'Forced Negotiations': How Municipalities Can Reduce the Perception That 'Economic Development' Takings are Unfair While Still Eliminating Holdouts

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The Takings Clause of the Fifth Amendment has always been controversial. Courts are required to give deference to the legislature's determination of what constitutes "public use." This has resulted in transfers of land from one private party to another for reasons of "economic development."

The most well-known case on this issue is *Kelo v. City of New London*.[1] In *Kelo*, the city of New London, Conn., devised a plan to improve its failing economy.[2] The plan—projected to increase jobs and tax revenues—involved assembling parcels of privately owned land and transferring them to Pfizer.[3] The city purchased several parcels and used eminent domain to acquire the rest.[4] Several individuals argued the taking was unconstitutional. The Supreme Court upheld the takings, holding that the city's purpose of economic development was in the scope of its police power.[5] Because the transfer of land was rationally related to the city's purpose of economic development, the Court held it was irrelevant that the transfer was to another private party.[6]

The decision in *Kelo* elicited "unprecedented public opposition" to the government's use of eminent domain.[7] Some viewed the taking as "theft" of private property by the state.[8] Similar criticism has arisen in light of the use of eminent domain for the Dakota Access Pipeline.

At the same time, the use of eminent domain is necessary to avoid one or two "holdouts" preventing valuable development.[9] If a landowner knows his parcel is necessary for an economically beneficial project he has an incentive to hold out for a high, and possibly restrictive, price.[10] Eminent domain in these situations is an "antimonopoly device."[11]

It would be desirable for municipalities to possess a tool that ensured land was transferred for economic development when it was beneficial to do so while eliminating the potential for holdouts. To that end, I propose a system of "forced negotiations" in which the municipality condemns the plot of land and then requires the landowners and the potential transferee to "negotiate" by submitting confidential bids for the property.

Forced Negotiations

Under this system, when a municipality wishes to transfer a lot of privately owned parcels to another party, it will condemn the lot and ask each individual landowner how much they are willing to bid to purchase their parcel "back" for. The municipality adds those bids to the fair market value of the land. The sum of these figures becomes the "landowners' subjective value" of the land.

The municipality then asks the proposed transferee to bid on the lot. If the transferee's offer is equal to or more than the landowners' subjective value, a sale occurs at the landowners' subjective value. In that case, each landowner receives the fair market value of their land plus the value of their bid (if any). Accordingly, the landowners will receive a payment that encompasses the true value of their parcel.

If the transferee's offer is less than the landowners' subjective value, a sale does not occur and the landowners keep their parcels. The landowners then make a payment to the municipality in an amount equal to the difference between the subjective value and the transferee's offer (in other words, the amount by which the landowners prevented the transfer). The municipality earmarks the money for other economic development projects. Each landowner contributes to this payment in an amount proportional to his bid.

Two Examples

There are four outcomes in this proposed system: Each landowner will either bid or not bid, and the sale will either occur or not occur.

Example 1: A municipality has determined that it would be for the public benefit to transfer a lot of 10

	Sale Occurs	Sale Doesn't Occur
Landowner Bids	**A** Landowner gets paid fair market value plus the amount he bid	**B** Landowner keeps parcel, makes payment to municipality
Landowner Doesn't Bid	**C** Landowner gets paid fair market value	**D** Landowner keeps parcel

parcels to a corporation. The municipality condemns the land. Each parcel has a fair market value of $100,000. Five of the landowners bid to purchase their parcels back for $5,000 each; the other five bid nothing. The landowners' subjective value of the entire lot is $1,025,000 ($1,000,000 fair market value + five $5,000 bids).

The corporation offers to purchase the lot for $1,500,000. In this instance, the municipality would force a sale of the lot to the corporation at $1,025,000. The landowners who bid receive payments of $105,000, which amounts to the fair market value of their parcel plus the amount they bid to keep it (Box A). The landowners who did not bid receive fair market value (Box C).

Example 2: The facts are the same as in Example 1, only this time, the corporation offers to purchase the lot for $1,010,000 ($15,000 less than the landowners' subjective value). Because the landowners have outbid the corporation, the sale does not occur. The landowners who bid pay the municipality $15,000—the amount they prevented the transfer by—and the money is earmarked for economic development initiatives.

Because this sale did not occur, the landowners keep their parcels (Boxes B and D)—but those who bid (Box B) have to pay the municipality a total of $15,000, or $3,000 per landowner.

Advantages

This proposed system would reduce the perception that economic takings are unfair while eliminating the potential for holdouts to prevent a beneficial development.

First, by allowing the landowners to bid to keep their parcels, this system eliminates the perception that an economic development taking is "theft."[12] Although the negotiations are "forced," the landowners have a chance to bid, which results in either (1) preventing the transfer or (2) receiving a purchase price that incorporates the landowner's subjective value of the parcel.

Second, the system is consistent with the theory of wealth maximization. This theory argues that transactions should occur only when they increase society's aggregate wealth.[13] Consider the lot of 10 parcels with a fair market value of $100,000 each. In this example, each landowner values their parcel at $110,000 ($1,100,000 total). If the municipality condemned the lot and paid each landowner fair market value ($100,000 each; $1,000,000 total), the transfer would result in a net decrease of $100,000. Each landowner would lose $10,000 of value.

In contrast, a system of forced negotiations produces fair outcomes that cannot result in a decrease of wealth whether or not the transfer occurs.

For example, if each of the 10 landowners valued their parcel at $110,000—and each accordingly bid $110,000 to keep it—the landowners' total subjective value would be $1,100,000. If the corporation places a higher bid (for example, $1,500,000) the transfer would take place at $1,100,000. The corporation's wealth increases by $400,000 (since it paid $1,100,000 for a lot it values at $1,500,000). Each landowner receives a payment of $110,000, resulting in neither an increase nor a loss of wealth.

On the other hand, if the facts were the same as above only the corporation bids less than the landowners' subjective value of $1,100,000 (for example, $1,050,000), the landowners would keep their parcel and pay the municipality $50,000 ($5,000 each) (the amount by which the landowners prevented the transfer). This situation results in neither an increase nor decrease of wealth: the landowners are collectively out $50,000, but the municipality gained $50,000 to fund other economic development initiatives. The landowners are still in what most would consider a "fair" situation: each paid $105,000 for parcels they value at $110,000.

Third, and finally, this system would reduce the potential for holdouts. By allowing the landowner to bid, this system allows the landowner's subjective valuation of the parcel to be included in the transaction. Because the landowner must be willing to "back up" his purported valuation in the event the transfer does not occur, each landowner has incentive to place a bid at, or very close to, his true value of the parcel.

Conclusion

Eminent domain is a powerful constitutional tool available for municipalities to utilize in implementing development for "public use." While eminent domain is necessary to prevent holdouts from obstructing an otherwise valuable project, takings that amount to bare transfers between private parties have been criticized from New London, Conn., to South Dakota as unfair. By condemning the lots and forcing negotiations between the landowners and the proposed transferee, municipalities can achieve fair outcomes while still eliminating the possibility of holdouts. ⦿

Endnotes

[1] *Kelo v. City of New London*, 545 U.S. 469, 472 (2005).
[2] *Id*. at 472.
[3] *Id*. at 473-75.
[4] *Id*. at 476-75.
[5] *Id*. at 480-82, 484.
[6] *Id*. at 485.
[7] Thomas W. Merrill & Henry E. Smith, *The Morality of Property*, 48 Wm. & Mary L. Rev. 1849, 1880 (2007).
[8] *Id*.
[9] *See* Richard A. Posner, *The Supreme Court 2004 Term, Foreward: A Political Court*, 119 Harv. L. Rev. 31, 93-94 (2005).
[10] *Id.*
[11] *Id.*
[12] *See* Merrill & Smith, *supra* note 7.
[13] *See* Richard A. Posner, *Wealth Maximization Revisited*, 2 Notre Dame J.L. Ethics & Pub. Pol'y 85 (1985).