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Restricting Use of Eminent Domain for Economic Purposes

In June 2005, the 79th Legislature enacted a law that curbed the use of eminent domain for economic purposes in Texas, and the 80th Legislature may consider additional changes to the state's laws governing the taking of private property by governments and other entities. The 79th Legislature's actions were in response to a 2005 U.S. Supreme Court ruling that upheld the use of eminent domain for certain economic purposes under Connecticut law.

The Supreme Court said in its ruling that states were not preempted from placing restrictions on the uses of eminent domain that are stricter than is allowed by the U.S. Constitution. The Texas Legislature exercised this authority by amending state statutes to prohibit governments or private entities from using eminent domain if the property taking gives a private benefit to a particular private party, is for a public use that is a pretext to confer a private benefit to a particular private party, or is primarily for economic development purposes. Since the Supreme Court's ruling, at least 34 other states also have acted to restrict the use of eminent domain for economic development purposes, some through constitutional amendments and others through their state statutes.

Debate over Texas' laws governing eminent domain has continued, with new proposals emerging to make additional changes to the state statutes and Constitution. Some proposals would define terms such as "public use" and "blight" so that the use of eminent domain would be prohibited under certain circumstances. Other proposals would amend the standards used by courts when reviewing designations of public use by an entity taking property, and others would impose requirements governing compensation paid to property owners.

The law enacted by the Texas Legislature in June 2005 created an interim legislative committee to study the use of eminent domain power, including its use for economic development and the issue of what constitutes adequate compensation for property taken through eminent domain. Click here to read the committee's report to the 80th Legislature.

(See Eminent Domain, page 4)

State Windstorm Pool Seeks To Shore up Funding

The state's financial exposure for windstorm damage caused by hurricanes has increased dramatically in the past year as coastal residents who cannot secure coverage in the private insurance market seek coverage through the Texas Windstorm Insurance Association (TWIA), the state-sponsored windstorm insurance pool.

As more homeowners, businesses, and governments seek coverage through TWIA, concerns have arisen about whether the association is sufficiently structured and funded to cover losses resulting from one or a series of major storms. If TWIA does not have the resources to provide such coverage, the state could be forced to provide credits to insurers to cover these costs, which would in turn lead to significant losses in revenue to the state from these insurers.

With no major hurricanes this year, residents along the Texas coast were spared major damages like those in 2005 as a result of hurricanes Katrina and Rita. But in response to those storms, windstorm coverage for private residences and commercial and government buildings in coastal counties has become more expensive and difficult to secure in the private insurance market.

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(Insurance, from page 1)

Two of the state's largest insurers have announced that they no longer will offer windstorm coverage to thousands of homeowners along the Texas coast. The companies cite losses from last year's hurricanes as well as increased risk of future hurricane activity as reasons for limiting this coverage.

Windstorm coverage generally is included as part of a standard homeowner's policy to insure against damage caused by hurricanes and hailstorms. However, insurance companies are not required to write windstorm insurance coverage for the Texas coast. Some insurers that choose not to offer this coverage exclude windstorm damages from property insurance polices, while others elect not to renew entire policies.

This year, Allstate is not renewing windstorm coverage for 65,000 policyholders in coastal counties. State Farm has announced that it will not renew personal or commercial/government policies for properties located within 2,500 feet of coastal waters or bays. In Galveston County, about 3,200 policies will be dropped, according to State Farm. Travelers, another major insurer of coastal properties in Texas, also has decided not to renew policies for coastal properties. A number of smaller insurers also have scaled back coverage or dropped policies along the coast.

Residential and commercial/government risks that cannot obtain windstorm insurance through the voluntary market may obtain coverage through TWIA, the state-chartered insurance pool that provides coverage of last resort for coastal properties. TWIA operates like any insurance company by issuing policies and processing claims. Any company authorized to write property insurance in Texas is a member of TWIA.

The bulk of the association's exposure – about $25.4 billion – is for residential property. TWIA also provides coverage for about $8.1 billion in commercial properties and $2.5 billion in government buildings, including school district facilities and buildings owned by institutions of higher education.

Over the past five years, policies in force at TWIA have increased dramatically. Between 2001 and 2006, the number of TWIA policies has nearly doubled, from 68,758 to 135,000 in the TWIA coverage area comprising 14 coastal counties and a portion of Harris County. As of November 30, 2006, TWIA's exposure for windstorm losses from all costs reached more than $40 billion. The association currently has about $180 million of premiums in force, of which about $100 million can be used to cover the cost of windstorm-related losses.

If TWIA were unable to cover these losses from collected premiums, the following funding mechanisms would apply, in numerical order:

1. $100 million assessed to member insurers;
2. Catastrophe Reserve Trust Fund and reinsurance (about $900 million);
3. $137 million assessed to member insurers; and
4. unlimited assessment to member insurers, which would be subject to premium tax credits for five or more successive years.

According to TWIA General Manager Jim Oliver, the current statutory funding structure does not provide a sufficient level of funding to cover potential losses over a long period of time. "We have on hand roughly $1 billion for a single storm or a series of storms, but that is insufficient over the long term to cover the losses that our models project we will have. TWIA's rates need to be raised gradually over time by about 50 percent above what they are today in order to cover the losses we anticipate," says Oliver.

Under current law, TWIA may not seek annual rate increases of more than 10 percent unless the insurance commissioner finds that a catastrophic loss or series of losses justifies a need for higher rates to ensure the adequacy and availability of windstorm coverage.

In 2006, TWIA requested two rate increases to cover losses and expenses and to put aside money for future storms. The association first requested increases of 20 percent for residential and 23 percent for commercial/government. In response to this request, the insurance commissioner approved increases of 3.1 percent for residential and 8 percent for commercial customers. In August 2006, TWIA applied for an additional increase of 19 percent for residential and 24 percent for commercial customers, citing the rapid growth in enrollment and higher reinsurance costs caused by hurricanes Katrina and Rita as justification to exceed the 10 percent cap. The commissioner

approved increases of 4.3 percent for residential and 3.7 percent for commercial/government policies, effective January 1, 2007.

State Farm also sought a rate increase in the wake of the two major hurricanes from 2005, citing rising reinsurance costs and the potential for future storms. Before announcing its intention to withdraw from certain coastal areas, the company filed a rate increase of up to 39 percent in coastal counties. The insurance commissioner denied the company's request. State Farm currently is appealing the commissioner's decision.

Legislative history and proposed changes

The Legislature established a catastrophe insurance pool in 1971 in response to a lack of property insurance coverage on the Texas coast following Hurricane Celia. In 1991, the 72nd Legislature changed the agency's funding mechanism to provide protection of last resort for coastal properties. That funding structure has remained in place even as the agency's loss exposure has more than quintupled since 1991.

Recent efforts to restructure TWIA include HB 1890 by Smithee, which died in conference committee during the 2005 regular session of the 79th Legislature. The bill would have restructured the statutory funding mechanism to allow for the issuance of up to $800 million in public revenue bonds to establish and maintain reserves to pay claims.

Supporters said the bill would help address the growing need for resources to cover potential windstorm losses and thereby would reduce potential losses to the state's general revenue fund if a major hurricane generated significant losses. This improved structure also would help stimulate economic growth along the coast by providing sufficient windstorm coverage. This economic growth would benefit the whole state by generating increased tax revenue. While windstorm insurance may be an issue of special importance to coastal residents, it is in the entire state's interest, according to supporters, to establish a solid system to protect against windstorm losses.

Opponents said that because debt service on the revenue bonds would be borne by policyholders on other insurance lines, the bill effectively would create an unfair "tax" on all policyholders for a bond program that primarily benefits coastal residents.

Other proposed legislative changes to improve TWIA funding include eliminating the 10 percent cap on annual rate increases or changing rating methods to allow TWIA annually to increase rates by less than 5 percent without the approval of the insurance commissioner. Rate increases of more than 5 percent still would require approval from the Texas Department of Insurance.

Supporters say this would give TWIA the flexibility it needs to build reserves over a long period of time so that sufficient funding would be available to cover one or a series of losses in a particular year. Under the current funding structure, if such a storm or storms occurred, private insurers might have to cover the costs and receive tax credits in return. These tax credits could result in a significant loss of revenue to the state, say supporters.

Others say that the state also should consider ways to encourage private insurers to provide more windstorm coverage to reduce the financial risks and pressures on TWIA. This year, insurers in the voluntary market have enjoyed record profits, in spite of higher reinsurance costs resulting from Katrina and Rita. In return for these record profits, some observers say, insurers in the voluntary market should have to assume more of the risk involved with issuing policies in coastal areas.

In 2006, the joint Senate/House Interim Committee on Windstorm Coverage and Budgetary Impact, cochaired by Sen. Mike Jackson and Rep. John Smithee, held public hearings in Austin, Corpus Christi, and Galveston. The committee expects to publish its interim study in January 2007.

– by Betsy Blair

(Eminent Domain, from page 1)

Background

The Fifth Amendment to the U.S. Constitution prohibits the taking of private property for public use without just compensation, commonly referred to as the "takings clause." Texas Constitution, Art. 1, sec. 17 – often called the "public use clause" – prohibits a person's property from being taken, damaged, or destroyed without consent for public use without adequate compensation.

The authority of government to claim private property for public benefit is called eminent domain and is considered an inherent attribute of sovereignty. Texas has limited that power through its Constitution and has granted it to numerous other entities, including political subdivisions, special districts, and private concerns such as utilities. These specific grants of authority to other entities are found throughout the statutes. Property Code, ch. 21 establishes the procedures for exercising eminent domain authority. For more information on the types of entities that are granted eminent domain power and codes that grant, restrict, or prohibit eminent domain power, click here to see *Texas Statutes Granting, Prohibiting, or Restricting the Power of Eminent Domain* published in March 2006 by the Texas Legislative Council.

In June 2005, the U.S. Supreme Court ruled in *Kelo v. City of New London*, 545 U.S. 469 (2005), that the proposed use of property by the city of New London, CT for a development project qualified as a "public use" within the meaning of the U.S. Constitution's takings clause. In the case, the city of New London was attempting to use eminent domain to acquire property from owners who refused to sell land earmarked for a development project that, by some estimates, would create more than 1,000 jobs, increase tax and other revenues, and revitalize an economically distressed city. The city invoked a state law that specifically authorizes the use of eminent domain to promote economic development.

The Supreme Court said that the plan unquestionably served a public purpose and ruled that it did not violate the U.S. Constitution's takings clause. The court ruled that promoting economic development is a traditional and long accepted government function and that there is no principled way of distinguishing it from other purposes the court has recognized. The Supreme Court said it was embracing the broader and more natural interpretation of public use as "public purpose."

The court also found that the city had determined that the area at issue was sufficiently distressed to justify a program of economic rejuvenation and that the city had developed a plan designed to benefit the community, including the generation of new jobs and increased tax revenue. While the city could not take the private land simply to confer a private benefit on a particular private party, the exercise of eminent domain in this case, according to the Supreme Court, was envisioned under a carefully considered development plan that was not adopted to benefit a particular class of identifiable individuals.

The court also emphasized that nothing in its opinion precluded a state from placing further restrictions on its exercise of the takings power. It said that many states already impose "public use" requirements that are stricter than the basic federal standards.

Response to *Kelo* in Texas. The 79th Legislature, second called session, responded to the *Kelo* decision by enacting SB 7 by Janek, which prohibits governmental or private entities from using eminent domain to take private property if the taking:

- confers a private benefit on a particular private party through the use of the property;
- is for a public use that merely is a pretext to confer a private benefit on a particular private party; or
- is for economic development purposes, unless economic development is a secondary purpose that results from municipal community development or municipal urban renewal activities to eliminate an existing affirmative harm on society from slum or blighted areas.

The bill states that a determination by a governmental or private entity that a proposed taking of property does not involve one of these prohibited reasons does not create a presumption about what the taking involved.

SB 7 does not affect the authority of a governmental entity to condemn a leasehold estate on property owned by that entity. Nor does the bill affect the ability of an authorized entity to exercise eminent domain power for

a number of specified purposes, including the taking of property for transportation projects, public buildings, utility projects and services, and others. Government Code, sec. 2206.001(c) contains a complete list of the specific purposes that are not affected by SB 7.

The provisions in SB 7 apply to the use of eminent domain under all state laws – including a local or special law – by any governmental or private entity including a state agency or institution of higher education, a political subdivision of the state, or a corporation created by a governmental entity to act on behalf of the entity.

The Texas Department of Transportation (TxDOT) is prohibited from using eminent domain to take property for an ancillary facility, such as a gas station or convenience store, on both the Trans-Texas Corridor and other state-owned toll roads unless the acquisition is for one of multiple ancillary facilities included in a comprehensive development plan approved by the county commissioners court of each county in which the property is located.

SB 7 also prohibits a governing board of an institution of higher education from using the power of eminent domain to acquire land for a lodging facility, parking, or a parking structure intended to be used in conjunction with the use of a lodging facility.

Supporters of SB 7 said the bill was necessary to protect property rights in Texas following the *Kelo* ruling. Under the precedent established in *Kelo*, cities or other entities with eminent domain authority could argue that nearly any project benefited the public through economic development and could, for example, take private homes to enable the construction of a shopping mall that would generate more tax revenue than the homes. Without SB 7, supporters said, the state and local governments could subject Texans to the same abuse of eminent domain power that has occurred in the *Kelo* case and in similar cases in the Texas cities of Freeport and Hurst.

The bill's supporters said that the language in SB 7 is specific enough to protect private property from inappropriate takings for economic development, yet it also allows state and local governments to continue to use eminent domain in clear public-use situations, many of which are listed specifically in the bill. The bill would not violate the state's policies of local control or of encouraging economic development. Projects with economic development ramifications that rely on takings under eminent domain could proceed as long as they were undertaken for legitimate public uses in which economic development was not the primary purpose. In addition, supporters said, projects undertaken purely for economic development purposes could proceed under SB 7 as long as the entity acquired the property through the free market rather than the exercise of eminent domain.

Opponents said enacting new restrictions on eminent domain use would be an overreaction to the *Kelo* decision. The laws and Constitution of Texas allow for a broad interpretation of public use to include economic development in some situations involving eminent domain, and that flexibility should not be eliminated. An overly broad statewide limit on the use of eminent domain for all economic development projects, opponents said, could conflict with the state's policy of encouraging state and local officials to think creatively about economic development.

This bill would conflict with the principle of local control, said opponents. Local officials are in the best position to make and account for decisions about when to exercise eminent domain for public uses and when public use should be broadly interpreted to include economic development.

SB 7 could have the unintended consequence of restricting many legitimate uses of the power of eminent domain for public purposes, said opponents. Private property owners could challenge its legitimate exercise by claiming that almost any project was being undertaken primarily for economic development reasons.

Response to *Kelo* in other states. According to the National Conference of State Legislatures (NCSL), 34 states have responded to the *Kelo* decision by enacting new legislation, amending their constitutions, or both. Twenty-one have restricted the use of eminent domain for purposes of economic development, increasing tax revenue, or transferring private property to a private entity. Ten states restrict the use of eminent domain to "blighted" properties and place an emphasis on public health, safety, and welfare criteria when designating blighted properties. A number of others have:

- adopted more limited definitions of "public use";
- required certain actions during the process of exercising eminent domain such as public notice, public hearings, and local government approval;
- required compensation at greater than fair market value;
- placed a moratorium on eminent domain for economic development; and
- established legislative committees to study the issue.

In November 2007, voters in 12 states considered property rights questions, while voters in Louisiana approved a ballot question on the issue in September, according to NCSL. In general, the eminent domain questions restricted the taking of private property for economic development purposes while continuing to allow the taking of property for traditional uses such as highways and schools, according to NCSL.

Ballot questions solely about eminent domain were approved in eight states: Florida, Georgia, Michigan, Nevada, New Hampshire, North Dakota, Oregon, and South Carolina. Voters in one state, Arizona, approved ballot questions amending state statutes dealing with both eminent domain and regulatory takings. Voters in California and Idaho rejected proposals dealing with both eminent domain and regulatory takings, while voters in Washington state rejected a proposal dealing solely with regulatory takings. (More information about legislation related to regulatory takings appears in the box below).

Proposals for the 80th Legislature

The Texas Legislature's response to the *Kelo* decision, SB 7, took effect in November 2005. Proposals likely will emerge in the coming regular session to make further changes to state laws governing the use of eminent domain.

Regulatory takings

In November 2007, four of the states in the western United States voted on proposals dealing with regulatory takings. A regulatory taking generally can be defined as a governmental action or restriction on property use that removes the economic viability of private property.

Voters in Washington state defeated a regulatory takings proposition that would have required payments to property owners under some circumstances, according to NCSL. Voters in California and Idaho rejected propositions that paired restrictions on eminent domain and regulatory takings, while voters in Arizona approved a proposal dealing with eminent domain and regulatory takings. In general, the parts of these propositions dealing with regulatory takings would have required that property owners be compensated for the amount of reduction in property value resulting from a government regulation or else have the regulation waived.

In 1995, the Texas Legislature enacted SB 14 by Bivins (Government Code, ch. 2007), which allows state agencies and other political subdivisions to be sued for compensation for actions that reduce the market value of property by 25 percent or more.

In 2005, the House approved HB 2833 by R. Cook which would have revised the definition of "takings" and the regulations that must be followed when governments take certain actions affecting private property values. It would have specified that a taking of private property by a governmental entity could result not just from a governmental action but from a series of governmental actions, including actions that limited impervious cover in specified ways.

HB 2833 would have removed an exemption for municipal actions, including those that imposed regulations on a city's extraterritorial jurisdiction but not on the city itself. It would have retained exemptions for certain actions when they did not affect building size, lot size, or impervious cover, including municipal regulations governing sexually oriented businesses, fireworks, noise, and smoking, among other matters. The bill died in the Senate.

Supporters of these changes argue that SB 7 was a stop-gap measure and that the 80th Legislature should address overly broad exceptions and loopholes in the bill to ensure that property owners are not subject to abuses of eminent domain for inappropriate economic development purposes. Others argue that SB 7 adequately addressed the issues raised by *Kelo* and is working to prevent inappropriate uses of eminent domain in Texas. Since the enactment of SB 7, they argue, no entity has attempted to use eminent domain in a manner that would violate the new law.

Proposals to amend Texas law include changes to the definitions of public use and blight, to the standards used by courts when reviewing designations of public use, and to the requirements governing compensation to property owners. Other proposals would revise the process used when eminent domain powers are invoked. Some proposals would amend the Texas Constitution, while others would make only statutory changes.

Constitutional amendment. Some proposals would place restrictions on eminent domain into the Texas Constitution. Supporters of this idea argue that the Legislature should allow voters to decide if they want the additional protection that would be afforded by amending the state's fundamental guiding document to restrict the uses of eminent domain. A constitutional amendment would strengthen and clarify Texans' rights in a way that the statutes cannot because the protections could not easily be changed by a future Legislature, they argue. Opponents argue that the details governing the use of eminent domain in Texas are best placed in statute, rather than the Constitution, so that any necessary changes can be made without the time and expense necessary to hold a vote on a constitutional amendment.

Definition of "public use." Some proposals would amend the statutes or the Constitution to define the term "public use" in a limited, specific way. Critics of these proposals argue that current law adequately limits uses of eminent domain for economic purposes. Supporters argue that over time courts have interpreted this term too broadly and allowed eminent domain to be used for inappropriate economic development projects that go well beyond traditional uses such as roads and parks. They say that even with the restrictions enacted in SB 7, the term "public use" could be construed too broadly and that a more precise, restrictive definition of the term would make it more difficult to skirt the legal prohibitions and proceed with inappropriate uses of eminent domain.

For example, supporters of narrowing the definition of public use point to language in SB 7 that prohibits takings for economic development if they confer a private benefit on a particular party or unless the economic development is a secondary purpose resulting from other governmental activities. They say this language is broad enough that it could allow takings that confer private benefits on undesignated private parties or that are only nominally for another purpose.

Some proposals would limit public use by requiring public ownership, possession, control, occupation, or use of the property and by limiting transfers of property to private entities after it is taken. Others would narrow the definition of public use by prohibiting takings for the broader reasons of "public purposes" or "public benefits."

Definition of "blight." Some proposals would amend SB 7's language that allows uses of eminent domain in some circumstances to eliminate an existing affirmative harm on society from slum or blighted areas. They would change the language dealing with slums and blight so that it applies to blighted properties, not areas, or restrict this exemption to properties that threaten public health or safety or properties that meet other specific criteria.

Review by courts. Some argue that SB 7's language concerning the standards used by courts when reviewing designations of public use are not strong enough to protect property owners or broad enough to cover all determinations of public use or necessity. Others argue that the language in SB 7 adequately ensures a neutral, level playing field when eminent domain takings go before a court.

In general, prior to SB 7, courts would give deference to determinations by entities taking property if the entity declared that the taking was for a public use or public purpose. SB 7 states that a determination by an entity about a proposed taking of property does not create a presumption about whether the taking is prohibited by the law. Some proposals would revise this presumption language to state explicitly that all determinations of public use and public necessity are reviewable by the courts. Others would require

that the taking entity prove the legality of the taking or that any decision about the legality of a taking be a judicial decision.

Compensation. Proposals to change Texas law dealing with eminent domain may focus on the issue of compensation for property owners. Most proposals would set a benchmark for the amount of money that must be paid to property owners when eminent domain is used.

Proposals include requiring that compensation greater than market value be paid in some cases or that compensation be based on the new use of the property, on its replacement value, or on the value of the property after improvements. Another proposal would require property owners whose land was seized for a utility line or a pipeline to receive additional compensation such as royalty payments.

Supporters of these proposals argue that such requirements are necessary to ensure that property owners are fairly and adequately compensated when their property is taken. Critics argue that compensation issues should be dealt with locally and that blanket compensation requirements could result in the use of taxpayer money to overpay property owners in some circumstances.

Another set of proposals would deal with the price and circumstances under which property should be offered back to its original owner. Currently, Property Code, sec. 21.023 requires governmental entities to notify property owners that they are entitled to repurchase the property if the public use for which it was acquired is canceled within 10 years of the acquisition and that the repurchase price is the fair market value at the time the public use was canceled.

– by Kellie Dworaczyk

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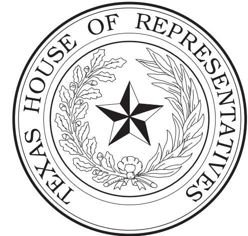

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