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The *Kelo* case and eminent domain -- setting the record straight and a proposal for reform

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On June 23, the U.S. Supreme Court decided *Kelo v. City of New London*, a case involving the question of whether the government's eminent domain power can be exercised on behalf of private parties to take private homes, land, and businesses for private commercial development. The March 2005 issue of this newsletter, the feature article focused on the case, and predicted that the U.S. Supreme Court would uphold the Connecticut Supreme Court's approval of the exercise of the power on behalf of a private party. As expected, the U.S. Supreme Court did affirm the lower court. That outcome was not surprising — the Court has approved such takings for over 50 years. However, the decision has been criticized widely in the media and among those less familiar with the process of emi-

nent domain and the long line of judicial decisions interpreting the Fifth Amendment's "public use" requirement.

Some agricultural groups and private property advocacy groups have begun pushing for the Congress to enact legislation designed to "protect" the property rights that the *Kelo* opinion supposedly has taken away. Similar calls have been made for states to also enact "corrective" legislation. However, before action is taken to reform the eminent domain system to prohibit state and local governments from using eminent domain for economic development purposes, it is important to understand just what *Kelo* did and did not decide; what, if anything, is significant about the decision; and what policy response, if any, should be taken.

continued on page 2

Handbook updates

For those of you subscribing to the handbook, the following updates are included.

Grain Marketing Terms
– A2-05 (10 pages)

Corn and Soybean Price Basis
– A2-40 (3 pages)

Grain Price Options Basics
– A2-66 (6 pages)

Farmland Value Survey
– C2-75 (2 pages)

Please add these files to your handbook and remove the out-of-date material.

continued on page 6

Inside . . .

Two issues may shape the 2007 Farm Bill Page 5

The *Kelo* case and eminent domain, continued from page 1

Sorting Fact From Distortion — Just What Exactly Did *Kelo* Do?

Clearly, *Kelo* does not break new ground by authorizing the use of eminent domain solely for economic development. The Court has ruled in two major cases dating back to 1954 that the practice is constitutional. In addition, the Court has upheld the use of eminent domain to facilitate agriculture and mining because of their importance to the states in question. Likewise, the Court has also upheld the condemnation of trade secrets in order to promote economic competition in pesticide markets. In none of these prior decisions was eminent domain exercised because of some “precondemnation use” that inflicted “affirmative harm.” Indeed, Justice Stevens, the author of the *Kelo* majority opinion, concluded that “[p]romoting economic development is a traditional and long accepted function of government” — surely an irrefutable proposition — and that there was “no principled way” of distinguishing what the petitioners characterized as economic development “from the other public purposes that we have recognized.” So, *Kelo* does not expand the government’s power to take property when some “harm” to society is not trying to be avoided. The Court has authorized such takings for a long time.

Some have claimed that *Kelo* authorizes condemnations where the only justification is a change in use of the property that will create new jobs or generate higher tax revenues. That is an incorrect reading of the case. While that possibility was raised at oral argument, the Court did not have to decide whether an isolated taking to produce a marginal increase in jobs or tax revenues satisfies the Constitution’s “public use” requirement. The New London Redevelopment Project at issue in the case was designed to do more than simply achieve an “upgrade” in the use of one tract of land. Indeed, the project was also designed to generate a number of traditional “public uses,” including a renovated marina, a pedestrian riverwalk, the site for a new U.S. Coast Guard museum (including public parking for the museum), an adjacent state park, as well as retail facilities.

Kelo also does not, as some have claimed, dilute the standard of review for determining whether a particular taking is for a public use. The Court’s 1984 opinion in *Hawaii Housing Authority v. Midkiff*, establishes that the applicable standard of review is the same minimum rationality test the Court uses in reviewing substantive due process and equal protection challenges to economic regulation. That standard did not change. Indeed, the Court noted that condemnations should be reviewed carefully when they result in a private retransfer of property, or are not carried out in accordance with some comprehensive plan. This is to ensure that property is not being taken under the mere pretext of a public purpose, when the actual purpose is to bestow a private benefit. Importantly, the Court indicated that, in the future, it might impose a higher standard of review in public use cases. Relatedly, before *Kelo*, courts merely had to ask whether the use of eminent domain was “rationally related to a conceivable purpose.” After *Kelo*, courts must determine whether the alleged public purpose is a “mere pretext” to justify a transfer driven by “impermissible favoritism to private parties.” As such, *Kelo* was a significant victory for property rights advocates. That point has been obscured completely by the widespread criticism of the Court’s opinion.

It is also not clear that the original understanding of the Takings Clause would limit the use of eminent domain to cases of government ownership or public access. Justice Thomas filed a separate dissenting opinion in *Kelo*, arguing that the Court should return to the original understanding of the Takings Clause, but it is unclear what the Framers meant by the words “for public use.” The phrase “nor shall private property be taken for public use without just compensation” illustrates that “public use” modifies “taken.” As such, there are various subsets of takings — those for public use, and those not for public use. But that does not necessarily mean that the Clause requires that a taking must be for a “public use.” Perhaps the Framers were simply describing the type of taking for which just compensation must be given — a tak-

The Kelo case and eminent domain, continued from page 2

ing of property by eminent domain as opposed to some other type of taking, such as by tort, taxation or regulation.

It is also questionable that takings for economic development pose a particular threat to “discrete and insular minorities,” as Justice Thomas stated in his dissenting opinion. Under Justice Thomas’s view, and that of the groups that have roundly criticized the Kelo opinion, eminent domain should be restricted to takings for government use or actual use by the public. Any other type of real estate development would have to use market transactions. However, the high transaction costs associated with assembling large tracts of land in developed areas result in market-based development projects being concentrated at the perimeters of urban areas, far from most poor communities. Thus, it is doubtful that leaving all commercial real estate development to market transactions would improve the welfare of poor communities which tend to occur most in inner-city urban areas.

Possible Responses to Kelo

Clearly, one possible approach is for the Congress to declare that the use of eminent domain for economic development is impermissible. This strategy would leave it up to courts to decide which exercises of eminent domain are prohibited. Unfortunately, courts have proven that they are not very good at policing the uses to which eminent domain is put. A better approach is that such decisions be exercised by politically accountable actors, not courts. Another problem is that this approach raises questions about federalism. While it is appropriate to correct eminent domain abuses, state courts have often eliminated such abuses as a matter of state law. Without evidence of a national problem of overuse of eminent domain, it is probably not a good idea for the Congress to take action. Another problem of the Congress prohibiting the use of eminent domain for private economic development is that it helps only property owners whose cases fall near the margins of the prohibition. Those who experience takings regarded as clearly permissible — including those whose prop-

erty is taken for new highways, airport expansions, public convention centers, and public stadiums — get no relief. Also, it will be more difficult for ordinary landowners to find a lawyer to bring an action challenging a questionable taking. Many condemnation lawyers work on a contingent fee basis, and are paid a percentage of any additional “just compensation” they obtain from the state beyond the state’s initial offer. A no-public use action, if it succeeds, means that there will be no fund of money with which to pay the lawyer. So, the incentive for lawyers to bring and aggressively prosecute such actions is diminished.

Alternatively, the decision whether or not to use eminent domain could be pushed down to the local level with the requirement that the decision be made by elected rather than unelected officials. Another approach would be to put the burden on the condemning authority to establish the legality of the taking, including whether it constitutes a public use, before title changes hands. Many jurisdictions today have “quick take” statutes that presume the validity of the taking, and require condemnee (landowner) to file a private action seeking to enjoin the taking. This procedure puts the burden of proof on the condemnee, including the burden of proving that the taking is not a public use. That could be changed as a means of strengthening landowner rights. Also, it may be possible to increase the amount of compensation paid to condemnees above the current requirement of fair market value.

Suggested Approach

It is important that any legislative action provide “relief” to all property owners who experience eminent domain, not just a select few. A strategy that provides more money to persons whose property is taken by eminent domain accomplishes that objective and will minimize the actual use of eminent domain. Also, eminent domain procedures were developed in the nineteenth century and have been modified only slightly over time. Under the typical approach, a legislative body makes a decision to condemn property without providing any

The Kelo case and eminent domain, continued from page 3

explanation, with a court then holding a hearing to see whether the condemnation meets the court's understanding of the meaning of public use. There is typically no detailed proposed project that is set forth for public comment and hearings. Disaffected persons generally cannot seek judicial review concerning the wisdom of the proposed taking. Retooling current eminent domain procedures to require open, public, participatory inquiries into the need for the exercise of eminent domain would provide better protection for property owners than imposing an abstract definition of prohibited categories of eminent domain enforced by courts. Modernizing the process in this fashion would allow the real objections to the project to be addressed, and would create a mechanism for identifying a way to proceed that would involve less or no use of eminent domain, and would allow property owners a forum in which to voice their objections to being uprooted.

Another reform might be to require more complete compensation for persons whose property is taken by eminent domain. The constitutional standard requires fair market value, no more and no less. Congress modified this when it passed the Uniform Relocation Act in 1970, which requires some additional compensation for moving expenses and loss of personal property. Congress could modify the Relocation Act again, to push the compensation formula further in the direction of providing truly "just" compensation.

Alternatively, Congress could require that when a condemnation produces a gain in the underlying land values due to the assembly of multiple parcels, some part of the gain must be shared with the people whose property is taken. Under current law, all of the assembly gain goes to the condemning authority, or the entity to which the property is transferred after the condemnation.

Conclusion

Adjusting the level of just compensation and/or reforming the current eminent domain process would do more to protect homeowners against eminent domain abuses than declaring a federal prohibition on takings for economic development. These techniques would protect all property owners — those whose property is taken for clear public uses, as well as those whose property is taken for private economic development. Moreover, the "takings" process would remain subject to the oversight of attorneys who represent property owners in condemnation proceedings. Providing additional compensation in cases of greatest concern would also discourage local governments from using eminent domain without barring its use altogether. Perhaps most importantly, assuring a more "just" measure of compensation would leave the ultimate decision about when to exercise the eminent domain power in the hands of local elected officials who are politically accountable to local voters.

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Two issues may shape the 2007 Farm Bill

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As I look at the issues that cannot be avoided as we prepare to lay the groundwork for a discussion of the shape of the 2007 Farm Bill, several things come to mind. The first is the federal deficit and the second is the pressure that is being put on WTO negotiators to eliminate agricultural subsidies. These two factors have the potential to significantly affect the nature of the 2007 Farm Bill discussion.

While these two issues may seem to be unrelated, one domestic and the other international, they in fact stem from a common cause. If crop prices in the 1997-2004 period were at the same level that they were in early 1996, we wouldn't be talking about either one. However, because of low market prices for the eight major U.S. crops, spending on the farm program zoomed to over \$20 billion a year and recently has settled back into the mid-teens. Much of the time over the last nine years, crop prices have been well below the cost of production. When these crops are sold into export markets at low prices, farmers and governments around the world accuse us of dumping our excess production on international markets at a price that is below the full cost of production. As a result we have seen a growing chorus of those who, as a part of WTO negotiations, are calling for the elimination of all subsidies in the U.S. and other developed countries.

The issue that has to be addressed, then, is the part that recent U.S. farm policy may have played in bringing about these low prices. I would argue that the low prices are the consequence of basing farm policy on an incorrect set of assumptions about the nature of the agricultural sector, particularly crop agriculture. Going into the 1996 Farm Bill, it was assumed that

(1) the agricultural sector behaves more like other economic sectors than it did when farm programs were first adopted in the 1930s;

(2) exports are the key to a prosperous US agricultural sector, after all 95 percent of the consumers of food live outside the U.S.; and

(3) government farm programs are the problem, not the solution, and if the government would get out of the way and allow markets to work, U.S. agriculture would be on the road to a market-driven prosperity. Let us look at these one at a time.

In other economic sectors, low prices stimulate two responses—consumers increase their purchases while manufacturers reduce production quickly returning to industry to profitability. Low food prices, however, do not stimulate consumers to increase their food intake from three meals to five meals a day. Similarly, it is not in the best interest of individual crop farmers to measurably reduce their acreage or use of inputs in the face of lower prices. Any income they receive above the variable cost of production can be put toward the fixed costs.

U.S. farmers have enjoyed an export driven prosperity three times in the last century—WWI, WWII, and the mid-to-late 1970s—and none of them were triggered by U.S. farm policy instruments. These periods of surging exports lasted a total of no more than 14 years out of the last hundred. Most countries view their domestic food production in the same way that U.S. residents view the military, it is a matter of national security. Most nations that have an adequate amount of arable land would prefer to grow their own food rather than become dependent on imports. The level of U.S. exports of crops like corn are more a function of production variations in other nations than it is a function of price.

Under government farm programs in effect prior to the adoption of the 1996 Farm Bill, the non-re-course loan rate set an effective floor on program

Two issues may shape the 2007 Farm Bill, continued from page 5

crop prices by taking production out of the commercial market and placing it into government storage. With the extension of Loan Deficiency Payments (LDP) to crops like corn, soybeans, and wheat, prices could fall below the loan rate, farmers could collect the difference between the posted county price and the loan rate while still retaining possession of the crop that could then be sold at prices well below the cost of production. A comparison of corn prices before and after the implementation of the FAIR Act shows that for the same year-ending stocks-to-use ratio, prices in the post 1996 period were 34 cents a bushel lower than they were when government policy put a floor on corn prices. Before the adoption of the FAIR Act, government policy worked in a manner so as to ensure that farmers received the bulk of their income from the marketplace and at the same time maintained lower government costs. With a floor on crop prices, other nations had little reason to accuse the U.S. of dumping.

If a variation of the pre-1996 farm programs were in effect today, crop prices would be higher, government farm program costs would be significantly lower, farmers would receive more of their income from the marketplace, the volume of our crop exports would be virtually the same as it is today, the value of our crop exports would be higher, and farmers around the world would be receiving higher prices for their crops making the accusations of dumping moot.

For all of their weaknesses, farm policies in effect prior to 1996 had fewer negative side effects than the policies in effect today. We would contend that the reason for this is that the earlier policies took into account the unique economic characteristics of crop agriculture and were designed to work both in periods of stable to declining exports and increasing exports.

Updates, continued from page 1

Internet updates

The following updates have been added to www.extension.iastate.edu/agdm.

Decision Tools

Grain Drying Cost Calculator– Use this decision tool to calculate total drying cost per bushel based on the type of drying system and price inputs.

Grain Transportation Costs – Use this decision tool to find ownership and operator costs for transporting grain by wagon or truck.

Crop Rotation Summary – Use this decision tool to estimate the returns for different crop rotations.

Livestock Revenue Protection (LRP) Analyzer - Use this decision tool to compare the price risk protection available with Livestock Revenue Protection to using futures contracts, put options or no price protection.

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