, there was no explicit commitment by government to him that the law would not change, or that he would be indemnified if it did. Nor was there any exploitation or overreaching by government that would justify the rare conclusion that a bargain of this type should be implied. Government did not induce this investor to act in order to further government's own, particular, self-interested strategy; its benefit, if any, was only of a kind that all law-abiding activities of all citizens might produce. The benefit that government sought to

achieve, from the initial drinking-age law or its successor, was simply the kind of generalized public benefit that has no particular relationship to a particular individual or previous transaction. As a consequence, both our intuition and the law would deny a claim to justified reliance and indemnification in this case.

This principle is, again, illustrated by our cases. In *Fletcher*, the government transferred title to particular parcels of land to particular individuals; completed land sales, without reservations or contingencies, are express agreements that all parties are entitled to believe will not be revoked. However, in *Charles River Bridge* and the "regulated utilities" cases, there were no such explicit understandings, or assumption of the risk of change, by government; and that absence was fatal to those individual reliance claims. Although the situation was similar in *Winstar*, the fact of government double-dealing tipped the balance in that case. The government's calculated inducement of the healthy banks' takeovers of the ailing thrifts, together with the government's acknowledged desire to avoid its own crushing financial liability through this stratagem, justified findings of implied reliance and an obligation to indemnify in this case.

II. CLAIMED RELIANCE SETTINGS: THE REGULATION OF LAND

The case of *Lucas v. South Carolina Coastal Council*,[57] decided by the United States Supreme Court in 1992, presents classic claims of individual reliance and required government forbearance in the context of property rights in land. In the late 1970s, Lucas began residential-development activities on the Isle of Palms near Charleston, South Carolina.[58] In 1986, he purchased two lots for development. At the time of their purchase, these lots were within an area generally covered by the Coastal Zone Management Act,[59] which was enacted by South Carolina some years before. This Act required owners of coastal land that was part of a "critical area" under the Act to obtain a permit prior to development. At the time of their purchase, Lucas's plots were not deemed to be "critical areas," and—as a result—development was unrestricted.[60]

---

57. 505 U.S. 1003 (1992).
58. *See id.* at 1008.
59. S.C. CODE ANN. § 48-39-10 *et. seq.* (1987).
60. *See Lucas*, 505 U.S. at 1008.

Two years after the lots' purchase, South Carolina enacted a new law to more closely regulate shoreline activity. This law, the Beachfront Management Act,[61] was intended to protect the beach/sand dune coastal system from unwise development that could jeopardize the stability of the beach/dune system, accelerate erosion, and endanger adjacent property. Under the regulations issued pursuant to the Act, development of Lucas's two parcels was prohibited.[62] Lucas challenged this situation in court, arguing that it effected a "taking" of his property without just compensation.[63]

Lucas was not, obviously, deprived of the title to his land; rather, his claim was that he—as the title holder—had a prior right to build on his land, and that this right was, itself, the property that was taken. In the words of Justice Scalia, who wrote the majority opinion for the Court, "Lucas did not take issue with the validity of the [Beachfront Management] Act as a lawful exercise of South Carolina's police power, but contended that the Act's complete extinguishment of his property's value entitled him to compensation regardless of whether the legislature had acted in furtherance of legitimate . . . objectives."[64] In other words, Lucas did not argue that the South Carolina authorities could not—as a matter of general law—do what they did; rather he argued that they could not do it *to him*, because of the destruction that the legal change caused to his legitimate, investment-backed expectations.[65] In our terms, he argued that he was entitled to rely on the prior legal status quo; and that a change in the law, detrimental to him, required the payment of damages (or government forbearance).

The Supreme Court held that Lucas should prevail, provided that the new restrictions were "not part of his title to begin with"[66] (something that was clear from the facts, and confirmed on remand). On what basis did the Court make this decision?

The theoretical basis for the Court's decision is—quite frankly—obscure. The majority began by observing that the question was whether the government went "too far" in its redefinition of the

61. S.C. CODE ANN. § 48-39-280 *et. seq.* (Supp. 1988).

62. *See Lucas*, 505 U.S. at 1008–09.

63. *See* U.S. CONST. amend. V ("No person shall be . . . deprived of . . . property, without due process of law; nor shall private property be taken for public use without just compensation.").

64. *Lucas*, 505 U.S. at 1009.

65. *See id.* at 1008–10.

66. *See id.* at 1027.

landowner's previously existing interests.[67] This seems to be a comparison of what the claimant began with, and what the claimant has left. The Court stated that when a regulation "denies all economically beneficial or productive use of land," it is, by definition, "too far" and compensation must be paid.[68]

This does not, of course, of itself explain why this result should obtain. The majority acknowledged this, stating that "[w]e have never set forth the justification for this rule."[69] Justice Scalia then proceeded to speculate what those reasons might be. "Perhaps it is simply . . . that a total deprivation of beneficial use is, from the landowner's point of view, the equivalent of a physical appropriation."[70] In any event, in such a case, "it is less realistic to indulge in our usual assumption that the legislature is simply 'adjusting the benefits and burdens of economic life.'"[71] In addition, the danger that such cases present—that government will be paralyzed if compensation is required for "every such change in the general law"—is minimal if confined to cases such as this. That concern "does not apply to the relatively rare situations where the government has deprived the landowner of all economically beneficial uses."[72]

The rationale, therefore, seems to be an idea of compensatory justice. If we take from you, you deserve compensation. But this does not answer the real, underlying question. Why have we "taken" from you? What did you have, that has now been taken?

The majority's approach assumes that there was some kind of "thing" or "entitlement" of which Lucas was deprived. Lucas still owned the land, so the title to the land could not be it. The only other possibility is that he had a legal right to the previously existing legal status quo.

The easy answer is, "of course he did"—that right being a kind of "property." One could simply say—as the Court has seemed to imply, at various times—that there is a right to use land, of some uncertain and unexplained origin.[73] However, there has to be more.

---

67. *See id.* at 1014–15.
68. *See id.* at 1015.
69. *Id.* at 1017.
70. *Id.*
71. *Id.* (quoting Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978)).
72. *Id.* at 1018.
73. *See, e.g.*, *id.* at 1016, 1027–31 (right to "essential use" of land); Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 496 (1987) (right to "economically viable use").

Right to use how? In what way? For what? There has to be more than the answer that "there was an entitlement" held by Lucas to use his land in contravention of now existing law "because there was an entitlement."

To the extent that the Court's majority articulates an underlying theory, it seems to be one of reliance. For instance, the majority places great weight on whether the owner should have known of the restrictions as "part of his title to begin with."[74] "Any limitation so severe cannot be newly legislated or decreed (without compensation), but must inhere in the title itself, in the restrictions that background principles of the State's law of property and nuisance already place upon land ownership."[75] Although an owner of personal property "ought to be aware of the possibility that new regulation might . . . render his property economically worthless," the same is not true of the owner of land.[76] Such an outcome would violate the "historical compact recorded in the Takings Clause," and the owner's "investment-backed expectations."[77]

Reliance, as we have seen in the discussion above, is not a free-floating concept. There is reliance that is justified, and reliance that is not. To be justified, in this context, there must be more than the simple existence of law, around which the individual planned—there must be some kind of personal, individual/government transaction.

When juxtaposed next to our prior cases, above, the flimsiness of a reliance claim in Lucas's case is striking. There was no personal, negotiated relationship between Lucas and the government of any kind; the law—which grounded his reliance claim—presented, at most, a particular legal environment for his private operation. His case even more starkly fails the second reliance condition that we derived above—that there must be some kind of explicit understanding between the individual and government that the risk of change is something that the public (government) has undertaken. Lucas's claim involves no communication about government's undertaking the risk of change of any sort, and there is no (alternative) evidence of government exploitation or overreaching. When compared to the cases that we have previously considered, it is most akin

74. *See Lucas*, 505 U.S. at 1027.
75. *Id.* at 1029.
76. *See id.* at 1027–28.
77. *See id.* at 1028, 1019 n.8.

to the disappointed bar owner who invested, and then was disappointed when a general change in the law impacted his investment.

There is one additional possibility that needs to be explored. Is Lucas entitled to different treatment from other citizen investors, because it was *in land* that he invested?

When one views the whole of the legal landscape, this certainly seems to be a prominent feature of what one sees. Changes in law affect investments of all kinds and can dramatically reduce their value. Stocks, farming enterprises, the production of industrial chemicals, the value of airplane companies, the value of machinery, and investments of every kind and description are affected—day in and day out—by changes in laws of general application. Conceivably all of these changes could be challenged by takings claims. However, land-based claims clearly dominate the takings landscape. And with few exceptions,[78] we do not find the kind of solicitude for other claims that we find for land-based claims in the nation's courts.

As a formal matter, however, the Supreme Court has never drawn a distinction between land-based claims and others.[79] All that we hear are the majority's musings in *Lucas*, to the effect that owners of personal property should be aware of the risk of financial wipeout, while owners of land (for some reason) should not.[80] Whatever the reasons one might advance for such bias, in that case they remain unexplored and unexplained. When one considers the blood, sweat, and tears of ownership and financial risk, the reasons for a radical difference in treatment—as far as the reliance theory goes—are far from obvious.

The bottom line is that reliance alone cannot really provide ground for Lucas's claim or provide the theory for the Court's decision. It is handy to say that "he relied on it, therefore he deserves it." But on closer analysis, the theory crumbles. Unless we adopt the bold and sweeping assertion that there is a compact or agreement between government and all landowners that the latter shall never (without compensation) be deprived of all of the developmental use of their land, there is nothing to distinguish Lucas's reliance from that of anyone else on what are laws of general application. And that bold

78. *See, e.g.*, E. Enters. v. Apfel, 524 U.S. 498 (1998); Phillips v. Wash. Legal Found., 524 U.S. 156 (1998).

79. Hints about a distinction between land-based claims and other claims are rare. *See, e.g.*, *Lucas*, 505 U.S. at 1027–28; *E. Enters.*, 524 U.S. at 554–56 (Breyer, J., dissenting).

80. *See Lucas*, 505 U.S. at 1027–28, and note 76, *supra*.

assertion—even if made—is not a practical one. For instance, as the Court has implicitly found, it is completely financially impracticable for the government to pay "development prices" to all of the owners of the nation's millions of acres of preserved—indeed, critically preserved—wetlands.[81]

If individual reliance is not—in fact—what drives *Lucas* and other land-regulation cases, what does? Because of the Court's continual reliance on misplaced reliance theories, this question is not easy to answer. Maybe it is the need to encourage investment in particular cases. Maybe it is the need to balance the loss of one individual against the losses of another. Maybe it is the need to achieve justice through the evaluation of competing individual and public interests. Explicit engagement of such questions will be difficult, no doubt. But it would yield more substance and insight than the unthinking use of an empty theory of reliance.

CONCLUSION

The problems posed by reliance and changes in law are not trivial; rather, they are ubiquitous. Any recognized configuration of rights, which property initially confers, is at most a snapshot of the way that conflicting individual and collective interests are resolved at that moment.[82] The honoring of individual reliance claims—rooted in the prior legal status quo—attempts to freeze the process of legal change, at the cost of government indemnification.

As the result of the fundamental struggle that the individual claims and government defenses in this area represent, the circumstances under which individual claims of this type will be honored are limited. For individual claims to be honored, there must be more than reliance on the simple existence of law. There must be some kind of personal transaction between the government and the individual. In addition, for individual reliance to be justified, there must be some kind of explicit understanding between the individual and government that the risk of change is something that the public (government) has undertaken. Absent these restraints, "reliance" is unlimited, and creates more problems than it answers.

---

81. *See, e.g.*, *Palazzolo v. Rhode Island*, 533 U.S. 606 (2001) (*Lucas* claim for preserved wetlands sidestepped, on the ground that the parcels in question had "upland" portions).

82. Laura S. Underkuffler, *Property and Change: The Constitutional Conundrum*, 91 TEX. L. REV. 2015, 2035 (2013).