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## Treading Water: Can Municipal Efforts to Condemn Underwater Mortgages Prevail?

Michael S. Moskowitz

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*“There is nothing which so generally strikes the imagination, and engages the affections of mankind, as the right of property.”<sup>1</sup>*

Sir William Blackstone, 1765.

*“[T]he Sovereign has a greater right over the property of his subjects, where the public good is concerned, than the owners themselves have.”<sup>2</sup>*

Hugo Grotius, 1625.

*“[T]he doctrine of eminent domain is diametrically opposed to the law of God—the law of nature—and embodies the very antithesis of the unalienable right of private property.”<sup>3</sup>*

Gerald R. Thompson, 1990.

I. INTRODUCTION

Across the nation, economic turmoil and the collapse of the housing market have plunged countless homeowners into financial peril.<sup>4</sup> Communities large and small have watched foreclosure signs spring up and have seen the “American Dream” become increasingly elusive.<sup>5</sup> Homes are now worth only a fraction of what families paid, leaving them with hefty mortgage payments for value that simply is not there.<sup>6</sup> Some residents find that their only option is to walk away, defaulting on their debts and severely damaging both their personal credit and the stability of the local economy.<sup>7</sup>

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1. 2 WILLIAM BLACKSTONE, COMMENTARIES \*2.  
2. HUGO GROTIUS, ON THE LAW OF WAR AND PEACE 5 (n.p., Kessinger Publishing 2004) (1625), available at, [http://www.constitution.org/gro/djbp\\_101.htm](http://www.constitution.org/gro/djbp_101.htm).  
3. Gerald R. Thompson, *The Unalienable Right of Property: Examining the Fourth and Fifth Amendments*, 8 J. CHRISTIAN JURISPRUDENCE 189, 202 (1990).  
4. See *infra* Part II.A (summarizing the history of the financial crisis).  
5. See *infra* notes 41–44 and accompanying text.  
6. See *infra* notes 52–53 and accompanying text.  
7. See *infra* note 197.

Leaders in these communities struggle to provide aid to their constituents, usually with little to no success.<sup>8</sup> They feel their pleas fall on deaf ears at the state and federal levels, leaving them to shoulder the burden alone.<sup>9</sup> Government and bank programs provide limited relief, but many remain desperately in need of help.<sup>10</sup>

And desperate times can call for desperate measures. It is in this climate of desperation that some political leaders have turned to unorthodox solutions, willing to take bold action to solve the problems plaguing their citizens.<sup>11</sup> Unbridled boldness, however, does not make a solution the right one. No matter how tempting the proposals marketed by outsiders seem to a vulnerable and desperate community, it is important that the consequences and limitations of those actions be realistically considered. This Comment aims to investigate the legal and practical implications of one of the more radical plans under consideration.

Specifically, it will dissect the controversial new eminent domain proposal engineered by the investment firm Mortgage Resolution Partners (MRP). The firm hopes to utilize the eminent domain power of local municipalities as a creative solution to the recent collapse of the U.S. housing market.<sup>12</sup> This Comment will study the proposal as applied in the case of San Bernardino County (S.B. County). Although S.B. County is just one of the municipalities that have entertained the eminent domain proposal, this county is “ground zero” for the proposal—until recently, it was “widely considered to be the local government furthest along in considering the proposal.”<sup>13</sup> Although the proposal appears to be presently “off the table” in S.B. County,<sup>14</sup> the saga surrounding its potential application there is the ideal case study for thoroughly analyzing the factual and legal issues involved.

Part II provides a brief look at the history of the current financial crisis

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8. See FIN. CRISIS INQUIRY COMM’N, THE FINANCIAL CRISIS INQUIRY REPORT, 405–06 (2011), available at [http://fcic-static.law.stanford.edu/cdn\\_media/fcic-reports/fcic\\_final\\_report\\_full.pdf](http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf); Kevin Jursinski, *The Mortgage Foreclosure Crisis in Florida: A 21st Century Solution*, 84 FLA. B.J. 91, 92 (2010).

9. See *infra* Part II.C–E.

10. See *infra* notes 42–44 and accompanying text.

11. See *infra* Part II.C.

12. See *infra* Part II.C (outlining MRP’s proposal).

13. Alejandro Lazo, *Lt. Gov. Gavin Newsom Alleges ‘Threats’ Against Mortgage Plan*, L.A. TIMES (Sept. 11, 2012), <http://articles.latimes.com/2012/sep/11/business/la-fi-eminent-domain-20120911>.

14. See *infra* Part II.E.

and its effect on S.B. County's local economy; it then walks through the proposed eminent domain plan. Part III provides some of the relevant legal background. Part IV examines the lawfulness of the mortgage condemnation proposal on the state level. Part V measures the proposal against the various protections of the U.S. Constitution. Part VI addresses the impact and significance of the proposal, and Part VII outlines the current state of the issue and briefly concludes.

## II. HISTORY

### A. *The History of the Financial Crisis*

In 2007 and 2008, the burst of the American "housing bubble" prompted the country's longest economic downturn since World War II.<sup>15</sup> Economic and legal commentators present competing theories on how and why the American housing and financial markets collapsed.<sup>16</sup> These suggested causes, to name but a few, include the nation's misguided monetary policy, a global savings surplus, government policies encouraging affordable homeownership, irrational consumer expectations of rising housing prices, and an inelastic housing supply.<sup>17</sup>

In May of 2009, Congress created the Financial Crisis Inquiry Commission (FCIC) to officially "examine the financial and economic crisis . . . and explain its causes to the American people."<sup>18</sup> The FCIC's published

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15. *Business Cycle Dating Committee Report*, NAT'L BUREAU OF ECON. RESEARCH 1 (Sept. 20, 2010), <http://www.nber.org/cycles/sept2010.pdf>. The committee determined that the original recession, which began in December of 2007, ended eighteen months later, in June of 2009. *Id.*

16. *See, e.g.*, Major Coleman IV et al., *Subprime Lending and the Housing Bubble: Tail Wags Dog?*, 17 J. HOUSING ECON. 272 (2008) (proposing that the housing bubble was caused jointly by the subprime market, house price increases, and the changing institutional, political, and regulatory environment of the time); Edward L. Glaeser et al., *Can Cheap Credit Explain the Housing Boom?*, in HOUSING AND THE FINANCIAL CRISIS 301 (Edward L. Glaeser & Todd Sinai eds., 2013) (finding that low interest rates explain only one-fifth of the rise in home prices); Adam J. Levitin & Susan M. Wachter, *Explaining the Housing Bubble*, 100 GEO. L.J. 1177 (2012) (positing a supply-side cause to the crisis); Dale Arthur Oesterle, *The Collapse of Fannie Mae and Freddie Mac: Victims or Villains?*, 5 ENTREPRENEURIAL BUS. L.J. 733 (2010) (explaining the roles that Fannie Mae and Freddie Mac played in the crisis and noting specifically that extreme increases in residential mortgage defaults triggered the recession in 2008).

17. Levitin & Wachter, *supra* note 16, at 1179–80.

18. *See* FIN. CRISIS INQUIRY COMM'N, *supra* note 8, at xv. Unfortunately, even the congressional report does not provide a definitive opinion: four of the ten members dissented from

report concluded that the crisis was avoidable, the result of “human action and inaction,” and named as contributing causes: (1) failures in financial regulation and supervision;<sup>19</sup> (2) failures of corporate governance and risk management at key financial institutions; and (3) a combination of excessive borrowing, risky investments, and lack of transparency.<sup>20</sup> It also accused the federal government of being “ill prepared” and blamed its “inconsistent response” for contributing to uncertainty and panic in the financial markets.<sup>21</sup>

The one thing that commentators *can* agree on, however, is that one of the greatest contributors to this economic collapse was the failure of the mortgage-backed securities (MBSs) market.<sup>22</sup> MBSs are asset-backed interests secured by a mortgage or, more frequently, a number of mortgages in a pool.<sup>23</sup> First issued in the 1970s, they have traditionally been used as a means for smaller financial institutions to reduce the inherent risks of mortgage lending by selling their interests as mortgagees to the investing public.<sup>24</sup> For these mortgage originators, the MBS system was a proverbial

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the report’s conclusions. *Id.* at 411–39.

In an interesting twist, FCIC chairman Phil Angelides originally became the executive chairman of Mortgage Resolution Partners, the investment firm behind the eminent domain scheme discussed in this Comment. Matthew Goldstein & Jennifer Ablan, *Exclusive: Angelides to Lead Distressed Mortgage Firm*, REUTERS (Jan. 13, 2012), <http://www.reuters.com/article/2012/01/13/us-usa-housing-angelides-idUSTRE80C26820120113> [hereinafter Goldstein & Ablan, *Angelides to Lead Distressed Mortgage Firm*]; see also *infra* notes 56–66 and accompanying text (discussing the eminent domain proposal). This appointment was controversial primarily because, in its fundraising materials, Mortgage Resolution Partners touted its ability to use its “secret formula” of “legal and political leverage” in negotiating its deals with municipalities. Matthew Goldstein & Jennifer Ablan, *Phil Angelides Gives Up His “Secret Formula”*, REUTERS (Feb. 13, 2012), <http://blogs.reuters.com/unstructuredfinance/2012/02/13/phil-angelides-gives-up-his-secret-formula/> [hereinafter Goldstein, *Phil Angelides Gives Up His “Secret Formula”*] (internal quotation marks omitted). Angelides eventually resigned from his position with the investment firm. See *infra* notes 83–87 and accompanying text (describing the political objection to this relationship).

19. FIN. CRISIS INQUIRY COMM’N, *supra* note 8, at xvii–xviii (specifically citing failures by the Securities and Exchange Commission and the Federal Reserve Bank of New York).

20. *Id.* at xvi–xx.

21. *Id.* at xxi.

22. See, e.g., Kurt Eggert, *The Great Collapse: How Securitization Caused the Subprime Meltdown*, 41 CONN. L. REV. 1257, 1259 (2009).

23. See Ronald Greenspan & William Nolan, *Description of the Mortgage and Asset-Backed Securities Markets, Roles of Principal Participants and Key Terms*, in MORTGAGE AND ASSET BACKED SECURITIES LITIGATION HANDBOOK § 1:1 (Talcott J. Franklin & Thomas F. Nealon III eds., 2012).

24. *Id.*; see also *Times Topics: Mortgage-Backed Securities*, N.Y. TIMES, <http://topics.ny>

golden goose—by selling their mortgage interests for inclusion in MBS pools, they would receive immediate revenue from mortgages (instead of waiting years for full payment) while completely avoiding the risk of the homeowner defaulting; with that money in hand, the originators could make new loans to prospective homeowners, and begin the cycle again.<sup>25</sup>

For decades, these MBSs were viewed as extremely safe investments.<sup>26</sup> As this “secondary mortgage market”<sup>27</sup> grew, the MBSs became more complicated in form, more companies began to securitize mortgages, and the lending standards of the underlying mortgages began to fall.<sup>28</sup> Investment banks began to issue their own “private label” MBSs (PLSs) that comprised “nonconforming” or “subprime” loans with reduced underwriting standards—loans not guaranteed by government-sponsored mortgage entities (GSEs) Fannie Mae or Freddie Mac.<sup>29</sup> At first, the investing community viewed PLSs skeptically,<sup>30</sup> but, due primarily to the support of ratings agencies,<sup>31</sup> they soon became widely successful.<sup>32</sup> Eventually, Fannie Mae and Freddie Mac followed suit by lowering their own underwriting

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times.com/top/reference/timestopics/subjects/m/mortgage-backed-securities/index.html (last visited Jan. 11, 2014) (providing various links to additional pages and news articles discussing MBSs).

25. See, e.g., Chris Wilson, *What Is a Mortgage-Backed Security?: The Financial Instrument that Destroyed Bear Stearns*, SLATE (Mar. 17, 2008), [http://www.slate.com/articles/news\\_and\\_politics/explainer/2008/03/what\\_is\\_a\\_mortgagebacked\\_security.html](http://www.slate.com/articles/news_and_politics/explainer/2008/03/what_is_a_mortgagebacked_security.html).

26. See *id.* (“When the housing market is doing well and interest rates are low, investing in a mortgage-backed security is a fairly safe bet.”). This was due in part to the high ratings assigned to them by credit rating agencies like Standard & Poor’s (S&P), Moody’s, and Fitch. See *infra* note 38 (expanding on the role of these agencies).

27. An appropriate definition of “secondary mortgage market” is “the purchase and sale of MBS[s] either upon their issuance or between market participants.” THOMAS P. LEMKE ET AL., MORTGAGE-BACKED SECURITIES § 5:1 (2013).

28. Tyler R. Morgan, *The Refinancing Crisis in Commercial Real Estate: Dodd-Frank Threatens to Curtail CMBS Lending*, 13 TRANSACTIONS: TENN. J. BUS. L. 361, 374 (2012); see also FIN. CRISIS INQUIRY COMM’N, *supra* note 8, at xxiii (naming this as one of the failures leading to the financial crisis).

29. See Patricia A. McCoy et al., *Systematic Risk Through Securitization: The Result of Deregulation and Regulatory Failure*, 41 CONN. L. REV. 1327, 1331 (2009) (“In contrast [with GSEs], private-label securitizers did not issue guarantees of credit risk.”).

30. See generally Donald C. Langevoort, *Editor’s Introduction: Responding to the Financial Crisis*, 2010 SEC. L.R. § 1:2 (Donald C. Langevoort ed., 2010) (“While GSE-issued certificates were considered near-substitutes for U.S. Treasury securities, private label securities could not immediately instill confidence.”).

31. See *infra* note 38 and accompanying text.

32. See McCoy, *supra* note 29, at 1330 (noting that PLS issuance rose from 24% of all MBSs in 2003 to 55% in 2005, amounting to \$1.19 trillion in loans).

standards.<sup>33</sup> Banks responded by creating “collateralized mortgage [or debt] obligations,”<sup>34</sup> in which the shares in an MBS were organized into different “tranches” according to the perceived risk.<sup>35</sup>

MBSs fell into a dangerous cycle—repeatedly sold, resecuritized, restructured, and resold—theoretically spreading the risk of any individual homeowner defaulting so thin that it became practically non-existent.<sup>36</sup> Eventually, it became impossible for investors to identify the original mortgages backing their securities, or their quality, forcing them to rely on credit rating agencies to determine MBS value.<sup>37</sup> For a variety of reasons, these ratings agencies had been inflating the ratings on even very risky classes of MBSs.<sup>38</sup> These high ratings made the MBSs all the more

33. Other factors also played a role in these lower standards: a major source was pressure from the Department of Housing and Urban Development (HUD). Richard E. Mendales, *The Fall and Rise of Fannie and Freddie: Securitization After the Meltdown*, 42 No.1 UCC L.J. art. 2 (2009) (“Despite warnings that [MBSs] based on subprime mortgages were significantly more prone to default than other such securities, [HUD], seeking to aid lower-income families in finding housing, pressed the GSEs first to buy lower-grade mortgages . . . and then securities backed by subprime mortgages . . .”).

According to the FCIC, Fannie Mae and Freddie Mac “relaxed their underwriting standards to purchase or guarantee riskier loans and related securities in order to meet stock market analysts’ and investors’ expectations for growth, to regain market share, and to ensure generous compensation for their executives and employees.” FIN. CRISIS INQUIRY COMM’N, *supra* note 8, at xxvi.

34. Mendales, *supra* note 33.

35. FIN. CRISIS INQUIRY COMM’N, *supra* note 8, at 43.

36. Eggert, *supra* note 22, at 1265.

37. *Id.* For example, the 3,500 loans targeted in S.B. County, *supra* Part II.B–C, were reportedly placed into 2,000 separate trusts, which then issued 17,000 separate trust certificates (backed by the loans), which were then sold to various investors. Tad Friend, *Letter from California, Home Economics: Can an Entrepreneur’s Audacious Plan Fix the Mortgage Mess?*, NEW YORKER, Feb. 4, 2013, at 26, 27.

38. See Eggert, *supra* note 22, at 1298–1303. A large part of the problem stemmed from conflicts of interests—the ratings agencies were *paid* by the entities whose securities they rated. Mendales, *supra* note 33. They gave investment-grade ratings to most of the GSEs’ MBSs, even when the mortgages backing the securities were of low quality. *Id.*

The overrating of MBSs was another major contributor to the financial meltdown. FIN. CRISIS INQUIRY COMM’N, *supra* note 8, at xxv (“We conclude the failures of credit rating agencies were essential cogs in the wheel of financial destruction.”). In what would be the first suit of its kind, the U.S. Justice Department plans to file civil charges against S&P’s Ratings Services, reportedly accusing it of “knowingly and with the intent to defraud, devised, participated in, and executed a scheme to defraud investors.” Andrew Ross Sorkin & Mary Williams Walsh, *U.S. Accuses S. & P. of Fraud in Suit on Loan Bundles*, N.Y. TIMES (Feb. 4, 2013), <http://dealbook.nytimes.com/2013/02/04/u-s-and-states-prepare-to-sue-s-p-over-mortgage-ratings/?hp>.



attractive to investors, further boosting their popularity and value.<sup>39</sup>

The MBS system was not entirely unlike the classic pyramid scheme—it could not be sustained forever.<sup>40</sup> When the housing bubble burst and homeowners around the nation defaulted on their loans, the unforeseen spike in foreclosure rates unveiled the flaws in the MBS system; the loss of the hundreds of billions of dollars invested in these questionable MBSs “shook markets as well as financial institutions that had significant exposures to those mortgages.”<sup>41</sup>

As of the publication date of the FCIC Report,<sup>42</sup> about four million families had lost their homes to foreclosure in the wake of the housing bubble burst, and another four and a half million were delinquent in or had defaulted on their mortgage payments.<sup>43</sup> Cities and counties across the country remain in dire straits and still desperately seek a solution to the housing woes plaguing their communities.<sup>44</sup>

#### B. San Bernardino County’s Economic Situation

The burst of the housing bubble rocked few spots in the country more severely than S.B. County.<sup>45</sup> After decades of high unemployment and low incomes, the national housing boom of the 1990s and 2000s gave a much-needed boost to S.B. County’s economy.<sup>46</sup> House prices skyrocketed (homes could sometimes be “flipped” for profit over the course of a few days), peaking in about 2006, investors saturated the local housing market,

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39. Many financial institutions “loaded up on” these risky mortgages and MBSs in the years preceding the crisis. FIN. CRISIS INQUIRY COMM’N, *supra* note 8, at xxv. Lehman Brothers, for example, had amassed \$111 billion in them (four times the institution’s total equity). *Id.* at xx.

40. For an explanation of a “pyramid scheme” in the context of financial investments, see *What is a Pyramid Scheme?*, INVESTOPEDIA (Dec. 16, 2009), <http://www.investopedia.com/articles/04/042104.asp>

41. FIN. CRISIS INQUIRY COMM’N, *supra* note 8, at xvi.

42. See *supra* notes 18–21 and accompanying text.

43. FIN. CRISIS INQUIRY COMM’N, *supra* note 8, at xv.

44. This may explain the open-minded approach many municipalities have taken to the MRP proposal. See *infra* notes 76–77 and accompanying text (describing positive responses of local politicians to the eminent domain scheme).

45. 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](http://www.huffingtonpost.com/2012/09/01/eminent-domain-mortgages_n_1836710.html) [hereinafter Hallman, *Fight Closely Watched*].

46. See *id.*

and jobs related to the industry flooded into the area.<sup>47</sup>

When the housing bubble burst, the county's skyrocketing housing-market-based economy rapidly collapsed and the inflated value of homes plummeted.<sup>48</sup> Even now, five years later, the county is struggling. Unemployment and foreclosures in S.B. County hit all-time highs: when the nationwide unemployment rate was 8.1% in August of 2012,<sup>49</sup> the rate in the Riverside–San Bernardino–Ontario metropolitan area remained as high as 12.3%.<sup>50</sup> Meanwhile, the value of homes continued to sink; the median value of homes in the area, which peaked in 2006 at \$382,000, is now hovering around \$167,800.<sup>51</sup> Many mortgages acquired or refinanced by homeowners around the 2006 peak were deeply “underwater”—where the owner's equity in the house is less than the value still owed to the lender.<sup>52</sup> Reports released in June of 2012 put S.B. County in the top 5% of counties in the nation for percent of homes underwater.<sup>53</sup> Reports published in late 2012 suggest that 2013 will be a slightly brighter year for S.B. County.<sup>54</sup> Home prices are rising and foreclosure rates are declining throughout the country; in S.B. County itself, the number of defaulted loans dropped nearly 22%—the lowest since 2007.<sup>55</sup>

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47. See *id.* A recent *New Yorker* article discussing the MRP proposal dubbed California the “Barbary Coast of loan originators.” Friend, *supra* note 37, at 26. S.B. County in particular had become an investing hot spot because of its “cheap dirt.” *Id.* at 29.

48. *Id.* at 29. (“After housing prices in the area tripled between 2000 and 2006, the subsequent plunge cut them by more than half . . . . The ebb tide left only the shells of broken subdivisions . . . .”).

49. *Databases, Tables & Calculators by Subject*, BUREAU OF LABOR STATISTICS, <http://data.bls.gov/timeseries/LNS14000000> (last visited Jan. 13, 2013).

50. *News Release—Wednesday, October 3, 2012*, BUREAU OF LABOR STATISTICS (Oct. 12, 2012), [http://www.bls.gov/news.release/archives/metro\\_10032012.pdf](http://www.bls.gov/news.release/archives/metro_10032012.pdf).

51. Hallman, *Fight Closely Watched*, *supra* note 45. But see *infra* notes 54–55 and accompanying text.

52. *Underwater Mortgage*, INVESTOPEDIA, <http://www.investopedia.com/terms/u/underwater-mortgage.asp> (last visited Jan. 14, 2014).

53. ZILLOW REAL ESTATE RESEARCH, NEGATIVE EQUITY REPORT (June 2012). This research puts the percent of homes underwater at 52% for S.B. County, as compared to just 30.9% of homes for the U.S. overall. *Id.* at 1.

54. See THE CMTY. FOUND., SAN BERNARDINO COUNTY 2012 COMMUNITY INDICATORS REPORT 8, 27–28 (2012), available at [http://www.sbcounty.gov/uploads/cao/feature/content/2012\\_cir\\_sb.pdf](http://www.sbcounty.gov/uploads/cao/feature/content/2012_cir_sb.pdf); see also *infra* notes 188–90 and accompanying text.

55. See Joe Nelson, *Homeownership Protection Program JPA Cancels October Meeting*, SAN BERNARDINO COUNTY SUN (Oct. 21, 2012), [http://www.sbsun.com/ci\\_21832939/homeownership-protection-program-jpa-cancels-october-meeting](http://www.sbsun.com/ci_21832939/homeownership-protection-program-jpa-cancels-october-meeting).

C. *The Eminent Domain Proposal*

Enter Mortgage Resolution Partners (MRP), the private, San Francisco-based venture fund behind the eminent domain proposal that drew consideration from S.B. County.<sup>56</sup> After pitching the program to S.B. County CEO Greg Devereaux in the fall of the 2011,<sup>57</sup> the county Board of Directors publicly discussed it in a June 2012 meeting.<sup>58</sup> MRP's eminent domain proposal, dubbed the CARES (Community Action to Restore Equity and Stability) Program:

- Assists communities in using their power of eminent domain to acquire underwater mortgage loans and offering to refinance them into sustainable loans with lower principal balances.
- Prevents the costs to communities and neighbors of future defaults and foreclosures.
- Is voluntary; does not affect homeowners who choose not to refinance.
- Is privately funded, requires no taxes or funding from communities or homeowners.
- Targets loans trapped in private securitization trusts; avoids mortgages whose owners have broad powers to reduce principal, such as banks and government agencies.
- Creates incentives for homeowners to maintain their good credit to qualify for the program. Many other mortgage programs require borrowers to default before

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56. MORTGAGE RESOLUTION PARTNERS, <http://mortgageresolution.com> (last visited Jan. 14, 2014). In its own words, MRP is a "Community Advisory firm working to stabilize local housing markets and economies by keeping as many homeowners with underwater mortgages in their homes as possible." *Id.*

57. Friend, *supra* note 37, at 29. An early proponent of the plan, Devereaux was ultimately the one to announce its abandonment. *See infra* notes 97–101.

58. Andrew Edwards, *Mortgage Resolution Partners Executive Defends Eminent Domain Proposal*, SAN BERNARDINO COUNTY SUN (July 25, 2012, 9:00 PM), [http://www.sbsun.com/ci\\_21168357/mortgage-resolution-partners-executive-defends-eminent-domain-proposal](http://www.sbsun.com/ci_21168357/mortgage-resolution-partners-executive-defends-eminent-domain-proposal). In addition to Devereaux, California Lieutenant Governor Gavin Newsom was an early supporter of MRP's plan. Friend, *supra* note 37, at 29. The meeting's minutes are available on the county's website: [http://sanbernardino.granicus.com/MediaPlayer.php?view\\_id=13&clip\\_id=2444](http://sanbernardino.granicus.com/MediaPlayer.php?view_id=13&clip_id=2444) (last visited Jan. 14, 2014).

considering their needs.

- Is designed and controlled by each local government, which chooses the loans and methods for resolving them to meet local needs.<sup>59</sup>

In short, MRP plans to raise money from private investors<sup>60</sup> and then front that money to a municipality for the purpose of compensating mortgage holders for the condemned loans.<sup>61</sup> MRP would receive a \$4,500 flat fee per loan in addition to return on their investment.<sup>62</sup> According to MRP, the firm itself does not earn any profit share.<sup>63</sup> The county would then use its power of eminent domain to condemn specific mortgages.<sup>64</sup> Once the municipality acquires the loans, homeowners could refinance these mortgages at a lower principal, reducing mortgage payments.<sup>65</sup> The plan would have applied to approximately 10% of S.B. County loans held in private security trusts.<sup>66</sup>

On June 19, 2012, the S.B. County Board of Supervisors took its first steps toward implementing the MRP proposal.<sup>67</sup> Along with the cities of

59. MORTGAGE RESOLUTION PARTNERS, *supra* note 56.

60. 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> [hereinafter Goldstein & Ablan, *Investors Tout Controversial "Condemnation"*]. MRP is apparently working with investment banks Evercore Partners, Inc. and Westwood Capital to find the institutional investors needed to finance the plan. *Id.*

61. *See infra* notes 230–42 (discussing compensation requirements on the state level), 263–66 (discussing federal compensation requirements).

62. Ben Hallman, *San Bernardino Eminent Domain Proposal Arousing Concern from Mortgage Industry*, HUFFINGTON POST (Aug. 16, 2012), [http://www.huffingtonpost.com/2012/08/16/san-bernardino-eminent-domain\\_n\\_1791773.html](http://www.huffingtonpost.com/2012/08/16/san-bernardino-eminent-domain_n_1791773.html) [hereinafter Hallman, *Proposal Arousing Concern*].

63. *Fact or Fiction*, MORTGAGE RESOLUTION PARTNERS, <http://mortgageresolution.com/fact-or-fiction> (last visited Jan. 14, 2014). However, MRP claims the loans would likely generate a 20% annual return for its investors. Goldstein & Ablan, *Angelides to Lead Distressed Mortgage Firm*, *supra* note 18.

64. Hallman, *Proposal Arousing Concern*, *supra* note 62.

65. *Id.*

66. *Id.* However, homeowners would not *have* to refinance their loans, and could choose to continue to make payments on the existing loans. *FAQs: What Rights and Obligations Will Homeowners Have When the Local Government Acquires Their Loans? What Happens to Homeowners Who Do Not Refinance?*, MORTGAGE RESOLUTION PARTNERS, <http://mortgageresolution.com/faqs> (last visited Jan. 19, 2014).

67. HOMEOWNERSHIP PROTECTION PROGRAM JOINT POWERS AUTHORITY, FIRST AMENDED AND RESTATED JOINT EXERCISE OF POWERS AGREEMENT § 4 (June 19, 2012) [hereinafter JPA

Ontario and Fontana, the county created the Homeownership Protection Program Joint Powers Authority (JPA).<sup>68</sup> The JPA was authorized to use the joint powers of all three government entities (S.B. County, Ontario, and Fontana),<sup>69</sup> including the use of eminent domain.<sup>70</sup> The JPA Agreement granted it all the powers necessary to implement the MRP proposal. Among other things, it authorized the JPA to “acquire by voluntary purchase, gift, eminent domain, or otherwise home loans,”<sup>71</sup> to “own, maintain, and manage home loans . . . including, but not limited to, modification, restructuring, hypothecating, assigning, pledging, securitizing, conveying, and reconveying,”<sup>72</sup> to “receive contributions and donations of property, funds, services, and other forms of assistance from any source,”<sup>73</sup> and to “assign, delegate, or contract with a Party or third party to perform any of the rights and duties of the Board.”<sup>74</sup>

#### D. The Backlash

When word that S.B. County was considering the MRP proposal went public, the backlash was fast and ferocious. Politicians on the local, state, and federal levels voiced strong opinions on the plan; industry representatives vehemently opposed it; and commentators from various sectors added their two cents to the nationwide debate.<sup>75</sup>

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AGREEMENT], available at <http://www.homeownershipjpa.org/Portals/18/Documents/Agreement.pdf>.

68. *Id.* The City of Hesperia had also considered joining the JPA, but voted on June 5, 2012 not to participate. Goldstein & Ablan, *Investors Tout Controversial “Condemnation”*, *supra* note 60.

69. See CAL. GOV’T CODE § 6502 (West 2008) (“If authorized by their [legislature] . . . two or more public agencies by agreement may jointly exercise any power common to the contracting parties . . .”).

70. JPA AGREEMENT, *supra* note 67, § 4(d).

71. *Id.* This authorizes the condemnation aspect of the proposal and would allow the county to subsequently transfer the mortgages to a servicer, presumably MRP. See *supra* note 64 and accompanying text.

72. JPA AGREEMENT, *supra* note 67, § 4(e). This section would give the JPA the power to restructure the loans at reduced principals under the MRP proposal.

73. *Id.* at § 4(i). This power would allow MRP to contribute the funds that the county would need to condemn the selected loans.

74. *Id.* at § 4(l). Possibly the most controversial section, this would allow the JPA to transfer any of its powers directly to MRP.

75. The *Wall Street Journal* published a few memorable critiques, calling the plan, among other things, “grand theft mortgage” and “an eminently bad idea.” See *Grand Theft Mortgage: American Enterprise Institute Fellow Ed Pinto on California Cities that Want to Seize and Refinance*

Leaders of economically troubled municipalities generally supported the plan, or at least expressed cautious optimism. Sacramento Vice Mayor Angelique Ashby, for example, was vocal in her support of the MRP proposal, and her desire to bring the plan to Sacramento.<sup>76</sup> The proposal also piqued the interest of other California communities, like Elk Grove—Gary Davis, an Elk Grove city councilman, reportedly spoke with MRP and was “intrigued” by the plan.<sup>77</sup> At present, at least one community has actually voted to enact the proposal: Richmond, California.<sup>78</sup> However, at least one high-profile local politician has expressly rejected the plan: Chicago Mayor Rahm Emanuel.<sup>79</sup> After considering MRP’s proposal, which could affect as many as 20,000 Chicago homeowners, Emanuel decided that the MRP plan was not “the right way to address the problem,” telling reporters: “I don’t think it’s the power of the city . . . to deal with the housing issue. We have a national issue. I think we have to address the issue. I just don’t think that’s the right instrument.”<sup>80</sup>

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*Mortgages Under the Auspices of Eminent Domain*, WALL ST. J. (July 5, 2012), <http://live.wsj.com/video/opinion-grand-theft-mortgage/8CC3E75C-2DA4-4550-B3C0-97D78CA74902.html#!8CC3E75C-2DA4-4550-B3C0-97D78CA74902>; *An Eminently Bad Idea*, WALL ST. J. (July 12, 2012), at A16.

76. Peter S. Goodman, *Eminent Domain as Underwater Mortgages Fix: Why Some Cities Are Considering Unorthodox Measure*, HUFFINGTON POST (Oct. 1, 2012), [http://www.huffingtonpost.com/2012/10/01/eminent-domain-mortgages\\_n\\_1917391.html](http://www.huffingtonpost.com/2012/10/01/eminent-domain-mortgages_n_1917391.html). In an interview with the *Sacramento Bee*, Ashby explained that her community “is one of the worst-hit communities in the country,” giving vivid examples of struggling homeowners in her neighborhood. Hudson Sangree, *Sacramento Area Officials Explore Using Eminent Domain to Aid Underwater Homeowners*, SACRAMENTO BEE (Aug. 11, 2012), at 1A, available at <http://www.sacbee.com/2012/08/11/4715792/sacramento-area-officials-explore.html>.

77. Sangree, *supra* note 76 (“I’m intrigued by the notion . . . . We’re engaged in a conversation with [MRP] to better understand it.”).

78. Jim Christie, *California City Backs Plan to Seize Negative Equity Mortgages*, REUTERS (Sept. 11, 2013), <http://www.reuters.com/article/2013/09/11/us-richmond-eminentdomain-idUSBRE98A0FN20130911>; *Judge Dismisses Lawsuit Against Richmond, California Mortgage Plan*, REUTERS (Sept. 16, 2013), <http://www.reuters.com/article/2013/09/16/us-usa-mortgages-ruling-idUSBRE98F12M20130916> [hereinafter *Judge Dismisses Lawsuit Against Richmond*].

79. Mary Ellen Podmolik & John Byrne, *Emanuel: Eminent Domain Not ‘The Right Instrument’ to Address Underwater Mortgages*, CHI. TRIBUNE (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](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).

80. *Id.* Emanuel’s willingness to defer to federal authority on the issue might be attributable to his former roles in Washington as a U.S. Congressman from Illinois and President Obama’s Chief of Staff. Jeff Zeleny & Peter Baker, *Rahm Emanuel Accepts Chief of Staff Post*, N.Y. TIMES (Nov. 6, 2008), <http://www.nytimes.com/2008/11/06/us/politics/07elect.html>.

At the state level, California Lieutenant Governor Gavin Newsom—while not expressly endorsing the plan—encourages “bold action” in solving the crisis, and vocally defended S.B. County’s consideration of the proposal.<sup>81</sup> Newsom went as far as complaining to the U.S. Department of Justice’s antitrust division when he believed the mortgage and finance industries, as well as the federal government, had threatened the communities considering the plan.<sup>82</sup>

The federal government more vehemently opposed the MRP proposal. Some politicians, like U.S. Representative Patrick McHenry, a Republican from North Carolina, have challenged MRP’s financial motivation and the potential for corruption.<sup>83</sup> McHenry complained in a letter to the Secretary of Housing and Urban Development, Shaun Donovan, about the risks of “cronyism or conflicts” associated with MRP,<sup>84</sup> and asked for information on the preventative steps being taken.<sup>85</sup> The controversy erupted after MRP, in soliciting funding, touted its ability to use “legal and political leverage” in negotiating its deals with municipalities.<sup>86</sup> Angelides eventually left MRP,

81. Andrew Edwards, *California’s Lieutenant Governor Steps into Mortgage Debate*, SAN BERNARDINO COUNTY SUN (July 26, 2012), [http://www.sbsun.com/ci\\_21177556/californias-lieutenant-governor-steps-into-mortgage-debate?IADID=Search-www.sbsun.com-www.sbsun.com](http://www.sbsun.com/ci_21177556/californias-lieutenant-governor-steps-into-mortgage-debate?IADID=Search-www.sbsun.com-www.sbsun.com). In a phone interview, Newsom told the *San Bernardino County Sun* that: “The economy in our state is not going to rebound until we address the number one thing holding us back, and that’s these homes that are underwater.” *Id.*

82. Newsom’s letter read, in part: “I am most disturbed by the threats leveled by the mortgage industry and some in the federal government who have coercively urged local governments to reject consideration of any proposal that would exercise the powers constitutionally granted local governments to use eminent domain.” Lazo, *supra* note 13; *see also infra* notes 88–90 (discussing federal legislation against the MRP proposal).

83. Matthew Goldstein & Jennifer Ablan, *Financial Crisis Chair Angelides Quits Mortgage Firm*, REUTERS (Feb. 13, 2012), <http://www.reuters.com/article/2012/02/13/us-mortgages-angelides-idUSTRE81C20A20120213> [hereinafter Goldstein & Ablan, *Angelides Quits Mortgage Firm*]. Representative McHenry is the chairman of the House Oversight and Government Reform subcommittee on the Troubled Asset Relief Program (TARP). *Id.* Among other functions (like overseeing government bailouts), TARP manages the Making Home Affordable (MHA) program—which it created to provide mortgage relief to homeowners and prevent avoidable foreclosures—and its cornerstone program, the Home Affordable Modification Program (HAMP). *Housing*, U.S. DEP’T OF THE TREASURY, <http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/pages/default.aspx> (last visited Jan. 16, 2014). HAMP “reduces [homeowners’] mortgage payments to affordable levels for qualifying borrowers” and is the primary federal competitor to the MRP proposal. *Id.*

84. Goldstein & Ablan, *Phil Angelides Gives Up His “Secret Formula”*, *supra* note 18.

85. Goldstein & Ablan, *Angelides Quits Mortgage Firm*, *supra* note 83.

86. Goldstein, *Phil Angelides Gives Up His “Secret Formula”*, *supra* note 18 (noting that

but Representative McHenry insisted that he still wanted Donovan to respond to his questions.<sup>87</sup> In a more extreme reaction to the plan, U.S. Representative John Campbell, a Republican from California, introduced a bill in the House of Representatives intended to discourage municipalities from taking action like that featured in MRP's proposal.<sup>88</sup> The goal of the bill, creatively named the Defending American Taxpayers from Abusive Government Takings Act, was:

To prohibit Fannie Mae and Freddie Mac from purchasing, the FHA from insuring, and the Department of Veterans Affairs from guaranteeing, making, or insuring, a mortgage that is secured by a residence or residential structure located in a county in which the State has used the power of eminent domain to take a residential mortgage.<sup>89</sup>

The bill currently rests with the House Financial Services Committee, its fate to be determined at some later date.<sup>90</sup>

Another instrumentality of the federal government has also expressed disapproval of the plan: the Federal Housing Finance Agency (FHFA). The FHFA, which rejected a principal reduction strategy similar to MRP's for GSE loans,<sup>91</sup> published in the Federal Register that:

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Angelides "quietly stepped down from the firm" about two weeks after the story of his involvement was published on Reuters).

87. *Id.*

88. H.R. 6397, 112th Cong. (2012), available at <http://www.govtrack.us/congress/bills/112/hr6397> (last visited Jan. 16, 2014). The bill, cosponsored by eleven other House Republicans, was introduced on September 13, 2012 and referred to the House Committee on Financial Services. *Id.*; see also Jann Swanson, *Congress Gets Bill Prohibiting Eminent Domain Mortgage Seizures*, MORTGAGE NEWS DAILY (Sept. 13, 2012), [http://www.mortgagenewsdaily.com/09132012\\_emanent\\_domain\\_loan\\_mods.asp](http://www.mortgagenewsdaily.com/09132012_emanent_domain_loan_mods.asp). The bill was re-introduced as H.R. 2733 on July 18, 2013 and has an estimated 2% chance of being enacted. H.R. 2733, 112th Cong. (2013), available at <https://www.govtrack.us/congress/bills/113/hr2733> (last visited Jan. 16, 2014).

89. H.R. 6397. This bill was one of the actions challenged by Gavin Newsom as being retaliatory. See *supra* notes 81–82 and accompanying text.

90. H.R. 2733.

91. Letter from Edward J. DeMarco, Acting Director, FHFA, to the Committee on Banking, Housing, and Urban Affairs (July 31, 2012) [hereinafter Letter from Edward J. DeMarco], available at [http://www.fhfa.gov/webfiles/24110/PF\\_LettertoCong73112.pdf](http://www.fhfa.gov/webfiles/24110/PF_LettertoCong73112.pdf). The letter read, in part:

After much study, I have concluded that [the GSEs'] adoption of [this principal reduction plan] would not make a meaningful improvement in reducing foreclosures in a cost effective way for taxpayers.

...  
... [The] longer-term view by investors that the mortgage contract is less



FHFA has significant concerns about the use of eminent domain to revise existing financial contracts and the alteration of the value of [GSE] or Bank securities holdings. . . .

FHFA has determined that action may be necessary on its part as conservator for the [GSEs] 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.<sup>92</sup>

Not surprisingly, the strongest opposition comes from those with the most to lose from the MRP plan—the industries currently owning, servicing, and profiting from the considered mortgages. Most notable is the Securities Industry and Financial Markets Association (SIFMA). In its official position statement on the topic, SIFMA “strongly object[ed] to any proposed use of eminent domain to take mortgage loans out of securitized pools.”<sup>93</sup> In the same statement, SIFMA also explained that “[e]minent domain stands to hurt the very borrowers it seeks to help; there are better alternatives.”<sup>94</sup>

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secure than ever before . . . could lead to higher mortgage rates, a constriction in mortgage credit lending or both, outcomes that would be inconsistent with FHFA’s mandate to promote stability and liquidity in mortgage markets and access to mortgage credit.

*Id.* at 1, 4.

92. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 47652 (Aug. 9, 2012), available at <http://www.gpo.gov/fdsys/pkg/FR-2012-08-09/pdf/2012-19566.pdf>.

93. *Eminent Domain Resource Center*, SEC. INDUS. & FIN. MKTS. ASS’N, <http://www.sifma.org/issues/capital-markets/securitization/eminent-domain/overview/> (last visited Jan. 17, 2014).

94. *Id.*

Along with twenty-five other trade organizations,<sup>95</sup> SIFMA submitted a joint response to the FHFA's request for comments on the proposed eminent domain solution, citing as objectionable the impact of such a plan on mortgage markets and mortgage investors; the valuation and profit motivation that underlies the plan; and the various legal issues discussed in this Comment.<sup>96</sup>

*E. The Demise of the Proposal (for S.B. County)*

On January 24, 2013 the JPA board met to discuss, among other things, whether it would actually pursue the MRP eminent domain proposal.<sup>97</sup> After months of debate, the JPA board voted unanimously not to consider the MRP proposal further.<sup>98</sup> Greg Devereaux, chairman of the JPA and county CEO—the same Greg Devereaux that instigated the MRP dialog months earlier<sup>99</sup>—announced that the JPA would be “taking [the proposal] off the table” due to a lack of public support.<sup>100</sup> David Wert, spokesman for S.B.

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95. Letter from SIFMA et al. to Alfred Pollard, General Counsel, FHFA (Sept. 7, 2012), available at <http://www.sifma.org/workarea/downloadasset.aspx?id=8589940214> [hereinafter Letter from SIFMA]. These include trade organizations like the American Bankers Association, the California Bankers Association, the Consumer Bankers Association, the Association of Mortgage Investors, and the American Insurance Association. *Id.*

96. *Id.*

97. 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> [hereinafter Lazo, *County Abandons Eminent Domain Mortgage Plan*]; see also Meeting Agenda for January 24, 2013, Homeownership Prot. Program Joint Powers Auth. (Jan. 24, 2013), available at [http://sanbernardino.granicus.com/MediaPlayer.php?publish\\_id=531](http://sanbernardino.granicus.com/MediaPlayer.php?publish_id=531); Press Release, Homeownership Prot. Program JPA, JPA Declines to Consider Eminent Domain Proposals, (Jan. 24, 2013), available at [http://www.sbcounty.gov/uploads/CAO/pressreleases/content/JPA\\_RFQ\\_PR\\_1-24-13.pdf](http://www.sbcounty.gov/uploads/CAO/pressreleases/content/JPA_RFQ_PR_1-24-13.pdf) [hereinafter JPA Press Release].

98. Lazo, *County Abandons Eminent Domain Mortgage Plan*, *supra* note 97.

99. See *supra* notes 57–58 and accompanying text.

100. Lazo, *County Abandons Eminent Domain Mortgage Plan*, *supra* note 97. “Devereaux also echoed criticisms by the mortgage industry and Wall Street groups, who have argued such a plan would spark lawsuits, higher interest rates and a tightened market for borrowers.” Alejandro Lazo, *San Bernardino County Abandons Mortgage Plan*, L.A. TIMES (Jan. 25, 2013), <http://articles.latimes.com/2013/jan/25/business/la-fi-eminent-domain-20130125> [hereinafter Lazo, *County Abandons Mortgage Plan*]; see also Kathleen Pender, *San Bernadino County Won't Use Eminent Domain to Seize Mortgages*, S.F. CHRON. BLOG (Jan. 24, 2013), <http://blog.sfgate.com/pender/2013/01/24/san-bernadino-county-wont-use-eminent-domain-to-seize-mortgages/>. “Many experts warned that eminent domain would destabilize an already weak local housing market, . . . Devereaux . . . said in a press release.” *Id.*

County, reported that “[s]ome residents said, ‘We don’t like eminent domain in any form.’”<sup>101</sup>

In addition to this negative feedback from residents, the proposal had a “chilling effect” on the county’s relationship with other parties.<sup>102</sup> In the county’s statement, Wert went on to say that:

The presence of a potential eminent domain proposal was causing problems with us developing relationships with other people who actually have solutions. The people we should be relying on to help solve this problem . . . are the bankers, the mortgage industry, the investment community. Just the presence of eminent domain was causing that relationship not to develop. It had a chilling effect.<sup>103</sup>

Rather than continuing to explore MRP’s plan, the JPA voted to explore additional proposed solutions to the mortgage problems plaguing the county.<sup>104</sup> Exactly what steps the JPA will take to further these programs,

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101. Pender, *supra* note 100 (internal quotation marks omitted).

102. Pender, *supra* note 100 (acknowledging the existence of such “chilling effect”). Here, “parties” refers to those like SIFMA and the federal government. See *supra* notes 94–96 and accompanying text.

103. Pender, *supra* note 100. In an interview following the plan’s rejection SIFMA’s director reported:

We are encouraged to hear that the county has decided it will not pursue use of eminent domain to restructure mortgages . . . . As SIFMA has said, the unprecedented, potential use of eminent domain would cause severe damage to struggling housing markets and is likely unconstitutional on its face. We are pleased that the county has recognized these risks and decided to move in other directions.

Lazo, *County Abandons Eminent Domain Mortgage Plan*, *supra* note 97 (internal quotation marks omitted).

104. Lazo, *County Abandons Eminent Domain Mortgage Plan*, *supra* note 97. At the same January 24, 2013 meeting, the board approved an agreement to work “with finance and real estate industry groups on publicizing existing government and bank programs available to homeowners.” Imran Ghorri, *San Bernardino County: Eminent Domain Mortgage Solution Rejected*, PRESS ENTERPRISE (Jan. 24, 2013), <http://www.pe.com/local-news/politics/imran-ghori-headlines/20130124-san-bernardino-county-eminent-domain-solution-rejected.ece> [hereinafter Ghorri, *Eminent Domain Rejected*]; see also JPA Press Release, *supra* note 97. The county’s current programs include “www.saveyourhomesbcounty.org,” a county website designed to “make [local] homeowners aware of programs and local events aimed at addressing foreclosures and negative equity.” *Id.* The JPA plans to draft a new version of its written request for proposals once the eminent domain restriction has been added, along with a new “risk assessment” requirement for submitted plans. *Id.*

however, is unclear.<sup>105</sup>

The JPA appears to have definitively retired the plan, but the MRP proposal lives on. MRP Chairman Steven Gluckstern reports that his firm remains in talks with over thirty other communities.<sup>106</sup> In fact, one of the JPA municipalities, the City of Fontana, has indicated that it might move forward independently; Fontana's mayor, Acquanetta Warren, asserted that it would be irresponsible for the city not to consider all options to aid homeowners.<sup>107</sup> The most promising municipality today, however, is Richmond.<sup>108</sup> Nevertheless, For S.B. County, the proposal appears to be dead in the water.

### III. LEGAL BACKGROUND

#### A. *Origin and Scope of Eminent Domain Power*

In order to understand the limitations and range of the county's power of eminent domain, one must understand the source of this particular brand of police power.<sup>109</sup> Where does the county's authority to take private property come from? More importantly, what is the extent of that power currently exercisable by the JPA?

Eminent domain—the “power of a governmental entity to take privately owned property and convert it to public use”<sup>110</sup>—is considered an inherent attribute of sovereignty.<sup>111</sup> It is “necessary to the very existence of the

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105. The power assigned to the JPA by its member entities was fairly specific to the MRP proposal. See *infra* notes 126–29 and accompanying text (discussing the express powers of the JPA). That being the case, the JPA's ability to implement broader plans may be ineffective.

106. Ghori, *Eminent Domain Rejected*, *supra* note 104 (“A handful of [these communities] could begin acquiring mortgages within the next month, [Gluckstern said in January 2013].”).

107. *Id.* Mayor Warren reportedly complained that: “This is falling on complete deaf ears on the state and federal level . . . . They have abandoned the guy who plays by the rules, the guy who pays his mortgage every month. Nobody wants to talk about this guy.” *Id.* (internal quotation marks omitted).

108. See *supra* note 78 and accompanying text. Again, because the events in Richmond occurred after this Comment was initially drafted, it will be discussed only briefly.

109. See 26 AM. JUR. 2D *Eminent Domain* § 3 (2012) (“Eminent domain is a right founded on the law of necessity which is inherent in sovereignty and essential to the existence of government.”).

110. *Id.* at § 2.

111. *Cnty. of San Mateo v. Coburn*, 63 P. 78, 79 (Cal. 1900). See also 26 AM. JUR. 2D *Eminent Domain* § 3 (2012).

government.”<sup>112</sup> The takings clauses of the federal and state constitutions, therefore, do not *grant* the power to condemn property; they “merely place limitations upon its exercise.”<sup>113</sup> The only external limitations on California’s power as a sovereign entity are those enumerated in the United States Constitution.<sup>114</sup> Internally, the power to exercise eminent domain is limited further by the California constitution<sup>115</sup> and any restrictions voluntarily enacted by the state legislature.<sup>116</sup>

On the other hand, municipal corporations (like counties and cities) do *not* have an inherent power of eminent domain.<sup>117</sup> Counties and cities “can exercise [eminent domain], if at all, only when expressly authorized by law.”<sup>118</sup> In California, both the state constitution and the Government Code provide this express authorization.<sup>119</sup> Article XI, section 7 of California’s constitution provides that “[a] county or city may make and enforce within its limits all local, police, sanitary, and other ordinances and regulations not in conflict with general laws.”<sup>120</sup> Statutory law—contained within the California Government Code—acknowledging the assignment of condemnation power complements the state constitution’s broad grant of authority.<sup>121</sup>

This broad authority trickles down in its entirety to the county, but S.B. County is additionally restricted by a self-imposed limitation incorporated

112. NICHOLS ON EMINENT DOMAIN § 1.14[2] [hereinafter NICHOLS].

113. *People ex rel. Dep’t of Pub. Works v. Chevalier*, 340 P.2d 598, 601 (Cal. 1959) (in bank); *Gober v. Stubbs*, 682 So. 2d 430, 433 (Ala. 1996).

114. *See infra* Part V (analyzing whether federal constitutional restrictions will block the S.B. County proposal).

115. “Private property may be taken or damaged for a *public use* and only when *just compensation*, ascertained by a *jury* unless waived, has first been paid to, or into court for, the owner.” CAL. CONST. art. I, § 19(a) (emphasis added).

116. *See infra* Part IV (discussing legality of the mortgage takings within state law).

117. *City of S.F. v. Ross*, 279 P.2d 529, 531 (Cal. 1955) (in bank).

118. *Id.*

119. *See* CAL. CONST. art. XI, § 7 (state constitution’s eminent domain clause); CAL. GOV’T CODE § 25350.5 (West 2012) (state’s statutory eminent domain scheme).

120. CAL. CONST. art. XI, § 7.

121. GOV’T § 25350.5 (“The board of supervisors of any county may acquire by eminent domain any property necessary to carry out any of the powers or functions of the county.”). A careful reading of the California Government Code reveals that “property,” as it is used here, “includes real and personal property.” *Id.* § 180. Because the county is limited to the powers *expressly* granted to it, the fact that the California Code assigning the power to condemn “property” does not expressly include intangible property in its definition might present a legitimate, yet likely surmountable, challenge. *See* CAL. GOV’T CODE §§ 180, 25350.5.

into the county's charter via a voter-approved amendment in 2006.<sup>122</sup> It mandates that the county “may not exercise the power of eminent domain to acquire property from any private Owner [of fee interest], without such Owner's consent, when the purpose of the acquisition is to convey the property so acquired to any private party.”<sup>123</sup> This local restriction, of course, would not apply to other municipalities considering the MRP proposal, but it is still relevant in a broader analysis—local governments across the nation have commonly adopted this sort of charter amendment or ordinance.<sup>124</sup>

Finally, the JPA itself is limited to exercising powers (which are legitimately held by the county *and* the other parties to the Joint Powers Authority agreement<sup>125</sup>) that are expressly granted to it in the agreement itself.<sup>126</sup> These include the powers to “acquire [mortgages] by voluntary purchase, gift, eminent domain, or otherwise”;<sup>127</sup> to “own, maintain, and manage” these mortgages through various means;<sup>128</sup> and to “assign, delegate, or contract with . . . third part[ies] to perform any of the rights and duties of the [JPA].”<sup>129</sup>

The question of whether the mortgage takings proposed in S.B. County would have withstood judicial scrutiny depends on whether the plan falls within the bounds of these limitations. Because the county's power of eminent domain flows from the state's authority, the county is subject to all laws constraining the state.<sup>130</sup> Any taking that violates local, state, *or* federal limitations on eminent domain will fully invalidate the MRP proposal.<sup>131</sup>

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122. SAN BERNARDINO COUNTY, CAL. CHARTER Foreword (2006), *available at* <http://www.co.sanmateo.ca.us/bos.dir/CharterReviewCommittee/SanBernardinoCharter.pdf>.

123. *Id.* art. VI, § 5; *see also* discussion *infra* Part IV.A.

124. These laws were enacted in the wake of *Kelo v. City of New London*, 545 U.S. 469 (2005), a decision that expanded the scope of eminent domain. *See infra* note 159.

125. *See supra* note 69 and accompanying text.

126. *See* JPA AGREEMENT, *supra* note 67, § 4.

<sup>127</sup> *Id.* §4(d)

128. *Id.* § 4(e). Specifically, these means include, but are not limited to, “modification, restructuring, hypothecating, assigning, pledging, securitizing, conveying, and reconveying.” *Id.*

129. *Id.* § 4(l); *see also supra* notes 71–74 and accompanying text (explaining the correlation between the JPA's powers and those required by the MRP proposal).

130. *See supra* notes 116–21 and accompanying text.

131. *See* Robert Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, 18 STAN. J.L. BUS. & FIN. 121, 163 (2012) [hereinafter Hockett, *It Takes a Village*].

*B. Can Mortgages Be Taken?*

While there is no record of California—or any other state—using eminent domain to condemn a mortgage (as opposed to extinguishing a mortgage as a result of a *real* property taking),<sup>132</sup> case law strongly suggests that states can take mortgages just like any other kind of property.<sup>133</sup> As far back as 1848, the U.S. Supreme Court has refused to draw a distinction between the application of eminent domain to physical property and its application to intangible property.<sup>134</sup> The California Supreme Court has mirrored that sentiment, holding that “neither the federal nor the state Constitution distinguishes between property which is real or personal, tangible or intangible.”<sup>135</sup>

In *City of Oakland v. Oakland Raiders*, the California Supreme Court considered whether the City of Oakland had acted constitutionally in its unprecedented use of eminent domain in attempting to condemn the Oakland Raiders football franchise.<sup>136</sup> In that case, the court acknowledged that, unless expressly restricted, “the right of eminent domain encompasses property of every kind and character,”<sup>137</sup> including “patent rights, franchises, charters or any other form of contract.”<sup>138</sup> The California Supreme Court viewed the Oakland Raiders franchise as a collection of personal property, real property, intellectual property, and contractual rights—all of which can, at least in theory, be taken by the state.<sup>139</sup> Conceptually, there is no reason

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132. Although he believes the firm’s plan will withstand legal challenges, even MRP’s chairman acknowledges that using eminent domain for mortgages is untested. Goldstein & Ablan, *Investors Tout Controversial “Condemnation,”* *supra* note 60.

133. See, e.g., *City of Oakland v. Oakland Raiders (Oakland Raiders I)*, 646 P.2d 835, 838–40 (Cal. 1982) (in bank). *But cf.* *San Diego Metro. Transit Dev. Bd. v. Handlery Hotel, Inc.*, 86 Cal. Rptr. 2d 473, 484 (Ct. App. 1999) (holding that the possibility to lease property in the future is not an interest, but contractual options to renew are).

134. *W. River Bridge Co. v. Dix*, 47 U.S. 507, 534 (1848) (concluding that such a distinction “has no foundation in reason”).

135. *Oakland Raiders I*, 646 P.2d at 840.

136. *Id.* at 835.

137. *Id.* at 839 (quoting 26 AM. JUR. 2D *Eminent Domain* § 87 (2012)) (internal quotation marks omitted).

138. *Id.* (quoting NICHOLS, *supra* note 112, § 2.01[2]) (internal quotation marks omitted).

139. See generally *id.* In *Oakland Raiders I*, the respondents use the phrase “network of intangible contractual rights.” *Id.* at 837. This case was eventually remanded and the city was found to have acted unconstitutionally. *City of Oakland v. Oakland Raiders (Oakland Raiders II)*, 220 Cal.

that mortgages—nothing more than contractual debt obligations secured by an interest in real property<sup>140</sup>—should not be considered property for the purposes of eminent domain proceedings.

C. *Where is a Mortgage Located?*

Traditionally, a government entity can exercise the power of eminent domain over any property physically located within its boundaries.<sup>141</sup> When eminent domain is extended to intangible property, it becomes less clear where the property is “located” and whether the government entity can lawfully condemn that property.<sup>142</sup> In *Indianapolis Colts v. Mayor of Baltimore*, the Seventh Circuit encountered an interesting twist on the facts in *Oakland Raiders* that allowed it to address the issue of intangible property jurisdiction.<sup>143</sup> The controversy began with failed lease negotiations between the owners and operators of the Baltimore Colts’ (now the Indianapolis Colts) stadium and the team.<sup>144</sup> When the Colts began negotiating with a new venue, located in Indianapolis, the Maryland Senate attempted to keep the team in Maryland by initiating eminent domain proceedings against the team.<sup>145</sup> Upon learning of this, the team “fled Baltimore under the cloak of darkness,” literally loading the team’s equipment into moving vans and driving to Indianapolis.<sup>146</sup>

This case raised jurisdiction issues that the Supreme Court had not previously addressed.<sup>147</sup> The Court has, however, addressed the issue of

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Rptr. 153, 154, 158 (Ct. App. 1985); *see also* discussion *infra* Part V.C.

140. 54A AM. JUR. 2D *Mortgages* § 1 (2012). In title theory jurisdictions like California, a mortgage can be defined as “in essence a defeasible deed, requiring the grantee to reconvey the property held as security to the grantor upon satisfaction of the underlying debt or fulfillment of established conditions.” *Id.*

141. NICHOLS, *supra* note 112, § 2.07 (“[Eminent domain is] inherently limited to subjects within the state’s jurisdiction.”); *see also* CAL. GOV’T CODE § 181 (West 2012) (reserving to the government the “original and ultimate right to all property *within the limits of the State*” (emphasis added)).

142. *See supra* Part III.B.

143. *Indianapolis Colts v. Mayor of Balt.*, 741 F.2d 954 (7th Cir. 1984).

144. *See id.* at 955.

145. *Id.*

146. *Id.*

147. *See* Ellen Z. Mufson, Note, *Jurisdictional Limitations on Intangible Property in Eminent Domain: Focus on the Indianapolis Colts*, 60 IND. L.J. 389, 392 (1985) (“[T]he main difficulty lies in determining just where the franchise was located at the time of the suit.”).



intangible property location in other contexts—for example, the sovereign power of taxation.<sup>148</sup> Traditionally, “[f]or the purposes of taxation, a debt<sup>149</sup> has its *situs* at the residence of the creditor, and may there be taxed.”<sup>150</sup> A debt is not the property of the debtor “in any sense”;<sup>151</sup> it is the property of the creditor, and is taxed as such.<sup>152</sup> The creditors holding ownership rights to the mortgages, in this case, could be located anywhere in the world.

Although neither California nor U.S. Supreme Court precedent squarely addresses the jurisdiction issues faced here, treatment under federal tax law is telling. The fact that federal tax law treats mortgages as intangible property located in the creditor’s domiciliary state indicates that the power of eminent domain (a sovereign power like taxation) will follow suit.<sup>153</sup> Accordingly, if the mortgages themselves are determined to exist *beyond* the boundaries of the state, the MRP plan will likely fail on those grounds alone.<sup>154</sup>

#### IV. ANALYSIS ON THE STATE LEVEL

##### A. *Violation of Local Law?*

The first hurdles that the S.B. County proposal would face are those

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148. *Id.* at 395–96. *See, e.g.,* Mobil Oil Corp. v. Comm’r of Taxes of Vt., 445 U.S. 425, 436–37 (1980) (applying a minimum contacts test in taxing a foreign entity).

149. A “debt” is analogous to a mortgage here. *See supra* note 140 and accompanying text. In title theory states like California, the government would theoretically be condemning the title and the contractual obligation. *See supra* note 140. Even if the “title” is conveyed, it cannot be taken except as part of the entire mortgage obligation. First, taking the title of the homes was expressly excluded from the JPA’s powers. JPA AGREEMENT, *supra* note 67, Recital C. Additionally, although taking the title from the mortgagor in title theory states seems simpler, doing this would result in the government holding exclusive title to the house—this would require the creation of an entirely new mortgage with the homeowner and infinitely complicate the plan, far beyond the scope of this Comment.

150. *Kirtland v. Hotchkiss*, 100 U.S. 491, 491 (1879) (holding that a state may tax debt of its residents upon a citizen of another state, secured by a deed of trust or mortgage upon real estate situated in that other state). This doctrine is known as *mobilia sequuntur personam*—“movables follow the . . . person.” *See Mufson, supra* note 147, at 391 & n.11 (quoting BLACK’S LAW DICTIONARY 905 (5th ed. 1979)) (internal quotation marks omitted).

151. *Farmers’ Loan & Trust Co. v. Minnesota*, 280 U.S. 204, 213 (1930).

152. *Id.* (“[D]ebts can have no locality separate from the parties to whom they are due.”).

153. *See Mufson, supra* note 147, at 410–11 (“[T]he rule of *mobilia sequuntur personam* for intangible property provides a workable standard for eminent domain.”).

154. NICHOLS, *supra* note 112, § 2.07.

created by its own local laws.<sup>155</sup> The JPA's use of eminent domain is indirectly considered action by the state legislative body,<sup>156</sup> but the county must still follow its own municipal law and charter.<sup>157</sup> In this case, S.B. County's charter *does* in fact contain a provision expressly limiting its use of eminent domain.<sup>158</sup> Specifically, it prohibits taking property for the purpose of "convey[ing] the property so acquired to any private party."<sup>159</sup>

The question then becomes whether the *purpose* of the S.B. proposal is indeed to convey to a private party, or whether a subsequent conveyance to MRP would solely be a consequential benefit for the greater purpose of reducing home loan principals, etc. The statute's use of the word "purpose" leaves room for ambiguity, but it seems likely that California courts will hold that the S.B. County proposal would violate this amendment of the county's charter. Conveying to third parties is an express power assigned to the Homeownership Protection Program JPA,<sup>160</sup> and the MRP proposal would involve the transfer of mortgages to third parties (as opposed to the county holding and servicing the loans itself), if only for the purposes of coordinating servicing and resolution of acquired mortgages.

Regardless of whether the true "purpose" of the proposed taking is debatable, California law dictates that "[s]tatutory language defining eminent domain powers is strictly construed and any reasonable doubt concerning the existence of the power is resolved against the entity."<sup>161</sup> There is surely at least a "reasonable doubt" that this sort of taking is precluded by the county's charter and, using this standard, the MRP proposal

155. See *supra* note 124 and accompanying text (explaining the likely relevance of this local analysis to future manifestations of the MRP proposal).

156. For example, the JPA is exercising the county's eminent domain power as assigned to it in the Joint Exercise of Powers Agreement. JPA AGREEMENT, *supra* note 67, § 4(d).

157. The principles that apply to construing statutes also apply to the interpretation of county charter provisions and ordinances. See *Armtz v. Superior Court*, 114 Cal. Rptr. 3d 561, 568 (Ct. App. 2010).

158. SAN BERNARDINO COUNTY, CAL. CHARTER, art. VI, § 5 (2006), available at <http://www.co.sanmateo.ca.us/bos.dir/CharterReviewCommittee/SanBernardinoCharter.pdf>.

159. *Id.* This is just one of countless similar laws passed around the country in the aftermath of the private-party-to-private-party economic development takings decision of *Kelo v. City of New London*, 545 U.S. 469 (2005). See generally Ilya Somin, *The Limits of Backlash: Assessing the Political Response to Kelo*, 93 MINN. L. REV. 2100 (2009).

160. JPA AGREEMENT § 4(e) (granting power to engage in "conveying" and "reconveying").

161. *Burbank–Glendale–Pasadena Airport Auth. v. Hensler*, 99 Cal. Rptr. 2d 729, 733 (Ct. App. 2000) (quoting *Kenneth Mebane Ranches v. Superior Court*, 12 Cal. Rptr. 2d 562, 566 (Ct. App. 1992) (internal quotation marks omitted)).

could have been blocked in S.B. County on these grounds alone.<sup>162</sup>

Additionally, looking to the Board of Supervisors' intent in supporting the measure creating this amendment provides insight into its intended scope.<sup>163</sup> The Board itself urged voters to approve the amendment, stating in its officially filed argument that “[t]he power of eminent domain must be limited and must *only* be used in cases of a demonstrated public necessity such as highway or flood control channel.”<sup>164</sup> The Board argued that this justified a charter *amendment*, as opposed to a mere ordinance, in order to ensure that “this protection of property rights is . . . not subject to change by any future Boards of Supervisors.”<sup>165</sup>

Despite the expressed intent that the amendment not be changed, a county's charter is not immutable.<sup>166</sup> If S.B. County truly wishes to push through these proposed mortgage takings, there is a procedure for repealing this provision of its charter and defaulting its power of eminent domain to the maximum level assigned to it by the state.<sup>167</sup> The California Constitution establishes that: “[A] county or city may adopt a charter by majority vote of its electors voting on the question. . . . A charter may be amended, revised, or repealed in the same manner.”<sup>168</sup>

162. Additionally, a taking for the sole purpose of transferring property to a private party, without a public good being served, is *always* invalid. See *infra* Part IV.C.1. If the county charter's additional provision (added on November 7, 2006) is not read to prohibit these mortgage takings, then the charter is essentially “toothless”—it provides no additional limitation and would not change the scope of the county's power. SAN BERNARDINO COUNTY, CAL. CHARTER Foreword (2006), *available at* <http://www.co.sanmateo.ca.us/bos.dir/CharterReviewCommittee/SanBernardinoCharter.pdf>. It seems unlikely that the county would expressly add this limitation (by *amendment*) if it did not mean to change the scope of local eminent domain power. See *infra* note 163 and accompanying text (demonstrating the legislative intent here).

163. San Bernardino County Board of Supervisors & the Howard Jarvis Taxpayers Ass'n, Measure “O”, Argument in Favor (on file with author). No arguments were filed in opposition to the measure. *Id.*

164. *Id.*

165. *Id.* The amendment was eventually approved by a 37% margin in the November 7, 2006 general election. *Nov. 7, 2006 General Election Results*, SAN BERNARDINO COUNTY ELECTIONS OFFICE OF THE REGISTRAR OF VOTERS (Dec. 1, 2006), [http://cms.sbcounty.gov/Portals/9/Elections/Past\\_Elections/2006-11-06\\_ElectionResults.pdf](http://cms.sbcounty.gov/Portals/9/Elections/Past_Elections/2006-11-06_ElectionResults.pdf).

166. S.B. County's charter was originally approved by the State Legislature and filed with the Secretary of State on April 7, 1913 and has been amended thirty-six times since then. SAN BERNARDINO COUNTY, CAL. CHARTER Foreword (2006), *available at* <http://www.co.sanmateo.ca.us/bos.dir/CharterReviewCommittee/SanBernardinoCharter.pdf>.

167. See CAL. CONST. art. XI, § 3(a).

168. *Id.*

So, S.B. County could have overcome this obstacle, but not without substantial effort. The issue would have had to go to the people and receive a majority vote in a municipal election.<sup>169</sup> In a practical sense, this challenge at the local level might have been one of the hardest to overcome.<sup>170</sup> If the S.B. County charter had to be amended, the sheer logistics required might have discouraged the county from moving forward with the mortgage takings proposal, or at least delayed it substantially.<sup>171</sup>

### *B. Violation of California Statutory Law?*

Courts will not generally consider broader constitutional issues if the condemnation action is unlawful according to applicable statutes.<sup>172</sup> In this case, California has enacted an extensive set of requirements, limitations, and procedures for the use of eminent domain<sup>173</sup>—eminent domain can *only* be exercised in accordance with those rules and procedures.<sup>174</sup> The California Civil Procedure Code establishes three specific requirements for any use of eminent domain: (1) “public interest and necessity require the project”; (2) “[t]he project is planned or located in the manner that will be most compatible with the greatest public good and the least private injury”; and (3) “[t]he property sought to be acquired is necessary for the project.”<sup>175</sup>

#### 1. Public Interest and Necessity Must Require the Project

California statutory law demands that public interest and necessity require the MRP project.<sup>176</sup> Although this is a fact-sensitive inquiry, and one

169. *Id.* See also, CAL. ELEC. CODE § 9102 (West 2013) (“[N]othing in this article shall be construed to allow a board of supervisors to enact, amend, or otherwise revise a county charter without submitting the proposal to the voters.”).

170. The California Elections Code provides extensive regulation of county elections. ELEC. §9100–90.

171. See *supra* notes 166–70 and accompanying text.

172. See *Gatto v. Cnty. of Sonoma*, 120 Cal. Rptr. 2d 550, 556 (Ct. App. 2002) (“If this statutory violation is established, it would be unnecessary for us to address the constitutional question, as constitutional issues ordinarily will be resolved on appeal only if ‘absolutely necessary’ and not if the case can be decided on any other ground.” (quoting *Palermo v. Stockton Theatres*, 195 P.2d 1, 9 (Cal. 1948))).

173. CAL. CIV. PROC. CODE §§ 1230.010–1274.17 (West 2007).

174. *Id.* § 1230.020.

175. *Id.* § 1240.030.

176. *Id.* § 1240.030(a). “Public interest and necessity” is read to include “all aspects of the public

in which the decision of the legislative body will be given great deference,<sup>177</sup> this necessity is still subject to judicial review.<sup>178</sup> For the purposes of this requirement, the details of specific mortgages are irrelevant—the court will review the eminent domain plan in its entirety for the requisite public interest and necessity.<sup>179</sup>

The stated purpose of this project is to “assist in preserving home ownership and occupancy for homeowners with negative equity,” to “avoid the negative impacts of underwater loans and further foreclosures,” and to “enhance the economic vitality and the health of . . . communities.”<sup>180</sup> Proponents asserted that the proposal *was* needed to address the housing crisis;<sup>181</sup> however, data provided by the FHFA suggests that it may not be.<sup>182</sup> Little independent research or hard evidence was provided suggesting that the FHFA’s conclusions on principal reduction are invalid, or that S.B. County’s particular situation warranted a different approach,<sup>183</sup> but the

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good including but not limited to social, economic, environmental, and esthetic considerations.” *Id.* (Legis. Comm. Comments).

177. See, e.g., *Shell Cal. Pipeline Co. v. Compton*, 41 Cal. Rptr. 2d 753, 758–59 (Ct. App. 1995) (“Public use and necessity are to be construed liberally in favor of the condemnor.”).

178. Civ. § 1230.050.

179. See *infra* Part IV.B.3.

180. JPA AGREEMENT, *supra* note 67, Recital C.

181. See, e.g., Yuki Noguchi, *County Considers Eminent Domain as Foreclosure Fix*, NPR NEWS (July 13, 2012), <http://www.npr.org/2012/07/13/156683302/county-considers-eminant-domain-as-foreclosure-fix> (explaining that, in Gluckstern’s view, what is “needed to undo [the mortgage crisis] . . . is a powerful legal tool [like MRP’s eminent domain proposal] that can force mortgage investors to sell those loans and cut through all the red tape”).

182. Letter from Edward J. DeMarco, *supra* note 91 (refusing to implement a principal reduction/forgiveness plan—the same strategy that MRP would use on S.B. County mortgages—for Fannie Mae and Freddie Mac mortgages). In his letter to the Committee on Banking, Housing, and Urban Affairs, DeMarco explained that principal reduction “would not make a meaningful improvement in reducing foreclosures in a cost effective way for taxpayers.” *Id.*; see *supra* Part II.D.

183. See generally Hockett, *It Takes a Village*, *supra* note 131 (discussing the FHFA’s conclusions). MRP’s primary proponent has been Cornell School of Law Professor Robert Hockett. Hockett wrote a fifty-six-page paper outlining and analyzing the viability of proposals like MRP’s. *Id.* He has also blogged in support of the MRP proposal. Robert Hockett, *A Solution for Underwater Mortgages: Eminent Domain*, REUTERS (June 19, 2012), <http://blogs.reuters.com/great-debate/2012/06/19/a-solution-for-underwater-mortgages-eminant-domain/>.

However, Professor Hockett’s paper is not entirely independent. In a conversation with blogger Felix Salmon, MRP chairman Steven Gluckstern revealed that his company had paid Hockett an “honorarium” to write the paper. Felix Salmon, *Why Using Eminent Domain for Liens Is a Bad Idea*, REUTERS (June 21, 2012), <http://blogs.reuters.com/felix-salmon/2012/06/21/why-using-eminant-domain-for-liens-is-a-bad-idea/>. Reporting on his conversation with Gluckstern, Salmon

county, MRP, or their supporters may have produced more concrete supporting evidence, had project progressed further.<sup>184</sup>

This factor is especially unclear here because the exact details of MRP's plan, as it would be enacted in S.B. County, had not yet been determined.<sup>185</sup> In fact, MRP had retooled the plan at least once (presumably) in response to opponents' criticism and to conform more closely to this element of California's statutory requirements.<sup>186</sup> While the final plan encompassed all mortgages, it originally would condemn only performing, current mortgages—as opposed to those in default or with delinquent payments—whose homeowners had good credit.<sup>187</sup>

Adding still more uncertainty to this element is the fact that the S.B. County and California economies and housing markets are, it seems, improving.<sup>188</sup> More importantly, the average value of a home in San Bernardino is actually on the rise.<sup>189</sup> The home sales price for the county rose 24.4% between April 2012 and April 2013.<sup>190</sup> This rise in home values

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skeptically noted that “MRP did not see the paper before Hockett published it, but seeing as how Hockett wrote ‘The Way Forward’ [another paper on this subject] with Dan Alpert, one of the key principals behind MRP's scheme, there was surely no doubt about what his conclusions would be.” *Id.* Hockett does disclose in a footnote that “the author is disinterested in what he is here recommending, but may subsequently undertake more legal, financial or expository work in connection with the proposals offered and advocated herein.” Hockett, *It Takes a Village*, *supra* note 131, at 121 n.\*.

184. If they did *not*, a court could have blocked eminent domain actions brought pursuant to the plan for failure to provide “substantial evidence,” amounting to “gross abuse of discretion.” *Santa Cruz Cnty. Redev. Agency v. Izant*, 43 Cal. Rptr. 2d 366, 371 (Ct. App. 1995) (“[G]ross abuse of discretion may be shown by a lack of substantial evidence supporting the resolution of necessity.”).

185. MRP notes that its plan is adaptable to local conditions: “Each local government has the power to determine whether to acquire loans, and if so which loans.” *Fact or Fiction*, *supra* note 63.

186. See Imran Ghori, *San Bernardino County: Mortgage Aid Expanded*, PRESS ENTERPRISE (Sept. 6, 2012), <http://www.pe.com/local-news/politics/imran-ghori-headlines/20120906-san-bernardino-county-mortgage-aid-expanded.ece> [hereinafter Ghori, *Mortgage Aid Expanded*].

187. *Id.* The original policy was made “because of the increased risk and difficulty of refinancing such loans.” *Id.*

188. See Nelson, *supra* note 5554. According to a DataQuick Information Systems report released in October 2012, California foreclosure rates actually dropped to the lowest level since 2007 (a 31% drop in number of foreclosures statewide). *Id.* In S.B. County specifically, there had been a nearly 22% drop at the time of the DataQuick report. *Id.*

189. CAL. ASS'N OF REALTORS, SAN BERNARDINO 2012 ECONOMIC PROFILE, available at <http://www.realtor-info.com/reports/sbeconomicreport.pdf> (last visited Jan. 20, 2014).

190. *Id.* The California Association of Realtors, citing a DataQuick Information Systems Report, reports that the median countywide home value rose from \$156,000 to \$194,000 between April 2012 and April 2013. *Id.*

and fall in foreclosure rates weakened the argument that necessity and public interest supported or required adoption of the eminent domain project.<sup>191</sup>

2. Project Must Be Arranged in Manner Most Compatible with the  
Greatest Public Good and the Least Private Injury

Second, is the project planned in a manner that will be most compatible with the greatest public good and the least private injury? Again, this is a fact-sensitive inquiry that allows for a great degree of legislative deference.<sup>192</sup> In order to determine the answer to this question, the purpose of this proposal must be examined and it must be determined whether the use of eminent domain is “most compatible” with achieving that purpose.<sup>193</sup>

If the purported purpose of the plan is to keep homeowners in their homes, it is not difficult to see how the originally proposed plan might have been attacked as ill-tailored to those purposes: homeowners *still making* their monthly mortgage payments are more valuable to the holders of those loans than homeowners in default (so the proposal would maximize private harm), and restructuring the loans of homeowners that *can* afford to pay does not target the group most likely to lose their homes to foreclosure (so the proposal would minimize public benefit).<sup>194</sup> Wisely, after the initial wave of controversy following the plan’s announcement, MRP decided to change this and include delinquent homeowners and those in default in the program.<sup>195</sup> The expansion of the program would increase the number of eligible homeowners from 3,500 to 15,000, according to MRP executive chairman Steven Gluckstern.<sup>196</sup>

Including more loans in the program necessarily increases the amount of private loss to loan holders, but it also increases the public benefit to homeowners. Accordingly, including the homeowners most likely to need assistance will make the ratio of private loss to public gain more favorable, increasing its odds of passing statutory muster. Whether the statutory requirement would have actually been satisfied, however, is far from clear

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191. *See supra* note 180 and accompanying text (reiterating the stated purposes of the Homeownership Protection Program).

192. *See supra* note 177–78 and accompanying text.

193. *See supra* notes 175, 180 and accompanying text.

194. *See supra* note 186–87 and accompanying text.

195. *See Ghori, Mortgage Aid Expanded, supra* note 186.

196. *Id.*

and will remain unanswered.<sup>197</sup>

### 3. Particular Property Must Be Necessary to Proposal

Finally, the specific property sought (in this case, any particular mortgages on underwater property) must be necessary for the project.<sup>198</sup> The traditional (and lenient) standard used for necessity here is whether the property is “reasonably suitable and useful for the improvement.”<sup>199</sup> When a taking entity condemns property, it must first approve a “resolution of necessity.”<sup>200</sup> Once approved, the element of necessity is *conclusively* established, with a few enumerated exceptions: when (a) the property is outside the entity’s boundaries;<sup>201</sup> (b) the resolution is affected by gross abuse of discretion;<sup>202</sup> or (c) the resolution is adopted through bribery.<sup>203</sup>

Once the municipality determines that the use of eminent domain is necessary and approves a resolution of necessity, it will take fairly

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197. Extrapolating this logic, the proposal would be even more likely to pass muster on this element if it *only* included delinquent mortgages or those in default. These are the homeowners that are most likely to default and the loans that are least valuable to the current loan holders. On the other hand, this introduces the risk of homeowners “strategically defaulting,” or walking away from their mortgages as part of a financial strategy, not an actual inability to pay. *Strategic Default*, INVESTOPEDIA, <http://www.investopedia.com/terms/s/strategic-default.asp> (last visited Jan. 20, 2014).

198. CAL. CIV. PROC. CODE § 1240.030(c) (West 2007). This question, as it relates to the S.B. County takings, presents a bit of a paradox. MRP would not have restructured all underwater mortgages; the proposal allowed homeowners to choose whether to actually participate in the restructuring program. *FAQs*, *supra* note 66. (“Homeowners will have the same rights and the same obligations that they have now . . . . If they do not refinance then they simply continue to pay on their existing loan.”). This means that some of the condemned mortgages could have remained exactly as they were. *Id.* If the county approved a resolution determining that restructuring these loans was necessary, justifying the use of eminent domain, the county should require that the taken loans *are*, in fact, restructured. If the decision to restructure a loan is completely optional at the choice of the homeowner, condemnation of that loan could not have been necessary to the eminent domain proposal as a whole. *See* CIV. § 1240.030(c).

199. *City of Hawthorne v. Peebles*, 333 P.2d 442, 445 (Cal. Ct. App. 1959) (quoting NICHOLS, *supra* note 112, § 4.11[4]) (internal quotation marks omitted).

200. CIV. § 1245.220 (“A public entity may not commence an eminent domain proceeding until its governing body has adopted a resolution of necessity . . .”).

201. *Id.* § 1245.250(c).

202. *Id.* § 1245.255(b).

203. *Id.* § 1245.270(a)(1). Although bribery would justify overturning a resolution of necessity, *id.*, there is no evidence of such impropriety in this case, and this Comment will operate under the assumption that there is no improper or illegal activity involved.



compelling evidence to rebut that presumption.<sup>204</sup> However, rebuttal is possible—for example, if the situs of the mortgage is determined to exist *outside* the county’s boundaries, the resolution could be defeated.<sup>205</sup> Additionally, “gross abuse of discretion” might be established if the resolution is shown to be “arbitrary, capricious, or entirely lacking in evidentiary support,”<sup>206</sup> or that the taking entity had already committed to the plan prior to approving the resolution.<sup>207</sup> Abuses of discretion that might justify judicial rejection of resolutions of necessity include “a fatally vague statement of purpose.”<sup>208</sup>

If a municipality passes a resolution of necessity pursuant to the MRP proposal, it might have difficulty avoiding such excessive vagueness.<sup>209</sup> It will be difficult to provide definitive answers to precisely how many mortgages will be taken, which loans will be taken, or whether the municipality will actually restructure each loan.<sup>210</sup> California law requires that eminent domain proposals be sufficiently defined: “[T]hat which is left unlimited, and is to be determined only by such future action as the [c]ity

204. See *infra* notes 246–61 and accompanying text (discussing the issue of judicial scrutiny of legislative determinations).

205. See *supra* notes 141–54 and accompanying text. See also *infra* Part IV.B.4 (discussing territorial limits).

206. *Redev. Agency of Chula Vista v. Rados Bros.*, 115 Cal. Rptr. 2d 234, 240 (Ct. App. 2001); *Huntington Park Redev. Agency v. Duncan*, 190 Cal. Rptr. 744, 748 (Ct. App. 1983). See also *Santa Cruz Cnty. Redev. Agency v. Izant*, 43 Cal. Rptr. 2d 366, 371 (Ct. App. 1995) (“[G]ross abuse of discretion may be shown by a lack of substantial evidence supporting the resolution of necessity.”).

207. See *Redev. Agency of Huntington Park v. Norm’s Slauson*, 219 Cal. Rptr. 365 (Ct. App. 1985).

208. *City of Stockton v. Marina Towers LLC*, 88 Cal. Rptr. 3d 909, 924 (Ct. App. 2009). In *Marina Towers*, the California Court of Appeal rejected the city’s resolution of necessity as a gross abuse of discretion in part because it relied on vague conclusions, such as the declaration that the condemned property was “within a ‘catalyst site’ for [the area’s] revitalization.” *Id.* at 914. The city planned to transfer the condemned property to private developers for the construction of an apartment complex, *id.*, but “simply trot[ted] out a laundry list of statutes setting forth a plethora of possible purposes for condemning property.” *Id.* at 922. Despite having the power to review resolutions for “gross abuse of discretion,” *supra* note 202 and accompanying text, state courts must not “retrace the legislative body’s analytic route when the statutory scheme requires much greater deference to the condemning body’s determination of necessity.” *City of Saratoga v. Hinz*, 9 Cal. Rptr. 3d 791, 807 (Ct. App. 2004) (quoting *Izant*, 43 Cal. Rptr. 2d at 372) (internal quotation marks omitted).

209. This would make the taking invalid under section 1240.030(c). CAL. CIV. PROC. CODE § 1240.030(c) (West 2007).

210. See *supra* note 198.

*may hereafter decide upon, is not defined.*<sup>211</sup> If the MRP plan continues to allow the borrower to choose whether to restructure the loans, there is a strong chance that it could fail on these grounds: taking mortgages on the theory that they *might* be restructured later (dependent entirely upon the will of the individual homeowners), is likely to fall short of the required level of specificity.<sup>212</sup>

#### 4. Territorial Limitations

The California Code of Civil Procedure also specifies that, for local entities, the condemned property must be within the entities' territorial limits.<sup>213</sup> The entity exercising eminent domain in this case is the Homeownership Protection JPA.<sup>214</sup> As a joint entity, the territorial limits in question here would have been those of S.B. County and the cities of Ontario and Fontana.<sup>215</sup>

If the situs of a mortgage is not, in fact, located exclusively at the situs of the real property securing it,<sup>216</sup> then another problem might arise.<sup>217</sup> If the property (the mortgage) is legally located at the domicile of the *creditor*, the JPA could not have condemned loans unless the current holders of the mortgages themselves were domiciled within its physical boundaries.<sup>218</sup>

#### C. Violation of State Constitution?

For the most part, California courts have interpreted the limitations of

211. *Marina Towers*, 88 Cal. Rptr. 3d at 923 (quoting *City of Cincinnati v. Vester*, 281 U.S. 439, 448 (1930)).

212. *See supra* note 59 and accompanying text.

213. Civ. § 1240.050.

214. *See supra* notes 67–74 and accompanying text.

215. *See supra* note 69 and accompanying text.

216. *See supra* Part IV.B.3.

217. That is, if the mortgage is “located” at the situs of the *lender*—as Part III.C argues it is—the JPA may be limited not only to loans within California, but only to those within S.B. County. *See supra* notes 67–74 and accompanying text.

218. Part III.C presents this view. If this argument is accepted, even mortgages (or *parts* of mortgages) purchased by private trusts and banks located *within* California would be beyond the reach of the JPA. This could drastically reduce the number of eligible loans, further damaging the argument for a general public good and placing additional strain on the other statutory takings requirements. *See supra* Parts IV.B.1–3.

the state's takings clause congruently with those of its federal counterpart.<sup>219</sup> Specifically, the only limitations provided by the U.S. Constitution are the requirements that the taking serves a public use and that just compensation is paid.<sup>220</sup> California's Constitution, however, is slightly more restrictive. It includes a provision requiring compensation for *damaged* property in addition to condemned property; furthermore, "fair compensation" must be determined by a jury, not the condemning entity or a judge.<sup>221</sup>

### 1. Public Use Requirement

For purposes of the California state constitution, a public use is "a use which concerns the whole community as distinguished from a particular individual or a particular number of individuals; public usefulness, utility or advantage; or what is productive of general benefit; a use by or for the government, the general public or some portion of it."<sup>222</sup> MRP states that the public purpose of its program is "to protect neighbors and the broader community from defaults, foreclosures, and the losses that they cause."<sup>223</sup> On its face, this purpose seems to satisfy the definition of public use required by California courts: the terms "neighbors" and "broader community" clearly suggest a purpose that concerns the whole community and conveys a general benefit.<sup>224</sup> Further, the JPA Authority Agreement of the Homeownership Protection Program states the JPA was created to, among other things, "enhance the economic vitality and the health of . . . communities [of homeowners with negative equity]."<sup>225</sup> This, too, sounds like a purpose that satisfies the public use standard applied in California.

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219. *Small Prop. Owners of S.F. v. City of S.F.*, 47 Cal. Rptr. 3d 121, 125 (Ct. App. 2006). Based on this standard, state courts will likely apply the same standards discussed *infra* Part V.A. regarding the U.S. Takings Clause.

220. *Mt. San Jacinto Cmty. Coll. Dist. v. Superior Court*, 151 P.3d 1166 (Cal. 2007).

221. CAL. CONST. art. I, § 19(a).

222. *City of L.A. v. Superior Court*, 124 Cal. Rptr. 3d 499, 506 (Ct. App. 2011) (quoting *Customer Co. v. City of Sacramento*, 895 P.2d 900, 908 (Cal. 1995) (in bank)) (internal quotation marks omitted). This definition of "public use" originates from the *Cyclopedia of Law and Procedure*. 15 *CYCLOPEDIA OF LAW AND PROCEDURE* 581 (William Mack ed., 1905), available at <http://archive.org/details/cu31924061134379>. However, it is still commonly cited, at least in California cases. See, e.g., *Customer Co.*, 895 P.2d 900 (Cal. 1995) (in bank); *Miller v. City of Palo Alto*, 280 P. 108, 109 (Cal. 1929).

223. *Fact or Fiction*, *supra* note 63.

224. *Id.*

225. JPA AGREEMENT, *supra* note 67, Recital C.

However, public use is still a question of law to be determined by a court.<sup>226</sup> The California Constitution limits eminent domain to use of property for public purposes, and if a judge decides that the plan, despite legislative intent to the contrary, does *not* in fact do so, the proposal will be shot down.<sup>227</sup>

## 2. Just Compensation

The second crucial element of any eminent domain action is the requirement that just compensation be paid.<sup>228</sup> But what is “just compensation”? It is difficult to discuss whether the plan will, in fact, satisfy this constitutional requirement because the JPA has not offered any hard figures yet, and every condemnation proceeding will be unique.<sup>229</sup> However, because this element is central to the analysis, this section will discuss what amount of payment would theoretically have been needed to pass constitutional muster.

In its Civil Procedure Code, the California legislature has codified earlier court decisions defining just compensation in an eminent domain action.<sup>230</sup> Specifically, the state must pay:

[T]he highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but

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226. See *infra* notes 243–61 and accompanying text.

227. See *City of S.F. v. Ross*, 279 P.2d 529 (Cal. 1955) (finding use of eminent domain to be, in fact, for private use, despite legislative declaration of public use); see generally, Timothy Sandefur, *A Natural Rights Perspective on Eminent Domain in California: A Rationale for Meaningful Judicial Scrutiny of “Public Use”*, 32 SW. U. L. REV. 569 (2003).

228. See *supra* note 220 and accompanying text.

229. The JPA, exercising its assigned legislative power, is free to set forth the prices it is willing to offer mortgage holders—“[i]ts choices, however, are not necessarily the measure of the ‘just’ compensation constitutionally due.” *Redev. Agency of Burbank v. Gilmore*, 700 P.2d 794, 803 (Cal. 1985). MRP acknowledges that good faith negotiations will be required. Comment Letter from Mortgage Resolution Partners to Alfred Pollard, General Counsel, FHFA (Sept. 7, 2012), available at [http://mortgageresolutionpartners.com/sites/default/files/attachments/fhfa\\_comment\\_letter\\_9.7.12.pdf](http://mortgageresolutionpartners.com/sites/default/files/attachments/fhfa_comment_letter_9.7.12.pdf) [hereinafter Comment Letter from Mortgage Resolution Partners to FHFA] (last visited Jan. 20, 2014).

230. CAL. CIV. PROC. CODE § 1263.320(a) (West 2007) (codifying *Sacramento So. R.R. v. Heilbron*, 104 P. 979 (Cal. 1909) as explained in the relevant Legislative Committee Comments).

under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.<sup>231</sup>

Other state court decisions have further defined the scope and purpose of the fair compensation requirement. In *City of Carlsbad v. Rudvalis*, the Court of Appeal specified that the purpose of just compensation for condemned property is “to put the owner in as good a position pecuniarily as he would have occupied if his property had not been taken.”<sup>232</sup> In *Joffe v. City of Huntington Park*, the court added that both federal and state constitutional requirements look to “not what the taker has gained, but what the owner has lost.”<sup>233</sup>

To determine what just compensation should be, a hypothetical illustration might be helpful. Take an S.B. County homeowner who purchased a house at the peak of the housing bubble, in 2006, at \$382,000.<sup>234</sup> At the time of the MRP proposal in S.B. County, the house would be worth \$167,800.<sup>235</sup> Assume also that the homeowner had not refinanced the mortgage and had a current outstanding principal of \$275,000.<sup>236</sup> How much should the JPA and MRP have paid the holder of this mortgage to condemn it?

It seems logical that the minimum value that at which the lender would agree to sell the loan is equal to the value of the property securing the loan (i.e., the home). If the homeowner fully stops making payments, the

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231. *Id.* But see *supra* note 229 (describing the limited nature of legislative declarations of fair compensation).

232. 135 Cal. Rptr. 2d 194, 202 (Ct. App. 2003) (citing *City of San Diego v. Rancho Penasquitos P'ship*, 130 Cal. Rptr. 2d 108, 118–19 (Ct. App. 2003)); see also *San Diego Metro. Transit Dev. Bd. v. Cushman*, 62 Cal. Rptr. 2d 121, 124 (Ct. App. 1997).

233. 134 Cal. Rptr. 3d 868, 874 (Ct. App. 2011) (quoting *Tilem v. City of L.A.*, 191 Cal. Rptr. 229, 233 (Ct. App. 1983)).

234. See *supra* note 51 and accompanying text.

235. See *supra* note 51 and accompanying text.

236. Suppose our hypothetical borrower made a 20% down payment on the property (\$76,400) and took out a thirty-year fixed-rate mortgage (“FRM”) at 6.28% (the national monthly average for January of 2006). See *HSH's National Monthly Mortgage Statistics: 2006*, HSH.COM, <http://www.hsh.com/natmo2006.html> (last visited Jan. 20, 2014)). Assuming he continued making his scheduled payments, he would currently owe \$274,838 on the remaining \$305,600. See *Mortgage Amortization Calculator*, HSH.COM, <http://www.hsh.com/calc-amort.html> (last visited Jan. 20, 2014).

mortgage holder will at least retain the property (worth \$167,800 in this example). However, the mortgage holder will forgo the expenses involved in the foreclosure process.<sup>237</sup> Some estimates place this at almost \$80,000,<sup>238</sup> which would reduce the low-end estimate to \$87,800. In the high-end figure scenario—the scenario in which the homeowner continues making regular payments until the loan is paid off—the mortgage holder would, after fully paying off principal and interest, have received \$679,535.<sup>239</sup> The lender would not have received the full value of the loan, however, until December of 2035, which means that the high-end figure must be discounted to present value—\$305,977.<sup>240</sup>

“Just compensation” will likely fall somewhere between those two values, after considering the odds of the homeowner defaulting.<sup>241</sup> Explaining the appropriate benchmark to a jury,<sup>242</sup> however, could prove to be difficult, making the ultimate determination of just compensation unpredictable.

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237. They must be paid the flat compensation *before* the mortgage is actually taken, and theoretically, there will be no foreclosure. See CAL. CONST. art. I, § 19(a).

238. Glenn Setzer, *Foreclosures Cost Lenders, Homeowners, the Community Big Bucks*, MORTGAGE NEWS DAILY (Jun. 2, 2008), [http://www.mortgagenewsdaily.com/622008\\_Foreclosure\\_Costs.asp](http://www.mortgagenewsdaily.com/622008_Foreclosure_Costs.asp).

239. These figures were calculated using the mortgage amortization calculator accessible at *Mortgage Amortization Calculator*, *supra* note 236.

240. In other words, the right to receive \$679,535 over the course of twenty-three years would be worth only \$305,977 at the time of the MRP proposal. See *Present Value Calculator*, INVESTOPEDIA, <http://www.investopedia.com/calculator/pvcal.aspx> (last visited Feb. 7, 2013) (using 3.53% interest rate—the average rate on a thirty-year FRM on Feb. 7, 2013—compounded yearly over twenty-three years). See *Weekly Primary Mortgage Market Survey*, FREDDIE MAC, <http://www.freddiemac.com/pmms/> (last visited Jan. 20, 2014) (used to determine the discount rate).

An even more extensive calculation would probably include other deductions from this present value figure, like any other demonstrable expenses forgone by giving up the mortgage (servicing expenses, etc.).

241. *San Bernardino County Real Estate Trends & Market Info*, REALTYTRAC, <http://www.realtytrac.com/trendcenter/ca/san+bernardino-county-trend.html> (last updated Dec. 2013).

242. A jury determination of just compensation is expressly required by the California Constitution. See CAL. CONST. art. I, § 19(a).

## V. ANALYSIS ON THE FEDERAL LEVEL

## A. Violation of Federal Takings Clause?

## 1. Public Use Requirement

Just as on the state level,<sup>243</sup> federal eminent domain law does not interpret the term “public use” to *literally* mean that the condemned property must be made physically available for public access. On the federal level, courts will generally uphold the use of eminent domain so long as the condemnation relates to a “conceivable public purpose.”<sup>244</sup> The taking does not need to benefit the whole community, or even necessarily a considerable portion of it.<sup>245</sup>

While a “purely private taking could not withstand the scrutiny of the public use requirement,”<sup>246</sup> the fact that the property is taken from one private party and transferred immediately to a different private party does not necessarily “condemn that taking as having only a private purpose.”<sup>247</sup> The legislative determination that eminent domain can be used for a particular project is “deemed to be a declaration . . . that such use . . . is a public use.”<sup>248</sup> This declaration, however, is not completely immune from judicial review.<sup>249</sup>

In *Hawaii Housing Authority v. Midkiff*, the U.S. Supreme Court found that a condemnation action in which the state of Hawaii took private property for the benefit of another private party did *not* violate the public use

243. See *supra* note 222 and accompanying text.

244. See *Nat'l R.R. Passenger Corp. v. Bos. & Me. Corp.*, 503 U.S. 407, 422 (1992) (quoting *Haw. Hous. Auth. v. Midkiff*, 467 U.S. 229, 241 (1984)); *Berman v. Parker*, 348 U.S. 26, 32–34 (1954).

245. *Rindge Co. v. L.A. Cnty.*, 262 U.S. 700, 707 (1923). However, the fact that the condemned land in *Rindge Co.* was to be used as a highway was important. *Id.* at 706. In deciding the case, the court stressed: “That a taking of property for a highway is a taking for public use has been universally recognized,” and that the state’s code specifically named highways to be a public use. *Id.* The determinations in this case seem highly distinguishable upon the facts; condemning a mortgage has not been universally recognized as a public use.

246. *Midkiff*, 467 U.S. at 245.

247. *Id.* at 243–44.

248. CAL. CIV. PROC. CODE § 1240.010 (West 2007).

249. See *supra* note 227 and accompanying text.

limitation on a state's power of eminent domain.<sup>250</sup> While the Court acknowledged that its role in reviewing the use of eminent domain should be an "extremely narrow" one, it addressed two primary issues regarding the public use requirement.<sup>251</sup> First, the Court held that the condemnation act fell within the traditional scope of a "classic exercise of a State's police powers" to regulate the perceived social and economic evils of a land oligopoly traceable to Hawaii's original monarchical and feudal system of land ownership.<sup>252</sup> Second, the state act's method of redistributing the parcels of land was considered rational.<sup>253</sup>

The Court set a very low standard for scrutinizing public purpose in *Midkiff*, one that the MRP proposal could very well satisfy. In order to have met the federal standard of public purpose, it must only be determined that the county could have rationally believed that this proposal would promote its objective: reducing foreclosures on underwater mortgages.<sup>254</sup> This is a question of fact, and one that will probably be analyzed using the same standards as those on the state level, if not with slightly more deference to the county's determination.<sup>255</sup>

*Midkiff* does demonstrate, however, that the Supreme Court does have the power to review state eminent domain proceedings for "rationality."<sup>256</sup> Despite the Court's expressed reluctance, it *did* in fact look at the details of the plan and factually determined whether, in its opinion, the act was rational.<sup>257</sup> So, even if it is determined that state and federal takings clauses use the same standard for public use, there is still room for separate U.S. Supreme Court review under the federal version of the clause.

250. *Midkiff*, 467 U.S. at 241.

251. *Id.* at 240 (quoting *Berman v. Parker*, 348 U.S. 26, 32 (1954)).

252. *Id.* at 241–42.

253. *Id.* at 242. Specifically, the constitutionality test is satisfied if the state legislature "rationally could have believed that the [Act] would promote its objective." *Id.* (alteration in original) (quoting *W. & S. Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 671–72 (1981)).

254. *See id.*

255. *See supra* Part IV.C.1 (discussing judicial limitations on public use determinations).

256. This suit was filed in federal court, where the Court of Appeals rejected the legislature's determination that the act served a public use. *Midkiff*, 467 U.S. at 234–35. The decision was reversed not because the appellate court acted beyond its power to review, but because it applied the wrong level of scrutiny in its review. *Id.* at 243 (rejecting the appellate court's decision that the taking in question warranted "more rigorous judicial scrutiny").

257. *Id.* at 240 ("There is, of course, a role for courts to play in reviewing a legislature's judgment of what constitutes a public use, even when the eminent domain power is equated with the police power.").



If MRP's proposal survived Supreme Court scrutiny on the public use factor, the Court's holding would depend greatly on the factual information available to the county at the time it passes the resolution of necessity.<sup>258</sup> Other than the paper written by Professor Robert Hockett,<sup>259</sup> the majority of then-available information suggests that the negative consequences outweigh the positive.<sup>260</sup> This certainly cuts against finding that the plan satisfies the rationality standard; however, *Midkiff* sets the level of legislative deference so high that the federal Takings Clause will provide little scrutiny of public use beyond California's statutory and constitutional requirements.<sup>261</sup>

## 2. Just Compensation Requirement

Like the California Constitution's takings clause,<sup>262</sup> the U.S. Takings Clause also contains a just compensation requirement.<sup>263</sup> The Fifth Amendment prohibits the taking of "private property . . . for public use, without just compensation."<sup>264</sup> The just compensation clause here is less restrictive than its California counterpart in that (1) it lacks the jury requirement of the California Constitution, and (2) it does not require the compensation be paid *before* the taking.<sup>265</sup> Because it is less restrictive, the just compensation requirement of the U.S. Takings Clause will likely provide little constitutional protection above and beyond that provided by the California Constitution—if it satisfies the state requirement, the federal clause is not likely to obstruct the MRP proposal.<sup>266</sup>

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258. See *supra* Part IV.B.3.

259. See *supra* note 183 and accompanying text.

260. See, e.g., Letter from Edward J. DeMarco, *supra* note 91.

261. See *supra* Part IV.B (discussing the relevant statutory limitations); *supra* Part IV.C (discussing the relevant state constitutional limitations).

262. See *supra* Part IV.C.

263. U.S. CONST. amend. V.

264. *Id.*

265. California's takings clause expressly requires that just compensation be paid to the owner (or into court for the owner) *before* taking the property. CAL. CONST. art. I, § 19(a). Federal courts have held, on the other hand, that an eminent domain action does not violate the Fifth Amendment merely because it occurs before payment of just compensation. See, e.g., *Bragg v. Weaver*, 251 U.S. 57, 62 (1919); *Liberty Cent. Trust Co. v. Greenbrier Coll. for Women*, 50 F.2d 424, 429 (S.D. W. Va. 1931) (citing precedent), *aff'd* 283 U.S. 800; see also *Yearsley v. W.A. Ross Constr. Co.*, 309 U.S. 18, 21 (1940) (holding that "[t]he Fifth Amendment does not entitle [the owner] to be paid in advance of the taking") (quoting *Hurley v. Kincaid*, 285 U.S. 95, 104 (1932)).

266. Therefore, in the case of S.B. County and any other California municipalities considering the

*B. Violation of Contract Clause?*

The federal Contract Clause prohibits state legislatures from passing any law “impairing the Obligation of Contract.”<sup>267</sup> While there is an argument that the MRP proposal would violate this clause, there is mixed precedent on the issue—it is uncertain how successful such a challenge would be. Eminent domain proceedings often interfere with private contracts, but the U.S. Supreme Court has held that private property and contract rights must yield to legitimate use of state police power.<sup>268</sup> In *Midkiff*, the Court held that “the Contract Clause has never been thought to protect against the exercise of the power of eminent domain.”<sup>269</sup>

Interpretation of the U.S. Contract Clause has undergone a great deal of transformation over the years: it has gained and lost popularity in cycles. The clause was incorporated into the Constitution without record of much debate—its creation is “shrouded in mystery.”<sup>270</sup> At the beginning of the nineteenth century, the Supreme Court applied the clause liberally; it held on multiple occasions that private contracts, in addition to contracts with the state, were protected by the Contract Clause from state interference.<sup>271</sup>

Eventually, the Court began to carve out exceptions. Most notably, and of most relevance here, was the exception for contracts violated through the exercise of certain sovereign functions, including eminent domain.<sup>272</sup> In one case, the Court held that Vermont had not violated the Contract Clause when it condemned a toll bridge, the operation of which it had previously chartered to a private party.<sup>273</sup> The Court noted that eminent domain is “paramount to all private rights vested under the government . . . and must yield in every instance to its proper exercise.”<sup>274</sup>

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plan, the restrictions expanded upon *supra* Part IV.C.2 would likely be determinative.

267. U.S. CONST. art. I, § 10, cl. 1.

268. See *Queenside Hills Realty Co. v. Saxl*, 328 U.S. 80 (1946).

269. *Haw. Hous. Auth. v. Midkiff*, 467 U.S. 229, 243 n.6 (1984).

270. James W. Ely Jr., *Whatever Happened to the Contract Clause?*, 4 CHARLESTON L. REV. 371, 373 (2010) (quoting FORREST MCDONALD, *NOVUS ORDO SECLORUM: THE INTELLECTUAL ORIGINS OF THE CONSTITUTION* 271 (1985)).

271. See, e.g., *New Jersey v. Wilson*, 11 U.S. 164, 167 (1812) (using the clause to protect tax-exemption agreements); *Fletcher v. Peck*, 10 U.S. 87, 142–43 (1810) (using the clause to protect land grants).

272. See *W. River Bridge Co. v. Dix*, 47 U.S. (6 How.) 507 (1848).

273. *Id.* at 536.

274. *Id.* at 532. Although the decision appears to cut strongly in the county’s favor, the Court

In 1934, the Supreme Court further expanded the scope of this police power exception to the Contract Clause. In *Home Building & Loan Ass'n v. Blaisdell*, the Court upheld a legislative moratorium on the foreclosure of mortgages created during the Great Depression.<sup>275</sup> The parallels between *Blaisdell* and the MRP takings proposal are apparent (*Blaisdell* dealt with state interference with mortgage contracts during a time of financial depression); however, *Blaisdell* is also distinguishable due to the temporary nature of the state interference at issue.<sup>276</sup>

By the 1940s, “[t]he advent of New Deal constitutionalism” and the rise of modern skepticism of federal regulation had “completed the effective destruction of Contract Clause jurisprudence.”<sup>277</sup> But the Contract Clause had not been completely destroyed; the Supreme Court revisited the issue in *Allied Structural Steel Co. v. Spannaus*.<sup>278</sup> In that case, Justice Stewart,

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here did not consider the state to have condemned the *contract*, as California did in *Oakland Raiders I* and as S.B. County would do pursuant to the MRP proposal, but rather that the state had condemned the *land*, rendering the contract meaningless in the process. *Id.* at 533. This case would have been more comparable to the S.B. County proposal if the state had taken *only* the charter to use the bridge, and operated it in a way more conducive to the “public good.” Justice McLean directly addressed this in his concurring opinion:

No State could resume a charter, under the power of appropriation, and carry on the functions of the corporation. A bank charter could not be thus taken, and the business of the bank continued for public purposes. Nor could this bridge have been taken by the State, and kept up by it, as a toll-bridge. This could not be called an appropriation of private property to public purposes. There would be no change in the use, except the application of the profits, and this would not bring the act within the power. The power must not only be exercised bona fide by a State, but the property, not its product, must be applied to public use.

*Id.* at 537 (McLean, J., concurring). This precisely demonstrates the difference between extinguishing a mortgage in the process of condemning a *house* and simply condemning the mortgage itself, the former supported by Justice McLean’s analysis and the latter forbidden. *See id.*

275. 290 U.S. 398, 447–48 (1934).

276. The Court noted that:

Whatever doubt there may have been that the protective power of the state, its police power, may be exercised—without violating the true intent of the provision of the Federal Constitution—in directly preventing the immediate and literal enforcement of contractual obligations by a temporary and conditional restraint, where vital public interests would otherwise suffer, was removed by our decisions relating to the enforcement of provisions of leases during a period of scarcity of housing.

*Id.* at 440.

277. Ely, *supra* note 270, at 391–92.

278. 438 U.S. 234 (1978).

delivering the opinion of the Court, addressed the decline in the Clause's use over the preceding decades:

Although it was perhaps the strongest single constitutional check on state legislation during our early years as a Nation, the Contract Clause receded into comparative desuetude with the adoption of the Fourteenth Amendment, and particularly with the development of the large body of jurisprudence under the Due Process Clause of that Amendment in modern constitutional history. Nonetheless, the Contract Clause remains part of the Constitution. It is not a dead letter. And its basic contours are brought into focus by several of this Court's 20th-century decisions.

. . . .

If the Contract Clause is to retain any meaning at all, however, it must be understood to impose *some* limits upon the power of a State to abridge existing contractual relationships, even in the exercise of its otherwise legitimate police power.<sup>279</sup>

The Court addressed the holding in *Blaisdell* and indicated that the decision "clearly implied that if the . . . moratorium . . . had not possessed the characteristics attributed to it by the Court, it would have been invalid under the Contract Clause of the Constitution."<sup>280</sup> The Court then went on to examine the holdings of a number of other post-*Blaisdell* Contract Clause cases.<sup>281</sup>

Particularly relevant to the MRP takings proposal, the *Allied Steel* Court

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279. *Id.* at 241–42 (footnotes omitted).

280. *Id.* at 242.

281. *Id.* at 243–44. *See, e.g.*, *Treigle v. Acme Homestead Ass'n*, 297 U.S. 189 (1936) (holding a Louisiana law that modified existing withdrawal rights of building and loan association members as invalid under the Contract Clause); *W. B. Worthen Co. v. Thomas*, 292 U.S. 426 (1934) (holding an Arkansas law that exempted the proceeds of a life insurance policy from collection by the beneficiary's judgment creditors to be invalid under the Contract Clause since it was not reasonably and definitively tailored to address a severe, temporary emergency for the purpose of furthering the general welfare).

cited *W. B. Worthen Co. v. Kavanaugh*,<sup>282</sup> in which the Court held that “[e]ven when the public welfare is invoked as an excuse’ . . . the security of a mortgage cannot be cut down ‘without moderation or reason or in a spirit of oppression.’”<sup>283</sup> The *Allied Steel* Court also cited *United States Trust Co. v. New Jersey*, in which the Court recognized that:

[A]lthough the absolute language of the Clause must leave room for the essential attributes of sovereign power, . . . necessarily reserved by the States to safeguard the welfare of their citizens, that power has limits when its exercise effects substantial modifications of private contracts. Despite the customary deference courts give to state laws directed to social and economic problems, [l]egislation adjusting the rights and responsibilities of contracting parties must be upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption.<sup>284</sup>

After reviewing these cases, the *Allied Steel* Court held that “[t]he severity of the impairment measures the height of the hurdle the state legislation must clear,” and that “[s]evere impairment . . . will push the inquiry to a careful examination of the nature and purpose of the state legislation.”<sup>285</sup> This checkered history renders Contract Clause arguments somewhat unpredictable at the federal level. While the *Allied Steel* case is said to have revitalized the modern treatment of the Contract Clause after the “near-fatal punch”<sup>286</sup> delivered by *Blaisdell*, these cases are distinguishable. *Allied Steel* dealt with simple contract modification through legislative action, not contract destruction as a result of eminent domain.<sup>287</sup> The *West River Bridge Co.*<sup>288</sup> case, on the other hand, *did* deal with an eminent domain

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282. *W.B. Worthen Co. ex rel. Bd. of Comm'rs of St. Imp. Dist. No. 513 of Little Rock, Ark. v. Kavanaugh*, 295 U.S. 56 (1935).

283. *Allied Structural Steel Co.*, 438 U.S. at 243 (quoting *Kavanaugh*, 295 U.S. at 60 (1935)).

284. *Id.* at 244 (quoting *U.S. Trust Co. v. New Jersey*, 431 U.S. 1, 12 (1977) (internal quotation marks and citations omitted)).

285. *Id.* at 245.

286. Ely, *supra* note 270, at 388.

287. *Allied Structural Steel Co.*, 438 U.S. at 246 (the legislative act “retroactively modif[ied]” back pension payments and “chang[ed] the company’s obligations”).

288. *W. River Bridge Co. v. Dix*, 47 U.S. (6 How.) 507 (1848).

proceeding, albeit one involving real property that affected a contract in a merely consequential manner.<sup>289</sup>

The strongest argument for finding that the Contract Clause will prohibit the MRP proposal comes from the historical function of the clause:

[The Contract Clause] was made part of the Constitution to remedy a particular social evil—the state legislative practice of enacting laws to relieve individuals of their obligations under certain contracts—and thus was intended to prohibit States from adopting ‘as [their] policy the *repudiation of debts* or the destruction of contracts or the denial of means to enforce them.’<sup>290</sup>

Although S.B. County framed the MRP proposal as an eminent domain proceeding with a “voluntary” contract modification, the expressly stated purpose of the legislative action was, at its core, to relieve citizens of debt—“lower principal balance.”<sup>291</sup> This was never the purpose of the eminent domain proceedings in *Midkiff* or the other twentieth century Contract Clause cases, and the fact that it is the goal of the MRP proposal may be the most important distinction.<sup>292</sup>

At the very least, the Contract Clause will place the proposal under an additional level of scrutiny and will keep the door open for independent federal review of the issue. The decision in *Allied Steel* suggests that even if the MRP proposal is found to be a legitimate exercise of state power, and within the bounds of state and federal takings clauses, it could still be invalid under the Contract Clause; indeed, all of the cases above *also* dealt with otherwise legitimate uses of state power that were invalidated on Contract

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289. *Id.* The Vermont legislature used eminent domain to condemn a bridge, necessarily impairing and destroying a franchise agreement between the bridge’s owner and its operator. *Id.* at 516.

290. *Allied Structural Steel Co.*, 438 U.S. at 256 (Brennan, J., dissenting) (alteration in original) (emphasis added) (quoting *Home Bldg. & Loan Ass’n v. Blaisdell*, 290 U.S. 398, 439 (1934)).

291. MORTGAGE RESOLUTION PARTNERS, *supra* note 56.

292. For an expanded discussion on the S.B. County takings proposal and the relevance of the historical purpose of the Contract Clause, see *Examining California County’s Controversial Proposal to Use Eminent Domain to Provide Relief for Underwater Homeowners*, AMERICAN BANKRUPTCY INSTITUTE (July 26, 2012), <http://news.abi.org/podcasts/118-examining-california-countys-controversial-proposal-to-use-eminant-domain-to-provide-re>. This podcast features commentary by Pepperdine School of Law Professor, and former American Bankruptcy Institute Resident Scholar, Mark S. Scarberry.

Clause grounds alone.<sup>293</sup>

### C. Violation of Commerce Clause?

Another clause of the U.S. Constitution worth considering in this analysis is the Commerce Clause. This clause expressly grants to Congress the power “[t]o regulate Commerce with foreign Nations, and among the several States.”<sup>294</sup> In addition to granting this express power, the Commerce Clause has traditionally been read to include a “dormant” clause implicitly forbidding the States from enacting legislation that restricts or imposes upon such interstate commerce, even in areas in which Congress has yet to legislate.<sup>295</sup>

Adopting this interpretation, the Commerce Clause could have blocked the MRP proposal, even without express Congressional action, if adopting the proposal would “regulate those phases of the national commerce which, because of the need of national uniformity, demand that their regulation, if any, be prescribed by a single authority.”<sup>296</sup> By taking mortgages, the condemning government entities may burden national—and even international—securities markets by devaluing the securitized interest in those mortgages.<sup>297</sup> In its report analyzing the current financial crisis, the FCIC determined that such a lack of national uniformity was a major contributor to the collapse of the housing market.<sup>298</sup>

The Commerce Clause is most easily applied to state laws that are genuinely “protectionist” in nature—laws that aim to economically isolate the state.<sup>299</sup> The MRP proposal clearly did not fit into this category of

293. See *supra* note 279 and accompanying text.

294. U.S. CONST. art. I, § 8, cl. 3.

295. See, e.g., *S. Pac. Co. v. Ariz. ex rel Sullivan*, 325 U.S. 761, 767–68 (1945) (“Whether or not [the restriction on state regulation of interstate commerce] is predicated upon the implications of the [C]ommerce [C]ause itself, or upon the presumed intention of Congress, where Congress has not spoken, the result is the same.”) (citations omitted). The Dormant Commerce Clause has an extensive history, first recognized by the Court in *Gibbons v. Ogden*. 22 U.S. 1 (1824). The validity of a state law that interferes with an area in which Congress *has* already acted, on the other hand, is best discussed in terms of the Constitution’s Supremacy Clause. See U.S. CONST. art. VI, cl. 2.

296. *S. Pac. Co.*, 325 U.S. at 767.

297. See Letter from SIFMA, *supra* note 95, at 2. SIFMA asserts that the proposal will create valuation issues for the “complex contractual arrangements traded in national and international markets.” *Id.*

298. See *supra* notes 18–21 and accompanying text.

299. See *City of Phila. v. New Jersey*, 437 U.S. 617, 623–24 (1978); see also *Chem. Waste*

commercial burden: it would not have actually “regulated” the flow of commerce; rather, the MRP proposal addressed local interests and only would have affected interstate commerce incidentally.<sup>300</sup> The Court has adopted a more flexible approach in such cases: it will allow statutes that have this kind of incidental effect on commerce “unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.”<sup>301</sup> The question becomes, therefore, not whether there is an effect on interstate commerce, but to what degree—“the extent of the burden that will be tolerated will . . . 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.”<sup>302</sup>

This test was used in the context of eminent domain, coincidentally, in the remanded Court of Appeal hearing of the *City of Oakland v. Oakland Raiders* case.<sup>303</sup> After the California Supreme Court held that intellectual

Mgmt., Inc. v. Hunt, 504 U.S. 334, 339, 348 (1992) (finding that an additional fee on out-of-state waste products violated the Commerce Clause); *H. P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 544–45 (1949) (invalidating a state law for burdening interstate commerce in order to promote its own economic advantages).

300. The JPA could only have condemned mortgages on homes located within the boundaries of its member municipalities. See *supra* notes 67–74 and accompanying text (outlining the JPA’s authority).

301. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970); see also *City of Phila. v. New Jersey*, 437 U.S. at 623–24.

302. *Pike*, 397 U.S. at 142. However, slight interference with securities transactions at the state level is usually constitutional—statutes requiring registration statements to be filed in-state, for example, are permissible “blue sky laws.” 69A AM. JUR. 2D *Securities Regulation—State* § 6 (2013) (exploring the constitutionality of state securities regulations); see also *Merrick v. N.W. Halsey & Co.*, 242 U.S. 568 (1917) (upholding a Michigan statute that, among other things, required licensing to sell corporate stock); *Hall v. Geiger-Jones Co.*, 242 U.S. 539 (1917) (upholding similar statutes in Ohio).

The actual condemnation and revaluation of securities, however, seems to reach further than most of the burdens in these cases, and remains constitutionally untested. These decisions reflect the pre-Depression era preference *against* federal regulation of securities. *About the SEC: What We Do*, SEC, <http://www.sec.gov/about/whatwedo.shtml> (last visited Jan. 22, 2014). Following the 1929 stock market crash, Congress passed the Securities Act of 1933 and the Securities Exchange Act of 1934 (which created the SEC), radically altering the federal government’s involvement in the securities industry. *Id.*; see also 15 U.S.C. § 77a–aa (the Securities Act of 1933); 15 U.S.C. § 78a–pp (the Securities Exchange Act of 1934). These acts so shifted the balance between federal and state authority over securities law that court decisions predating them provide little guidance in predicting the modern outcome.

303. *Oakland Raiders II*, 220 Cal. Rptr. 153 (Ct. App. 1985); see *supra* notes 136–54 and accompanying text (discussing *Oakland Raiders I*, 646 P.2d 835 (Cal. 1982)). Because *Oakland Raiders II* was heard by the California Court of Appeal, this interpretation of the federal Commerce



property was subject to eminent domain to the same extent as other property, the case was remanded to the lower courts to determine whether Oakland's eminent domain action was in fact a valid exercise of power.<sup>304</sup> The case ultimately hinged on the federal Commerce Clause argument raised by the Raiders.<sup>305</sup> The court held that professional football was such a nationwide business and so completely involved in interstate commerce that acquiring a franchise by eminent domain would "impermissibly burden interstate commerce."<sup>306</sup> The court found that the local public interest in this action—including social welfare and economic benefits—was not compelling enough to outweigh the burden imposed on interstate commerce.<sup>307</sup>

So, the balancing test analysis proposed in *Pike* and applied in *Oakland Raiders II* requires that the burden on interstate commerce created by the MRP proposal *not* outweigh the local benefits it provides.<sup>308</sup> If professional football is so intermingled with interstate commerce that condemning a franchise violates the Commerce Clause, it seems very likely that state action affecting the mortgage industry would also prove unconstitutional, if only because mortgages are traded on a national and international basis.<sup>309</sup>

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Clause would be binding precedent on the MRP proposal as utilized in S.B. County, or anywhere else in California.

304. See *supra* notes 136–54.

305. *Oakland Raiders II*, 220 Cal. Rptr. at 158. Interestingly, the constitutionality of intangible property condemnations that incidentally burdens interstate commerce appears to be a novel question, first addressed by the *Oakland Raiders II* court here. *Id.* at 156.

306. *Id.* at 156–57. The court found a recent California Supreme Court case dealing with interstate commerce and the NFL supported this view. See *Partee v. San Diego Chargers Football Co.*, 668 P.2d 674 (Cal. 1983).

307. *Oakland Raiders II*, 220 Cal. Rptr. at 158. The court determined that the Commerce Clause violation obviated the need to even consider the public use requirement. *Id.*

308. *Supra* note 302–03 and accompanying text.

309. The federal interest in securities-based investment companies is demonstrated by, among other things, the treatment of these companies in the Securities Act and the Security Exchange Act. See *supra* note 302. For example, the Securities Exchange Act protects these companies from certain acts of state interference, on the theory that these investment companies are "affected with a national public interest," and that:

[T]he activities of such companies, extending over many States, their use of the instrumentalities of *interstate commerce* and the wide geographic distribution of their security holders, make difficult, if not impossible, effective State regulation of such companies in the interest of investors.

*Securities Exchange Act*, 15 U.S.C. § 80a-1(a), (a)(5) (2012) (emphasis added). The congressional intent expressed in these regulations suggests that the MBSs that contain S.B. County's mortgages might also be "affected with a national public interest"—by involuntarily revaluing such securities through the condemnation of mortgages, municipalities like S.B. County might be stepping on the

While the burden created by each individual taking may seem insignificant, the nature of mortgages—regulation of the housing industry, roles of the GSEs, nationally controlled interest rates, etc.—suggest that this sort of action could have serious effects that impermissibly extend beyond the borders of the state.

## VI. IMPLICATIONS

While the squabbles of local politicians might not seem to warrant the level of attention currently garnered,<sup>310</sup> this debate did in fact have widespread significance, both legally and practically. Judicial approval of the MRP proposal would likely have redefined our legal understanding of state sovereignty, intangible property rights, and the economic direction of the post-housing-crisis world. The unanswered, and perhaps unanswerable, question remaining today is whether the dire consequences of enacting the MRP proposal outweigh those of not acting at all.

The true danger, in the eyes of MRP's opponents,<sup>311</sup> lies not in the legal precedent set by the proposal, but in its more practical implications—the financial and economic consequences of using eminent domain to take mortgages.<sup>312</sup> In its Federal Register notice,<sup>313</sup> the FHFA cited as paramount its fear that programs like MRP's would make credit less available to new potential homeowners, as well as to potential investors.<sup>314</sup> The “unquantifiable new risk” of municipal use of eminent domain on mortgages will force mortgage originators to retool their lending policies.<sup>315</sup> The mortgage industry claims that these eminent domain proposals will result in significant loss to originators, providing them with less funding for extending future credit and forcing them to “underwrite in a defensive manner.”<sup>316</sup> The citizens of the taking municipalities will ultimately bear the

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toes of the federal government. *See id.*

310. Countless national media outlets have covered S.B. County's handling of the mortgage crisis in recent months, from the *Los Angeles Times*, *supra* notes 13, 97, to the *New Yorker*, *supra* note 37.

311. Most notably SIFMA, *see supra* note 95 and accompanying text, and the FHFA, *see supra* notes 91–92 and accompanying text.

312. *See* Letter from SIFMA, *supra* note 95.

313. *See supra* note 92 and accompanying text.

314. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 47652 (Aug. 9, 2012), available at <http://www.gpo.gov/fdsys/pkg/FR-2012-08-09/pdf/2012-19566.pdf>.

315. Letter from SIFMA, *supra* note 95, at 2.

316. *Id.*

burden of the plan—it will discourage mortgage originators from lending in these municipalities and make credit less accessible.<sup>317</sup>

Taxpayers nationwide would also feel the losses caused by municipal mortgage takings through the extinguishing of federally held investment interest. The FHFA expressed fears that municipalities might target mortgages in which GSEs Fannie Mae and Freddie Mac<sup>318</sup> hold an investment interest.<sup>319</sup> While MRP has never intended to take wholly owned GSE mortgages,<sup>320</sup> the GSEs also own mortgage-backed securities secured by private mortgages.<sup>321</sup> When a city or county takes property, they take it free and clear of any interest burdening it.<sup>322</sup> Therefore, these “secured” mortgage interests in GSE investment portfolios, in addition to those in private investment funds across the globe,<sup>323</sup> would simply disappear, saddling taxpayers with the loss.<sup>324</sup>

The most dangerous consequences of the successful enactment of the

317. *Id.* However, politicians are already challenging the mortgage industry’s right to adjust its lending practices in this way. *See supra* note 82 and accompanying text.

318. GSEs are “privately held corporations with public purposes created by the U.S. Congress to reduce the cost of capital for certain borrowing sectors of the economy.” *Definition of ‘Government-Sponsored Enterprise-GSE’*, INVESTOPEEDIA, <http://www.investopedia.com/terms/g/gse.asp> (last visited Jan. 22, 2014).

319. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. at 47652.

320. MORTGAGE RESOLUTION PARTNERS, *supra* note 56.

321. At the time of their bailouts, “[t]he two GSEs . . . held between them ownership of, guarantees on, or securities backed by over half of the United States’ \$12 trillion residential mortgages.” Oesterle, *supra* note 16, at 733. By owning securities backed by these mortgages, the GSEs would therefore have partial ownership interest in the mortgages in the securitization pool—the very mortgage interest that would be subject to eminent domain in the MRP proposal. *See supra* notes 256–58 and accompanying text.

322. 27 AM. JUR. 2D *Eminent Domain* § 824 (2012). *See* A.W. Duckett & Co. v. United States, 266 U.S. 149, 151 (1924) (“[T]he accurate view would seem to be that such an exercise of eminent domain founds a new title and extinguishes all previous rights.”); Schoellkopf v. United States, 11 Cl. Ct. 447, 450 (1987) (reaching the same conclusion).

323. For example, the Federal Home Loan Banks (FHLBanks), which are also government-sponsored entities, had amassed both GSE MBSs and PLS MBSs—the latter being the type targeted by the MRP plan. FHFB OFFICE OF SUPERVISION, EXAMINATION MANUAL 2–3 (2007), *available at* <http://www.fhfa.gov/webfiles/2671/12.1%20Inv%20Port%20Mgmt%20Narr-1.pdf>. For a more extensive explanation of the FHLBank system, see generally FHFB OFFICE OF SUPERVISION, FHFB EXAMINATION MANUAL (2007), *available at* <http://www.fhfa.gov/webfiles/2654/2.1%20Overview%20of%20the%20FHLBank%20System-1.pdf>.

324. *But cf.* Comment Letter from Mortgage Resolution Partners to FHFA, *supra* note 229, at 2 (claiming that taxpayers will not suffer any loss and that the plan will actually benefit the GSEs, who will avoid the risk of future defaults).

MRP proposal derive from the fact that it will likely be very profitable, creating a high incentive for other investors and municipalities to follow suit. While MRP frequently mentions that it will take only a flat fee, the true value will come from the collateral retained by MRP's investors: the condemned mortgages themselves.<sup>325</sup> This means that in the event of homeowner default, MRP's investors can foreclose on the home and collect its full value—a value that will likely have risen since they paid to condemn it.<sup>326</sup> Like any successful business venture, there will be imitators and this will not be an isolated incident. Before long, firms across the country will attempt to cash in on this lucrative strategy, investing money with cities and counties to fund condemnations. Because the MRP plan hinges on *independently* acting municipalities, the end result will be countless cities and counties across the country condemning securitized mortgages by their own individual terms, resulting in the same lack of national uniformity blamed for contributing to the housing crisis in the first place.<sup>327</sup>

## VII. CONCLUSION

When the JSA voted to turn its attention away from the MRP proposal, the mortgage takings controversy seemed to have come to an end. Mortgage Resolution Partners, however, still had faith in its proposed solution to the housing crisis and continued to encourage municipalities across California, and the nation, to consider turning to eminent domain as the solution to their housing woes. MRP's CEO, Steven Gluckstern, may have phrased it best: “[T]his is a marathon not a sprint, and we’re in the first few miles.”<sup>328</sup> “[W]e have had lots of conversations . . . . You’d like your first guy to have gotten there, but maybe he drops out of the race.”<sup>329</sup>

Without a prominent community pursuing the plan, California courts seem to have lost the opportunity to place these complex legal issues under the judicial microscope. The questions raised by the MRP proposal, however, will not likely go unanswered for long. On September 11, 2013,

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325. *FAQs*, *supra* note 63.

326. Current trends suggest home prices in S.B. County and California will continue to rise, not plummet. *See supra* notes 54–55 and accompanying text.

327. *See supra* note 298 and accompanying text.

328. Ghori, *Eminent Domain Rejected*, *supra* note 104.

329. Lazo, *County Abandons Eminent Domain Mortgage Plan*, *supra* note 97 (internal quotation marks omitted).

the city council of Richmond, California voted four to three to move forward with a version of the MRP plan, making the city the likely site of the next phase of the mortgage takings proposal.<sup>330</sup> Banks representing some of the nation's largest bond investors have already fought back by filing for an injunction against the city (the case was dismissed on procedural grounds).<sup>331</sup>

The MRP proposal suffers from a number of serious flaws that leave it vulnerable to challenges on the local, state, and federal levels. MRP will continue to court struggling municipalities like S.B. County and Richmond. Inevitably, the issue will find its way into a courtroom and both sides of the debate will have the opportunity to plead their cases. S.B. County's flirtation with the MRP plan has set the stage for this future conflict—one that may prove to be among the most important eminent domain cases in recent memory.

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330. Christie, *supra* note 78. Richmond's adaptation of the plan allows the city to "invoke eminent domain if trusts for more than 620 delinquent and performing 'underwater' mortgages reject offers made by the city to buy the loans at deep discount . . . to refinance them and reduce their principal." *Id.*

331. See Wells Fargo Bank, N.A. v. City of Richmond, No. C 13-03663 CRB (N.D. Cal. dismissed Sept. 16, 2013), available at <http://docs.justia.com/cases/federal/district-courts/california/candce/3:2013cv03663/268907/78/0.pdf>. In the dismissal order, the district court judge held that it is not possible to determine the constitutionality of the Richmond proposal until the details of the plan are finalized. *Id.* at 2 ("Ripeness of these claims does not rest on contingent future events certain to occur, but rather on future events that may never occur. . . . [P]ut simply, there may never be a 'final version.'"); see also *Judge Dismisses Lawsuit Against Richmond*, *supra* note 78.

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