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"Correcting" the Foreclosure Crisis?

I. INTRODUCTION

Mortgage Resolution Partners (MRP), a venture capitalist firm based out of San Francisco, has been visiting with state and local governments across the country.[1] MRP proposed to these local governments that eminent domain can, and should, be used to seize mortgages and refinance them in an attempt to correct the United States' foreclosure crisis.[2] This is not the first time this idea has been identified as a solution to the foreclosure crisis;[3] it is, however, the first time that it has had the backing of a firm that can assist financially with its implementation.[4] San Bernardino County in

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1. *An Eminently Bad Idea*, WALL ST. J., July 11, 2012, http://online.wsj.com/news/articles/SB10001424052702304299704577504631625599136.
2. *Id.*
3. *See generally* Howell E. Jackson, *Build a Better Bailout*, CHRISTIAN SCI. MONITOR (Sept. 25, 2008), http://www.csmonitor.com/Commentary/Opinion/2008/0925/p09s02-coop.html; Lauren E. Willis, *Stabilize Home Mortgage Borrowers, and the Financial System Will Follow*, (Loyola-L.A. Legal Studies, Working Paper No. 2008-28, 2008), *available at* http://ssrn.com/abstract=1273268; Robert Hockett, *Breaking the Mortgage Debt Impasse: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, WALL ST. J., http://online.wsj.com/public/resources/documents/EMINENT-legal-brief.pdf.
4. *See* Matthew Goldstein & Jennifer Ablan, *Exclusive: Investors Tout Controversial "Condemnation" for Housing Fix*, REUTERS, June 8, 2012, http://www.reuters.com/article/2012/06/08/us-mortgages-condemnation-housing-idUSBRE85719Z20120608.

California was one local government that had been receptive to the plan.[5] However, in January 2013, the county decided not to proceed any further with the plan due to a lack of support from the community.[6] Other local governments across the country have also considered the proposal made by MRP but have also not been receptive.[7] In January 2013, the city of Brockton, Massachusetts "commission[ed] a study into the feasibility of using eminent domain powers to seize the mortgages of local residents struggling to pay off their loans."[8] There exists disagreement over implementation of MRP's plan across the country, because it involves many legal and policy issues.[9] This Comment attempts to identify and address the major legal and policy concerns inherent in MRP's proposal.

The Federal Housing Finance Agency (FHFA) stated in the Federal Register on August 9, 2012 that:

> FHFA has significant concerns about the use of eminent domain to revise existing financial contracts and the alteration of the value of [Government Sponsored] Enterprise or Bank securities holdings. In the case of the [Government Sponsored] Enterprises, resulting losses from such a

5. Ben Hallman, *San Bernardino Eminent Domain Fight Closely Watched by Other Struggling Communities*, HUFFINGTON POST, Sept. 1, 2012, http://www.huffingtonpost.com/2012/09/01/eminent-domain-mortgages_n_1836710.html.

6. Alejandro Lazo, *San Bernardino County Abandons Eminent Domain Mortgage Plan*, L.A. TIMES, Jan. 24, 2013, http://www.latimes.com/business/money/la-fi-mo-eminent-domain-20130124,0,4577228.story.

7. Mary Ellen Podmolik & John Byrne, *Emanuel: Eminent Domain Not 'the Right Instrument' to Address Underwater Mortgages*, CHI. TRIB., Aug. 14, 2012, http://articles.chicagotribune.com/2012-08-14/business/chi-emanuel-eminent-domain-not-the-right-instrument-to-address-underwater-mortgages-20120814_1_eminent-domain-underwater-homeowners-mortgages.

8. Eleaszar David Melendez, *Brockton, Massachusetts, Considering Eminent Domain to Address Foreclosures*, HUFFINGTON POST, Jan. 11, 2013, http://www.huffingtonpost.com/2013/01/11/brockton-eminent-domain-foreclosure_n_2458369.html.

9. *See generally* Memorandum from Walter Dellinger, Jonathan Hacker, and Matthew Close, to Secs. Indus. and Fin. Markets Ass'n on San Bernardino Eminent Domain Proposal (July 16, 2012), *available at* http://www.sifma.org/uploadedfiles/issues/capital_markets/securitization/eminent_domain/memorandumfromo'melvenymyerstosifmaresanbernardinoeminentdomainproposal071612.pdf; Memorandum from Am. Securitization Forum, to San Bernardino Cnty. Bd. of Supervisors on Joint Exercise of Powers Agreement (July 13, 2012), *available at* http://www.americansecuritization.com/uploadedFiles/ASF_Eminent_Domain_Letter_7_13_12.pdf; Andrew M. Grossman, *San Bernardino Mortgage Seizure Plan Raises Serious Constitutional Concerns*, HERITAGE FOUNDATION (July 16, 2012), http://www.heritage.org/Research/Reports/2012/07/San-Bernardino-Mortgage-Seizure-Plan-Raises-Serious-Constitutional-Concerns.

> program would represent a cost ultimately borne by taxpayers. At the same time, FHFA has significant concerns with programs that could undermine and have a chilling effect on the extension of credit to borrowers seeking to become homeowners and on investors that support the housing market. FHFA has determined that action may be necessary on its part as conservator for the [Government Sponsored] Enterprises and as regulator for the Banks to avoid a risk to safe and sound operations and to avoid taxpayer expense. Among questions raised regarding the proposed use of eminent domain are the constitutionality of such use; the application of federal and state consumer protection laws; the effects on holders of existing securities; the impact on millions of negotiated and performing mortgage contracts; the role of courts in administering or overseeing such a program, including available judicial resources; fees and costs attendant to such programs; and, in particular, critical issues surrounding the valuation by local governments of complex contractual arrangements that are traded in national and international markets.[10]

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10. Use of Eminent Domain to Restructure Performing Loans Notice, 77 Fed. Reg. 47,652 (Aug. 9, 2012). The United States Code defines "government-sponsored enterprise" as follows:

> For purposes of this Act . . . (8) The term "government-sponsored enterprise" means a corporate entity created by a law of the United States that
> (A)
> (i) has a Federal charter authorized by law; has a Federal charter authorized by law;
> (ii) is privately owned, as evidenced by capital stock owned by private entities or individuals;
> (iii) is under the direction of a board of directors, a majority of which is elected by private owners;
> (iv) is a financial institution with power to--
> (I) make loans or loan guarantees for limited purposes such as to provide credit for specific borrowers or one sector; and
> (II) raise funds by borrowing (which does not carry the full faith and credit of the Federal Government) or to guarantee the debt of others in unlimited amounts; and
> (B)

Other prominent government officials have also expressed concern about the plan.[11] Rahm Emanuel, the Mayor of Chicago, stated, "I don't think it's the right way to address the problem . . . . I think we have to address the issue. I just don't think that's the right instrument."[12] Of course, there are also many supporters of the plan.[13] Representative Brad Miller of North Carolina stated, "[a] legal challenge by Wall Street [to MRP's proposal] might be expensive to fight, but the arguments are pretty flimsy."[14] Still, there exists opposition to MRP's proposal on both the local and federal level.[15] Therefore, this Comment attempts to identify the major concerns with MRP's plan that lead to this opposition. Part II of this Comment provides a history of how increasing home prices, sub-prime lending, and greed led to the foreclosure crisis that now requires a plan like MRP's. Part III elaborates on MRP's proposal and how the plan is designed to correct the foreclosure crisis. Part IV identifies the major legal and, more specifically, constitutional issues with the plan. Finally, Part V identifies policy issues that would arise if the plan were implemented.

II. HISTORY

The main reason local governments are even considering MRP's proposal is because of the devastating effects the subprime mortgage crisis had, and continues to have, on local communities and the United States in general, due to the foreclosure crisis that followed shortly after the subprime

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> (i) does not exercise powers that are reserved to the Government as sovereign (such as the power to tax or to regulate interstate commerce);
> (ii) does not have the power to commit the Government financially (but it may be a recipient of a loan guarantee commitment made by the Government); and
> (iii) has employees whose salaries and expenses are paid by the enterprise and are not Federal employees subject to title 5 of the United States Code.

2 U.S.C.S § 622 (2012).

11. Podmolik, *supra* note 7.

12. *Id.*

13. *See* Rep. Brad Miller, *No Wonder Eminent Domain Mortgage Seizures Scare Wall Street*, AM. BANKER, July 11, 2012, http://www.americanbanker.com/bankthink/eminent-domain-mortgage-seizures-terrify-wall-street-1050811-1.html; David Reiss, *Eminently Reasonable*, THE NAT'L L. J., Sept. 24, 2012, http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202572203513&slreturn=20121012162631; Robert J. Shiller, *Reviving Real Estate Requires Collective Action*, N.Y. TIMES, June 23, 2012, http://www.nytimes.com/2012/06/24/business/economy/real-estates-collective-action-problem.html?_r=0.

14. Miller, *supra* note 13.

15. *See* Podmolik, *supra* note 7; Use of Eminent Domain to Restructure Performing Loans Notice, 77 Fed. Reg. at 47,652.

mortgage crisis.[16] "Many policy makers and ordinary people blame the rise of foreclosures squarely on subprime mortgage lenders who presumably misled borrowers into taking out complex loans at low initial interest rates."[17] To understand why MRP's proposal is so attractive to many local governments, we must first examine the difference between a prime mortgage and a subprime mortgage.[18]

"The main difference between prime and subprime mortgages lies in the risk profile of the borrower; subprime mortgages are offered to higher-risk borrowers."[19] The level of risk applied to a borrower is based on a variety of factors.[20] These factors may include "previous bankruptcy filings, debt-to-income (DTI) ratios, and the level of documentation provided by the applicants to verify income."[21] Once the level of risk is determined, the lender will next look at the borrower's credit score and the initial payment the borrower will be making.[22] Once this is all compiled, a borrower will be determined to be either high risk (a subprime borrower) or low risk (a prime borrower).[23] "Generally, subprime borrowers pay 200 to 300 basis points above the prevailing prime rates."[24] There also exists one other subsection of mortgage classification.[25] Alt-A loans are a type of subprime loan but consist of the lowest high-risk borrowers.[26] "According to the Mortgage

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16. *See* Stephanie Armour, *Foreclosure Crisis Spreads from Subprime to Prime Mortgages*, USA TODAY, June 9, 2009, http://usatoday30.usatoday.com/money/economy/housing/2009-06-08-home-loan-foreclosures-subprime_N.htm.

17. Stan Liebowitz, *New Evidence on the Foreclosure Crisis: Zero Money Down, Not Subprime Loans, Led to the Mortgage Meltdown*, WALL ST. J., July 3, 2009, http://online.wsj.com/article/SB124657539489189043.html ("[T]he focus on subprimes ignores the widely available industry facts (reported by the Mortgage Bankers Association) that 51% of all foreclosed homes had prime loans, not subprime, and that the foreclosure rate for prime loans grew by 488% compared to a growth rate of 200% for subprime foreclosures.").

18. *See* Memorandum from Am. Securitization Forum, to San Bernardino Cnty. Bd. of Supervisors on Joint Exercise of Powers Agreement 1, 2 (July 13, 2012), available at http://www.americansecuritization.com/uploadedFiles/ASF_Eminent_Domain_Letter_7_13_12.pdf.

19. Sumit Agarwal & Calvin T. Ho, *Comparing the Prime and Subprime Mortgage Markets*, CHICAGO FED LETTER (The Fed. Reserve Bank, Chicago, IL), Aug. 2007, at 1-2, available at http://www.chicagofed.org/digital_assets/publications/chicago_fed_letter/2007/cflaugust2007_241.pdf.

20. *See id.*

21. *Id.*

22. *See id.*

23. *See id.*

24. Agarwal & Ho, *supra* note 19.

25. *See id.*

26. *See id.*

Bankers Association, prime mortgages make up about 80% of the mortgage market, subprime mortgages about 15%, and Alt-A loans about 5%. These figures represent the stock of mortgages outstanding as of 2006."[27]

With the possibility of greater returns, the subprime mortgage market grew greatly in the first decade of the twenty-first century.[28] In 2002, only 6% of all loans created were subprime, but by 2006, over 20% of all mortgages created were subprime mortgages.[29] However, with greater reward came greater risk, and many mortgage issuers began to decrease their requirements for issuance of subprime mortgages.[30] This was, in part, due to the fact that, almost right after the subprime mortgage was issued, it was bundled into a mortgage-backed security (MBS) and sold to another financial institution.[31] Even worse, after being sold, the MBS could, and generally would, be repackaged and resold again as a collateralized debt obligation (CDO).[32] Therefore, the risk of default on the mortgages was also moved—meaning the issuers of the mortgages had little to no incentive to check the credit worthiness of the individuals they were issuing loans to because they would be resold soon thereafter and became someone else's problem.[33] However, the issuers kept the origination fees and other fees.[34] This all,

27. *Id.*

28. *See id.* at 2.

29. *Mortgage Market Statistical Annual 2006*, INSIDE MORTGAGE FINANCE PUBLICATIONS, *cited in* Agarwal & Ho, *supra* note 19

30. *See* THE FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 423 (2011), available at http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf (stating that "[t]here was a steady deterioration in mortgage underwriting standards (enabled by securitizers that lowered the credit quality of the mortgages they would accept, and credit rating agencies that overrated the subsequent securities and derivatives). There was a contemporaneous increase in mortgages that required little to no documentation").

31. *See id.* at 7 ("Under the radar, the lending and the financial services industry had mutated. In the past, lenders had avoided making unsound loans because they would be stuck with them in their loan portfolios. But because of the growth of securitization, it wasn't even clear anymore who the lender was. The mortgages would be packaged, sliced, repackaged, insured, and sold as incomprehensibly complicated debt securities to an assortment of hungry investors. Now even the worst loans could find a buyer.").

32. *See id.* at 8 ("The firms would package the loans into residential mortgage–backed securities that would mostly be stamped with triple-A ratings by the credit rating agencies, and sold to investors. In many cases, the securities were repackaged again into collateralized debt obligations (CDOs)—often composed of the riskier portions of these securities—which would then be sold to other investors.").

33. *See id.* at 10.

34. *See id.* ("James Rokakis, the longtime county treasurer of Cuyahoga County, where Cleveland is located, told the Commission that the region's housing market was juiced by 'flipping on mega-steroids,' with rings of real estate agents, appraisers, and loan originators earning fees on each transaction and feeding the securitized loans to Wall Street.").

arguably, came to a head on August 9, 2007 "when BNP Paribas stopped withdrawals from three investment funds because it could not value their holdings, and in particular their subprime-mortgage assets."[35] BNP and other investors could not value these holdings because "[a]s investors tried to delve into the details of the value of CDO assets and the reliability of their cash flows, the extraordinary complexity of the instruments provided a significant impediment to insight into the underlying financial data."[36]

The subprime mortgage financial instruments were difficult, if not impossible, to value because Generally Accepted Accounting Principles (GAAP) began requiring fair value accounting in 2007.[37] Therefore,

> In the first quarter of 2007, the largest banks and investment banks began complying with a new accounting rule and for the first time reported their assets in one of three valuation categories: "Level 1 assets," which had observable market prices, like stocks on the stock exchange; "Level 2 assets," which were not as easily priced because they were not actively traded; and "Level 3 assets," which were illiquid and had no discernible market prices or other inputs. To determine the value of Level 3 and in some cases Level 2 assets where market prices were unavailable, firms used models that relied on assumptions. Many financial institutions reported Level 3 assets that substantially exceeded their capital.[38]

Because many of the subprime mortgage instruments had never been based on "observable inputs," companies holding these instruments had to apply valuation models based only upon information they had at their disposal, forcing them to apply massive write-downs to their holdings of subprime mortgage instruments.[39] This was in large part due to the fact that the underwriters of the mortgages had become lax in their requirements, and therefore, the cash flows that supposedly existed for some of the subprime

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35. A.P., *The Financial Crisis: Unhappy Birthday*, ECONOMIST (Aug. 9, 2012), http://www.economist.com/blogs/schumpeter/2012/08/financial-crisis.

36. Michael R. Young et al., *The Role of Fair Value Accounting in the Subprime Mortgage Meltdown*, J. OF ACCT., May 2008, http://www.journalofaccountancy.com/Issues/2008/May/TheNeedforReliabilityinAccounting.htm.

37. *See Summary of Statement No. 157*, FIN. ACCT. STANDARDS BD., http://www.fasb.org/summary/stsum157.shtml (last visited Dec. 28, 2013).

38. *See* THE FIN. CRISIS INQUIRY COMM'N, *supra* note 30, at 226.

39. *See* Young, *supra* note 36.

financial instruments did not exist, forcing companies to write-down these assets to their actual value.[40] These write-downs on subprime mortgage instruments led to "commercial banks' earnings declin[ing] to a 16-year low."[41] With massive asset write-downs required and earnings stifled at the largest of banks, liquidity became a major issue in the market.[42] "[T]he loss of liquidity in the financial sector was making it more difficult for business and consumers to get credit . . . ."[43]

Also, around early 2007, and even earlier in some areas of the country, it was beginning to become clear that many of the subprime mortgages that had been issued to homebuyers would not be able to be paid by the homebuyers.[44] The lax requirements of many of the issuers of mortgages were beginning to catch up with the issuers as many mortgagors became delinquent on their payments soon after their mortgage was given to them.[45] Consequently, this led to the inability for investors to determine the actual value of many of the subprime mortgage financial instruments, because the cash flows that had been promised had now disappeared.[46] With payments on subprime mortgages nonexistent, massive write-downs being required, and liquidity in the market gone, the subprime mortgage and subsequent foreclosure crisis had begun in earnest.[47]

> In a spring 2010 survey, 85% of the responding mayors ranked the prevalence of nonprime or subprime mortgages as either first or second on a list of factors causing foreclosures in their cities. Almost all the mayors, 92%, said they expected the foreclosure problems to stay the same or worsen in their cities over the next year.[48]

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40. *See* THE FIN. CRISIS INQUIRY COMM'N, *supra* note 30, at 423.
41. *Id.* at 301.
42. *See id.* at 274-75.
43. *Id.* at 274-75.
44. *See id.* at 215.
45. *See* THE FIN. CRISIS INQUIRY COMM'N, supra note 30, at 215.
46. *See id.* at 406. *See also* Young, *supra* note 36.
47. *See* THE FIN. CRISIS INQUIRY COMM'N, *supra* note 30, at 215, 274-275,402 ("Prior to 2007, the foreclosure rate was historically less than 1%. But the trend since the housing market collapsed has been dramatic: In 2009, 2.2% of all houses, or 1 out of 45, received at least one foreclosure filing."); Young, *supra* note 36.
48. THE U.S. CONFERENCE OF MAYORS, IMPACT OF THE MORTGAGE FORECLOSURE CRISIS ON VACANT AND ABANDONED PROPERTIES IN CITIES: A 77-CITY SURVEY 3-4 (June 2010), *cited in* THE FIN. CRISIS INQUIRY COMM'N, *supra* note 30, at 403.

III. MORTGAGE RESOLUTION PARTNER'S PROPOSAL

With the background of the devastating effects that the subprime mortgage crisis and foreclosure crisis have had on the United States' economy, we will now turn in more detail to MRP's proposal to correct the foreclosure crisis through the use of eminent domain. To reiterate, MRP is a venture capitalist firm based in San Francisco.[49] Evercore Partners and Westwood Capital LLC advise MRP.[50] Evercore Partners and Westwood Capital LLC are investment banking advisory firms.[51]

MRP's plan begins with the identification of current, but underwater, mortgages.[52] An "underwater" mortgage exists when a mortgagor owes more to the mortgagee than the property is worth on the market.[53] A "current" mortgage is one where the mortgagor is not in default.[54] "Mortgage default is defined to occur when homeowners are delinquent on their payments by one month or more."[55] Therefore, for MRP to be targeting current but underwater mortgages means that MRP desires to target mortgages where the mortgagor is making payments on time but will be paying an amount beyond what that property is currently worth.[56] Underwater mortgagors are commonly referred to as having "negative equity" in their property.[57] Having "negative equity" simply means that the mortgagor owes more on a mortgage than the property giving rise to the mortgage is worth.[58] Whether it is called being underwater or having negative equity,

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49. *An Eminently Bad Idea*, *supra* note 1.

50. Shahien Nasirpour & Tom Braithwaite, *US Housing Plan Aims to Woo Bondholders*, FIN. TIMES, Sept. 27, 2012, http://www.ft.com/intl/cms/s/0/b4305aa4-07ea-11e2-a2d8-00144feabdc0.html#axzz2A3YBGBHl.

51. *Overview*, EVERCORE, http://www.evercore.com/about (last visited Jan. 6, 2013); *Who We Are*, WESTWOOD CAPITAL, http://www.westwoodcapital.com/whoweare/ (last visited Jan. 6, 2013).

52. Al Yoon, *Seizing Mortgages Could Yield Big Returns*, WALL ST. J., July 24, 2012, http://online.wsj.com/article/SB10000872396390443295404577547243807191280.html.

53. *See* Les Christie, *Underwater Borrowers Are on the Rise*, CNN MONEY (Mar. 1, 2012), http://money.cnn.com/2012/03/01/real_estate/underwater_borrowers/index.htm.

54. *See Frequently Asked Questions*, MORTGAGE RESOL. PARTNERS 1, 8 (2012), http://online.wsj.com/public/resources/documents/EMINENT-faqs.pdf.

55. Wenli Li & Michelle J. White, *Mortgage Default, Foreclosures and Bankruptcy in the Context of the Financial Crisis*, INT'L MONETARY FUND 3 (Paper presented at the 10th Jacques Polak Annual Research Conference, Washington, D.C.) (Nov. 5-6, 2009), http://www.imf.org/external/np/res/seminars/2009/arc/pdf/li.pdf.

56. *See Frequently Asked Questions*, *supra* note 54, at 8.

57. *Can't Pay or Won't Pay?*, ECONOMIST, Feb. 19, 2009, http://www.economist.com/node/13145239?story_id=13145239.

58. *See id.*

these are the types of mortgages that MRP is looking to target based on their proposal.[59]

Once select current but underwater mortgages have been identified, it will be determined whether they are privately owned mortgages.[60] MRP states that they will be "emphasizing loans held by private-label securitization trusts."[61] To understand what this means, an explanation of mortgage-backed securities (MBS) is required. MBS are:

> [D]ebt obligations that represent claims to the cash flows from pools of mortgage loans, most commonly on residential property. Mortgage loans are purchased from banks, mortgage companies, and other originators and then assembled into pools by a governmental, quasi-governmental, or private entity. The entity then issues securities that represent claims on the principal and interest payments made by borrowers on the loans in the pool, a process known as securitization.[62]

Therefore, a securitization trust is created when a "mortgage security issuer . . . segregates the collateral or deposits it in the care of a designated *trustee*, a party who holds and manages the collateral for the exclusive benefit of the mortgage security bondholders."[63] Private-label mortgage securities are issued by private companies that generally do not meet certain requirements and are, therefore, "the sole obligation of their issuer and are not guaranteed by one of the [Government Sponsored Enterprises] or the U.S. Government."[64]

After MRP has identified the private-label mortgage securities they wish to target, they will then receive funding from investors that will be used to purchase the mortgages in eminent domain proceedings.[65] In many states, such as Illinois, "quick-take" eminent domain proceedings exist that allow MRP to gain ownership of selected mortgages faster than under nor-

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59. *An Eminently Bad Idea*, *supra* note 1.

60. *See id.*

61. *Homeownership Protection Program: A Solution to a Critical Problem*, MORTGAGE RESOL. PARTNERS 9 (2012), http://online.wsj.com/public/resources/documents/EMINENT-powerpoint.pdf.

62. *Mortgage-Back Securities*, U.S. SEC. AND EXCH. COMM'N, http://www.sec.gov/answers/mortgagesecurities.htm (last visited Jan. 6, 2013).

63. *About MBS/ABS: Agency vs. Private Label*, INVESTINGINBONDS.COM, http://www.investinginbonds.com/learnmore.asp?catid=11&subcatid=56&id=134 (last visited Jan. 6, 2013).

64. *Id.*

65. *See Homeownership Protection Program*, *supra* note 61, at 12.

mal eminent domain proceedings.[66] In Illinois, certain criteria are required to be met before a "quick-take" will be successful.[67] More specifically, in Illinois, a "quick-take" requires "the motion for taking [to state] . . . the necessity for taking the property in the manner requested in the motion."[68] It has been stated, "[t]his requirement is due to the fact that the exercise of quick take power is an even more drastic procedure than the usual eminent domain proceedings because of the *immediate vesting* of title in the sovereign entity."[69]

MRP plans to use "quick-take" proceedings where available because it allows them "to purchase the loan first and finally determine fair value later."[70] Once MRP has acquired the mortgages they have targeted in "quick-take" proceedings, they will pay the value for the mortgages that the court has decided upon.[71] The mortgages will then be transferred from the "[t]rustee/mortgagee . . . for cash consideration."[72] Because the mortgages were taken in "quick-take" proceedings, another hearing will be held before the court at some point post-transfer to determine if the amount previously provided for the mortgages was fair.[73] If the previous compensation is deemed inadequate, the government, who will be repaid by MRP, will pay any remaining amount deemed required by the court.[74] In either event, whether the government has to pay more for the mortgages or not, the government now owns the mortgages, and MRP will begin the refinancing process.[75]

The process of refinancing the new mortgages will require underwriting the mortgages once again.[76] Mortgage underwriting is simply the "[p]rocess of evaluating the credit characteristics of a mortgage and borrower."[77] MRP stated that they "will [be] determin[ing] the underwriting criteria for selecting loans based on the requirements of third party lenders, Fannie Mae, Freddie Mac, the FHA, and other parties who will ultimately

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66. *See* 735 ILL. COMP. STAT. 30/20-5-5 (2012).
67. *See id.*
68. *Id.*
69. Dep't of Transp. ex. rel. People v. First Galesburg Nat'l Bank & Trust Co., 189 Ill. App. 3d 797, 801 (3d Dist. 1989) (emphasis added).
70. *See Frequently Asked Questions*, *supra* note 54, at 3.
71. *See Homeownership Protection Program*, *supra* note 61, at 12.
72. *See id.*
73. *See id.*
74. *See id.*
75. *See id.*
76. *See* Clea Benson, *FHA Said to Set Sage for Treasury Draw as Losses Mount*, BLOOMBERG, Nov. 5, 2012, http://www.bloomberg.com/news/2012-11-05/fha-said-to-set-stage-for-treasury-draw-as-losses-mount.html ("[R]efinanc[ing] under FHA's streamline program . . . waives many underwriting requirements [which] enable[s] borrowers to take advantage of low interest rates.").
77. THE FIN. CRISIS INQUIRY COMM'N, *supra* note 30, at 542.

acquire, refinance or guarantee the loans."[78] MRP also states that they "will not refinance or modify loans for borrowers who do not qualify. [They] will manage credit risk through underwriting to the requirements of third party lenders and guarantors . . . ."[79] Finally, "[t]he loans [will] then be sold to hedge funds, pension funds, or other investors, with the proceeds being used to pay off outside financiers secured by MRP, who are funding the eminent domain process."[80] Of course, MRP is not performing this service for free and will be "tak[ing] a $4,500 fee for each loan seized and modified."[81]

IV. LEGAL ISSUES

Multiple legal issues exist with respect to MRP's plan as it is currently conceived.[82] What follows is an examination of some of the more concerning legal issues with MRP's current proposals.

A. TAKINGS CLAUSE

To begin, we must first examine whether mortgages can even be taken through eminent domain. Generally, when people speak of eminent domain, the first thought that comes to mind is the government taking tangible physical property from a private owner rather than intangible property such as loans or mortgages.[83] However, eminent domain proceedings can, in fact, be implemented against intangible property.[84] In *West River Bridge Company v. Dix*, the Supreme Court stated:

> A distinction has been attempted, in argument, between the power of a government to appropriate for public uses property which is corporeal, or may be said to be in being, and the like power in the gov-

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78. *Frequently Asked Questions*, *supra* note 54, at 7.
79. *Id.*
80. *See* Joe Nelson, *Arguments Over Eminent Domain Mortgage Seizure Program Ramp up for 2013*, SAN BERNARDINO COUNTY SUN (Nov. 30, 2012), http://www.sbsun.com/ci_22105597/arguments-over-eminent-domain-mortgage-seizure-program-ramp?source=most_viewed.
81. *Id.*
82. *See generally* Dellinger et al., supra note 9, at 1.; Memorandum from Am. Securitization Forum to San Bernardino Cnty. Bd. of Supervisors on Joint Exercise of Powers Agreement (July 13, 2012), available at http://www.americansecuritization.com/uploadedFiles/ASF_Eminent_Domain_Letter_7_13_12.pdf; Grossman, *supra* note 9.
83. *See* Miller, *supra* note 13 ("Eminent domain is commonly used to buy land for projects like roads and schools.").
84. *See* West River Bridge Co. v. Dix, 47 U.S. 507, 533-34 (1848).

> ernment to resume or extinguish a franchise. The distinction thus attempted we regard as a refinement which has no foundation in reason, and one that, in truth, avoids the true legal or constitutional question in these causes; namely, that of the right in private persons, in the use or enjoyment of their private property, to control and actually to prohibit the power and duty of the government to advance and protect the general good. We are aware of nothing peculiar to a franchise which can class it higher, or render it more sacred, than other property. A franchise is property, and nothing more; it is *incorporeal property*. . . .[85]

This sentiment was reaffirmed by the Supreme Court over 100 years later in *Kimball Laundry Co. v. U.S.*[86] Additionally, in *City of Oakland v. Oakland Raiders* the California Supreme Court stated, "[f]or eminent domain purposes, neither the federal nor the state Constitution distinguishes between property which is real or personal, tangible or intangible."[87] Therefore, it is clear that intangible property, such as mortgages, is completely within the authority of a state or local government to take through eminent domain proceedings.[88] With the ability of state and local governments to take intangible property such as mortgages in mind, we must now turn to other issues with MRP's plan that are of concern.

1. Public Use

The Fifth Amendment of the United States Constitution provides, in pertinent part, "[n]o person shall be . . . deprived of . . . property, without due process of law; nor shall private property be taken for public use, without just compensation."[89] As James Madison stated in *Property*, "[g]overnment is instituted to protect property of every sort; as well that which lies in the various rights of individuals, as that which the term particularly expresses. This being the end of government, that alone is a just gov-

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85. *West River Bridge Co.*, 47 U.S. at 533-34 (emphasis added).

86. Kimball Laundry Co. v. United States, 338 U.S. 1, 11 (1949) ("[T]he intangible acquires a value to a potential purchaser no different from the value of the business' physical property."). *See* City of Oakland v. Oakland Raiders, 32 Cal. 3d 60, 68 (1982).

87. *City of Oakland*, 32 Cal. 3d at 68.

88. *See West River Bridge Co.*, 47 U.S. at 533. *See also Kimball Laundry Co.*, 338 U.S. at 11; *City of Oakland*, 32 Cal. 3d at 68.

89. U.S. CONST. amend. V.

ernment, which impartially secures to every man, whatever is his own."[90] Therefore, the Fifth Amendment's requirement that "(1) [a]ny taking must be for a 'public use,' and (2) the government must provide the property's owner 'just compensation'" helps to "impose two substantive limitations on the use of eminent domain."[91] With this general background in mind, we now turn to the MRP proposal and consider the application of the Takings Clause to the plan.

The most recent and important case involving the Takings Clause was *Kelo v. City of New London*, which was decided in 2005.[92] In *Kelo*, the Court stated, "it has long been accepted that the sovereign may not take the property of A for the sole purpose of transferring it to another private party B, even though A is paid just compensation."[93] It would seem apparent that MRP's plan, as currently constructed, would do exactly what is not allowed under the Takings Clause—that is, primarily taking mortgages from one private party and giving them to another private party.[94] The Court in *Kelo* did hold that the transfer from party A to party B was constitutional in the previously discussed situation because the transfer was but one of multiple actions taken as part of a comprehensive development plan.[95] Therefore, it would appear as though, if MRP had as part of its proposal a comprehensive plan, the transfer would be allowed.[96] The issue is that MRP does not have a comprehensive plan and instead "the one-to-one property transfer is not just one component of an integrated program . . . the systematic transfer of property from A to B is the *scheme itself*."[97] Furthermore, "[MRP's] proposal addresses properties one at a time (rather than in a comprehensive fashion)."[98] However, it could also easily be argued that MRP's plan is, in fact, a "comprehensive plan" as, in the aggregate, the plan calls for the taking of multiple mortgages concurrently, over time, in specific local communities that choose to implement the proposed plan.[99]

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90. THE PAPERS OF JAMES MADISON DIGITAL EDITION (J. C. A. Stagg, ed., Charlotesville: University of Virginia Press, Rotunda 2010), available at Northern Illinois University Libraries (emphasis omitted).

91. Douglas W. Kmiec, *Takings Clause,* THE HERITAGE GUIDE TO THE CONST., http://www.heritage.org/constitution/#!/amendments/5/essays/151/takings-clause, *cited in* Grossman, *supra* note 9.

92. *See generally* Kelo v. City of New London, 545 U.S. 469 (2005).

93. *See id.* at 477.

94. *See id.; An Eminently Bad Idea*, *supra* note 1 (stating that mortgages would be purchased, refinanced, and sold to other investors); Grossman, *supra* note 9, at 2.

95. *Kelo*, 545 U.S. at 483-84.

96. *See id.*

97. Dellinger, supra note 9, at 1, 4.

98. Grossman, *supra* note 9, at 2.

99. *See generally* Kelo v. City of New London, 545 U.S. 469 (2005).

Even if it was determined that MRP's plan was not an unconstitutional transfer of property from party A to party B, outside of a comprehensive plan, MRP's proposal might still fail to meet the first requirement under the Takings Clause of the Fifth Amendment because the plan lacks the requirement of a public purpose.[100] The most logical argument that could be made as to why MRP's plan satisfies the public purpose requirement is that the plan attempts to stop blight in the local community.[101] The issue here is that "blight" has different definitions and treatment depending on in which state the taking is occurring:[102] "[b]light is so broadly defined in many states it gives the government almost unlimited power to use eminent domain."[103] In Illinois, for example:

> A "blighted or slum area" means any area [that] . . . has been designated by municipal ordinance or by the Authority as an integrated project for rehabilitation, development or redevelopment, where (a) buildings or improvements, by reason of dilapidation, obsolescence, overcrowding, faulty arrangement or design, lack of ventilation, light or sanitary facilities, excessive land coverage, deleterious land use or layout or any combination of these factors, are a detriment to public safety, health or morals, or welfare.[104]

This type of broad statutory definition of "blight" provides Illinois with almost limitless authority to exercise eminent domain to stop or control blight, and therefore, it would appear as though MRP's plan would be feasible in Illinois as well as in other states with equally broad definitions of blight.[105] However, even when applying one of the broader definitions of "blight," as Illinois does, MRP's proposal may still be unconstitutional as it is currently constructed, because it has been alleged by opponents to the plan that the plan attempts to prevent blight in the future rather than correct

100. *See id.* at 478.
101. *See* Hockett, *supra* note 3.
102. *See* Nathan Koppel, *There Goes the Neighborhood: A Fight Over Defining 'Blight'*, WALL ST. J., April 30, 2009, http://online.wsj.com/article/SB124105581784671561.html.
103. *See id.* (quoting Prof. D. Benjamin Barros).
104. 310 ILL. COMP. STAT. 10/9 (2012).
105. *See Id.*; Koppel, *supra* note 102.

current blighted areas.[106] As stated earlier, MRP's plan calls for purchasing current but underwater mortgages.[107] MRP has stated:

> The purpose of acquiring and resolving underwater loans is to protect neighbors and the broader community from defaults, foreclosures, and the losses that they cause. The Federal Housing Finance Agency has concluded that the single best way to reduce losses is to proactively fix loans that are current, deeply underwater, and securitized. Once a borrower stops paying, the ability to mitigate loss falls dramatically. Each local government has the power to determine whether to acquire loans, and if so which loans. It might rightly purchase loans that are current, delinquent or in default. It chooses the public goals and methods that it wants to pursue — not private financial interests who want taxpayers to bail them out of their holdings of defaulted loans.[108]

Looked at through a business perspective, MRP's proposal to select current but underwater mortgages is a good idea for both the government and MRP.[109] But opponents argue that, constitutionally, the concept of selecting property that is currently not blighted to prevent blight in the future is a tenuous proposition to support legally.[110] Opponents of the plan point to *99 Cents Only Stores v. Lancaster Redevelopment Agency*, where the court stated, "[defendant's] 'public use' theory fails for another independent reason. [Defendant] can point to no authority—and the Court could find none—supporting its novel legal proposition that the prevention of 'future blight' is a legitimate public use."[111] The court went on to state, "[i]n [de-

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106. *See* Dellinger et al., *supra* note 9, at 4; Memorandum from Am. Securitization Forum on Joint Exercise of Powers Agreement to San Bernardino Cnty. Bd. of Supervisors, *supra* note 9, at 7; 310 ILL. COMP. STAT. 10/9 (2012).

107. *See An Eminently Bad Idea*, *supra* note 1.

108. *Fact or Fiction*, MORTGAGE RESOL. PARTNERS, http://mortgageresolution.com/fact-or-fiction (last visited January 6, 2013).

109. *See An Eminently Bad Idea*, *supra* note 1 ("[T]he government has every economic incentive to underpay the investor who owns the mortgage to cover transaction costs and boost return for itself and MRP.").

110. *See* Dellinger et al., *supra* note 9, at 4; Memorandum from Am. Securitization Forum on Joint Exercise of Powers Agreement to San Bernardino Cnty. Bd. of Supervisors, *supra* note 9, at 7.

111. 99 Cents Only Stores v. Lancaster Redevelopment Agency, 237 F. Supp. 2d 1123, 1130 (C.D. Cal. 2001). *See* Dellinger et al., *supra* note 9, at 4; Memorandum from

fendant's] view, then, no redevelopment site can ever be truly free from blight because blight remains ever latent, ready to surface at any time. Such an untenable position . . . defies logic."[112] MRP's plan calls for the taking of mortgages that may, but have not yet, contributed to "blight" in the local community.[113] Therefore, as the plan is currently conceived, the plan may be an unconstitutional taking, because it does not meet the "public use" requirement of the Takings Clause.[114] However, considering that many states have broad definitions of blight, the issue of "future blight" versus "current blight" may be an irrelevant argument, as any minor imperfection on a property may constitute current blight.[115] Therefore, MRP's plan could conceivably survive a constitutional challenge under the Fifth Amendment that alleged the plan lacks a public purpose in states like Illinois with broad definitions of blight.[116]

Furthermore, recently, in a comment letter to the FHFA, MRP stated: "MRP will [be] expand[ing] the services it provides to cover *all* PLS loans, not just those that are current."[117] Legally, the expansion of MRP's proposal to include all private label security (PLS) mortgages would surely bring the plan within the provisions of a "public use," as all PLS loans would certainly include mortgages of blighted properties.[118] However, only time will tell if, upon actual implementation of MRP's plan, both current and non-current mortgages will be targeted for seizure.[119]

Am. Securitization Forum on Joint Exercise of Powers Agreement to San Bernardino Cnty. Bd. of Supervisors, *supra* note 9, at 7.

112. 99 Cents Only Stores, 237 F. Supp. 2d at 1131.

113. *See Fact or Fiction*, *supra* note 108; *99 Cents Only Stores*, 237 F. Supp. 2d at 1130-31; Dellinger et al., *supra* note 9, at 4; Memorandum from Am. Securitization Forum on Joint Exercise of Powers Agreement to San Bernardino Cnty. Bd. of Supervisors, *supra* note 9, at 7.

114. *See Fact or Fiction*, *supra* note 108; *99 Cents Only Stores*, 237 F. Supp. 2d at 1130-31; Dellinger et al., *supra* note 9, at 4; Memorandum from Am. Securitization Forum on Joint Exercise of Powers Agreement to San Bernardino Cnty. Bd. of Supervisors, *supra* note 9, at 7.

115. *See* 310 ILL. COMP. STAT. 10/9 (2012); Koppel, *supra* note 102 (quoting Prof. D. Benjamin Barros).

116. *See* 310 ILL. COMP. STAT. 10/9 (2012); Koppel, *supra* note 102 (quoting Prof. D. Benjamin Barros).

117. Comment Letter from Mortgage Resolution Partners, to Fed. Hous. Fin. Agency on Federal Register Notice No. 2012-N-11 1, 5 (Sept. 7, 2012), available at http://mortgageresolutionpartners.com/sites/default/files/attachments/fhfa_comment_letter_9.7.12.pdf.

118. *See* David Streitfeld, *Blight Moves in After Foreclosures*, L.A. TIMES, http://www.latimes.com/la-fi-vacant28aug28,0,7927104.story?page=1 (last visited Jan. 6, 2013).

119. *See* Comment Letter from Mortgage Resolution Partners, to Fed. Hous. Fin. Agency on Federal Register Notice No. 2012-N-11, *supra* note 117, at 5.

2. *Just Compensation*

The next issue with MRP's proposal, with respect to the Takings Clause of the Fifth Amendment of the United States Constitution, is that the plan arguably does not provide current mortgage holders with "just compensation."[120] In *United States v. Miller*, the Court stated that just compensation is "the full and perfect equivalent in money of the property taken. The owner is to be put in as good position pecuniarily as he would have occupied if the property had not been taken."[121] The Court went on to state that "[i]n an effort . . . to find some practical standard, the courts early adopted, and have retained, the concept of market value. The owner . . . [is] . . . entitled to the 'value,' the 'market value,' and the 'fair market value' of what is taken."[122] Therefore, "[u]nder this standard, the owner is entitled to receive 'what a willing buyer would pay in cash to a willing seller' at the time of the taking."[123]

As previously stated, MRP's plan is based on the assumption that "[l]oans and liens will be acquired through eminent domain at *fair value*, which is expected to be <u>less</u> than the market value of the home."[124] MRP's plan most likely calls for a price less than the market value of the home because the government and MRP would need to "cover transaction costs and boost returns for itself and MRP."[125] However, "MRP President Steve Gluckstern [has] . . . argued that the fair market value MRP would pay is the very value Fannie assigned its securities in financial filing disclosures, based on the amount of loans expected to default."[126] Therefore, this valuation may in fact be the fair or market value for the assets and, therefore, satisfies the requirement of "just compensation" under the Fifth Amendment of the Constitution.[127] The next issue that must now be analyzed with respect to MRP's proposal is application of the Contracts Clause.

B. CONTRACTS CLAUSE

The Constitution of the United States provides in Article 1, Section 10, Clause 1 that, "[n]o State shall . . . pass any . . . Law impairing the Obliga-

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120. *See* Grossman, *supra* note 82, at 2.
121. United States v. Miller, 317 U.S. 369, 373 (1942).
122. *Id.* at 374.
123. United States v. 564.54 Acres of Land, 441 U.S. 506, 511 (1979) (citing Miller, 317 U.S. at 374-75).
124. *Homeownership Protection Program*, *supra* note 61, at 9.
125. *See An Eminently Bad Idea*, *supra* note 1.
126. Jon Prior, *Still No Partner for Radical Mortgage Resolution*, POLITICO Jan. 16, 2013, http://www.politico.com/story/2013/01/still-no-partner-for-radical-mortgage-resolution-86233.html.
127. *See id.*; *564.54 Acres of Land*, 441 U.S. at 511; *Miller*, 317 U.S. at 373-74.

tion of Contracts . . . ."[128] As James Madison explained in *The Federalist No. 44*, this clause was included in the Constitution as added protection for the public.[129] He stated, "laws impairing the obligation of contracts, are contrary to the first principles of the social compact, and to every principle of sound legislation . . . additional fences against these dangers ought not to be omitted. Very properly therefore have the Convention added this constitutional bulwark in favor of . . . private rights."[130]

With this background in mind, the question then becomes whether MRP's proposal in fact violates the Contract Clause.[131] In response to questions already being raised about the constitutionality of the plan with respect to the Contract Clause, MRP stated on July 15, 2012, "[i]n *Hawaii Housing Authority v. Midkiff*, the Court both considered and, decisively for present purposes, *unanimously* rejected the argument that eminent domain takings can violate the Contract Clause."[132] However, this "decisive" rejection that MRP references is footnote 6 of the opinion, which states, "the Contract Clause has never been *thought* to protect against the exercise of the power of eminent domain."[133] In reading the footnote, it clearly is not as "decisive" a rejection as MRP claims.[134] It is hard to conclude that phrasing that includes the term "thought" could be considered a "decisive" ruling on a particular matter.[135] Furthermore, footnotes are generally considered only dictum.[136] As stated in *Henderson v. Morgan*, "new rules of constitutional law are not established in dicta in footnotes."[137] For these reasons, it is currently ambiguous whether the Contract Clause applies to eminent domain.[138] For argument's sake, we will assume the Contract Clause does apply to eminent domain for the moment.[139] Therefore, an analysis of the constitutionality of MRP's proposal under the Contract Clause is required.

The Supreme Court created, in *Energy Reserves Group, Inc. v. The Kansas Power and Light Company*, a three-part test to determine when a

128. U.S. CONST. art. 1, § 10, cl. 1.

129. *See* TERRENCE BALL, FEDERALIST WITH LETTERS OF BRUTUS 218 (Cambridge University Press 2003). ,

130. *Id.*

131. *See* Memorandum from Am. Securitization Forum, to San Bernardino Cnty. Bd. of Supervisors on Joint Exercise of Powers Agreement, *supra* note 18, at 8.

132. *Of Course They Can!*, MORTGAGE RESOL. PARTNERS, http://mortgageresolutionpartners.com/jones-day-response (last visited Jan. 6, 2013).

133. Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 243 n. 6 (1984) (emphasis added).

134. *See id.*; *Of Course They Can!*, *supra* note 132.

135. *See Of Course They Can!*, *supra* note 132.

136. *See* Henderson v. Morgan, 426 U.S. 637, 651; Hohn v. United States, 524 U.S. 236, 259 (1998) (Scalia, J., dissenting) ("What the Court relies upon is the mere dictum, rendered in the course of this opinion (and dictum in a footnote, at that).").

137. *Henderson*, 426 U.S. at 651.

138. *See Haw. Hous. Auth.*, 467 U.S. at 243 n.6; *Henderson*, 426 U.S. at 651.

139. *See Haw. Hous. Auth.*, 467 U.S. at 243 n.6; *Henderson*, 426 U.S. at 651.

contract has been impaired.[140] The Court stated, "[t]he threshold inquiry is 'whether the state law has, in fact, operated as a substantial impairment of a contractual relationship.'"[141] Next, "[i]f the state regulation constitutes a substantial impairment, the State, in justification, must have a significant and legitimate public purpose behind the regulation such as the remedying of a broad and general social or economic problem."[142] Finally, "[o]nce a legitimate public purpose has been identified, the next inquiry is whether the adjustment of 'the rights and responsibilities of contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption.'"[143]

Therefore, to determine if MRP's plan violates the Contract Clause, the Supreme Court's three-part test must first be applied to the proposed plan.[144] In applying step one under the *Energy Reserves Group, Inc.* test, it would appear as though MRP's proposal would "operate as a substantial impairment of a contractual relationship."[145] MRP's plan appears to impair contractual rights because, as the plan states, "[l]oans and liens will be acquired through eminent domain at *fair value*, which is expected to be <u>less</u> than the market value of the home."[146] Since the mortgage holders entered into a contract for one price and MRP's plan would unilaterally decrease that price, it is apparent that these contracts would be impaired if MRP's plan were implemented.[147] Furthermore, the mortgages would be substantially impaired based on the large discrepancy between fair value and market value in the current market.[148]Although MRP's plan may constitute a "substantial impairment of a contractual relationship," it could still be deemed constitutional if it serves "a significant and legitimate public purpose."[149] As stated earlier, the question of whether the plan does or does not serve a public purpose or use is up for debate.[150]

Assuming a court did find MRP's plan serves a public purpose, the plan could still be unconstitutional under the Contracts Clause.[151] The ad-

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140. *See* Energy Reserves Grp., Inc. v. Kan. Power and Light Co., 459 U.S. 400, 411-13 (1983).

141. *Id.* at 411 (quoting Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 244 (1978)).

142. *Id.* at 411-12 (citations omitted).

143. *Id.* at 412 (quoting U.S. Trust Co. v. New Jersey, 431 U.S. 1, 22 (1977)).

144. *See id.* at 411-13.

145. *See Energy Reserves Grp., Inc.*, 459 U.S. at 411 (quoting Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 244 (1978)).

146. *Homeownership Protection Program*, *supra* note 61, at 9.

147. *See id.*

148. *See id.*

149. *Energy Reserves Grp.*, 459 U.S. at 411-13.

150. *See supra* Part IV.A.

151. *See Energy Reserves Grp*., 459 U.S. at 412.

justment that would occur via the seizure of underwater mortgages would clearly not be based on "reasonable conditions" nor be of "appropriate character."[152] This type of adjustment would seem to only be on "reasonable conditions" and be of "appropriate character" if it were the last resort to correcting the foreclosure crisis.[153] The federal government has taken (via Independent Foreclosure Review)[154] and continues (via National Mortgage Settlement) to take action in an attempt to correct the foreclosure crisis.[155] These measures are not nearly as radical as the use of eminent domain.[156] However, many have argued that these measures have also been entirely ineffective.[157] Only once all other options have been exhausted would a court most likely conclude that this final part of the *Energy Reserve Group* test had been satisfied.[158] Until then, it appears that MRP's proposal may violate the Contracts Clause of the United States Constitution if implemented by a local or state government and is therefore possibly unconstitutional.[159] However, one commentator has stated that the test under *Energy Reserve Group* is a fairly deferential approach to application of the Contracts Clause.[160] Therefore, it is also quite possible that a court would determine that if a local government were to implement MRP's plan it would not violate the Contracts Clause.[161]

C. DORMANT COMMERCE CLAUSE

MRP's plan may also violate the Dormant Commerce Clause of the United States Constitution.[162] Article 1, Section 8, Clause 3 of the United States Constitution provides that "[c]ongress shall have Power . . . To regu-

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152. *Id.*
153. *See id.*
154. *See What You Need to Know: Independent Foreclosure Review*, BOARD OF GOVERNORS OF THE FED. RES. SYS. (July 26, 2013), http://www.federalreserve.gov/consumerinfo/independent-foreclosure-review.htm.
155. *See National Mortgage Settlement*, THE UNITED STATES DEPARTMENT OF JUST. (Dec. 17, 2012, 10:26 AM), http://www.justice.gov/ust/eo/public_affairs/consumer_info/nms/index.htm.
156. *See* Jennifer Medina, *California County Weighs Drastic Plan to Aid Homeowners*, N.Y. TIMES, July 14, 2012, http://www.nytimes.com/2012/07/15/us/a-county-considers-rescue-of-underwater-homes.html?pagewanted=all&_r=0.
157. *See* Bill Whitaker, *Some Relief for Victims of Foreclosure*, CBS NEWS, Dec. 28, 2012, http://www.cbsnews.com/8301-18563_162-57561192/some-relief-for-victims-of-foreclosures/.
158. *See Energy Reserves Grp.*, 459 U.S. at 412.
159. *See id.*
160. GEOFFREY R. STONE ET AL., CONSTITUTIONAL LAW 955 (Richard A. Epstein, et al. eds., 4th ed. 2001).
161. *See id.*
162. *See* Memorandum from Am. Securitization Forum, to San Bernardino Cnty. Bd. of Supervisors on Joint Exercise of Powers Agreement, *supra* note 18, at 7.

late Commerce with foreign Nations, and among the several States, and with the Indian Tribes . . . ."[163] Courts in the United States have, over time, inferred a power from this clause, which has come to be known as the "Dormant Commerce Clause."[164] In *Welton v. Missouri*, the Supreme Court stated, "[t]he fact that Congress has not seen fit to prescribe any specific rules to govern inter-State commerce does not affect the question. Its *inaction* on this subject . . . is equivalent to a declaration that inter-State commerce shall be free and untrammelled [sic]."[165] "The case most frequently cited for the contemporary analysis of burden on interstate commerce is *Pike v. Bruce Church, Inc.*"[166] In *Pike*, the Court created a balancing test to determine when a non-facially discriminatory regulation violates the Dormant Commerce Clause.[167] The Court stated:

> Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities. Occasionally the Court has candidly undertaken a balancing approach in resolving these issues but more frequently it has spoken in terms of "direct" and "indirect" effects and burdens.[168]

This test appears to have been used in *City of Oakland v. Oakland Raiders* to determine whether a sports franchise could be seized via eminent domain without violating the Dormant Commerce Clause.[169] The court held that, "[the City of Oakland's] proposed action would more than indirectly or incidentally regulate interstate commerce . . . . This is the precise brand of parochial meddling with the national economy that the commerce clause

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163. U.S. CONST. art. I, § 8, cl. 3.

164. Gillian E. Metzger, *Congress, Article IV, and Interstate Relations*, 120 HARV. L. REV. 1468, 1472 (2007).

165. Welton v. Missouri, 91 U.S. 275, 282 (1875) (emphasis added).

166. 3 CHESTER JAMES ANTIEAU & WILLIAM J. RICH, MODERN CONSTITUTIONAL LAW: THE STATES AND THE FEDERAL GOVERNMENT § 43.24 (West Group 2d ed. 1997).

167. *See* 8A NICHOLS ON EMINENT DOMAIN § G22.03 at 4 (3d ed. 2013).

168. Pike v. Bruce Church, 397 U.S. 137, 142 (1970) (citations omitted).

169. *See* 8A NICHOLS ON EMINENT DOMAIN § G22.03 at 4 (3d ed. 2013).

was designed to prohibit."[170] If the court in *City of Oakland* held that a sports franchise could not be seized via eminent domain, proponents of MRP's plan would be hard pressed to showcase how the seizure of mortgages would not violate the Dormant Commerce Clause.[171] In addition, "MRP's proposal specifically targets mortgage loans that have been securitized in out-of-state transactions to back securities traded in interstate commerce . . . . [Therefore,] [t]he effect and burden on interstate commerce would be intentional and direct, rather than only 'incidental' or 'indirect.'"[172] Based on the current legal landscape, with respect to the use of eminent domain to seize intangible assets, it is unlikely that MRP's plan would be found to be constitutional and not a violation of the Dormant Commerce Clause.[173]

V. POLICY CONCERNS

In addition to the legal issues that exist with respect to MRP's proposal to seize underwater mortgages via the use of eminent domain, there are also multiple policy issues that must be considered if the plan were implemented.[174] As mentioned earlier, the FHFA in particular has multiple concerns with MRP's current plan.[175]

A. "CHILLING EFFECT"

The FHFA is primarily concerned that the use of eminent domain would, as they state, have a "chilling effect on the extension of credit to borrowers seeking to become homeowners and on investors that support the housing market."[176] Additionally, the FHFA is concerned that if the plan was implemented and losses occurred, taxpayers would be liable for any losses with respect to Government Sponsored Enterprise (GSE) assets.[177]

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170. City of Oakland v. Oakland Raiders, 220 Cal. Rptr. 153, 157 (1985).

171. *See id.*; *Pike*, 397 U.S. at 142.

172. Memorandum from Am. Securitization Forum, to San Bernardino Cnty. Bd. of Supervisors on Joint Exercise of Powers Agreement, *supra* note 18, at 8. *See also* Dellinger et al., *supra* note 9, at 10 (stating that "the proposal would permit the JPA to seize notes held in trust outside the state").

173. *See City of Oakland*, 220 Cal. Rptr. at 157; *Pike*, 397 U.S. at 142.

174. *See* Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 47,652 (Aug. 9, 2012).

175. *Id.*

176. *Id.*

177. *Id.*

The FHFA is not the only entity that is concerned with the implementation of MRP's proposal on the housing market.[178] Multiple trade organizations and forums have also spoken out against MRP's plan.[179] The American Securitization Forum (ASF) stated on July 13, 2012, "even in the most challenging of economic times, poor policy solutions such as the proposal to seize mortgage loans through eminent domain are not productive or legal answers."[180] This statement was reiterated again by ASF as recently as December 16, 2012 in an open memorandum to the Salinas City Council.[181] The Securities Industry and Financial Market Association (SIFMA) has also expressed disapproval of MRP's plan.[182] SIFMA stated in an open memorandum to Treasury Secretary Honorable Timothy Geithner that:

> Unfortunately, some investment groups and academics have recently been advocating for the use of the sovereign power of eminent domain to seize individual underwater mortgages from established private-label securitization pools. As you are no

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178. *See generally* Memorandum from Am. Securitization Forum, to San Bernardino Cnty. Bd. of Supervisors on Joint Exercise of Powers Agreement , *supra* note 18; Dellinger et al., *supra* note 9; Memorandum from Am. for Prosperity, to the Office of Gen. Counsel for the Fed. Hous. Fin. Agency on Use of Eminent Domain to Restructure Performing Loans (Sept. 4, 2012), *available at* http://www.fhfa.gov/webfiles/24283/9_Americans_for_Prosperity_Foundation.pdf; Memorandum from the Undersigned Orgs. to the Fed. Hous. Fin. Agency on Use of Eminent Domain to Restructure Performing Loans (Sept. 7, 2012), *available at* http://www.aba.com/advocacy/letterstocongress/documents/mortgage-ed-jointletter-090712.pdf.

179. *See generally* Memorandum from Am. Securitization Forum, to San Bernardino Cnty. Bd. of Supervisors on Joint Exercise of Powers Agreement , *supra* note 18; Dellinger et al., *supra* note 9; Memorandum from Am. for Prosperity, to the Office of Gen. Counsel for the Fed. Hous. Fin. Agency on Use of Eminent Domain to Restructure Performing Loans (Sept. 4, 2012), *available at* http://www.fhfa.gov/webfiles/24283/9_Americans_for_Prosperity_Foundation.pdf; Memorandum from the Undersigned Orgs. to the Fed. Hous. Fin. Agency on Use of Eminent Domain to Restructure Performing Loans (Sept. 7, 2012), *available at* http://www.aba.com/advocacy/letterstocongress/documents/mortgage-ed-jointletter-090712.pdf.

180. Memorandum from Am. Securitization Forum, to San Bernardino Cnty. Bd. of Supervisors, *supra* note 18, at 1.

181. *See* Memorandum from Am. Securitization Forum, to Salinas City Council on Use of Eminent Domain to Seize and Restructure Mortgage Loans 1, 1 (Dec. 16, 2012), *available at* http://www.americansecuritization.com/content.aspx?id=8651 ("Even in the most challenging of economic times, however, poor policy solutions such as the proposal to seize mortgage loans through eminent domain are not productive or legal answers.").

182. *See* Memorandum from Secs. Indus. and Fin. Market Ass'n, to the Honorable Timothy Geithner on Use of Eminent Domain to Restructure Performing Loans 1, 1-2 (Aug. 27, 2012), available at http://www.sifma.org/workarea/downloadasset.aspx?id=8589940087.

> doubt aware, the County of San Bernardino, California, is considering a plan under which it would exercise eminent domain to seize performing underwater mortgages, transfer the mortgages to new private investors who would restructure the mortgages by writing down the outstanding principle and then selling the mortgages through FHA or Ginnie Mae programs. The proposal is inherently based on paying the current mortgage owners far less than the true value of these performing mortgages and transferring this additional value to the new private investors. Similar proposals are being considered in other jurisdictions across the country. However, given the inherent flaws in this approach, many legal analysts, investors, banks, trade associations, and thoughtful public officials, including Chicago Mayor Rahm Emmanuel and Federal Housing Agency Acting Director Edward DeMarco have expressed grave concern.[183]

A similar open memorandum was also sent to Honorable Martin J. Gruenberg, Chairman of the Federal Deposit Insurance Corporation (FDIC).[184] Both ASF and SIFMA have the same or similar concerns with MRP's proposal as the FHFA.[185] The so-called "chilling effect" is the predominant concern of the aforementioned organizations and agencies.[186] SIFMA has stated that:

> Adoption of this, or similar, eminent domain approaches would have an immediate impact on the short and long-term interests of those who have long financed our mortgage markets – bankers, individual investors, pension funds, insurance companies, and many others. We should not forget that a deep and liquid mortgage market in the United States has long been a sound foundation for much

183. *Id.*

184. *See* Memorandum from Secs. Indus. and Fin. Market Ass'n, to Martin J. Gruenberg on Use of Eminent Domain to Restructure Performing Loans, supra note 182.

185. *See generally* Memorandum from Secs. Indus. and Fin. Market Ass'n, to the Honorable Timothy Geithner on Use of Eminent Domain to Restructure Performing Loans, *supra* note 182; Memorandum from Am. Securitization Forum, to San Bernardino Cnty. Bd. of Supervisors on Joint Exercise of Powers Agreement, *supra* note 9.

186. *See* Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. at 47,652.

> upward mobility and economic development. While our ongoing national recovery from the collapse of the speculative housing bubble has proven difficult, we should not abandon the underpinnings of the market.[187]

Furthermore, "[t]he federal government has threatened to redline cities and counties that engage in the practice, saying it could make it harder to get loans and force lenders to levy additional fees as a safeguard against government mortgage seizures."[188] On September 13, 2012, Representative John Campbell of California introduced the Defending American Taxpayers from Abusive Government Takings Act.[189] In a press release he stated:

> There is no question that we need to take steps to assist American homeowners in distress . . . but, these steps must not undermine rule of law, must not engage in corruptive and abusive practices, must protect the American taxpayer, and must not further degrade the housing market. The eminent domain programs in question are atrocious, corruptive, irresponsible and unconstitutional. We do need to fix the housing sector, but it must be done in a way that does not break the law and *does not enrich undeserving, politically-connected entities*

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187. Memorandum from Secs. Indus. and Fin. Market Ass'n, to the Honorable Timothy Geithner on Use of Eminent Domain to Restructure Performing Loans, *supra* note 182, at 3.

188. *See* Nelson, *supra* note 80.

Senator William Proxmire, sponsor of legislation against redlining, put the case this way:

> By redlining let me make it clear what I am talking about. I am talking about the fact that banks and savings and loans will take their deposits from a community and instead of reinvesting then in that community, they will invest them elsewhere, and they will actually or figuratively draw a red line in a map around the areas of their city, sometimes in the inner city, sometimes in the older neighborhoods, sometimes ethnic and sometimes black, but often encompassing a great area of their neighborhood.

THOMAS SOWELL, THE HOUSING BOOM AND BUST 113 (Basis Books rev. ed. 2009).

189. John Campbell III, *Campbell Introduces The Defending American Taxpayers from Abusive Government Takings Act*, PROJECT VOTE SMART (Jul. 18, 2013), http://votesmart.org/public-statement/807369/campbell-introduces-the-defending-american-taxpayers-from-abusive-government-takings-act#.UjzisjYo74g.

> in cities and counties with unsustainable budget deficits.[190]

Representative Campbell went on to state, "these programs will dramatically hurt the markets they are employed in as they will virtually destroy private lending in these cities and counties for years to come."[191] Representative Campbell's bill did not pass, but odds are that the bill will be put up for vote again in 2013.[192] In addition, the concern is that "if the MRP proposal spreads beyond San Bernardino County, the entire market for securitization of mortgage loans could be upended, as investors would never know when a local government might try to seize desirable loans . . . ."[193]

Proponents of MRP's proposal question the concern of SIFMA, ASF, Representative Campbell, and other concerned organizations with respect to the "chilling effect" that the use of eminent domain will have on the mortgage market.[194] Proponents of MRP's proposal state that the so-called "chilling effect" is, in actuality, just concern for the loss of profits that many holders of underwater mortgages would be forced to absorb if mortgages were seized and written down.[195] As Representative Brad Miller of North Carolina wrote, "[these concerns] convey[] the unmistakable threat that Wall Street will sic its lawyers on . . . [San Bernardino] county and will 'likely be reluctant to provide future funding to borrowers in these areas.'"[196] Representative Miller goes on to state that the "threat of a boycott is . . . hollow . . . . [Because a] threat of a boycott by Fannie Mae and Freddie Mac would be credible, but the threat of a boycott by Wall Street is not."[197] Furthermore, MRP, in a comment letter to the FHFA, stated, with respect to the "chilling effect" MRP's plan may have, that "[l]enders will [now] price this risk into future loans whether or not any local government actually exercises the power now, so there is no reason to impede the use of sovereign power of eminent domain to mitigate losses now."[198] Obviously, there is great disagreement over the alleged "chilling effect" that MRP's proposal will have on the market in general.[199] However, the concern over a "chilling

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190. *Id.* (emphasis added) (internal quotation marks omitted).
191. *Id.*
192. *See* Nelson, *supra* note 80.
193. Dellinger et al., *supra* note 9, at 10.
194. *See* Miller, *supra* note 13.
195. *See id.*
196. *Id.*
197. *Id.*
198. Comment Letter from Mortgage Resolution Partners, to Fed. Hous. Fin. Agency on Federal Register Notice No. 2012-N-11, *supra* note 117, at 8.
199. *See* Miller, *supra* note 13; Comment Letter from Mortgage Resolution Partners, to Fed. Hous. Fin. Agency on Federal Register Notice No. 2012-N-11, *supra* note 117, at 8.

effect" from MRP's proposal will surely continue to be a concern voiced by opponents to the plan.[200]

B. TAXPAYERS WOULD BE LIABLE FOR ANY LOSSES INCURRED

The FHFA's second major concern, that MRP's plan could cause losses that would have to be absorbed by taxpayers, may not be as problematic as the concerns over a "chilling effect" on the market.[201] As stated earlier, the FHFA is concerned that implementation of MRP's plan has the possibility to cause significant losses for taxpayers.[202] The FHFA is deeply concerned about this issue because Fannie Mae and Freddie Mac were placed into conservatorship under the FHFA on September 6, 2008.[203] Fannie Mae and Freddie Mac are GSEs that "play a critical role in the U.S. home mortgage market . . . ."[204] As conservator to Fannie Mae and Freddie Mac:

> [T]he FHFA has taken over the assets and assumed all the powers of the shareholders, directors, and officers. It may take any necessary action to restore the firms to a sound and solvent condition . . . . GSE business operations will continue as before; . . . . The conservatorship will end when the FHFA finds that a safe and solvent condition has been restored.[205]

For this reason, the FHFA is particularly concerned with any actions that may affect the mortgage market.[206] In addition, "[s]ince establishing conservatorships for Fannie Mae and Freddie Mac (the Enterprises) in 2008, the Federal Housing Finance Agency (FHFA) and the Enterprises have focused on three key goals [including] mitigating Enterprise losses, which ultimately accrue to taxpayers . . . ."[207] It is for these reasons that the

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200. *See* Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 47,652 (Aug. 9, 2012).

201. *See id.*; Comment Letter from Mortgage Resolution Partners to Fed. Hous. Fin. Agency on Federal Register Notice No. 2012-N-11, *supra* note 117, at 7-8.

202. *See* Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. at 47,652.

203. FEDERAL HOUSING FINANCE AGENCY, FHFA SENDS CONGRESS STRATEGIC PLAN FOR FANNIE MAE AND FREDDIE MAC CONSERVATORSHIPS 1 (Feb. 21, 2012), *available at* http://www.fhfa.gov/webfiles/23344/StrategicPlanConservatorshipsFINAL.pdf.

204. Mark Jickling, *CRS Report for Congress: Fannie Mae and Freddie Mac in Conservatorship*, CONGRESSIONAL RESEARCH SERVICE 1 (Sept. 15, 2008), http://fpc.state.gov/documents/organization/110097.pdf.

205. *Id.* at 3.

206. *See* Jickling, *supra* note 204, at 1.

207. FEDERAL HOUSE FINANCE AGENCY, *supra* note 203, at 2.

FHFA stated in the Federal Register on August 9, 2012, "FHFA has significant concerns about the use of eminent domain to revise existing financial contracts and the alteration of the value of [Government Sponsored] Enterprise or Bank securities holdings."[208]

However, the FHFA's concerns may be misdirected.[209] MRP stated in a comment letter to the FHFA that "[l]ocal governments must pay fair value for all mortgage loans and therefore will not cause any losses. All losses have in fact already occurred because of the disastrous collapse of housing prices in affected communities."[210] However, this simply is a return to the argument over fair value versus market value, which was discussed in Part IV.A.II.[211] Therefore, the question of whether losses will be borne by taxpayers upon implementation of MRP's proposal will truly be determined by the question of whether mortgage holders will be given fair value or market value.[212] If the mortgage holders are given market value, they may not be provided "just compensation."[213] If the mortgage holders were given fair value rather than market value, it would increase the likelihood of taxpayers being subject to the risk of increased losses.[214] In the end, the question of the level and amount of losses taxpayers could be liable for will continue to be an important policy concern of MRP's proposal.[215]

Finally, there is also the issue of what has come to be known as "moral hazard."[216] "Moral hazard . . . refers to the undue risks that people are apt to take if they don't have to bear the consequences."[217] Therefore, in a housing market context, the concern is that "[c]utting the loan balance of a troubled homeowner will only encourage future borrowers to take on debts they can't pay back . . . ."[218] MRP disagrees with the concerns over "moral haz-

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208. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 47,652 (Aug. 9, 2012).

209. *See* Comment Letter from Mortgage Resolution Partners to Fed. Hous. Fin. Agency on Federal Register Notice No. 2012-N-11, *supra* note 117, at 5.

210. *Id.*

211. *See supra* Part IV.A.II.

212. *See* Grossman, *supra* note 9, at 2; Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. at 47,652 .

213. *See* Grossman, *supra* note 9, at 2.

214. *See* Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. at 47,652.

215. *See id.*

216. *See* John W. Schoen, *Governments Mull Radical Solution to Underwater Mortgages: Seize Them*, NBC NEWS, Aug. 16, 2012, http://www.nbcnews.com/business/economywatch/governments-mull-radical-solution-underwater-mortgages-seize-them-945670.

217. Shaila Dewan, *Moral Hazard: A Tempest-Tossed Idea*, N.Y. TIMES, Feb. 25, 2012, http://www.nytimes.com/2012/02/26/business/moral-hazard-as-the-flip-side-of-self-reliance.html?pagewanted=all.

218. Schoen, *supra* note 216.

ard."[219] MRP has stated, "America is facing an economic crisis and the solution requires practical action that keeps people in their homes . . . . The real moral hazard is that the system is forcing homeowners to default in order to achieve rational solutions."[220] However, MRP fails to state how their proposal would not constitute a "moral hazard," and therefore, the concern over "moral hazard" will continue to be a position voiced by opponents to the plan.[221]

VI. CONCLUSION

Considering the legal and policy issues with respect to MRP's plan, the question becomes whether the proposal will go any further.[222] As stated in Part I, San Bernardino County was one local government that had been considering MRP's plan.[223] However, the county decided to scrap that plan in response to heightened public disapproval.[224] The disapproval in San Bernardino was most likely more than a vocal minority based on an informal internet survey conducted on November 27, 2012 the results of which showed that:[225] "of 113 Californians, *96 percent* . . . said they oppose[d] eminent domain to seize mortgages because they didn't believe it would stabilize housing prices. In addition, the majority of those surveyed felt that borrowers understood the risks they assumed when they bought their homes."[226] Clearly, there are some reservations held by the public over the use of eminent domain to correct the foreclosure crisis.[227] This is not even considering the legal challenges that would ensue upon the implementation of the plan by local governments and MRP.[228] Therefore, it remains to be seen whether MRP's proposal will ever actually be put into operation.[229] Considering the fact that a court could halt a local government's implementation of MRP's proposal for just one of the many legal issues mentioned above, the odds are not in favor of successful implementation of the plan in

219. *See Frequently Asked Questions*, *supra* note 54, at 5.
220. *Id.*
221. *See id.*; Schoen, *supra* note 216.
222. *See supra* Parts IV-V.
223. *See supra* Part I.
224. *See* Lazo, *supra* note 6.
225. *See* Nelson, *supra* note 80.
226. *Id.* (emphasis added) ("Matt Strickberger of OnPoint PR and Consulting in Warren, N.J., said he conducted the survey independently and it was not commissioned by any client. . . . He acknowledged that the survey, at only 113 surveyed Californians, was anything but scientific.").
227. *See id.*
228. *See id.*; Grossman, *supra* note 9, at 3.
229. *See* Nelson, supra note 80.

the future.[230] Furthermore, considering the policy concerns being voiced about the plan, it would appear that future implementation of MRP's proposal by a local government will be an uphill battle, at best.[231]

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230. *See supra* Part IV; Grossman, *supra* note 9, at 3.
231. *See supra* Parts IV-V.
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