

**IN SEARCH OF ROBIN HOOD: SUGGESTED LEGISLATIVE
RESPONSES TO *KELO***

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I. INTRODUCTION

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, "nor shall private property be taken for public use, without just compensation[,]"²

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1. *Kelo v. City of New London*, 545 U.S. 469 (2005).
2. U.S. CONST. amend. V.

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 is to increase their tax bases by revitalizing run down neighborhoods that provide homes mainly to the less well-to-do. The perception is further solidified because often the recipient of the land is a large impersonal entity, usually a corporation, which 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.⁵ 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 emi-

3. *Kelo*, 545 U.S. at 477. *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. *Id.* at 489-90. 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.

5. *See* DANA BERLINER, INSTITUTE FOR JUSTICE, PUBLIC POWER, PRIVATE GAIN: A FIVE-YEAR, STATE-BY-STATE REPORT EXAMINING THE ABUSE OF EMINENT DOMAIN (2003), available at http://www.castlecoalition.org/pdf/report/ED_report.pdf (listing new state legislation); *see also* The Castle Coalition, <http://www.castlecoalition.org> (last visited Feb. 16, 2008) (reporting grassroots movement of eminent domain abuse).

ment domain power to transfer property from one private entity to another.⁶ 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.⁷ 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.⁸ Thus, when state-level politics limits the power of state and local governments to use takings to transfer private ownership, those limits are not only consistent with, but are actually envisioned by the *Kelo* decision.⁹ 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.¹⁰ 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. However, it concludes that concerns should not focus per se on 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.

6. *Kelo*, 545 U.S. at 472.

7. *Id.* at 479-80. 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.” *Id.* at 477.

8. *See id.* at 478.

9. *Id.* at 489 (“We emphasize that nothing in our opinion precludes any State from placing further restrictions on its exercise of the takings power.”).

10. This article thus assumes that there is interest at least in some states for reforming *Kelo* power use. 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. *See* Ilya Somin, *The Limits of Backlash: Assessing the Political Response to Kelo* 14-15 (Geo. Mason L. & Econ. Research Paper Series, Working Paper No. 07-14, 2007), available at http://www.law.gmu.edu/assets/files/publications/working_papers/07-14.pdf. 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. *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.

In Part II 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 III, I describe potential *Kelo* power abuses. In Part IV, I discuss mechanisms that other scholars have suggested obviate the need for the *Kelo* power, and explain why a need for that power still remains. In Part V, 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. This section also explains how these legal changes 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, as well as incentives of potential private recipients of the property, to solve problems that these commentators have concluded are insurmountable.

II. POTENTIAL BENEFITS FROM USE OF *KELO* POWER

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

Generally we trust private mechanisms—in particular voluntary agreements for purchase and sale of land—to ensure that land goes to the highest valuing user.¹¹ When there are transaction costs that prevent transfer to the highest valuing user using such mechanisms,¹² 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 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

11. See Gary D. Libecap & Nat'l Bureau of Econ. Research, *Contracting for Property Rights* 15 (U. of Ariz. Dep't of Econ. Working Paper No. 00-07, 2000), available at http://economics.eller.arizona.edu/downloads/working_papers/anderson3s.pdf (“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.”).

12. R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960) (explaining that in the absence of transaction costs, parties will transfer property rights to maximize wealth, but that transaction costs can interfere with such transfers).

that they claim invalidates the *Kelo* holding.¹³ But use is not automatically public when run by the state.¹⁴

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 competitive marketplace that induces private entities to meet consumer demand at the lowest cost.¹⁵ In addition, government does not have any particular expertise in running hospitals or, for that matter, most of the other projects that

13. See *Kelo v. City of New London, Conn.*, 545 U.S. 469, 494-523 (dissenting opinions); cf. 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, 495-500 (2006) (agreeing with the dissent in *Kelo* that the *Kelo* holding effectively removed the phrase "for public use" from the Takings Clause, but recognizing that the holding was in line with precedent, thus proposing a ban on takings for development by way of state legislation or constitutional amendment).

14. For example, local governments often provide essentially private goods that generate external benefits, such as primary education, public transportation and garbage collection. See Amnon Lehari, *Property Rights and Local Public Goods: Toward a Better Future for Urban Communities*, 36 URB. L. 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 (Curt Peoples, Jeanne Heise & Amy Ullrich, eds., 1981) (noting that 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, e.g., Mark Gradstein, *Rent Seeking and the Provision of Public Goods*, 103 ECON. J. 1236, n.1 (1993) ("[P]ublic goods . . . are characterised by the absence of rivalry in consumption."); Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387, 387 (1954) ("[E]ach 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.

15. See, e.g., MATTHEW MITCHELL, RIO GRANDE FOUND., *THE PROS OF PRIVATELY-HOUSED CONS: NEW EVIDENCE ON THE COST SAVINGS OF PRIVATE PRISONS* (2003), http://www.correctionscorp.com/overview/prison_study_march18.pdf (comparing efficiency of private-run versus government-run prisons). See generally Timothy K. Barnekov & Jeffrey A. Raffel, *Public Management of Privatization*, 14 PUB. PRODUCTIVITY & MGMT. REV. 135 (1990) (sorting through the debates for and against privatization of services and offering suggestions on when privatization may be a viable option).

have been promoted by use of the *Kelo* power.

Government may be best at envisioning highest value uses and coordinating transfers, but it is unlikely to be best at actually managing the property use once the transfer is accomplished.¹⁶ 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,¹⁷ and even if it is, the need to separate ownership from management by government will create agency costs.

B. Overcoming Holdout Problems

Problems of effecting transfer to the 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 the 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.¹⁸ 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 trans-

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

17. See Andrei Shleifer, *State Versus Private Ownership*, 12 J. ECON. PERSP. 133, 141, 144 (1998) (asserting that 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, 1343-44 (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 nongovernmental organization (NGO)).

18. See STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 124-25 (2004); see also 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).

fer 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.¹⁹ 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 benefits once it has acquired the property.²⁰ 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 project costs 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. However, this creates uncertainty about the ultimate costs and revenues that will flow from the project. In that situation, the owners' risks will not fully realize the synergistic benefits of aggregation of property and may be dissuaded from investing in the aggregation of 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.²¹

C. Accounting for External Benefits

There may also be beneficial externalities from use of private

19. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 40-42 (2d ed. 1977); Richard A. Epstein, *Holdouts, Externalities, and the Single Owner: One More Salute to Ronald Coase*, 36 J.L. & ECON. 553, 557 (1993) (stating generally that the use of eminent domain is to prevent holdouts); A. Mitchell Polinsky & Steven Shavell, *Economic Analysis of Law* 4 (Stanford L. & Econ. Olin, Working Paper No. 316, 2005), available at <http://ssrn.com/abstract=859406> ("When . . . the state needs to assemble many contiguous parcels . . . acquisition by purchase might be stymied by hold-out problems, making the power to take socially advantageous.").

20. See Mark Fenster, *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, maps, zoning, subdivision ordinances, and variances are all negotiable).

21. See *id.* at 661-62.

property.²² 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 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.²³ These benefits to local government may in turn encourage the government to offer incentives to land owners (such as property tax breaks and direct subsidies) 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.²⁴ In other words, the government will be able to utilize its land use regulatory power to structure the transfer to maximize wealth, including the external benefits that the private owner otherwise would not be able to realize.

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

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 entire tract of two parcels. Efficiency is best served by having the parties negotiate the sale of each parcel to the prospective buyer. The price would fall between \$100,000 and \$150,000 per parcel, assuming that the transaction costs of imple-

22. See generally PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, *ECONOMICS* 32, 751 (15th ed. 1995) (discussing externalities generally).

23. See Elizabeth F. Gallagher, *Breaking New Ground: Using Eminent Domain for Economic Development*, 73 *FORDHAM L. REV.* 1837, 1854 (2005); see also Matthew L. Cypher & Fred A. Forgey, *Eminent Domain: An Evaluation Based on Criteria Relating to Equity, Effectiveness, and Efficiency*, 39 *URB. AFF. REV.* 254, 263 (2003) ("One of the arguments made in favor of using eminent domain for the redevelopment of an area is that unproductive land would be put to its highest and best use, which would ultimately result in an increased property tax base.").

24. "[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).

menting the sale and transfer are negligible. However, 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 give the owner who gets this price to keep all the surplus created by the transfer. If each owner asks for \$200,000, though, 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 instead that the potential buyer values 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 put to its new use. Suppose further that all three increases in social wealth, added together, total \$120,000. Assuming that the potential owners cannot 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.

III. 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.²⁵ 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

25. See 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 do not need the protection of judicially-imposed just compensation, and 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, 1358-60 (1991) (arguing that government impositions on private owner’s 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).

such projects²⁶—that is to rent seek.²⁷ 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.

This can be illustrated using the example above. Just compensation under eminent domain law is market value.²⁸ 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 (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 land would not be efficient or fair. It would decrease the total value of the land from \$200,000 to \$170,000.²⁹ It would also deprive each of the existing owners of \$50,000 of the value that they place on the land because they would only receive market value.

Even if condemnation with just compensation does not decrease the wealth of original land owners, it may provide undeserved benefit to the property recipient by allowing the recipient to keep the value created by synergistic benefits.³⁰ If the benefits result from synergies in land use alone, rather than from particular capabilities of the entity that ends up owning the entire tract of

26. 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 . . . [h]e 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).

27. Rent seeking is the "behavior in institutional settings where individual efforts to maximize value generate social waste rather than social surplus." James M. Buchanan, *Rent Seeking and Profit Seeking*, in TOWARD A THEORY OF THE RENT-SEEKING SOCIETY 3, 4 (James M. Buchanan, Robert D. Tollison & Gordon Tullock eds., 1980).

28. "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).

29. The inefficiency of market value as a measure for just compensation has long been noted. See RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* 183 (1985); see also Robert C. Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Use Controls*, 40 U. CHI. L. REV. 681, 735-37 (1973).

30. Abraham Bell & Gideon Parchomovsky, *Givings*, 111 YALE L.J. 547, 579 (2001) ("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.").

property, then those benefits result from the government's ability to facilitate the consolidating transfer of property. Therefore the benefits should belong to the government entity that exercises eminent domain. Otherwise, the private recipient receives a windfall from the property transfer.³¹

Those distrustful of government might object, stating that the surplus would be better used if placed in the hands of private entities. However, other mechanisms by which government might raise revenue, such as taxes, are economically distorting and therefore impose a net loss of social value,³² while this mechanism actually corrects 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 to collect the value of property aggregation is preferable to other revenue generating mechanisms. They might also argue that allowing the private transferee to keep the surplus would create incentives for private entities to identify areas that are currently devoted to uses other than maximization of the land 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 local government.

The *Kelo* power's ability to move land to its highest valued use, even in the presence of externalities, can best 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 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, the use of the *Kelo* power would not be unfair to O1 or O2, as they will each receive their value for the land and, and the taking leads to an efficient outcome. But, there is still the question of who gets the \$100,000 surplus. Since the surplus 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 for agency costs that local residents incur to control local officials, granting the surplus to the local government

31. *Id.*

32. See Martin Feldstein, *The Welfare Cost of Capital Income Taxation*, 86 J. POL. ECON. S29 (1978).

would encourage efficient consolidation. But, because there are such agency costs, *Kelo* does nothing to ensure that the local government keeps this surplus. In fact, public choice theory would predict that local government officials will transfer it to some private entity that can best deliver votes at the next election³³ or, if the officials responsible for exercise of the *Kelo* power are not elected, to some entity that is likely to provide a benefit to them such as future employment.³⁴ 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).³⁵

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 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, 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_{best} , who has a reputation for creativity in design of such mixed-use developments and, because of this creativity, can create a development worth \$400,000 on the tract. We would want the local government to use its *Kelo* power to transfer the land to D_{best} . But local officials may instead want to transfer the land to a proverbial brother-in-law, or more likely, to some entity that will support and contribute money to their reelection.³⁶ The land will end up worth \$300,000, representing a loss of

33. See Herbert Hovenkamp, *Legislation, Well-Being, and Public Choice*, 57 U. CHI. L. REV. 63, 106 (1990) ("Public choice theory suggests that . . . [t]hrough highly effective lobbying, [interest] groups purchase the legislation they want . . ."); see also Garnett, *supra* note 25, at 977 and accompanying quote.

34. Concerns about capture of officials not subject to direct electoral accountability were at the heart of James Landis's critique of the administrative state during the latter part of his career. See JAMES M. LANDIS, REPORT ON REGULATORY AGENCIES TO THE PRESIDENT-ELECT (1960), available at http://www.sechistorical.org/collection/papers/1960/1960_1221_Landis_report.pdf (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").

35. See Shleifer, *supra* note 17, 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.")

36. See Garnett, *supra* note 25, at 977; see also James Geoffrey Durham, *Efficient Just Compensation as a Limit on Eminent Domain*, 69 MINN. L. REV. 1277, 1309-10 n.187 (1985) ("[I]nefficient takings . . . result from the weakness of the political check on the use of eminent domain: the corruption, unfairness, or mistakes of elected officials and the elec-

the \$100,000 surplus that would be created if D_{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 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 the plans. Takings law, which is geared 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.³⁷ Knowing this, private entities have an incentive to overstate the public benefits that their proposed projects will create, increasing the probability that the local government will transfer land to them, and providing a windfall to these entities without any concomitant obligation to proceed as planned.³⁸

IV. THE NEED FOR *KELO* POWER — PROBLEMS WITH ALTERNATIVES TO SOLVING THE HOLDOUT PROBLEM

The fact that the *Kelo* power can be, and maybe is even likely to be abused in itself does not imply that the power is not beneficial in some contexts. Rather, if we use efficiency as our normative criteria for decisions regarding the use of this power, then justification will hinge on the costs of using the power compared to the costs of alternatives that might also alleviate the holdout problem.³⁹

A. *Secret Purchases of Parcels*

One alternative is the creation of fictitious entities to hide both the identity of the buyer and the fact that one entity is trying to

torate's failure to effectively or fairly review the actions of its representatives.”).

37. See Ilya Somin, *Controlling the Grasping Hand: Economic Development Takings after Kelo*, 15 SUP. CT. ECON. REV. 183, 192-96 (2007), available at http://ssrn.com/abstract_id=874865.

38. *Id.*

39. See Thomas J. Miceli & Kathleen Segerson, *The Paradox of Public Use: The Law and Economics of Kelo v. New London*, 14 CONN. ECON. 4, 4-6 (2006) (explaining that the holdout problem is a justification for using eminent domain, assuming that the social benefits of the project exceed the social costs).

buy up an entire set of contiguous parcels.⁴⁰ Secret purchase of the parcels 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.⁴¹ Hence, the eminent domain power makes sense for 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 they wish to consolidate.⁴²

The secret-agent-as-buyer solution works only so long as no one can glean that an entity seeks the entire set of parcels. 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 reveal 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 buyer's intent, 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

40. Thomas W. Merrill, *The Economics of Public Use*, 72 CORNELL L. REV. 61, 81 (1986) ("[R]eal estate developers and others are frequently able to assemble such parcels by using buying agents, option agreements, straw transactions, and the like.")

41. See, e.g., Kelly, *supra* note 24, at 19-22; William A. Fischel, *The Political Economy of Public Use in Poletown: How Federal Grants Encourage Excessive Use of Eminent Domain*, 2004 MICH. ST. L. REV. 929, 950 (2004) ("Unlike private developers of such activities . . . community planning must take place in the open, and holdouts will be far more problematic."). As Thomas Merrill stated,

[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.

Merrill, *supra* note 40, at 82.

42. 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 that is slated to be redeveloped to increase the 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.

many small parcels to aggregate them for a larger project is Disney's purchase of land for Disney World in Orlando, Florida.⁴³ In 1964 Disney began the process of purchasing the land through agents without revealing its identity as the true purchaser.⁴⁴ At that time, it paid about \$80 per acre.⁴⁵ 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.⁴⁶ 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 her suspicion that Disney was the true buyer,⁴⁷ and the price of land jumped to \$80,000 per acre as sellers recognized the value of the land to Disney.⁴⁸

All in all, Disney bought 27,443 acres of land for an average price of \$185 per acre.⁴⁹ 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,⁵⁰ the fact remains that Disney had to pay more than double the initial market value of the property.⁵¹ Moreover, the land Disney bought was essentially swampland,⁵² and not an 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

43. Mark Andrews, *Disney Assembled Cast of Buyers to Amass Land Stage for Kingdom*, ORLANDO SENTINEL, May 30, 1993, at K2.

44. See T. D. Allman, *The Theme-Parking, Megachurching, Franchising, Exurbing, McMansioning of America: How Walt Disney Changed Everything*, NATIONAL GEOGRAPHIC, March 2007, available at <http://ngm.nationalgeographic.com/ngm/0703/feature4/>; see also Wade Sampson, *Emily Bavar Spills the Beans*, MOUSE PLANET, Oct. 4, 2006, <http://www.mouseplanet.com/articles.php?art=ww061004ws> ("Beginning in 1964, Disney through a variety of dummy corporations quietly began buying large tracts of land, sparking speculation about the identity of the mystery buyer.").

45. J. Dave Harris, *Toward Improved Visualization of Unstructured Information*, Mar. 4, 2005, http://www7.nationalacademies.org/bms/Dave_Harris.ppt; Orlando Vacation Guide: Walt Disney World, http://www.o-towninfo.com/Attractions/Full_Day_Parks/Walt_Disney_World/walt_disney_world.html (last visited Feb. 16, 2008).

46. Harris, *supra* note 45.

47. Emily Bavar, *Is Our "Mystery" Industry Disney?*, Oct. 21, 1965, in Wade Sampson, *Emily Bavar Spills the Beans*, MOUSE PLANET, Oct. 4, 2006, <http://www.mouseplanet.com/articles.php?art=ww061004ws>.

48. Harris, *supra* note 45.

49. *Id.*

50. See A History of the Walt Disney World Resort, <http://www.disneyworldtrivia.com/trivia/wdwhistory.php> (last visited Mar. 10, 2008).

51. 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 Allman, *supra* note 44.

52. *Id.*

sought all contiguous property in the area been identified earlier, there is a chance that strategic behavior and the potential for holdouts 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 fifty-two acres on its behalf for \$88 million.⁵³ 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.⁵⁴ Harvard defended its right against paying a premium to strategic holdouts who might ask for unreasonable sums for their land knowing that a rich entity like Harvard had plans to buy property in the area.⁵⁵ 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 fourteen separate parcels, all but one of which were commercial or industrial, as they came on the market over a seven-year period.⁵⁶ Hence, the signal that the market might have perceived was much weaker than had Harvard needed to buy a larger number of small, residential parcels over a shorter period of time or if Harvard had needed its agent to approach parcel owners who had not put their land up for sale. Even in the context of the secret Allston purchases, savvy 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.⁵⁷ Thus, even with the secret purchases, Harvard probably paid some premium on the purchases demanded by strategic sellers.⁵⁸

Most interestingly, Harvard later had to defend its purchase,

53. Tina Cassidy & Don Aucoin, *Harvard Reveals Secret Purchases of 52 Acres Worth \$88M in Allston*, BOSTON GLOBE, June 10, 1997, at A1.

54. *Id.*

55. *Id.*; see also Sara Rimer, *Some Seeing Crimson at Harvard 'Land Grab'*, N.Y. TIMES, June 17, 1997, at A16.

56. Cassidy & Aucoin, *supra* note 53; Editorial, *A Bum Rap in Allston*, BOSTON HERALD, June 12, 1997, at 34.

57. Cassidy & Aucoin, *supra* note 53.

58. Harvard's agent reported that owners of some parcels adjacent to parcels it purchased offered to sell their parcels, but the agent turned these offers down because the price the owners were asking was too high. *Id.* 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 increasing property prices strategically.

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, “[s]ince most of the campus in Cambridge is surrounded by residential neighborhoods, and displacement of those neighborhoods was not in the university’s interests *or in the realm of possibility*, it was necessary to look to other places.”⁵⁹ Although Harvard never disclosed what rendered the purchase of sufficient contiguous residential parcels in Cambridge impossible, the difficulty of purchasing the parcels anonymously is certainly a strong possibility.

B. Options and Auctions to Purchase the Parcels

Use of an option is another strategy that can help defeat the holdout problem.⁶⁰ If there is more than one suitable parcel, the entity seeking land can purchase options on multiple parcels.⁶¹ That entity can then choose to exercise the option to purchase the tracts that will allow it to obtain the needed property at the lowest cost, taking away existing landowners 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 option 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 holdout problem, only at the option stage. Of course, the purchaser can play each holdout against the other,

59. Lewis Rice, *Cambridge v. Allston*, HARV. L. BULL., (Summer 2002) (quoting Kathy Spiegelman, Associate Vice President for Planning and Real Estate, Harvard University) (emphasis added), available at http://www.law.harvard.edu/alumni/bulletin/2002/summer/feature_1-1.html.

60. See Coleman Woodbury, *Land Assembly for Housing Developments*, 1 LAW & CONTEMP. PROBS. 213, 214 (1934) (asserting that the traditional method of land assembly is to start by securing options); see also Merrill, *supra* note 40, at 81 and accompanying quote; 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.”).

61. Woodbury, *supra* note 60, at 214 (“[T]his 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.”).

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.⁶²

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.⁶³ 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.⁶⁴ Economists have shown that bidders can be induced to reveal their true value by use of a second price auction, one 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.⁶⁵ 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 aggregate will, by definition of the second price mechanism, be greater than the value of the land to the owners. This leaves a question about how the owners of the property will divide the surplus that the buyer offers them together, which reintroduces the potential for holdouts.

62. 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 one of the holdouts will capture some rent from strategic action. A potential purchaser might try to set up a "voting" mechanism to play parcel owners 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). See, e.g., T. Nicolaus Tideman & Gordon Tullock, *A New and Superior Process for Making Social Choices*, 84 J. POL. ECON. 1145 (1976) (describing the process by which individuals are motivated to reveal their public good preferences). 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). See *id.* at 1148-50.

63. See R. Preston McAfee & John McMillan, *Auctions and Bidding*, 25 J. ECON. LIT. 699, 701 (1987) ("An 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.").

64. *Id.* at 726 ("[T]he 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.").

65. See Stephen A. Smith & Michael H. Rothkopf, *Simultaneous Bidding with a Fixed Charge if Any Bid is Successful*, 33 OPERATIONS RES. 28, 30 (1985) ("Second price auctions, [are] those in which the highest bid wins, but the bidder pays the amount of the second highest bid.").

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 the same price for every parcel.⁶⁶ 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, which will encourage all potential sellers to try to capture the surplus from the project. The second problem is that, in the real world, each parcel will not be worth the same value to each owner. The third problem is that 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. Together these problems 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.⁶⁷ In essence, precommitment avoids holdouts only by forfeiting a 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

66.

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.

Cohen, *supra* note 13, at 568. See also Somin, *supra* note 37, 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.

67. See, e.g., EPSTEIN, *supra* note 29, at 183-84 (noting that parcel owners should be compensated for subjective value of their land).

(e.g., they have different geographical features or locations that objectively would change their value), then the purchaser must 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,⁶⁸ 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.

V. 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

68. See Dana Berliner, *Public Power, Private Gain: The Abuse of Eminent Domain*, CAPITALISM MAGAZINE, Feb. 14, 2005, <http://www.capmag.com/article.asp?ID=4420> ("Power without any checks inevitably leads to abuse, and eminent domain is certainly no exception.").

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.⁶⁹ The value to the individual owners will often exceed the market value.⁷⁰ 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 their idiosyncratic value.⁷¹ 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

69. 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).

70. Nathan Burdsal, *Just Compensation and the Seller's Paradox*, 20 *BYU 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.")

71. 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 ("[J]ust compensation is adjusted upwards in specific ways as the use of condemned property moves from classic public use to possible public use to naked transfer."); Merrill, *supra* note 40, at 90-93 (proposing that parcel owners be compensated at 150% of the market value for land with high subjective value); cf. Merrill, *supra* note 40, at 84 (advocating that courts scrutinize takings of property with high subjective values, because inadequacy of compensation will give signals to condemners 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 "noninstrumental" losses. Nicole Stelle Garnett, *The Neglected Political Economy of Eminent Domain*, 105 *MICH. L. REV.* 101, 148 (2006).

perfectly as market value.⁷² 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 decision-makers 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.⁷³

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,⁷⁴ but many states provide such a right by statute or state constitution.⁷⁵ 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.⁷⁶ 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.⁷⁷ If compensation is greater than actual value to a parcel owner whose property was taken, the owner receives a

72. See John Fee, *Eminent Domain and the Sanctity of Home*, 81 NOTRE DAME L. REV. 783, 812 (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.").

73. 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) ("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.").

74. See *United States v. Reynolds*, 397 U.S. 14, 18 (1970) ("[T]here is no constitutional right to a jury in eminent domain proceedings."); see also FED. R. CIV. P. 71.1(h)(2)(A) (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.").

75. See, e.g., MICH. COMP. LAWS § 213.54 (2007); CAL. CONST. art. I, § 19; ILL. CONST. art. I, § 15.

76. 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, e.g., Mark A. Geistfeld, *Due Process and the Determination of Pain and Suffering Tort Damages*, 55 DEPAUL L. REV. 331, 338-39 (2006).

77. See Neil Vidmar, Russell M. Robinson II & Kara MacKillop, "Judicial Hellholes: Medical Malpractice Claims, Verdicts and the 'Doctor Exodus' in Illinois", 59 VAND. L. REV. 1309, 1312 (2006).

windfall. Moreover, such excessive compensation awards will discourage efficient use of the *Kelo* power, as the government will decline to transfer land to users who value it more than the current owners but less than the compensation the government would have to pay. Finally, jury trials are a notoriously time and labor-intensive means of fact finding. Because the evidence that will bear on idiosyncratic value is, almost by definition, unique to each parcel owner, the trial process could easily get mired in technical evidentiary issues that in turn can encourage appeals, which would seriously delay the compensation determination.⁷⁸ In short, if compensation were to include idiosyncratic value, the jury process might compromise efficient *Kelo* takings by 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 costs 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.⁷⁹

The 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

78. 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.

79. 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 homeowners from their property. See Garnett, *supra* note 71, at 107-10. Both of these can be taken into account by decisionmakers setting subjective value of the taken property if the decisionmakers deem them legitimate constituents of such value.

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 for four generations, and that particular owner had lived there for seventy 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 the types of evidence parcel owners might present would tend to be of the same type, over time, a board could develop expertise and precedent that would render the idiosyncratic value determinations 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 may be for the legislature to offer a parcel owner whose land is taken under the *Kelo* power the alternative of getting idiosyncratic value rather than market value for his property, if he is willing to waive his right to a jury trial. 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.⁸⁰ That is what

80. 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 Lehari & Amir N. Licht, *Eminent Domain, Inc.*, 107 COLUM. L. REV. 1704, 1734-35 (2007). 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,

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 taken by 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 reasonable expectation in getting the value that results from aggregation of his parcel with others if that aggregation cannot occur but for the 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 is currently exercised, is the ability of government to transfer land to political supporters or other friends. This encourages rent seeking and forfeits the synergistic values that the government creates by use of eminent domain.⁸¹ 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. That argument is analogous to those of corporate law

even if I did think that initial owners were entitled to that expectation, at least in the residential setting (which is the most troublesome), I doubt that many landowners would choose Lehari 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.

81. 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 37, at 210-13 (using a public choice analysis); Garnett, *supra* note 71, at 110-17 (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.

scholars against allowing targets to hold auctions following tender offers.⁸² 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 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 needed to determine whether a change in control of the property would be wealth-maximizing. 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 the corporate takeover context, local officials have the means and incentive to identify sites for which property aggregation will lead to wealth increases.⁸³

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

82. See Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1177-79 (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, 236-38 (1986) (auctions in the corporate takeover market decrease the search for undervalued corporations).

83. 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 an 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, 35-36 (1991).

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. 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.⁸⁴

Whatever process a local entity is required to use to exercise the *Kelo* power, like an auction, it should be structured to strip away value that does not derive from unique attributes of the subsequent owner, leaving the synergistic value of aggregation 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 entities (including other potential users of the land) to file comments supporting, opposing, or suggesting alternatives to the project. This will permit initially identified recipient competitors 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 rule-making, 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.⁸⁵

The requirement that local government justify its decision as one that maximizes value to its citizens would also alleviate the problem, in many cases, that 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

84. Lehari and Licht, like I, also envision some process that auctions the land to the highest value owner. Lehari & Licht, *supra* note 80, 1734. These authors, however, envision an actual auction conducted by a "special purpose development corporation" to whom the local government would transfer the land after it is condemned. As I explain, an actual auction is problematic because the value of the property after transfer may be composed significantly of external benefits from the new use, and a private entity will not be willing to include these benefits in its bids.

85. As I have written elsewhere, the review process 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).

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.

V. CONCLUSION

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. Instead, 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 idiosyncratic value as compensation for property taken for redevelopment and require governments to employ a process that invites competing bids for the land at issue, subject to judicial review, thereby 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 both expertise and 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.