Notes

Tender Offer Taking: Using Game Theory to Ensure that Governments Efficiently and Fairly Exercise Eminent Domain

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I. INTRODUCTION

In *Kelo v. City of New London*, the Supreme Court held that the United States Constitution does not prevent the government from exercising its power of eminent domain to take private land for the purpose of economic development.[1] States, uncomfortable with this broad power, have been experimenting with a variety of laws designed to rein in the power of eminent domain,[2] yet none of these experiments have been entirely successful. The difficulty stems from the need to allow eminent domain to solve the holdout problem while, at the same time, preventing eminent domain from introducing new problems, such as economic inefficiency and exploitation of minorities. This Note proposes that all of these goals can be achieved by requiring the government to follow a new process called Tender Offer Taking (TOT) before it can exercise eminent domain.

The TOT process uses game theory to neutralize opportunistic holdouts and prevent communities from being disrupted, unless the cost of disruption will be less than the benefit generated by a new project. The steps of the process, which will be elaborated and justified in greater detail below, are designed to separate opportunistic holdouts from subjective-value holdouts. Opportunistic holdouts are defined as those landowners who will hold out for a higher offer whenever they think they can get one. Subjective-value holdouts, on the other hand, are defined as landowners who reject an offer only because the offer is below their subjective valuation of their land. The TOT, by setting up a species of the one-shot prisoner's dilemma, flushes out opportunistic holdouts by making acceptance of the government's offer the only rational, selfish choice.

Once the subjective-value holdouts have been isolated, their acceptance rate is used as the measure of the true economic efficiency of a project. The government may only exercise eminent domain once a

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[1] Kelo v. City of New London, 545 U.S. 469, 489–90 (2005).

[2] *2006 Eminent Domain Legislation*, NAT'L CONF. OF STATE LEG., http://www.ncsl.org/default.aspx?tabid=17593 (last visited May 14, 2011) (listing seven categories of statutes enacted after *Kelo* to limit eminent domain).

certain acceptance threshold is reached. The TOT process is designed so that the more social capital a community has, the harder it will be for the government to reach the acceptance threshold. This allows social capital to protect itself even when landowners do not fully weigh the value of social capital in their calculations of subjective value. Social capital is worth preserving because it allows a community to overcome a wide range of collective action problems, including resisting TOT offers below aggregate subjective value.

This Note proceeds as follows. Part II explains the problem for which eminent domain was designed: holdouts. Part III explains why the traditional exercise of eminent domain disregards subjective value; why disregarding subjective value leads to economic inefficiency; and how eminent domain has been used to target minorities and thereby unbalance the reciprocity of advantage. Part IV explains and critiques some illustrative attempts by academics and legislators to fix eminent domain. Part V defines the novel TOT process; discusses the advantages of the TOT process over current and previously proposed eminent domain laws; discusses potential problems with the TOT process; and explains why these problems will probably not be a serious hindrance. Part VI concludes with a summary and a suggestion for how to turn the TOT process into a legal reality.

II. THE PROBLEM THAT EMINENT DOMAIN WAS DESIGNED TO SOLVE

The most common justification for granting the government the extraordinary power to take land without consent is that eminent domain is necessary to overcome the problem of holdouts.[3] When a government project requires the assembly of many separately-owned parcels of land, every landowner in the project area has the power to veto the project.[4] When landowners realize that they have this power, they may attempt to charge the government an extortionate price. Payment of this extortionate price is problematic because it unfairly appropriates taxpayer money. This Note adopts the Kaldor-Hicks definition of efficiency that a project is efficient if it would increase the welfare of some people, even if those who benefited had to fully compensate everyone for the amount by which the project decreased their welfare.[5]

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[3] Errol Meidinger, *The "Public Uses" of Eminent Domain: History and Policy*, 11 ENVTL. L. 1, 49 (1980); *see also* Richard A. Posner, *Foreword: A Political Court*, 119 HARV. L. REV. 31, 93 (2005) ("The only justification for this almost random form of taxation [caused by eminent domain] is the existence of holdout problems. . . .").

[4] *See* Lee Anne Fennell, *Taking Eminent Domain Apart*, 2004 MICH. ST. L. REV. 957, 972 (2004) ("[E]very individual landowner along that route enjoys monopoly power. . . .").

[5] Jules L. Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 HOFSTRA L. REV. 509, 513

The TOT process relies upon the behavioral differences between opportunistic holdouts and subjective-value holdouts. Opportunistic holdouts are defined in this Note as landowners who refuse a government offer solely because they believe that the government needs their land so much that it will pay them a greater price if they holdout. The acceptance behavior of these holdouts is not correlated with how much they subjectively value their land. Subjective-value holdouts are defined as landowners who refuse a government offer because they idiosyncratically derive more value from their land than the average buyer in the market, but the government does not include this subjective value in its offer. Subjective-value holdouts are not necessarily a problem, but they can become a problem if the government begins developing some of the land for a project before realizing that it will not be able to acquire all of the land it needs due to a subjective-value holdout. As will be discussed later, the TOT process sorts these two types of holdouts and turns subjective-value holdouts into a benefit by altering the traditional eminent domain process in two ways. First, the potential for subjective-value holdouts to waste government resources is removed by preventing the government from beginning a project until it knows that it will be able to acquire all necessary land. Second, the behavior of subjective-value holdouts is used to give the government critical information about whether a project will be economically efficient.

III. THE PROBLEMS THAT EMINENT DOMAIN INTRODUCES

A. No Compensation for Subjective Value

The Takings Clause of the United States Constitution requires that "just compensation" be paid to condemnees.[6] On its face, that phrase does not present economic or ethical problems. However, such problems were introduced when the Supreme Court interpreted "just compensation" to mean objective fair market value.[7] The fair market value will not compensate condemnees for a variety of subjective values.[8] Usually, the subjective value will be significantly higher than the

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(1980).

[6] U.S. CONST. amend. V ("[N]or shall private property be taken for public use, without just compensation.").

[7] United States v. 564.54 Acres of Land in Monroe and Pike Counties, Pa., 441 U.S. 506, 511 (1979) ("[W]e have recognized the need for a relatively objective working rule. . . . The Court therefore has employed the concept of fair market value to determine the condemnee's loss.").

[8] *See* Steven J. Eagle, *Privatizing Urban Land Use Regulation: The Problem of Consent*, 7 GEO. MASON L. REV. 905, 915 (1999) ("[G]iven that the destruction of subjective value almost always occurs in eminent domain proceedings, 'just compensation' is hardly ever 'full compensation.'").

market value. The existence of this discrepancy can be deduced simply from the fact that the owner has not sold his land.[9] Subjective value can come from a variety of locality-dependent assets, such as the goodwill that businesses have developed among local customers[10] and the social capital developed between friendly neighbors.[11] Social capital is a valuable asset that will be explored in more detail in the following discussions of economic efficiency. Social capital has not only an emotional value to residents of a cohesive community, but also an economic value, which derives from its ability to solve collective action problems.[12]

B. Inefficiency

The failure to consider subjective value causes not only the perception of unfairness, but also the mistake of using eminent domain even when the value created by a project will be less than the value destroyed. To see this inefficiency, we can look at the following hypothetical.

Imagine that there is a thriving community of deaf homeowners around an airport. The market value of that land is extremely low because most people would suffer a large reduction in welfare due to airplane noise. However, the deaf homeowners are not significantly affected by the noise. The deaf neighbors greatly enjoy being near so many people who can use sign language, and over many years they have formed close social ties. These social ties allow the community to accomplish great things, such as organizing a local crimewatch and ensuring considerate treatment of common areas.

Now imagine that the government considers using eminent domain to acquire the land around the airport in order to build upon it a luxury apartment building. The government may have a reasonably accurate estimate of the economic development of this new building, but it has no information about how much the owners of that land value it. If the

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See also Kelo v. City of New London, 545 U.S. 469, 521 (2005) (Thomas, J., dissenting) ("[N]o compensation is possible for the subjective value of these lands to the individuals displaced.").

[9] Posner, *supra* note 3, at 93 ("Ordinarily an owner's subjective valuation will exceed market value . . . otherwise he would probably have sold it.").

[10] A minority of states expressly recognize and compensate for goodwill lost to eminent domain. *See* Nicole S. Garnett, *The Neglected Political Economy of Eminent Domain*, 105 MICH. L. REV. 101, 124 (2006) (citing CAL. CIV. PROC. CODE § 1263.510 (West 2005); FLA. STAT. ANN. § 73.071(3) (West 2004); VT. STAT. ANN. tit. 19, § 501(2) (2000); WYO. STAT. ANN. § 1-26-713 (2005)).

[11] *See generally* ROBERT D. PUTNAM, BOWLING ALONE: THE COLLAPSE AND REVIVAL OF AMERICAN COMMUNITY (2000).

[12] *See* ELINOR OSTROM, GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION 184 (1990) ("When individuals have . . . developed shared norms and patterns of reciprocity, they possess social capital with which they can build institutional arrangements for resolving CPR [Common Pool Resource] dilemmas.").

government opts to employ its eminent domain power, it will never know whether the value that it destroys is greater than the value it will create because the government will only be required to pay the landowners what the average buyer on the market would pay. This undercompensation may mislead the government into believing that its project will be economically efficient even though it will actually be transferring the property to those who will value it less. Eminent domain would create a mediocre apartment building while taking from the current landowners a uniquely suitable location and a valuable social arrangement.

While the government is not constitutionally required to compensate for subjective value, theoretically it could restrain itself by cancelling projects that it believes will destroy too much subjective value. However, the government often goes ahead with inefficient projects because undervaluation incentivizes developers, who will gain the entire assembly surplus and bear none of the subjective costs, to lobby for eminent domain.[13]

An important function of compensation is to help the government determine when it will be economically efficient to take land.[14] The assumption that government officials, rather than a voting or market system, can determine how much citizens value their property is a timeworn error that has doomed countless government projects.[15] The solution proposed by this Note enhances the efficiency-signaling function of compensation[16] by using landowner behavior as a gauge for value. The solution will also enhance the risk-reduction function of compensation. The risk of undercompensation dissuades risk-averse investors from investing, even if their project would be more efficient than alternatives.[17]

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[13] Thomas W. Merrill, *The Economics of Public Use,* 72 CORNELL L. REV 61, 87 (1986).

[14] *See* Michael Heller & Rick Hills, *Land Assembly Districts*, 121 HARV. L. REV. 1465, 1483 (2008) (arguing that armed with only eminent domain "government has no institution by which to get an accurate appraisal of what an unassembled neighborhood . . . is really worth").

[15] *See, e.g.,* H.B. MAYO, AN INTRODUCTION TO DEMOCRATIC THEORY 217 (1960) (explaining that the Soviet Union made a common mistake by assuming that "the wishes of the people can be ascertained more accurately by some mysterious methods of intuition open to an elite rather than by allowing people to discuss and vote"); Nicole Stelle Garnett, *The Neglected Political Economy of Eminent Domain*, 105 MICH. L. REV. 101, 140 (2006) ("Today's fiercely competitive 'market' for economic development strongly suggests that many government actors may well *overestimate* the benefits of condemning property.") (emphasis added).

[16] *See* RICHARD EPSTEIN, BARGAINING WITH THE STATE 84–85 (1993) (arguing that compensation deters the government from taking too much land).

[17] *See* Lawrence Blume & Daniel L. Rubinfeld, *Compensation for Takings: An Economic Analysis,* 72 CAL. L. REV. 569, 586–88 (1984) (giving a hypothetical in which a risk-averse investor whose project had a higher expected value bids less than a risk-neutral investor).

C. Exploitation of Politically Weak Groups

Even if government officials were able to accurately weigh the subjective value of land, they might still use the power of eminent domain for economically inefficient projects. This could be because they have been captured by politically powerful interest groups or because the majority of voters will be shielded from the full costs of eminent domain. This phenomenon may explain why minority communities have been frequently targeted for inefficient redevelopment that benefits a politically powerful group, such as a corporation or a nearby affluent neighborhood.[18] Empirical studies have charted the extent of the disparity. One study showed that 63% of the people who were displaced by urban renewal between 1949 and 1963, and whose race could be identified, were nonwhite.[19] Daniel Farber acknowledged this risk but maintained that "the takings clause can be defended as a barrier against a serious form of discrimination against politically disfavored groups."[20] However, the "public use" barrier in the takings clause has been effectively nullified by stretching public use to include giving land to private developers.[21] The solution proposed by this Note presents a more effective barrier by giving a veto to groups that are a minority in the wider political unit but a majority in a targeted locality.

The selective targeting of politically weak groups not only violates equal protection, but also undermines one of the fundamental justifications for eminent domain: the reciprocity of advantage.[22] The reciprocity of advantage can justify eminent domain if, in the long run, each target of eminent domain can expect that they will eventually be compensated for their loss by the benefits that accrue to the members of a polity because of that polity's use of eminent domain.[23] Members of minority communities are unlikely to receive a reciprocal advantage if they are forced to shoulder a disproportionate share of the costs of

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[18] *See* Charles 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, 547–48 (2006) (pointing out that the urban renewal projects of the early 20th century, which largely targeted African American communities, are now considered to have been mistakes).

[19] BERNARD J. FRIEDEN & LYNNE B. SAGALYN, DOWNTOWN, INC.: HOW AMERICA REBUILDS CITIES 28 (1989).

[20] Daniel A. Farber, *Economic Analysis and Just Compensation*, 12 INT'L REV. L. & ECON. 125, 137 (1992).

[21] *See Kelo*, 545 U.S. 469, 484 (2005) (holding that the economic growth caused by private development counts as public use). *See also id.* at 506 (Thomas, J., dissenting) ("If such 'economic development' takings are for a 'public use,' any taking is, and the Court has erased the Public Use Clause from our Constitution . . . .").

[22] Hanoch Dagan, *Takings and Distributive Justice*, 85 VA. L. REV. 741, 771 (1999) (asserting that "reciprocity of advantage should be regarded as an important component of takings jurisprudence since it allows the incorporation of the value of social responsibility into the legal doctrine.").

[23] *See id.* (explaining that eminent domain is only justified so long as targeted landowners receive in the long run proportional advantages by virtue of their membership in a community that uses eminent domain).

eminent domain.

IV. PREVIOUSLY PROPOSED SOLUTIONS

The serious deficiencies of eminent domain jurisprudence have spurred numerous scholars and legislators to suggest solutions. In the two years after *Kelo v. City of New London* was decided, 34 states passed a responsive statute or constitutional amendment.[24] Despite this flurry of activity, no solution has managed to fix both the problems for which the eminent domain power was created and the problems that eminent domain causes. There have been so many proposed solutions that this Note can only sample a few of the most instructive. These solutions can be roughly divided into those that limit the purpose, the target, the recipient, and the process of condemnation.

A. Limiting the Purpose: Banning Taking for the Purpose of Economic Development

Some states responded to *Kelo* by banning any taking for the purpose of economic development.[25] This type of limitation is not an ideal solution because it thwarts many economically efficient projects and will almost always leave loopholes open. For example, if "economic development" is defined as "any activity performed to increase tax revenue, tax base, employment rates, or general economic health,"[26] then the government can sidestep the ban by claiming that its purpose is actually to improve the aesthetics of an area.

B. Limiting the Target: Disallowing Eminent Domain for Anything but Blight

Some states limited the power of eminent domain so that it could only target blighted areas. The first problem with this approach is that the criteria for blight are so flexible that blight can be found in whatever area the government desires.[27] The second problem is that this method

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[24] Lynn Blais, *Urban Revitalization in the Post-Kelo Era*, 34 FORDHAM URB. L.J. 657, 659 (2007).

[25] *See, e.g.*, 2007 ND S.B. 2214 (NS) (removing economic development from the definition of "public use" for eminent domain purposes).

[26] *Id.*

[27] *See* Heller & Hills, *supra* note 14, at 1509 ("[N]eighborhoods are condemned as blighted even when their quality is not noticeably lower than the quality of an average city block."). *See also*

exacerbates the tendency to wield eminent domain against ethnic minorities[28] and the poor,[29] who live in areas most likely to be labeled "blighted."

C. Limiting the Recipient: Requiring the Recipient to Be a Not-for-Profit Entity

Charles Cohen has proposed a constitutional amendment that would limit the category of potential recipients of land taken by eminent domain to not-for-profit entities.[30] This has the advantage of preventing wealthy for-profit corporations from aggressively lobbying the government for a particular use of eminent domain. The risk of such lobbying can be seen in the pressure that General Motors exerted on the city of Detroit, which resulted in the summary destruction of vast swaths of Poletown without the benefits that had been promised.[31] While not-for-profit entities would not pressure the government out of monetary greed, they might do so in furtherance of their institutional mission without regard for all of the costs, as was arguably the case when Columbia University convinced the state of New York to use eminent domain to obtain land for expansion in Harlem.[32] The tendency of not-for-profit organizations to ignore wider economic effects in the single-minded pursuit of their mission has been well-documented.[33] For example, environmental agencies tend to "discount the potential effects of their actions on the performance of the economy."[34]

The problem of government capture that Cohen's proposal struggled to solve is a significant cause of inefficient eminent domain. To see why capture of the eminent domain power is so prevalent, we can

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Matter of Kaur v. New York State Urban Dev. Corp., 15 N.Y.3d 235, 256 ("[B]light is an elastic concept. . . .").

[28] Blais, *supra* note 24, at 678 (arguing that the blight exceptions in legislative responses to *Kelo* push government towards the type of urban renewal programs in which "large numbers of poor minority residents [are] displaced" without achieving the promised benefit).

[29] David A. Dana, *The Law and Expressive Meaning of Condemning the Poor after Kelo*, 101 NW. U. L. REV. 365, 379 (2007) (explaining that, given the tendency for limits on eminent domain to allow an exception for blight without addressing the need for affordable housing, "it is hard to understand any of the contours of Kelo-inspired reform as shaped by concern for the needs of the poor and poor neighborhoods").

[30] Cohen, *supra* note 18, at 566–67.

[31] *See* Poletown Neighborhood Council v. Detroit, 410 Mich. 616, 658 (1981) (Ryan, J., dissenting) ("[T]he city chose to march in fast lock-step with General Motors."). *See also* Cohen, *supra* note 18, at 545 ("[T]he actual benefits provided by the General Motors plan fell far short of the 6,150 jobs projected. Seven years after displacing 4,000 residents, destroying 1,400 homes and between 140 and 600 businesses, the plant employed only about 2,500 people.").

[32] *See generally* Kaur v. N.Y. State Urban Dev. Corp., 933 N.E.2d 721 (N.Y. 2010).

[33] *See, e.g.*, Richard J. Pierce, Jr., *Seven Ways to Deossify Agency Rulemaking*, 47 ADMIN. L. REV. 59, 78 (1995) (arguing that relaxing the duty of an agency to consider policy in statutes besides the organic statute will reinforce the "tendency of single-mission agencies to use tunnel vision").

[34] *Id.* at 78–79.

look at the work of James Q. Wilson on the effect of the distribution of costs and benefits. Wilson explained that government capture is most likely in "client politics," which occurs when the benefits are narrowly concentrated and costs are widely distributed.[35] Eminent domain for private economic developers is client politics because a narrow group of people get most of the benefit while the cost of an inefficient project is spread out amongst all taxpayers. Each taxpayer is rationally apathetic about the loss of a few cents while a developer will expend vast resources to influence the government because it may stand to gain millions of dollars. The TOT system may ameliorate this capture problem by shrinking the "voter" pool to those who have the most to lose, thus shifting from "client politics" to a more balanced "interest group" politics.

D. Limiting the Process: Land Assembly Districts

Land Assembly Districts (LADs), first proposed by Michael Heller and Rick Hills, would substitute a new local governance process for the eminent domain process whenever land is desired not for its uniqueness, but for its greater value once assembled.[36] This requirement to distinguish between different purposes of eminent domain is the first problem with LADs, because it will be difficult to draw this distinction given that all land is to some degree unique.

A LAD would be created by the approval of the government and the owners of a majority of the value or square-footage of land in that area. Members of the LAD would then evaluate proposals by developers and determine by a majority vote whether or not to sell the entire district to the developer. This vote is binding on all owners within the LAD, except for the largely symbolic exit option of demanding fair market value under normal eminent domain rules.[37] If the majority of a LAD votes not to sell, then no one has the power to force a sale through eminent domain.

While the LAD system's ability to consider subjective value and democratic preference is an advantage over the current eminent domain process, it does not adequately protect minorities or distinguish opportunistic holdouts from subjective-value holdouts.

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[35] JAMES Q. WILSON, THE POLITICS OF REGULATION 369 (1980).
[36] Heller & Hills, *supra* note 14, at 1470.
[37] *Id.* at 1496–97.

V. NEW SOLUTION: TENDER OFFER TAKING

A. Description of TOT

Tender Offer Taking (TOT) is the optimal way to overcome the problems of holdouts, economic inefficiency, and exploitation of minorities. Tender Offer Takings are so named because of their similarity to tender offers for securities of publicly traded companies. A tender offer for securities is a public offer to buy a certain number of shares of a corporation at the same above-market-price for each share.[38] "[T]he tender offer is an innovation in corporate law designed to overcome the holdout problem. . . ."[39] The strategies and regulations for tender offers for securities can illuminate the advantages of TOT.

The TOT process operates when the government has bound itself by statute or constitutional amendment to follow a specific process before resorting to eminent domain. The required process is that the government must move sequentially through the following steps: (1) draw the boundaries of an area of land that it requires for a specific project; (2) simultaneously offer every landowner within that boundary the same percentage above market price for their land;[40] (3) confidentially collect acceptances during a 20 business-day period;[41] (4) publicly announce at the end of the period whether the threshold has been met without revealing the percentage of acceptances; (5) if the threshold has been met, then pay the premium price to every landowner

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[38] *See* 15 U.S.C. § 78n(d)(7) (2006) ("Where any person varies the terms of a tender offer or request or invitation for tenders before the expiration thereof by increasing the consideration offered to holders of such securities, such person shall pay the increased consideration to each security holder . . . .").

[39] Donald J. Kochan, *"Public Use" and the Independent Judiciary: Condemnation in an Interest-Group Perspective*, 3 TEX. REV. L. & POL. 49, 88 (1998).

[40] For example, if the government decides to offer a 10% premium then it would have to offer $1,100,000 to the owner of land with a market value of $1,000,000 and $11,000 to the owner of land with a market value of $10,000. By binding itself to pay the same percentage to every landowner, the government prevents any one landowner from trying to extract a disproportionate share of the premium. As a side note, this offer could conceivably be in the form of shares of the project rather than cash. Offering shares has been proposed as a way of allowing condemnees to share in the surplus created by assembly. Amnon Lehavi & Amir N. Licht, *Eminent Domain, Inc.*, 107 COLUM. L. REV. 1704, 1707 (2007). Offering shares could also serve as a way to let a market rather than government officials decide the value of an assembly project. However, homeowners will not usually be as capable of assessing the value of a project as they will be capable of assessing the value of their own homes.

[41] The 20 day period is borrowed from the 20 days that a tender offer must remain open according to the Williams Act. *See* STEVEN EMANUEL & LAZAR EMANUEL, CORPORATIONS 454 (6th ed. 2009) ("[A] tender offer must be kept open for at least 20 business days. . . . [The rationale being that this] ensures stockholders of enough time to carefully consider whether they want to tender."). If stockholders can fully assess the value of a corporation in 20 days then, in that same period of time, homeowners should be able to assess the value of their own land, an asset about which they should be uniquely knowledgeable. However, states may want to experiment with longer time periods because decisions about land may be more emotionally complex.

who accepted and use eminent domain to pay market value to every landowner who had not accepted by the 20th business day; or (6) if the threshold has not been met, then either end the TOT process or repeat the process by restarting at step two with a higher offer.

B. Advantages of TOT

By binding itself to follow the TOT process, the government enhances its bargaining position while at the same time preventing economic inefficiency and the oppression of minorities. While it might seem counterproductive for the government to remove some of its options for dealing with holdouts, "precommitments are often used strategically to control others."[42] One example of this strategy would be removing the incentive for criminals to take hostages by passing a law that prohibits law enforcement from considering hostages when formulating arrest plans or trading any benefit for hostages.

1. Economic Advantages

TOT enhances the bargaining position of the government because it protects the government against opportunistic holdouts. One way to see how this protection would work is to look at the way that tender offers for securities that deny a premium to latecomers successfully induce potential holdouts to accept quickly rather than risk stalling for a higher offer.[43] Given that acceptances of a TOT are kept confidential, a landowner contemplating holding out for a higher offer regardless of his subjective valuation would have to fear that his neighbors had already accepted the premium and that he would be stuck in the small group of latecomers who will receive only market value. This confidentiality will also defeat attempts to organize a voting bloc for holdout purposes because the optimal strategy of every rational owner seeking only to maximize his own wealth would be to publicly claim that he will not accept while secretly accepting in case the threshold is reached. This is an advantage over the LAD process, because it would be rational for opportunistic holdouts to organize a voting bloc within a LAD and then personally vote against offers until they feel that they cannot extract any

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[42] John A. Robertson, *"Paying the Alligator": Precommitment in Law, Bioethics, and Constitutions*, 81 TEX. L. REV. 1729, 1731 (2003).

[43] *See* Nathaniel B. Smith, *Defining 'Tender Offer' Under the Williams Act*, 53 BROOK. L. REV. 189, 193 (1987) (explaining that tender offers that denied a premium to late acceptors were effective because they caused shareholders to stampede to avoid being left without a premium and under the power of a controlling shareholder).

more rent.

The tendency to defect will be particularly strong because of the one-shot nature of TOT transactions; the only time that a betrayal will come to light is when the neighborhood is sold and neighbors will never again have to cooperate.[44] The threat of defection and lower compensation will create a stampede effect among opportunistic holdouts. In the stock market context, legislators and courts have created rules that mitigate the stampede effect in order to protect average shareholders from powerful corporate raiders. However, the stampede effect should be encouraged not mitigated in the land assembly context in order to protect the taxpayers against opportunistic holdouts.[45]

The holdout protection TOT supplies is superior to the protection supplied by LADs because while LADs merely require holdouts to equally share the rents they extract, LADs do nothing to prevent opportunistic holdout behavior. LADs contain no threat of being left without a premium, so opportunistic holdouts can vote with impunity to hold land hostage.

The government's position is also enhanced by the all-or-nothing nature of TOT. The government will not find itself in the unfortunate position of having purchased a large number of lots only to belatedly discover that it will not be able to purchase the rest of the lots necessary for the project at an acceptable price.

Another advantage of the TOT process is that it separates the opportunistic holdouts from the subjective-value holdouts. This sorting facilitates the formulation of project plans because "it is exceedingly difficult to distinguish a landowner's opportunistic holdout behavior, against which policy measures may be justified, from legitimate bargaining."[46] Opportunistic holdouts will likely accept any TOT offer above market value because some profit is better than none. Subjective-value holdouts, on the other hand, will likely refuse a TOT offer that is below their subjective value, especially if they believe that their neighbors share their valuation and if there is enough social capital to prevent defections. Therefore, the government will be able to use the TOT process to accurately gauge the amount of subjective value that will be destroyed by its project. This gauge function is essential because subjective value cannot be accurately determined by asking owners who

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[44] *See* ROBERT AXELROD, THE EVOLUTION OF COOPERATION 12–14 (1984) (explaining that cooperation emerges from repeat-play dilemmas).

[45] One protective legislative rule is the Williams Act requirement that if there are more willing sellers than the offeror wanted, all sellers must be give a pro rata share. 15 U.S.C. § 78n(d)(6) (2010). One protective judicial rule is that corporations can take defensive measures to protect their shareholders when faced with a front-loaded, two-tier tender offer, meaning that the second tier offers latecomers a less liquid asset, such as junk bonds. *See* In re Pure Res. S'holders Litig., 808 A.2d 421 (2002). The existence of these protections is evidence of the power of tender offers to deprive latecomers of a premium.

[46] Lehavi & Licht, *supra* note 40, at 1732.

know that their answers will influence the offer price.[47]

These assumptions about behavior could be challenged on the ground that even subjective-value holdouts will accept an offer below subjective value out of fear that they will be stuck with an even lower compensation. However, scholars have "repeatedly demonstrate[d] the ability of close-knit groups to prevent individual members from acting strategically and to encourage them to act instead in a way that maximizes group welfare."[48] Social capital can help solve collective action problems,[49] and resisting a TOT offer below subjective value is a collective action problem. Therefore, the more social capital that a community has the more likely it will be to resist inefficient offers. This correlation serves the TOT system well because it allows a valuable asset to protect itself.

Let us briefly sketch one hypothetical operation of social capital in the TOT system to illustrate how social capital can serve as both a means and an end. Neighborhood One is primarily composed of warehouses and young professionals who move so often that they have not formed strong social bonds. Neighborhood Two is primarily composed of neighbors with strong social ties. They are able to solve many collective action problems using the strength of those ties, such as getting neighbors to refrain from littering or from using excessively noisy leaf-blowers. Neighborhood Two uses those same social ties to prevent its members from accepting offers that are above market value but do not include the value of the social ties. Neighborhood One is easily acquired by any TOT offer over market value because the social ties in Neighborhood One are not strong enough to prevent every landowner from selfishly accepting. These outcomes are both emotionally and economically desirable.

The precise percentage of acceptances needed for a TOT to consummate may require calibration as states learn by trial and error, but a promising initial percentage can be extrapolated from game theory studies of the prisoner's dilemma. The one-shot version of the prisoner's dilemma presents participants with choices and reward structures similar to those faced by landowners considering a TOT. In the one-shot prisoner's dilemma, two participants secretly indicate whether they will defect or cooperate. If both cooperate, then the aggregate reward will be maximized but each cooperator will receive less than he would have if he

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[47] 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, 26 (2006) ("[Subjective] values are difficult to quantify . . . [because] existing owners have an incentive to inflate their selling prices. . . .").

[48] Gideon Parchomovsky & Peter Siegelman, *Selling Mayberry: Communities and Individuals in Law and Economics*, 92 CALIF. L. REV. 75, 109 (2004).

[49] Richard Pildes, *The Destruction of Social Capital Through Law*, 144 U. PA. L. REV. 2055, 2061 (1995) (describing scholarship that has brought to light "the dependence of effective collective action on norms of cooperation").

had defected when the other participant cooperated. The lowest aggregate and personal reward occurs when both participants defect.

Because defection in a one-shot dilemma incurs no risk of retribution, since the participants will never interact again, the rational, selfish choice is to defect because the highest individual reward goes to the person who defects while his partner chooses cooperation.[50] Not every participant is both rational and selfish, so the average percentage of cooperators is approximately 58%.[51] This Note uses that prisoner's dilemma percentage to assume that 58% of landowners will cooperate with the neighborhood by not sending in acceptances for a TOT when the offer is above market value but below subjective value. The behavior of the other 42% tells the government nothing about how much subjective value will be destroyed by an assembly since landowners in that 42% will send in an acceptance for any offer above market value, regardless of how much they subjectively value their land. Since their behavior does not serve any useful gauge function, they should be excluded from the percentage calculation. Therefore, a TOT should not go forward if rejected by a majority of landowners who are bargaining in good faith based on subjective value, a majority being more than 29% of the total landowners. This means that we should set the acceptance threshold at 71%.[52] If 71% of landowners accept an offer, it is probable that the project is efficient even when considering lost subjective value.

It is true that the percentage of cooperators will increase with the strength of the social capital of a neighborhood, just as the percentage of cooperators increased when participants in the prisoner's dilemma were taught about ethics before participating.[53] However, this distortion of the game theory calculations is desirable because we want to give greater protection to the neighborhoods with the most social capital. There will be situations in which landowners do not realize the true value of the social capital they share, and the distortion will serve to protect that value even if some landowners fail to include it in their calculation of subjective value.

To summarize, the inclusion of subjective value in the assessment of whether assembly is worth the cost will prevent the power of eminent

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[50] *See* Harvey James, Jr. & Jeffrey Cohen, *Does Ethics Training Neutralize the Incentives of the Prisoner's Dilemma? Evidence from a Classroom Experiment*, 50 J. OF BUS. ETHICS 53, 53–56 (2004) (describing the one-shot prisoner's dilemma and the rational selfish strategy).

[51] *Id.* at 59 (reporting that 58% of subjects chose to cooperate in a one-shot prisoner's dilemma). This percentage is consistent with other game theory studies. *See* Chen-Bo Zhong, Jeffrey Loewenstein, & J. Keith Murnighan, *Speaking the Same Language: The Cooperative Effects of Labeling in the Prisoner's Dilemma,* 51 J. OF CONFLICT RESOL., 431, 432 (2007) ("[R]eviews of PD and social dilemma research note that a baseline expectation for cooperation rates among anonymous strangers should be . . . around 50 percent.").

[52] As discussed in the Conclusion of this Note, this number may need to be adjusted after further experimentation.

[53] James, *supra* note 50, at 59 (observing that participants given an ethics lesson cooperated at the higher rate of 78%).

domain from being used for economically wasteful projects.[54] This advantage of TOT is absent in many academic proposals. For example, Lehavi and Licht "call for separating the two phases of eminent domain—namely, taking and just compensation."[55] While their idea of using the market mechanism of a Special-Purpose Development Corporation to better calibrate compensation to true value may achieve that purpose, it will not achieve the larger purpose of using compensation to determine when an assembly would be efficient.

2. Justice Advantages

TOT allows groups that are politically weak to veto discriminatory projects. The precise mechanism by which this veto operates will depend on the voting system chosen for TOT, a problem discussed in a later section. Nonetheless, all of the viable voting systems would hamper attempts to target weak groups. The Supreme Court has acknowledged the possible need for special constitutional protection for "discrete and insular minorities."[56] When one neighborhood is targeted for eminent domain, the inhabitants of that neighborhood are a discrete and insular minority within the larger political unit. This problem is exacerbated by the fact that ethnic minorities tend to live in segregated communities.[57] When the costs of a project are tied to land, as is the case with eminent domain, spatial segregation allows voters of a majority ethnic group to impose a disproportionate share of the costs of a project on members of a minority group. A similar segregation and discrimination targets the poor, who, if they do not lack numbers, often lack political strength.

Under the TOT system, ethnic and socio-economic segregation strengthens the voting power of minority groups. Even groups that form a small percentage of overall voters can comprise the majority of voters in neighborhoods where they congregate.

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[54] *But see* Nicole Garnett, *The Neglected Political Economy of Eminent Domain*, 105 MICH. L. REV. 101, 140 (2006) ("Takers tend to respond to political incentives rather than economic ones."). If Garnett's assertion is true, then the TOT system would fail to prevent a project even when it forces the government to pay more than the government believes that the project is worth. However, at some point, economic incentives surely turn into political incentives such as the incentive to avoid a backlash from raising taxes.

[55] Lehavi & Licht, *supra* note 40, at 1732.

[56] United States v. Carolene Prods. Co., 304 U.S. 144, 153 n.4 (1938).

[57] *See generally* Rajiv Sethi & Rohini Somanathan, *Inequality and Segregation*, 112 J. OF POL. ECON. 1296 (2004) (developing theories to explain the persistence of racial segregation).

C. Potential Problems with TOT

1. Method of Calculating Acceptance Percentage

The most feasible way to calculate the acceptance percentage is to focus on an objective, easily assessable measurement such as (1) the number of landowners who accept, (2) market value of the land of the landowners who accept, or (3) square footage of the land of the landowners who accept. Heller and Hills argue that the goal of overcoming the collective action problems of assembly "suggests allocating voting rights in proportion to the owner's share of land."[58] However, there are both economic and legal reasons why proportional voting might not work.

The economic problem with apportioning votes by land value is that this will give too much weight to the votes of those with no subjective value. For example, the owner of a widget factory might get as many votes as dozens of families in the same neighborhood even though the factory owner does not care more about his location than the average buyer on the market, and the families care deeply about living in that community. Perhaps the reason that Heller and Hills assume that votes should be correlated with value is that in most situations, the more economic interest you have on the line, the more informed you become. However, for most landowners, their land is their most valuable asset so they will become as informed as possible about decisions that will affect their land.[59]

The legal problem with apportioning votes in any way besides one-person-one-vote stems from the equal protection clause of the Fourteenth Amendment. Courts have been strict with laws that disenfranchise voters based on land ownership; this strictness can be seen in cases such as Kramer v. Union Free School District.[60] Heller and Hills argue that because LADs have a very narrow power, courts would allow them to apportion votes by land ownership, just as "the plurality in Ball v. James permitted Arizona to allocate votes for control over an agricultural improvement district based on each landowner's share of acreage within the district, on the theory that the district had the narrow task of distributing water . . . in proportion to their share of the district's

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[58] Heller & Hills, *supra* note 14, at 1503.

[59] *See generally* WILLIAM FISCHEL, THE HOMEVOTER HYPOTHESIS: HOW HOME VALUES INFLUENCE LOCAL GOVERNMENT TAXATION, SCHOOL FINANCE, AND LAND-USE POLICIES (2001) (arguing that because homeowners cannot diversify to reduce their investment in homes, and because homes are their largest asset, they actively participate in political decisions that could affect the value of their homes).

[60] 395 U.S. 621, 632 (1969) (invalidating a statute that conditioned the right to vote in a school district on ownership of taxable land in the district because the ownership of land was not tailored to encompass all those primarily interested).

acreage."[61] However, TOT and LADs are more similar to the situation faced by the court in *Kramer* than the court in *Ball* because the connection between acreage and water requirements is stronger than the connection between the market value and subjective value of land owned. While this legal obstacle is not insurmountable, combined with the economic problem, it makes the number of landowners the preferred measurement of acceptance.

There remains the difficult question of how, if at all, leasehold interests should count towards the acceptance percentage. The answer may follow from two observations: first, one of the main reasons to lease instead of buy is to preserve mobility; and second, one of the main risks of renting is that renters can be displaced at any time. This suggests that renters value their ties to the community less, meaning their subjective value will not be significantly above market value, and therefore their input on whether the land on which they rent should be sold will not help determine when a project is economically efficient. An additional problem with counting renter acceptances is that renters would always be incentivized to refuse to accept any offer unless the system is changed to give renters a share of the sale price.

2. Violation of Nondelegation Doctrine

Regardless of which method is chosen for calculating acceptance, courts might invalidate TOT laws as an impermissible delegation of legislative power to private parties. The ability to force neighbors to sell and to direct the use of eminent domain is surely a tremendous legislative power. The Supreme Court showed the teeth of the nondelegation doctrine when it invalidated a statute giving private leaders of industry the nearly unfettered power to formulate binding rules to regulate their industries.[62] However, those teeth may have been dentures as the Court seems to have put them aside in the intervening decades. The current permissive rule is that "there is no forbidden delegation of legislative power 'if Congress shall lay down by legislative act an intelligible principle' to which the official or agency must conform."[63] The power of private landowners to assemble each other's land can be narrowly circumscribed by intelligible principles. The law creating the TOT process should set in stone the way acceptance is calculated and the way land owners share the profits from a sale. The law's main objective, the promotion of economic efficiency, is much easier to monitor than the

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[61] Heller & Hills, *supra* note 14, at 1504 (citing Ball v. James, 451 U.S. 355(1981)).

[62] A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935).

[63] Amalgamated Meat Cutters & Butcher Workmen v. Connally, 337 F. Supp. 737, 746 (1971) (citing Hampton v. United States, 276 U.S. 394, 409 (1928)).

objective of the law struck down in Schechter Poultry Corp. v. United States, which was to foster "fair competition."[64] Therefore, the courts will easily be able to monitor whether the TOT is operating according to the will of the legislature. While it is impossible to say with certainty how the nondelegation doctrine will apply to the TOT system, the novelty of TOT is not necessarily an impediment because "the fact that a delegation of zoning power to a non-elected local body has not previously been made does not mean that such a delegation is unconstitutional."[65] For these reasons, the nondelegation doctrine is unlikely to hinder the spread of the TOT system.

3. Gerrymandering

There are some potential problems with the way the government can draw the boundaries of a TOT area and with the way that developers can infiltrate an area to manipulate a vote. The drawing of the boundary is the one step in the TOT process where judicial review may be required with any frequency. Without the threat of review, the government might be tempted to define a boundary that includes some land, not because it is necessary for a project, but because it is necessary to reach the acceptance threshold. For example, the boundary could be purposefully stretched beyond the residential neighborhood actually used for the project in order to encompass a cluster of factories that would gladly sell at anything above market price. One solution to this problem may lie in adoption of the means-end scrutiny proposed by Nicole Garnett.[66] Means-end scrutiny would require the government to show that the land it seeks to take is "related both in nature and extent" to the proposed assembly project.[67]

The ability of developers to manipulate the acceptance rate will be constrained by the confidentiality of acceptances and the calculation method chosen. Because the developer cannot know how many more acceptances are needed to consummate the TOT, it will not be able to figure out how much land it needs to buy to tip the scales. To prevent the developer from estimating based on previous offer periods, the government will announce only whether or not the acceptance threshold was met at the end of each offer period, not the percentage of acceptances. This problem would disappear in states that choose the one-

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[64] 295 U.S. at 523.

[65] Bailey v. Shelby Cnty., 507 So. 2d 438, 443 (1987) (upholding the delegation of zoning authority to private citizens because the delegation imposed adequate procedures and safeguards against arbitrary action).

[66] Nicole Garnett, *The Public-Use Question as a Takings Problem*, 71 GEO. WASH. L. REV. 934, 939 (2003).

[67] Dolan v. City of Tigard, 512 U.S. 374, 391 (1994).

person-one-vote calculation as recommended because one developer would not be able to increase his influence by purchasing more land. Heller and Hills recognized this flaw in the proportional voting methods they recommended, but suggested that it could be overcome by rules such as limiting the percentage of votes that can be controlled by any one owner.[68]

4. Failure to Obtain Unique and Necessary Land

The existence of an inflexible acceptance threshold means that, inevitably, there will be some situations when the government will be unable to acquire land that it desires for a project. When the desired land is merely the best of many viable locations, it is easy to see how it might be worth choosing an alternative location to preserve subjective value. However, critics might argue that the TOT process malfunctions if it allows a community to resist eminent domain at any affordable price when their land is the only land suitable for a project—for example, because it is the only earthquake-safe ground on which to build a nuclear reactor. One response to these critics is that project-fatal refusals to sell will be extremely rare,[69] and that a community of such rare cohesion is a community that very well might be more important than a government project. Even if this is not always the case, the possibility that a project idea will occasionally have to be abandoned when it would have been desirable does not outweigh the many advantages of the TOT process over the way that eminent domain has traditionally been employed.[70]

VI. CONCLUSION

The last topic to discuss is the ideal means of legal implementation. Because of the delicate balance of interests in the TOT process, the ideal implementation might require states to pass both a constitutional amendment and a statute. A constitutional amendment is necessary to deprive opportunistic holdouts of any incentive to reject an offer above market price. If opportunistic holdouts believe that the TOT requirements can be dispensed with by a simple majority vote in the legislature, then

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[68] *See* Heller & Hills, *supra* note 14, at 1502 (suggesting that the law "bar any landowner from voting more than 30% of the property within a LAD").

[69] *See* Cohen, *supra* note 18, at 568 (asserting that alternatives to eminent domain "in most cases, provide solutions to the holdout problem" and that while it is conceivable that some projects cannot be modified to work around holdouts, "such projects would be rare").

[70] *See id.* ("Risking the infrequent derailment of an economic development project in order to eliminate the injustice and inefficiency herein described seems to be not only a smart choice, but a necessary one.")

they may be tempted to stall and lobby for such a vote. While the steps of the TOT process should be made relatively indelible through inclusion in the constitution, the precise acceptance threshold should be set in a statute because it may require fine-tuning. Actual experience with TOT may reveal that the recommended threshold, derived from artificial experiments, does not achieve the best result in practice. However, to prevent quantitative modifications from qualitatively changing the nature of the TOT process, the constitutional amendment ought to contain a provision preventing the threshold from falling below 50%. If TOT is a success in the majority of states, then the federal government may want to implement its own statute and constitutional amendment.

The TOT process ensures that the power of eminent domain will not be used to facilitate inefficient projects or to target vulnerable minorities. At the same time, it preserves the most important function of eminent domain, which is to deprive opportunistic holdouts of the ability to hold land hostage. The TOT process utilizes game theory to separate opportunistic holdouts from subjective-value holdouts, and it appropriately weighs the interests of subjective-value holdouts who refrain from accepting because of the strong social ties in their community. For these reasons, the TOT process is superior to the process by which eminent domain is currently exercised.