Searching for Robin Hood: Suggested Legislative Responses to Kelo

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In Search of Robin Hood: Suggested Legislative Responses to *Kelo*

Mark Seidenfeld*

Few cases involving property law have engendered the level of concern that the Supreme Court’s recent *Kelo* decision spawned.¹ Despite the language of the fifth amendment that “no property shall be taken for public use without just compensation,”² *Kelo* held that the government can use its eminent domain power to take property from private owners in order to transfer that property to other private owners.³ For the sake of brevity, I will refer to the ability of government to use eminent domain to transfer property between private owners as the “*Kelo power.” Local governments’⁴ use of the *Kelo* power creates a perception that the government today is acting much as the reviled Sheriff of Nottingham in the childhood story of Robin Hood, taking property from the poor to line the coffers of those who curry favor with the authorities. This perception is reinforced because the ostensible reason for local governments’ exercise of their *Kelo* power.

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² U.S. CONST. amend. V.
³ *Kelo* expanded the boundaries of public use to include economic development and increasing the local government tax base by broadly interpreting “public purpose” and giving great deference to local government determinations of public needs. *Kelo*, 125 S. Ct. at 2668. The Supreme Court had previously approved the use of eminent domain to transfer property from one private entity to another when existing ownership imposed direct costs on the local community, such as where one landowner exercised monopoly power over all land in the area or the land that was taken was a slum. *See, e.g.*, Haw. Hous. Auth. v. *Midkiff*, 467 U.S. 229 (1984); *Berman* v. *Parker*, 348 U.S. 26 (1954).
⁴ Any governmental entity with eminent domain power can exercise the *Kelo* power. I use the term “local government” to refer to the governmental entity actually exercising the *Kelo* power, in order to distinguish this entity from other bodies of government, such as state legislatures, that have the authority to limit the use of eminent domain by lower bodies of government, such as municipalities and counties. This usage comports with the reality that it is usually a local government that has exercised the power, in large part because it generally will have an easier time making a plausible argument that its use is good for its citizens than will governments that represent citizens spread out across a large geographical area.

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power is to increase their tax bases by revitalizing run down neighborhoods that provide homes mainly to the less well-to-do. And the perception is further solidified because often the recipient of the land is a large impersonal entity, usually a corporation, that is frequently given tax breaks along with the property. In return, the corporation promises that it will devote the land to uses that will help create jobs and attract other businesses and wealthier residents, whose property tax payments will shore up the failing tax base of the local government entity.

It is therefore not surprising that Kelo has generated a host of citizen initiatives and state legislation restricting the use of the eminent domain power to transfer property from one private entity to another. Such efforts, of course, are entirely consistent with the rationale of Kelo itself. In Kelo, the Supreme Court addressed the question whether, by including the phrase “for public use” in the Fifth Amendment, the Constitution prohibited the use of eminent domain power to transfer property from one private entity to another. The Court essentially reasoned that the term “public use” was not meant to restrict the use of eminent domain to situations where the property is publicly owned, or even put directly to a public use. Implicit in the Kelo holding is the principle that it is up to the political processes to prevent local governments from abusing the power of eminent domain to enrich supporters of local officials responsible for the decision to take the property at issue. Thus, when state-level politics limits the powers of state and local governments to use takings to transfer private ownership, those limits are not only

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6 In Kelo, the Court used condemnation of land for a railroad with common-carrier duties as an illustration of when “a State may transfer property from one private party to another if future ‘use by the public’ is the purpose of the taking…” Kelo, at 2661.
consistent, but actually envisioned by the Kelo decision.\footnote{Kelo, at 2668. (“We emphasize that nothing in our opinion precludes any State from placing further restrictions on its exercise of the takings power.”)} In essence, the Court declined the invitation to play the role of Robin Hood, instead stating that it was up to the state legislatures to do so.

This article provides some guidelines for how state legislatures might best play that role. It suggests that a legislative response by state governments is warranted to prevent abuse of the Kelo power.\footnote{This article thus assumes that there is interest at least in some states for reform of use of the Kelo power. Ilya Somin uses classic public choice theory to contend that such interest by state legislators is mostly illusory. He has surveyed state legislative responses to Kelo and concluded that most will be ineffective. Ilya Somin, \textit{The Limits of Backlash: Assessing the Political Response to Kelo} 14-15 (George Mason Law & Econ. Research Paper No. 07-14, 2007), available at http://ssrn.com/author=333339. His conclusion, however, is belied to some extent by his own admission that Pennsylvania, Michigan, Kansas (and I would add Florida) are states in which the Kelo power had been exercised with some regularity and that did adopt meaningful reform. \textit{Id.} at 12, 14. His categorization of legislative reactions also suffers from failure to take into account that the courts are well aware of the public outcry from Kelo and are not likely to simply continue to approve use of the Kelo power just because the legislation leaves them that alternative.} It does so by using economic analysis to address the constitutional and political issues raised by government use of the Kelo power. The article focuses directly on concerns that the Kelo power creates an opportunity for local government to act like the Sheriff of Nottingham, but it concludes that the concerns should not be per se with the government forced transfer of property from one private entity to another, but rather with the level of compensation that the courts have demanded for takings coupled with a lack of procedures to ensure that the use of the Kelo power provides public benefits, rather than a simple wealth transfer from one private entity to another.

In part one of this article I use economics to review the potential benefits that can flow from the use of eminent domain to transfer property from one private entity to another. In part two, I describe the abuses to which exercise of the Kelo power can lead. In part three, I discuss mechanisms that other scholars have suggested obviate the need

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for the Kelo Power, and explain why a need for that power still remains. In part four, I propose two changes in law – one regarding compensation to owners whose property is condemned using the Kelo power, and the other regarding procedures that local governments should have to follow to use the Kelo power, and explain how these would minimize the potential for abuse without forfeiting the Kelo power altogether. In proposing these changes, I suggest that commentators to date have ignored procedural means that can harness the expertise of government officials and the incentives of other potential private recipients of the property to solve problems that these commentators have concluded are insurmountable.

I. Potential Benefits from Use of Kelo Power

A. Efficiency Gains from Transferring Property to Highest Valuing User.

Generally we trust private mechanisms – in particular voluntary agreements for purchase and sale of land – to ensure that land goes to highest valuing user.9 When there are transaction costs that prevent transfer to highest valuing user using such mechanisms,10 we want government to be able to induce transfer without necessarily having to own the property itself.

Use of the Kelo power is not theoretically distinguishable from other uses of eminent domain with respect to efficiency gains. If transfer of the property from the

9 Gary D. Libecap, Contracting for Property Rights, in THE LAW AND ECONOMICS OF PROPERTY RIGHTS 15 (Terry L. Anderson & Fred S. McChesney eds., 1989) (“With secure rights to land and the existence of land markets, price signals will direct land to those who will place it in its highest-valued use at any point in time.”)

10 R.H. Coase, The Problem of Social Cost, 3 J.L. & ECON. 1, 15 (1960) (proving that in the absence of transaction costs, parties will transfer property rights to maximize wealth, but that transaction costs can interfere with such transfers).
original owners is justified when the government takes title to the condemned property, it can be justified when the government retransfers that property to a private entity.

According to the language of the Fifth Amendment, critics of the Kelo majority focus on “public use” as the key term that they claim invalidates the Kelo holding. But use is not automatically public when run by the state.

For example, if the state condemns land for a hospital that it owns and runs, the hospital only serves a select subset of the general public (those who either cannot pay for alternative hospital care or prefer to use the public hospital because of convenience, the hospital’s resources or any other reason). If the state runs the hospital, the use of the property is per se a public use. But if a private entity runs the hospital is the use any less public? There is absolutely no difference in use.

Moreover, as a matter of policy, do we want the state running hospitals simply because that is the only way the state could exercise its eminent domain power to make construction of the hospital feasible? Economists often critique government provision of services that could be privately provided because the government operates outside the

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12 For example, local governments often provide essentially private goods that generate external benefits, such as primary education, public transportation, and garbage collection. See Amnon Lehavi, Property Rights and Local Public Goods: Toward a Better Future for Urban Communities, 36 URB. LAW. 1, 11-12 (2004) (noting that parks, roads and schools provided by local governments do not exhibit the classical public goods attributes of non-rivalrous use and inability to exclude individuals from enjoying these services); see also WILLIAM B. NEENAN, URBAN PUBLIC ECONOMICS 171-75 (1984) (“services provided by local governments have a mixed public private nature”). Although such services are used by members of the public, they primarily benefit the individuals who use them, and are not public goods in the classic economic sense because it is possible to exclude individuals from their use and their consumption is rivalrous. See Mark Gradstein, Rent Seeking and the Provision of Public Goods, 103 ECON. J. 1236, n.1 (1993). (“Public goods are characterized by the absence of rivalry in consumption.”); Paul A. Samuelson, The Pure Theory of Public Expenditure, 36 REV. ECON. & STAT. 387, 387 (1954) (“…each individual’s consumption of such a good leads to no subtraction from any other individual’s consumption of that good.”). Moreover, many individuals purchase such services from private providers, and the use of the services in those instances is no different from when the local government provides the service.
competitive marketplace that induces private entities to meet consumer demand at the least cost. In addition, government does not have any particular expertise in running hospitals, or for that matter, most of the other projects that have been promoted by use of the Kelo power.

Government may be best at envisioning highest value uses and coordinating transfers, but is unlikely to be best at actually managing the property use once the transfer is accomplished. Perversely, without the Kelo power, government may be forced to actually own and operate the enterprise that it finds maximizes public wealth, even though government is unlikely to be the most efficient owner and operator. The government can perhaps avoid this conundrum by contracting the operation of the facility to a private entity while continuing to own it, but government is not likely even to be best at exercising ownership, and even if it is, the need to separate ownership from management by government will create agency costs.

B. Overcoming Holdout Problems

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14 M. Shamsul Haque, *Public Service Under Challenge in the Age of Privatization*, 9 GOVERNANCE: INT’L J. POL’Y & ADMIN. 186 (1996) (stating that critics of the public sector usually claim that private enterprises are more efficient because of the competitive nature, more capable of ensuring fairness and welfare, and more suitable for achieving a proper allocation or distribution of resources.)

15 Andrei Schleifer, *State versus Private Ownership*, 12 J. ECON. PERSP. 133, 141, 144 (1998) (asserting that generally private ownership of facilities that produce goods and services is preferable to government ownership because private owners have incentives to keep costs down while government officials have incentives to supply monopoly rents); see also Timothy Besley & Maitreesh Ghatak, *Government versus Private Ownership of Public Goods*, 116 Q. J. ECON. 1343 (2001) (concluding that government ownership is appropriate only when a project creates primarily public goods, and the government values those goods more than any other entity, e.g. more than any NGO).
Problems of effecting transfer to highest valuing user are especially apt to arise when there are synergistic benefits from coordinated uses of contiguous property. The increase in wealth may come about because the value of the use of the whole tract of land may exceed the value of the sum of the individual contiguous parcels in current owners’ hands. Wealth can be increased only if highest valuing entity can buy up the entire tract. That entity will face holdout problems that can raise the cost of purchase and perversely even prevent the transfer of the property entirely.\textsuperscript{16} In that case, the land value never increases to reflect these synergistic benefits. Eminent domain power counteracts the ability of the holdout to capture an unfair share of wealth increases from transfer of parcels with synergistic uses. This is the classic economic defense of use of eminent domain to allow the government to take land for its own use.\textsuperscript{17} The thought is that the business of government by democratically accountable officials should not be thwarted by the prospect of holdouts and private strategic behavior.

In addition to the holdout problem, which creates a barrier to the ability of a single entity to purchase multiple land parcels to realize synergistic benefits, a private entity may face significant regulatory risks that threaten its ability to realize these

\textsuperscript{16} STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 124-25 (2004); Patricia Munch, An Economic Analysis of Eminent Domain, 84 J. POL. ECON. 473, 474 (1976) (“consolidation of many contiguous but separately owned parcels of land under one owner supposedly creates a holdout problem, with each seller having an incentive to hold out to be the last to settle and capture any rent accruing to the assembly”); Jonathan Klick & Francesco Parisi, The Disunity of Unanimity, 14 CONST. POL. ECON. 83, 91-92 (2003).

\textsuperscript{17} RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 41-42 (2d ed. 1977); Richard A. Epstein, Holdouts, Externalities, and the Single Owner: One More Salute to Ronald Coase, 36 J.L. & ECON. 553 (1993) (stating that the use of eminent domain is to prevent holdouts); A. Mitchell Polinsky & Steven Shavell, Economic Analysis of Law 4 (Stanford Law & Econ. Olin Working Paper No. 316, 2005), available at http://ssrn.com/abstract=859406 (stating that “[w]hen…the state needs to assemble many contiguous parcels…acquisition by purchase may be stymied by hold-out problems, making the power to take socially advantageous.”)
benefits once it has acquired the property.\textsuperscript{18} Today, the development of multiple-use projects necessarily involves local government to make sure that the private entities provide sufficient infrastructure such as roads, schools, parks, and other government provided goods that the ultimate users of the project will demand. If these are not built, the development will tax the existing infrastructure, and some of the cost of the project will be borne by the current residents and other taxpayers within the local government unit. A private owner can proceed with a project and then negotiate with city planners about the requisite infrastructure it will have to provide. But this creates uncertainty about the ultimate costs and revenues that will flow from the project. In that situation, the owner risks not fully realize the synergistic benefits of aggregation of property and may be dissuaded from investing in aggregating the parcels in the first place. In the extreme, local governments may find it expedient simply to deny approval for a controversial development rather than negotiate and face litigation over conditions it imposes.\textsuperscript{19}

\textbf{C. Accounting for External Benefits}

There may also be beneficial externalities from use of private property.\textsuperscript{20} Certain uses will increase neighboring property values, create job opportunities, etc. These benefits will never be captured by any owner, but the local government is the most likely entity to represent the interests of neighboring property owners and others in the

\textsuperscript{18} See Mark Fenster, \textit{Takings Formalism and Regulatory Formulas: Exactions and the Consequences of Clarity}, 92 CAL. L. REV. 609, 622-23 (2004) (critiquing the uncertainty inherent in the Supreme Court’s imposition of constitutional scrutiny on local government exactions from developers but not the current regime of local government control of development through a flexible bargaining process in which comprehensive land use plans and maps, zoning, subdivision ordinances, variances are all negotiable).
\textsuperscript{19} See \textit{id.}, at 661-62.
community who stand to benefit from a new land development project. This is true because those benefits are reflected as increased property value, business revenue or residents’ income, which in turn increase the tax revenue of the local government. These benefits to local government may in turn encourage the government to offer incentives to land owners (e.g. property tax breaks and direct subsidies) to prospective owners who promise to use land in ways that generate such external benefits. When the external benefits depend on synergies of land use of contiguous parcels that are not currently owned by one entity, a city may need to coordinate the consolidation of property and the resulting uses to maximize the net social wealth. In other words, the government will be able to use its land use regulatory power to structure the transfer to maximize wealth, including the external benefits that the private owner will not be able to realize.

D. An Example of the Potential Benefits of the Kelo Power

For example, consider two contiguous parcels of land, owned by O1 and O2 respectively. The market value of each parcel is $50,000; the value to O1 of his parcel is $100,000 and the value to O2 of his parcel is $100,000. Suppose that the value of the parcels to any one of a multitude of potential buyers is not great individually, but because of synergies in uses of the parcels, the value is $300,000 if a potential buyer can buy the

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22 “[A] situation could arise in which the *private* benefit of the taking is lower than the actual value of the properties to all of the existing owners, but the *social* benefit of the taking is greater than the actual value to the existing owners.” Daniel B. Kelly, *The “Public Use” Requirement in Eminent Domain Law: A Rationale Based on Secret Purchases and Private Influence*, 92 CORNELL L. REV. 1, 42 (2006).
entire tract of two parcels. Efficiency is best served by having the parties negotiate sale of each parcel to the prospective buyer. The price would be between $100,000 and $150,000 per parcel assuming that the transaction costs of implementing the sale and transfer are negligible. But, each of the owners has an incentive to demand $200,000 for his parcel, as that would still allow the transaction to occur, but would allow the owner who gets this price to keep all the surplus created by the transfer. But if each owner asks for $200,000, then the buyer will not pay the price, and the efficient transfer does not occur. In a situation like this, the local government can force the transfer by using its Kelo power.

Suppose now instead that the potential buyers value the entire tract at only $180,000, but that the city gains tax revenues, local businesses increase profits, and the value of neighboring land increases if ownership of the tract is transferred, and the tract is put to its new use. Suppose further that all three increases in social wealth, added together, total $120,000. Then, assuming that the potential owners can not extract this added value from the neighbors, the transfer will not take place voluntarily even though the transfer is efficient. Hence, we would hope that the municipality would obtain the land and transfer it to one of the highest valuing users to secure the increase in social wealth for the community. Again, if the local government runs into a holdout problem, it can use its Kelo power.

II. Abuses of Kelo Power: Robbing from the Poor to Give to the Rich
The Kelo power can be seen as use of government power to transfer wealth from one set of individuals who for the most part have little political influence because they do not generate benefits such as tax revenues for the city, to others who, as potential owners or developers of a large multi-use project, are likely to have more power to influence local officials. Because developers stand to gain substantially from the transfer of property, such developers have an incentive to seek out and even create the opportunities for such projects – that is to rent seek. They can then use some portion of the rents they garner to provide political support for incumbent local officials. Reciprocally, because those whose property is taken do not have significant political clout, officials do not bear the costs of the wealth transfer from these individuals to the officials’ influential supporters. Hence there are no incentives to prevent transfer of land from a higher to lower valuing user.

23 Nicole Stelle Garnett, *The Public-Use Question as a Takings Problem*, 71 GEO. WASH. L. REV. 934, 977 (2003) (“[T]he available evidence strongly suggests that private parties standing to benefit from an exercise of eminent domain frequently exert political pressure on the condemning government.”); see also Saul Levmore, *Just Compensation and Just Politics*, 22 CONN. L. REV. 285, 306-11 (1990) (contending that compensation requirements distinguish between interest groups who are easily organized repeat players in political decisionmaking, and who therefore do not need the protection of judicially imposed just compensation, from the individual who is involved once in a lifetime when his property is taken, and for whom organizing to participate in the political marketplace would be highly inefficient); Saul Levmore, *Takings, Torts, and Special Interests*, 77 VA. L. REV. 1333, 1359-60 (1991) (arguing that government impositions on private owners use of property are compensable as takings when the beneficiaries of the imposition are special interest groups capable of capturing the political process, and those who bear the burden are singled out and unable to compete effectively in the political process).

24 For example, if a developer “can get local government officials to decide that the business he is going to establish on the land is in the ‘public interest’ because it will generate employment in the community and increase the tax base...he negotiates with the local officials, who decide to condemn the land and sell it to him...well below its market value.” Bruce L. Benson, *The Mythology of Holdout as a Justification for Eminent Domain and Public Provision of Roads*, 10 INDEP. REV. 165, 173 (2005).

25 Rent seeking is the “behavior in institutional settings where individual efforts to maximize value generate social waste rather than social surplus.” *Rent Seeking and Profit Seeking*, in *TOWARD A THEORY OF THE RENT-SEEKING SOCIETY* 4 (James M. Buchanan, Robert D. Tollison, & Gordon Tullock eds., 1980).
This can be illustrated using our example above. Just compensation under eminent domain law is market value.\textsuperscript{26} Hence, if the local government uses its Kelo power, it will pay only $100,000 for the tract of land. Suppose the value of the land when aggregated (i.e. including synergistic value) to the highest valuing user other than O1 and O2 is $170,000. Then the city has an incentive to condemn the land and sell it for somewhere between $100,000 and 170,000. But such a transfer of the land would not be efficient or fair. It would decrease the total value of the land from $200,000 to $170,000.\textsuperscript{27} It would also deprive each of the existing owners of $50,000 of the value that they place on the land because they would get only market value for it.

Even if government does not decrease wealth of original land owners, it may give a windfall to the property recipient by allowing the recipient to keep the value created by synergistic benefits.\textsuperscript{28} If the benefits result from synergies in land use alone, rather than to particular capabilities of the entity that ends up owning the entire tract of property, then those benefits result from the government’s ability to facilitate the consolidating transfer of property and should therefore belong to the government entity that exercises eminent domain. Otherwise, the private recipient receives a windfall from the property transfer.

Those distrustful of government might object that the surplus will be better used if placed in the hands of private entities. But, other mechanisms by which government

\textsuperscript{26}“Just compensation includes all elements of value that inhere in the property, but it does not exceed market value fairly determined.” Olson v. United States, 292 U.S. 246, 255 (1934).
\textsuperscript{27} The inefficiency of market value as a measure for just compensation has long been noted. See Richard A. Epstein, Takings: Private Property & the Power of Eminent Domain 183 (1985); Robert C. Ellickson, Alternatives to Zoning: Covenants, Nuisance Rules and Fines as Land Use Controls, 40 U. Chi. L. Rev. 681, 735-37 (1973).
\textsuperscript{28} “While people can view windfalls that befall another with sanguinity, when the windfall arrives as a result of a strategic and deliberate decision of the government, the reaction may turn to resentment and frustration.” Abraham Bell & Gideon Parchomovsky, Givings, 111 Yale L.J. 547, 579 (2001).
might raise revenue, such as taxes, are economically distorting and therefore impose a net loss of social value, while this mechanism actually corrects for economic distortions that result from strategic behavior of land owners. Hence, even those who do not support increasing government’s ability to raise revenue should recognize that the use of the Kelo power is preferable to other revenue generating mechanisms. They might also argue that allowing the private transferee to keep the surplus would create incentives for such entities to identify areas that are currently devoted to uses other than those which maximizes the land’s value. As I explain, below, however, it is unlikely that such incentives are necessary because such opportunities will either be easily identified based on public information, or known to local officials who have an incentive to exploit them on behalf of the local government.

Again, the Kelo power’s ability to move land to its highest valued use even in the presence of externalities can be illustrated with a variant on our previous example. Suppose now that the market value of each parcel is $100,000, and that both O1 and O2 put this value on the parcel each owns. Suppose further, however, that again due to synergistic uses, the value of the entire tract is $300,000. Now the use of Kelo power will not decrease the value of the land; in fact, if the local government transfers the tract to an entity that values it at $300,000, then use of the Kelo power would not be unfair to O1 or O2 as they are indifferent to whether it is used, and it leads to an efficient outcome. But, there is still the question of who gets the $100,000 surplus. Since that is created by the ability of the local government to force consolidation of the parcels, the value should belong to the local government (i.e. go to benefit the residents of the entity exercising the eminent domain power). But Kelo does nothing to ensure that that the local government

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keeps this surplus. In fact, public choice theory would predict that the government will transfer it to some private entity that can best deliver votes at the next election\(^{30}\), or if the officials responsible for exercise of the Kelo power are not elected, to some entity that is likely to provide some benefit like future employment to the officials exercising the power.\(^ {31}\) If we relax the assumption that every entity that can use the tract values it equally, then there is a high probability that local officials will transfer the property (and with it the surplus in value created by consolidation) not to the highest valuing user, but instead to the user who can do the most for the local official (e.g. the quintessential official’s brother-in-law).\(^ {32}\)

Of course, if there is an entity that is a unique highest valuing user, then that entity should get the land, and should be able to keep the part of the surplus that results from its unique ability to maximize the property value. Thus in our running example, suppose that the best use of the land is as a mixed use development that includes homes of various values, stores for the residents of those homes to use, and some heavier commercial uses that provide jobs for many of the residents of the new development. Suppose further that there is one developer \(D_{\text{best}}\) who has created a reputation for itself for the creativity it brings to design of such mixed use development, and because of this

\(^{30}\) See Herbert Hovenkamp, *Legislation, Well-Being, and Public Choice*, 57 U. CHI. L. REV. 63, 106 (1990) (public choice theory suggests that through highly effective lobbying, interest groups purchase the legislation they want); See also Garnett, *supra* note 23, at 977 (noting that “the available evidence strongly suggests that private parties standing to benefit from an exercise of eminent domain frequently exert political pressure on the condemning government.”)

\(^{31}\) Concerns about capture of officials not subject to direct electoral accountability were at the heart of James Landis’s critique of the Administrative State his expertise model of government helped to justify during the New Deal. See Staff of Subcomm. on Admin. Practice and Procedure to the Senate Comm. on the Judiciary, 86th Cong., Report on Regulatory Agencies to the President-Elect (Comm. Print 1960) (written by James Landis) (warning of “the subtle but pervasive methods pursued by regulated industries to influence regulatory agencies by social favors, promises of later employment in the industry itself, and other similar means”).

\(^{32}\) Shleifer, *supra* note 15, at 141 (“Governments throughout the world have long directed benefits to their political supporters, whether in the form of jobs at above-market wages or outright transfers.”)
creativity, it alone can create a development worth $400,000 on the tract. We would
want the local government to use its Kelo power and transfer the land to D\text{best}. But, local
officials may instead want to transfer the land to their brothers-in-law, or more likely
some entity that will support and contribute money to their reelection.\footnote{Garnett, supra note 23, at 977 ("the available evidence strongly suggests that private parties standing to benefit from an exercise of eminent domain frequently exert political pressure on the condemning government"); see also James Geoffrey Durham, \textit{Efficient Just Compensation as a Limit on Eminent Domain}, 69 MINN. L. REV. 1277, 1309 n.187 (1985) (noting the "inefficient takings that result from the weakness of the political check on the use of eminent domain: the corruption, unfairness, or mistakes of elected officials and the electorate’s failure to effectively or fairly review the actions of its representatives.").} The land will
end up worth $300,000, which represents a loss of the $100,000 surplus that would be
created if D\text{best} got the parcel. Hence, government discretion to give the land away after it
is taken often will lead to inefficient land transfers.

Past use of the Kelo power to promote redevelopment has highlighted a third
abuse of the power, albeit one that stems from local officials failing to take care to protect
their own political interests in seeing the project to fruition. In many instances, the
putative recipient of the property, who is expected to build a facility that will provide jobs
that ultimately will drive demand for the use of the property, and perhaps to build other
infrastructure, simply decides not to follow through with its plans. Takings law, being
grounded primarily toward the transfer of land to a government entity, provides no
mechanism to ensure that these putative recipients make good on their implicit promises
once the land is transferred to the private entity.\footnote{See Ilya Somin, \textit{Controlling the Grasping Hand: Economic Development Takings after Kelo}, 15 SUP. CT. ECON. REV. 183, 192-94 (2007).} Knowing this, private entities have an
incentive to overstate the public benefits that their proposed projects will create, thereby
increasing the probability that the local government will transfer land to them, providing
them with a windfall without any concomitant obligation to proceed as planned.35

III. The Need for Kelo Power – Problems with Alternatives to Solving the
Holdout Problem

The fact that the Kelo power can be, maybe is even likely to be, abused, in itself
does not imply the power is not useful, at least in some contexts. Rather, if we use
efficiency as our normative criteria for decisions regarding the use of this power, then
justification for the power will hinge on the costs of using power compared to the costs of
alternatives that might also alleviate the holdout problem.36

A. Secret Purchases of Parcels

One alternative is the creation of fictitious entities to hide the identity of the buyer
and the fact that one entity is trying to buy up an entire set of contiguous parcels.37 This
attempts to solve the holdout problem by denying sellers information that there is
synergistic value they can capture by holding out. Several commentators have posited
that government must operate in the sunshine and cannot hide its identity when it seeks to
consolidate various land parcels.38 Hence, the eminent domain power makes sense for

35 Id. at 194-95.
36 Thomas J. Miceli and Kathleen Segerson, The Paradox of Public Use - The Law and Economics of Kelo v. New London, 14 CONN. ECON. 4 (2005) (explaining that the holdout problem is a justification for using eminent domain assuming that the social benefits of the project exceed the social costs.)
37 Thomas W. Merrill, The Economics of Public Use, 72 CORNELL L. REV. 61, 81 (1986) (noting that “real estate developers and others are frequently able to assemble such parcels by using buying agents, option agreements, straw transactions, and the like.”)
transfers of private property to the public domain. But some of these same commentators contend that private entities, being under no constraint against employing secret agents, can use the mechanism to solve the holdout problem, and therefore do not need eminent domain power to buy the parcels it wishes to consolidate.39

The secret agent as buyer solution works only so long as no one can glean that an entity seeks the entire set of parcels. But even if the buyer hides its identity with respect to each purchase, in order to purchase all the parcels the buyer will eventually have to take the initiative to approach those who have not put their property on the market. This will tip off perceptive observers that someone is really interested in parcels in the area, and eventually will lead to revelation of the plans of the buyer, which in turn will encourage holdouts. Hence, use of fictitious entities will delay the holdout problem and thereby potentially decrease the number of holdouts, but it will not eliminate the problem entirely. Eventually, some current owners are likely to discern the intent of the buyer, even if not perfectly, and will try to capture some of the synergistic value for themselves.

An example in which a private entity successfully purchased many small parcels to aggregate them for a larger project is Disney’s purchase of land for Disney World in

("Unlike private developers of such activities...community planning must take place in the open, and holdouts will be far more problematic."); Merrill, supra note 37, at 82 ([A]lthough buying agents, option agreements and straw transactions may work well for private developers, it is unclear whether government can use these devices effectively. The necessary ingredient of these techniques is secrecy, and governments, at least in an open society like the United States, are not very good at keeping secrets.")

39 Although a government entity may have a harder time keeping a prospective land acquisition hidden than would a private entity, it may also have more power to punish holdouts. For example, if owners in a residential neighborhood slated to be redeveloped to increase tax base refuse to sell, the local government might decide that the land, if not redeveloped, is most suited for industrial use, and rezone the land, thereby imposing the noise, grime, traffic etc. that goes along with an industrial area on the recalcitrant residents. As my colleague, Manuel Utset, remarked when we discussed this punitive power, the notion that local government has such power is captured in the classic joke that a person might suddenly find that his house is on a one-way dead-end street.

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Orlando, Florida.\(^{40}\) In 1964 Disney began the process of purchasing the land through agents without revealing its identity as true purchaser.\(^{41}\) At that time, it paid about $80 per acre.\(^{42}\) By May of 1965, it had purchased about 9,000 acres for $1.5 million (about $165 per acre), and suspicion was aroused that some big company was behind the purchase of the land.\(^{43}\) By June of 1965, Disney had purchased most of the 27,000 acres of land it planned on using, but the price it had to pay for the land had risen. At that time, a newspaper reporter revealed that Disney was the true buyer,\(^{44}\) and the price of land jumped to $80,000 per acre as sellers recognized the value of the land to Disney.\(^{45}\)

All in all, Disney bought 27,443 acres of land for an average price of $185 per acre.\(^{46}\) Although this turned out to be a good deal for Disney, as the creation of Disney World has made the land worth much more than the $5 million Disney paid for it\(^ {47}\), the fact remains that Disney had to pay more than double the initial market value of the property.\(^ {48}\) Moreover, the land Disney bought was essentially swampland,\(^ {49}\) and not an


\(^{43}\) Harris, supra note 42, at 9.


\(^{45}\) Harris, supra note 42, at 10.

\(^{46}\) Id.


\(^{48}\) One might argue that the increased price reflects that later sellers placed a greater subjective value on the land than those who sold early at close to market value. The nature of the land, however, suggests that landowners had no significant subjective value in it. See Wikipedia, the free encyclopedia, *Walt Disney World Resort*, http://en.wikipedia.org/wiki/Walt_Disney_World; See also T.D. Allman, *The Theme-Parking, Megachurching, Franchising, Exurbing, McMansioning of America: How Walt Disney Changed Everything*, available at http://www7.nationalgeographic.com/ngm/0703/feature4/.
inner city neighborhood where a sudden interest even by seemingly different individuals in buying unlisted parcels will quickly signal that the land is being used for some big project. Had the increase in the value of the land been less, and had the signal that a private buyer essentially sought all contiguous property in the area been identified earlier, there is a chance that strategic behavior and the potential for hold outs could have scuttled the Disney project.

Another example often used to show that private entities can overcome hold out problems is Harvard University’s secret purchase of land in the Allston neighborhood in Boston. Harvard used an agent to purchase 52 acres on its behalf for $88 million. In 1997, when Harvard revealed that it had purchased the land, some local residents and politicians complained that Harvard had used dirty tricks by not revealing that it was the buyer of the property. Harvard defended its right not to have to pay a premium to satisfy strategic hold outs who might ask for unreasonable sums for their land knowing that such a rich entity as Harvard had plans to buy property in the area. Given the urban setting for this secretive purchase, one might conclude that this example undermines my point that use of agents is of limited value due to signaling.

In fact, the details of Harvard’s purchase demonstrate that it does not undermine my point, and in fact some of Harvard’s later statements about this purchase support the point. Harvard purchased 14 separate parcels, all but one of which were commercial or

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49 See Wikipedia, the free encyclopedia, supra note 48, (“…the owners were happy to get rid of the land, which was mostly swampland.”).
51 Id.
industrial, as they came on the market over a seven year period. Hence, the signal that the market might have perceived was much weaker than had Harvard needed to buy a larger number of smaller, residential parcels over a shorter period of time and if Harvard had had its agent approach parcel owners who had not put their land up for sale. And even in the context of the secret Allston purchases, savvy real residents in Allston were aware that someone was buying up all the available commercial real estate in the area. They just did not know who or why. Thus, even with the secret purchases, Harvard probably paid some premium on the purchases demanded by strategic sellers.

Most interestingly, Harvard had to defend its purchase later not only to some irate members of the public, but to its own University community. In doing so, it essentially conceded that expansion in Cambridge would have been preferable, but noted: “Since most of the campus in Cambridge is surrounded by residential neighborhoods, and displacement of those neighborhoods was not in the university’s interests or the realm of possibility, it was necessary to look to other places.” Although Harvard never stated what rendered the purchase of sufficient contiguous residential parcels in Cambridge impossible, the difficulty of purchasing the parcels anonymously is certainly a strong possibility.

53 Cassidy & Aucoin, supra note 50; Editorial, A Bum Rap in Boston, BOSTON HERALD, June 12, 1997, at 34.
54 Cassidy & Aucoin, supra note 50.
55 Harvard’s agent reported that owners of some parcels adjacent to parcels it purchased offered to sell their parcels to it, but the agent turned these offers down because the price the owners were asking was too high. Cassidy & Aucoin, supra note 50. The fact that these owners approached the agent, rather than vice versa, and asked a price that the agent considered higher than justified, provides some support for the conclusion that some owners were jacking up property prices strategically.
B. Options and Auctions to Purchase the Parcels

Use of an option is another strategy that can help defeat the holdout problem. If there is more than one suitable parcel, the entity seeking land can purchase options on multiple parcels. That entity can then condition exercise of its option on agreement of purchase price, taking away existing landowner’s incentives to capture wealth by holding out. Options will only work if there is at least one suitable alternative parcel, and even then, the entity seeking land will need to negotiate and pay for the options. Put another way, costs of the options approach include the cost of potentially locating in a less than ideal location and the cost of negotiating and implementing the options.

In addition, the existence of one alternative may not be sufficient to deter strategic behavior entirely. If one parcel-owner at each site decides that it is worth gambling for the huge payoff that may go to a holdout, rather than accepting a price that is only slightly more than the value of the parcel to him, then the purchaser will still have a

57 Coleman Woodbury, *Land Assembly for Housing Developments*, 1 L. & CONTEMP. PROBS. 213 (1934) (asserting that the traditional method of land assembly is to start by securing options.). See also Merrill, supra note 37, at 81 (“…real estate developers and others are frequently able to assemble [large tracts of land] by using buying agents, option agreements, straw transactions, and the like.”); See also Ilya Somin, *Overcoming Poletown: County of Wayne v. Hathcock, Economic Development Takings, and the Future of Public Use*, 2004 MICH. ST. L. REV. 1005, 1027 (2004) (“A second mechanism by which developers can prevent holdout problems without recourse to eminent domain is by means of ‘precommitment’ strategies…”)

58 Woodbury, supra note 57, at 213, 214 (“…this method consists of quietly securing options on as much of the area to be acquired as possible, often in the name of different persons and of dummy corporations…”)

59 Charles E. Cohen, *Eminent Domain after Kelo v. City of New London: An Argument for Banning Economic Development Takings*, 29 HARV. J.L. & PUB. POL’Y 491, 568 (2006) (“One common practice is the use of the so-called ‘precommitment’ contract, whereby a developer signs contracts with all potential sellers in a targeted area, promising to pay each owner the same price. As a negotiating strategy, this allows the developer to argue convincingly that he cannot pay a substantially higher price to a holdout without incurring ruinous expenses in the form of higher payments that would thereby be owed to every other seller. Of course, such a strategy can work only where the purchaser could maintain that the value of the parcels are identical. Also, there is nothing to stop a holdout from refusing to agree to the price, essentially asking the buyer to go back to the other sellers and agree to modify their contracts to allow the sale to happen, which brings the buyer back to free rider problem.”)
holdout problem, only at the option stage. Of course, the purchaser can play each holdout
against the other, but this will signal to each that they have the potential to strike it rich if
they maintain an asking price above the actual value they place on their parcel.\textsuperscript{60}

When there are multiple sites that are almost equally good for its project a likely
buyer can also try to use an auction to prevent holdouts.\textsuperscript{61} An auction at which the buyer
agrees to pay the lowest asking price bid for all the parcels for any one of the alternative
sites, however, is problematic because it encourages sellers to bid strategically, asking a
price above their true value for the property but low enough, in their estimation, not to
cause the buyer to reject the site that includes their parcel.\textsuperscript{62} Economists have shown that
bidders can be induced to reveal their true value by use of a second price auction, in
which a buyer agrees to pay the owners of the alternative with the lowest bid the price
asked by the owners of the alternative with the second lowest bid.\textsuperscript{63} But it is not clear
whether this mechanism will work when the buyer is seeking property that is owned by
several individuals and it is the total of all their bids that is crucial. Assuming that
owners reveal their true values in a second price auction, the price paid for the property in

\textsuperscript{60} Essentially, if there is one potential buyer with holdouts for each of the two alternative sites, the situation
is a monopsonist trying to buy in an oligopoly market. If negotiation is not costless and takes time, and
there is a deadline by which the monopsonist needs to make the purchase, then there is some chance that
the one of the holdouts will capture some rent from acting strategically. A potential purchaser might try to
set up a “voting” mechanism to play parcel owners off against each other to get them to reveal the true
values they place on their parcels (e.g. the price they would ask for their parcels aside from strategic
behavior to try to capture surplus). \textit{See, e.g.,} T. Nicolaus Tideman & Gordon Tullock, \textit{A New and Superior
Process for Making Social Choices,} 84 J. POL. ECON 1145 (1976). But such mechanisms rely on a penalty
that any voter who flips the decision about which land to use pays to those harmed by the flip, and that
penalty mechanism will not work if the parcel owners ultimately get paid according to the value they claim
they derive from the outcome for which they vote (i.e. for the value of the land that they claim). \textit{See id. at
1148, 1149-50.}

auction is a market institution with an explicit set of rules determining resource allocation and prices on the
basis of bids from the market participants.”)

\textsuperscript{62} \textit{Id.} at 726 (“The choice of bids reflects individuals’ strategic attempts to manipulate the selling price, so
that the quantity and price interval reached are not necessarily those of the competitive equilibrium.”).

\textsuperscript{63} Stephen A. Smith and Michael H. Rothkopf, \textit{Simultaneous Bidding with a Fixed Charge if Any Bid is
Successful,} 33 OPERATIONS RES. 28, 30 (1985) (”Second price auctions,” i.e. those in which the highest bid
wins, but the bidder pays the amount of the second highest bid.)
aggregate will by definition of the second price mechanism, be greater than the value of land to the owners. This leaves a question about how the owners of the property will divide the surplus that the buyer offers them altogether, which reintroduces the potential for holdouts.

C. Precommitment Strategies

Private entities might use a precommitment strategy to avoid the holdout problem. If the value of each parcel is the same, the entity desiring to purchase a group of contiguous parcels can condition the purchase of any parcel on the purchase of all, and offer a set price for each parcel. Thus, a holdout knows that he will not get anything above what other parcel owners receive.

There are, however, some significant problems with this strategy. The first problem is that precommitment must be done publicly to work. That is, the purchaser must acknowledge its interest in buying the entire tract. The second problem is that, in the real world, each parcel will not be worth the same value to each owner. Together these factors imply that the purchaser will have to offer a price that will be acceptable to every parcel owner. Even without a holdout problem, to be successful a purchaser will have to price every parcel at the premium that meets the subjective valuation of the most demanding landowner. In essence, precommitment avoids holdouts only by forfeiting a

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64 See Somin, supra note 34, at 208-09; Donald J. Kochan, “Public Use” and the Independent Judiciary: Condemnation in an Interest-Group Perspective, 3 TEX. REV. L. & POL. 49, 88-90 (1998). Kochan contends that because precommitment works in the context of tender offers for corporations, it is a proven mechanism for overcoming holdouts, and Somin merely cites Kochan for support that precommitment can overcome holdout problems in amassing parcels of land. Neither seriously addresses the problems raised for precommitment strategies by the facts that parcels of land are not identical and have subjective value. Nor does Kochan address the fact that a buyer of stock essentially gains control by purchasing a controlling percentage of shares, and the only holdout the buyer needs to worry about is an existing controlling shareholder.
premium to those who do not place significant subjective value on the land. If, in addition to having owners who place different values on the parcels, the parcels are not similar in terms of their inherent traits (e.g. they have different geographical features or locations that objectively would change their value), then the purchaser will have to specify the factors on which it bases its different offers for the various parcels. This may be perceived by a parcel owner as unfair, and sour his willingness to negotiate at all if he finds that these factors do not capture the attributes of the land that he considers valuable. For these reasons, it is not surprising that the literature cites no examples of private entities using precommitment strategies to amass large areas of land from numerous contiguous parcels.

D. Bottom Line on Whether the Kelo Power May Promote Efficient Land Transfers

Analysis of the alternatives to eminent domain manifests that whether Kelo power is an efficient way to transfer land from one set of private owners to another depends on whether it will be abused, as well as empirical questions about the costs of implementing the alternatives compared with the cost of implementing eminent domain plus the costs of abuses of eminent domain. The goal for state legislatures should be first to discourage local governments from using the Kelo power when the resulting property transfer will be inefficient or unfair, and second to provide an efficient mechanism for providing compensation to those whose property is taken even when the resulting transfer is welfare increasing.

65 Berliner, supra note 5 (“Power without any checks inevitably leads to abuse, and eminent domain is certainly no exception.”).
IV. Conditions on Kelo Power to Retain Benefits but Avoid Abuses

If state legislatures are to enable local governments to use the Kelo power to facilitate efficient property transfers without empowering them to abuse the power, they will have to address three issues. First, local governments will have to pay an owner whose property is taken the full value of the property to him – the reserve price at which he would voluntarily sell the property absent strategic behavior. I will refer to this value as the idiosyncratic value of the current parcel owner, recognizing that it will include some objectively determinable value such as the opportunity cost of the owner having to move, and some subjective value such as the owner’s particular attachment to the property. Second, local governments should have to engage in something comparable to an auction when transferring the property to a private entity to ensure that the property goes to the entity that maximizes the net social value of the property. Finally, the procedures for implementing the use of the Kelo power should be sufficiently efficient so that they are cheaper than the transaction costs private entities would incur using alternative means to aggregate the necessary parcels for their projects without use of eminent domain.

A. Recognition of Existing Owners’ Idiosyncratic Value

Currently, the constitutional doctrine of eminent domain provides that owners receive market value as just compensation under the Fifth Amendment for any property
that the government has taken. The value to the individual owners often will exceed the market value. When it does, the local government may have an incentive to transfer property to an owner that puts it to a use that generates a total value that is less than the value to the current owners, which is an inefficient outcome. This can be avoided by changing compensation to provide owners with their idiosyncratic value. Although state legislatures cannot change the just compensation requirement imposed by the Constitution, because market value is a lower bound on idiosyncratic value, these legislatures can demand that local governments pay the greater idiosyncratic value without running afoul of constitutional doctrine.

Idiosyncratic value, however, cannot be determined as easily or perfectly as market value. In the context of determining compensation for takings, every parcel owner has an incentive to claim that the value of the property to her is greater than it really is. But, tort systems frequently deal with issues of subjective value, for example when they award damages for pain and suffering. Such determinations are based on a  

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66 Market value under the takings clause of the fifth amendment is defined by case law as what a willing buyer would pay in cash to a willing seller. United States v. Miller, 317 U.S. 369, 374 (1943).

67 Nathan Burdsal, Just Compensation and the Seller’s Paradox, 20 B.Y.U. J. PUB. L. 79, 84 (2005) (“Empirical evidence supports the contention that the fair market value fails to justly compensate landowners. Specifically, the disparity between the "fair market" value and the jury award or negotiated settlement - presumably based on what a jury or arbitrator believe the fair market value to be -is often very large.”)

68 Others have recognized this problem and also proposed that owners be paid their subjective value for takings that are especially prone to give rise to inefficient property transfers. See James E. Krier & Christopher Serkin, Public Ruses, 2004 MICH. ST. L. REV. 859, 867 (2004) (proposing that “just compensation [be] adjusted upwards in specific ways as the use of condemned property moves from classic public use to possible public reuse to naked transfer”); Merrill, supra note 37, at 74-77 (proposing that parcel owners be compensated at 150% of the market value for land with high subjective value), cf. id. at 84 (advocating that courts scrutinize takings of property with high subjective values, because inadequacy of compensation will give signals to condemnors that might lead them to move property to a lower valued use). Nicole Garnett has argued that owners already are compensated at above market value to provide them with some of their idiosyncratic value, but that for takings that transfer land to private entities, compensation is still insufficient to cover “non-instrumental harms.” Nicole Stelle Garnett, The Neglected Political Economy of Eminent Domain, 105 MICH. L. REV. 101, 121-26, 133-34, 148 (2006).

69 John Fee, Eminent Domain and the Sanctity of Home, 81 NOTRE DAME L. REV. 783, 812-13 (2006) (“The two most serious problems with awarding compensation according to an owner's subjective value have to do with unreasonable and unverified subjective values.”)
decision-maker determining the factors that bear on injuries that are unique to the plaintiff, and then deciding how much money they think would compensate for those injuries. In essence, the subjective value determination is reduced to an objective determination of a reasonable value attributable to one in the plaintiff’s position. The same technique can be used to determine subjective value of property.70

The Supreme Court has held that a person whose property is condemned does not have a federal constitutional right to a jury trial to determine just compensation,71 but many states provide such a right by statute or state constitution.72 Nonetheless, juries may not be the best mechanism for determining subjective value. Depending on who is actually on a particular jury, the determination of reasonable value will vary greatly from case to case.73 This impedes the local government from accurately estimating how much it will have to pay for property taken under the Kelo power, essentially imposing risk which can unduly discourage use of the power. In addition, doctors and medical insurers claim that jury awards of subjective value, or at least pain and suffering, tend to be inflated.74 If compensation is greater than actual value to a parcel owner whose property was taken, the owner receives a windfall. Moreover, such excessive compensation awards will discourage efficient uses of the Kelo power, as the government will decline

70 Laura H. Burney, Just Compensation and the Condemnation of Future Interests: Empirical Evidence on the Failure of Fair Market Value, 1989 BYU L. REV. 789, 799 (1989) (noting that “if juries are permitted to decide questions as nebulous as mental anguish and pain and suffering, they should be allowed to determine a ‘fair’ condemnation award.”)
71 See United States v. Reynolds, 397 U.S. 14, 18 (1970) (“no constitutional right to a jury in eminent domain proceedings); see also FED. R. CIV. P. 71.1 (in eminent domain under federal law, when a party has requested a jury to determine just compensation, a court may instead appoint a commission to determine just compensation “because of the character, location, or quantity of the property to be condemned or for other just reasons”).
72 See, e.g., MICH. COMP. LAWS § 213.54 (2007); CAL. CONST. art I, § 19; ILL. CONST. art I, § 15.
73 Thus, the main scholarly critique of jury awards of subjective harms, such as pain and suffering, appears to be that the awards are arbitrary. See Mark A. Geistfeld, Due Process and the Determination of Pain and Suffering Tort Damages, 55 DEPAUL L. REV. 331, 338 (2006).
to transfer land to users who value it more highly than the actual value to current owners but less than the compensation the government would have to pay. Finally, jury trials are notoriously time and labor intensive means of finding facts of any kind. Because the evidence that will bear on idiosyncratic value is, almost by definition, unique to each parcel owner, the trial process easily could get mired in technical evidentiary issues that in turn can encourage appeals, which would seriously delay the compensation determination.\(^7^5\) In short, if compensation were to include idiosyncratic value, the jury process might compromise efficient Kelo takings by sufficiently adding administrative and risk costs or perhaps even inflating just compensation awards beyond the actual harm to the property owner such that the alternative mechanisms for aggregating parcels of property would be less costly.

Therefore, when the right to a jury trial is provided by statute, the state legislature should override that provision and create a special state-wide board to determine idiosyncratic value for Kelo takings. Boards can use less formal fact-finding procedures than jury trials, and can develop expertise in evaluating the kinds of evidence parcel owners are likely to present of idiosyncratic value. Such evidence can be put in various categories about which the board can develop expertise. For example, opportunity cost of having to move and subjective attachment to the property would seem to include most of the types of evidence that parcel owners might claim contribute to idiosyncratic value above market value.\(^7^6\)

\(^7^5\) Over time, as the board creates precedents for idiosyncratic value determinations, the process may be sufficiently efficient that it might even cost less than jury trials to determine market value and hence might lower the present administrative costs of just compensation.

\(^7^6\) Nicolle Garnett summarizes the components of subjective value that would not be compensated by market value. In addition to objective idiosyncratic and psychological value, she includes a premium due to the endowment effect and dignitary harms from the fear that the government will force them from their
Opportunity cost issue boils down to determining the cost of obtaining other land that is at least as good, from the perspective of the initial landowner. For example, the parcel owner might be a resident who offers evidence that she has a job in the local area and little ability to obtain a job paying a similar amount elsewhere. Idiosyncratic value would then include the lesser of the cost of obtaining other adequate housing in the local area or the lost wages from having to take another job. Subjective attachment would cover any unique psychological attachment to the land. For example, if a land owner’s family owned a house that was confiscated for four generations, and the owner had lived there for 70 years, one could reasonably conclude that the owner would have more attachment than if the owner was a landlord who rented to tenants who generally moved in and out every year or two. Because of the types of evidence parcel owners might present would tend to be of the same type, over time, a board could develop expertise and a set of precedents that would render the idiosyncratic value determinations both more transparent (and therefore accountable) and more predictable.

Legislators may not be able to eliminate the right to jury determination of just compensation where that right is provided by the state constitution. In addition, even if the legislature can eliminate the role of the jury by statute, legislators may be concerned that property owners will feel slighted in the Kelo context if they are deprived of this right. It would be perverse if legislation meant to protect property owners from abuses of eminent domain power was perceived as depriving the owners of the right to get their valuation claims heard by a jury. One way out of this conundrum would be for the legislature to offer a parcel owner whose land is taken under the Kelo power the

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See Garnett, supra note 68, at 107-10. Both of these can be taken into account by decisionmakers setting subjective value of the taken property.
alternative of getting idiosyncratic value rather than market value for his property if he is willing to waive his right to a jury determination. Because market value is necessarily lower than idiosyncratic value, many parcel owners would have an incentive to accept this alternative. Most significantly, those who believe that their idiosyncratic value is significantly greater than market value would be most apt to accept the alternative, and for the others, use of market value will be sufficiently close to their actual value that we need not worry about the inefficiencies and unfairness caused by use of market value.

One further objection to my proposal for just compensation is that it would deprive owners of the value that they could have derived from a private sale of the property. Usually, when a person sells property, the seller and buyer divide any surplus from the transfer of ownership as part of their agreement.\textsuperscript{77} That is what makes a private sale a wealth increasing transaction. My position is predicated on the assumption that neither the original nor the ultimate private owner of property that is taken by use of the Kelo power is entitled to surplus from the transfer that does not derive from their unique abilities to put the property to a highest valuing use. In essence, if the transfer is wealth increasing but would not come about by private transactions because of strategic behavior or other transaction costs that only use of eminent domain can overcome, the government as enabler of the transfer deserves the surplus. The original owner cannot have a

\textsuperscript{77} See Lee Anne Fennell, Taking Eminent Domain Apart, 2004 Mich. St. L. Rev. 957, 965-66 (2004). Two scholars recently proposed giving original parcel owners a choice between fair market value and a share in the project for which their land is taken as a way of giving the initial owners their expectation in the surplus that might be derived from sale. Amnon Lehavi & Amir N. Licht, Eminent Domain, Inc. 107 Colum. L. Rev. (forthcoming 2007) (manuscript at 28 -29). I question whether initial owners are entitled to that expectation in the context where use of the Kelo power is warranted and therefore they could not otherwise have obtained any of the value that results from aggregation of parcels. I would also note that, even if I did think that initial owners were entitled to that expectation, at least in the residential setting (which is the most troublesome setting), I doubt that many landowners would choose Lehavi and Licht’s option to invest in the project rather than taking a certain sum that they could use to purchase a replacement for their residence.
reasonable expectation in getting the value that results from aggregation of his parcel with others if that aggregation cannot occur but for use of eminent domain. Moreover, if local government action is necessary for a wealth maximizing transfer, we want to give the government an incentive to take that action.

B. “Auctioning” Kelo Property

The second problem with the Kelo power as it can currently be implemented is the ability of government to transfer land to political supporters or other friends. This both encourages rent seeking and forfeits the synergistic values that the government creates by use of the eminent domain power. In order to retain this value, the government needs to harness the incentives of other potential recipients of the property. In other words, the local government should essentially be required to auction the condemned land to the highest bidder, thereby capturing any value from the conglomeration of the individual parcels that is not unique to the ultimate recipient for itself.

One might counter that the payoff to private entities who obtain property after a local government exercises its Kelo power provides a needed incentive to private entities to identify potential sites for projects that can result in wealth maximizing property aggregation. The argument is analogous to that in corporate law regarding whether the

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78 For this reason, several scholars have invoked public choice theory and political realism to argue that use of the Kelo Power cannot be constrained adequately by the political process even with more transparent procedures. See Somin, supra note 34, at 210-13 (using a public choice analysis); Garnett, supra note 68, at 114-17 (noting, in the context of discussing use of eminent domain to build Chicago’s expressways, the realities that political power depends on attachment to cohesive communities and other connections). These scholars, however, ignore the potential of harnessing other private entities with significant interests in the property to highlight uncertainties and inefficiencies of a proposed use of the Kelo power.
law should encourage auctions following tender offers. In the context of Kelo takings, however, entrepreneurial companies are not as likely to have the capability to identify opportunities to create synergistic property value as corporate raiders are to have the ability to identify opportunities for creating value by taking over other corporations and replacing their managers. The information about land values and land uses is much more public than information about corporate operations. Hence, the opportunities for creating such value will often be recognized by many people, and there will be less need and less return from engaging in identifying such opportunities. If there is a situation involving non-public information about the potential uses of contiguous land parcels, that information will most likely be known to local government officials, who may know and control plans for changing land uses around the parcels. Local government officials thus are analogous to the original managers of the corporation: they have much of the information which is needed to determine whether a change in control of the property would be wealth maximizing, and essentially they can do much to prevent any aggregation going forward, both by declining to exercise the Kelo power and by zoning of the affected property. Unlike the corporate context, however, local officials do not lose their jobs if the transfer occurs. In fact, they have incentives to facilitate wealth increasing transfers to increase revenues to the city either from increased taxable property values or from direct payments from Kelo property recipients. Hence, unlike in the

79See Daniel Fischel & Frank Easterbrook, The Proper Role of a Target’s Management in Responding to a Tender Offer, 94 HARV. L. REV. 1161, 1178 (1981) (arguing against auctions for corporate takeovers because they transfer surplus from initial offerers to target shareholders, thereby eliminating incentives for offerers to identify underpriced corporations); Alan Schwartz, Search Theory and the Tender Offer Auction, 2 J. L. ECON. & ORG. 229, 237 (1986) (auctions in the corporate takeover market decrease the search for undervalued corporations).
corporate takeover context, local officials have the means and incentive to identify sites for which property aggregation will lead to wealth increases.\(^{80}\)

A more significant problem for constraining abuses of the wealth transfer in the Kelo context is the actual mechanism by which an appropriate auction can be conducted. In most cases, justification of a project depends on external benefits that accrue to the local population and the local governmental entity. Hence, the value of the project to the putative bidder, the potential property transferee, will not reflect the entire social value of the project. Hence, a straightforward auction will not work because the use that maximizes value to the bidder may not maximize the net social value of the tract, or even the value that the local government derives from exercising the Kelo power.\(^{81}\)

Whatever process a local entity is required to use to exercise the Kelo power, like an auction, it should be structured to strip away all value that does not derive from unique attributes of the subsequent owner, leaving the synergistic value of aggregation to be captured by the local government. Essentially, the process should incorporate competition between private bidders for a Kelo project. Perhaps the best process to promote competition from private bidders would require a local government to announce proposed projects in advance, and to allow any interested person (including other potential users of the land) to file comments supporting, opposing or suggesting

\(^{80}\) Local government officials, however, do have an incentive to transfer the surplus from the land transfer to those who will best serve the officials personal interest. In this sense, while we can expect officials to look for opportunities for such land transfer, we cannot trust them to maximize the benefit to the public they serve. In such situations, local officials are analogous to “unfaithful” corporate managers, and auctions are appropriate means of reducing the agency costs between such managers and the body to which they owe a duty of loyalty. See Peter Cramton & Alan Schwartz, Using Auction Theory to Inform Takeover Regulation, 7 J. L. ECON. & ORG. 27, 36 (1991).

\(^{81}\) Lehavi and Licht, like I, also envision an auction conducted by a “special purpose development corporation” to whom the local government would transfer the land after it is condemned. See Lehavi and Licht, supra note 77 (manuscript at 29). Lehavi and Licht, however, envision an actual auction, which as I explain is problematic because the value of the property after transfer may be comprised significantly in external benefits from the new use, and a private entity will not be willing to include these benefits in its bids.
alternatives to the project. This will permit competitors to the initially identified recipient to propose their own projects and to submit evidence that their projects will provide more benefit to the local community than the project initially proposed. The process should mandate that the local government justify the project it chooses as the one that maximizes the value to the citizens of the municipality. By analogy to notice and comment rulemaking, the process should mandate either judicial or administrative review of the agency reasons for its choice, that defers to the ultimate facts found and evaluations made by the local government, but demands a connection of those facts to the record and a thorough explanation of how the local government reached its decision.82

The requirement that local government justify its decision as maximizing values to its citizens would also alleviate the problem that, in many cases, the private entity for whom the land is taken never follows through with development of the land. Consideration of whether a planned project will provide the requisite public benefits necessarily takes into account the probability that those benefits do not materialize. A public process in which several entities compete for the land will give each an incentive to monitor the reliability of the others’ assertions about public benefits that will accrue from their proposals. Moreover, a private entity that truly believes it will provide public benefits can guaranty such benefits, perhaps in the form of a surety bond that agrees to pay the local government if a property recipient fails to deliver on its promises.

Conclusion

82 As I have written elsewhere, the process of review of agency reasoning provides salutary benefits of ferreting out agency dishonesty and inducing care in the agency decision-making process. See generally Mark Seidenfeld, Cognitive Loafing, Social Conformity, and Judicial Review of Agency Rulemaking, 87 CORNELL L. REV. 486 (2002).
The Kelo case generated an enormous public outcry about the potential impact of local government use of eminent domain because, in that case, the City of New London seemed to rob from the poor residents whose property was taken to give to the rich and well connected Pfizer company. Many hoped that the Supreme Court would play the role of Robin Hood and stop the abuses by modern day Sheriffs of Nottingham – local governments seeking to increase their tax base. But the Court reaffirmed that taking of property to transfer it from one set of private entities to another is not constitutionally improper, and thereby left it to state legislatures to be Robin Hood in the modern analog to the classic tale.

I have suggested that the best way for legislatures to play this role is to pass statutes entitling landowners to receive their idiosyncratic value as compensation for their property that is taken for redevelopment, and requiring governments to employ a process that invites competing bids for the land at issue, subject to judicial review forcing the government to justify its ultimate decision to take the property and transfer it to its new private owner. The problems of determining idiosyncratic value are not so great that a state-wide board could not develop expertise and develop a list of factors making the determination both rational and predictable. In addition, competition for use of land that a local government condemns with the intent to transfer it to a private entity, can constrain the use of eminent domain so that the benefit of aggregating parcels of land to allow a more valuable use flows to the jurisdiction that exercises the eminent domain power, rather than to those who are simply politically powerful and well connected.