www.njlnews.com

NEW JERSEY LAWYER

Volume 15, Number 14 The Weekly Newspaper April 3, 2006 $5

Kelo and the states of (and on) development

By Mark D. Mako and Maulik Shah

Since the decision in *Susette Kelo, et al. v. City of New London, et al.*, 125 S. Ct. 2655 (2005), people have two principal questions: What is its real impact on redevelopment? Are states falling in line with the decision?

In *Kelo* the U.S. Supreme Court held that economic redevelopment meets the "public use" requirement of the Fifth Amendment to the U.S. Constitution in certain instances. Upholding New London's attempt to convert private homes into an office park, the court expanded its broad interpretation of the "public use" requirement to include revitalization of economically distressed areas. Based on the holding, a municipality may transfer property from one private party to another to stimulate the economy, raise tax revenue or create jobs. In such instances, the transfers do not infringe on federal constitutional rights.

Accordingly, state courts must now decide whether to permit such takings under their own constitutions. Their determinations may broadly impact redevelopment projects nationwide. Some states are looking to curtail *Kelo's* impact by enacting legislation prohibiting the use of eminent domain for economic development, for creating tax revenues or for the purpose of transferring private property to another private party.

The decision also opens the door for a change to the just compensation requirement — possibly making development projects more expensive.

Eminent domain, police power and the Fifth Amendment

Though not expressly granted to the federal or state governments in the Constitution, the Supreme Court noted long ago that "[t]he power of appropriating private property to public purposes is an incident of sovereignty." *Mayor, Aldermen and Inhabitants of City of New Orleans v. U.S.*, 35 U.S. 662 (1836). This power "appertains to every independent government. It requires no constitutional recognition." *Mississippi & Rum River Boom Co. v. Patterson*, 98 U.S. 403 (1878). The power of eminent domain is considered part of what is traditionally known as the police power. Not easily defined or delimited, the police power refers generally to the means by which a sovereign can fulfill its duties to maintain law and order, secure its citizenry, and promote the general welfare, restricted by the Constitution and particularly the Bill of Rights. Specific to eminent domain, the Fifth Amendment limits exercise of this power by stating "private property [shall not] be taken for public use, without just compensation." U.S. Const. amend. V, cl. 4.

The Fifth Amendment's takings clause has three components. First, private property must actually be taken. The definition of "taking" extends beyond the obvious seizure and eviction to more subtle notions of use restriction and regulation. The court has held that "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922). Numerous cases have sought to determine what constitutes "too far" and to determine when a taking actually has occurred.

Second, private property can only be taken for public use, which definition reaches beyond general use by the public to cover activities by private parties in the public interest or which serve a public purpose.

Third, the taking must be accompanied by just compensation. Though there is no agreement on how to calculate the exact number, just compensation is generally "the market value of the property at the time of the taking." *Olson v. United States*, 292 U.S. 246 (1934).

Since the action in *Kelo* was undeniably a taking, the central question before the court was whether economic redevelopment constituted a valid public use. Additionally, the court suggested the appropriate measure for just compensation in these situations might not be market value. However, this question was not before the court and therefore remains undecided.

Public use requirement

The original meaning of public use, as envisioned by the framers of the constitution, is hotly debated. There are two views. Under the narrow view, public use means actual use by the public. Under this definition, private land can only be taken for purposes directly benefiting the public — roads, public schools, courthouses, military bases, national parks. In these situations the government retains possession of the land after the taking.

The broad view equates public use with "public purpose" or "public interest." This conception justifies using eminent domain

Mark D. Mako is an associate at Kirkpatrick & Lockhart Nicholson Graham in Newark. He practices real estate law, with an emphasis on land use, commercial real estate and commercial and retail leasing.

Reprinted with the permission of *New Jersey Lawyer*© April 3, 2006

to help industries overcome assembly and holdout problems. For example, railroads and utilities need long contiguous strips of land to lay their lines, while miners and farmers need rights of way across private property to transport ore and irrigate fields. These groups often are frustrated by private owners who refuse to sell or demand exorbitant prices since they know the companies have no other options.

The public purpose definition allows the government to force the holdouts to sell and then transfer the land to corporations that provide vital public services.

By and large, courts have accepted the broad view, acknowledging "[i]t is obvious, however, that what is a public use frequently and largely depends upon the facts and circumstances." *Fallbrook Irrigation Dist. v. Bradley,* 164 U.S. 112 (1896). The Supreme Court has consistently avoided such factual inquiry, deferring instead to the determinations of state courts and legislatures. It has never fully abdicated its role, maintaining that "[t]he nature of a use, whether public or private, is ultimately a judicial question." *Rindge Co. v. County of Los Angeles*, 262 U.S. 700 (1923). But it will respect the legislature's determination, "unless the use be palpably without reasonable foundation." *United States v. Gettysburg Electric R. Co.*, 160 U.S. 668 (1896).

Modern approach

Modern public use jurisprudence begins with the landmark case of *Berman v. Parker*, 348 U.S. 26 (1954). In *Berman*, a store owner protested the taking of his building by the National Capital Planning Commission (Commission). The Commission was acting under the District of Columbia Redevelopment Act of 1945 which Congress had passed "to provide for the replanning and rebuilding of slum, blighted, and other areas of the District of Columbia." 79 P.L. 592. At the time, large portions of D.C. had become an urban wasteland. The Commission found that in one neighborhood in southwest D.C. more than 50 percent of the buildings had neither toilets nor baths and more than 60 percent were beyond repair. After public hearings and detailed investigation, the Commission prepared and approved a comprehensive plan for the area. Berman's department store was within the project area and scheduled for condemnation.

Berman claimed that since his store wasn't a dilapidated residential building, the Commission couldn't constitutionally give his land to another private party; while slum clearance is a permissible public purpose, taking a man's property merely to develop a better balanced, more attractive community is not. The Supreme Court responded:

"The concept of the public welfare is broad and inclusive. The values it represents are spiritual as well as physical, aesthetic as well as monetary. It is within the power of the legislature to determine that the community should be beautiful as well as healthy, spacious as well as clean, well-balanced as well as carefully patrolled … subject to specific constitutional limitations, when the legislature has spoken, the public interest has been declared in terms well-nigh conclusive. In such cases the legislature, not the judiciary, is the main guardian of the public needs to be served by social legislation, whether it be Congress legislating concerning the District of Columbia, or the States legislating concerning local affairs."

The court supported its decision in *Berman* by articulating a distinction between ends and means, reasoning that once the public purpose has been established, "the means of executing the project are for Congress and Congress alone to determine." The court would not make a building-by-building, lot-by-lot evaluation or give any opinion on whether a particular development plan was the best available. The Fifth Amendment, in their view, demanded only that they determine whether the stated goal was a valid public use. After answering that question, the constitutional inquiry is complete.

The logic in *Berman* was reaffirmed 30 years later in *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984). In *Midkiff*, several estate owners claimed the Hawaii Land Reform Act of 1967 authorized the unconstitutional taking of their land. This law had been passed to fix the state's distorted distribution of land ownership. Hawaii's legacy as a feudal chiefdom had left 49 percent of its land in the hands of the government and 47 percent in the hands of only 72 individuals. On Oahu, the most urbanized of the islands, 72.5 percent of private land was owned by just 22 individuals. The concentrated ownership inflated housing prices and forced the vast majority of Hawaiians to rent their homes.

The Land Reform Act sought to remedy the situation by allowing groups of Hawaiians to collectively request the Hawaii Housing Authority (HHA) to condemn the property on which they lived. HHA would then acquire title to the land via eminent domain and resell it to the residents. HHA could lend residents up to 90 percent of the purchase price, but could not sell more than a single tract to any one person. The scheme involved several public hearings, was subject to judicial oversight, and contained several provisions to ensure the process did not disfavor existing property owners or burden taxpayers. Indeed, most landowners supported the scheme since the forced sale through eminent domain lowered their tax liability.

However, one group of landowners resisted, claiming the law was nothing more than a naked attempt by the government to take land from one person and give it to another. The Supreme Court disagreed. Comparing the Hawaiians' plight to that of the original colonists who sought "to reduce the perceived social and economic evils of a land oligopoly traceable to their monarchs," the court held that "[r]egulating oligopoly and the evils associated with it is a classic exercise of a State's police powers." Since the scheme designed under the Act was rationally related to achieving a legitimate goal, the Constitution would not proscribe it.

The *Midkiff* court clarified two important points in the public use debate. First, private property seized by the government may be immediately transferred to another private party for exclusively private use. Second, the government does not have to show its plan will actually be successful. It is these two points that proved dispositive in *Kelo.*

Kelo v. New London

In 1998, New London, Conn., was in dire straights. The city had been in an economic decline for decades — the unemployment rate was twice the national average, tax revenue was stagnant and the population was the lowest since 1920. In January 1998, the city began planning the redevelopment of the Fort Trumbull area, a small peninsula jutting into the Thames River. That February, pharmaceutical giant Pfizer, Inc. announced it was building a global research facility on property adjacent to Fort Trumbull. The city sought to capitalize on Pfizer's presence by developing Fort Trumbull into a high-tech office park. It hoped the newer facilities would attract ancillary businesses that would support Pfizer's needs. In January 2000, it approved a comprehensive plan covering about 90 acres of land that would create a waterfront hotel and conference center, a marina for recreational and commercial ships, a public boardwalk, 80 residences, a U.S. Coast Guard museum, more than 200,000 square feet of office space and parking, and retail shops to support the nearby state park. The city began purchasing land within the development area and in October 2000, voted to use eminent domain to acquire land from those unwilling to sell.

After their homes were condemned in November 2000, Suzette Kelo and her neighbors challenged the taking in Connecticut state court. They claimed economic development was not a valid "public use" under the federal or state constitution, and attempted to distinguish their case from *Berman* and *Midkiff* with a subtle legal argument: they claimed in both those cases the public purpose was served by the actual taking, not the subsequent use by private parties. The moment the properties in *Berman* had been seized and demolished, the blight was eliminated and the public purpose served. In *Midkiff*, the moment the land was seized, the oligarchy was broken and the public purpose served. What happened to the land and how the private parties used it afterwards was of little consequence. In New London's case, however, the public purpose could only be served if the private parties were successful in creating jobs and generating tax revenue.

The plaintiffs also presented a slippery slope argument: if the mere possibility of increased taxes and new jobs is sufficient to justify a taking, then the public/private distinction is meaningless. Theoretically, commercial property will always generate more tax revenue and create more jobs than residential property. More important, the promise of economic development encourages municipalities to exploit poorer neighborhoods and favor large corporations. In fact, the plaintiffs alleged the entire redevelopment plan had been designed to benefit two private companies, Pfizer and Corcoran Jennison, the contractor hired to implement the development plan.

After extensive investigation, the trial court found economic development was a valid public use and that while undue corporate pressure was a real danger, neither Pfizer nor Corcoran Jennison had improperly influenced the preparation of this particular development plan. The Connecticut Supreme Court affirmed the trial court's decision, finding both state and federal law supported the takings.

Reprinted with the permission of *New Jersey Lawyer*© April 3, 2006

The U.S. Supreme Court upheld the Connecticut Supreme Court's decision but the 5-4 split and scathing dissents reflect just how divided opinions are on the issue. Writing for the majority, Justice Stevens largely echoed the court's holdings in *Berman* and *Midkiff.* Repeating the broad view of public use, he concluded, "Promoting economic development is a traditional and long accepted function of government. There is, moreover, no principled way of distinguishing economic development from the other public purposes that we have recognized." *Kelo*, No. 04–108, slip op. at 14 (June 23, 2005). He was not persuaded by plaintiffs' argument that *Berman* and *Midkiff* were different because there the taking itself affected the public purpose, noting that in each of the court's precedents "the public purpose we upheld depended on a private party's future use of the concededly non-harmful property that was taken."

In addition, Justice Stevens dismissed the abuse-of-power concern by stressing *Kelo* involved a comprehensive development plan with adequate public input. "[T]he hypothetical cases posited by petitioner," he wrote, "can be confronted if and when they arise."

Justice O'Connor found such an argument dangerous. While the facts might support the government in this case, she noted, "none have legal significance" and that nothing in Justice Steven's opinion would "prevent the State from replacing any Motel 6 with a Ritz-Carlton, any home with a shopping mall, or any farm with a factory."

The majority, however, was unconvinced. Justice Stevens continued, "A parade of horribles is especially unpersuasive in this context, since the Takings Clause largely 'operates as a conditional limitation, permitting the government to do what it wants so long as it pays the charge.' " The just compensation requirement, coupled with other constitutional provisions such as due process and equal protection, should be a sufficient deterrence.

Justice Stevens concluded his opinion with a reminder that "nothing in our opinion precludes any State from placing further restrictions on its exercise of the takings power." Indeed the most surprising aspect of the majority's decision is that in many ways, it doesn't actually change anything. Prior to *Kelo* the definition of public use had largely been decided at the state level in accordance with state constitutions. The *Kelo* decision merely rubber stamps the *status quo.*

State courts

When the Supreme Court says the government cannot do something, it means both state and federal governments must abstain. However, when the court says the government can do something, it does not mean state and federal governments must act. Had the court ruled for the homeowners in *Kelo* and held that economic development is not a valid public use under the federal constitution, the decision would have ended national debate. By ruling for New London, it is up to each state, either through its legislature or high court, to decide if economic development is a valid public use under its state constitution.

The debate at the state level began with the landmark decision of the Michigan Supreme Court in *Poletown Neighborhood Council v. City of Detroit*, 304 N.W.2d 455, 410 Mich. 616 (1981). Finding economic development a valid public use, the court held Detroit could use eminent domain to seize an entire neighborhood and transfer it to General Motors for the creation of an industrial park. Arguably, the facts underlying the *Poletown* decision are just the "parade of evils" Justice O'Connor warned of and Justice Stevens dismissed in *Kelo.*

In *Poletown*, General Motors informed Detroit sometime in 1980 that it would shut down two of its plants there by 1983. However, GM also offered to build a new assembly facility if a suitable site could be found. Of more than a dozen areas considered, only one met GM's stringent demands. The neighborhood, home to some 3,500 mainly Polish residents, 150 businesses and 16 churches, was neither blighted nor economically depressed. The city as a whole, of course, was suffering from 18 percent unemployment and could not stop the hemorrhaging of automobile jobs. The city chose to accommodate GM. In a 5-2 decision, the Michigan Supreme Court held that as per the Michigan Constitution, public use and public purpose were interchangeable and creating 6,000 jobs was a valid public purpose for the takings requirement.

Last year Michigan's Supreme Court overruled *Poletown.* In *County of Wayne v. Hathcock*, 684 NW 2d 765 (Mich. 2004) the court redefined the public use requirement with a three-factor test. A taking is valid if: (1) the purpose of the taking could not be accomplished without government, i.e. roads, utilities, etc.; (2) the public retains some measure of control over the property; and (3) the reason for taking the land is independent of the subsequent use, i.e. removing blight. Michigan's proposed test has drawn some criticism for being too vague and difficult to apply. Nonetheless, the clear message in Michigan is that public use will be interpreted narrowly.

Thus Michigan and Connecticut are the two paragons for the public use debate at the state level. Four states' eminent domain jurisprudence falls in line with Michigan's and prohibits eminent domain for economic development purposes: Arizona, Montana, South Carolina and Washington. Five states have taken Michigan's stance in the past, but have not actually addressed the issue in more than 20 years: Arkansas, Florida, Kentucky, Maine and New Hampshire. Alabama and Delaware also likely support the narrow view, but have not spoken definitively on the matter.

On Connecticut's side are Hawaii, Idaho, Kansas, Louisiana, Maryland, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Jersey, New York and North Dakota. Eight other states also appear to support the broad view, but either have not addressed the question recently or spoken only in the blight clearance context: Colorado, Georgia, Indiana, North Carolina, Rhode Island, Tennessee, Texas and Utah. For the remaining states, little in their case law suggests a clear direction one way or another.

Regardless of their current position, the holding in *Kelo* has caused each state to re-examine its eminent domain jurisprudence to determine whether economic development falls within public use and, if so, whether it is necessary to prohibit the use of eminent domain in such context. Some state courts may be persuaded by Justice Stevens, others by Justice O'Connor. Decisions will turn on the specific facts of each case, the relevant case law and on each state's constitution and legislative requirements.

Legislative responses

Following *Kelo,* both federal and state legislatures proposed legislation prohibiting the use of eminent domain for economic development. Since the decision, several members of the House of Representatives proposed resolutions expressing their disapproval of the decision. In addition, the House recently approved a resolution prohibiting a state or local government from using eminent domain authority when the project is funded with federal money. Further, the Senate has recently proposed legislation prohibiting the use of eminent domain for economic development.

In further response to *Kelo,* more than half the states' legislatures recently proposed or enacted legislation prohibiting the use of eminent domain in certain instances or restricting the use of eminent domain by providing specific requirements.

The following states currently have legislation pending that, in essence, prohibits the use of eminent domain for economic development or for the purposes of generating tax revenues or creating jobs: Illinois, Kansas, Michigan, Mississippi, Nebraska, Pennsylvania and Tennessee. In addition, the following states have similar legislation pending but have provided exceptions for "blighted areas": California, Maine and Oklahoma. Both New York and New Jersey have legislation pending which limits the use of eminent domain in certain specific instances. In Alabama, California, Florida, Michigan, New Jersey, Oklahoma and Texas, legislators are considering state constitutional amendments prohibiting the use of eminent domain for economic development.

Several states enacted legislation prohibiting the use of eminent domain in certain instances. Alabama recently passed a law prohibiting the use of eminent domain for retail, commercial, residential or apartment development, for purposes of generating tax revenue, or for the purpose of transferring private property to another private party. The Alabama statute does, however, provide an exception for blighted areas. Delaware also recently enacted a statute restricting the use of eminent domain to a recognized public use. Delaware's restrictions would still permit a taking for economic development; however, the statute restricts it to certain circumstances. Texas prohibits the use of eminent domain economic development with certain exceptions. Ohio recently placed a moratorium on the use of eminent domain for economic development until Dec. 30, 2006 in order to further study eminent domain issues in the state.

Just compensation

The public use debate does not change the requirement that every condemnation be compensated. In *Kelo*, the court was only presented with the issue of public use, so it could not voice any opinion on the measure of compensation when land is taken for economic development.

Overwhelmingly, fair market value — what a willing buyer would pay a willing seller — has been the measure of just compensation. Of course,

Reprinted with the permission of *New Jersey Lawyer*© April 3, 2006

in a forced sale there is no willing seller and the resulting value is always undercompensatory. Nonetheless, the difficulty of accurately incorporating subjective value into the calculation has led courts to reject deviations from the market approach. Repeatedly, the Supreme Court has found fair market value all the constitution requires. However, during oral arguments in *Kelo*, Justices Kennedy and Souter discussed the possibility of altering the fair market value formula to more accurately compensate homeowners when their land is taken for economic development. Justice Stevens also acknowledged the issue in his opinion, but declined to address it.

Although it is unlikely the court would ever adopt a set formula for measuring just compensation in economic development cases, there are several alternatives. One option is to grant condemnees a premium above the fair market value. While effective, such a plan may create even greater confusion as parties quibble over the appropriate amount of the premium. A second option is to use substitute value as the measure of compensation. Rather than measuring the value of the property taken, the government should determine the cost of placing the property owner in an equivalent structure, accounting for moving and incidental expenses.

Whether the justices' comments were merely dicta or serious propositions remains to be seen. Nonetheless, the issue exists and should influence developers, planning authorities and property owners. All parties should be aware that a proposed taking may still be challenged and courts might find enhanced compensation an ideal filter for weeding out speculative projects and protecting property rights where other private parties benefit from the taking.

Conclusion

Kelo has removed all federal obstacles to taking private property for economic development. Acting in accordance with decisions over the past 200 years, the court has deferred to local authorities and placed the responsibility of determining the boundaries of legitimate public uses in state hands. The next few years will see tremendous changes for development projects as states establish their positions through case law or by enacting legislation. City planners and developers should rethink their plans, particularly in terms of site selection and financial compensation for condemned lands.

Reprinted with the permission of *New Jersey Lawyer*© April 3, 2006