Kelo: An American Original

Of Grubby Particulars & Grand Principles

Richard A. Epstein

The American public has found few cases in the past 50 years as riveting as the ongoing saga in *Kelo v. City of New London*.[1] As everyone doubtless knows, the case began when the City of New London, having fallen on hard times, sought to spur urban redevelopment by forming a private redevelopment program with large powers and vast ambitions: take a large 90-acre plot of land and construct, in addition to marinas and walkways, office buildings, hotels, and luxury homes. In one sense New London's task was easy because much of the land that it needed was already in public hands. But there were a number of private homes on different parts of the site, and these New London sought to condemn for inclusion in its overall project.

Like all eminent domain cases, the *Kelo* condemnations raised the typical questions of valuation for the property to be taken, where the rules of the game are all rigged in favor of the government entity. Remember the only compensation is for the property taken, typically at the time of the taking, and thus excludes attorney and appraisal fees,[2] moving expenses, loss of subjective amenities, and the like.[3] But *Kelo* was a different animal because the lots on which these private homes were located were not slated for marinas or walkways, but for some other largely undefined uses. Many homeowners capitulated when faced with the eviction order, and from a narrow perspective they may well have been right, given the continuing ordeal of the 15 or so homeowners who dug in their heels to fight City Hall. Their argument, which gains power in its simplicity, was that this taking was not for a public use, as the eminent domain clause requires, but only for private purposes captured under the vague but lofty rubric of economic redevelopment.

Richard Epstein is James Parker Hall Distinguished Service Professor of Law and Director of the Law and Economics Program at the University of Chicago Law School. He is also the Peter and Kirsten Bedford Senior Fellow at the Hoover Institution.

1 125 S. Ct. 2655 (2005).

2 See, e.g., Dohany v. Rogers, 281 U.S. 362 (1930) (attorney fees); United States v. Bodcaw Co., 440 U.S. 202 (1979) (appraisal fees).

3 Kimball Laundry Co. v. United States, 338 U.S. 1 (1949).

On this contentious public use issue, I thought that the *Kelo* plaintiffs were on solid ground, and in the interests of full disclosure wrote, with Mark Moller of the Cato Institute,[4] a brief that argued New London's land grab flunked any sensible test of public use.[5] One reason was that the City offered no stated use for many of the homes to be taken, other than to say they were slated for "park support" purposes that no one could define. A second reason was that the central purposes of economic redevelopment could have easily been accomplished if the City had made sensible use of the 90 or so acres that it already owned, and on which it had spent some $73 million of state funds on strategic planning, infrastructure improvement, and environmental cleanup. But in a saga that resembles Hamlet without the prince, only one element was missing from the plot. The City had not, and to my knowledge has not yet, found any suitable projects to put on that land. Urban renewal is a slow and clumsy process, and by the time the haggling over this plan had concluded, its time had already past: many new developments proceeded without eminent domain to fill the area needs for hotel and office space. New London's rosy projections of an expanded tax base with increased jobs and revenues were falsified long before the Supreme Court decided the case. The City's own viable asset, as we shall see, was the homes that it wants to tear down in the name of economic progress.

Notwithstanding the particulars of this sorry tale, the Supreme Court by a 5-to-4 vote followed its broad precedents that allowed the taking to go forward because any "public benefit" from the redevelopment plan that the City promised was enough to allow the City bulldozers to raze the homes of Susette Kelo and anyone else who stood in their way. As is so typical in these cases, a weak rational basis standard was used to guide the review, so that all the unsavory particulars of this particular scheme were left unmentioned in Justice Stevens's *Kelo* opinion. To him it was an easy case, and the real surprise was that four dissenters (Chief Justice Rehnquist, Justices O'Connor, Scalia, and Thomas) put up such spirited resistance to the decision.

And on this issue, it was the dissenters who had the pulse of the public. The stark realization that one person could be booted off his property so that another could take his place brought forth a huge sigh of disbelief from all parts of the political spectrum. For most people, the key question was whether a man's home is his castle, for which the naïve answer is yes, except when property is used for traditional public purposes such as roads and parks. In fact, it is important not to push too hard on the public use test, because long before the rise of the social welfare state some eminent domain takings were held to pass the public use test when the ownership of the property ended up in private hands for private uses. The two most common instances of such use of the eminent domain power involved the Mill Act cases, where farmlands were taken to allow for the raising of a river,[6] and in mining contexts, where overhead tramways were condemned to permit the movement of ore from mines to railheads over barren scrublands.[7]

In both these settings, two stringent conditions, wholly absent in *Kelo*, were sat-

4 Brief of the Cato Institute as Amicus Curiae in Support of Petitioners, Kelo v. City of New London, at http://www.cato.org/pubs/legalbriefs/kelovcityofnewlondon.pdf.

5 For my general views, see Richard A. Epstein, Takings: Private Property and the Power of Eminent Domain (1985).

6 Head v. Amoskeag Mfg. Co., 113 U.S. 9 (1885).

7 Clark v. Nash, 198 U.S. 361 (1905).

isfied. First, the land taken had no subjective value to its owners. Second, the right to exclude created a strong holdout situation that met the standards of easements by necessity at common law. *Kelo* was the precise opposite. There was huge subjective value and no holdout possibilities at all. The case was easy on its facts, and raises no grim prospects of sliding down some slippery slope. The Supreme Court's decisions of 100 years ago were cabined within narrow and sensible confines, until judicial sentiment changed to the view that all sorts of indirect public benefits could meet the test of public use, including blight removal, urban renewal, and beautification.[8]

Kelo galvanized the public at large because unified the progressives with the classical liberals as few issues can. The progressives who believe in community were hard-pressed to see how New London and its development corporation were anything other than the usual conspiracy of the rich and powerful against the common man. The classical liberals were only strengthened in their belief that this sorry episode showed the dangers of faction and rent-seeking that only a strong system of property rights can effectively resist. The relentless adverse publicity to the decision focused not on the bumbling incompetence of the city planners in this case, but on the larger issue of whether the planners should be cut any slack at all. And everyone in Congress and the state houses is busily contemplating constitutional or legislative responses to *Kelo*, some of which are being put into law as this article goes to press.[9]

The Grubby Particulars

The *Kelo* case, as a case, did not grind to a halt once the Supreme Court blessed the taking. It was still necessary to carry out the condemnation, which raises the question of just compensation that had been shoved to one side while litigation focused on the more glamorous public use question. But that prosaic issue returned with a vengeance when the City of New London went on the offensive, notwithstanding all the adverse publicity that it had received on the public use issue. Recall that the homeowners grimly remained in possession of their homes for the five years after the original condemnation order was made.[10]

So the passage of time brings two issues to the fore. The first deals with one of timing: is the property valued as of the condemnation order in 2000, or with final dispossession when it takes place five or more years later? The second involves New London's audacious claim that the defeated homeowners owe the City back rent for the period of occupation, equal to the fair rental value of their homes. In the case of the lead plaintiff, Susette Kelo, that sum works out to $57,000. For her co-plaintiff Matt Dery, the bill came out to $6,100 per month, for a total of some $300,000. It is hard to know whether the City's aggression on this second point comes from resentment or necessity, but it is worth noting that after all this wrangling over public use, it may not have the funds to pay the full current market value for the property after all. So should it succeed with these two gambits?

The first line of analysis looks more to private contract, and less to the Constitution. Eminent domain is rarely a snapshot. Usual-

8 Berman v. Parker, 348 U.S. 26 (1954).

9 Tresa Baldas, States Ride Post-'Kelo' Wave of Legislation, National L.J., August 1, 2005, at 1.

10 Jonathan O'Connell, A New (London) Low: A refrigerator box under the bridge: The Kelo Seven prepares for the worst, http://fairfieldweekly.com/gbase/News/content?oid=oid:119000 (July 14, 2005).

ly it plays out over months or years. Accordingly, it is common for parties to eminent domain disputes to enter into various agreements over the disposition of proceeds pending the outcome of the case. Whenever the landowner peaceably abandons the premises before the exact amount of compensation is determined, the interim solution frequently gives the landowner some cash as a down payment, equal perhaps to the amount of the City's offer, with a promise to pay the remainder plus interest once a final valuation is determined by settlement or final judgment.

The calculations are far more complicated and delicate when the owner of the property remains in possession, because the public use question is not resolved. In this case, Scott Bullock, the attorney for the Institute for Justice, asserted "that the NLDC had agreed to forgo rents as part of a pretrial agreement in which the residents in turn agreed to a hastened trial schedule."[11] That bargain, if made, is perfectly enforceable, but leaves unresolved the question of whether valuation of the homes is to be decided with reference to the 2000 or 2005 date.

The expedited trial agreement is arguably consistent with both positions. In the absence of an explicit agreement, what is the right way to proceed when the public use issue is in the litigation mix? Here one key factor involves the relative capacity to litigate and to bear risk. The City represents a large agglomeration of taxpayers and has access to sophisticated financial markets to hedge risk as it thinks appropriate. Isolated individuals, especially those who are not fortunate to have the Institute for Justice on their side, have little or no capacity to diversify their portfolio by hedging their bets in these markets. With the local government as the better risk-bearer, the valuation should be made only when it gets an unquestioned right to take the property, not at the date when it first asserts its claim. In this instance, the substantial appreciation of Kelo's home between 2000 and 2005 should belong to her. If the value of the property declined in the interim, she has to take the loss just as if the City had waited. As a first approximation, the risk of loss follows the change in title.

The alternative solution is just too difficult to contemplate. On average, property values will tend to move upward, if only for inflation. To be told that the valuation is fixed at the date of the original request while the public use issue is resolved means that on average the homeowner who fights and loses will be far worse off than before. The deck is already stacked against the homeowner on the valuation question. Postponing valuation is one way to redress the balance.

So that brings us to the second question, what about that pesky claim for back rent for the use and occupation of the property? Start with the assumption that the title does not pass until the public use phase of the trial is over. If so, so then the claim is easily rejected because the City does not own the property at all. But matters get murkier if the condemnation is held to have occurred as of 2000, even if the case dragged on another five years. Now the City's claim is that the condemnees are tenants who lived on at sufferance and who should have to pay back rent with interest, after they are vanquished in the Courts.

Note the supreme irony to this ghastly claim. The City's measure of damages is the benefit that the original homeowners gained from the continued use of their property. It is as though for five years the "public use" of the property was the right to rent it back to the original owners. That unhappy irony should prompt us to look at the case from the other side, by asking this question: what revenues

11 Id.

did the City lose because the homeowner occupation lasted five extra years? Now the case takes on an entirely different complexion. Front and center, the revised analysis asks what the City lost because it could not take the property when it first filed its condemnation proceedings.

Now recalling the larger picture matters, for the likely scenario in this case runs as follows. The houses get knocked down, at some cost to the City, and the land remains vacant as the futile negotiations take place over its future use. Hence the City lost no rent from actual use, but deferred extensive costs that it otherwise would have incurred immediately. The tongue does not have to be extended too far into the cheek to prod the City into sending a small additional check to the landowners for saving them from wasteful expenditures. The government should not collect rent for the occupation of property it would have destroyed if it had had its way. It should never benefit from the utter ineptness of its own development plan. When all is said, and done, that's why jaws drop when ordinary people get wind of the City's new tactic.

Broad Implications

Having dispensed with these grubby particulars in *Kelo*, what systematic lessons can be learned from watching local land use planning stray so far from its sensible purposes? At this point, the analysis shifts from the precarious position of the individual landowner to the large questions of government purpose and function.

A Perfect Government

Start from this counterintuitive, but sound, proposition: there would be no reason to have any takings protection at all if governments routinely satisfied two key conditions. First, they only acted in the interests of the entire public every time they took land. And, second, they had superior knowledge of the anticipated consequences of their actions, so that on balance the use of the eminent domain power maximized social welfare. If both motive and knowledge reside in local governments, then why slow down the wheels of progress by throwing sand in the gears, which is just what those messy condemnation proceedings do? Confident that each government action makes us all better off socially, we should let it rip: the more aggressive the use of the condemnation power, the better, for everyone wins in the long run if the wise and just government just has its way.

That fairy tale rendition of government behavior is manifestly falsifed by the *Kelo* setting, in which ambition exceeded judgment every step of the way. Now there is some gain to imposing limits on what a runaway government can do. We have two: just compensation and public use. Today, both come up short, with bad social consequences.

Just Compensation

To start with the obvious point first, the conscious decisions of the Supreme Court to short-change the compensation formula means that government officials always face the *wrong* set of prices every time they resort to the condemnation power, even when it is undoubtedly for public use. Here is a simple numerical example of how it plays out. The total losses inflicted on the private owner are $10,000. The gain to the municipality and its other citizens is $8,000. The price required of the state is only $5,000. The rational government official compares the last two numbers and charges ahead. Its $3,000 gain (the value of the property in public hands less the condemnation price) is duly registered, and

the $5,000 loss to the owner (total loss less condemnation proceeds received) is wholly ignored. The law treats a transaction that creates a net social *loss* of $2,000 as though it created a net social *gain* of $3,000.

Not good. The upshot is in one respect the same as it is with price controls: excessive demand for the commodity in question. But in a second respect it differs from price controls, for in any voluntary market, the inevitable consequence of price controls is shortages, as owners take goods off the markets. But with eminent domain that corrective of exiting the market is not available. So the state takes and pays. It thereby generates too many projects that are undertaken because the price is set too low. The New London plan has elements of this distortion.

The situation with many urban condemnations for development is in reality even worse. At a *National Law Journal* conference on *Kelo* in December 2004, one harried landowner from New Jersey had a cogent observation that stopped me in my tracks. The value of land in condemnation proceedings is not (to use my words) "exogenous" to the process itself. More concretely, her observation was that the value of a private parcel depends, as most planners constantly remind us, not only on its distinctive attributes, but also on the infrastructure on which it sits.[12] That infrastructure, supported by general tax revenues, is dependent on the City for its preservation and improvement. It is common knowledge that city governments use public moneys to support wards in which they have strong political support: Chicago is one notorious example. But their discretion in public expenditures is not just limited to those kinds of situations. It is easy to let infrastructure deteriorate in neighborhoods in which condemnation is planned, so as to lowball the dollars to be paid to the hapless owners who lack the requisite political clout. One way to do this is to hold off on street and sewer improvements until the current residents are forced out, and then commit substantial funds to the next developer coming in. Easy to do, hard to detect, and harder yet to prove up in trial.

In my own view, these systematic and institutional biases all move for systematic undercompensation even for land that is taken for undoubted public uses. I can think of no subtle case-by-case way to deal with these endemic problems. What is needed is a blunderbuss approach that pushes the compensation levels systematically upward. I would advocate two maneuvers, either separately or in combination. The first is to include in just compensation some fraction of property value to cover those hard items for which compensation has been denied in recent years: appraisal and attorney fees, and moving expenses. Then use some multiple to get at those hard-to-measure social losses. The old Mill Act cases sometimes authorized compensation equal to 150 percent of market value, in cases where there were no relocation expenses and the like. Raise the price and the overcondemnation problem will be abated. Municipal budget constraints will reduce the need for courts to make individual adjudications. Raise them too high (as is done for residents in favored communities) and we have the reverse problem of the "eager condemnee," which does not include the Kelo contingent. But it does, alas, include Chicago: the sweet deals offered to residents who lived near old Comisky Park had them

12 The common argument runs that people should not be able to complain of regulation that reduces the value of their land because they have already benefited from state roads. But those roads were already financed by contributions from all landowners. So the claim is that regulation is fine because everyone should be made to pay twice for the same benefit.

clamoring to have their homes designated for destruction. Strange what money can do!

Public Use

The second part of the program is to insist on a revitalized public use test for its desirable institutional effects. One common objection to having any public use limitation is that it is redundant, for once the homeowner is fully compensated, then we have a clear case of an overall social (or Pareto) improvement no matter who gets the ultimate benefit. The landowner is not worse off and the public (or even one single beneficiary of public largesse) is better off, so who can complain?

Answer: often everyone. That argument presupposes that the public process that generated the taking works well. If there is one lesson loud and clear from New London, it is that it often reeks, as all sorts of local interests push private agendas in the effort to forge a winning coalition to divide the spoils at the expense of others. Remember the folks who brought you the New London master plan are the same folks that put all sorts of dubious zoning restrictions into place as well. If the public use requirement gets some new teeth from reinvigorated courts, then the latitude for abuse at the political level is reduced, which tamps down by indirection on the misallocations wrought by government power. So in the end the same point dominates: if you think that most municipalities are virtuous and knowledgeable on local planning matters, then be happy with *Kelo* and the culture of deference that the United States Supreme Court has built up to buttress their powers. But if you really believe that, then the aftermath of *Kelo* gives you reason to think again. As a matter of general constitutional theory, the presumption should always be set against the use and expansion of government power. The grisly aftermath of *Kelo* offers vivid evidence of how sound that presumption is. ❧