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Property Rules, Liability Rules, and Adverse Possession

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PROPERTY RULES, LIABILITY RULES, AND ADVERSE POSSESSION

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INTRODUCTION

The law of adverse possession tends to be regarded as a quiet backwater. Both judicial opinions and leading treatises treat the legal doctrine as settled. The theory underlying the doctrine, although routinely discussed in the opening weeks of first-year property courses, is only rarely aired in the law reviews any more. Indeed, the most frequently cited articles on adverse possession date from the 1930s and earlier.[1] Perhaps most tellingly, adverse possession seems to have completely escaped the attention of the modern law and economics movement—almost a sure sign of obscurity in today's legal-academic world.[2]

Nevertheless, two recent events—one academic, the other judicial—are sufficiently challenging to our conventional understanding of adverse possession that they deserve comment. The academic event is the publication of a law review article by Professor Richard Helmholz of the University of Chicago concerning the state of mind that a possessor must have before he can obtain title by adverse possession.[3] Earlier treatments of this subject tended to proceed normatively, asserting the "correct" rule based on considerations of policy.[4] Helmholz, however, is interested

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[1] *E.g.*, Ballantine, *Claim of Title in Adverse Possession*, 28 YALE L.J. 219 (1918); Ballantine, *Title by Adverse Possession*, 32 HARV. L. REV. 135 (1918) [hereinafter cited as Ballantine, *Title]; Bordwell, Mistake and Adverse Possession*, 7 IOWA L. BULL. 129 (1922); Sternberg, *The Element of Hostility in Adverse Possession*, 6 TEMP. L.Q. 207 (1932); Taylor, *Titles to Land by Adverse Possession*, 20 IOWA L. REV. 551 (1935); Taylor, *Actual Possession in Adverse Possession of Land*, 25 IOWA L. REV. 78 (1939); Walsh, *Title By Adverse Possession*, 16 N.Y.U. L.Q. REV. 532 and 17 N.Y.U. L.Q. REV. 44 (1939).

[2] There is a considerable economic literature on the evolution of private property rights, *see, e.g.*, Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347 (Papers & Proceedings 1967); Anderson & Hill, *The Evolution of Property Rights: A Study of the American West*, 18 J. LAW & ECON. 163 (1975), but none that I am aware of on the operation of the legal doctrine of adverse possession as it applies in the mature Anglo-American common law system. For instance, there are no index entries to adverse possession or prescription in R. POSNER, ECONOMIC ANALYSIS OF LAW (2d ed. 1977).

[3] Helmholz, *Adverse Possession and Subjective Intent*, 61 WASH. U.L.Q. 331 (1983).

[4] *See, e.g.*, the articles by Ballantine, Sternberg, and Walsh, *supra* note 1.

in determining what state of mind is actually demanded by courts before they will award title by adverse possession. To this end, he has surveyed "the bulk" of all reported cases dealing with adverse possession decided since 1966.[5] His conclusion is rather startling. Although academic commentators generally argue that the subjective mental state of the possessor should be irrelevant, Helmholz finds that "where courts allow adverse possession to ripen into title, bad faith on the part of the possessor seldom exists. Where the possessor knows that he is trespassing, valid title does not accrue to him simply by the passage of years."[6]

If nothing else, Helmholz' study casts doubt on whether we should take the common law test for acquiring title by adverse possession at face value. According to the common law, adverse possession requires, in addition to the running of the statute of limitations, that the possession be (1) actual, (2) open and notorious, (3) exclusive, (4) continuous, and (5) hostile under a claim of right.[7] The common law test does not demand subjective good faith belief on the part of the possessor that he is entitled to the property.[8] Nevertheless, it appears that judges and juries rather consistently manipulate the five standard elements in such a way as to award title to the possessor who entered the property in good faith, i.e., without actual knowledge of the paramount title of the true owner, and to deny title to the possessor who entered in bad faith, i.e., with actual knowledge of the paramount title. Subjective good faith is, then, an unstated sixth element—one which can be overcome perhaps if the

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[5] Helmholz, *supra* note 3, at 333. In a footnote, Professor Helmholz reports that he "examined about 850 appellate opinions" in preparing his study. *Id.* at 333 n.7.

[6] *Id.* at 347.

[7] *Id.* at 334; *see also* R. CUNNINGHAM, W. STOEBUCK & D. WHITMAN, THE LAW OF PROPERTY 758 (1984).

[8] The requirement that the possessor have a "claim of right" is sometimes construed to mean a subjective good faith belief that he is entitled to the property *(see, e.g.*, Jasperson v. Scharnikow, 150 F. 571 (9th Cir. 1907)) but the interpretation of "claim of right" favored by most courts and commentators is that the possessor must claim the property on some basis other than the permission of the title owner, i.e., the possessor may not be a tenant or licensee of the title owner. *See, e.g.*, C. DONAHUE, T. KAUPER, & P. MARTIN, PROPERTY: AN INTRODUCTION TO THE CONCEPT AND THE INSTITUTION 137 (2d ed. 1983) ("By and large, most American courts today require neither that the adverse possessor have a subjective hostile intent nor that he be in good faith."); *see also* Helmholz, *supra* note 3, at 334 n.10.

Notwithstanding this "preferred" interpretation of claim of right, a number of states require that the possessor's subjective state of mind be taken into account in some way. For example, New Mexico requires good faith, color of title, and payment of taxes as a condition to obtaining title by adverse possession, N.M. STAT. ANN. § 37-1-22 (1978); Arkansas requires color of title and payment of taxes, ARK. STAT. ANN. §37-102 (1962); and Georgia requires that the possession "not have originated in fraud," GA. CODE ANN., § 85-402 (1978). In other states, the statute of limitations is shortened by the presence of one or more of these elements. Illinois, South Dakota, and Washington decrease the period where there is good faith, color of title, and payment of taxes, ILL. ANN. STAT. §83-6 (Smith-Hurd 1966); S.D. COMP. LAWS ANN. §15-3-15 (1967); WASH. REV. CODE ANN. ch. 7.28.070 (1961); Alaska, Arizona, and Michigan where there is color of title, ALASKA STAT. §12-523; MICH COMP. LAWS ANN. § 600.5801 (West 1968); and Louisiana where there is good faith, LA. CIV. CODE ANN. art. 3475 (West 1953).

equities strongly cut the other way,[9] but a presumptive element all the same. This conclusion, which Helmholz convincingly demonstrates, suggests the need to reassess the common law doctrine.

The judicial event which challenges our traditional understanding of adverse possession is a decision of the California Supreme Court, *Warsaw v. Chicago Metallic Ceilings, Inc.*,[10] concerning a first cousin of adverse possession—prescriptive easements.[11] The plaintiff had constructed a large commercial building with a narrow driveway that left insufficient room for delivery trucks to turn around and back up to its loading dock. Consequently, trucks regularly drove onto a vacant portion of the defendant's land next door in order to make this maneuver. The plaintiff was aware of the problem, and tried several times, without success, to purchase an easement from the defendant. Later, the defendant decided to develop its land, erecting a pad of earth (and, after the plaintiff was denied a preliminary injunction, a warehouse) at the point where the trucks turned onto its property. The plaintiff sued, contending that the construction interfered with an easement it had acquired by prescription. The trial court sustained this contention, finding that the plaintiff had used the subject property for the statutory period of five years, and had satisfied all of the other elements necessary for prescription. The defendant was ordered to remove the pad of earth and the structure.

What is signficant about *Warsaw* is the debate about remedies which took place on appeal. The court of appeal, although sustaining the finding that the plaintiff had satisfied the requirements for prescription, declared that the plaintiff could obtain a prescriptive easement and force the defendant to remove the improvements, only if the *plaintiff* agreed to pay the defendant the fair market value of the easement thus acquired.[12] The California Supreme Court likewise upheld the finding that the plaintiff had satisfied the requirements for prescription, but overturned this novel form of relief.[13]

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9 Helmholz notes several reported cases in which the bad faith possessor was awarded title, but observes: "Many involved the conjunction of four 'equitable' factors: a sympathy-inducing possessor, an unsympathetic record owner who had knowingly slept on his rights, the passage of a considerable period of time, and improvements made on the land by the hostile possessor." Helmholz, *supra* note 3, at 347-48.

10 35 Cal. 3d 564, 676 P.2d 584, 199 Cal. Rptr. 773 (1984).

11 Prescriptive easements involve nonpossessory *use* of property which ripens into an easement, as opposed to possession of property which ripens into a fee simple. 7 R. POWELL, REAL PROPERTY ¶1026 (P. Rohan ed. 1977). Generally speaking, the same legal requirements apply to both adverse possession and prescriptive easements, although the non-possessory nature of an easement generally means that the continuity and exclusivity elements must be interpreted differently. *See* C. DONAHUE, T. KAUPER & P. MARTIN, *supra* note 8, at 143.

12 139 Cal. App. 3d 260, 188 Cal. Rptr. 563, 569 (1983) (The full opinion of the court of appeal appears only in the California Reporter; this Article will therefore cite only to that volume).

13 Four justices thought that the court of appeal's indemnification requirement would interfere with policies central to adverse possession, and was inconsistent with the California statutes codifying the principle of prescription, which make no mention of payment. 35 Cal. 3d at 573-76, 676 P.2d

The significance of the debate in *Warsaw* emerges in terms of the typology of legal rules introduced by Calabresi and Melamed.[14] Traditionally, adverse possession and prescription have reflected what Calabresi and Melamed call a system of "property rules." That is, before judgment the true owner's (TO's) interest is protected by a property rule: no one—including the adverse possessor (AP)—can take it from the TO without his consent. After entry of judgment awarding the AP title by adverse possession, the *AP's* interest is protected by a property rule: no one—including the TO—can take it from the AP without his consent. The court of appeal's decision in *Warsaw*, however, suggests a different kind of scheme. Before judgment, the TO's entitlement would be protected, as before, by a property rule. But after judgment, the entitlement would remain with the TO, protected now by what Calabresi and Melamed call a "liability rule." In other words, after judgment the TO would keep the property, but the AP could take it away from the TO without his consent by paying the TO the fair market value of the property taken.

In what follows, I will suggest that the research of Professor Helmholz and the remedial innovation proposed in *Warsaw* are related. After all, *Warsaw* is, in Professor Helmholz' terminology, a clear case of bad faith—there is no question that the plaintiff knew that its trucks were encroaching on land belonging to the defendant. In light of Professor Helmholz' study, therefore, it is somewhat surprising that the California courts ruled in favor of the plaintiff in the first place. This may explain why a majority of the judges who heard the *Warsaw* case, even if they felt constrained to hold that the plaintiff had established an easement by prescription, were sympathetic to the idea of making the plaintiff pay for the easement so acquired—a liability rule. More generally, it suggests that liability rules may be an appropriate mediating device between the traditional policies supporting the institution of adverse possession—all of which apply whether the possessor is acting in good faith or in bad faith—and the evident reluctance of courts to "reward" bad faith possessors by giving the AP an entitlement protected by a property rule.

In Part I, I will consider the theory underlying adverse possession as an entitlement determination rule. In particular, I will consider what sort of factors are relevant in deciding *who* should be awarded the entitle-

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at 591, 199 Cal. Rptr. at 778-80 (Richardson, J., joined by Mosk, Kaus & Broussard, JJ.). Two justices thought that the relief was fair and equitable and would not interfere with the policies of adverse possession, but felt constrained by the California statutes to leave such a reform in the hands of the legislature. 35 Cal. 3d at 576-77, 676 P.2d at 591, 199 Cal. Rptr. at 780 (Grodin, J., joined by Bird, C.J.). One justice argued that the change was fair, equitable, and consistent with the traditional purposes of adverse possession, and that the courts had sufficient lawmaking powers to impose a payment requirement consistent with the statutory scheme. 35 Cal. 3d at 577-81, 676 P.2d at 591, 199 Cal. Rptr. at 780-83 (Reynoso, J., dissenting).

[14] Calabresi & Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

ment to the property both before and after the statute of limitations runs. In Part II, I will discuss the nature of the rules used to answer this question. I will argue that, from the perspective of a functioning market in property rights, a mechanical (formalistic) rule would be desirable, but that the problem of the bad faith possessor introduces a discordant element that pushes us in the direction of a judgmental standard. Finally, in Part III, I will consider what impact the adoption of a liability rule, as suggested in *Warsaw*, would have on the system of adverse possession. If we required indemnification in all cases of adverse possession, such a reform would rather clearly undermine the rationale for this institution. A stronger case can be made, however, for requiring indemnification only in those cases where the TO can show that the AP acted in bad faith. Making the AP pay for the property in such cases would comport with our shared sense of the greater moral culpability of the bad faith possessor, and should help deter forced transfers of property. Moreover, adoption of a liability rule in cases of bad faith might allow the ordinary entitlement determination rules to take on a more mechanical cast, reducing the need for litigation to establish title by adverse possession, and thereby enhancing the general efficiency of the system of property rights.

I. THE THEORY OF ADVERSE POSSESSION

According to Calabresi and Melamed, disputes about legal entitlements necessarily entail two subsidiary inquiries: first, to whom should the entitlement be assigned, and second, what sort of rule should be used to protect this entitlement—a property rule or a liability rule.[15] In this section, I will consider how adverse possession operates as a system for answering the first, or "who," question.

The assignment of entitlements in the period before the statute of limitations runs need not detain us for long. There is no question about who gets the entitlement during this period: courts uniformly and automatically award it to the TO. The reasons for this are generally the same as those which support a system of private property rights, as opposed to one which recognizes only possessory, i.e., squatter's rights.[16] First, there

[15] *Id.* at 1090-93. Calabresi and Melamed also discuss a third possibility which will not be considered here—inalienability rules. *Id.* at 1111-15. An inalienability rule prohibits the transfer of the entitlement. *Id.*

[16] The property rights/possessory rights distinction, as I shall use it, is essentially that which divides the common law actions of ejectment (and the early real actions) from trespass (and the original assize of novel disseisin). The former protects the interest of one who has title to property, although he may be out of possession. The latter protects the interest of one who is in possession, but is not available to the title holder out of possession. A system of possessory rights, in this sense, is not equivalent to a "state of nature," in which might equals right. In a system of possessory rights, as I envision it, one who is in possession of property—however that may be defined—could invoke the power of the state to redress violent or fraudulent dispossession. However, unless one could claim to have been in possession of property, one would lack any basis for calling upon the power of the state to redress depredations by others. The primary consequence of a system consisting purely

is a strong economic justification. If the state did not protect title but only the fact of possession, no one would ever be secure in leaving valuable things unattended, or entrusting them to someone else through lease or bailment.[17] The result would undoubtedly be over-investment in security devices, and under-investment in the cultivation and development of natural resources. In addition, there is a derivative justification based upon civic values: cultural diversity, countervailing centers of political power, and independent institutions of scholarly inquiry may require larger accumulations of private wealth than would be possible under a system of mere possessory rights.[18] Finally, and again derivatively, there is a justification based on human personality: accumulated material wealth may be important to an individual's identity and plans for the future, and property rights in material things protect these interests.[19] All of this, with varying degrees of emphasis on different aspects of the justification for property rights, has rarely been a matter of controversy, at least within the Anglo-American legal tradition.[20]

The problem comes in determining who should get the entitlement to the property *after* the statute of limitations runs. Clearly, courts often award the entitlement to the possessor rather than to the title holder during this period—that's what adverse possession is all about. But as Professor Helmholz' study reminds us, courts may also grant the entitlement to the TO.[21] Given the strong case for maintaining a system of property rights, a threshold question is why we are *ever* justified in shifting the entitlement from the TO to the AP after the passage of a number of years. Suprisingly, there is very little systematic discussion of this fundamental issue in the legal literature.[22] Nevertheless, it is possible, with

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of possessory rights, in this sense, would be to limit the accumulation of material wealth to that over which an individual could effectively assert personal dominion.

17 *See* 2 W. BLACKSTONE, COMMENTARIES ch. 1 (1766); R. POSNER, *supra* note 2, at 27-28; Demsetz, *supra* note 2.

18 *See* M. FRIEDMAN, CAPITALISM AND FREEDOM ch. 1 (1962); Reich, *The New Property*, 73 YALE L.J. 733 (1964).

19 *Cf.* Radin, *Property and Personhood*, 34 STAN. L. REV. 957 (1982) (contrasting property for personhood and "fetishistic," i.e., purely accumulative, property).

20 Even the Marxist critique of private property advocates state or collectively owned property—not a system of possessory rights—as an alternative. As Demsetz has pointed out, state or collectively owned property is in many respects more like private property than possessory rights. *See* Demsetz, *supra* note 2. In recent critical legal studies literature one finds some flirtation with the notion that a "state of nature" (i.e., a society with neither property nor possessory rights) might be as good or better than a system of property rights. *See* Kennedy & Michelman, *Are Property and Contract Efficient?*, 8 HOFSTRA L. REV. 711 (1980).

21 Helmholz, *supra* note 3, at 334-35.

22 To say that the condition of the legal literature is archaic after years of almost complete neglect is an understatement. The best effort at a systematic restatement of the policies of adverse possession with which I am familiar is C. CALLAHAN, ADVERSE POSSESSION 79-111 (1961), although even here the treatment is highly discursive and (in my view) unduly dismissive of certain points of view. Casebooks often try to compensate for the lack of systemic scholarly discussion by offering a collection of chestnuts from various legal sources that suggest different rationales for ad-

some effort, to glean from that literature four different, and yet essentially complementary, rationales for the institution of adverse possession.

The first justification is one that is commonly invoked in support of statutes of limitations generally—the difficulty of proving stale claims.[23] As time passes, witnesses die, memories fade, and evidence gets lost or destroyed. The statute of limitations recognizes this problem by adopting a conclusive presumption against attempting to prove claims after a certain period of time has elapsed.

The concern about lost evidence is common-sensical. As the quality and quantity of evidentiary material deteriorates over time, the process of fact-gathering and proof becomes more difficult. Surrogate witnesses and documents generally are not as accessible or as reliable as originals; consequently, more resources must be expended in finding them and corroborating their veracity. A rule requiring prompt resolution of claims is thus efficient in that it helps to minimize the costs of litigation and trial. There is also a fairness concern underlying the lost evidence rationale. Requiring that disputes be resolved promptly prevents the plaintiff from unfairly surprising the defendant with a claim that may be difficult or impossible to refute because evidence that would allow the defendant to defeat the claim no longer exists.

To be sure, the lost evidence rationale probably carried greater force in the seventeenth century, when Parliament passed the first general statute limiting the right to recover possession of land,[24] than it does today. In seventeenth-century England there were no recording acts, and surveys were probably expensive or unreliable, or both. In modern America, in contrast, all states have acts which provide for permanent public recordation of deeds to real property and which generally establish the primacy of the recorded deed over unrecorded interests.[25] Furthermore, professional surveys now are widely available at relatively low cost. Yet even today, lost evidence related to the issue of title can be a problem. Recorded deeds may contain defects or omissions; the court house or title plant may burn down; surveying errors may have resulted in misplaced boundary markers. Moreover, states generally do not maintain a system of public registration or recordation for chattels such as art work, furniture, and jewelry.[26] Thus, in the case of personal property, the lost-evidence rationale applies with as much force today as it did to real property in the seventeenth century.

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verse possession. *See, e.g.*, C. HAAR & L. LIEBMAN, PROPERTY AND LAW 55-57 (1977); J. DUKEMINER & J. KRIER, PROPERTY 82-85 (1981).

[23] *See, e.g.*, United States v. Kubrick, 444 U.S. 111, 117 (1979); Toussie v. United States, 397 U.S. 112, 114 (1970); C. CALLAHAN, *supra* note 22.

[24] 21 Jac., ch. 16 (1623).

[25] The Massachusetts Bay Act of 1634 is generally regarded as the first public recording act. *See* 6A R. POWELL, THE LAW OF PROPERTY ¶ 904[1] (1984). For a listing of states by type of recording act see 4 AMERICAN LAW OF PROPERTY § 17.5 n.63 (Casner ed. 1952).

[26] *See* O'Keefe v. Snyder, 83 N.J. 478, 416 A.2d 862 (1980) (no registration of artwork).

A second concern which has frequently been advanced in the literature on adverse possession is the interest in "quieting titles" to property.[27] This objective is related to, yet analytically distinct from, the problem of lost evidence. Imagine a state where lost evidence of title is never a problem—there is a universal recording system, accurate and indestructable boundary markers, and so forth. Nevertheless, if that state has no mechanism for eliminating old claims to property, the information costs, transaction costs, and hold out problems involved in discovering and securing the releases of these claims would very likely impose a significant impediment to the marketability of property. Title examiners would have to trace every deed back to its source; ancient easements, unextinguished spousal rights, grants of future interests, unreleased mortgages or liens could well be discovered; these interests would have to be traced to present-day successors; and releases of these interests would then have to be secured. If the buyer always purchased subject to such claims, no matter how old they might be, he would have to go through a complicated process of fact-gathering and negotiating in order to obtain clear title to the property. The "nuisance" value of these claims could easily lead to holding out or other rent-seeking behavior that would make the process of obtaining clear title even more burdensome.

Of course, these sorts of impediments exist today with respect to certain "perpetual" interests like rights of reverter and rights of entry,[28] and with respect to interests too recent to be extinguished by statutes of limitations. Buyers have learned to cope with these problems, in part because of the development of title insurance. Why couldn't title insurance handle the much larger set of claims created by making all competing claims to property perpetual? Perhaps title insurance *would* become available to cover this larger set of potentially conflicting claims, but premiums would be much higher than those of today. Thus, whether the buyer incurred the costs of actually securing releases or paid huge insurance premiums, the net effect would be the same: transactions in property would become more costly. The institution of adverse possession is designed to reduce this drag on the market by extinguishing most of the older claims. In the language of takings jurisprudence, adverse posses-

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27 Indeed, the English statute, which limited the right to recover possession of land, expressly stated that the limitations period was enacted "[f]or the quieting of men's estates, and avoiding of suits." 21 Jac., ch. 16 (1623). *See* Ballantine, *Title, supra* note 1, at 135:

> The statute has not for its object to reward the diligent trespasser for his wrong nor yet to penalize the negligent and dormant owner for sleeping on his rights; the great purpose is automatically to quiet all titles which are openly and consistently asserted, to provide proof of meritorious titles, and correct errors in conveyancing.

See also C. CALLAHAN, *supra* note 22; Sternberg, *supra* note 1, at 212; Walsh, *supra* note 1, at 535-36.

28 Indeed, because reverters and rights of entry are a perpetual "clog on title," they have frequently been the subject of legislative limitations which have been upheld on the theory that they improve the marketability of property. *See, e.g.*, Trustees of Schools of Township No. 1 v. Batdorf, 6 Ill. 2d 486, 130 N.E.2d 111 (1955).

sion rests on a collective judgment that the reduction in information and transaction costs (or insurance costs) achieved by wiping these older claims off the books outweighs the "demoralization costs" of eliminating such remote claims.[29]

A third reason commonly advanced in support of a system of adverse possession is that it punishes TO's who "sleep on their rights."[30] Under this view, the shift in entitlement acts as a penalty to deter TO's from ignoring their property or otherwise engaging in poor custodial practices. Since forfeiture is a stiff penalty (frequently deemed unconscionable in other contexts[31]) presumably the objective will be realized in most cases.

At first blush, this rationale seems to rest on a social policy favoring "active" owners of property, who develop or exploit their land, rather than "passive" owners. Such a policy seems dubious, because it ignores the possibility that passive owners, such as land speculators, may perform a valuable social function by preserving the property for use by future generations.[32] Moreover, the notion that a property owner must engage in active exploitation or development or risk losing his property runs counter to the principle that a property owner can do whatever he wants with his property, at least so long as he does not injure others.[33] Why not then let him ignore the property, if by ignoring it he does not injure others?

On closer examination, however, these criticisms overstate what is required of the TO in order to avoid forfeiture. The TO does not have to develop his land or even occupy it; all he has to do periodically is assert his right to exclude others. Moreover, there is at least an arguable economic justification for imposing such an affirmative obligation on the landowner. The passive (and presumably absentee) owner will be harder to negotiate with, if only because he will be harder to locate. When the TO is required to assert his right to exclude, therefore, he is in effect being asked to "flush out" offers to purchase his property, to make a market in the land.[34] On this view, then, the sleeping-owner rationale is

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29 *See* Michelman, *Property, Utility, Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165 (1967). *Cf.* Epstein, *Not Deference, But Doctrine: The Eminent Domain Clause*, 1982 SUP. CT. REV. 351 (recording acts do not constitute a taking because they afford implicit in-kind compensation in the form of an improved market in property rights).

30 This rationale is said to be more prominent in English than in American law. *See* J. AMES, LECTURES ON LEGAL HISTORY 197 (1913): "English lawyers regard not the merit of the possessor, but the demerit of the one out of possession."

31 *E.g.*, Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965).

32 *See* Williams, *Running Out: The Problem of Exhaustible Resources*, 7 J. LEGAL STUD. 165, 181-85 (1978).

33 This principle is reflected in the traditional maxim of nuisance law, *sic utere tuo ut alienum non laedas* (no one should use his land so as to injure that of another). *See, e.g.*, Fontainebleau Hotel Corp. v. Forty-Five Twenty-Five, Inc., 114 So. 2d 357, 359 (Fla. Dist. Ct. App. 1959).

34 The Supreme Court has indicated that this is a legitimate state objective. Texaco v. Short, 454 U.S. 516, 529 (1982).

again a justification based on the desirability of encouraging market transactions in property rights.

A fourth and final explanation for the system of adverse possession focuses on the possessor, and in particular on the reliance interests that the possessor may have developed through longstanding possession of the property. This justification appears in several different forms. One form, having distinct echoes of a frontier society, invokes the interest in "preserving the peace."[35] After a sufficient period of time has elapsed, so the argument goes, the AP's attachment to the property will be so strong that any attempt by the TO to reassert dominion may lead to violence. In another form, the reliance argument draws upon the personality theory of property rights, and posits that the AP may have developed an attachment to the property which is critical to his personal identity. As Holmes colorfully put it, "[t]he true explanation of title by prescription seems to me to be that man, like a tree in the cleft of a rock, gradually shapes his roots to his surroundings, and when the roots have grown to a certain size, can't be displaced without cutting at his life."[36]

There is also a third, economic version of the reliance theory, grounded in an ex post analysis of the AP's dilemma. The key concept here is that of sunk costs or "quasi-rents."[37] Suppose the AP has built an addition to his house which he thinks is on his own land, but which later turns out to be built on land belonging to the TO. Had the TO and the AP negotiated for the sale of additional land before the structure was built, the TO probably would receive no more than market value for the land, because the AP could always redesign or relocate the addition, or move elsewhere. Now, however, the TO has the AP over a barrel, and may be able to extract not only the value of the land but the full value of the addition as well. In effect, the value of the addition becomes a quasi-rent from the perspective of the TO. This kind of "extortion" is unfair because it creates a disproportionate penalty given the initial "wrong" of the AP (in this case, negligence in failing to procure a survey prior to construction). It is also inefficient, at least if the prospect of appropriating quasi-rents leads to strategic bargaining or other rent-seeking conduct on the part of the parties.[38]

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[35] *E.g.*, Warsaw v. Chicago Metallic Ceilings, 35 Cal. 3d at 574, 676 P.2d at 590, 199 Cal. Rptr. at 779.

[36] *See* R. PERRY, THE THOUGHT AND CHARACTER OF WILLIAM JAMES 461-62 (1974). *See also* Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 476-77 (1897).

[37] *See, e.g.*, Klein, Crawford & Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. LAW & ECON. 297 (1978). *See generally* TOWARD A THEORY OF THE RENT-SEEKING SOCIETY (Buchanan, Tollison & Tullock, eds. 1980).

[38] The economic version of the reliance theory has at least two problems, however. One difficulty is that it is overbroad, since the problem of appropriation of rents and strategic bargaining will arise the moment the AP builds his addition. In other words, unlike other rationales for adverse possession, this view does not explain adequately the significance of the passage of time. Another difficulty is that the problem of strategic bargaining (and to a large extent the "unfairness" of appro-

The reliance rationale is troubling, however, at least in any of the foregoing forms, because it seems to ignore a competing reliance-type interest: the interest of the TO and of society generally in preserving the integrity of the set of entitlements grounded in law. Indeed, most modern property theorists, following Bentham,[39] assume that property rights are the creature of law, not of unilateral expectations inconsistent with the law.[40] Thus, a policy of transferring entitlements to individuals in order to protect extra-legal expectations would inevitably undermine the general security of property rights. Arguably, this generalized interest in the security of legal entitlements could outweigh—or at least counterbalance—the expectations of the AP which have grown up through long-standing possession of the property.

There is, however, yet another category of reliance interests that may tip the balance in favor of the institution of adverse possession. So far, the discussion has focused exclusively on the competing claims of the AP and the TO. But there may be third parties who also have an interest in the assignment of entitlement, i.e., vendors, creditors, contractors, tenants, subsequent purchasers of all or part of the property for value. To be sure, public recording acts are designed in part to protect such persons from mistaking an AP for a TO. But it simply is not feasible to expect every interested third party to perform a title search before extending credit to, providing services for, or purchasing an interest from someone who appears to be a TO. The appearance of title—particularly the appearance of title consistently maintained for a long period of time—necessarily becomes a rough and ready substitute for an expensive and time-consuming title search. When we add the expectations of these interested third parties into the mix, there seems to be more than enough justification to invoke "reliance" as a rationale for the institution of adverse possession.[41]

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priating quasi-rents as well) could be solved just as easily by applying a liability rule—allowing the AP to acquire the property from the TO by paying fair market value—as by shifting the entitlement to the AP. *See generally* Part III, *infra*. Despite these problems, however, it may be that after a sufficiently long time has passed, the magnitude of the quasi-rents may be so great, and the perception of "unfairness" in requiring the payment of any compensation to the TO so pronounced, that even a liability rule seems out of place.

39 *See* J. BENTHAM, THEORY OF LEGISLATION 111-13 (1914).

40 As the Supreme Court put it in Board of Regents v. Roth, 408 U.S. 564, 577 (1972): "To have a property interest in a benefit, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it." The Court went on to explain that "legitimate" claims of entitlement "are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law." *Id.*

41 Note that all four rationales for adverse possession really only justify barring the TO's action for possession. They do not explain why the passage of the statute of limitations should also give rise to a new title in the AP. The problem of lost evidence, for example, tells us why we do not permit the TO to sue, but does not account for why the AP should now be rewarded with a legal title to the property, rather than simply an undisturbed right of possession. Similarly, the quieting title ration-

In sum, there are four traditional justifications or clusters of justifications which support transferring the entitlement to the AP after the statute of limitations runs: the problem of lost evidence, the desirability of quieting titles, the interest in discouraging sleeping owners, and the reliance interests of AP's and interested third persons. The important thing to note about these rationales is that, at least at the level of general justification, they are mutually supportive.[42] One can like some and dislike others, or one can subscribe to all four, and the result is still the same—the entitlement should be transferred to the AP after the statute of limitations runs. Indeed, standing alone some of these rationales may appear too weak to overcome the presumption in favor of a system of property rights rather than of possessory rights. But taken together, they represent a rather imposing case for transferring the entitlement to the AP after a significant period of time has elapsed.

All of this makes Professor Helmholz' study the more puzzling. The traditional theories suggest that the entitlement should be transferred to the AP after the expiration of the limitations period, and provide no basis for distinguishing between the good faith and bad faith possessor. Yet Professor Helmholz' findings about the importance of subjective intent cast considerable doubt on whether the traditional theories provide a complete account of the relevant concerns. Of course, his findings do not necessarily mean that the proclivities of judges and juries who decide adverse possession cases are correct. One could argue that judges and juries, absorbed in an ex post analysis of the facts of particular controversies, simply have failed to appreciate the strength of the systemic justifications for the institution of adverse possession. But it is probably unwise to denounce the voice of collective experience. A better approach would be to ask whether the inclination of the courts has some

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ale, sleeping owner rationale, and reliance rationale are essentially explanations for cutting off claims by the TO or preserving the status quo, not for creating a new root of title.

Nevertheless, there is a sound economic reason for giving the AP a new title rather than merely a right to undisturbed possession. If the TO is forever barred from suing the AP for possession, then the AP will be forever free to use and consume the property as he likes. Moreover, the AP presumably could sell this right to forever possess and consume the property to AP^1; AP^1 could sell it to AP^2; and so forth. Since the AP therefore has all the principal incidents of property—the right to possess, consume, and transfer the thing in question—save formal title, it only makes sense to give him title as well. Indeed, the principal consequence of refusing to award title to the AP would be to increase the costs of determining entitlement to the property, requiring AP, AP^1, AP^2, etc., to prove AP's perpetual right to possess, consume, and sell the property. Thus, the reason we give the AP a new title once the TO is barred from asserting his claim is to eliminate the potential drag on the market in property rights that would be created by the need to re-try the issue of adverse possession upon every subsequent sale of the property.

[42] This does not mean that the rationales do not have different implications for more specific issues. Consider, for example, the question whether the statute of limitations should be tolled because of the minority, insanity, or imprisonment of the TO. These sorts of disability provisions make good sense under the sleeping owner rationale, but no sense from a lost evidence, quieting title, or reliance perspective.

justification of its own—a justification which perhaps the legal literature has overlooked. If such a countervailing rationale exists, then the question of assigning the entitlement after the statute of limitations runs may not be so simple after all.

Actually, it is not hard to identify a countervailing concern: the interest in punishing or deterring those who engage in purely coercive transfers of property.[43] This concern can be stated in terms of incentives. Purely coercive transfers of property are socially undesirable because they undermine incentives for productive activity, stimulate excessive precautionary measures, and generally destroy the fabric of human relations. What then will be the effect on the incidence of this activity if the dispossessor can, after the passage of a certain period of time, obtain title to the property? Obtaining title constitutes a powerful reward for such a coerced transfer. With title, the dispossessor no longer has to fear legal retribution from the TO (or the state), and can develop, sell, subdivide, or borrow against the property at will. One would expect a potential dispossessor, in calculating whether to seize someone else's property, to balance this potential reward against the probability of apprehension and the severity of the penalty if caught.[44] If we assume any degree of rationality at all (and decisions about taking property are generally "rational," i.e., economically motivated) then the potential reward, even if it is several years in coming, should lead to a higher incidence of coerced transfers than we would expect to find in the absence of such a reward.[45]

In the period before the statute of limitations runs, the concern with punishing or deterring coerced transfers is much in evidence. Intentional dispossession of property—whether in the form of trespass or theft—generally is regarded as a felony punishable by imprisonment. Moreover, the TO has an impressive array of civil remedies to recover the property or its value in money, often fortified by statutory provisions for multiple

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[43] I have borrowed the phrase "purely coercive transfer" from R. Posner, An Economic Theory of the Criminal Law (unpublished manuscript). The account set forth below of why it makes sense to distinguish between good faith and bad faith dispossession closely parallels the explanations given by Posner and by Calabresi and Melamed for the existence of criminal sanctions: to induce parties to use market transactions, *see* R. POSNER, *supra* note 2, at 121, or to prevent parties from turning property rules into liability rules, *see* Calabresi & Melamed, *supra* note 14, at 1125. *See also* Klevorick, *On the Economic Theory of Crime*, XXVII NOMOS: CRIMINAL JUSTICE 289, 301-04 (1985) (generalizing the point by arguing that criminal sanctions reinforce the "transaction structure" of society). *But see* Coleman, *Crime, Kickers, and Transaction Structures*, in XXVII NOMOS, *supra* at 313, 323-26 (questioning whether this theory can adequately account for the moral force of the criminal law).

[44] This is the general cost-benefit criterion reflected in the Learned Hand formula and in the literature on the deterrent effect of the criminal law. *See, e.g.*, R. POSNER, *supra* note 2, chs. 6, 7; Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968).

[45] A number of older cases reflect testimony to the effect that the AP entered the property in hopes of eventually acquiring title by adverse possession. *See, e.g.*, Guaranty Title & Trust Corp. v. United States, 264 U.S. 200 (1924); Jasperson v. Scharnikow, 150 F. 571 (9th Cir. 1907).

or punitive damages.[46] After the statute runs, however, the concern with punishing or deterring coerced transfers disappears; or at least it *seems* to disappear in the common law doctrine and traditional legal commentary on adverse possession.

For present purposes, what is especially promising about the interest in punishing or deterring coerced transfers is that it provides a basis for distinguishing between the good faith and bad faith possessor, and thus for explaining the findings of Professor Helmholz. Of course, the concern about dispossession of property applies in some measure whatever the mental state of the dispossessor. There is an interest in discouraging people from taking someone else's property, whether they do so intentionally or by mistake. But the interest in discouraging purely coercive transfers—that is, those in which the dispossessor knows the property is not his—is clearly stronger than the interest in discouraging innocent dispossession. This is true whether we view the question in conventional moral terms—the intentional dispossessor is clearly more culpable or blameworthy and hence more deserving of punishment than the unwitting dispossessor—or from the vantage point of economic theory.[47]

In economic terms, the intentional dispossessor is distinguishable from the inadvertent or negligent dispossessor because he has more clearly turned his back on consensual (i.e., market) mechanisms for the transfer of property rights.[48] To be sure, in nearly all adverse possession cases the structure of relationships suggests a low transaction cost setting. The number of parties involved and the costs of drafting and enforcing a contract should be low in virtually every case, and should not vary with the subjective mental state of the possessor.[49] But the *information costs* involved in identifying the affected parties and the scope of the affected property rights are clearly lower in the case of intentional dispossession than in a case of negligent dispossession. By definition, the intentional dispossessor knows that he is dealing with property that belongs to

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[46] *See* Annot., 111 A.L.R. 79 (1937).

[47] As Helmholz notes, the good faith/bad faith distinction was expressly recognized in the Roman law of prescription and remains a requirement in civil law systems. Helmholtz, *supra* note 3, at 356. Even in common law jurisdictions, it is an important factor in areas of the law loosely associated with adverse possession such as accession and confusion. *See* J. DUKEMINIER & J. KRIER, *supra* note 22, at 80-82. Perhaps most significantly for present purposes, courts often condition an award of injunctive relief to a TO against encroaching structures or improvements (as opposed to limiting the TO to an award of damages) on a finding of bad faith on the part of the AP. In fact, this was one of the issues in *Warsaw*. *See* Warsaw v. Chicago Metallic Ceilings, 35 Cal. 3d at 576, 676 P.2d at 591, 199 Cal. Rptr. at 779-80 (1984) (upholding an injunction to the plaintiff against the encroaching warehouse—the plaintiff having been found to be the owner of a prescriptive easement—because the defendant acted "with prior notice of the plaintiffs' claim," i.e., in bad faith).

[48] *See* R. POSNER, *supra* note 2, at 121. It may also be that the intentional dispossessor is a more dangerous person, i.e., more likely to engage in such depredations again.

[49] For an analysis of transaction costs in terms of these sorts of structural features, see Merrill, *Trespass, Nuisance, and the Costs of Determining Property Rights*, 14 J. LEGAL STUD. 13, 21-22 (1985).

someone else. Thus, the intentional dispossessor has less excuse for disregarding the possibility of consensual exchange than does the unintentional dispossessor.[50]

Given this distinction between intentional and unintentional dispossession, it is possible to rationalize Professor Helmholz' findings as follows. In the case of the good faith AP, courts have implicitly balanced the interest in punishing the dispossessor against the systemic justifications for the institution of adverse possession, and have come out in favor of adverse possession. Apparently the benefits derived from forcing an innocent or merely negligent AP to forfeit the property—whether these benefits are expressed in moral terms such as punishing carelessness or avoiding unjust enrichment, or in economic terms such as encouraging a high degree of care to avoid dispossession of property—are outweighed by the costs that such a policy would impose in terms of the underlying functions of adverse possession. In the case of the bad faith AP, however, courts have engaged in the same implicit balancing and have generally (although not exclusively) come out against adverse possession. Here, the implicit judgment must be that the benefits derived from forcing a bad faith AP to forfeit the property— again, whether expressed in moral or economic terms—are sufficiently great that they outweigh the costs that this policy imposes on the institution of adverse possession.

Introducing the countervailing concern with punishing or deterring bad faith possession, however, at most explains only the *results* of adverse possession cases, as revealed by Professor Helmholz' study. This countervailing concern does not account for the curious fact that the leading opinions, treatise writers, and casebook editors all generally declare that the subjective state of mind of the AP should be irrelevant. If in fact a desire to punish or deter the bad faith possessor animates the law of adverse possession, then the failure of the law to acknowledge this fact

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[50] The blanket distinction between unintentional or good faith possessors on the one hand, and intentional or bad faith possessors on the other hand, is undoubtedly an over-simplification. For example, there would seem to be a difference between the AP who knows the property is not his *and* knows the identity of the TO (as in *Warsaw*), and the AP who knows the property is not his but does not know the identity of the TO. *See, e.g.*, Patterson v. Reigle, 4 Pa. 201 (1846). The information costs will be lower in the former case than in the latter—how much lower would depend on the specific facts of the case.

On the other side of the ledger, there would seem to be a difference between the AP who is negligent, in the sense that he has failed to take cost-effective measures to ascertain the identity and scope of the involved property rights, and the AP who is truly "innocent," in the sense that he has taken all cost-effective measures to make this determination. *See* Christensen v. Tucker, 114 Cal. App. 2d 554, 563, 250 P.2d 660, 668 (1952). Arguably, some kind of sanction is appropriate in the former case to induce parties to take greater precautions. On the other hand, one could argue that where the costs of obtaining information about entitlements are sufficiently low relative to the costs of not proceeding with such information, even the innocent AP should be forced to proceed at his peril. In this vein, I have previously argued for a right of automatic injunctive relief against even innocent building encroachments as a way of inducing landholders to obtain the correct information about boundaries. *See* Merrill, *supra* note 49, at 37-38.

seems utterly perverse. The professed legal standard does not further the hypothesized objective; on the contrary, it can only result in *more* intentional dispossession of property than would otherwise exist because it suggests to the squatter or the thief that he can eventually obtain title by adverse possession. All of which presents the further inquiry: Why hasn't the legal doctrine come to recognize the good faith of the AP as one factor or element to be taken into account in determining the assignment of entitlement? Why in this area are we treated to the odd spectacle of the law doing virtue while it pays homage to vice?

II. Adverse Possession as an Entitlement Determination Rule

Questions about legal entitlements can be analyzed not only in terms of who gets the entitlement and the choice of remedies to protect those entitlements, but also along another dimension that cuts across these two categories, the degree of discretion given to judges and juries in determining the assignment of rights and remedies. Viewed from this perspective, entitlement determination rules fall on a continuum ranging from highly mechanical (formalistic) rules at one extreme, to highly judgmental rules at the other.[51] Mechanical rules are those that afford very little discretion to judges and juries in establishing substantive and remedial rights. Since they afford little discretion, they are comparatively inexpensive to apply—lawyers or even laymen usually can apply them without having to engage in litigation. Judgmental rules, in contrast, afford broad discretion to judges and juries in determining entitlements. Since they are broadly discretionary, however, they are unpredictable and hence relatively expensive to apply. When the parties disagree about who is entitled to do what with respect to any particular resource, judgmental rules increase the probability that the parties will engage in litigation to obtain a resolution.

Mechanical rules are ideally suited to low transaction cost situations where voluntary exchange or modification of property rights is commonplace.[52] Because they are highly predictable and inexpensive to apply, mechanical rules facilitate such market transactions. Moreover, the arbitrary quality of mechanical rules is of little consequence in these low transaction cost settings, because the outcome dictated by the rule can be rearranged by negotiation.[53]

On the other hand, if transaction costs are high or exchange or modification of property rights is otherwise unlikely, then the superiority of mechanical rules is no longer obvious. Mechanical rules still will be

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51 The following discussion draws upon Merrill, *supra* note 49.

52 This insight is not new. *See* Pound, *The Theory of Judicial Decision*, 36 Harv. L. Rev. 940 (1923).

53 The truth of this assertion is conditioned upon the usual assumptions about universal rationality, no wealth effects and so forth. *See, e.g.*, Calabresi & Melamed, *supra* note 14, at 1094-95.

more predictable and inexpensive to apply, and they may have other advantages, such as deterring certain kinds of socially undesirable behavior.[54] But in cases where exchange or modification of rights is improbable and the socially desirable result is not certain, the application of a mechanical rule may result in an arbitrary or irrational allocation of resources. In this sort of situation, judgmental rules, which give judges and juries greater discretion in deciding allocation questions, may reach results which are perceived as being more efficient or fairer.

Applying these principles to the system of adverse possession, it is relatively easy to explain the state of affairs that prevails before the statute of limitations runs. As we have seen, the entitlement is always awarded to the TO in this situation. Moreover, this conclusion is reached mechanically—without the exercise of any significant degree of judicial discretion. Before the statute of limitations expires, the dispute between AP and TO is governed by the action of ejectment (or trespass) in the case of real property, and replevin (or detinue or trover) in the case of personal property.[55] Under these actions, the TO only has to show that the AP is responsible for an unconsented physical occupation of the TO's property as defined by the ad coelum rule[56] (in the case of real property), or that the AP is responsible for an unconsented asportation of the TO's property (in the case of personal property). So long as he can establish the fact of encroachment or asportation without his consent, the TO has an unqualified right to recover possession of the property or its value in damages.

Use of mechanical entitlement determination rules makes sense in this context. Ex ante, there is little reason to think that there will be significant transaction costs involved in the sorts of situations typically encountered in adverse possession cases—squatters, misplaced fences, building encroachments, and the like. As previously suggested, these disputes are likely to involve small numbers of people—typically only one AP and one TO. Moreover, given the universal practice of publicly recording deeds and the ready availability of professional surveys, the AP should not find it difficult to ascertain the identity of the TO and to determine where his property ends and that of the TO begins. These sorts of conditions—small numbers of easily identified parties competing over easily defined property rights—generally lead to consensual exchange. Consequently, the use of mechanical entitlement determination rules in this context facilitates the development of a market in property rights.[57]

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[54] *See* Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1695-96 (1976).

[55] *See generally* C. DONAHUE, T. KAUPER & P. MARTIN, *supra* note 8, at 60-66, 71-76, 90-96.

[56] *Cuis est solum eius est usque ad coelum et usque ad inferos* (he who owns the soil owns all the way up to the heavens and all the way down to the depths).

[57] A similar analysis applies with respect to personal property, although the costs of identifying the dispossessor and of identifying the dispossessed property are obviously much greater. Indeed,

The problem, again, arises in determining the proper sort of rule to apply *after* the statute of limitations has expired. Structurally, the situation facing the AP and the TO after the statute of limitations runs is the same as before. There are probably only a small number of parties involved, the identity of the parties should be relatively easy to ascertain, and the scope of the affected property rights should be relatively easy to determine. Viewing the situation ex ante, therefore, we should expect to find that property rights are exchanged or modified by voluntary agreement rather than by self-help. When we consider the situation ex post, however, it is clear that something has gone wrong. For some reason, perhaps a unilateral or mutual mistake of fact, or negligence or indifference on the part of the TO, we are faced with what is in effect a situation of "market failure." At the very least, we know that the AP has for some time been enjoying rights which ordinarily can be acquired only by purchase, and yet no exchange or modification of property rights has taken place. Thus, it would seem that the general rationale for applying a mechanical rule here—to faciliate market exchange between the TO and persons in the position of the AP—no longer carries much, if any, force.

Nevertheless, the fact that we have uncovered an instance of "market failure" does not mean that we should rush to employ a judgmental entitlement determination rule. Although there may be little hope of a negotiated exchange between AP and TO, this does not mean that the property will not be subject to market transactions in the future—in particular, voluntary exchanges between AP and his successors. Similarly, it does not mean that interested third parties—creditors, contractors and the like—will not deal with the property in the expectation that AP is the true owner. Use of a mechancial entitlement determination rule in settling the assignment of entitlements between AP and TO may be of considerable value in facilitating these future exchanges, and in inducing various third parties to rely on apparent ownership as a probable indicator of title.

To illustrate these concerns, consider again the example of the AP who decides to build an addition on what turns out to be TO's property. Assume that the TO sleeps on his rights, the statute of limitations runs, and now AP wants to sell the property to AP^1. Application of a mechanical rule in settling the question of entitlement between AP and TO will have significant advantages in this context. Suppose that AP^1 has obtained a survey in conjunction with his proposed purchase (which is customary in most jurisdictions),[58] and the survey reveals that TO rather than AP is the title owner of the land. If AP^1's attorney can nevertheless advise that AP owns the property by adverse possession, then AP^1

the high costs of making these kind of identifications with respect to chattels undoubtedly explains why today theft of chattels is a major social problem, whereas disseisin of land is not.

[58] A. AXELROD, C. BURGER & Q. JOHNSTONE, LAND TRANSFER AND FINANCE 369 (1974).

should be willing to go through with the transaction. In fact, if AP's entitlement was crystal clear, AP^1's lender and title insurance company might not even demand that AP or AP^1 obtain a judgment showing title by adverse possession. Moreover, even if they did demand a judgment,[59] it probably could be obtained by default or stipulation, since TO's lawyer would advise him that his interest in the land has been extinguished and TO would not want to incur needless litigation expenses by contesting the issue.

On the other hand, if AP^1's attorney must advise that AP's entitlement is uncertain and requires a judge and jury to apply a judgmental entitlement determination rule, then AP^1 may not be willing or able to go through with the transaction. Almost certainly, AP^1's lender and title insurance company will insist that AP obtain a judgment showing title by adverse possession. However, it will be difficult for AP to obtain such a judgment by default or stipulation, since the discretionary nature of judgmental rules makes it hard for the parties to predict how the court will award the entitlement, and the possibility of appropriating substantial rents from a favorable judgment may make it hard to induce the TO to settle.[60] Consequently, the parties may have to litigate the issue of title, and, given the judgmental nature of the rule, the litigation may be costly.[61] Ultimately, the uncertainty and cost associated with a judgmental rule may defeat the transaction. In this fashion, the use of judgmental entitlement determination rules operates as a restraint on the alienation of property.

But even if mechanical rules are desirable after the statute runs as well as before, is it possible to formulate a mechanical rule in this context? To answer this question it is necessary to consider what sorts of functions an entitlement determination rule must perform. The four basic rationales for the institution of adverse possession surveyed in Part I suggest that an entitlement determination rule has to perform at least two functions: (1) it must assure the passage of a significant period of time between the original dispossession and the shift in entitlement; and (2) it must assure adequate notice to the TO and interested third parties of AP's claim of entitlement.

All four of the traditional rationales for adverse possession suggest that the entitlement should be transferred to the AP only after the AP

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[59] As suggested earlier, a judgment would be helpful in eliminating the need to reestablish continually the AP's entitlement upon subsequent transfers of the property. *See supra* note 41.

[60] Default is unlikely because the Supreme Court has held that due process requires reasonable and appropriate efforts to insure that the title holder has actual notice of a quiet title action. *See* Walker v. City of Hutchinson, 352 U.S. 112 (1956); Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306 (1950). Such notice will apprise the title holder of the potential for appropriating economic rents, making it likely that he will appear and defend the suit.

[61] In theory, it would be rational for the plaintiff and defendant to settle the case by dividing the appropriable rents and saving attorneys' fees, but given uncertain entitlements, such behavior cannot be guaranteed. *See* Cooter, *The Cost of Coase*, 11 J. LEGAL STUD. 1 (1982).

has been in possession for a significant period of time. It takes time for evidence to get lost and for remote claims to pile up which might impair the marketability of property. Moreover, a significant period of time must elapse before the TO has unreasonably slept on his rights and the AP and interested third parties have developed strong reliance interests related to the property. In principle, of course, a judgmental entitlement determination rule could accomodate these concerns. Thus, courts could consider, on a case-by-case basis, the likelihood that evidence has been lost or destroyed or that ancient claims will impair the marketability of the property. The courts could also inquire directly into the reasonableness of the TO's delay and the strength of the various reliance interests. After weighing all these factors, the court could then decide whether to award the entitlement to the AP or to the TO.

In practice, however, these considerations have been reflected in what may be the most extreme of mechanical entitlement determination rules: the legislature selects a fixed number of years, set forth in the statute of limitations, after which we conclusively presume that evidence will be lost, remote claims will impair marketability, the TO has unreasonably slept on his rights, and the AP and others will have developed strong expectations of AP's continued possession. The rule is undoubtedly arbitrary—the period of limitation ranges from 5 to 20 or more years, depending on the predilections of the legislators of the jurisdiction[62] and undoubtedly some TO's have lost their property even though they could have shown, had they been allowed, that the underlying rationales for a system of adverse possession do not apply. Yet the attractive features of selecting an arbitrary number of years should be apparent. Allowing the TO to attempt to prove the underlying factors on a case-by-case basis would be time-consuming and would yield unpredictable results. Consequently, litigation would become far more frequent and costly. The universal practice of using an arbitrary number of years as a proxy for lost evidence, dilatoriness on the part of the TO, etc., is thus a testament to the desirability of mechanical entitlement determination rules in this context.

In addition to the passage of time, it is also necessary to insure that the TO and others have had adequate notice of AP's claim of entitlement. In part, this is simply a reflection of the fact that adverse possession is based on the statute of limitations.[63] In order for the statute of limitations to expire, there must be some point at which the TO's cause of action accrues, and it makes sense that this should be a point when a reasonably diligent TO would be on notice of a rival claim. The notice requirement can also be explained in terms of the sleeping owner rationale. It would be unreasonable to punish the TO for failing to assert his

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62 *See* Taylor, *Titles To Land By Adverse Possession*, *supra* note 1, at 554.

63 *See* Walsh, *supra* note 1, at 545-55.

right to exclude unless he has some reason to know that someone is contesting his rights. Finally, notice to the world is necessary before we can talk about possible reliance interests of third parties.

Again, the notice requirement could be accomodated by a judgmental rule. We could ask, on a case-by-case basis, whether the TO (or others) subjectively knew or, perhaps, as a prudent owner, should have known, of AP's claim of entitlement. In practice, however, the common law has adopted a series of relatively objective criteria that single out forms of behavior by which AP's are likely to provide notice to the TO and the world at large.[64] Most clearly, the requirement that the AP's possession of the property be "open and notorious" demands a certain form of behavior likely to put others on notice. In addition, however, the requirements that the possession be "actual," "continuous," and "exclusive" also function to delineate forms of behavior likely to alert the world to AP's claim to the property. Finally, even the requirement that the possession be "hostile under claim of right" performs a notice function, at least under the "objective" interpretation of this element favored by most cases and the commentators. So interpreted, this requirement simply eliminates those claimants—such as tenants or licensees—who have had possession of the property with the actual or implied permission of the TO—permission that would lull the TO into thinking that the AP's claim is not truly adverse and negate any presumption by others that AP is the true owner.

Again, these various common law elements are only proxies for notice. Consequently, they will deprive some TO's of property where they might be able to prove that they had no forewarning of the AP's possession. But the unpredictability and cost of inquiring into whether the TO and others had notice-in-fact would undoubtedly exceed that of making the objective behavioral inquiries demanded by the common law. Thus, the common law doctrine again can be seen as a testament to the desirability of mechanical rules, although admittedly in a less dramatic fashion than in the case of the statute of limitations.[65]

In short, if we ignore the problem of the bad faith AP, the law of adverse possession could operate—and in fact it tries to operate—through a relatively mechanical entitlement determination rule. To be sure, the common law test is rather complex, and some of the factors, such as the requirement that the possession be adverse under a claim of

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64 For commentary recognizing the connection between the common law test for adverse possession and notice see Rose, *Possession as the Origin of Property*, 52 U. CHI. L. REV. 73 (1985); Sternberg, *supra* note 1, at 208-09; Walsh, *supra* note 1, at 542.

65 The five common law elements can also be viewed as a proxy for the strength of the AP's reliance interest. Possession which is actual, open and notorious, exclusive, continuous and hostile under a claim of right generally will conform to a pattern of behavior which is characteristic of one who is a true owner. Persons who behave like a TO will presumably harbor expectations characteristic of a TO.

right, must be carefully defined in such a way (absence of permission from the TO) that they retain a hard-edged quality. But all in all, the law of adverse possession appears on its face to constitute a rather remarkable achievement: a doctrine that serves a number of distinct yet complimentary functions and does so under a decisional rule which is sufficiently mechanical that it will not unduly interfere with a functioning market in property rights.

If, however, we decide to take into account the competing concern with deterring coerced transfers of property, then the possibility of using a mechanical rule to fix the assignment of entitlements starts to disappear. Obviously, if we required courts to inquire directly into the subjective state of mind of the AP, the costs of the rule would rise dramatically. The kinds of fact-finding and inference-drawing necessary to establish the AP's subjective state of mind necessarily would make the rule highly judgmental. On the other hand, it is difficult to think of any objective behavioral test that could serve as a satisfactory proxy for subjective good faith. One possibility found in many jurisdictions is "color of title"—a requirement that the AP enter the property pursuant to a deed or other presumptive evidence of title which later turns out to be invalid.[66] However, although entry under color of title typically represents a case of good faith, it does not begin to exhaust the possible circumstances of good faith dispossession. The typical case of mistaken boundaries, for example, is one of good faith, but generally does not satisfy the color of title requirement. Absent some more general behavioral proxy for good faith, analogous to the open and notorious proxy for notice, the law faces an unhappy dilemma. It can either jettison the relatively mechanical test for establishing adverse possession—the statute of limitations plus the traditional common law elements—and adopt a judgmental test that includes some consideration of subjective intent or it must ignore the reasons for differentiating between those who enter in good faith and those who enter in bad faith.

Without discussing the problem, legal commentators have generally opted for the latter course. With virtual unanimity, they insist that the law ignore the distinction between the good faith and bad faith possessor, however anomolous this might be in light of the general practice of the law.[67] Professor Helmholz reveals, however, that although the courts have usually followed the commentators in the formulation of applicable

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[66] *See generally* Taylor, *Titles to Land by Adverse Possession*, *supra* note 1, at 554. For representative statutes and case law construing the meaning of "color of title," see CAL. CODE § 324 (West 1982); Safwenberg v. Marquez, 50 Cal. App. 3d 301, 123 Cal. Rptr. 405 (1975) (adverse possession under color of title is founded upon a written instrument or judgment or decree which purports to convey title but is somehow defective); S.C. CODE ANN. § 15-67-22 (Law. Co-op. 1976); Mullis v. Winchester, 237 S.C. 487, 118 S.E.2d 61 (1961) (color of title means any semblance of title by which the possession may be ascertained).

[67] *See supra* note 4.

doctrine, they have rebelled when it comes to applying that doctrine. In effect, they have transformed what appears to be a relatively mechanical entitlement determination rule into a judgmental rule.

Without doubt, the primary vehicle for this transformation has been the requirement that the possession be "hostile under claim of right."[68] Although the commentators have insisted that claim of right means no more than that the possession be without express or implied permission, judicial application of this element is less secure, sometimes tending toward an objective standard of no permission, sometimes toward a subjective standard of good faith, sometimes, remarkably enough, toward a subjective standard of *bad faith*.[69] No doubt in most jurisdictions there is enough ambiguity in the explication of this element that judges—or counsel arguing to a jury—can shade the meaning in one direction or another based on the facts of the case.

The other elements of adverse possession, however, also provide opportunities for manipulation. For example, the requirement of "continuous" possession seems to reflect a fairly mechanical standard. Yet in cases of bad faith, judges and juries can seize on the AP's absence for a few days as grounds for denying title by adverse possession,[70] whereas in cases of good faith, they can excuse repeated absences of months at a time.[71] In this fashion, a rule which appears to be capable of quieting title to property rather quickly and efficiently has been transformed into a font of litigation.[72]

There appears to be no easy solution to the dilemma, at least at the stage of assignment of entitlements. We could of course insist that subjective good faith be expressly recognized as a factor in establishing title by adverse possession. This would make the law more principled than it is now. But the added costs of doing so would be formidable. In cases which rather clearly involve good faith—faulty deeds, surveying errors, and the like—the additional requirement would increase the uncertainty and costs of establishing title by adverse possession, with little corresponding benefit. Moreover, even in cases of bad faith possession, it appears that courts implicitly "balance" the need to punish or deter coerced transfers against other factors, such as the length of time that has passed, the degree of negligence on the part of the TO, and the strength of the

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68 Helmholz, *supra* note 3, at 342-43.

69 The most notorious example is the so-called "Maine rule" with respect to boundary disputes, which requires a subjective belief that the occupied property belongs to someone else. *See* Preble v. Maine Cent. R.R., 85 Me. 260, 27 A. 149 (1893). There is a general consensus that this rule is rapidly dying out. *See* Mannillo v. Gorski, 54 N.J. 378, 255 A.2d 258 (1969) (overruling "Maine rule" in New Jersey).

70 *E.g.*, Mendonca v. Cities Service Oil Co., 354 Mass. 323, 237 N.E.2d 16 (1968).

71 *E.g.*, Howard v. Kunto, 3 Wash. App. 393, 477 P.2d 210 (1970).

72 Helmholz notes: "The relevant cases are abundant. In fact they are over-abundant. Many of them involve relatively insignificant pieces of land, backyard boundary disputes being depressingly common." Helmholz, *supra* note 3, at 333.

reliance interests of the AP and others.[73] So the new, "principled" rule would have to include a balancing element as well as an inquiry into subjective good faith, making the costs and uncertainty even greater. In short, attempting to accommodate the interest in punishing or deterring coerced transfers presents no happy options at the stage of deciding who should get the entitlement. Perhaps if we turn to the question of remedies we can discover some way out of the dilemma in which the law of adverse possession appears to be mired.

III. Adverse Possession and Liability Rules

We come at last to the issue reflected in the title of this essay—the choice of remedies to implement the system of adverse possession. As noted earlier, adverse possession heretofore has operated as a system of property rules.[74] In this section, I would like to consider what would happen if, as suggested by the California Court of Appeal in *Warsaw*,[75] courts applied a liability rule in the period after the lapse of the statute of limitations. Specifically, I would like to ask what would happen if the expiration of the statute of limitations and the satisfaction of the common law test for adverse possession simply transformed the TO's entitlement from one protected by a property rule into one protected by a liability rule, requiring the AP to pay the TO the fair market value of the property in order to retain possession and obtain a new title.

To facilitate discussion, it will help to consider at the outset how such a system might operate. I will assume that the transformation would be effected along the lines suggested by *Warsaw*, through judicial recognition of an independent action by the TO for indemnification.[76] In other words, if the TO sued for possession and the AP successfully interposed a defense of adverse possession, then the TO would be allowed to assert an independent claim against the AP for indemnification. Alternatively, if the AP filed a quiet title action and successfully showed that he had satisfied the elements of adverse possession, then the TO could counterclaim with an action for indemnification. I will examine two different

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[73] *Id.* at 347-48.

[74] *See supra* text accompanying notes 16-17.

[75] 139 Cal. App. 3d 260, 188 Cal. Rptr. 563 (1983) *vacated*, 35 Cal. 3d 564, 676 P.2d 584, 199 Cal. Rptr. 773 (1984); *see supra* text accompanying notes 10-14.

[76] *See* Spur Industries, Inc. v. Del E. Webb Dev. Co., 128 Ariz. 178, 494 P.2d 700 (1972) (expressly referring to such a plaintiff-payment requirement as "indemnification"). Whether it is legitimate for the judiciary to adopt an indemnification requirement, as opposed to leaving any such modification to the legislature, is beyond the scope of this paper. A majority of the California Supreme Court justices in *Warsaw* felt that, at least under the California statutes codifying the common law principles of prescription, adoption of an indemnification requirement would have to await legislative action. *See supra* text accompanying notes 12-13. My own view would be that since the California statutes were a codification of commmon law rules, the legislature probably did not intend to preclude further common law development. *See* Merrill, *The Common Law Powers of Federal Courts*, 52 U. Chi. L. Rev. 1 (1985).

versions of the indemnification proposal: "universal indemnification," which would apply in all cases of adverse possession without regard to the mental state of the AP, and "limited indemnification," which would apply only in cases in which the AP acquired the property in bad faith.

Implementing the liability rule by means of an action for indemnification helps to eliminate several possible objections to the proposal. First, since the TO must appear and file the indemnification action (either in conjunction with his action for possession or by counterclaim to the AP's quiet title action), the system of adverse possession would not break down if the TO cannot be found or otherwise defaults. In such cases, the AP would acquire the property without paying just as he does now.[77] Second, requiring the TO to assert a claim for indemnification when he files the action to regain possession, or as a counterclaim to the AP's quiet title action, would eliminate a possible source of uncertainty for the AP. The AP would know within the limitations period for an action for indemnification or immediately upon judgment (if the jurisdiction views the action as a compulsory counterclaim) whether he must pay to remain in possession of the property. Finally, casting the liability rule in the form of an action for indemnification would put the burden of persuasion on the TO. Under either version of the proposal, the TO would bear the burden of establishing the fair market value of the property. Moreover, under a system of limited indemnification, the TO would bear the burden of showing that the AP entered the property in bad faith. Consequently, the AP would not have the onerous task of proving a negative—his lack of knowledge of the TO's paramount title.

The most obvious cost of either universal or limited indemnification is that it would add to the expense of litigating adverse possession cases. Under a system of universal indemnification, the parties (or at least the TO) would have to submit evidence of the market value of the property, something which is not required now. Under a system of limited indemnification, the parties (or at least the TO) would in addition have to present evidence of the AP's subjective mental state at the time of dispossession—an historical fact that might be very difficult to establish, and again something not required now. But these added administrative costs and uncertainties are only a small part of the picture. More importantly, the indemnification proposal would have serious implications for the general policies previously identified as underlying the system of adverse possession.

First, indemnification would frustrate the objective of eliminating claims involving lost or destroyed evidence. Under either version, the proposal requires that the parties submit evidence of the value of the property. There are several different points in time which conceivably

[77] This would be the case unless, perhaps, we adopted a system of civil fines or escheat for cases in which the TO defaults or cannot otherwise be discovered.

could be selected for valuing the property: the date of AP's original entry (when the statute of limitations starts to run); the date on which the statute of limitations expires (when the AP's right to title accrues); or the date of judgment (when the AP obtains title-in-fact). Whatever else may be said about the choice between these different measuring points,[78] existing case law suggests that the date of the AP's original entry is the appropriate time for valuation. Under current doctrine, when the AP acquires title by adverse possession, his title is deemed to "relate back" to the date of original entry.[79] Since the AP is considered to have "owned" the property from the date of original entry, any action by the TO for mesne profits or for improvements made after this date is cut off, even if the statute of limitations on these actions has not expired. By parity of reasoning, application of a liability rule should award the TO the fair market value of the property as it stood at the time of AP's original entry, saving the value of any improvements and capital appreciation after this time (above the rate of prejudgment interest) to the AP.[80] As should be clear, however, if we select the date of original entry as the time for valuation of the property, this will present a potential problem of lost evidence.

Under a system of limited indemnification, another troubling evidentiary issue arises: the need to prove the AP's state of mind at the time of original dispossession. Since dispossession is necessarily an event which occurred at least as long ago as the term of the statute of limitations, the limited indemnification proposal is also clearly inconsistent with the lost-evidence rationale. To be sure, the fact that the TO has the burden of persuasion to show that the AP entered in bad faith alleviates the potential for unfairness to the AP here. If evidence of the AP's state of mind is lost or inconclusive, then the TO will fail to discharge this burden and the AP will get the property without paying—the situation as it exists today. Moreover, in most cases the AP should be in as good or better position than the TO to rebut or offer alternative interpretations of such evidence of the AP's past mental state as exists.[81]

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78 I argue below that there are other good reasons for selecting the time of original entry as the relevant date for determining value. *See infra* text accompanying notes 79-92.

79 *See* Henderson v. First National Bank of De Witt, 254 Ark. 427, 494 S.W.2d 452 (1973); Burket v. Krimlofski, 167 Neb. 45, 91 N.W.2d 57 (1958); Counce v. Yount-Lee Oil Co., 87 F.2d 572 (5th Cir. 1937).

80 Since the object of a liability rule is to put the TO in roughly the same position he would have been had the AP agreed to purchase the property at the time of original dispossession, the TO should also be awarded prejudgment interest on the indemnification award running from the date of original dispossession to the date of judgment. This is analogous to the award of prejudgment interest where the defendant has been found to have wrongfully withheld payment from the plaintiff in the past. *See* Southern Pacific Trans. Co. v. San Antonio, Texas, 748 F.2d 266 (5th Cir. 1984).

81 Nevertheless, because of the very real possibility that the AP will be deprived of documents or witnesses that might otherwise disprove a claim of bad faith, perhaps a court adopting a limited indemnification system would want to consider as an additional safeguard a heightened burden of persuasion, such as proof by clear and convincing evidence. This higher standard of proof is gener-

Furthermore, under a system of limited indemnification, the TO's action should run only against the original AP who entered in bad faith, not against subsequent purchasers for value or other good faith AP[1]'s who are allowed to "tack" their possession onto that of the original AP. This would avoid the unfairness of requiring a good faith possessor to disprove an allegation that some other possessor acted in bad faith at a point in the distant past.

Indemnification would also interfere with the quieting-title function of adverse possession. Under universal indemnification, every TO would be entitled to indemnification upon entry of a judgment in favor of an AP. In effect, quiet-title actions would become condemnation proceedings, with holders of remote and fractional claims lining up to receive their "just compensation." Of course, effective notice to the successors of some remote interest holders would be impossible, and these claims would go by default. But most remote holders who received actual notice would probably assert a claim for indemnification—it would be like a legacy from a long-lost uncle. Consequently, securing title by adverse possession would become much more expensive. Recognizing this fact, title insurance companies would raise their premiums. The net result would be an additional drag on the market in property rights.

Note that limited indemnification would interfere with the quieting-title function much less than would universal indemnification. Only a fraction of adverse possession cases involve bad faith dispossession,[82] and thus only a fraction would require indemnification of the TO. Under limited indemnification, therefore, the aggregate costs of quieting title would rise, but not by as much as under universal indemnification.[83]

Furthermore, indemnification would interfere with the sleeping-owner rationale. Universal indemnification would reduce the TO's incentive to assert his right to exclude. Under a regime of property rules, the sanction for failing to assert the right to exclude is forfeiture of the property—a fairly powerful deterrent to indifferent custodial practices. With universal indemnification, however, the only sanction would be conversion of an entitlement protected by a property rule into one protected by a liability rule. In other words, the TO would lose the right to the "thing" in question, but would receive its cash value as of the date of entry instead. Given that in many cases the TO who has been less than fully vigilant is an absentee owner who holds the property for investment purposes only, this would be no sanction at all except to the extent that the property has appreciated in value. Consequently, absentee owners

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ally required in civil fraud cases, where proof of historical knowledge (in this case, of materially false misrepresentations) is also at issue. *See* 9 J. WIGMORE, EVIDENCE § 2498 (3d ed. 1949).

82 *See* Helmholz, *supra* note 3, at 335, 338. Unfortunately, Helmholz does not provide an estimate of what percentage of adverse possession cases involve bad faith.

83 In cases where the current possessor entered in good faith, they would not rise at all, except to the extent that administrative costs would be marginally higher.

would be less likely to assert their right to exclude, and there would be a marginal shift away from the use of the market for the transfer of property rights.

Limited indemnification would also reduce the incentives for good custodial practices, but to a much lesser extent than universal indemnification would. Since bad faith dispossession is only a subset of adverse possession cases, TO's could not count on indemnification upon failing to assert their right to exclude. Thus, under the limited form of the proposal, there would still be a signficant incentive for the TO periodically to inspect the property and remove encroachments and intruders, and less of a shift away from market transactions toward self-help.

Finally, the indemnification proposal would substantially undermine long-term reliance interests of AP's and interested third parties. Universal indemnification would amount to imposing a one-time tax on the AP equal to 100% of fair market value as of the date of original entry. The AP would be put to the choice of paying this enormous tax or losing the property. No doubt many AP's would pay, but in paying they would lose everything except the value of improvements, any appreciation in market value since the date of original entry above the rate of prejudgment interest, and the subjective "premium" which they attach to their holding.[84] Clearly, if we selected some date other than that of original entry for valuation of the property, the exaction would be an even higher percentage of total value. But the interference with the AP's expectation interest is only a small part of the problem. More serious would be the frustration of justifiable reliance by third persons if the AP's unwillingness or inability to pay this huge tax resulted in forfeiture of the property to the TO.

Limited indemnification would also tax away much of value of the property, but only in cases where the TO could show that the AP acquired the property in bad faith. Since the bad faith possessor is probably someone to whom we are less sympathetic in the first place, the frustration of expectations here is considerably less troubling, although admittedly the interference with third party reliance if the AP refused to pay would remain a problem.

In sum, the costs of the indemnification proposal are substantial. The California Supreme Court may have overstated the case when it said that "[t]o exact such a charge would entirely defeat the legitimate policies underlying the doctrines of adverse possession and prescription . . . ."[85] But it seems fairly clear that at least the universal indemnification proposal would go a long way toward undermining the system of adverse possession. Limited indemnification is, in at least one respect,

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[84] Most property owners value their property higher than the market does because of the costs of relocation, if not for more sentimental reasons. *See generally*, Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Use Controls*, 40 U. CHI. L. REV. 681 (1973).

[85] 35 Cal. 3d 564, 570, 676 P.2d 584, 590, 199 Cal. Rptr. 773, 779 (1984).

worse than universal indemnification; it would present a new and troubling problem in lost evidence in allowing the TO to attempt to prove that the AP acquired the property in bad faith. Otherwise, however, the costs of limited indemnification would be significantly lower than those of universal indemnification. In particular, the quieting-title, sleeping owner, and reliance functions would be diminished, but not irreparably damaged, under the limited indemnification proposal.

Despite these substantial costs, three general benefits have been or can be asserted to follow from indemnification: (1) fairness to the TO; (2) promotion of the most efficient use of the land; and (3) deterrence of coerced transfers of property.

In *Warsaw*, both the California Court of Appeal and the dissenting and concurring justices in the California Supreme Court suggested that indemnification was necessary in order to insure fair treatment of the TO. Recall that in *Warsaw*, the TO refused the AP's offer to purchase an easement, but the AP's trucks persisted in driving on and off the property anyway. Moreover, the TO was apparently not indifferent to its property, but merely waiting for a more propitious time for development. Justice Reynoso asserted that in these circumstances, the law of adverse possession or prescription requires an innocent TO to file a suit for trespass or risk losing all right to the property.[86] He implied that it is unfair to put a TO to such a burden, and that at the very least the law should allow indemnification when the property right is taken away.

But Justice Reynoso clearly exaggerated the burden placed on the TO to preserve his property rights. In most cases, the TO will not need to file suit to preserve his right to exclude—he can do so merely by calling the police or erecting a temporary fence. This could, of course, elicit a lawsuit by the AP, which the TO would have to defend. But since the TO's right to exclude is protected by a mechanical entitlement determination rule, the AP's chance of prevailing in such a suit (before the statute of limitations runs) is negligible. Most likely, therefore, the AP faced with a police inquiry or a fence would either desist from trespassing or submit an offer to purchase.

Moreover, *Warsaw* is something of an unusual case in that the TO was aware of the intrusion and was more or less actively planning to make use of the property in the future. In most adverse possession cases, the TO is oblivious to the adverse use and has been completely out of possession for the full period of the statute of limitations.[87] In these more typical cases, it is hard to feel that the transfer of the property to the AP will defeat some important reliance interest of the TO. In most cases, the TO's interest in seeking to eject the AP probably is just a desire

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[86] 35 Cal. 3d at 574, 676 P.2d at 593, 199 Cal. Rptr. at 783 (Reynoso, J., dissenting).

[87] This follows from the exclusivity and continuity requirements of the traditional five-part standard.

to obtain economic rents; it is the AP (or interested third parties) who can claim reliance based on AP's active use and occupation. Thus, fairness to the TO is at most a feeble reason for adopting a liability rule.

A student commentator has recently argued in the pages of this Review that the result reached by the court of appeal in *Warsaw* can be justified not only on fairness but also on efficiency grounds.[88] Drawing an analogy to the use of liability rules in nuisance disputes,[89] the commentator argues that a liability rule assures that the property will end up in the hands of the party who can exact the most value from it. If the AP values the property more highly than the market, he will pay the TO to keep it; if AP does not value the property more highly than the market, he will refuse to pay and the property will revert to the TO.

The analogy to nuisance disputes is misplaced, however, because there is no impediment to market exchange here.[90] Certainly, *after* judgment has been rendered (if not before), we are dealing with a low transaction cost situation—the number of disputants is undoubtedly small, the costs of drafting and enforcing a contract are manageable, and the identity of the owner and the scope of the affected rights have been clearly established by the judgment. Consequently, the Coase Theorem tells us that the property should end up in the hands of the party who can exact the most value from it, no matter who is awarded the entitlement, and no matter whether it is protected by a property rule or a liability rule.

For example, suppose we follow the ordinary rules of adverse possession and award the property to the AP protected by a property rule. If the TO (or anyone else) values it more highly than the AP, he can buy it from the AP, thus assuring that it ends up in its most productive use. Or, suppose we give the entitlement to the AP protected by a liability rule. If the TO values the property more than the market, he will pay the AP the fair market value; alternatively, if the AP values it even more than the TO, then he will pay the TO a premium above its market value in order to buy it back. The point is that in a situation of low transaction costs, *any* combination of entitlements and remedies to protect those entitlements should achieve the value-maximizing result. Thus, indemnification cannot be justified, at least directly, on allocational efficiency grounds.[91]

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88 Comment, *Compensation for the Involuntary Transfer of Property Between Private Parties: Application of a Liability Rule to the Law of Adverse Possession*, 79 NW. U.L. REV. 759 (1984).

89 *Id.* at 766-72. *See also* Boomer v. Atlantic Cement Co., 26 N.Y.2d 219, 257 N.E. 2d 870, 309 N.Y.S.2d 312 (1970); Spur Industries, Inc. v. Del E. Webb Dev. Co., 108 Ariz. 178, 494 P.2d 700 (1972).

90 Not all nuisance disputes entail high transaction costs, but the use of liability rules has generally been urged on the assumption that they do. *See* Calabresi & Melamed, *supra* note 14, at 1119; Merrill, *supra* note 49.

91 The commentator repeatedly cites Professor Coase's seminal article, *The Problem of Social Cost*, 3 J. LAW & ECON. 1 (1960), but argues that it has no bearing on the efficiency argument because high transaction costs prevent exchange between the AP and the TO, making courts a more

The only asserted benefit of a liability rule with any degree of plausibility, in my view, is that it will help punish or deter coerced transfers of property. As discussed in Part I,[92] awarding the property to the AP after the statute of limitations runs increases the incentives of AP's to dispossess other persons of their property. As previously discussed, the concern about innocent or negligent dispossession is a relatively weak one. At least, it does not seem that the judges and juries rate it more highly than the systemic justifications which underlie the system of adverse possession. Intentional dispossession, however, is of greater concern. There are sound reasons for treating intentional dispossession as potentially a more serious social problem, both from a moral and an economic point of view, and judges and juries seem to share this intuition.

In Parts I and II, I suggested that courts manipulate the common law doctrine of adverse possession in order to punish or deter those who intentionally dispossess others of their property. A less drastic means of achieving a similar end would be to apply a liability rule in cases of bad faith possession. A rule of limited indemnification would in effect impose a fine on bad faith dispossessors equal to the value of the property at the time of original entry. Squatters and thieves would know that, even if they could obtain title to property after the passage of the statute of limitations and the satisfaction of the common law's five elements, they would have to pay for their gain. Consequently, the incentives to engage in coerced transfers would be reduced.

There are several advantages to reflecting our disapproval of the bad faith possessor at the stage of remedy rather than entitlement. First, in cases where the TO has disappeared or the dispossession occurred so long ago that evidence of the mental state of the possessor has been lost or forgotten, an action for indemnification would simply fail, leaving the main purposes of the system of adverse possession intact.[93] Conversely, if subjective bad faith were an express requirement for obtaining title by adverse possession, the difficulties of proof associated with this element

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efficient agency for the allocation of resources. *See* Comment, *supra* note 88, at 769. But even if it were plausible to assert that there are barriers to exchange *before* the statute of limitations runs (perhaps because of difficulty in locating the TO or because the AP has made improvements which give rise to strategic bargaining), this does not mean that there would be similar impediments *after* entry of a judgment transferring the entitlement to the AP protected by a property rule. The judgment should reduce information costs about entitlements to zero, and it is unlikely that the TO, having been out of possession for the period of the statute, will have sunk costs which would give rise to strategic bargaining. In asserting that courts are more efficient in allocating resources than the market, *see id.* at 770, the commentator also fails to count the higher administrative costs associated with a liability rule as a social cost although clearly from an efficiency perspective these costs are just as "real" as are transaction costs.

92 *See supra* text accompanying notes 42-48.

93 Presumably the action for indeminification would itself be subject to a statute of limitations. If the indemnification action accrues upon the entry of judgment, this means that the failure of the TO to appear within the period of limitations on the indemnification action would give the AP the property without any further liability for damages.

could interfere measurably with the functions of adverse possession.[94]

Second, by limiting the issue of subjective intent to the remedial stage, we would strengthen the extent to which AP's and interested third parties could rely on an AP's continued possession of the property. Consider the case, probably not that unusual, where the AP has some inkling that the title rests in someone else—in other words, where the evidence of bad faith is ambiguous—and yet the TO has not filed an action to regain possession. If the subjective intent of the AP were a relevant issue at the stage of entitlement, then the AP would face considerable uncertainty. If he should go ahead and improve or develop the property, he could have his entire interest wiped out by a subequent action by the TO for possession.[95] However, if the issue of subjective intent were relevant only to the question of remedy, the worst that could happen in this situation would be that the AP would have to pay the fair market value as of the date of original entry (plus prejudgment interest). This should encourage AP's to improve and develop the property, safe in the knowledge that they would be assured at least continued possession of the property and the value of the improvements. In addition, interested third parties (who do not know whether the AP acquired the property in good faith or bad faith) should have greater confidence that the AP will remain in possession.

Finally, and perhaps most importantly, if courts knew that the bad faith possessor would be faced with an action for indemnification, they might not feel compelled to manipulate the traditional common law doctrine in order to "punish" those who acquired the property in bad faith, and "reward" those who acquired it innocently. Adoption of the limited indemnification requirement would permit the basic entitlement determination rule to take on a more mechanical cast, reducing the need for litigation to establish title by adverse possession, at least in cases where the TO has disappeared or there is no question that the AP acted in good faith. Admittedly, there is an element of speculation here. But it stands to reason that judges and juries would be much more willing to apply a mechanical rule at the stage of entitlement if they knew that there was a way of "doing justice" at the stage of remedy. Certainly, it is hard to imagine that this reform would produce greater uncertainty than exists today, when the official doctrine says one thing and the results reached by the courts say another.

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[94] Admittedly, one could try to achieve the same effect at the entitlement stage by making the bad faith of the AP a relevant factor only if the TO appeared and carried the burden of persuasion on this issue. But jury confusion would be less likely if the issue arose only in what would technically be a separate action for indemnification, rather than as an integral part of the case on the merits.

[95] I assume here the application of the common law rule denying the trespasser any recovery for the value of improvements made to the land. *See* Merryman, *Improving the Lot of the Trespassing Improver*, 11 STAN. L. REV. 456, 465-66 (1959). With respect to personal property, the value of improvements may be recoverable if the doctrine of accession applies.

CONCLUSION

Faced with a particularly blatant case of bad faith possession, a court once declared: "This idea of acquiring title by larceny does not go in this country. A man must have a bona fide claim, or believe in his own mind that he has got a right as owner, when he goes upon land that does not belong to him, in order to acquire title by occupation and possession."[96] Professor Helmholz shows that this statement, although subsequently derided by commentators as a deviant or minority view,[97] accurately reflects the sentiments of the judges and juries who decide adverse possession cases.

Before reading Professor Helmholz' study, I probably would have rejected out of hand the idea of applying liability rules in adverse possession cases. Certainly, requiring every AP to indemnify the TO would seriously undermine the institution of adverse possession. But Helmholz' findings suggest that a right of indemnification limited to cases of bad faith dispossession may make sense on a kind of "theory of the second best." As things presently stand, the law insists that subjective intent does not matter, but then permits the rules of adverse possession to be manipulated so that it does. The result is unpredictability and a steady stream of litigation. A right of limited indemnification would interfere to some extent with the policies of adverse possession, but it might also render the doctrine more principled and predictable, and hence reduce the volume of litigation. Given that judges and juries insist on taking subjective intent into account, and given that there is some justification for their doing so, it may be better to implement a system of limited indemnification than to persist along the present path.

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96 Jasperson v. Scharnikow, 150 F. 571, 572 (9th Cir. 1907).

97 *See* Helmholz, *supra* note 3, at 342. *See also* R. CUNNIGHAM, W. STOEBUCK & D. WHITMAN, *supra* note 7, at 761 (characterizing *Jasperson* as an "extreme view").