BARGAINING WITH THE STATE: OFFSETS AND MITIGATION
IN DEVELOPING LAND

Robert Cooter*

A. Introduction

According to the economic theory of bargaining, each party to a voluntary agreement must receive at least the amount that he can get on his own (“threat value”), plus a share of the surplus from the bargain. Courts frequently monitor bargains between citizens and the state. To protect citizens, the courts should focus on the fairness and efficiency of the threat points of the citizens. Unfortunately, courts often focus on the terms of the agreement, not the threat points. The wrong focus leads courts to impose rules that block bargains that would benefit both parties.

I analyze an example where the U.S. Supreme Court precluded the possibility of a beneficial bargain between a private property owner and a land-use planning authority. The private property owner wanted a permit to develop land. The state required the private owner to offset the harm by giving something to the public in exchange for the development permit. By focusing on the outcome and not the threat points, the Supreme Court misconceived the problem. Specifically, the Supreme Court misconceived the requirement of a “causal nexus” between the harm that private development will cause to the public and the bargain with the state to offset this harm.

B. Nollan v. California Coastal Commission

Viewed from an ecological perspective, adjacent parcels of land are so interdependent that anything one owner does affects the others. When the “transformative economy” (Sax 1992 fall) meets ecology,¹ almost any restriction can be justified as controlling an externality. In such cases, property owners often bargain with the state over permits. Sometimes the state grants a permit conditional on the owner mitigating the harm to the public. Sometimes the state grants a permit in exchange for the owner donating something valuable to offset the

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* Robert Cooter is Herman Selvin Professor of Law, University of California at Berkeley. This article is based on Chapter 12 of my book, The Strategic Constitution (Princeton University Press, 2000).

harm to the public. Mitigation and offset are quite different in their economic consequences for bargaining with the state. I will explain how an imperfect understanding of the difference resulted in an inferior court decision in a landmark case decided in the U.S. Supreme Court, *Nollan v. California Coastal Commission.*

North of Los Angeles, the magnificent coastline of California remains largely unspoiled by development and the California Coastal Commission is responsible for keeping it that way. This case arose when a property owner sought a permit from the Commission to enlarge a small coastal dwelling into a house. The property was located between the beach and a public highway, as depicted in Figure 1. The house would have diminished and degraded the view of the coast from the highway.

![Aerial View](image)

**Figure 1: Nollan**

The Commission wanted to protect the view from the road, but that was not its only purpose. In addition, the Commission wanted to obtain a walking path along the beach so the public could stroll there at high tide. The Commission did not refuse permission to build the house, which the Supreme Court suggests that the Commission could have done legally. Instead, the Commission required the owner to donate a public path along the beach in exchange for permission to build the house. The owner sued and the case was eventually appealed all the way to the U.S. Supreme Court.

The state can regulate property to protect the public against harm, but the supply of public goods must be financed from general taxes, not by expropriating selected property owners. Was the Coastal Commission protecting the public or forcing a private person to pay

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