

# ESSAY

## EMINENT DOMAIN, INC.

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*This Essay proposes a novel solution for “squaring the eminent domain circle” when large-scale, for-profit development projects require the assembly of land from numerous private property owners. Such “anticommons” situations may justify government intervention through eminent domain, yet they often leave landowners undercompensated. This may skew the incentives for initiating land development projects and lead to considerable injustice. Although the taking component of eminent domain may need to remain an involuntary nonmarket transaction, we propose a market-based mechanism for the compensation component in the form of a Special-Purpose Development Corporation (SPDC). An SPDC would acquire unified ownership of the land and the development project, and would offer condemnees a choice between receiving pre-project “fair market value” compensation or pro rata shares in the SPDC. This would make it more likely that compensation is closely linked to the true economic value of the land and, consequently, that land assembly projects are both more just and genuinely social welfare maximizing.*

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### INTRODUCTION

The U.S. Supreme Court’s decision in *Kelo v. City of New London*<sup>1</sup> sparked a fierce debate throughout the United States by validating the use of eminent domain for purposes of economic development. Especially troublesome was its validation of eminent domain where the confiscated lands are then transferred to private parties that implement the economic development project and enjoy its gains.

Opponents, who come from practically all wings of the political spectrum, see the decision as pronouncing the ultimate death of the Constitution’s Fifth Amendment requirement that eminent domain be restricted to property taken for “public use.”<sup>2</sup> They claim it grants governments carte blanche for compulsory transfer of private property from ordinary citizens to politically-powerful real estate entrepreneurs.<sup>3</sup> Lobbying groups such as the Castle Coalition have argued that the *Kelo* decision has “opened the floodgates” of eminent domain abuse, spurring governments to proceed with hundreds of projects in which homes, small businesses, and other properties would be razed in favor of high-profile

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1. 545 U.S. 469 (2005).

2. U.S. Const. amend. V, § 4.

3. For a survey of the wall-to-wall criticism of *Kelo*, see Abraham Bell & Gideon Parchomovsky, *The Uselessness of Public Use*, 106 Colum. L. Rev. 1412, 1423–26 (2006) [hereinafter Bell & Parchomovsky, *Uselessness*] (arguing, against *Kelo*’s critics, that it conforms to settled law about government powers with respect to property, and that just compensation requirement makes eminent domain rather less pernicious than other forms of uncompensated governmental intervention). Some of *Kelo*’s critics call for an outright ban on what they deem to be essentially private takings in disguise. See, e.g., 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, 547–51 (2006) (discussing possible abuse of eminent domain by politically powerful groups and concluding that “ready availability of eminent domain for economic development projects poses grave risks of unfairness, inefficiency, and abuse”); Gideon Kanner, *Kelo v. New London: Bad Law, Bad Policy, and Bad Judgment*, 38 Urb. Law. 201, 233–35 (2006) [hereinafter Kanner, *Bad Law*] (concluding that *Kelo* majority “surrendered the vital function of constitutional review to an unaccountable, self-serving business-government alliance”).

private developments.<sup>4</sup> This situation would leave landowners with minimal compensation based on the pre-project “objective” land values.

But this version of events is only partially correct, both in theory and in fact. Many state legislatures and courts have already taken steps to mitigate the potential overuse of eminent domain powers. In more than forty states, legislatures have placed new prohibitions on the use of eminent domain by prohibiting its use for private economic development, redefining more stringently the terms “public use” or “blight,” or otherwise increasing restrictions on the use of eminent domain for such private projects.<sup>5</sup> In addition, some state courts, like those in Ohio<sup>6</sup> and Oklahoma,<sup>7</sup> have interpreted state legal limits on the use of eminent domain for private economic development more stringently than the Supreme Court’s reading of the federal Constitution in *Kelo*. In this sense, post-*Kelo* reality includes a strong reaction against the floodgates of eminent domain that *Kelo* supposedly opened.

Moreover, as we argue in this Essay, a flat prohibition on the use of eminent domain to assemble land from numerous owners to allow large-scale, financially profitable projects is highly problematic on the policy level. Development or redevelopment projects involving dozens or hundreds of landowners, each holding an exclusive entitlement to a fragment of the designated project’s area, could be impossible to implement if every affected property owner could veto the plan by refusing to sell his parcel. Unanimous consent is not a reasonable requirement for such large-scale projects in view of such “anticommons” scenarios.<sup>8</sup> Cases of land assembly for development or redevelopment plans are thus rife with market failures, which may justify maintaining the land assembly process as an involuntary, nonmarket transaction carried out through the government’s power of eminent domain.

At the same time, however, since the constitutionally mandated “just compensation” to the landowners is currently based on pre-project objective “fair market value,” the government or third parties that take part in the implementation of the project may enjoy the entire incremental increase in the value of the assembled land. This compensation regime

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4. Dana Berliner, *Opening the Floodgates: Eminent Domain Abuse in the Post-Kelo World 1* (2006), available at <http://www.castlecoalition.org/pdf/publications/floodgates-report.pdf> (on file with the *Columbia Law Review*).

5. See Patricia E. Salkin, *Eminent Domain Legislation Post-Kelo: A State of the States*, 36 *Envtl. L. Rep.* 10864, 10865–70 (2006) (describing changes to eminent domain laws since *Kelo*); Castle Coalition, *50 State Report Card: Tracking Eminent Domain Reform Legislation Since Kelo 1* (2007), available at [http://www.castlecoalition.org/pdf/publications/report\\_card/50\\_State\\_Report.pdf](http://www.castlecoalition.org/pdf/publications/report_card/50_State_Report.pdf) (on file with the *Columbia Law Review*) (introducing evaluation of eminent domain laws by noting that since *Kelo*, “[forty-two] states have passed new laws aimed at curbing the abuse of eminent domain for private use”).

6. *City of Norwood v. Horney*, 853 N.E.2d 1115 (Ohio 2006).

7. *Bd. of County Comm’rs v. Lowery*, 136 P.3d 639 (Okla. 2006).

8. See *infra* Part I.B.

may seem unfair due to its distributional consequences, and it could distort governmental decisionmaking by encouraging use of the eminent domain power even when it is socially undesirable or unnecessary.

This Essay proposes a novel solution for “squaring the eminent domain circle” for large-scale, for-profit projects that require land assembly from private property owners, by separating the two components of eminent domain: taking and just compensation. The goal of our proposal is to restore market mechanisms to the extent possible by restructuring the legal compensation regime. We develop a market-based solution for the compensation component that takes advantage of the market’s powerful price system to align the interests of landowners, public authorities, and land developers. In brief, our proposed model would offer condemnees a choice between receiving either traditional pre-project “fair market value” compensation or pro rata shares in a special-purpose development corporation that would acquire unified ownership of the land and the development project. This innovative mechanism would make it more likely that compensation is closely linked to the true economic value of the land and, consequently, that land assembly projects are both more just and more likely to genuinely maximize social-welfare.

This Essay is structured as follows. Part I presents the dilemma concerning projects that require the assembly of land from numerous owners. It explains the substantial transaction costs embedded in attempts to reorganize a certain area for development or redevelopment and the difficulty in distinguishing between authentic, benign reservations, and strategic holdout tactics. It thus reveals the reasons for the very limited success of voluntary land assembly projects. It then addresses the dark side of current eminent domain-based land assembly, by pointing to the skewed incentives and unjust distribution that result from the current legal “just compensation” regime. This is illustrated by the somber socio-economic history of urban renewal projects, as well as the abundance of instances in which the interests of ordinary homeowners and businesses are pushed to the side in favor of politically and financially powerful private bodies.

Part II uses a comparative approach to explain why current land use regulation and land tax laws in the United States make *Kelo*-type scenarios particularly dramatic. It highlights some of the American system’s deficiencies by offering a brief comparative review of the legal regime and current reform trends in Britain, which is facing similar dilemmas, especially with regard to large-scale urban redevelopment programs. In particular, it shows how recently imposed planning obligations and the designated taxation of land betterment resulting from the land assembly and redevelopment make the “public” trait of land assembly in Britain more highly developed than is currently the case in the United States. The broad public interest in Britain plays a more straightforward role in the land assemblage decision and the public directly captures some of the incremental value.

Part III briefly reviews current proposals for reforms (beyond the aforementioned restrictions on the very use of governmental powers in for-profit projects). These proposals include calls to implement the planning tool of land readjustment that is prevalent in many countries, as well as various proposals to change the legal “just compensation” formula. We argue that these suggested reforms, while intriguing, are either impracticable or normatively problematic, and thus do not offer a systematic solution to the land assembly dilemma.

Part IV sets out our approach to eminent domain, which is based on a corporate finance perspective. It introduces the Special-Purpose Development Corporation (SPDC), explaining the method by which shares would be allocated to private and public parties. It discusses several prominent issues pertaining to the institutional design of the SPDC, its corporate governance mechanism, and the ways in which corporate and securities law can be utilized to protect the interests of the private-landowners-turned-shareholders. We conclude by discussing the larger potential of the corporate structure for solving land use related collective action problems.

## I. THE LAND ASSEMBLY DILEMMA

### A. *The (Post) Kelo Saga*

In 2000, the then distressed city of New London, Connecticut, approved a redevelopment plan for the ninety-acre Fort Trumbull site. It was hoped that this redevelopment, adjacent to and in conjunction with a new Pfizer research facility, would help revitalize the local economy. The redevelopment plan included construction of waterfront hotels, marinas, offices, retail spaces, and other commercial buildings and spaces. The Fort Trumbull site, however, included 115 privately owned properties, as well as thirty-two acres of publicly owned lands.<sup>9</sup>

The city tasked a nonprofit corporation, the New London Development Corporation (NLDC), with implementing the plan. The city delegated its eminent domain power to the NLDC to assist in this implementation. The NLDC was able to successfully negotiate the purchase of most privately owned properties in the plan’s designated area. However, it failed to reach agreement with nine property owners, who altogether held fifteen properties. Ten of these properties were occupied by the owner or a family member and the rest were held for investment.<sup>10</sup> In response, the city and NLDC initiated the requisite state law condemnation procedures.<sup>11</sup> These procedures were validated first by the Connecticut courts and later by the U.S. Supreme Court.<sup>12</sup>

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9. *Kelo v. City of New London*, 545 U.S. 469, 472–75 (2005).

10. *Id.* at 475.

11. *Id.*

12. *Id.* at 473–90.

Following the Supreme Court's decision in June 2005, the city and NLDC had won a legal victory but faced a public relations defeat. As a result, they sought to settle with the petitioners to make unnecessary the consummation of the eminent domain proceedings and to move forward with redevelopment. Through early June 2006, seven of the landowners settled, while two remained defiant: Susette Kelo and Pasquale Cristoforo. On the night of June 5, 2006, the city council voted to proceed with eminent domain proceedings for these two remaining properties.<sup>13</sup> Shortly afterwards, Kelo and Cristoforo also settled.<sup>14</sup>

The settlement efforts proved costly for the city and NLDC. The last six deals alone cost them more than \$4.2 million—\$2.3 million above the properties' total appraised value in 2000. In addition, the NLDC waived almost \$1.2 million in fees for use and occupancy by the landowners during the post-condemnation period. Kelo accepted an offer of \$442,155 for her house, more than \$319,000 above its appraised value in 2000, and was permitted to stay on the land until June 15, 2007. Cristoforo received \$475,000 for a house previously appraised at \$105,000. These deals aroused the discontent of the landowners who settled previously (and who had enjoyed substantial, but lower, premiums). One landowner noted that the city and NLDC "rewarded [those who settled last] for holding out further."<sup>15</sup>

Despite the settlement, Susette Kelo did not show outward signs of contentment. In the months following the settlement, Kelo toured the country, passionately describing the love and care she lavished on what used to be a run down cottage when she bought it. She urged listeners to push for legislative reforms that would better protect private property rights against eminent domain.<sup>16</sup> Kelo thus became a national symbol for private property advocates as well as a vivid illustration of the intricate dilemmas that haunt land assembly.

### B. *Land Assembly as an Anticommons Setting*

Land assembly problems are far from new. The law has long dealt with land assemblage scenarios rife with potential and actual market failures. The chief problem the law has struggled with is the problem that is nowadays dubbed "anticommons."<sup>17</sup> The anticommons problem refers

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13. Ellaine Stoll, *City Votes to Proceed with Property Seizures*, Day (New London, Conn.), June 6, 2006, at A1.

14. Ted Mann, *Fort Trumbull Saga Ends on Costly Note*, Day (New London, Conn.), Aug. 23, 2006, at A1.

15. *Id.* It should be noted that these additional funds came, as did most of the \$73 million expended over the project's course up to that point, from the State Department of Economic and Community Development, which has largely underwritten New London's redevelopment efforts. *Id.*

16. Anne Saunders, *Kelo Urges NH to Restrict Powers of Eminent Domain*, Union Leader (Manchester, N.H.), Sept. 22, 2006, at A2.

17. See Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 Harv. L. Rev. 621, 667–79 (1998) (defining

to the situation that arises when large-scale projects implicate numerous property owners, each of whom hold an exclusive entitlement to a fragment of the designated project's area. In such a scenario, if each owner were able to effectively veto the plan unless he consented to it, such over-fragmentation of private property rights could prevent the pooling together of the land for its more efficient reorganization.<sup>18</sup>

1. *From Quintessential Public Projects . . .* — Probably the most frequent scenario in this context concerns the establishment of roads, navigable water routes, pipelines, and other types of linear infrastructures and utilities. In such cases, the market for the purchase of land, or of a right of way in it, is particularly thin because often there may be only one feasible route.<sup>19</sup> Even where alternative routes exist, once the railroad or pipeline has begun building the line, abandoning it for an alternative route might prove very costly. Accordingly, persons owning land along the designated path are tempted to hold out for a high price in excess of the land's opportunity cost.<sup>20</sup>

To prevent each landowner along the path from gaining de facto monopoly power, governments often resort to using their eminent domain powers.<sup>21</sup> Governments have also delegated these powers to private corporations that build or operate such transportation or infrastructure services.<sup>22</sup> In the early twentieth century, this delegation was scaled back.<sup>23</sup> However, many legislatures still authorize private corporations to use the power of eminent domain because of the public nature of their

"anticommons" and exploring effect on scarce resource when many individuals have rights to it).

18. The anticommons problem is obviously not unique to land. It may also deter scientific innovation; for example, granting patents in isolated gene fragments may hamper development of integrative biomedical products. Michael A. Heller & Rebecca S. Eisenberg, *Can Patents Deter Innovations? The Anticommons in Biomedical Research*, 280 *Sci.* 698, 699–701 (1998).

19. See Thomas W. Merrill, *The Economics of Public Use*, 72 *Cornell L. Rev.* 61, 74–77 (1986) (discussing thin market settings).

20. Richard A. Posner, *Economic Analysis of Law* 55 (6th ed. 2003). The term "opportunity cost" generally refers to the economic cost of an alternative that is, or might be, foregone—in this case, the value of using the land for the designated public project. See *id.* at 6.

21. See Merrill, *supra* note 19, at 97–98 (noting high proportion of land assembly cases, and especially of public utilities, in use of governmental eminent domain powers).

22. See Harry N. Scheiber, *Property Law, Expropriation, and Resource Allocation by the Government: The United States, 1789–1910*, 33 *J. Econ. Hist.* 232, 237 (1973) ("[T]he most important single development in early nineteenth century eminent domain law probably was the wholesale transfer of [cost-reducing, expediting] doctrines over to the private sector, in aid of incorporated companies on which legislatures devolved the power of eminent domain.").

23. See Wendell E. Pritchett, *The "Public Menace" of Blight: Urban Renewal and the Private Uses of Eminent Domain*, 21 *Yale L. & Pol'y Rev.* 1, 9–13 (2003) (recounting development of eminent domain doctrine from American Revolution to first half of twentieth century).

services and courts generally defer to legislatures as to the granting of such powers.<sup>24</sup>

Moreover, even proponents of strong private property rights generally agree that the use of eminent domain is less problematic when the good or service for which the power of eminent domain is employed possesses the economic traits of a public good or otherwise mandates substantial centralized intervention for its provision.<sup>25</sup> Beyond the use of eminent domain, the law has employed other methods to prevent monopolistic holdouts in anticommons settings. Examples of these other methods include the nineteenth century judicial development of implied “prescription” or “dedication” theories, which deprived private owners of the right to exclude persons from segments of roads or navigable water routes that were used by the general public and thus subject to particularly high negotiation costs.<sup>26</sup>

2. . . . to *Nonprofit Private Development Projects* . . . — Anticommons scenarios are also common in cases of large-scale development or redevelopment projects for residential, commercial, or industrial purposes. The use of eminent domain in these situations is more problematic than in the earlier public goods scenarios. The federal urban renewal programs that ran between the late 1940s and the mid-1960s used eminent domain to raze entire neighborhoods in the name of removing “blight” and to make room for middle and upper income housing. These programs are considered in retrospect a resounding failure. They only exacerbated the socioeconomic problems of the priced-out former residents of what were physically run down, yet socially vibrant communities.<sup>27</sup>

24. See, e.g., *Steele v. Mo. Pac. R.R. Co.*, 659 P.2d 217, 222–24 (Kan. 1983); *Burlington N. & Santa Fe Ry. Co. v. Chaulk*, 631 N.W.2d 131, 137 (Neb. 2001); *Cabletelevision of the Midwest, Inc. v. Gross*, 639 N.E.2d 1154, 1156–57 (Ohio 1994). See generally 26 Am. Jur. 2d Eminent Domain § 28 (2004) (describing principles and limits of legislative conferral of eminent domain power to private entities).

25. See, e.g., Richard A. Epstein, *Takings: Private Property and the Power of Eminent Domain* 166–69 (1985) (arguing that “[a] large core of activities falls within this conception of public goods, so the economic conception, however interpreted, easily legitimates the state’s exercise of its eminent domain power”).

26. See Carol Rose, *The Comedy of Commons: Custom, Commerce, and Inherently Public Property*, 53 U. Chi. L. Rev. 711, 723–30, 762–66 (1986).

27. For criticisms of these eminent domain-backed programs, and especially of their acute adverse distributional outcomes on members of low-income minorities, see Bernard J. Frieden & Marshall Kaplan, *The Politics of Neglect: Urban Aid from Model Cities to Revenue Sharing* 24–25 (1975) (arguing that “[a]fter taking over [low-income] neighborhoods for the benefit of others, the cities gave only belated and inadequate attention to the problem of finding decent relocation housing for the former residents”); Jane Jacobs, *The Death and Life of Great American Cities* 270–90 (1961) (“At best, [urban renewal] merely shifts slums from here to there, adding its own tincture of extra hardship and disruption. At worst, it destroys neighborhoods where constructive and improving communities exist and where the situation calls for encouragement rather than destruction.”); Pritchett, *supra* note 23, at 31–47 (noting that in cities across United States, urban renewal came to be known as “Negro clearance”). See also Justice Thomas’s dissenting opinion in *Kelo v. City of New London*, 545 U.S. 469, 520–23 (2005) (Thomas,



Current, more subtle, redevelopment programs learned from these past mistakes while still realizing the essentiality of systematic and comprehensive area-wide solutions to problems of urban decline. A recent report commissioned by the Environmental Protection Agency, which studied redevelopment projects in nine states, stresses that since “no property is an island,” most successful redevelopment initiatives focus on areas in their entirety.<sup>28</sup> Thus, even “social” redevelopment initiatives, carried out chiefly by nonprofit organizations and explicitly committed to holistically helping low-income residents by building or rehabilitating affordable housing in addition to providing social services such as job training, youth programs, and small business assistance, must spread to the entire map to succeed.<sup>29</sup> Accordingly, vacant lots or neglected buildings that remain in disrepair adversely influence the prospects of “moving up” the neighborhood.<sup>30</sup>

Interestingly (yet not surprisingly), one of the most celebrated cases of grassroots, community-based revival of an impoverished urban neighborhood, the Dudley Street Neighborhood Initiative (DSNI) in Boston, is also the only instance in the United States in which a community organization—DSNI—was granted the power of eminent domain. In this case,

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J., dissenting) (“So-called ‘urban renewal’ programs provide some compensation for the properties they take, but no compensation is possible of the subjective value of these lands to the individuals displaced and the indignity inflicted by uprooting them from their homes.”).

28. Int’l Econ. Dev. Council, Targeted Area Redevelopment 3–8 (2005).

29. See Rachel G. Bratt, Community Development Corporations and Other Nonprofit Housing Organizations: Challenges Presented by the Private Housing Market 8–11 (2006) (unpublished working paper, on file with the *Columbia Law Review*) (noting successful redevelopment initiatives “are not based in a single community”). For the work of Community Development Corporations (CDCs) and the comprehensive approach they take in rehabilitating neighborhoods, see generally Avis C. Vidal, *Rebuilding Communities: A National Study of Urban Community Development Corporations* (1992) (presenting findings of research regarding structure, accomplishments, and potential growth of CDCs); Alexander Von Hoffman, *House by House, Block by Block: The Rebirth of America’s Urban Neighborhoods* (2003) (describing CDCs efforts in revitalizing major American cities).

30. Many U.S. cities suffer from staggering numbers of vacant lots and abandoned buildings, whose negative effects include increased crime, environmental and safety hazards, decreased adjacent property values, and self-perpetuating disinvestments. See Alan Mallach, *Bringing Buildings Back: From Abandoned Properties to Community Assets* 1–9 (2006) (discussing distribution, characteristics, causes, and effects of abandoned properties); Michael A. Pagano & Ann O’M. Bowman, Brookings Inst., *Vacant Land in Cities: An Urban Resource* 1–3 (2000), available at <http://www.brookings.edu/es/urban/pagano/paganoexsum.htm> (on file with the *Columbia Law Review*) (finding that, on average, fifteen percent of urban land is vacant); Lavea Brachman, *Vacant and Abandoned Property: Remedies for Acquisition and Redevelopment*, *Land Lines*, Oct. 2005, at 1, 1–6 (stating that “prevalence of vacant and abandoned property in U.S. cities has reached crisis proportions” and discussing potential remedies).

eminent domain was granted to DSNI by the city and the Boston Redevelopment Agency (BRA).<sup>31</sup>

The Triangle, a sixty-four acre area in the heart of the Dudley neighborhood, was home to about 2,000 people in the late 1980s and was also where most vacant land in the neighborhood was concentrated. Of the thirty acres of vacant land in the Triangle, fifteen were owned by the city. The other fifteen acres, comprising 181 lots, were privately owned. Of these privately owned lots, 101 were in tax title, with municipal liens placed against them, or under petition for tax foreclosure. Moreover, the public/private ownership map looked like a jigsaw puzzle—there was no substantial territorial consecutiveness of public property, with little “islands” of private holdings spread all over the Triangle. Although most privately owned lots were tax delinquent, their formal foreclosure one by one would have been an onerous, time-consuming process whose inefficiency might have hampered any revival efforts.<sup>32</sup>

It was then that the idea of community-based use of eminent domain was conceived. DSNI, well aware of the traumatic experience of Bostonians with previous eminent domain projects, suggested two distinguishing principles for the use of this power in order to overcome the anticommons problem. These distinguishing principles were: (1) it would be restricted to vacant lots, meaning that no homes or businesses would be displaced, and (2) eminent domain would be exercised only for land owned by persons living outside the neighborhood. This second restriction was not overly restrictive since 81 of the 131 private owners of vacant land in the Triangle, many of whom were land speculators holding their lots in anticipation of future profit, lived outside Roxbury or Dorchester.<sup>33</sup> DSNI first gained mayoral support and formal approval by the BRA, and then took three years to raise the funds for compensation (over \$2 million, coming from private grants and a loan from the Ford Foundation). Only after this time did DSNI exercise its eminent domain powers through judicial decree for the privately owned, nonresident vacant lots in the Triangle. They simultaneously received the city-owned vacant lots for a nominal fee of \$1.<sup>34</sup>

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31. This was made possible by Section 121A of Massachusetts General Laws, which allows a local renewal agency to empower a charitable organization to carry out a redevelopment project and to employ the power of eminent domain for that purpose. Mass. Gen. Laws ch. 121A, § 3 (2003).

32. Peter Medoff & Holly Sklar, *Streets of Hope: The Fall and Rise of an Urban Neighborhood* 117 (1994).

33. *Id.* at 119–21.

34. *Id.* at 129–47, 154–58. To ensure both concentrated control over the land and its affordability for low-income residents for generations to come, DSNI set up a Community Land Trust (CLT). The Dudley CLT thus owns the land in perpetuity, and the individual homeowner leases the land for a long period and is the owner of the building. The resale price is restricted to a formula aimed at giving the departing homeowner a fair return on his investment, while at the same time giving future homebuyers fair and affordable access to this housing. Other mechanisms embedded in the CLT, and especially its unique tri-layered property structure, preserve the ongoing, collective neighborhood control over the

3. . . . and For-Profit Ones. — We now move to the issue of land assembly for what are essentially for-profit development or redevelopment projects, such as the Fort Trumbull plan. While land assembly for such projects is prone to the same basic anticommons hurdles that haunt public or private nonprofit projects, these projects suffer from especial criticism. The constitutional “publicness” of such projects is fiercely debated and there is a growing gap between the federal legal regime and that of many states.<sup>35</sup> Legal scholarship has largely looked unfavorably on the use of takings in such contexts.<sup>36</sup>

In some cases, private entrepreneurs may overcome the anticommons problem by assembling large tracts of land through the use of secret buying agents, as in Walt Disney’s secret purchase of thousands of acres from numerous property owners in Florida and in Virginia.<sup>37</sup> Yet such techniques are often inapplicable, and would usually be legally prohibited for governmental development or redevelopment plans.<sup>38</sup> In such publicly known cases, potential holdouts are very likely.

Importantly, when a designated project becomes public knowledge, the ability of the governmental entity or a private entrepreneur to move forward with contractual land assembly hinges to a large extent on the

project. *Id.* at 158–67. DSNI’s activity later extended to the entire neighborhood’s area. *Id.* at 161–67. For the CLT’s structure and property attributes, see John Emmeus Davis, Nat’l Hous. Inst., *Shared Equity Homeownership: The Changing Landscape of Resale-Restricted, Owner-Occupied Housing 18–23* (2006), available at <http://www.nhi.org/pdf/SharedEquityHome.pdf> (on file with the *Columbia Law Review*).

35. See *supra* notes 1–7 and accompanying text.

36. See, e.g., Cohen, *supra* note 3, at 498 (arguing “for a . . . ban on takings for economic development, enacted either by state legislation or . . . state constitutional amendment”); Kanner, *Bad Law*, *supra* note 3, at 203 (arguing that *Kelo*’s “premise is flawed” because it holds that public use requirement is met simply if “municipal functionaries predict that more money will be made from the subject property in the redevelopers’ hands than its present owner’s”); Ilya Somin, *Overcoming Poletown: County of Wayne v. Hathcock*, *Economic Development Takings, and the Future of Public Use*, 2004 *Mich. St. L. Rev.* 1005, 1009–16 (arguing that “categorical ban on economic development takings is the best way to control abuse of the eminent domain power for the benefit of private interests”). But cf. Bell & Parchomovsky, *Uselessness*, *supra* note 3, at 1445–49 (arguing that narrow public use doctrine harms property owners since government retains other means of seizing property); Nicole Stelle Garnett, *The Public-Use Question as a Takings Problem*, 71 *Geo. Wash. L. Rev.* 934, 982 (2003) (offering interim “means-ends” scrutiny approach rather than flat prohibition on certain types of projects).

37. See Robert C. Ellickson & Vicki L. Been, *Land Use Controls* 845–54 (3d ed. 2005); 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, 18–31 (2006) (arguing that ability of secret buying agents to overcome holdout problems associated with assembling large tracts of land mitigates private parties’ need for eminent domain). For a critical analysis of an unusual transaction in which the American Electric Power Company (AEP) bought out the entire small town of Cheshire, Ohio, in 2002 to solve the problem of pollution from AEP’s coal-fired power plant, see Gideon Parchomovsky & Peter Siegelman, *Selling Mayberry: Communities and Individuals in Law and Economics*, 92 *Cal. L. Rev.* 77, 78–89 (2004).

38. Kelly, *supra* note 37, at 31–33.

question, whether under the law of the specific jurisdiction, the power of eminent domain may be used to nonconsensually take properties of landowners who refuse to sell or move out. When the project's initiators have good reason to believe that they would be able to resort to eminent domain when push comes to shove, and to prevail against legal challenges, they typically enjoy more leverage during the negotiations (even though they may often be inclined to offer landowners above-market prices to save the delays and costs involved in actual condemnation proceedings).<sup>39</sup>

A recent vivid example is the \$4 billion Atlantic Yards project in Brooklyn, New York. Shortly after buying the NBA's New Jersey Nets franchise in 2004, developer Bruce Ratner announced plans to make Brooklyn the Nets's new home, and to turn a twenty-two acre site in the heart of the borough into a mixed-use development that will include the basketball arena, thousands of rental and condo apartments, office towers, retail space, and a boutique hotel.<sup>40</sup> Forest City Ratner Companies (FCRC) has won support for the project from both the state and the city of New York. This support extends to direct subsidies worth hundreds of millions of dollars,<sup>41</sup> which FCRC won after committing to designate a portion of the 6,400 planned apartments to low- and moderate-income families.<sup>42</sup>

Notably, FCRC purchased land in the project's footprint—a step that, in essence, broke ground on the project—before all the required regulatory approvals were granted (although they were finally obtained in December 2006).<sup>43</sup> With the background support of the city and the state, and especially of the Empire State Development Corporation—the state agency holding the power of eminent domain on behalf of the state, which publicly announced its plans to use this power against unwilling property owners<sup>44</sup>—FCRC has been able to privately buy out the vast majority of properties and to reach agreements with many rent-stabilized te-

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39. See Nicole Stelle Garnett, *The Neglected Political Economy of Eminent Domain*, 105 Mich. L. Rev. 101, 127–30 (2006) [hereinafter Garnett, *Neglected Political Economy*].

40. See Forest City Ratner Cos., *Atlantic Yards: A Vision for Downtown Brooklyn*, at <http://www.atlanticyards.com> (last visited Oct. 6, 2007) (on file with the *Columbia Law Review*).

41. In 2005, the city and the state agreed to commit \$100 million each to help fund the project's infrastructure. In January 2007, the city announced it would add an extra \$105 million in subsidy "for extraordinary infrastructure costs relating to the mixed use development." Eliot Brown, *Bloomberg's Budget Doubles Subsidy for Atlantic Yards*, N.Y. Sun, Jan. 30, 2007, at 3.

42. Although FCRC's commitment to affordable housing within the project, including for current rent-stabilized renters, has softened some of the public criticism, neighborhood groups still contest the proposed arrangements, and have recently filed a claim in state court, arguing that these plans fail to meet state legislative standards. Andy Newman, *Tenants Sue Agency over Brooklyn Project*, N.Y. Times, Jan. 13, 2007, at B3.

43. See Nicholas Confessore, *Atlantic Yards Enters New Phase, and Faces Next Hurdle: Lawsuits*, N.Y. Times, Dec. 22, 2006, at B9.

44. See Elaine Misonzhnik, *Getting Closer, Retail Traffic*, Jan. 1, 2007, at 13, 13.

nants on temporary and permanent solutions.<sup>45</sup> Yet a few dozen apartment owners, rent-stabilized tenants, and small businesses remain defiant and have recently filed a number of lawsuits in state and federal courts arguing, inter alia, that the Empire State Development Corporation may not use eminent domain for this private development. In rhetoric that should sound familiar enough to *Kelo* veterans, Daniel Goldstein, the spokesman for the lobbying group Develop Don't Destroy Brooklyn<sup>46</sup> and the only remaining apartment owner in a building bought out by FCRC, declared that “[o]ur victory will force a reshaping of the project, while protecting owners and renters nationwide from abuses of eminent domain.”<sup>47</sup> The fate of these last pockets of resistance to the Atlantic Yards project remains to be seen.

The motives for vetoing contractual land assembly for private for-profit development or redevelopment projects may vary considerably. In some cases, these motives may be benign, at least in the eye of the beholder. Susette Kelo seems sincere in her staunch opposition to leaving her cottage, even after receiving a fat premium from the NLDC. She places an exceptionally high emotional value on her house and thus serves as a vivid illustration of the personhood building theory of private property.<sup>48</sup> Property owners may experience a subjectively genuine insult to their sense of autonomy and liberty resulting from forced turnover, especially when the property is retransferred to a powerful developer.<sup>49</sup> Even the opportunity to share directly in the profits of the ambitious Fort Trumbull plan likely would not have overcome Ms. Kelo's emotional premium.

Landowners of agricultural or natural landscape properties may object to new development on ideological or environmental grounds. One recent fascinating example of an antidevelopment tactic employed for that purpose concerns “green burials.” In 1996, Billy Campbell—an avid environmentalist living in Westminster, South Carolina, a small town in the foothills of the Appalachian Mountains—came up with the idea to use burials to preserve land from future development. He bought thirty-three acres along a creek and offered residents “green burials.” Joining forces with Tyler Cassity, a consultant on HBO's *Six Feet Under* and the owner of celebrity cemetery Hollywood Forever, Campbell intends to bring this concept to different states, with the goal to “preserve 1-million acres over the next 30 years.” In August 2004, the partners closed on a

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45. Confessore, *supra* note 43.

46. General information regarding Develop Don't Destroy Brooklyn is available at <http://www.developdontdestroy.org> (last visited Oct. 6, 2007).

47. Confessore, *supra* note 43.

48. See generally Margaret Jane Radin, *Reinterpreting Property* 36–63 (1993) (describing personhood building theory of private property, its philosophical underpinnings, and its application to American legal system).

49. Lee Anne Fennell, *Taking Eminent Domain Apart*, 2004 Mich. St. L. Rev. 957, 966–67; Garnett, *Neglected Political Economy*, *supra* note 39, at 109–10 (describing this type of insult as “dignitary harm[ ]”).

thirty-two acre parcel beneath San Francisco's Golden Gate Bridge. Within a month, some 500 people signed up on the waiting list.<sup>50</sup>

In other cases, however, objections to land assembly for for-profit redevelopment might be purely financial, the result of strategic holdouts by those attempting to maximize their gains. In these instances, the collective action problem might unfairly reward strategic holdouts with a substantial premium, or cause the plan to fail altogether. Naturally, it may be exceedingly difficult to distinguish a landowner's opportunistic holdout behavior from regular bargaining.<sup>51</sup> But the main point is that, whether the holdout is sincere or merely tactical, awarding a sweeping veto to each one of the landowners in the designated development area often prevents innovation, economic growth, and the realization of genuine public preferences.<sup>52</sup> This effect, in our opinion, justifies maintaining the possibility of assembling land also through the nonconsensual mechanism of eminent domain. We believe, however, that reform of the just compensation component, which currently makes land assembly inefficient and unjust, is necessary.

### C. *The Ill Effects of Just Compensation*

The current legal regime governing eminent domain creates an uneasy dichotomy between not using eminent domain and using it but having the incremental value created captured by non-owners. When the use of eminent domain for certain types of for-profit developments is forbidden, projects offering potential private and public benefits may not happen. However, when eminent domain is validated to solve anticommons problems, the government or third parties involved in the project may enjoy the entire incremental value created by the land assemblage.

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50. See Leonora LaPeter, A Final Preservation, *St. Petersburg Times*, Sept. 19, 2004, at 1B.

51. A vivid illustration of a land assembly holdout—the motives for which remain unclear—is depicted in a recent report in *The Washington Post*. Austin Spriggs and his wife, Gladys, own a 116-year-old townhouse in Washington, D.C., which they bought in 1980 for \$135,000 and now used as an office for the family's small architecture firm. When developers began purchasing property along this area of Massachusetts Avenue near the Convention Center and Union Station in 2003, Spriggs refused to sell. While all his neighbors eventually sold their homes and businesses, Spriggs could not be persuaded despite being offered \$2 to \$3 million for a house assessed at just under \$200,000. The developers finally determined they would wrap a twelve-story office building and an upscale condominium around Spriggs's house. Meanwhile, the house has been secured at the developers' expense (adding about \$600,000 in costs) and is monitored daily to make sure it does not slip off its tenuous base. The end of this holdout's story is not yet known, but according to the president of a Maryland-based pizza chain, Spriggs intends to open a pizza franchise just in time for the condominium dwellers and office workers who will move into the neighborhood during 2007. Lyndsey Layton, *A Solitary Stand at the Precipice*, *Wash. Post*, May 3, 2006, at A01.

52. See Misonzhnik, *supra* note 44, at 13 (“These things can drag on for years and, unfortunately, around the country these sorts of lawsuits have caused well-intentioned urban renewal projects to die by the thousands.”).

Compensation to the landowners is based on the pre-project “fair market value,” not post-project value.<sup>53</sup>

There is nearly universal consensus that legal “fair market value” is practically a euphemism, in the sense that it generally does not fairly compensate landowners.<sup>54</sup> As Lee Anne Fennell observes, landowners restricted to such a measure of compensation are denied the “subjective premium” on their property (that is, the unique value that people often place on their properties, especially their homes); the chance for a share in the appreciation brought about by the land assembly and future development; and the intrinsic value that landowners may attribute to making autonomous decisions about the fate of their property.<sup>55</sup> Such a compensation regime seems unfair due to its distributional consequences in the trilateral relationship between landowners, governments, and project developers.<sup>56</sup> Moreover, it could also distort governmental decisionmaking by encouraging use of eminent domain even when the project is socially inefficient or when the use of this power is unnecessary in fact.<sup>57</sup>

To fully understand the inherent problems embedded in the current “just compensation” regime, one thus needs to view eminent domain law not only from the landowner’s perspective, but also from the perspective of the government and the private third parties that promote and implement the project. Several authors have recently criticized the conventional economic rationales for requiring governments to compensate landowners for land expropriation—namely public internalization of costs, avoidance of “fiscal illusion,”<sup>58</sup> and the lack of a private insurance market for landowners against possible takings.<sup>59</sup> According to these crit-

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53. Although, as we have seen, in some cases landowners, and especially the last to hold out, are able to enjoy a substantial extralegal premium. See *supra* notes 14–15 and accompanying text.

54. See, e.g., Posner, *supra* note 20, at 56 (viewing landowners as subsidizing their subjective values). But see Garnett, *Neglected Political Economy*, *supra* note 39, at 121–26 (arguing that this problem is largely overstated because actual compensation, given also relocation assistance laws, often exceeds formal “fair market value”).

55. Fennell, *supra* note 49, at 962–67.

56. We do not address broader questions of “distributive justice” or “vertical equity” concerning the relevant society as a whole, and we doubt whether takings in general is an appropriate arena for addressing such policy issues. For a contrary view, see Hanoch Dagan, *Takings and Distributive Justice*, 85 *Va. L. Rev.* 741, 767–78 (1999) (calling for explicit incorporation of “social responsibility” as component in defining scope of landowners’ rights in takings cases).

57. Merrill, *supra* note 19, at 88–89 (depicting deliberate market bypasses through eminent domain).

58. See, e.g., Lawrence Blume et al., *The Taking of Land: When Should Compensation Be Paid?*, 99 *Q.J. Econ.* 71, 88 (1984) (describing “fiscal illusion” by which uncompensated project is presented as costless); Robert C. Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 *Yale L.J.* 385, 420 (1977) (viewing compensation as a pricing mechanism).

59. See William A. Fischel & Perry Shapiro, *Takings, Insurance, and Michelman: Comments on Economic Interpretation of “Just Compensation”* *Law*, 17 *J. Legal Stud.* 269,

ics, governments often respond not only to economic incentives, but also, and often almost exclusively, to political incentives.<sup>60</sup>

This analysis builds on public choice theory. It points to the disproportionate influence that special interest groups, and chiefly politically powerful real estate entrepreneurs, have over governmental decisions in land policy issues.<sup>61</sup> According to this view, such a state of affairs is facilitated and exacerbated by the fact that the cost of paying just compensation for takings is dispersed among all taxpayers in the relevant constituency, whereas the private parties who implement the project and enjoy its gains are usually not required to reimburse the government for the cost of compensation. Thus, private developers use eminent domain as a vehicle for costless acquisitions.<sup>62</sup> This proposition is allegedly supported by the history of eminent domain, and especially of high-profile cases such as *Berman v. Parker*,<sup>63</sup> *Poletown Neighborhood Council v. City of Detroit*,<sup>64</sup> the recent *Kelo* case,<sup>65</sup> and many other instances in which the power of eminent domain was arguably abused to transfer lands from ordinary citizens—typically members of politically disempowered minorities—to the hands of mighty corporations at a nominal rate.<sup>66</sup> In *Poletown*, for exam-

286–87 (1988) (discussing possible reasons for lack of private insurance market and inadequacy of such market even if extant).

60. See, e.g., Garnett, *Neglected Political Economy*, supra note 39, at 138–43 (arguing that economic theories of takings assume policymakers discount costs “not translated into budgetary expenditures” but do not discount similarly untranslated benefits and so fail to account for political incentives); Deryl J. Levinson, *Making Governments Pay: Markets, Politics, and the Allocation of Constitutional Costs*, 67 U. Chi. L. Rev. 345, 348–51 (2000) (criticizing assumption that governments do not consider externalized costs).

61. See, e.g., Daniel A. Farber, *Public Choice and Just Compensation*, 9 Const. Comment. 279, 289–90 (1992) (noting that somewhat ironically, payment of compensation serves to buy off burdened property owners, which is only other constituency able to effectively resist development plans); Donald J. Kochan, “Public Use” and the Independent Judiciary: Condemnation in an Interest-Group Perspective, 3 Tex. Rev. L. & Pol. 49, 80–82 (1998) (listing several factors that allow special interest groups to successfully influence land use policy).

62. See Kelly, supra note 37, at 37–39. But see Christopher Serkin, *Big Differences for Small Governments: Local Governments and the Takings Clause*, 81 N.Y.U. L. Rev. 1624, 1664–65 (2006) (suggesting that these propositions do not apply equally to all levels of government, and arguing that majoritarian homeowner-dominated local governments are forced “to internalize at least some of the costs” of eminent domain).

63. 348 U.S. 26, 33–36 (1954) (upholding use of eminent domain as part of District of Columbia Redevelopment Act of 1945, which targeted “blighted” areas in southwest Washington, D.C.).

64. 304 N.W.2d 455, 459–60 (Mich. 1981) (per curiam) (validating use of eminent domain by Detroit on entire neighborhood for construction of new General Motors plant), overruled by *County of Wayne v. Hathcock*, 684 N.W.2d 765, 787 (Mich. 2004) (holding that condemnation of 1300 acres for private business park is invalid as matter of state constitutional law).

65. *Kelo v. City of New London*, 545 U.S. 469 (2005).

66. For a fifty-state survey of such alleged abuses, see generally Dana Berliner, *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](http://www.castlecoalition.org/pdf/report/ED_report.pdf) (on file with the *Columbia Law Review*). One should recall, however, that some of the high-



ple, the city of Detroit paid more than \$200 million in compensation for taking, demolishing, and redeveloping targeted properties before transferring the land to General Motors for approximately \$8 million.<sup>67</sup>

This depiction of governments (specifically local ones) as politically-captured, passive vehicles for naked transfers of private property is, however, somewhat lacking. Local decisionmakers are obviously influenced by self-promoting political motives, but they also place considerable weight on fiscal considerations. Land use regulation is probably local government's most fiscally driven area of activity—proposed plans are judged based on the government's fiscal opportunity cost for the land.<sup>68</sup> However, in the context of large-scale developments, and more prominently of redevelopment schemes, the present legal regime often causes the local government to align with the interests of aspiring developers at the expense of current landowners, and sometimes also at the expense of the general public that the government is supposed to serve.

This is especially the case in view of the proliferation of governmental redevelopment projects that are financed through Tax Increment Financing (TIF).<sup>69</sup> Such schemes are generally authorized for the purpose of reviving blighted areas. They allow a redevelopment agency or corporation, which is a subsidiary of the general-purpose local government, to incur expenditures (including the upfront costs involved in land assembly) and to issue revenue bonds that are paid back over time by earmarking the future incremental increase in property taxes in the designated development area. This means that throughout the period until the bonds are paid in full—typically around twenty years from issuance—the redevelopment agency does not have to share the incremental revenues with all the other agencies that regularly receive a proportionate share of the taxes (such as counties, school districts, park districts, and special service districts).<sup>70</sup>

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profile eminent domain legal controversies revolved around public plans that had different distributive goals. Thus, in *Hawaii Housing Authority v. Midkiff*, the Supreme Court validated the Hawaii Land Reform Act of 1967, which allowed the tenants of Hawaii's landowning oligopoly to request condemnation of the landowners' property and to purchase the condemned property for a nominal fee. 467 U.S. 229, 245 (1984).

67. 304 N.W.2d at 469.

68. See, e.g., Amnon Lehavi, Intergovernmental Liability Rules, 92 Va. L. Rev. 929, 948–52 (2006) (noting that reliance on local revenues results in fiscalization of zoning decisions); Jonathan Schwartz, Prisoners of Proposition 13: Sales Taxes, Property Taxes, and the Fiscalization of Municipal Land Use Decisions, 71 S. Cal. L. Rev. 183, 209–13 (1997–98) (describing impact of fiscal decisions made by rival communities).

69. For an overview of TIFs, see generally J. Drew Klacik & Samuel Nunn, A Primer on Tax Increment Financing, in *Tax Increment Financing and Economic Development: Uses, Structures, and Impact* 15, 15–29 (Craig L. Johnson & Joyce Y. Man eds., 2001) (discussing history, themes, terminology, and implications of tax increment financing).

70. See Rachel Weber, Tax Increment Financing in Theory and Practice, in *Financing Economic Development in the 21st Century* 53, 55 (Sammis B. White et al. eds., 2003). For the legal validity of TIFs, see, for example, *In re Request for Advisory Opinion on Constitutionality of 1986 PA 281*, 422 N.W.2d 186, 191–96 (Mich. 1988) (rejecting

In some states, redevelopment agencies are entitled to participate directly with the developer in the profits of the development, beyond the receipt of taxes. This is especially the case when the agency and the developer disagree about the value of the land during the predevelopment negotiations because of differing estimates about the project's future economic performance. In such instances, part of the payment for the land is often deferred dependent on that performance. The agency's participation in the cash flow provides it a means to recover expenditures it made, such as for parking and highway interchanges, that cannot be recouped as part of the price of the land.<sup>71</sup>

This fuller account of the forces that drive local governments makes clear why it is in their self-interest to designate areas as blighted to facilitate redevelopment schemes and to overuse their powers of eminent domain. Moreover, as several studies have shown, although TIFs are hailed as self-financing, thereby imposing no burden on public resources, many such projects are in fact detrimental to the overall social welfare. This is the case whenever the redevelopment scheme does not generate genuine municipality-wide gains but is used to merely shift existing economic activity to the TIF district, so that the positive effects on property values within the TIF district may be more than offset by the negative impacts on the non-TIF portions of the municipality.<sup>72</sup> In such cases, the current legal regime creates particularly skewed incentives for local governments to collude with private developers, to the detriment of the private owners of confiscated lands, other taxing jurisdictions, and the public at large.

## II. THE U.S. LEGAL REGIME IN A COMPARATIVE PERSPECTIVE

When compared to other countries, the prevailing land use regulation and land tax laws in the United States make the *Kelo* case and the use of eminent domain for private development particularly dramatic in regard to the allocation of gains and losses among landowners, government, private developers, and other stakeholders.

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argument that TIF is constitutionally impermissible diversion of school districts' tax funds under Michigan law). Some states do, however, limit the ability of redevelopment agencies to receive all tax increments generated from the project's area. See, e.g., David F. Beatty et al., *Redevelopment in California* 212–18 (3d ed. 2004) (describing such mitigating constitutional and statutory provisions in California).

71. See Beatty et al., *supra* note 70, at 175.

72. See Michael Dardia, *Subsidizing Redevelopment in California* 29 (1998), available at <http://www.ppic.org/main/publication.asp?i=70> (on file with the *Columbia Law Review*) (noting that where increase in tax revenue is due to general trends in real estate market, TIFs act as involuntary subsidies from counties and school districts to cities); Richard F. Dye & David F. Merriman, *The Effects of Tax Increment Financing on Economic Development*, 47 *J. Urb. Econ.* 306, 307 (2000) (arguing competitive government bidding could be zero-sum game with gains to some offset by losses to others); Weber, *supra* note 70, at 63 (noting studies showing evidence that positive effect on growth in property value in TIF district is offset by negative impact in non-TIF districts of same city).

Prevailing land use regulation and land tax laws make the takings side of eminent domain a drastic, winner-take-all proposition, but the same dynamic exists with the governmental “givings” awarded to a project’s developer. The Supreme Court’s decisions in *Nollan v. California Coastal Commission*<sup>73</sup> and *Dolan v. City of Tigard*,<sup>74</sup> strictly limit local governments (at least formally) in their ability to require land or in-kind exactions from the developer.<sup>75</sup> But the U.S. tax regime imposes no betterment tax on the increased value of land resulting from a regulatory giving.<sup>76</sup> As a result, a private developer that receives approval for a development project bears only a small portion of the total costs to the government and to affected parties in the surrounding community but enjoys the benefit of nearly the entire incremental increase to the land value. This state of affairs presents landowners with a “win all or lose all” situation: retaining their land ownership interests within the project and enjoying its gains, or being unwillingly bought out through eminent domain for compensation based on the pre-project value. It is no wonder, therefore, that the post-*Kelo* public and legal waters are so stormy.

Recent developments in Britain offer an interesting comparison. As in the United States, the British legal regime gives governments a broad mandate to assemble private land for urban regeneration (redevelopment) projects and to pass on the land to private developers. For example, the *Alliance Spring Co. v. First Secretary of State* case dealt with a major regeneration scheme resulting from Arsenal Football Club’s need for a new stadium with increased capacity.<sup>77</sup> The court validated compulsory purchase (eminent domain) for land assembly for this predominantly private development. It held that the Islington Council, the local planning authority, was within its authority to take 134 privately owned plots for the new stadium and for the larger scheme “which it regarded as a comprehensive redevelopment of the area in the public interest.”<sup>78</sup> The court noted that “developments which result in regeneration of an area are often led by private enterprise.”<sup>79</sup>

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73. 483 U.S. 825, 837 (1987) (requiring “essential nexus” between exaction and development’s expected harm to its surroundings).

74. 512 U.S. 374, 391 (1994) (imposing “rough proportionality” requirement both in nature and in scope between exaction and anticipated impacts of proposed development).

75. For a critique of the Court’s exactions jurisprudence, see Mark Fenster, *Takings Formalism and Regulatory Formulas: Exactions and the Consequences of Clarity*, 92 Cal. L. Rev. 611, 652 (2004) (arguing that Court’s insistence on formalistic rules fails to address real life land use needs).

76. See Abraham Bell & Gideon Parchomovsky, *Givings*, 111 Yale L.J. 547, 590–608 (2001) (criticizing Court’s approach to “givings” and calling for imposition of tax on certain types of land use regulatory benefits).

77. [2005] EWHC (Admin) 18, [5] (noting that beyond 60,000 capacity stadium, mixed-use scheme included learning centers, new and refurbished houses, general business space, shops, and leisure spaces).

78. *Id.* at [20].

79. *Id.* at [19]–[20]. Legal compensation to landowners in Britain resembles the U.S. regime, and thus denies condemnees a share in the future appreciation of land value

These governmental powers have been further broadened by the Planning and Compulsory Purchase Act of 2004, which amended Section 226(1) of the Town and Country Planning Act of 1990.<sup>80</sup> Section 226(1a) now allows the use of compulsory purchase for development or redevelopment that promotes or improves the economic, social, or environmental “well-being” of the area.<sup>81</sup> This statute-based mandate for compulsory purchase seems to resemble and even go beyond the *Kelo* validation of the use of eminent domain for “economic development.”<sup>82</sup>

The influx of the use of compulsory purchase for land assembly in the past few years, and its statutory and judicial vindication, are first and foremost a result of the growing recognition in Britain of the essentiality of government-coordinated urban regeneration. In the past, such projects were few and restricted to areas in which land was mostly publicly owned. This was the case with the Thatcher government’s most celebrated regeneration project, the Canary Wharf business district in the London Docklands.<sup>83</sup> A fragmented, multiple ownership structure of land is still considered a serious constraint on the possibility of urban renaissance projects in British cities.<sup>84</sup> This is why London, for example, is directing its regeneration efforts mainly toward areas located outside its core. These areas have a greater proportion of government owned lands (and are also less burdened by historic preservation requirements).<sup>85</sup> Nevertheless, urban regeneration schemes sometimes make necessary the

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resulting from the project. This is known as the “Pointe Gourde” rule (or “no-scheme rule”), according to which compensation “cannot include an increase in value which is entirely due to the scheme underlying the acquisition.” *Pointe Gourde Quarrying & Transp. Co. v. Sub-Intendent of Crown Lands*, [1947] A.C. 565, 572 (P.C. 1947) (appeal taken from Trin.). This principle was recently reaffirmed by the House of Lords in *Waters v. Welsh Dev. Agency*, [2004] UKHL 19, [40]–[42], [55]–[57], 2004 2 All E.R. 915 (noting that *Pointe Gourde* principle ensures “dispossessed owners . . . receive fair compensation but not more than fair compensation”).

80. Planning and Compulsory Purchase Act, 2004, c. 5, § 99(1)–(4), sched. 9 (amending Town and Country Planning Act, 1990, c. 8, § 226(1)).

81. Planning and Compulsory Purchase Act, 2004, c. 5, § 99(3). In addition, Section 226(4) regards as “immaterial by whom the local authority propose that any activity . . . should be undertaken or achieved” thus explicitly validating the plan’s private implementation. For an elaborate discussion of these recent changes, see Richard Clayton, *New Directions in Compulsory Purchase*, 2006 J. Plan. & Envtl. L. 133, 133–37.

82. Other recent cases seem to express a similar deferential approach to compulsory purchase for land assembly. See, e.g., *R. (on the application of Hall) v. First Sec’y of State*, [2006] EWHC (Admin) 2393, [30], [34]–[35], [42] (upholding compulsory land purchase order to secure completion of public park by British Airways (BA) and rejecting landowner contention that order had collateral purpose, in that BA sought to escape expensive option agreement previously signed with landowner and instead acquire land more cheaply), *aff’d*, [2007] EWCA (Civ) 612.

83. For the warped history of the Canary Wharf project, see David L. A. Gordon, *The Resurrection of Canary Wharf*, 2 Plan. Theory & Prac. 149, 150–61 (2001).

84. See David Adams et al., *Land Policy and Urban Renaissance: The Impact of Ownership Constraints in Four British Cities*, 3 Plan. Theory & Prac. 195, 210 (2002).

85. Randy Gragg, *London’s Large-scale Regeneration Projects Offer Community Benefits*, *Land Lines*, Oct. 2006, at 2, 5.

nonconsensual assembly of land, even for what are mainly private enterprises, and, as stated, they generally enjoy deference from reviewing courts.<sup>86</sup>

At the same time, however, and in contrast to the United States, the Crown holds all landed property development rights in Britain.<sup>87</sup> In theory, private landowners have no development rights in their property until these are explicitly granted by a governmental agency. This gives local governments in Britain substantial latitude both in deciding whether to grant planning permissions and in negotiating with the developer over its planning obligations.<sup>88</sup>

An influential analysis of housing supply in Britain by economist Kate Barker considered the role of planning obligations. These obligations generally require the developer to either perform certain actions or pay a sum to the planning authority to take the planned action itself.<sup>89</sup> The Barker report suggests that planning obligations actually fulfill two different economic roles: compensating affected parties for the negative externalities arising from the development and acting as an informal tax on land betterment.<sup>90</sup>

Barker recommended that these two functions be separated. Planning obligations would be scaled back and restricted to dealing with the actual impacts of the development, whereas a new tax would extract some of the windfall that accrues to landowners. This tax would be passed on to the local community to help share the benefits of growth and manage its impacts. It would also allow the community to provide the infrastructure necessary to support housing growth, while still preserving private development incentives.<sup>91</sup>

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86. In another recent case, *Pascoe v. First Secretary of State*, the court held, obiter, that the proportionality requirement developed by the European Court of Human Rights and by English courts according to the European Convention for the Protection of Human Rights and Fundamental Freedoms 1950, and the Human Rights Act 1998, respectively, does not in itself mandate a government to employ the “less intrusive means” for achieving urban regeneration, even if such means are practical but may adversely affect the implementation of the regeneration project in the public interest. [2006] EWHC (Admin) 2356, 4 All E.R. 1240, 1259–67.

87. Some scholars argue that the early 1970s saw an attempt to imbue the American government, in effect the “crown,” with all development rights, in an attempt to copy aspects of the British system. See Gideon Kanner, *Making Laws and Sausages: A Quarter-Century Retrospective on Penn Central Transportation Co. v. City of New York*, 13 Wm. & Mary Bill Rts. J. 679, 704–06 (2005).

88. Owen Connellan, *Land Value Taxation in Britain: Experience and Opportunities* 86 (2004).

89. Kate Barker, *Review of Housing Supply—Delivering Stability: Securing Our Future Housing Needs, Final Report—Recommendations 65–68* (2004), available at [http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/barker/consult\\_barker\\_index.cfm](http://www.hm-treasury.gov.uk/consultations_and_legislation/barker/consult_barker_index.cfm) (on file with the *Columbia Law Review*).

90. *Id.* at 65–66.

91. *Id.* at 65–67, 84–87.

The British Government has adopted the Barker recommendations, and in December 2005 issued a consultation paper<sup>92</sup> setting out the proposed features of the new tax, the Planning-Gain Supplement (PGS). This paper envisions that the PGS “would capture a modest portion of the value uplift arising on land for which full planning permission has been granted.”<sup>93</sup> The Government received hundreds of responses to its consultation paper. These responses came from a wide variety of stakeholders, including local governments, and developers, who were largely favorable to the idea. They did, however, express concerns over many details regarding the practical application of the proposal.<sup>94</sup> In response, the Government has included further details on the PGS in its 2006 Pre-Budget Report<sup>95</sup> and in December 2006 published three new consultation papers on elements of the design of PGS and the new approach to planning obligations.<sup>96</sup>

The evolving principles of the PGS, which would not be legislatively introduced earlier than 2009, include its levying at a modest rate across the United Kingdom, its application to both residential and non-residential land, and the hypothecation of a significant majority of PGS revenues for local infrastructure.<sup>97</sup> Thus, Britain, which has experimented with land betterment taxes throughout the twentieth century,<sup>98</sup> seems on its way to using taxation once again to share the benefits of increased land value increments between the developer and the public.

Therefore, while landowners in Britain face the same threat of losing ground (literally) to private developments, the conflicting interests are at least more balanced. The project’s developer must share its gains with

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92. HM Treasury, Planning-Gain Supplement: A Consultation 5–6 (2005), available at [http://www.hm-treasury.gov.uk/media/D/5/pbr05\\_planninggain\\_449.pdf](http://www.hm-treasury.gov.uk/media/D/5/pbr05_planninggain_449.pdf) (on file with the *Columbia Law Review*).

93. *Id.* at 10.

94. HM Treasury, Planning-Gain Supplement: A Summary of Consultation Responses 2 (2006), available at [http://www.hm-treasury.gov.uk/media/8/4/pbr06\\_pgs\\_summaryofresponses\\_220.pdf](http://www.hm-treasury.gov.uk/media/8/4/pbr06_pgs_summaryofresponses_220.pdf) (on file with the *Columbia Law Review*) (highlighting shareholder concerns about valuation process, mechanisms to return PGS funds to local communities, transitional arrangements, and risks of reduced incentives for certain development).

95. HM Treasury, Pre-Budget Report 2006: Investing in Britain’s potential: Building Our Long-Term Future 69–71 (2006), at [http://www.hm-treasury.gov.uk/pre\\_budget\\_report/prebud\\_pbr06/report/prebud\\_pbr06\\_repindex.cfm](http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr06/report/prebud_pbr06_repindex.cfm) (on file with the *Columbia Law Review*).

96. See Dep’t for Cmty. & Local Gov’t, Changes to Planning Obligations: A Planning-Gain Supplement Consultation 10–21 (2006), available at <http://www.communities.gov.uk/documents/planningandbuilding/pdf/152900> (on file with the *Columbia Law Review*); HM Revenue & Customs, Paying PGS: A Planning-Gain Supplement Technical Consultation 7 (2006), available at <http://www.hmrc.gov.uk/consultations/paying-pgs.pdf> (on file with the *Columbia Law Review*); HM Revenue & Customs, Valuing Planning Gain: A Planning-Gain Supplement Consultation 3 (2006), available at <http://www.hmrc.gov.uk/consultations/value-planning-gain.pdf> (on file with the *Columbia Law Review*) [hereinafter HM Revenue & Customs, Valuing Planning Gain].

97. HM Revenue & Customs, Valuing Planning Gain, *supra* note 96, at 3.

98. Connellan, *supra* note 88, at 79–90.

the public, mainly the local government's constituents. In this respect, the use of compulsory purchase in Britain is more public spirited, and less of a winner-take-all dynamic, than is currently the case with eminent domain in the United States.

### III. THE PROBLEMS WITH CURRENT SUGGESTIONS FOR REFORM

The growing dissatisfaction with the current state of affairs, which has intensified following the *Kelo* decision, has prompted numerous calls for reform in American legal doctrine. These reforms look beyond the aforementioned growing restrictions on the very use of governmental eminent domain powers in the context of for-profit projects.<sup>99</sup> In this Part, we briefly look at two categories of suggested reforms: first, calls to initiate institutional changes in the way developments or redevelopments are promoted and implemented, focusing attention on the planning tool of land readjustment; and second, suggestions to change the current legal "fair market value" formula. We discuss the advantages of each type of reform effort but also illuminate their potential pitfalls. These pitfalls make their implementation in the American context either practically infeasible or normatively undesirable.

#### A. *Structural Changes for Developments Involving Land Assembly*

An alternative mechanism for handling the collective action problems embedded in scenarios of land assembly and reorganization is the planning tool of land readjustment.<sup>100</sup> This planning tool is prevalent in many European and Far Eastern countries, but to date it has failed to gain currency in the United States.

Land readjustment was first introduced in Frankfurt, Germany, in 1902, when the city passed a law enabling it to coerce landowners to participate in what was purported to be a more efficient and viable reorganization of the lands for development. At the end of the process, new tracts targeted for development were redistributed to previous property owners, whereas the city allocated land required for public purposes to itself.<sup>101</sup> In Germany today, the reallocation of lands among private landowners is based on either pre-readjustment relative size or relative value. The amount of uncompensated taking of land for public purposes is limited to thirty percent of each original tract in the case of a relative size read-

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99. See *supra* notes 3–7 and accompanying text.

100. See generally *Land Readjustment: A Different Approach to Financing Urbanization* (William A. Doebele ed., 1982) (discussing land readjustment generally and reviewing its implementation in practice).

101. Rainer Müller-Jökel, *Land Readjustment—A Win-Win Strategy for Sustainable Urban Development I* (2004), available at [http://www.fig.net/pub/athens/papers/ts14/TS14\\_3\\_MullerJokel.pdf](http://www.fig.net/pub/athens/papers/ts14/TS14_3_MullerJokel.pdf) (on file with the *Columbia Law Review*) (explaining that "municipalities get the areas needed for public use . . . [while] net building land will be redistributed to the previous landowners").

justment scheme.<sup>102</sup> This basic formula seeks to allow landowners to enjoy the land betterment fruits of top-down coordinated action according to what is deemed a fair internal allocation formula, while at the same time providing the government with its own land use needs. In the years that followed its adoption in Germany, other European countries, such as France and the Netherlands, embraced this formula.<sup>103</sup>

In contrast, Japan has traditionally emphasized the importance of centrally coordinated land readjustment as a means of self-financing urban development or redevelopment through the government's ability to retain "cost equivalent" land parcels that it could later sell to recover the costs of providing infrastructure. This regime originated in the unique circumstances of early- and mid-twentieth century Japan. It is a response to the development challenges posed by major earthquakes, World War II, rapid economic development in the 1960s, and a lack of available public funds to otherwise finance urban infrastructure.<sup>104</sup>

Japanese culture's alleged tradition of group harmony and hierarchical obedience arguably made this original model possible. In recent decades, as private property rights have become more entrenched and the depiction of harmony and obedience in this context has increasingly been proven to be merely a myth, this model has come under increasing pressure.<sup>105</sup> Accordingly, the land readjustment legal regime in Japan has gradually changed and is currently based on gaining a special majority support of landowners (usually, eighty percent) within the designated project area as a precondition for carrying out the land readjustment. In spite of the substantial weakening of the possibility of holdout by a few defiant landowners, local governments—which are the primary advocates and initiators of such programs because of their dire need for public lands—often struggle to gain such majority support. Consequently, many readjustment plans get stuck in the pipeline.<sup>106</sup>

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102. *Id.* at 3–5 (explaining that in "projects where the criteria of redistribution by size is chosen up to 30% of the private old plots can be taken for public use without paying any monetary compensation"); see also Benjamin Davy, *Mandatory Happiness? Land Readjustment and Property in Germany*, in *Analyzing Land Readjustment: Economics, Law, and Collective Action* 37, 46 (Yu-Hung Hong & Barrie Needham eds., 2007) [hereinafter *Analyzing Land Readjustment*] (explaining that "readjustment gain can be captured by the municipality . . . as a deduction of up to 30 percent of the readjusted land").

103. See Yu-Hung Hong & Barrie Needham, *Preface to Analyzing Land Readjustment*, *supra* note 102, at xv–xvi.

104. William A. Doebele, *Introductory Remarks at the Lincoln Institute of Land Policy Workshop, Tools for Land Management and Development: Land Readjustment 1–2* (Mar. 21–22, 2002) (draft available at [http://www.lincolnst.edu/pubs/dl/636\\_doebele.pdf](http://www.lincolnst.edu/pubs/dl/636_doebele.pdf), on file with the *Columbia Law Review*).

105. André Sorensen, *Consensus, Persuasion, and Opposition: Organizing Land Readjustment in Japan*, in *Analyzing Land Readjustment*, *supra* note 102, at 89, 91–96.

106. *Id.* at 108–11.



In spite of some institutional initiatives<sup>107</sup> and academic calls<sup>108</sup> to introduce land readjustment in the United States, legislatures have been generally reluctant to import this mechanism. The reasons for this reluctance are not entirely clear. One reason may be that since land readjustment is based on some level of governmental coercion, this model does not seem an attractive alternative to the current form of coercion. Americans, to quote *Hamlet*, may “rather bear those ills we have [t]han fly to others that we know not of.”<sup>109</sup>

A more substantial constraint, in our view, on the use of land readjustment lies in the direct linkage that is kept between the landowners and the in-kind land allocations within the project’s area. Changes to the original plan with respect to the land use designation, location, or size of one of the new plots may become necessary because of planning needs as the project progresses. These changes threaten to send the project back to square one because in a reallocation system based on *relative* value or *relative* size these changes immediately implicate the relative status of the other plots. This means that land readjustment schemes may be more efficient for relatively small and medium scale redevelopment projects, which are more predictable and have a shorter time span, but may be problematic for large-scale or highly dynamic projects which necessitate flexibility during the implementation process.

Similarly, other suggestions for institutional reforms in the governance structure of decisionmaking about a proposed for-profit project and dedication of lands for this purpose do not yet seem to succeed in providing a systematic and satisfying solution to the land assembly dilemma.<sup>110</sup>

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107. See, e.g., Fla. Legislative Comm. on Intergovernmental Relations, *Platted Lands* 36 (2003), available at <http://www.floridalcir.gov/UserContent/docs/File/reports/plattedlands03.pdf> (on file with the *Columbia Law Review*); Luciano Minerbi, *Efforts Toward Land Readjustment Legislation in Hawai’i*, Presentation at the Lincoln Institute of Land Policy Workshop, *Tools for Land Management and Development: Land Readjustment* 8 (Mar. 21–22, 2002), available at [http://www.lincolninst.edu/pubs/dl/642\\_minerbi.pdf](http://www.lincolninst.edu/pubs/dl/642_minerbi.pdf) (on file with the *Columbia Law Review*).

108. See Lynne B. Sagalyn, *Land Assembly, Land Readjustment, and Public-Private Redevelopment*, in *Analyzing Land Readjustment*, supra note 102, at 159, 178–79 (finding that despite obstacles application of land readjustment in United States has “strong conceptual appeal”); Michael M. Schultz & Frank Schmidman, *The Potential Application of Land Readjustment in the United States*, 22 *Urb. Law.* 197, 237–43 (1990) (discussing potential opportunities and benefits of implementing land readjustment).

109. William Shakespeare, *Hamlet* act 3, sc. 1, lines 81–82 (Burton Raffell ed., Yale Univ. Press 2003) (n.d.).

110. In an unpublished paper, Michael Heller and Rick Hills propose establishing a Land Assembly District (LAD), which would have the power by a majority vote to approve or disapprove the sale of the district’s area to a developer or municipality seeking to consolidate the land into a single parcel. The LAD would also grant landowners a right to opt out and receive current “fair market value” compensation. Whereas the LAD mechanism differs from our proposal in numerous aspects, it shares the potential for overcoming the veto power problem resulting from over-fragmentation. The divide between the two proposals stems in part from differing views about the tradeoff between the potential benefits of a decentralized market for development compounds vis-à-vis the

### B. *New Formulas for Calculating "Just Compensation"*

Critics of current eminent domain law have also proposed amending the formula for the court-determined "fair market value" of the condemned property. Thomas Merrill suggested awarding condemnees 150% of the fair market value when there are "suspect" conditions in the eminent domain process, such as a high subjective value for the land, a potential for rent-seeking by the government or interested third parties, or fear of a deliberate bypass of potential market purchases.<sup>111</sup> However, the incentive structure under such a rule of increased compensation is not likely to improve dramatically.<sup>112</sup> Although such a regime might have a somewhat greater deterrent effect on governments, it may still result in under or overcompensation for landowners, thus potentially causing the failure of socially desirable plans. At any rate, such a regime fails to create a reliable financial link to subjective land values or to the risks and rewards of the planned project.

Alternatively, several scholars have proposed basing the compensation amount on a self-assessment made by the landowner. The purpose is to reflect the subjective value that the owner places on his property. To avoid the obvious tendency to strategically overestimate such value, these scholars have designed accompanying deterring mechanisms to ensure genuine evaluations. One such mechanism is found, though somewhat implicitly, in Saul Levmore's work on self-assessment.<sup>113</sup> Levmore, concerned with the cumbersome process of property evaluations for property tax purposes, called for a shift to a system of self-assessment. To penalize strategic assessments (in this case, underassessments), he proposed publicizing the periodic self-assessment of the property, and to allow any willing buyer (including the government) to take the property against payment of the owner's declared amount.<sup>114</sup>

More recently, Lee Anne Fennell dealt directly with the problem of just compensation and proposed implementing Levmore's insights in the context of eminent domain resulting in the retransfer of taken land to private hands. She suggested reversing the order of events by designing an opt-in mechanism to allow for such takings in exchange for tax benefits.<sup>115</sup> According to this proposal, property owners, when paying their annual property taxes, would be able to check off a box indicating their choice whether to permit the property to be taken for private transfer

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transaction and coordination costs of setting up and operating a multitude of LADs. Michael A. Heller & Roderick M. Hills, Jr., *LADs and the Art of Land Assembly* 20–28 (Oct. 24, 2006) (unpublished manuscript, on file with the *Columbia Law Review*).

111. Merrill, *supra* note 19, at 90–93 (citations omitted).

112. For a critical review of similar suggestions, see Garnett, *Neglected Political Economy*, *supra* note 39, at 146–48.

113. Saul Levmore, *Self-Assessed Valuation Systems for Tort and Other Law*, 68 *Va. L. Rev.* 771 (1982).

114. *Id.* at 778–79.

115. Fennell, *supra* note 49, at 995–96.

purposes. Then, the owner would select a private valuation of his property for such a taking, expressed as a percentage between 100% and 200% of the assessed property value. The higher the percentage selected, the smaller the tax break, with the largest possible tax break achieved by making the property available at 100% of the assessed property tax value.<sup>116</sup>

Following a somewhat different pattern, Abraham Bell and Gideon Parchomovsky advocate using self-assessment for all cases of eminent domain.<sup>117</sup> Their counter-opportunism mechanism is designed as a stick as opposed to Fennell's carrots. Under their proposed mechanism, once the government announces its plan to condemn a certain land, the landowner reports the value he attaches to the property. Then, the government decides whether to take the land at the landowner's price, or to forgo its plan. In determining the land's value, two restrictions are imposed on the property owner: (1) throughout his lifetime, he will not be able to transfer the property for less than the self-reported value (adjusted for housing index), and (2) his property tax liability will be based on the self-reported valuation (after discounting certain peculiarities of property tax assessments).<sup>118</sup>

While these self-assessment models are innovative and intriguing, they do seem to possess certain inherent difficulties that threaten their practical viability. The inevitable need for externally enforced counter-strategic rules contravenes the alleged simplicity of self-assessment. It is not entirely clear whether the advantages of these mechanisms are not offset by these new forms of governmental and legal monitoring. Further, these plans become increasingly complex once they introduce additional mechanisms to avoid the possible harsh or seemingly unjust consequences of applying these counter-opportunism "fines" in certain unique circumstances.<sup>119</sup> These new additions risk increasing the model's level of complexity to a point at which its overall feasibility is largely undermined.

Moreover, self-assessment models may have an unintended distributive impact. They may relatively disadvantage less well-off property owners, who usually also suffer from a corresponding inferiority in the political process. Once the determination of property value is placed in the hands of the property owner, especially against the background of a proposed governmental plan for which the power of eminent domain is

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116. *Id.* at 997–98.

117. Abraham Bell & Gideon Parchomovsky, *Taking Compensation Private*, 59 *Stan. L. Rev.* 871, 890–900 (2007).

118. *Id.* at 892–95.

119. For example, to prevent governmental abuse of their model, Bell and Parchomovsky suggest that the additional increment of property tax based on the self-assessment in case of governmental withdrawal from the plan can be donated to a charity of the owner's choice, rather than paid to the government. *Id.* at 900–01. Such an option would necessitate, however, initiating a new governmental monitoring mechanism to prevent "self-donation" or other acts of collusion.

sought, the owner would likely be tempted to report not only his pre-project subjective valuation of the land, but also a speculative component which would try to capture a portion of the *post-project* land value. Each landowner is uncertain whether the government would elect to take her land or else face the counter-opportunism “fines” that follow in the case of government withdrawal. In this situation, a landowner’s individual level of risk aversion is likely to bear heavily on her choice of subjective land value. Less well-off landowners, whose land is their sole material asset, are likely to be risk averse and thus have lower self-assessments. In contrast, land speculators that have multiple holdings and are better able to spread risks would state much higher prices, especially when their land is strategically located such that the governmental project could not be implemented without taking their specific tract. Thus, self-assessment models might inadvertently work to the detriment of the simple-rank landowners—the very people whom popular and academic critics of current eminent domain practices aim to help.<sup>120</sup>

In sum, whereas these and other suggested models for amending the “fair market value” formulas deserve careful consideration,<sup>121</sup> they do not yet seem to provide a systematic solution to the current problems with eminent domain law. One main reason for this is that these suggestions do not look for guidance in what we think is actually the most obvious place: the real post-project market.

#### IV. THE PROPOSED MECHANISM: A SPECIAL-PURPOSE DEVELOPMENT CORPORATION

##### A. *Uncoupling Taking and Just Compensation*

The circumstances of takings in the course of land assembly for economic development vary considerably. As mentioned in Part I, some landowners place an exceptionally high emotional value on their land, for which they are not compensated, while others expect a price that reflects not only the land’s market value but also the harm caused to their

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120. This type of discrimination, resulting also from differences in political influence, is already present in many current eminent domain cases. In a study of governmental land acquisitions in Chicago from 1962 to 1970, Patricia Munch found that owners of low-value lands were systematically undercompensated, whereas owners of high-value properties were overcompensated compared to assessed market values. Patricia Munch, *An Economic Analysis of Eminent Domain*, 84 *J. Pol. Econ.* 473, 485–88 (1976); see also Garnett, *Neglected Political Economy*, *supra* note 39, at 115–21.

121. See, e.g., James E. Krier & Christopher Serkin, *Public Ruses*, 2004 *Mich. St. L. Rev.* 859, 865–73 (suggesting adjustment of “fair market value” standard upwards to make up for absence of implicit in-kind benefits for landowners, or basing compensation on restitutionary principles derived from expected land value to the developer, as estimated *ex ante* by court); Paul Niemann & Perry Shapiro, *Efficiency and Fairness: Compensation for Takings 16–17* (Dec. 5, 2005) (unpublished manuscript, on file with the *Columbia Law Review*) (calling for compensation to landowners based on post-project values of non-taken lands in surrounding community).

sense of autonomy.<sup>122</sup> Moreover, it is exceedingly difficult to distinguish a landowner's opportunistic holdout behavior, against which policy measures may be justified, from legitimate bargaining. While some development projects may be promoted by benevolent public authorities, one cannot rule out scenarios in which eminent domain proceedings are initiated by opportunistic private developers who are motivated by the below-market compensation to current landowners. The specter of a corrupt official promoting a project that is not truly welfare-enhancing with a view to deriving private gains should not be dismissed either.

How, then, does one place the eminent domain circle in the market square? We propose a new approach to eminent domain that is based on a corporate finance perspective. To this end, we call for separating the two phases of eminent domain—namely, taking and just compensation.<sup>123</sup> We argue that the taking phase resembles a notional incorporation of a firm. This phase would remain an involuntary non-market transaction. The compensation phase, however, would be market-driven. Implemented through a special-purpose corporation whose securities would be offered to condemnees, this phase will transform landowners' real interests in land into financial interests in a firm. Market mechanisms will generate a more accurate assessment of compensation for takings and thus greatly diminish the current injustice of the legal "just compensation" regime.

### B. *Reconceptualizing Taking as Incorporation*

In his classic article *The Nature of the Firm*,<sup>124</sup> Ronald Coase observed that firms are solutions devised to overcome market failures—in particular, when parties fail to reach a contractual agreement because transaction costs are too high. Common sources of transaction costs include the time and other resources needed for negotiation as well as parties' bounded rationality. More importantly, one party may fear that another party would behave opportunistically by leveraging informational superiority or other forms of power. In such cases, market failure ensues and people wishing to pool assets for profitable projects would be unable to achieve this goal based on contracts alone. In Coase's view, firms help

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122. See *supra* notes 54–55 and accompanying text. More generally, Bruno Frey and Matthias Benz argue that people's well-being is affected by whether they can act independently, which is more highly valued, or are subject to decisions made by others—what the authors dub "market" versus "hierarchy" decisionmaking procedures. See Bruno S. Frey & Matthias Benz, *Being Independent Is a Great Thing: Subjective Evaluations of Self-Employment and Hierarchy*, 74 *Economica* (forthcoming 2007) (manuscript at 2, on file with the *Columbia Law Review*), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=359822](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=359822).

123. Cf. Michael A. Heller & James E. Krier, *Deterrence and Distribution in the Law of Takings*, 112 *Harv. L. Rev.* 997, 1002 (1999) (offering four-quadrant taxonomy, with yes/no taking on one axis and yes/no compensation on the second axis, based on uncoupling of normative principles of deterrence and distribution).

124. R.H. Coase, *The Nature of the Firm*, 4 *Economica* 386 (1937).

solve this market failure by allowing for the allocation of resources by fiat rather than by agreement. Coase likened firms to “islands of conscious power,” surrounded by an ocean of contracts, which is the market.<sup>125</sup>

Coase’s insight was later developed by Oliver Williamson. Williamson identified opportunism as a major source of transaction costs. He defined opportunism as “[s]elf-interest seeking with guile, to include calculated efforts to mislead, deceive, obfuscate, and otherwise confuse.”<sup>126</sup> As hierarchical organizations, firms could facilitate asset-specific investment that would not otherwise take place for fear of opportunistic behavior. Law and economics scholars continue to elaborate different nuances of this idea.<sup>127</sup> The common thread running through this strand of economic thought is that the consolidation of assets in a single entity that is subject to hierarchical governance is key to overcoming opportunism. Firms concentrate the assets they need for their operations in separate legal entities, namely, corporations. In exchange, equity investors receive nonfixed claims against the corporation in the form of shares.

The justification for takings in economic development projects requiring land assembly lies primarily in the likelihood of market failures due to collective action problems, high transaction costs, and, in particular, opportunistic behavior. Such market failures are not unlike the failures invoked in the economic theory of the firm. Inasmuch as one may feel sympathy for Susette Kelo and the residents facing displacement in the Atlantic Yards project, one can hardly deny that their refusal to sur-

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125. *Id.* at 388 (viewing firms as “islands of conscious power in this ocean of unconscious co-operation like lumps of butter coagulating in a pail of buttermilk” (internal citation omitted) (quoting D.H. Robertson & Stanley Dennison, *Control of Industry* 85 (1923))).

126. Oliver E. Williamson, *The Mechanisms of Governance* 378 (1996); see also Oliver E. Williamson, *The Economic Institutions of Capitalism* 47 (1985) (“By opportunism I mean self-interest seeking with guile[, which] includes but is scarcely limited to more blatant forms, such as lying, stealing, and cheating.”); Oliver E. Williamson, *Markets and Hierarchies* 255 (1975) (“[Opportunism] is self-interest seeking with guile.”).

127. See Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 *Va. L. Rev.* 247, 250–51 (1999) (arguing that firms may provide internal governance structures, dubbed “mediating hierarch[ies],” allowing individuals to profit from team production); Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 *Yale L.J.* 387, 390 (2000) (arguing that essential role of organizational law is to partition and shield entity assets from assets of managers and investors to protect them from creditor claims while retaining creditor financing); Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 *U. Pa. L. Rev.* 1619, 1619 (2001) (arguing that “raison d’être of firms is to replace legal/contractual governance of relations with [nonlegal norms]”); see also D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 *Vand. L. Rev.* 1399, 1400 (2002) (trying “to craft a unified theory of fiduciary duty”); Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: “Sacred Space” in Corporate Takeovers*, 80 *Tex. L. Rev.* 261, 261 (2001) (advocating “necessary ‘sacred space’ for shareholder self-help, free of directorial or judicial intrusion”).

render their property might also stem from “self-interest seeking with guile.” The exercise of eminent domain powers thus resembles an incorporation by the government of all landowners with a view to bringing all the critical assets under hierarchical governance. Establishing a corporation for this purpose and transferring land parcels to it thus would be merely a procedural manifestation of the substantive economic reality that already takes place in eminent domain cases.

The difference between regular incorporation and the notional incorporation (or an actual one under our proposal) in eminent domain cases is that the former is voluntary whereas the latter is not. One should thus bear in mind that we do not question whether eminent domain should be exercised for promoting large-scale economic development projects. This issue lies beyond the scope of this Essay, having been approved as a constitutional matter in *Kelo*. Our proposal is consistent with this view, and, since we part ways with the current legal regime with regards to just compensation, our proposal may actually draw support from both the conservative and liberal wings. Coupled with our proposal for implementing just compensation, the current model may support the type of governmental intervention upheld in *Kelo*.

### C. *The Special-Purpose Development Corporation*

We now come to the gist of our proposal: a new mechanism, based on a special-purpose corporation, for implementing just compensation. This section presents a skeletal overview of this mechanism, while the following sections elaborate its features.

We propose that a public authority (typically, a municipal agency) exercising its eminent domain powers for an economic development or redevelopment project incorporate a Special-Purpose Development Corporation (SPDC) for that project. This corporation may be set up as a subsidiary of the municipality’s regular development corporation, to which the municipality will have delegated its eminent domain powers. For instance, in *Kelo*, after the city of New London delegated its eminent domain powers to the New London Development Corporation (NLDC), the latter negotiated a ninety-nine-year ground lease for \$1 with Boston-based developer Corcoran Jennison.<sup>128</sup> Under our proposal, NLDC would have set up a subsidiary as an SPDC for the Fort Trumbull municipal development project.

Next, the municipality or its designated representative would exercise the city’s eminent domain power to take the private properties and then grant certain rights in the land—say, a ninety-nine-year ground lease for \$1—to the SPDC. These rights would be the SPDC’s sole material asset.

At this point, our proposal calls for a significant departure from the current state of affairs. Landowners whose land has been condemned

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128. *Kelo v. City of New London*, 545 U.S. 469, 476 n.4 (2005).

would have their choice of two forms of compensation: (1) just compensation under current law, which is based on the pre-project fair market value; or (2) securities<sup>129</sup> in the SPDC in proportion to the landowners' contributions. From a financial point of view, the latter choice would be equivalent to granting each landowner an option to purchase SPDC securities for the equivalent of the legal just compensation amount, while at the same time granting the landowner the sum needed to cover the purchase cost (known as the "strike price"). The SPDC would emerge from this stage with several—possibly numerous—shareholders.

Next, we envision the SPDC either auctioning its land rights or else negotiating these land rights with the private developer who initiated the project. In many cases, this developer, through sale or auction, will remain the land rights buyer, but the possibility of a bidding war among several private developers would only benefit the SPDC and its shareholders. Next, the SPDC would distribute the net proceeds from the sale as dividends to its shareholders. In the final stage, the SPDC, its role finished, would dissolve.

#### D. *Restructuring Just Compensation as a Financial Option*

Having laid out the basic scenario for the working of the SPDC, we next elaborate particular features of this mechanism. The following subsections discuss general design principles, some issues concerning corporate governance of the SPDC, and considerations from the landowners-turned-shareholders' perspective.

##### 1. *General Design Considerations.*

a. *Market-Based Just Compensation.* — The first major design consideration for the proposed SPDC mechanism is the goal of setting just compensation in eminent domain cases like *Kelo* closer to the social welfare optimum. The SPDC will constitute a sole owner of the land necessary for the project, thereby overcoming the anticommons-type market failure. As a sole owner, the SPDC will be in a better position to negotiate at arm's length and ensure that the ultimate price of the land will better reflect its actual value for the future project without the heavy discount associated with the anticommons problem.<sup>130</sup> Furthermore, the SPDC, unlike dispersed landowners, will be able to hold an auction for the land rights. The proposed mechanism will thus harness the market's powerful price system to generate better signals about the true economic value of the condemned land.

Consequently, only (for-profit) development projects that truly increase social welfare will go forward, and thus only such welfare-increas-

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129. We use "securities" and "shares" interchangeably throughout this Essay.

130. Not coincidentally, dispersed shareholders of a public corporation who face a hostile takeover bid may similarly benefit from legal mechanisms that reconstruct the position of a sole owner of the corporation. See generally Lucian Arye Bebchuk, *The Sole Owner Standard for Takeover Policy*, 17 *J. Legal Stud.* 197 (1988) (defending efficiency of sole owner theory and suggesting laws for its implementation and governance).



ing projects will be initiated in the first place with a plea to public authorities to exercise eminent domain powers. Henceforth, developers will know that they must bid a price not dampened by market failures. At the very least, developers and other potential bidders for the assembled land will know that they should bid a price close to their best assessment of the economic value of this land. Only projects whose value to developers exceeds this threshold would be initiated.

Our model thus suggests a significant modification to the just compensation component of eminent domain. Under current law, this compensation, notwithstanding the title "fair market value," bears only a weak relation to market conditions. We propose to link this compensation more closely to the true market value of condemned land. As a result, the aggregate proceeds likely will be greater than the legal compensation under current doctrine. In light of the general view that current law undercompensates landowners, the proposed mechanism will be, by construction, also more just than current legal "just compensation."

b. *Piggybacking on Existing Law.* — The second major design consideration of this proposal is to rely as much as possible on existing legal infrastructure. In particular, the conceptual similarity between taking for land assembly in for-profit projects on the one hand and the concentration of critical resources in business corporations on the other hand points to the potential of corporate law to provide well-tested tools for facilitating such an enterprise. Highly developed doctrines and rules in corporate and securities law can be utilized to mitigate the problems that currently haunt eminent domain. The most important tool, of course, is the corporation's separate legal personality. For the participants in the enterprise (called "members," "shareholders," or any other title), incorporation engenders a separation between property interests and financial interests.

Vesting property interests (ownership) in the corporation overcomes transaction costs of the sort that Coase and Williamson point out. It allows for interests in the corporation (shares) to be fungible and transferable; it enables members to enjoy limited liability; and it facilitates putting the amalgamated assets under professional management.<sup>131</sup> However, subjecting the amalgamated property to central management in the firm also engenders a new problem—generally known as the agency problem.<sup>132</sup> Corporate law has developed an effective set of means for mitigating this problem, upon which our proposal can piggyback.<sup>133</sup>

In order for landowners to actually benefit from the higher value of the entire land, it is not enough that the SPDC negotiate with potential buyers as the land's sole owner. The land's higher value when assembled

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131. For a lucid discussion of these advantages of the corporate form, see Robert C. Clark, *Corporate Law* 1–24 (1986).

132. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 *J. Fin. Econ.* 305, 309 (1976).

133. See *infra* Part IV.D.2 for a detailed discussion.

must trickle down to its former owners. In this context too, the proposed mechanism takes advantage of the existing infrastructure of financial markets. The SPDC shares of landowners who elected to receive them will be transferable. The SPDC likely will be a public corporation whose shares could trade on a stock market. The share price thus should reflect their true economic value as the net present value of future corporate profits. In the setting we propose for the SPDC, this net present value will be determined by the proceeds from selling the land rights minus operation costs, which would be minimized.<sup>134</sup> After SPDC securities are distributed to landowners, but before the sale of the land is effectuated, the price of the securities will reflect the market's best assessment of the land plot's value for the planned project and will also reflect all other publicly available information.<sup>135</sup>

Our proposal bears certain similarities to securitization transactions. In such transactions, the owner (called the "originator") of numerous yielding financial assets—e.g., mortgage-backed loans, credit card accounts, and auto loans—pools them together in a separate legal entity.<sup>136</sup> This entity, called a Special Purpose Vehicle (SPV), may be a corporation, a trust, or other entity and is designed to be detached from the originator's financial risk (referred to as "bankruptcy remoteness"). While similar in principle, these assets nonetheless have idiosyncratic risks. By pooling these assets together in the SPV, the originator is able to generate a stable, and thus more highly valuable, stream of proceeds against which she can issue securities that represent a fractional interest in the SPV. The SPDC too will pool together idiosyncratic assets and its securities will represent a fractional interest in its future stream of income.

c. *A Hybrid Regime.* — Our proposed mechanism would create a hybrid of regulatory and market-based legal regimes. The government would make the decision about the assembly of land and its use according to its judgment on the socially desirable use of the land. But the govern-

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134. See *infra* Part IV.D.3.

135. Stated otherwise, we assume that the efficient capital market hypothesis will generally hold for SPDC securities—that is, that market professionals will impound all publicly available information about the company into the price of its securities. See generally Ronald J. Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency*, 70 Va. L. Rev. 549 (1984) (explaining efficient capital market hypothesis and factors that create and limit capital market efficiency); Ronald J. Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias*, 28 J. Corp. L. 715 (2003) (revisiting earlier framework in light of behavioral finance theory). This assumption became a legal presumption following the Supreme Court's seminal decision in *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988) ("Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.").

136. See Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 Stan. J.L. Bus. & Fin. 133, 134–44 (1994) [hereinafter Schwarcz, *Alchemy*] (describing how securitization works and how companies benefit). See generally Steven L. Schwarcz, *Structured Finance, A Guide to the Principles of Asset Securitization* (3d ed. 2002) (providing practical guide to structured finance and securitization).

ment would not impose a price, such that the allocation of land and the compensation for infringing on property rights could be market-driven.

There are precedents for such hybrid regimes. For instance, modern environmental protection regulation sometimes features such a hybrid in the form of tradable emission rights.<sup>137</sup> In the first stage, the government exercises its regulatory powers to impose certain performance requirements according to its judgment on the socially acceptable level of pollution. Yet the rights/duties under such a regime—e.g., emission units or “allowances”—are tradable. In the second stage, private market transactions take place. Market forces thus may lead to an optimal allocation of these rights such that social welfare may be maximized.<sup>138</sup>

d. *Special Government Allocation and Tax Aspects.* — The present proposal entails certain advantages from a tax policy perspective. Recall the basic dilemma that is the genesis of our work: Who should enjoy—and to what extent—land value appreciation resulting in large part from the governmental act of consolidating and reorganizing fragmented rights in land?<sup>139</sup> Our proposal suggests a middle ground between avoiding too harsh an infringement of property rights and recognizing the essential role that the government plays in coordinating the collective action.

The latter consideration may justify taxing the landowners for this substantial governmental “giving” in the specific context of land assembly, without implicating the more general question of taxing land use regulatory benefits. Issuing a certain additional amount of shares in the SPDC to the government (beyond shares issued in exchange for government land that would be turned over to the SPDC) may serve as a form of taxing mechanism.

Allocating SPDC shares to the government (or to its development corporation) would reward it for its efforts and provide it with an immediate source of capital for funding the upfront public expenditures involved in the development project, including setting up and administer-

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137. See, e.g., Clean Air Act of 1990, Pub. L. No. 101-549, 104 Stat. 2399, (codified as amended in scattered sections of 42 U.S.C.) (permitting persons to transfer production allowances).

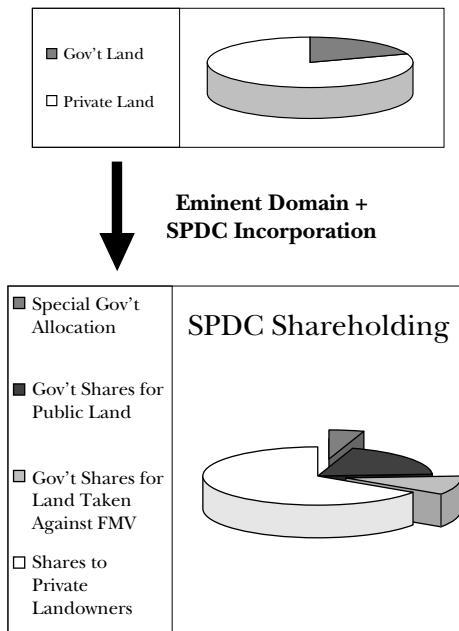
138. For the relative advantages (and disadvantages) of such schemes over traditional command-and-control regulation and other types of environmental regulation, see Daniel H. Cole, *Pollution and Property: Comparing Ownership Institutions for Environmental Protection* 45–84 (2002) (discussing mixed property/regulatory regimes for environmental protection and their limits); Daniel C. Esty, *Toward Optimal Environmental Governance*, 74 N.Y.U. L. Rev. 1495, 1503–08 (1999) (noting market failures in enhanced market for environmental property rights, even in countries with well-defined markets and rules of law); Carol M. Rose, *Common Property, Regulatory Property, and Environmental Protection: Comparing Community-Based Management to Tradable Environmental Allowances*, in *The Drama of the Commons* 233, 250–53 (Elinor Ostrom et al. eds., 2002) (contrasting community property approach to environmental regulation with market in tradable environmental rights).

139. For the nonlinear relationship between land price and parcel size in cases of land assembly, see Peter F. Colwell & Henry J. Munneke, *Land Prices and Land Assembly in CBD*, 18 J. Real Est. Fin. & Econ. 163, 164–65 (1999).

ing the SPDC. Such share allocation can, in appropriate cases, replace or supplement current governmental financing schemes, such as Tax Increment Financing.<sup>140</sup> This would be somewhat akin to the suggested PGS in England. Unlike the PGS, however, such additional share allotment would not impose a direct monetary burden on the landowners-turned-shareholders. Even more importantly, such allotment would not impose an additional, sometimes stealth tax on the general population.

Accordingly, the amount of shares allocated to the government could be based on the legislature’s general evaluation of the overall public costs typically involved in laying the ground (both physically and financially) for redevelopment. As a very general rule of thumb, we believe that an allocation at a rate somewhere around five percent of the overall SPDC shares would create the proper incentives for the government, while at the same time properly and justly preserving the financial interests of the landowners-turned-shareholders.

Thus, the transition from landownership in the fragmented area to shareholding in the SPDC owning the unified land will result in the initial allocation of shares to four groups of owners: 1) private landowners who wish to join the SPDC; 2) governmental entities for publicly-owned lands; 3) governmental entities for the above-mentioned special allocation of shares; and 4) shares acquired by the government through payment of legal fair market value (FMV) to landowners who decide not to opt-in to the SPDC. The following chart is a hypothetical image of what this initial transition into the SPDC may therefore look like:



140. See *supra* notes 69–72 and accompanying text.

2. *Corporate Governance*. — This subsection discusses the optimal corporate governance for the SPDC. Thus far, we have assumed that the SPDC would be a regular corporation that would take advantage of the standard corporate form. However, the disadvantages of the standard corporate form's flexibility call for adopting a more restricted form that is inspired by a structured finance approach.

The modern corporate form is an exceedingly flexible framework. There are several different forms of incorporation (e.g., a regular corporation, limited liability corporation, and limited liability partnership); the terms of incorporation, as reflected in the corporate bylaws, can be designed according to the incorporators' desire; and there are very few mandatory rules of conduct.<sup>141</sup> In particular, standard business corporations today are free to engage in any lawful business.<sup>142</sup> Coupled with the perpetual existence of the corporation as a legal entity separate from its members, the corporate form represents an impressive success story of legal technology.

Although corporations, as firms, purport to overcome market failures in purely contractual transactions, they are themselves not free of failures. Corporations are largely premised on a contractual basis, be it their bylaws or enabling corporate law provisions.<sup>143</sup> Due to the inevitability of incomplete information, however, the corporate contract too suffers from incompleteness. This enhances the power of parties with superior information and gives rise to the agency problem.<sup>144</sup> In a corporation with numerous dispersed shareholders, power lies mainly in the hands of management; in corporations with a dominant (majority) shareholder, that shareholder enjoys superior power.<sup>145</sup> To keep this power in check, corporate law has developed special doctrines—primarily the duty of loyalty and a set of ancillary rules. These rules purport to keep less powerful parties (mostly small shareholders) sufficiently informed and the more powerful parties (the “agents”) away from conflicts between the company's best interest and their own private interests. These rules are accompanied by structural safeguards—most importantly, independent directors on the board and on sensitive committees.

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141. See, e.g., Henry Hansmann & Reinier Kraakman, Agency Problems and Legal Strategies, in Reinier Kraakman et al., *The Anatomy of Corporate Law* 21, 30–31 (2004) (discussing default and mandatory rules in various types of business organizations).

142. E.g., Clark, *supra* note 131, at 17 (noting that most states now allow corporate charters without limitation of powers or purposes).

143. See generally Symposium, Contractual Freedom in Corporate Law, 89 *Colum. L. Rev.* 1395 (1989) (discussing nexus of contracts theory of corporation and limits on this contract theory).

144. Consequently, the common metaphor of the corporation as a nexus of contracts may need to be replaced with a metaphor of a nexus of power relations. Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values and Cognitive Style*, 29 *Del. J. Corp. L.* 649, 653 (2004).

145. For a classic account, see Adolph A. Berle, Jr. & Gardiner C. Means, *The Modern Corporation and Private Property* 70–90 (1933) (discussing company control scenarios ranging from majority shareholder to management).

Which corporate governance framework is most appropriate for the SPDC? In principle, a regular corporation would do, especially if it complied with certain extralegal corporate governance requirements set by stock exchanges, such as the requirement that independent directors comprise a majority of the board.<sup>146</sup> Consider, for instance, situations in which the SPDC has a dominant shareholder. This dominant shareholder may be the government, thanks to former holdings of large government land tracts that were turned over to the SPDC. The dominant shareholder may also be the developer herself, who had purchased land parcels in the project area before initiating the project.<sup>147</sup> In the transaction of selling the entire land tract to a developer, the SPDC's majority shareholder thus may be in a conflict of interest with regard to the price. To prevent conflicts of interest in such "affiliated party transactions" from harming the corporation and its minority/public shareholders, corporate law sets forth rules for full disclosure of material information and a requirement that corporate decisions be made by nonaffiliated parties.<sup>148</sup>

This may not suffice, however. The fundamental premise of corporate law is that companies should be allowed, if not encouraged, to take up every risky project that their managements believe in good faith would be profitable. This broad and flexible objective may be inconsistent with the objective of condemnees, who seek to maximize the consideration for their taken land. We believe that to ensure condemnees' participation in SPDCs, the latter must have a single, well-defined objective—namely, to sell the land tract for the highest price within a certain time. After this sale, they should distribute all proceeds as dividends and be wound up.<sup>149</sup> While it might be possible to ground this objective in current corporate law,<sup>150</sup> a more straightforward way would be to set this single objective and limited life span in the certificate of incorporation.

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146. See, e.g., NYSE Euronext, Listed Company Manual § 303A(1), available at [http://www.nyse.com/lcm/lcm\\_subsection.html](http://www.nyse.com/lcm/lcm_subsection.html) (last modified Nov. 4, 2003) (on file with the *Columbia Law Review*) ("Listed companies must have a majority of independent directors.").

147. In the Atlantic Yards project mentioned above, developer Bruce Ratner had actually gained rights in a majority of the land intended for the project. See *supra* note 45 and accompanying text.

148. For Delaware law on this subject, see Del. Code Ann. tit. 8, § 144(a) (2006); *Fliegler v. Lawrence*, 361 A.2d 218, 221 (Del. 1976) (interpreting § 144(a) as requiring approval of affiliated party transactions by disinterested directors unless transaction meets exacting test of "objective fairness"). The Model Business Corporation Act sets forth a more elaborate regime that is also based on full disclosure and disinterested approval. Model Bus. Corp. Act § 8.31 (2001).

149. There is no good reason to allow the SPDC to engage in any other business, which, in case of failure, will cause shareholders to lose the value of their land. Condemnees who wish to invest in business—including in the development project itself—will be free to do so outside of the SPDC.

150. Under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 184 (Del. 1985), when the board determines that the company faces an inevitable change of control, directors have a duty to obtain the best price reasonably available for the

We therefore propose a structured finance approach to the SPDC such that it will be designed from the outset as similarly as possible to an SPV in a securitization transaction. Consisting mostly of detailed documents, an SPV is run essentially from the outside by an unrelated trustee, administrator, or the like. To ensure bankruptcy remoteness, the documents establishing the SPV provide for full ownership in the assets transferred to it from the originating company (referred to as a “true sale”), a single purpose (to use all proceeds for servicing the SPV’s bonds), independence of directors from the originating company, and voting rights entrusted to a third party (to prevent changing the directors). An SPV might also have a limited life span in order to match the timing of its incoming proceeds with that of its obligations.<sup>151</sup> The upshot is that SPVs take advantage of the corporate form’s separate legal entity status, but beyond this feature they are designed more as automata than as regular business firms.

An SPV-like SPDC need not have much more business activity than regular SPVs have. Following the transfer of rights in land to the SPDC, its administrators could auction these rights. Or, bidding for land rights may take the form of a tender offer for the SPDC shares. Should there be only one bidder—most likely, the developer who initiated the project—the outside directors would nominate a committee to negotiate with her. There is reason to believe that these negotiations will be reasonably beneficial to SPDC shareholders because the administrators could be special service companies who will want to build up a reputation for running SPDCs efficiently and profitably, as they do with SPVs.

Thanks to their own stake in the SPDC’s capital,<sup>152</sup> local governments too will have a direct financial interest in maximizing the sale price. Over time, localities might even compete for a reputation of getting their constituents high values for their rundown properties. In any event, the fact that the SPDC in this configuration will not have an actual management represents an advantage in our view. The doctrines of corporate law notwithstanding, insiders (both managers and dominant shareholders) in American corporations have substantial leeway to benefit themselves in different ways as long as they follow proper procedures.<sup>153</sup> Finally, for an SPV-like SPDC, winding up the company subse-

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shareholders, including by auctioning the company off. By analogy, directors of the SPDC, which has a limited life span, will have a similar duty.

151. For more details, see Schwarcz, *Alchemy*, supra note 136, at 138.

152. See supra Part IV.D.1.

153. Having the government as a dominant shareholder in the SPDC, government officials in its management, or both, raises an additional set of prickly issues. Until recently, the received wisdom was that governments should stay out of business. It was assumed, among other things, that government officials do not face the right incentives for maximizing corporate value and that such corporate positions may be conducive to corruption. Privatization and outsourcing thus became standard policy recommendations. See, e.g., Oliver Hart, Andrei Shleifer & Robert W. Vishny, *The Proper Scope of Government: Theory and an Application to Prisons*, 112 *Q.J. Econ.* 1127, 1159 (1997)

quent to consummating the sale and dividend distribution would be equally straightforward.

3. *Landowners-Turned-Shareholders' Perspective.* — Suppose a jurisdiction adopted the present proposal. From the standpoint of condemnees contemplating whether to forgo the legal compensation for SPDC shares, God is in the details: how many shares will they get; what will they do with no money and no property (especially when such property is their residence), etc.? This subsection addresses these concerns.

a. *The Key for Internal Share Allocation.* — Two conceptual criteria may be used for designing the key for internal share allocation in the SPDC to former landowners: the physical area of condemned land (the “physical criterion”) and the value of condemned land (the “ad valorem criterion”). Such a key could be based solely on one criterion or on some combination of the two. According to the physical criterion, condemnees will receive SPDC shares in proportion to the ratio between their land and the total amount of land condemned for the project. In this scenario, Susette Kelo, together with ten other landowners of Parcel 4A in the Fort Trumbull Project, might have received 2.67% of the SPDC issued stocks for their 2.4 acre share in the ninety acre project. According to the ad valorem criterion, condemnees will receive SPDC shares in proportion to the ratio between the pre-project economic value of their land and the total value of the entire plot for the project. Respectively, Susette Kelo might have received stocks based on the \$123,000 value of her contribution to the SPDC capital, if the pre-project value were to be used.

The physical criterion’s main advantages are its simplicity and clarity. Using this criterion alone to calculate the amount of shares to be issued is a straightforward task. All that is needed is an objective measurement of

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(finding privatization provides lower cost prison service and greater quality innovation); William L. Megginson & Jeffrey M. Netter, *From State to Market: A Survey of Empirical Studies on Privatization*, 39 J. Econ. Lit. 321, 380–81 (2001) (finding privatized firms more profitable and efficient than state owned enterprises); Andrei Shleifer, *State Versus Private Ownership*, J. Econ. Persp., Fall 1998, at 133, 135–36 (arguing that recent trend is moving away from government control toward privatization, which is more efficient and effective). More recently, however, some are reassessing the desirability of delegating public functions to private parties and exploring new models of public-private partnerships that mitigate some of the risks of purely private contracting (e.g., information incompleteness and ambiguity). For economic analyses, see, for example, Timothy Besley & Maitreesh Ghatak, *Competition and Incentives with Motivated Agents*, 95 Am. Econ. Rev. 616, 618–25 (2005) (exploring public-private collaboration in mission oriented projects); Oliver Hart, *Incomplete Contracts and Public Ownership: Remarks, and an Application to Public-Private Partnerships*, 113 Econ. J. C69, C75 (2003) (questioning conventional thinking that “the private sector is a cheaper source of financing or insurance than the public sector”). For policy analyses, see, for example, Stephen H. Linder and Pauline Vaillancourt Rosenau, *Mapping the Terrain of the Public-Private Policy Partnership*, in *Public-Private Policy Partnerships* 1, 2–5 (Pauline Vaillancourt Rosenau ed., 2000) (discussing evolution of contemporary public-private partnerships and logic underlying these developments); Gillian E. Metzger, *Privatization as Delegation*, 103 Colum. L. Rev. 1367, 1377–94 (2003) (analyzing existing privatization schemes in context of health care, welfare programs, public education, and prisons).



the area of condemned land. This information is usually available well in advance, and disputes about it can be resolved quickly and inexpensively by hiring a surveyor. Using this criterion as a sole key can be justified further on substantive grounds. In a typical for-profit (re)development project, all preexisting buildings and other fixtures are razed. Consequently, all that an individual condemnee contributes (unwillingly) to the project is her most basic ownership rights in land. The choice to receive SPDC shares thus may be seen as a decision to invest in the SPDC by contributing capital in kind. People who contribute more land would receive proportionately more shares and vice versa.

The problem with the physical criterion is that it considers only the condemnee's contribution but ignores her loss. In particular, this criterion ignores potentially large differences in the value of condemned parcels in light of their pre-project nature and use. Using this criterion alone therefore may undermine the goal of giving condemnees a more just compensation.<sup>154</sup> While it may be possible to augment the amount of shares issued by taking into account the pre-project properties of the condemned land, such a step would deprive the physical criterion of its simplicity advantage.

The advantages and disadvantages of the physical criterion key are transposed in the ad valorem key. As it is often based on an assessment of economic value in the absence of a directly comparable arm's length transaction, the use of the ad valorem criterion is highly discretionary and therefore much more likely to be disputed. Should disputes of this kind be too numerous, the actual shareholding structure of the SPDC might remain uncertain for a long time. This is undesirable because such uncertainty likely will harm the SPDC's market value. Separately, adopting the ad valorem criterion entails making another policy choice—namely, whether the parcel's pre- or post-project value should be used as the basis for calculation.

We believe that the key for share allocation in the SPDC should be based on the pre-project ad valorem criterion. As noted, using the pre-project ad valorem criterion will avoid the injustice entailed by disregarding the condemnee's loss. Since the goal of our proposal is also to increase the justice of eminent domain, we do not wish to avoid this criterion merely for reasons of administrative convenience. Using the pre-project value of the condemned land will create a seamless interface between the proposed mechanism and existing eminent domain law and practice. That is, the election decision condemnees will face will have a single economic denominator: Either they receive monetary compensation according to the pre-project value under current doctrine or they receive SPDC shares in proportion to a capital contribution of the same

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154. Arguably, condemnees who chose to receive SPDC shares based on this criterion may not raise an objection on this ground because their choice was not coerced. We nevertheless believe that a compensation mechanism that on its face may appear unjust will not be welcomed and will not be used.

amount. This election is economically equivalent to a rights offering. Condemnees would receive an option to exchange their legal just compensation for SPDC shares.

b. *A Public Offering.* — The SPDC mechanism’s extensive reliance on existing legal mechanisms begins with the offer to participate in this enterprise. Under established rules concerning public offerings of securities, the offer to condemnees to choose between legally mandated just compensation and SPDC shares would be deemed a public offering that requires filing a registration statement under the Securities Acts.<sup>155</sup> This is because the group of offerees typically will consist of scores, if not hundreds, of landowners,<sup>156</sup> and, in virtually all cases, these offerees will not have all the material information necessary to evaluate the securities.<sup>157</sup> The financial scope of typical redevelopment projects—both in terms of total value and the value of particular condemned parcels—together with the lower- or middle-class status of many condemnees, indicates that an exemption under Regulation D will not be available.<sup>158</sup> Depending on the circumstances, however, some offerings might come under the umbrella of purely intrastate offerings.<sup>159</sup>

The upshot, that SPDC shares offerings should be accompanied by filing a registration statement with the SEC, is beneficial in our view. Granted, this regulatory requirement will increase the transaction costs of the SPDC mechanism—both directly, through legal and other incidental expenses, and indirectly, due to greater exposure to liability. However,

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155. Securities Act of 1933 § 5, 15 U.S.C. § 77e (2000).

156. Section 4(2) of the Securities Act of 1933, 15 U.S.C. § 77d(2), provides that the registration requirements in section 5 of the Act shall not apply to transactions by an issuer not involving any public offering. Courts have sidestepped the question of what is the numerical threshold beyond which a group of offerees should be deemed “public,” leading the Securities and Exchange Commission (SEC) to promulgate a safe harbor, bright-line rule in Rule 505 of Regulation D under the Securities Act, 17 C.F.R. § 230.505 (2007). The exemption under Rule 505 applies to offers and sales to no more than thirty-five purchasers (rather than offerees), thus suggesting a yardstick for the definition of “public.” The exemption under Rule 505 is contingent on additional conditions, however.

157. See *SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953) (“[T]he applicability of [§ 4(2)] should turn on whether the particular class of persons affected need the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction not involving any public offering.”); *Doran v. Petroleum Mgmt. Corp.*, 545 F.2d 893, 900 (5th Cir. 1977) (citing *Ralston*). To enjoy the § 4(2) exemption, one must show that “all offerees were actually furnished the information a registration statement would have provided.” *Doran*, 545 F.2d at 904.

158. See *supra* note 156. To be excluded from those investors counting towards the thirty-five person maximum, one must satisfy certain—largely financial—requirements to qualify as an “accredited investor” under Rule 501(a) of Regulation D. 17 C.F.R. § 230.501(a).

159. The exemption under Rule 147 requires that all offerees and purchasers be residents of the state in which the issuer is a resident and doing business. 17 C.F.R. § 230.147. Rule 147 was enacted under section 3(a)(11) of the Securities Act of 1933, 15 U.S.C. § 77c(a)(11). While the latter condition likely will hold for the SPDC, some landowners may be out-of-state residents.

an SEC filing (or a filing with state securities regulators) will furnish market professionals with the information necessary to evaluate the project and the SPDC shares. This will benefit landowners in several ways. First, landowners will be able to make informed decisions on whether to waive their legal compensation in favor of receiving SPDC shares. Second, the availability of information will facilitate the development of a market for SPDC shares—at the very least, an over-the-counter “pink sheets” market—which will increase the liquidity of these shares and, hence, their value.<sup>160</sup> The basic principle, that offerees of securities deserve protection through full disclosure, will protect landowners from excessive takings and will facilitate trading in their SPDC securities.

c. *Financing.* — One of the major advantages of the present proposal is that it does not impose an excessive financial burden on condemnees who wish to exercise their option to purchase SPDC shares. To appreciate this point, consider proposals made in the somewhat similar context of reorganization in bankruptcy under Chapter 11 of the Bankruptcy Code.<sup>161</sup> The basic problem in large-scale reorganizations<sup>162</sup> is that although the firm’s (liquid) assets do not suffice to satisfy senior creditors’ claims, junior creditors and even equity-holders demand, and receive, claims against the reorganized firm, ostensibly in contrast to the absolute priority rule. A large literature, which is beyond the present scope, debates the optimal mechanisms for corporate reorganizations.<sup>163</sup> At bottom, the conflict among different classes of claimants arises from disagreement over the value of the reorganized firm—a conflict that is partly genuine, due to unavoidable uncertainty, and partly calculated, stemming from strategic behavior.<sup>164</sup>

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160. It may be desirable to promulgate special regulations on such offers with certain exemptions from full-fledged prospectuses. Intended to allow nonpublic corporations to implement employee stock ownership plans (ESOPs), Rule 701 under the Act, 17 C.F.R. § 230.701, exempts from registration the offering and selling of securities to employees and consultants under compensatory benefit plans. This exemption is limited, however, to issuances over a twelve month period of no more than \$1 million, 15% of the issuer’s total assets, or 15% of the outstanding amount of the securities being offered—whichever is greatest. This ceiling ensures that Rule 701 issuances are not used for raising capital from employees. This rationale does not hold in the case of SPDCs.

161. 11 U.S.C. §§ 1101–1174 (2000).

162. See generally Douglas G. Baird & Edward R. Morrison, Serial Entrepreneurs and Small Business Bankruptcies, 105 Colum. L. Rev. 2310 (2005) (finding that large-scale reorganizations are exception; vast majority of Chapter 11 cases deal with small business entrepreneurs trying to extend lives of their businesses).

163. For a basic overview, see Lucian Arye Bebchuk, Chapter 11, in 1 The New Palgrave Dictionary of Economics and the Law 219 (Peter Newman ed., 1998) (discussing objectives of Chapter 11 reorganization, flaws in current bargain based approach, and alternative approaches to corporate reorganization).

164. See, e.g., Douglas G. Baird & Donald S. Bernstein, Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain, 115 Yale L.J. 1930, 1935 (2006) (arguing that uncertainties in valuation of reorganized corporations drive bargaining between creditor classes).

To overcome this conflict, Lucian Bebchuk proposed an option-based scheme, under which the most junior claimants would be given an option to buy out the claims superior to theirs at a price named by the superior claimants.<sup>165</sup> Philippe Aghion et al. commended this proposal as “ingenious,” yet pointed out that junior claimants who want to exercise their options will face liquidity constraints because they will have to raise the funds for buying out the senior claims.<sup>166</sup> As a way around this problem Oliver Hart et al. suggested creating a market where such options could be traded.<sup>167</sup>

The SPDC mechanism resembles Bebchuk’s options approach in several respects. In both contexts there are uncertainty and conflict over the value of the entire mass of assets. Both proposals give parties an option to buy into a project based on their own evaluations of it. Further, both proposals rely on the market to price these options and thus provide reliable signals about the profitability of the options.<sup>168</sup> Finally, as in Bebchuk’s proposal, even if the return on the SPDC shares (through dividends and/or market appreciation) turned out to be lower than the legal just compensation, landowners-turned-shareholders will not have a basis for complaint because they voluntarily chose this form of compensation.

The SPDC mechanism has an advantage over Bebchuk’s options system, however, as it does not feature the liquidity constraints that the latter entails. The option under our proposal is not to buy out other claimants, for which new funds may be needed, but rather to choose shares instead of legal compensation. The financial source for purchasing SPDC shares will be found in the waiver of the legal compensation. Moreover, as active trading in SPDC shares may emerge, condemnees who will need to find an alternative residence or business on an expedited basis will be able to use their shares as collateral or sell some shares

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165. This proposal arguably forces junior claimants to “put their money where their mouths are” since a junior claimant could buy out all the claims superior to her claim, on the assumption that the reorganized firm would be worth more than all these claims (on a pro rata basis). A junior claimant who didn’t exercise this option could not complain that she was short changed. See Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 *Harv. L. Rev.* 775, 793–94 (1988) (describing how option-based scheme would avoid both strategic and genuine disagreements over value); Lucian Arye Bebchuk & Jesse M. Fried, *A New Approach to Valuing Secured Claims in Bankruptcy*, 114 *Harv. L. Rev.* 2386, 2408–09 (2001) (describing option-based scheme and need for valuation of collateral); Lucian Arye Bebchuk, *Using Options to Divide Value in Corporate Bankruptcy*, 44 *Eur. Econ. Rev.* 829, 833–38 (2000) (presenting formal version of option-based approach); see also Barry E. Adler & Ian Ayres, *A Dilution Mechanism for Valuing Corporations in Bankruptcy*, 111 *Yale L.J.* 83, 85 (2001) (proposing alternative options-based mechanism for bankruptcy reorganizations).

166. Philippe Aghion et al., *The Economics of Bankruptcy Reform*, 8 *J.L. Econ. & Org.* 523, 535, 539 (1992).

167. See Oliver Hart et al., *A New Bankruptcy Procedure That Uses Multiple Auctions*, 41 *Eur. Econ. Rev.* 461, 471–72 (1997) (describing how public auctions would allow liquidity constrained creditors to benefit from their options).

168. Cf. Adler & Ayres, *supra* note 165, at 90 (noting that “even unbiased judges make mistakes that a market process would not permit”).

while keeping the rest, should they believe that their value will appreciate.

#### CONCLUSION

Our proposed model opens a promising new route for creating the right incentives for private developers and public authorities to exercise eminent domain power only in development projects that are truly welfare enhancing. While our mechanism does not purport to ensure that all parties involved will always be completely satisfied (given also the coercive nature of the land assembly through eminent domain and the potential obliviousness to idiosyncratic subjective land values), it does offer a significant improvement on the issue of fairness and justice toward simple-rank landowners.

The corporate structure—which largely solves the anticommons dilemma by denying each landowner the effective right of veto while providing her with sophisticated defenses against majority abuse—has considerable potential to solve a host of collective action problems associated with land use and development. For instance, one may think of a scenario in which neighboring landowners find themselves trapped in a deadlock over a smaller-scale self-initiative for joint improvement or redevelopment of their properties—one in which the government is not initially involved. In such a case, it is possible to conceive of a mechanism in which the neighbors could hold an internal vote and, if a certain special majority threshold passed, they would be able to turn to the local government and request that it carry on a process which would follow, *mutatis mutandis*, the principles of coordinated land assembly and the creation of an SPDC. Such a special majority vote would support the presumption of a “public use” which justifies governmental intervention. The corporate and securities law mechanisms elaborated in Part IV would be instrumental in preventing the exploitation of such a possible mechanism as a mere pretext for majority abuse or for a forced cheap group buyout of a disenfranchised minority landowner. We leave to future scholarship a discussion of the pros and cons of such a possible extension of our proposal.