

# Introducing the Moral Foundations of Capitalism in Undergraduate Business Law and Ethics Courses Using *Kelo v. City of New London*

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## Abstract

In its 2005 decision in *Kelo v. City of New London*, the US Supreme Court upheld the use of eminent domain to take private property for the use of other private entities so long as the taking is designed to confer a public benefit. This paper discusses how *Kelo* can be used in undergraduate business law and ethics courses to introduce students to the moral foundations of free enterprise capitalism. The case presents a unique opportunity to correct several fundamental misconceptions that many undergraduate students bring to the classroom about the nature of capitalism and business in general.

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## I. Introduction

Business law and ethics courses are typical core curriculum requirements in US colleges and schools of business (AACSB 2013 Standards; Miller and Crain 2011). Even where business ethics is not a standalone course, it is frequently covered in business law and legal environment courses (Allison 1991; Miller and Crain 2011). Many textbooks on these subjects briefly address profit maximization theory but otherwise devote little attention to the nature of free enterprise capitalism (see Clarkson, Miller, and Cross 2015; Cross and Miller 2014; Ferrell, Fraedrich, and Ferrell 2012; Melvin and Katz 2014; Reed et al. 2013; Treviño and Nelson 2014). In effect, many textbooks conflate profit maximization with the system of free enterprise in which it is to operate.

Addressing this shortcoming is essential given the misconceptions that many students develop long before college about what motivates businesspeople and drives business activities. Polls demonstrating Americans' distrust of business are ubiquitous (Ferrell, Fraedrich, and Ferrell 2013), and the media's portrayal of

businesspeople as villains has been well-documented (Treviño and Nelson 2014). Even more worrisome studies suggest that business students frequently harbor *more* cynical attitudes regarding business than the general public does (Treviño and Nelson 2014). Business ethics educators cannot expect students to develop a strong sense of legal and ethical duty when students are inundated with the message that by choosing careers in business, they must be greedy, amoral, and soulless.

This paper presents a teaching case for use by instructors of undergraduate business law, legal environment, or business ethics courses using the Supreme Court's 2005 decision in *Kelo v. City of New London*. The teaching case is designed to contextualize profit maximization theory within the bounds of free enterprise capitalism, which by definition requires the rule of law and the protection of individual rights. Exploring the underlying principles of free enterprise is an ideal way to address the challenges business students (and their instructors) face.<sup>1</sup>

Section 2 outlines the relationship between free enterprise capitalism and business ethics and explore how typical law and ethics texts inadequately explore the moral foundations of free enterprise capitalism. Section 3 summarizes *Kelo*. Section 4 provides teaching notes, including a description of my use of this case in class, student feedback, and suggested discussion questions. Section 5 concludes.

## II. Business Ethics and the Nature of Free Enterprise

Many textbooks address free enterprise capitalism solely by explaining profit maximization. Typical descriptions of profit maximization reinforce students' negative perceptions of business. For instance, two major business law and legal environment textbooks note that while many people consider the idea that corporations are designed solely to make profit “greedy or inhumane,” the theory remains valid—but only because it results in efficient outcomes (Clarkson, Miller, and Cross 2015; Cross and Miller 2014). Other law and ethics textbooks present the pursuit of profit as an obstacle to ethical behavior (Mann and Roberts 2012; Reed et al. 2013; Treviño and Nelson 2014).

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<sup>1</sup> Because many law and ethics courses are core curriculum requirements, many students will have already taken economics or will be taking the two courses simultaneously. Thus, introducing free enterprise in law courses reinforces concepts that students are learning across the core curriculum.

These sterile descriptions of profit maximization theory ignore the context within which profit maximization is to be pursued. Free enterprise capitalism is based on voluntary exchange and the cooperation of individuals (Friedman 1962). Coercion, force, and fraud are anathema to free enterprise. Individuals are free to pursue their own goals, so long as they respect the rights of others while doing so. Far from being an amoral or immoral system, free enterprise is premised on the dignity and rights of the individual.

Once students view themselves as participants in such a system, they begin to understand that recognizing the rights of others is not at odds with profit maximization. Free enterprise capitalism presumes that the goal of maximizing profits is pursued within the bounds of the rule of law (Friedman 1962, 1970). Because the rule of law and the freedom to choose are fundamental requirements, profit maximization is limited by these underlying assumptions; it is not a free-for-all with no moral grounding.

The teaching case presented here introduces students to these concepts in a novel and memorable way designed to elicit students' misconceptions about profit maximization as a limitless, amoral pursuit. This process allows the instructor to introduce the moral foundations of free enterprise capitalism as the context within which profit maximization operates, inviting students to view themselves as part of a fundamentally noble and ethical enterprise. Given that mindset, ethical decision-making becomes the expectation or the norm; ethics is not presented as an alternative, or a hindrance, to business decision-making.

### **III. The Case: *Kelo v. City of New London*<sup>2</sup>**

After her divorce, Susette Kelo dreamed of purchasing a home to call her own. In 1997, she found a small, ramshackle pink house in the Fort Trumbull neighborhood of New London, Connecticut, with

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<sup>2</sup> The facts of the case are summarized from the Court's opinion, 545 US 469 (2005), and from various other sources listed in the references (Benedict 2009; Brnovich 2004; Carpenter and Cross 2007). Because this article summarizes a teaching case I developed for use with my classes and describes how I have presented it in an actual classroom setting, I have presented the facts of the case here essentially as I explained them in class. For in-depth economic analyses of eminent domain, see Miceli (2011) and Somin (2015), addressing the argument that eminent domain is necessary to overcome holdout as a problem of market failure. Benson (2005) details his contention that private solutions can effectively surmount the holdout problem. For classic microeconomic analyses of eminent domain generally, see Hermalin (1995) and Munch (1976).

beautiful coastal views. Drawn to the house immediately, Susette contacted the listed realtor. She purchased and carefully restored the home, often learning to do home repairs and remodeling work herself.

However, in 1998, the city developed a plan to entice Pfizer, a large pharmaceutical company, to locate a major research division there. As part of its plan, the city set its sights on the Fort Trumbull neighborhood, located near the proposed Pfizer headquarters. Arguing that revitalization would result in economic development and increase tax revenues, the city used its power of eminent domain to buy the nine-acre neighborhood. Traditionally, eminent domain referred to the government's power to take private property for projects such as highways or public schools. In this case, the city intended to replace the Fort Trumbull neighborhood with an "urban village" consisting of condominiums and retail stores. The city created an entity called the New London Development Corporation to obtain the property in Fort Trumbull using eminent domain and to select a developer for the project.

Many Fort Trumbull residents, including Susette Kelo, objected to the city's plan to take their homes. They argued that the Constitution does not permit the use of eminent domain to take private property for private development projects because such projects do not fall within the scope of public use. In 2005, the US Supreme Court reviewed the case on appeal. In one of the most publicized opinions of the twenty-first century, the Supreme Court ruled that because the city undertook the project for a public purpose—economic growth, revitalization, and increased tax revenues—the use of eminent domain was constitutional.<sup>3</sup> The city

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<sup>3</sup> Case law decided well before *Kelo* interpreted "public use" expansively to mean public *purpose*. So long as the government's purpose is truly public (i.e., it is not mere pretext for conferring a private benefit), the Supreme Court has declined to interfere with the exercise of eminent domain. Key to the Supreme Court's reasoning in *Kelo* was the extensive deliberation of the issues through democratic, legislative processes. The Supreme Court found this compelling evidence that the takings in *Kelo* were motivated by a legitimate public purpose, as part of a comprehensive plan to improve the city. The Supreme Court refused to scrutinize the plan's merits, its likelihood of success, or even whether property owners' rights were adequately protected, holding that those issues were the province of the legislature to be determined through open, democratic, deliberative processes. Many states passed laws in the wake of *Kelo* restricting the use of eminent domain. For a thorough analysis of state responses to *Kelo*, see Lopez, Jewell, and Campbell (2009).

was then permitted to purchase and bulldoze the entire Fort Trumbull neighborhood, at a cost of nearly \$80 million to taxpayers.

The city's promises of the "urban village" creating 3,169 new jobs and \$1.2 million per year in tax revenue did not materialize. The developer selected for the project was unable to secure financing, and the entire project fell through. Today, the old Fort Trumbull neighborhood is a barren field.

#### **IV. Teaching Notes**

The following sections explain how I used *Kelo* in the classroom to provide a model that other instructors might follow.

##### *A. Classroom Use and Student Response*

I developed this teaching case to use with my Legal Environment of Business class, a freshman and sophomore level course. When I presented it to my class, I began by explaining eminent domain and the facts surrounding the *Kelo* case. Initially, many students seemed to find the case problematic and were quick to express ethical qualms even while demonstrating an understanding that the use of eminent domain in the case was *legal*. Many questioned the developer's decision to pursue the deal knowing that it involved removing people from their homes without their consent. Students empathized with the Fort Trumbull homeowners and expressed concern that "fair market value" might not adequately compensate them given the use of coercion to obtain the property.

I then asked students to consider how they would feel if the development project had proceeded as planned and was a resounding success. Suddenly, with the assumption of available profit, students began distinguishing between the right "business decision" and the right "ethical decision." Many said they would go with the "business decision"—that is, they would take the deal if they felt it would be profitable, regardless of the impact on the homeowners. Rather than try to defend the decision as ethical, they argued that making a sound business decision in this instance *required* making an unethical decision. Crucially, several students defended the deal because "that's just how it is in a free market system." The consensus was that capitalism supported the developer's decision to pursue this deal regardless of ethical concerns because there was an opportunity to

make money that businesspeople could seize, whatever the cost to the homeowners.<sup>4</sup>

The students' comments revealed their assumption that capitalism contains no guiding principles or restraints other than pursuing profit. This outcome is predictable given the acontextual presentation of profit maximization theory in typical textbooks: profit maximization becomes conflated with capitalism.

Eliciting this assumption provided the opportunity to discuss free enterprise capitalism's requirement of voluntary transactions. In such a system, government would never take private property through coercion on the ground that someone else would make better use of it (according to the state) than the original owner. Once profit maximization is placed in proper context, students realize it is justified not for its own sake, but because it takes place within a system *defined by* the protection of property rights and freedom of choice. Students found it particularly interesting that in this instance, the law appears to be *less* restrictive than would be consistent with the free market, whereas typically (such as when dealing with regulation) the law appears to restrict behavior *more* than the free market ideally would.

During our discussion, I noted that financial holding company BB&T, under then CEO John Allison, decided after *Kelo* not to finance projects that involved the use of eminent domain because of the ethical implications (Sanders 2006). This decision was a powerful example of a highly regarded and profitable company emphasizing ethics in the context of free enterprise capitalism. Rather than portraying its decision as a sacrifice in contradiction of free enterprise, BB&T has argued that its decision not to support coercion is indeed *required by* it.

The *Kelo* example is particularly effective because for many students, it is counterintuitive, as evidenced by their attempts to justify the developer's actions using "the free market." The readiness with which students raised this defense of the developer's decision to

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<sup>4</sup> As a caveat: I did not have any students in class who defended the use of eminent domain on grounds other than those described in this paper. To reiterate, all of the students who participated in the class discussion expressed significant qualms about the use of eminent domain in this case and the developer's decision to benefit from it. Nevertheless, regardless of my personal views on the outcome of *Kelo*, I made every effort to make clear to students that they were free to argue or believe that the use of eminent domain in this instance was proper, so long as their arguments were based on factually correct assumptions.

benefit from eminent domain underscores the importance of challenging their misconceptions.

### *B. Suggested Discussion Questions*

Instructors who wish to use *Kelo* to teach about ethics in free enterprise capitalism might use the following questions to initiate classroom discussions.

- The developer was unable to undertake the urban village project because it could not obtain financing. However, the developer may not have breached a contract with the city. Many contracts (including, for example, contracts to purchase homes) contain clauses that provide that the agreement is subject to a party obtaining financing.<sup>5</sup> Even if the developer did not breach a contract, do you think its decision to pursue this project without being sure it could obtain financing has any ethical implications given that the project involved the use of eminent domain?
- Would you pursue a deal such as the one in *Kelo* if you were a developer? Why or why not? How would you justify your decision to shareholders and to other stakeholders, such as employees, homeowners in the Fort Trumbull neighborhood, or other members of the community?
- Do you think that the development project could have succeeded *without* eminent domain—that is, could the proposed development’s benefits have been realized through free enterprise capitalism rather than through crony capitalism?<sup>6</sup>
- Although Detroit’s financial problems have many causes, some have argued that one contributing factor was

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<sup>5</sup> When it came to the developer being unable to obtain financing, the students in my class were very interested in whether there was a contract between the developer and the city, and whether the developer had breached it. At that point, I explained the concept of subject to financing clauses, and stated that in all likelihood, the contract contained such a clause. I have not found the details of the contract, however, so I cannot state definitively that this was the situation.

<sup>6</sup> This line of inquiry could further elucidate the distinction between free enterprise capitalism and crony capitalism. A 2004 policy report of the Goldwater Institute highlights Seattle’s development successes without resort to eminent domain and provides recommendations for pursuing development projects without takings. Further resources on this topic are available through the Castle Coalition (Pringle 2007), the Independent Institute, and the City Journal (e.g., Galinas 2005).

Detroit's extensive use of eminent domain over the last several decades (Henderson 2013; Somin 2013). Economic theory suggests that the failure to protect property rights leads to decreased investment and harms economic growth (Acemolgu and Robinson 2012). How might this argument impact your analysis of the ethical issues presented and the ultimate decision?

- Research suggests that eminent domain has a disproportionate impact on racial and ethnic minorities, the economically disadvantaged, and the elderly. In fact, the AARP and the NAACP wrote *amicus curiae* (“friend of the court”) briefs to the Supreme Court in favor of Susette Kelo. How, if at all, would this research impact your decision?

#### IV. Conclusion

Business curricula typically cover ethics but skimp on the moral foundations of free enterprise capitalism that underlie all business activity. This paper has argued that these foundations must be an integral part of ethics instruction in undergraduate business law and ethics courses. Students are far more likely to internalize ethical considerations and act upon them when they see themselves as part of a fundamentally moral system. To that end, this paper has offered a teaching case using *Kelo v. City of New London* to challenge and reframe students' misconceptions about the nature of business and free enterprise.

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