

Pushing the Limits of Eminent Domain

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Eminent domain is the power of government to take property for public use without an owner's consent, subject to constitutional and statutory restrictions. The use of eminent domain traditionally has been an important tool for assembling land for development purposes.¹ In *Kelo v. City of New London*,² a June 23, 2005, decision of the United States Supreme Court, the Court, in a 5-4 ruling, upheld the use of eminent domain for economic development, ruling that such development satisfies the "public use" requirement of the Takings Clause of the Fifth Amendment to the United States Constitution. Before delving into the facts and the Supreme Court's ruling in *Kelo*, a short historical review of the Supreme Court's pronouncements on the use eminent domain for economic development purposes is warranted.

I. The Law Before *Kelo*

In the modern era prior to *Kelo*, there were four United States Supreme Court cases dealing with the use of eminent domain for economic development. In each of these cases the Court, applying a deferential standard, upheld the use of eminent domain because the taking was found to serve a legitimate public purpose and the owner received just financial compensation.

*National R.R. Passenger Corp. v. Boston & Maine Corp.*³ involved an Interstate Commerce Commission order requiring one railroad to transfer a rail line to a second railroad. The ICC issued the order because the first railroad had neglected to maintain a portion of the line which carries the Amtrak "Montrealer" through New England, and it believed the second railroad would do a better job of maintaining the line. The Court unanimously rejected the first railroad's objection that the taking was not for a public use because the use of the rail line would not physically change. The Court said it could not "strike down a condemnation . . . so long as the taking is rationally related to a conceivable public purpose." In this case, Justice Kennedy wrote "there can be no serious argument that the ICC was irrational in determining that the condemnation will serve a public purpose by facilitating Amtrak's rail service. That suffices to satisfy the Constitution. . . ."

*Hawaii Housing Authority v. Midkiff*⁴ dealt with a challenge to a Hawaii statute designed to deal with the problem that a very few owners held most of the private land in the state. The statute required owners of large holdings, under certain conditions, to sell residential lots to individual citizens so that they could

¹ Brian Blaesser & Thomas Cody, *Redevelopment: Planning, Law and Project Implementation* (ABA Press 2008) at 111-12.

² 545 U.S. 469 (2005).

³ 503 U.S. 407 (1992).

⁴ 467 U.S. 229 (1984).

own their own homes. The unanimous Court, in an opinion by Justice O'Connor, recognized that the Constitution does not permit a compensated taking "for no reason other than to confer a private benefit on a particular private party"; however, the Court said it had an obligation to uphold the use of eminent domain where it is "rationally related to a conceivable public purpose." Under that standard, Justice O'Connor concluded that the Hawaii statute was constitutional. "Regulating oligopoly and the evils associated with it is a classic exercise of a State's police powers."

*Ruckelshaus v. Monsanto*⁵ addressed a takings challenge to the Federal Insecticide, Fungicide, and Rodenticide Act. The Act authorizes the Environmental Protection Agency to rely on trade secret data submitted by a prior pesticide applicant in considering the application of a subsequent applicant, subject to payment of compensation to the first applicant. While it acknowledged that subsequent applicants permitted to exploit confidential business information in this fashion were the "most direct beneficiaries," the Court had no difficulty concluding that this use of the eminent domain power served a public use.

Finally, *Berman v. Parker*⁶ involved a major urban redevelopment project in southwest Washington, D.C., that displaced numerous homeowners, renters and small businesses. The owner of a non-blighted department store in the redevelopment area challenged the taking as not being for a public use. The Court unanimously rejected the challenge, reasoning that the eminent domain power can be exercised to achieve any legitimate legislative objective. "Subject to specific constitutional limitations, when the legislature has spoken, the public interest has been declared in terms well-nigh conclusive. . . . This principle admits of no exception merely because the power of eminent domain is involved." The Court also rejected the argument that eminent domain can only be used to eliminate "slum" properties. "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."

These modern decisions are consistent with a long line of Court decisions stretching back to the 19th century. Indeed, if anything, the older decisions even more emphatically uphold the power of government to take and retransfer property, upon payment of just compensation, in order to promote economic development. To cite a few examples, in *Head v. Amoskeag Manufacturing Co.*,⁷ the Supreme Court authorized a manufacturing company to build a mill pond that flooded upstream landowners so that it could produce sufficient hydropower to

⁵ 467 U.S. 986 (1984).

⁶ 348 U.S. 26 (1954).

⁷ 113 U.S. 9 (1885).

drive a manufacturing facility. In *Strickley v. Highland Bay Gold Mining Co.*,⁸ the Court approved condemnation of a right-of-way over private property so that a private mining company could operate an aerial bucket line to its mine. Finally, in *Fallbrook Irrigation District v. Bradley*,⁹ the Supreme Court upheld condemnation so that an irrigation district could build an irrigation ditch across neighboring private property.

II. *Kelo*: Breaking New Ground or Not?

In light of the state of the law prior to *Kelo*, it is incorrect to suggest that *Kelo* broke new ground and expanded government's power of eminent domain. If anything, *Kelo* moved the law in the direction of more restrictions, not fewer restrictions, on the use of eminent domain for economic development.

The Court affirmed a decision by the Connecticut Supreme Court upholding the use of eminent domain to assemble over 100 separate parcels within a 90-acre area characterized by high vacancy rates, significant disinvestment and neglect. The City of New London had lost a substantial portion of its population and suffered an unemployment rate twice the state average. Seeking to take advantage of the economic spark generated by the decision of the Pfizer pharmaceutical company to construct a major new facility on an adjacent site, the city sought to implement a comprehensive redevelopment of the Fort Trumbull area of New London for residential, commercial, office and recreational purposes.

The Supreme Court said that New London's redevelopment plan easily met the public use test. "It would be incongruous," the Court said, "to hold that the City's interest in the economic benefits to be derived from the development of the Fort Trumbull area has less of a public character than any of . . . [the] other interests" endorsed in prior cases. Applying its deferential standard for local legislative judgments about how and when to deploy the eminent domain power, the Court also rejected plaintiffs' novel argument that it should demand a "reasonable certainty" that the redevelopment program would actually succeed.

Significantly, none of the dissenters in *Kelo* made a strong argument that the majority opinion departed from longstanding precedent. Justice O'Connor acknowledged that her position was inconsistent with the language, if not the specific holdings, of *Berman* and *Midkiff*. She suggested that those decisions could be distinguished on the ground that eminent domain had been used to address an "extraordinary, precondemnation condition of the targeted property [that] inflicted affirmative harm on society." But, in reality, nothing in the analysis

⁸ 200 U.S. 527 (1906).

⁹ 164 U.S. 112 (1896).

or facts of those cases — much less the full body of relevant Supreme Court precedent — supports a sharp distinction between harm-preventing and benefit-conferring government action. Furthermore, as Justice Scalia observed in *Lucas v. South Carolina Coastal Council*,¹⁰ this difference is often “in the eye of the beholder,” making it a weak potential basis for distinguishing action that serves a legitimate public use.

Justice Thomas argued, based on the language and original understanding of the phrase public use, that eminent domain should be used only when the public will own the property or have a legal right to use it. This constitutional analysis, however, is fundamentally flawed. Dictionaries (modern and old) include public “advantage” among the definitions of public use, meaning that actions which serve a legitimate public purpose fit comfortably within the language “taking for a public use.” Moreover, other scholarly examinations of the constitutional history indicate the drafters intended the phrase “public use” to impose few, if any, constraints on the eminent domain power.¹¹ Justice Thomas acknowledged that his position required overruling over a century of Supreme Court precedent. This candid statement confirms that *Kelo* does not expand the eminent domain power.

Even as it followed well-settled precedent in *Kelo*, the Supreme Court placed new limits on the use of eminent domain for economic development purposes. First, the Court emphasized that New London was seeking to implement a “carefully considered development plan” for the area based on “thorough deliberation,” including several public hearings and explicit approvals by the city council. The Court indicated that while it approved this type of carefully considered redevelopment program, it would not necessarily uphold “a one-to-one transfer of property, executed outside the confines of an integrated development plan.” The Court’s virtual mandate that future exercises of eminent domain proceed in accord with a comprehensive, carefully considered plan represents an important new limit on the eminent domain power.

Second, the Court strongly suggested that it is critical that the developer chosen to implement the development be bound to carry out the redevelopment and serve as the public’s agent. Opponents of redevelopment projects sometimes suggest that property is being turned over to private developers without strings, with the public benefiting solely through enhanced tax revenues and a general increase in economic activity. In fact, in *Kelo* the city will retain title to the property and lease the property to the redeveloper on a long-term basis. An enforceable agreement binds the developer to provide specific facilities and

¹⁰ 505 U.S. 1003 (1992).

¹¹ See, e.g., Mathew P. Harrington, “Public Use—and the Original Understanding of the So-Called ‘Takings’ Clause,” 53 *Hastings L.J.* 1245 (2002).

services in accord with the city's plan. Public welfare and private profit are no doubt inextricably linked – as in any effective public/private partnership – but there is no question that firm controls are in place to ensure the public interest will be protected.¹²

Finally, the limits placed on the eminent domain power in *Kelo* are underscored by Justice Kennedy's concurring opinion. Because his fifth vote was necessary to make a majority in *Kelo*, Kennedy's concurring opinion is likely to be especially influential in determining how courts interpret and local jurisdictions apply the decision. Although the judicial standard is deferential, Justice Kennedy said, courts should review exercises of eminent domain using a "meaningful" rational basis standard. He also echoed the concerns about one-to-one transfers, stating that there might be categories of eminent domain in which "a presumption (rebuttable or otherwise) of invalidity" might be warranted. He identified a set of factors that justified upholding use of eminent domain in this case, suggesting that the absence of these factors might lead to a different outcome in another case. These factors included that "[t]his taking occurred in the context of a comprehensive development plan," the plan was meant to address "a serious city-wide depression," the "economic benefits of the project cannot be characterized as de minimis," the identities of project beneficiaries "were unknown at the time the city formulated its plans," and the city followed various "procedural requirements" that facilitated review of the project's bona fides.

In sum, while *Kelo*, in line with prior precedent, upheld the city's use of eminent domain for economic development purposes, the decision represents a change in the direction of less, not more, deferential judicial examination of the use of the eminent domain by state and local governments.

III. *Kelo* as Constitutional Law

Many commentators who have opposed the *Kelo* decision have claimed that the Supreme Court found a new, shocking, unprecedented government power to condemn property for economic development. After reviewing the history of Supreme Court jurisprudence on the use of eminent domain for economic development purposes, it is clear that this is not true and that a ruling for Mrs. Kelo would have had to ignore a century of precedent.

In reviewing that precedent, it is very difficult to say why eminent domain for

¹² The Court also suggested in a footnote that the traditional measure of just compensation, based on fair market value, might not be an appropriate measure of compensation when government takes private property for economic development purposes. The Court said that this issue, while "important," was not raised by the *Kelo* litigation.

economic development should be forbidden, when these prior uses, which have both public benefits and clear benefits for private entities — the winning railroad, the competing pesticide companies, the individual farmers and mining companies — have been allowed. Moreover, there is no evidence that this line of cases is constitutionally suspect. Dictionary definitions of “use” at the time of the drafting and ratification included both strict “use” and the broader concept of “benefit.” The tradition of English law that the framers were deeply familiar with had a broad concept of use — as benefit. Thus, the *Kelo* decision is justifiable based on precedent and what we know and can reasonably surmise about the meaning of the term “public use.”

In several states, Texas among them, the constitutional validity of *Kelo* is a moot point, because the decision has been superseded, at least in some aspects. State and local governments are working like the laboratories of democracy that they are supposed to be. Some states have proposed time limits for authorization to acquire blighted property, for example, so that condemned or blighted sites do not sit vacant, dangerous, and menacing, further pulling down the neighborhood and fostering bad feeling about government.¹³ As one developer of blighted properties in inner cities told a Missouri committee studying eminent domain, “if you can’t get it done in three to five years, you shouldn’t be in the business.”¹⁴ Some state and local governments insist that condemnations be voted on by the local governing body, which means that individual city council members or county commissioners are held accountable for their votes — it is not left to a little-known redevelopment board, operating at one degree of separation from voters.¹⁵ This reform may continue to happen in Texas as well. Texas House Speaker Tom Craddick asked the House Committee on Land and Resource Management prior to the 2007 legislative session to look into whether it is appropriate for unelected bodies to use eminent domain.¹⁶ While no major post-*Kelo* legislation became law as a result of the 2007 legislative session,¹⁷ it is clear that further attempts will be made in future sessions to address eminent domain for economic development purposes.

¹³ See, e.g., *Final Report and Recommendations of the Missouri Eminent Domain Task Force* 23 (Dec. 2005), www.mo.gov/mo/eminentdomain/finalrpt.pdf.

¹⁴ *Preliminary Report and Recommendations of the Missouri Eminent Domain Task Force* 40 (Sept. 2005), www.mo.gov/mo/eminentdomain/prelimrpt.pdf.

¹⁵ Senate Bill 117, Utah 2006 Legislative Regular Session, found at www.le.state.ut.us/~2006/bills/sbillamd/sb0117.htm. This bill was sent to the governor on February 17, 2006.

¹⁶ *Interim Study Charges*, Texas House of Rep., 79th Legislature 26 (Oct. 2005), at www.house.state.tx.us/committees/charges/79interim/79thinterimcharges.pdf.

¹⁷ See Section V, herein.

An interesting aspect about many of the post-*Kelo* state eminent domain laws is that many of them inadvertently acknowledge that eminent domain is necessary for the state's economic health, even when benefits accrue to private interests or industries. The rhetoric of legislators sometimes is fervently against eminent domain if a project has a benefit for a private party, but the reality is quite different. Utah, for example, allows eminent domain to further the interests of extraction industries. It sanctions the practice for "roads, railroads, tramways, tunnels, ditches, flumes, pipes and dumping places to facilitate the milling, smelting or other reduction of ores, or the working of mines, quarries, coal mines or mineral deposits."¹⁸ Mining is a private enterprise, and one imagines that the general public of Utah does not spend a lot of time around mining tunnels, flumes, and dumping sites. One provision of Utah law allows eminent domain to be used for "pipelines for the purpose of conducting any and all liquids connected with the manufacture of beet sugar."¹⁹ Again, that is a private enterprise and not something to which the general public will have access or from which a direct benefit will be derived. It is difficult to make a credible distinction between using eminent domain to support long-standing industries in the state that may need to expand or find new sites, and using eminent domain to attract new kinds of jobs and industries to desperate, depressed places. It often is emotion, not reason, which creates a difference between mine smelters and shopping malls where eminent domain is concerned.

IV. The *Kelo* Backlash and Land Use Regulation

"*Kelo*" is and during the last three years has been the favorite four-letter word for those who believe that property owners should be able to do just about whatever they want, however they want, with their land, with little or no regard for their neighbors, upstream, downstream or anywhere else. Conservative strategist Grover Norquist has deemed the *Kelo* decision "manna from heaven" for the property rights movement, and predicted that "twenty years from now, people will look back at *Kelo* the way people look back at *Roe v. Wade*," as an unpopular decision that galvanized the losing side and created a decades-long legal and cultural battle.²⁰ Property rights activists hope to equate the frustration of every landowner annoyed because he or she cannot use his or her property in a way that might harm others with the acute pain of those whose homes are condemned.

In South Carolina, for example, a bill before the state House of

¹⁸ Utah Code Ann. § 78-34-1 (6).

¹⁹ Utah Code Ann. § 78-34-1 (12).

²⁰ THE ECONOMIST, *Hands off our Homes: Property Rights and Eminent Domain*, August 20, 2005.

Representatives combines eminent domain restrictions with a provision that requires compensation for any land use regulation (including zoning ordinances, comprehensive plans and environmental regulations) that reduces the value of property, even by trivial amounts.²¹ A Washington state ballot initiative has the same combination of eminent domain changes and a pay-to-obey-the-law scheme. Such laws conflate clear takings through eminent domain with the regulations that protect not only the environment but also the investments and expectations of a broad group of landowners. They may often sound great until it is your neighbor who decides to take advantage of them. When Oregon voters passed a pay-or-waive ballot initiative, a group of farmers sued, saying that it is not the zoning laws that threaten their income and livelihood, but the rollback of zoning laws that does so. Farmers who relied on agricultural zoning were suddenly faced with the prospect that their neighbor may sell a large tract for a residential subdivision, meaning that regular farm practices like pesticide spraying will suddenly subject the farmer to nuisance suits.

It is not the case that any government regulation of property, from zoning to wetlands protection ordinances to even temporary development restrictions, is tantamount to outright expropriation. This argument rests on the baseless idea that owners can do whatever they like with their property, and any restriction represents a loss of their rights. In fact, the American legal system — and for that matter most Americans — have never recognized unlimited, absolute property rights. Rather, courts weigh a regulation's impact on individual owners against the law's importance to the community.

These kinds of laws, which imply that adherence to state and local government ordinances is something that taxpayers have to buy, could be a devastating legacy of the *Kelo* decision for local governments. This is not a logical outgrowth of the *Kelo* decision — eminent domain and land use regulation are separate issues. But opponents of government regulation of real property are not stupid, and they recognize that the unpopularity of the *Kelo* decision can be used to cast a cloud of suspicion over anything the government does concerning privately owned land.

V. The Texas Response to *Kelo*

Not unlike most states around the nation, Texas responded promptly to *Kelo*, with Governor Rick Perry amending his call for a special session on school finance by adding to the call proposed legislation to address the effects of *Kelo*. The second state to adopt post-*Kelo* legislation, Texas Senate Bill 7 went far to protect private property from eminent domain for economic development purposes; however, it was a bill that exempted many projects, including Governor

²¹ H 4503 116th Gen. Assem. 2d Sess. (S.C. 2006).

Perry's pet Trans-Texas Corridor and the new Dallas Cowboys Stadium in Arlington. Senate Bill 7, which amended the Texas Government Code by adding a new Chapter 2206, provided in pertinent part as follows:

Sec. 2206.001. LIMITATION ON EMINENT DOMAIN FOR PRIVATE PARTIES OR ECONOMIC DEVELOPMENT PURPOSES.

* * *

(b) A governmental or private entity may not take private property through the use of eminent domain if the taking:

(1) confers a private benefit on a particular private party through the use of the property;

(2) is for a public use that is merely a pretext to confer a private benefit on a particular private party; or

(3) is for economic development purposes, unless the economic development is a secondary purpose resulting from municipal community development or municipal urban renewal activities to eliminate an existing affirmative harm on society from slum or blighted areas under:

(A) Chapter 373 or 374, Local Government Code, other than an activity described by Section 373.002(b)(5), Local Government Code; or

(B) Section 311.005(a)(1)(I), Tax Code.

(c) This section does not affect the authority of an entity authorized by law to take private property through the use of eminent domain for:

(1) transportation projects, including, but not limited to, railroads, airports, or public roads or highways;

(2) entities authorized under Section 59, Article XVI, Texas Constitution, including:

(A) port authorities;

(B) navigation districts; and

(C) any other conservation or reclamation districts that act as ports;

(3) water supply, wastewater, flood control, and drainage projects;

(4) public buildings, hospitals, and parks;

(5) the provision of utility services;

(6) a sports and community venue project approved by voters at an election held on or before December 1, 2005, under Chapter 334 or 335, Local Government Code;

(7) the operations of:

(A) a common carrier subject to Chapter 111, Natural Resources Code, and Section B(3)(b), Article 2.01, Texas

Business Corporation Act; or

(B) an energy transporter, as that term is defined by Section 186.051, Utilities Code;

(8) a purpose authorized by Chapter 181, Utilities Code;

(9) underground storage operations subject to Chapter 91, Natural Resources Code;

(10) a waste disposal project; or

(11) a library, museum, or related facility and any infrastructure related to the facility.

Not happy with the 2005 legislation that addressed the issue of eminent domain (rather than a constitutional amendment to limit perceived eminent domain abuses), the 2007 session of the Texas Legislature attempted to refine the definition of public purpose by eliminating what many considered large loopholes that permitted eminent domain for blighted areas. Consequently, HB 2006 and HB 3057 were introduced in the 2007 legislative session. Both bills significantly narrowed the definition of “public use” and the procedures regarding the condemnation of private property and specifically the condemnation of blighted areas. Specifically, HB 2006 would have limited local authority by providing that a city must identify *each unit of real property* in the city that has the characteristics of blight. In almost every case, an area to be redeveloped has one or two properties that do not meet the definition of “blight,” but that should be acquired as part of the greater redevelopment effort. Nevertheless, the restrictions in HB 2006 and HB 3057 would have hampered the ability of cities to revitalize such deteriorated areas. While HB 3057 did not make it to the Governor’s desk, HB 2006, which passed both houses, was vetoed by Governor Perry in June 2005. It would not be unreasonable to expect the 2009 session of the Texas Legislature to consider more post-*Kelo* bills that would have the effect of limiting the use of eminent domain and no doubt an effort will be made to initiate legislation to amend the Texas Constitution to limit eminent domain.

VI. Uses of Eminent Domain in a Post-*Kelo* World

Many of the key terms used in Chapter 2206 — “private benefit,” “public use,” “secondary purpose” and “economic development purposes” — are not defined in the legislation and will no doubt be the subject of heated debate as to their meanings and applications in particular contexts. Until there is legislative or judicial guidance as to the scope and application of the economic development limitations imposed by Chapter 2206, most entities impacted by this law will likely tread very carefully in exercising their condemnation powers unless the contemplated acquisition falls squarely within one of the enumerated exceptions set forth in the statute.

For example, “transportation projects” (roads, streets, highways and parking) are not subject to the law’s limitations. So, a city would appear to still

have the ability to lawfully condemn land for streets, roads and parking lots that would serve a regional shopping mall for instance, even though these publicly-owned facilities would have and confer a direct private benefit to the shopping center developer. Is there some point, however, when the public purpose for the transportation project becomes so closely aligned with the developer's wishes that it crosses a line and is no longer an authorized condemnation? If the city enters into a development agreement with the developer that requires that the developer pay for the costs of the acquisition (*i.e.*, land costs, attorney's fees, court costs, etc.), does this remove the project from an exempted transportation project into a prohibited economic development project? Could a city condemn land for purposes of exchanging the land with a developer for land that a city needs for right-of-way purposes? These are the types of unanswered questions that Chapter 2206 raises.

Some of the other projects that are exempted from Chapter 2206's reach include (1) water sewer and drainage projects, (2) public buildings, hospitals and parks, (3) waste disposal projects, and (4) libraries and museums. Traditional applications of these terms should not be a problem; but what about other non-traditional applications? Would a sports venue, auditorium, or convention center not be a public building? If so, could a city condemn land for such a use and then enter into a long-term lease with a private sector operator without violating Chapter 2206? Is the lease and operation of government-owned facilities to the private sector presumptively for economic development? Does it matter if the primary purpose of the lease is to provide quality of life facilities to citizens such as performing arts centers and stadiums? These are the types of unanswered questions that Chapter 2206 raises.

What about a city-owned convention center? While no one would dispute that a city can lawfully condemn land for a convention center, what about the land needed for the on-site or next-door hotel, which hotel has been determined by the city to be a required element for the success of the convention center due to the need to have the availability of large blocks of rooms in a single facility at or adjacent to the convention center? Even if the city (or an economic development corporation or other authority established by the city) were to own the hotel, it would no doubt enter into an agreement with a flagship hotel chain to operate the hotel, which would provide its expertise and reservation systems in exchange for the right to operate and benefit from the hotel. Would this type of arrangement confer a prohibited private benefit on the hotel operator? These are the types of unanswered questions that Chapter 2206 raises.

Also, given that many of the types of projects for which eminent domain is used are financed by municipal bonds or other forms of public financing, it remains to be seen if the uncertainties created by Chapter 2206 will impact the ability of public issuers to issue public debt. How will the bond market and bond rating services react to transactions that involve condemnation if there is uncertainty as to who will own the land condemned if the acquisition is challenged

as an unlawful economic development condemnation? Will interest rates rise to cover this risk and uncertainty, or will the project not be financed at all? These are the types of unanswered questions that Chapter 2206 raises.

What we can expect as a result of Chapter 2206 is that economic development projects will become more costly for both the private and public sectors due to the condemnation limitations and the uncertainties associated with those limitations. Taxpayers will pay more for these projects, and property owners whose properties are needed for such projects will be able to increase their selling prices since they will no longer be forced to sell. Litigation over whether a particular condemnation is allowed under Chapter 2206 can be expected to occur as property owners will most likely contest the condemnation's public purpose in less than clear cut situations, those delaying projects and increasing costs.

Given all of these factors — the lack of certainty over the scope and application of Chapter 2206, the impact that Chapter 2206 condemnations may have on public financing options, and increased project costs and delays — it will be prudent for cities and other condemning authorities to consider using other programs to promote economic development, which programs may allow the avoidance of Chapter 2206.

VII. Programs to Foster Economic Development in Texas

In Texas, there are other alternatives to condemnation for economic development purposes. As a result of *Kelo*, local governments are turning more often to these alternative economic development programs rather than facing public wrath (and the wrath of voters) for using eminent domain to acquire private property for arguably economic development purposes. There are four (4) types of economic development programs and/or incentives which are the most popular and most utilized programs in the State. The four programs are property tax abatements, municipal hotel occupancy tax, Chapter 380 agreements, and Section 4A/Section 4B sales taxes.

A. Property Tax Abatements

The statutory authority to enter into tax abatement agreements is found in the Property Redevelopment and Tax Abatement Act located in Chapter 312 of the Texas Tax Code. This chapter authorizes property taxing entities, excluding school districts, to limit the property taxes assessed on real property or tangible personal property located on real property due to the repairs or improvements to the property.²² Only property located within a reinvestment zone is eligible for a tax abatement agreement. A tax abatement agreement is an agreement limiting

²² Tex. Tax Code Ann. § 312.204(a) (Vernon Supp.2004-05).

the increase in the value of the property taxes due to improvements or repairs to real property. Such agreements are limited to ten (10) years in length.²³

The Texas Tax Code provides that a tax abatement agreement may provide for the exemption of the real property in each year covered by the agreement only to the extent its value for that year exceeds its value for the year in which the agreement is executed.²⁴ Accordingly, only the increase in value may be abated. For example, assume a business has a property site which as of January 1 is valued at \$1,000,000. The business entity agrees to make improvement or repairs to the property, which increases the value of the property to \$1,400,000. The taxing units may abate from taxation the \$400,000 increase in property value. Moreover, the taxing unit may abate from one percent (1%) to one hundred percent (100%) the property taxes paid on the \$400,000 increase.

B. Municipal Hotel Occupancy Tax

The Texas municipal hotel occupancy tax is a tax which may be imposed on the price paid for a hotel room.²⁵ The revenue generated by hotels within Texas cities generally may be expended on endeavors which promote tourism and the convention and hotel industry and is associated with one of seven (7) possible categories of expenditures.²⁶ The revenue generally may be expended for the following:

- (1) construction, improvement, enlarging, equipping, repairing, operation, and maintenance of convention centers or visitor information centers;
- (2) furnishing of facilities, personnel, and materials for the registration of convention delegates;
- (3) advertising and conducting solicitations and promotional programs to attract tourists and convention delegates;
- (4) encouragement and promotion of the arts;
- (5) historical restoration and preservation projects;
- (6) sporting events in which the majority of participants are tourists for cities located within a county of less than 1,000,000 in population;²⁷ and

²³ *Id.*

²⁴ Tex. Tax Code Ann. § 312.204(a).

²⁵ Tex. Tax Code Ann. § 351.003 (Vernon Supp. 2004-05).

²⁶ Tex. Tax Code Ann. § 351.101(a) (as amended by Texas House Bill 1734, 79th Legislature, Regular Session (2005) (effective date June 18, 2005)).

²⁷ Tex. Tax Code Ann. § 351.101(a)(1) – (6) (as amended by Texas House Bill

- (7) certain cities are authorized to use hotel occupancy tax revenue to upgrade certain existing sports facilities.²⁸

The hotel occupancy tax may be implemented by Texas municipalities by simply adopting an ordinance. The hotel occupancy tax rate is generally seven percent (7%).²⁹ This rate is set by state statute; nevertheless, the Texas legislature has authorized some communities to charge different rates ranging as high as nine percent (9%). For example, the cities of Fort Worth, Corpus Christi and San Antonio may assess a municipal hotel occupancy tax at the rate of nine percent (9%).³⁰ The City of South Padre Island, for example, may impose a municipal hotel occupancy tax at the rate of seven and one-half percent (7.5%) with certain requisite voter approval.³¹

C. Chapter 380 Grants

Chapter 380 is a reference to Chapter 380 of the Texas Local Government Code. This chapter of the Texas Local Government Code authorizes Texas municipalities, both home-rule and general law municipalities, to provide assistance for economic development. Texas cities may provide monies, loans, city personnel and city services for promotion and encouragement of economic development.

Cities are authorized to “provide for the administration of one or more programs, including programs for making loans and grants of public money and providing personnel and services of the municipality.” Nonetheless, the programs must serve the public purpose of promoting state or local economic development by stimulating business and commercial activity within the city, within the extraterritorial jurisdiction (or “ETJ”) of the city, or an area annexed by the city for limited purposes.³²

1734, 79th Legislature, Regular Session (2005) (effective date June 18, 2005).

²⁸ Tex. Tax Code Ann. § 351.101(a)(7) (as added by Texas House Bill 1734, 79th Legislature, Regular Session (2005) (effective date June 18, 2005).

²⁹ Tex. Tax Code Ann. § 351.003(a).

³⁰ Tex. Tax Code Ann. §§ 351.001(7) and 351.003(b), (c).

³¹ Tex. Tax Code Ann. § 351.003(d).

³² Tex. Loc. Gov’t Code Ann. § 380.001(a) (as amended by Texas House Bill 918, 79th Legislature, Regular Session (2005) (effective date May 17, 2005)).

The Texas Constitution requires all expenditures of municipal funds serve a “public purpose.”³³ Expenditures pursuant to Chapter 380 programs must also serve a public purpose. Prior to 1987, Texas cities did not have constitutional authorization to provide economic assistance to businesses for economic development; however, in 1987, Texas voters approved a constitutional amendment which provided that grants of monies for economic development serve a “public purpose.” Article III, Section 52-a of the Texas Constitution authorizes “the making of loans and grants of public money . . . for the public purposes of development and diversification of the economy of the state, the elimination of unemployment or underemployment in the state . . . or the development or expansion of transportation or commerce in the state.”³⁴ Further, any transaction providing public monies must contain sufficient controls “to insure that the public purpose [is] carried out.”³⁵

Unlike tax abatements which are limited to ten (10) years,³⁶ Chapter 380 of the Local Government Code does not contain a durational limitation. Consequently, some Texas cities have entered into Chapter 380 agreements which extend beyond ten (10) years. For example, one small city in the Dallas/Fort Worth Metropolex recently approved a 90-year (actually, a 45-year term with an automatic 45-year renewal) Chapter 380 economic development agreement. Further, many cities have conditioned the grant or loan of public monies upon estimated sales tax revenue generated by the business prospect. In a recent Texas Attorney General opinion, the Attorney General considered whether recent legislative changes prevented Texas cities from providing Chapter 380 grants in the form of a sales tax rebate.³⁷ The Attorney General concluded the “Local Government Code authorizes municipalities to refund or rebate municipal sales taxes and otherwise expend public funds for certain economic development purposes.”³⁸ Further, a recent legislative change “[did] not

³³ Tex. Const. art. III, § 52(a). See also *Texas Mun. League Intergovernmental Risk Pool v. Tex. Workers’ Comp. Comm’n*, 74 S.W.3d 377, 384 (Tex. 2002) (“A political subdivision’s paying public money is not gratuitous, within meaning of state constitutional provision prohibiting gratuitous payments to individuals, associations, or corporations, if the political subdivision receives return consideration.”).

³⁴ Tex. Const. art. III, § 52-a.

³⁵ Tex. Att’y Gen. Op. No. JM-1255 (1990) at 8-9.

³⁶ Tex. Tax Code Ann. § 312.204(a) (Vernon Supp. 2004-05).

³⁷ Tex. Att’y Gen. Op. No. GA-0071 (2003).

³⁸ Tex. Att’y Gen. Op. No. GA-0137 (2004) at 1.

invalidate existing tax rebate contracts, nor [did] it prohibit municipalities from executing new ones.”³⁹

D. Section 4A and 4B Economic Development Sales Tax

Section 4A and Section 4B sales taxes are sales taxes which Texas cities may impose for economic development. These sales taxes are authorized pursuant to the Development Corporation Act of 1979.⁴⁰ If adopted, the city under no circumstances may exceed the two percent (2%) local sales tax limit. The sales tax for economic development is one of the most popular tools used by Texas cities to promote economic development. Currently, 122 Texas cities have adopted a Section 4A economic development sales tax; 305 Texas cities have adopted a Section 4B economic development sales tax; and 88 Texas cities have adopted both a Section 4A and a Section 4B sales tax.

To adopt either a Section 4A or 4B sales tax, the voters must approve the sales tax at a sales tax election.⁴¹ The sales tax rate for either a Section 4A or 4B sales tax is 1/8th, 1/4th, 3/8ths or 1/2 of one percent. The total rate of all local sales and use taxes may not exceed two percent (2%).⁴²

The Section 4A sales tax may generally be used to assist with the following types of projects: manufacturing and industrial facilities; research and development facilities; military facilities, including closed or realigned military bases; recycling facilities; distribution centers; small warehouse facilities capable of serving as decentralized storage and distribution centers; regional or national corporate headquarters facilities; job training classes; and targeted infrastructure which promotes new or expanded business development.

The Section 4B sales tax may generally be used to assist with the same types Section 4A projects listed above; however, the Section 4B sales tax may also be used for “quality of life projects.” These projects include: projects consisting of professional and amateur (including children's) sports; athletic, entertainment, tourist, convention, and public park purposes and events; affordable housing projects; water supply facilities projects, with the requisite voter approval; and water conservation programs, with the requisite voter approval.

³⁹ *Id.* at 4.

⁴⁰ Tex. Rev. Civ. Stat. Ann. art. 5190.6 (Vernon 1987 & Supp. 2005).

⁴¹ Tex. Rev. Civ. Stat. Ann. art. 5190.6, §§ 4A(d) & 4B(d).

⁴² Tex. Rev. Civ. Stat. Ann. art. 5190.6, §§ 4A(d) & 4B(e).

VIII. Conclusion

In light of the *Kelo* decision, there has begun anew the debate about how local governments fulfill their centuries-old mission of protecting and promoting health, safety and the general welfare in 21st century circumstances. As state legislatures across the nation, including Texas, limit the use of eminent domain for economic development purposes, local governments will rely more upon fostering economic development through a variety of sales and property tax incentives rather than “traditional” condemnation procedures.

About the Authors

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