A series of memos to President-elect Obama identifying policy areas where his words line up with our vision.

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Protecting Property Rights to Preserve Freedom and Prosperity

A Memo to President-elect Obama

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Our Constitution places the ownership of private property at the very heart of our system of liberty.... The result of this business culture has been a prosperity that's unmatched in human history.... Our greatest asset has been our system of social organization, a system that for generations has encouraged constant innovation, individual initiative and the efficient allocation of resources.

—Barack Obama,
The Audacity of Hope[1]

PRESIDENT-ELECT OBAMA, you have been a strong and eloquent defender of property rights and the rule of law, recognizing that they undergird Americans' freedoms and protect us from unjust government actions. These protections may be most important to those of modest means, who are the disproportionate victims of government takings of property. As explained by the NAACP and other civil rights leaders, the poor are also affected more profoundly by takings that upset their communities and ways of life.[2] Any approach to governing that is premised, at least in part, on empathy for the weakest among us must therefore include strong protections for private property.

Pragmatism counsels the same focus. Government policies that place property rights at risk and upset reasonable investment-backed expectations discourage *all* investment, innovation, and beneficial risk-taking and dampen economic growth. When property rights are uncertain, neighborhoods are consumed by blight, entrepreneurs suffer for lack of credit, and those who are well connected appropriate the resources of those who lack financial means and political connections—

what is known as "crony capitalism." Strong legal protections for property rights are therefore a necessary condition for our continued economic and civil prosperity.

But as Americans have learned in recent years, and especially in recent months, their valuable property rights are under assault from all levels of government by seemingly well-meaning public officials who fail to consider the long-term consequences of their actions. Most strikingly, the Supreme Court's 2005 decision in *Kelo v. New London* sparked widespread public outrage. The Court's conclusion that the term "public use" in the Takings Clause of the U.S. Constitution does not limit the purposes for which the government may take a citizen's home caused Americans of all social stripes to recognize that their own property may be at risk of expropriation for transfer to more influential private parties for their own private ends.

In the wake of *Kelo*, and in response to the massive political backlash that it generated, legislators in 43 states enacted laws of varying degrees of strength to curb the abuse of eminent domain.[3] Similar legislation passed the U.S. House of Representatives but failed in the Senate.[4] Though President George W. Bush did issue an executive order on eminent domain abuse, its loose drafting appears to do no more than to reaffirm the standard in *Kelo* and provides no further limitations on takings.[5]

Recent financial crises have also raised the specter of counterproductive government interventions in the economy that endanger property rights. In particular, the government has intervened in the financial markets by taking ownership stakes in corporations through both voluntary and involuntary transactions. When conducted without the consent of the corporation, government purchases of preferred shares in banks may constitute a "taking" of private property, in the constitutional sense, from these corporations. Though the government has provided some compensation for these takings, difficulties in valuation that are worse than those that usually arise in the forced-sale context complicate the assessment of whether that compensation has been "just," as required by the Constitution; and whether or not there has been a constitutional taking, investors' shareholdings have been diluted and subordinated by the government stake. Similarly, government-backed loans that subordinate pre-existing priority debt may also constitute takings, in this case without any compensation.

These policies have severely upset the expectations of investors. In one instance, the government, operating through the Federal Reserve, effectively seized ownership of a major insurer over the objections of some of its largest shareholders rather than let the firm enter bankruptcy, sell off assets, or otherwise reorganize. This was done without a shareholder vote, as would ordinarily be required to protect shareholders' property rights in a control transaction.[6]

Important contractual rights are also being undermined by government action. The government's asset-purchase program, for example, requires participating corporations to abrogate the vested contractual rights of executives whose compensation packages are inconsistent with new government regulations. In certain instances, these corporations may also be required to "claw back" compensation already awarded to executives. In some cases, the government has sought to subordinate the debts of priority lenders—taking, in effect, a portion of the financial instrument that they negotiated with the borrower. As a result, lenders are even more reluctant to make loans to the ailing firms that need them most.

1. Barack Obama, *The Audacity of Hope: Thoughts on Reclaiming the American Dream* (New York: Crown Publishers, 2006), pp. 149–150.
2. NAACP et al., Brief in Support of Petitioner, Kelo v. City of New London, 545 U.S. 469 (2005). *See also* Mindy Fullilove, Eminent Domain & African Americans: What Is the Price of the Commons? Institute for Justice, at http://www.castlecoalition.org/pdf/publications/Perspectives-Fullilove.pdf.
3. Castle Coalition, Enacted Legislation Since Kelo, at http://www.castlecoalition.org/index.php?option=com_content&task=view&id=510&Itemid=107 (December 23, 2008).
4. H.R. 4128, 109th Cong. (2005); S. 3873, 109th Cong. (2005).
5. Exec. Order No. 13,406, 71 Fed. Reg. 36,973 (June 23, 2006), at http://www.whitehouse.gov/news/releases/2006/06/20060623-10.html. *See* Ilya Somin, "Another Failure of the Kelo Backlash: President Bush's Executive Order on Takings," June 23, 2006, at http://www.volokh.com/posts/1151111493.shtml.
6. *See* Stephen M. Davidoff, "The AIG Bailout Takes Shape," New York Times DealBook, September 24, 2008, at http://dealbook.blogs.nytimes.com/2008/09/24/the-aig-bailout-takes-shape.

The mortgage market is suffering similar turmoil. Building on the Depression-era Supreme Court decision in *Home Building & Loan Association v. Blaisdell* (1934), many state governments have been forcing mortgage holders to alter the terms of their agreements with borrowers, accept lower or no payments for periods of time, and delay foreclosures. Courts in some states have imposed unusual procedural burdens on lenders who are seeking to enforce lending agreements, thereby delaying justice.

These actions directly undermine the enforcement of voluntary contracts, increasing transaction costs across the economy and further increasing the cost of borrowing while, over the long term, reducing the availability of credit through secured transactions. As a result, unable to enforce the terms of their loans, lenders will be less willing to extend credit in the future, and many responsible individuals of limited means will be excluded from the mortgage market and, in the end, homeownership. This will reduce economic opportunities and income mobility for years to come.

Most ominously, the bailout legislation enacted in October and the Administration's unilateral auto bailout in December raise the specter of widespread contravention of fundamental constitutional principles that protect entrepreneurs and investors. Responding to a perceived crisis, Congress and the President agreed on policies that raise serious constitutional concerns because they appear to violate the Constitution's separation of powers and exceed the scope of the federal government's enumerated powers.

These acts may serve as a precedent for future "power sharing arrangements" that threaten the individual rights of citizens that the true separation of powers was designed to protect. With such vital walls breached, there is the real risk that, should financial markets continue to falter, the government will build on this precedent, enacting "emergency" measures that interfere further with Americans' property and other rights. This may be a self-fulfilling prophecy if investors, fearful of government interference, choose to sit on the sidelines as the economy collapses for lack of liquidity and credit.

To prevent that eventuality and to restore Americans' faith in the security of their private property, you and your Administration should take the following steps:

- **Adopt a stricter, more limiting definition of "public use" than that employed by the Supreme Court in *Kelo*.** As President, you will have an independent obligation to interpret and apply the Constitution. Because the Constitution's primary structural purpose is to limit the powers of the federal government, it offends no constitutional norms and violates no rights for you to adopt a view of takings that, consistent with federal law, limits the government's power more than the Supreme Court has declared is required.

  In particular, to prevent *Kelo*-style takings, you should adopt a definition of "public use" that excludes takings for "private purpose," as that term is defined in the Private Property Rights Protection and Government Accountability Act of 2008 (H.R. 6219). This legislation was carefully drafted to prevent takings for transfer to private parties that do not result in public services (e.g., roads and utilities) or the elimination of harmful uses that present an imminent and substantial danger to public health. Only this kind of approach is sufficient to allow the government the flexibility to address substantial public needs while preventing abuses, such as overuse of "blight" as a grounds for condemnation, that have facilitated so many unjust takings.

- **Curb uncompensated "regulatory takings."** As in *Kelo*, the Supreme Court's jurisprudence on takings by regulation—that is, when regulation significantly diminishes the value of property or undermines reasonable investment-backed expectations—fails to protect property rights. This state of the law also leads to bad public policy. As Professor Jonathan Adler has chronicled, regulations that have the effect of taking property often generate perverse incentives; for example, to avoid losing the use of their lands under the Endangered Species Act, some farmers plow their lands more often than is necessary to prevent endangered species from nesting. Further, the affordability of regulatory takings to policymakers, relative to other

approaches that would require government funds, has led to their overuse. The result, in the environmental context, is "less cost-effective environmental conservation programs and a net reduction in the quality and quantity of environmental conservation."[7] In these ways, ignoring regulatory takings would actually hold back your regulatory agenda.

Instead, your Administration should regard all takings—whether by regulation or physical possession—as the same when considering their propriety, their costs, and their effectiveness against alternatives. The result would be sounder, more effective policy; fairer regulations that do not impose the burdens of providing public goods on the few but spread them widely; and the improved transparency and accountability of putting more regulatory policy "on-budget."

- **Order federal departments and agencies to protect property rights in regulating and in all discretionary actions.** Immediately upon assuming office, you should reissue a stronger version of President Bush's June 2006 executive order on "Protecting the Property Rights of the American People" that actually limits the government's ability to take private property for essentially private purposes and to provide funding for such takings. This order should direct federal officials, in every discretionary action that they undertake, to protect property rights in accordance with your policy on takings. This action would demonstrate to all members of your Administration, as well as the public, that you regard this issue seriously and are doing more than paying lip service to Americans' property rights.

  You should also order the Office of Management and Budget (OMB) to enforce your takings policy in the regulatory clearance process. OMB coordinates rulemaking and enforces regulatory policy across the executive branch. Its centralized review of proposed rules and guidance is governed by Executive Order 12866, as modified in 2002 and 2007, and other OMB circulars and memoranda.

  You should direct all agencies, in regulatory planning, and OMB, in regulatory review, to identify any takings issues, including regulatory takings, that are raised by proposed regulations and to explain why these potential takings are either necessary to achieve the purpose of the regulation or required by law. This analysis should include a detailed consideration of policy alternatives that reduce or eliminate takings. The result will be better regulation, particularly in areas such as environmental policy in which the ease of takings—especially regulatory takings—has led to their overuse at the expense of more effective and efficient tools.

- **Support legislation to protect property rights.** The federal government should not take property primarily for private benefit. More important, in terms of effect, it should not provide funding to state and local programs that do so. Takings reform of this sort has broad bipartisan support—as evidenced by its success at the state level and near-passage in Congress—but has been stymied by well-connected special interests that benefit from the abuse of eminent domain. With your support, legislation that effectively puts an end to this practice and provides strong protections for homeowners, small-business owners, and others who rely on property more than political connection could become a reality.

- **Direct the Justice Department to evaluate legislation for takings issues.** The Office of Legal Counsel reviews pending legislation for constitutionality as well as its likely impact on areas of constitutional policy. You should direct OLC to adhere to your interpretation of the Takings Clause when reviewing legislation and to report through the normal inter-agency review process (and, ultimately, to Congress) potential violations of your policy on takings. If these potential violations are not resolved by Congress, you should consider them sufficient grounds to veto legislation and explain clearly to Congress and the public your concerns with the legislation.

- **Appoint constitutionalist judges.** Judges who follow the letter of the law rather than make policy from the bench tend to take a strong view of the Takings Clause's

7. *See* Jonathan Adler, *Money or Nothing: The Adverse Environmental Consequences of Uncompensated Land Use Controls*, 49 B.C. L. Rev. 301 (2008).

protections against government usurpation of private property. Taking the Constitution seriously means enforcing its very significant limitations on government action. In the end, constitutionalism serves to protect the people by securing their rights, while more open-ended approaches to judging only render rights less certain and more easily subject to abrogation.

- **Oppose changes in bankruptcy that undermine the enforcement of property rights.** With mortgage defaults at high levels and bankruptcy filings also growing, there has been some pressure to make the bankruptcy code more "consumer-friendly." In particular, some lawmakers support additional barriers to mortgage foreclosure in bankruptcy—in effect, undermining the enforcement of property-related contracts. This would serve the perverse effect of discouraging lending to consumers with checkered credit histories, making it more difficult for them to purchase real estate. This proposal is shortsighted and detrimental to long-term income mobility. Your Administration should oppose any such proposals.[8]
- **Reject shortsighted economic interventions that upset property rights and investment-backed expectations.** The past months have witnessed a succession of economic crises, each met in turn by a new, ad hoc federal response, and many of these responses have infringed property rights and the legal rights that accompany property rights. Undermining property rights to achieve specific policy goals is almost always shortsighted and counterproductive, but it is particularly so in this instance. For example, congressional and administrative proposals to subordinate private debt with government loans have further chilled commercial lending, especially to companies that need it the most. Similarly, the government's effective seizure of equity in several financial enterprises has contributed to a decline in equity valuations across several industries. More broadly, such policies erode confidence in the rule of law to the detriment of all economic activity.

  Contrary to some surprising recent claims, the Constitution does not allow for greater governmental or executive power in times of economic uncertainty or crisis. In that respect, the practice of economic policy differs from that of national security. The Framers knew economic crisis, and they knew war, and they did not conflate the two—for good reason. To the contrary, they conceived an executive energetic and strong in the realms of foreign policy and warfighting but, in the economic realm, relatively weak as the head of a government severely limited in its power to regulate.

  Though this distinction has been eroded, it must not be ignored. To do so, whatever the immediate benefit, threatens our prosperity and ultimately our freedom. Few countries that lack economic freedom are prosperous, and none are truly free.

Conclusion

Property rights are that rare area of strong agreement between individuals of different political affiliations, ideological commitments, and visions for our society. Reflecting this consensus, upwards of 80 percent of Americans believe that the Supreme Court got it wrong in *Kelo* and that no American should be turned out of his or her home so that the land it occupies can be turned over to a commercial developer. On the other side of the issue are some politicians who view abusive takings as an inexpensive way to accomplish certain political ends on the cheap and narrow, concentrated special interests, such as property developers, that benefit directly. The result has been deadlock at the federal level.

More surreptitious forms of takings, while less understood by the public, are no less damaging to Americans' rights and prosperity. They also threaten your agenda. Uncompensated regulatory takings and, more broadly, government interference in investment-backed expectations rarely accomplish the ends for which they have been dispatched and far more often result in unexpected, negative consequences. Thus, coercive capital infusions

8. *See* Hans A. von Spakovsky and Andrew M. Grossman, "Promoting the General Welfare Through Civil Justice Reform: A Memo to President-elect Obama," Heritage Foundation *Special Report* No. 38, January 6, 2009, at http://www.heritage.org/Research/LegalIssues/sr38.cfm.

meant to unfreeze markets have frightened lenders and investors, and regulations meant to protect endangered species have caused the preemptive destruction of their habitats. And still the government regards these tools as affordable, solely because their costs are shunted onto others.

This does not befit the rights that, as you so elegantly put it, are "the very heart of our system of liberty" and have been the cornerstone of achievement for all who have struggled to win civil rights. Americans cherish both their property rights and the rule of law that protects them. Whether for reasons of compassion, pragmatism, or a combination of the two, your Administration should strive to do no less.

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