A LIFE RAFT FOR UNDERWATER MORTGAGES? WHETHER THE FEDERAL CONSTITUTION PERMITS STATE AND LOCAL GOVERNMENTS TO CONDEMN HOME MORTGAGE CONTRACTS TO SOLVE THE HOUSING CRISIS

KELLY F. HUEDEPOHL*

> *The ongoing problems in the U.S. housing market continue to impede the economic recovery . . . . [A]n unprecedented number of households have lost, or are on the verge of losing, their homes . . . .*
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> *. . . [F]oreclosures inflict economic damages beyond the personal suffering and dislocation that accompany them.*[1]

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* Kelly F. Huedepohl is a third-year law student at the Willamette University College of Law. Ms. Huedepohl would like to thank Professor Gilbert Paul Carrasco for his invaluable insights on this piece, and also Rachel Constantino-Wallace, Trevor Findley, and Rebecca Frolander for their indispensable assistance in bringing this work to publication.

1. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE U.S. HOUSING MARKET: CURRENT CONDITIONS AND POLICY CONSIDERATIONS 1–2 (2012) [hereinafter FEDERAL RESERVE WHITE PAPER], *available at* http://www.federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf.

I. INTRODUCTION

During the first years of the twenty-first century, home prices in the United States skyrocketed. From 2007 to 2010 the housing market underwent a violent correction—causing the prices of real property and homes to fall even faster than they had risen.[2] The effect on local economies and on the national economy was devastating. Banks that held mortgages in securitized trusts sustained massive losses to their investment portfolios.[3] Unemployment levels also climbed sharply during this period.[4] From the year 2000 until early 2008 the unemployment rate in the United States generally was between 4- and 6-percent—occasionally falling below 4-percent.[5] By mid-2008 the unemployment rate began to rise above 6-percent it peaked at 10- percent in October 2009, and currently remains at nearly 8-percent.[6] The unemployment rate has remained above 7.5-percent since 2008.[7]

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2. For more information on the housing market throughout this period, see Robert Hardaway, *The Great American Housing Bubble: Re-Examining Cause and Effect*, 35 U. DAYTON L. REV. 33 (2009).

3. *See id.* at 37–38. The mortgages were packaged and sold in national securitized markets as collateralized debt obligations rated by Standard & Poor's (S&P). On February 4, 2013 the United States Justice Department sued S&P for the ratings it assigned those investments. Jean Eaglesham et. al., *U.S. Sues S&P Over Ratings: Justice Department Says Endorsements of Risky Mortgage Bonds Fueled Crisis*, WALL ST. J. , Feb. 5, 2013, at A1, *available at* http://online.wsj.com/article/SB10001424127887324445904578284064003795142.html; *see also* United States v. Mcgraw-Hill Co. Inc., No. CV13-00779 (C.D. Cal. filed Feb. 4, 2013). The lawsuit alleges violations of the Financial Institutions Reform, Recovery, and Enforcement Act. Complaint for Civil Money Penalties and Demand for Jury Trial at 1, *McGraw-Hill*, No. CV13-00779, *available at* http://www.justice.gov/iso/opa/resources/849201325104924250796.PDF; *see also* 12. U.S.C. § 1833a (2011).

4. *See, e.g.*, Susan Bisom-Rapp, Andrew Frazer & Malcolm Sargeant, *Decent Work, Older Workers and Vulnerability in the Economic Recession: A Comparative Study of Australia, the United Kingdom, and the United States*, 15 EMP. RTS. & EMP. POL'Y J. 43, 92 (2011) (noting that unemployment in the United States "rocketed from a November 2007 pre-recessionary rate of 4.7 percent to a high of 10.1 percent in October 2009").

5. *Labor Force Statistics from the Current Population Survey*, BUREAU OF LABOR STATISTICS, http://www.bls.gov/data/#unemployment (follow "Top Picks" hyperlink for Labor Force Statistics; then select "Unemployment Rate - Civilian Labor Force - LNS14000000"; then follow "Retrieve Data" hyperlink) (last visited Jan.27, 2013).

6. *Id.*

7. *Id.*

Faced with a severe economic contraction, the federal government implemented a nationwide bailout of the banking system to prevent the Great Recession from trumping the Great Depression as the worst economic downturn in the history of the United States.[8]

A. Status of the Housing Market in 2012

By 2012, home prices were no longer plummeting, but the housing market had by no means regained its pre-2007 level.[9] The price of houses in the country as a whole remained at 33 percent below their 2006 values.[10] More than $7 trillion in home equity was lost, an amount that represented more than half of the aggregate home equity that existed in 2006.[11]

As a consequence of the losses in home values, millions of homeowners who had purchased their homes near the peak of the housing "bubble" were "underwater"—they owed more than their homes were worth.[12] In early 2012, about 12 million homeowners nationwide were underwater on their mortgages, representing about 20 percent of all homes subject to a mortgage.[13] In some states, nearly half of all mortgages were underwater.[14] Middle-income families suffered particularly dramatic declines in the value of their home equity relative to their income.[15] Those homeowners who lost their jobs or took wage cuts during the Great Recession, and were unable to stay current on their mortgages, were also unable to sell their homes for the full value of the mortgage.[16] Foreclosure and short-sale rates dramatically increased as a result.[17]

It is against this backdrop that state and local governments in 2012 began to consider using the power of eminent domain to

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8. *See generally* Adam J. Levitin, *In Defense of Bailouts*, 99 GEO. L.J. 435, 437 (2011) (describing the banking system bailout).

9. *See* FEDERAL RESERVE WHITE PAPER, *supra* note 1, at 1.

10. *Id.* at 3.

11. *Id.* "Home equity" is the difference between the value of the home itself and the amount of mortgage debt owed on the property. *Id.* Home equity can be either positive, where the home is worth more than the mortgage debt owed on it, or negative, where the debt owed under one or more mortgage contracts exceeds the value of the property that secures the contract(s) (commonly known as an "underwater mortgage"). *Id.* at 3–4.

12. *Id.* at 4.

13. *Id.*

14. *Id.*

15. *Id.*

16. *See id.* at 5.

17. *See id.* at 8.

purchase and then refinance existing homes to reduce the foreclosure rates in their jurisdiction. One of the leading proponents of the use of eminent domain to combat the housing crisis is a private investment company—Mortgage Resolution Partners, LLC (MRP).[18] MRP's proposal serves as a case study for this Comment, and provides context for the analysis that follows.

B. The Proposed Program

In June 2012, the County of San Bernardino, California and the cities of Fontana and Ontario (collectively, the JPA Entities) created a Joint Powers Authority (JPA) and entered into a Joint Exercise of Powers Agreement (JPA Agreement) to consider proposals to assist homeowners within their jurisdictions whose mortgages reflect negative equity.[19] Each JPA Entity is organized and exists under the laws of the State of California.[20] The stated purpose of the JPA Agreement is to "assist in preserving home ownership and occupancy for homeowners with negative equity within the [JPA Entities'] jurisdictions, avoid the negative impacts of underwater loans and further foreclosures, and enhance the economic vitality and the health of their communities."[21]

The program proposed by the JPA Entities "may include the [JPA's] acquisition of underwater residential mortgage loans by voluntary purchase or eminent domain and the restructuring of these loans to allow homeowners to continue to own and occupy their homes."[22] The JPA Agreement "expressly excludes the power to acquire homes by eminent domain."[23] Thus, the JPA Entities proposed to use the power of eminent domain to take only the mortgage contracts secured by the relevant properties, not the homes themselves. San Bernardino County passed and adopted the JPA Agreement on June 19, 2012.[24]

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18. *See infra* Part I.B.

19. HOMEOWNERSHIP PROTECTION PROGRAM JOINT POWERS AUTHORITY, http://www.homeownershipjpa.org/ (last visited Nov. 11, 2012) [hereinafter JPA AUTHORITY]; First Amended and Restated Joint Exercise of Powers Agreement, Homeowner Protection Program, § C, at 1 (Jun. 19, 2012) [hereinafter JPA Agreement] *available at* http://www.homeownershipjpa.org/Portals/18/Documents/Agreement.pdf.

20. JPA Agreement, *supra* note 19, § A, at 1.

21. *Id.* § C, at 1.

22. *Id.*

23. *Id.*

24. Res. 2012-135, Bd. of Supervisors of the Cnty. of San Bernardino (Cal. 2012),

The JPA Entities began working with MRP to implement the use of eminent domain to acquire underwater mortgages (the Program).[25] According to MRP marketing materials, its implementation of the Program would "force lenders to surrender their mortgage loans to governments for full and fair value as determined by local courts in condemnation proceedings."[26] MRP will target loans held by private-label securitization trusts.[27] MPR further promises that, for homeowners, its Program "is voluntary[ ] [and] . . . does not affect homeowners who choose not to refinance."[28] It is therefore clear that the Program will permit homeowners to choose whether to participate, and the Program will not seek to condemn entire mortgage portfolios, but only individual mortgages.[29]

Importantly, MRP expects that "the current fair market value of such mortgage loans is considerably less than the face amount."[30] Additionally MRP anticipates that "[l]oans and liens will be acquired through eminent domain at *fair value*, which is expected to be less than the market value of the home."[31] This depreciation from both the face value of the contract as well as from the value of the underlying home is expected to occur despite the fact that, under the initial plan, "[o]nly borrowers who appear likely to repay their loans will be accepted. The Program will initially acquire loans that

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available at http://www.homeownershipjpa.org/Portals/18/Documents/Resolution.pdf.

25. Imran Ghori, *San Bernardino County: Mortgage aid expanded*, THE PRESS-ENTERPRISE (Sept. 6, 2012, 6:55 PM), http://www.pe.com/local-news/politics/imran-ghori-headlines/20120906-san-bernardino-county-mortgage-aid-expanded.ece; *see also* Mortgage Resolution Partners, Homeownership Protection Program: A Solution to a Critical Problem, 10, [hereinafter MRP Solution] *available at* http://online.wsj.com/public/resources/documents/EMINENT-powerpoint.pdf (last visited Jan. 24, 2013) ("A consortium of the county and city governments in San Bernardino County, California (the largest county in the United States, outside of Alaska) is promulgating a "Joint Powers Authority" to undertake the first series of the Program together with MRP.").

26. MRP Solution, *supra* note 25, at 4.

27. *Id.* at 9.

28. *See* Rick E. Rayl, *Eminent Domain and Underwater Mortgages: Framing the Debate, Part I*, CAL. EMINENT DOMAIN REP. (July 25, 2012), http://www.californiaeminentdomainreport.com/2012/07/articles/eminent-domain-and-underwater-mortgages-framing-the-debate-part-1/ (Author's note: this information was available on the Mortgage Resolution Partners homepage as of Dec. 26, 2012, http://mortgageresolutionpartners.com/, but has since been removed).

29. *See* MRP Solution, *supra* note 25, at 9, 11 (explaining that MRP will target specific mortgages).

30. *Id.* at 4.

31. *Id.* at 9 (emphases in original).

are . . . relatively current (not in default)."[32] MRP has since indicated that it will modify the Program to include mortgages that are delinquent or in default.[33] MRP also promises that "[n]o taxpayer funds will be used in connection with the Program."[34]

MRP suggests that, after exercising the power of eminent domain, "governments will be able to restructure the mortgage loans acquired though [sic] eminent domain and refinance severely underwater homeowners . . . into new loans to be sold to large, private sector investors as FHA GinnieMae securities."[35] MRP will act as a manager of the Program, work with local governments during the eminent domain process, and screen loans for Program qualification.[36] MRP will charge a flat fee for its services.[37]

On January 24, 2013, the JPA Entities rejected the use of eminent domain as a tool to combat the underwater mortgage crisis.[38] However, at least one Commissioner from the city of Fontana indicated that the city will continue to explore the use of eminent domain without JPA participation.[39] Fontana is not alone.[40] It is reported that as many as 30 other counties and cities have expressed interest in implementing the Program.[41]

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32. *Id.*

33. Joe Nelson, *Mortgage Resolution Partners' Proposal to Acquire Underwater Mortgages Via Eminent Domain Expanded to Include Delinquent and Defaulted Borrowers*, SAN BERNARDINO SUN (Sept. 7, 2012), http://www.canfieldpress.com/mortgage-resolution-partners-proposal-to-acquire-underwater-mortgages-via-eminent-domain-expanded-t.

34. MRP Solution, *supra* note 25, at 4.

35. *Id.*

36. *Id.* at 9.

37. *Id.*

38. 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.

39. Imran Ghori, *San Bernardino County: Eminent Domain Mortgage Solution Rejected*, THE PRESS-ENTERPRISE (Jan. 24, 2013), http://www.pe.com/local-news/politics/imran-ghori-headlines/20130124-san-bernardino-county-eminent-domain-mortgage-solution-rejected.ece.

40. *See* D.L. Taylor, *Concept Could Save Thousands of Salinas Homes: City Council Must Decide on Underwater Mortgages Plan*, THE CALIFORNIAN (Feb. 5, 2013), http://www.thecalifornian.com/article/20130205/NEWS01/302040036/Concept-could-save-thousands-Salinas-homes ("Several key elected officials . . . have been in contact with the principal of a firm called Mortgage Resolution Partners."); Eleazar David Melendez, *Brockton, Massachusetts, Considers Eminent Domain to Address Foreclosures*, HUFFINGTON POST (Jan. 11, 2013), http://www.huffingtonpost.com/2013/01/11/brockton-eminent-domain-foreclosure_n_2458369.html.

41. Jon Prior, *Still No Partner for Radical Mortgage Resolution*, POLITICO (Jan. 16,

C. FHFA Response to the Program

The JPA Entities' plan and their collaboration with MRP became the focus of national attention. On August 9, 2012, the Federal Housing Finance Agency (FHFA) submitted a request for comments on the use of eminent domain to revise existing financial contracts.[42] The request noted that "FHFA has significant concerns with programs that could have a chilling effect on the extension of credit to borrowers."[43]

FHFA's concerns stem in part from its oversight of Fannie Mae and Freddie Mac (the Enterprises).[44] The Enterprises operate in FHFA conservatorships to support the national housing market.[45] The MRP program could affect Enterprise holdings directly, as well as indirectly, through the market in which they operate, because "[t]he Enterprises purchase a large portion of the mortgages originated in the United States and they hold private label mortgage backed securities containing pools of non-Enterprise loans."[46] The FHFA also oversees the Federal Home Loan Banks (Banks).[47] According to the request for comment, "FHFA has significant concerns about the use of eminent domain to revise existing financial contracts and the alteration of the value of Enterprise or Bank security holdings."[48]

MRP's Program is responding to genuine troubles in the housing market. The Board of Governors of the Federal Reserve (the Federal Reserve Board) described the national housing market as experiencing "extraordinary problems."[49] According to the Federal Reserve Board, among other factors, those problems

> reflect three key forces originating from within the housing market itself: [1] a persistent excess supply of vacant homes on the market, many of which stem from foreclosures; [2] a marked and potentially long-term downshift in the supply of mortgage credit;

2013), http://www.politico.com/story/2013/01/still-no-partner-for-radical-mortgage-resolution-86233.html; *see also* Ghori, *supra* note 39.

42. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 154, 47652 (Aug. 9, 2012).

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

49. FEDERAL RESERVE WHITE PAPER, *supra* note 1, at 2.

> and [3] the costs that an often unwieldy and inefficient foreclosure process imposes on homeowners, lenders, and communities.[50]

Mortgage contracts impact all three of the "key forces" described by the Federal Reserve Board; therefore, it is perfectly logical for a local government to target mortgages when considering potential interventions or solutions to the housing crisis. Whether the taking of mortgages through the power of eminent domain is either desirable or constitutional is another matter.

In light of the MRP's proposed Program, "FHFA has determined that action may be necessary on its part as conservator for the Enterprises and as regulator for the Banks to avoid a risk to safe and sound operations and to avoid taxpayer expense."[51] Prior to the proposed Program, the Federal Reserve Board considered potential courses of action to respond to the housing market difficulties. Although it does not appear that the Federal Reserve Board specifically contemplated the use of eminent domain, it did consider the possibility that action taken to effect a housing market correction could negatively impact the holdings of the FHFA Enterprises, and concluded that "some actions that cause greater losses to be sustained by the [Enterprises] in the near term might be in the interest of taxpayers to pursue if those actions result in a quicker and more vigorous economic recovery."[52] Despite FHFA's concerns, federal policy is not necessarily uniformly against local governments using the power of eminent domain to buy up mortgage contracts.

D. Relevant Constitutional Provisions

"The Fifth Amendment [to the U.S. Constitution], made applicable to the States through the Fourteenth Amendment [to the U.S. Constitution], provides that 'private property' shall not 'be taken for public use, without just compensation.'"[53] Thus, local governments may only condemn property if they do so for a "public purpose." The condemning authority may take the property once a proper "public purpose" has been established, but the United States Constitution requires that just compensation be paid to the property's

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50. *Id.*

51. Use of Eminent Domain to Restructure Performing Loans, 77 Fed. Reg. 154, 47652 (Aug. 9, 2012).

52. FEDERAL RESERVE WHITE PAPER, *supra* note 1, at 2–3.

53. Phillips v. Wash. Leg. Found., 524 U.S. 156, 163–64 (1998).

owner.[54]

Because securitized mortgages, the very ones targeted by the Program, are traded regularly in interstate commerce, the Commerce Clause[55] may prohibit the use of eminent domain to target those mortgages. The negative aspect of the Commerce Clause, which sometimes prohibits states from interfering with interstate commerce even where Congress has not legislated in an area, is known as the Dormant Commerce Clause.[56] The Dormant Commerce Clause permits a state to take action in its sovereign capacity only where the effects on interstate commerce are "incidental," and where the burden on interstate commerce cause by the state's action is not "clearly excessive" in relation to the asserted local benefits.[57]

The Contracts Clause[58] may also prohibit a state or local government from using the power of eminent domain to condemn one party's property interest in a mortgage.[59] First, this Comment will address whether the Contracts Clause may foreclose the option to condemn mortgage contracts, and thereafter will analyze the proposed condemnation under the Fifth Amendment.

II. THE CONTRACTS CLAUSE

Article I, Section 10 of the United States Constitution provides that "No State shall . . . pass any . . . Law impairing the Obligation of Contracts." The Contracts Clause was adopted because "[t]he widespread distress following the revolutionary period and the plight of debtors had called forth in the States an ignoble array of legislative schemes for the defeat of creditors and the invasion of contractual obligations."[60] In fact, "legislative interferences had been so numerous and extreme that the confidence essential to prosperous trade had been undermined and the utter destruction of credit was

54. *See infra* Part III.

55. U.S. CONST., art. I, § 8, cl. 3.

56. *See, e.g.*, Edgar v. MITE Corp., 457 U.S. 624, 640 (1982).

57. Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

58. U.S. CONST., art. I, § 10.

59. *See, e.g.*, Walter Dellinger, Jonathan Hacker & Matthew Close, *Memorandum: San Bernardino Eminent Domain Proposal*, O'Melveny & Myers LLP, at 8 (July 16, 2012) [hereinafter O'Melveny Memo], *available at* http://www.sifma.org/uploadedfiles/issues/capital_markets/securitization/eminent_domain/memorandumfromo'melvenymyerstosifmaresanbernardinoeminentdomainproposal071612.pdf.

60. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 427 (1934).

threatened."[61] The underlying purpose of the Contracts Clause is particularly relevant to the present case, because it is proposed that mortgage contracts will be condemned and then modified to force one party to the contract to realize losses that result from a market fluctuation.

Under the Contracts Clause, "[t]he obligations of a contract are impaired by a law which renders them invalid, or releases or extinguishes them."[62] By this standard, the Program will impair any mortgage contracts that it condemns. The Program does not contemplate paying mortgage holders (mortgagees) the face value of any condemned contracts,[63] but because the contracts are condemned in their entirety, the homeowners' obligations to pay the face value will be extinguished.[64]

In *Home Building & Loan Association v. Blaisdell*, the State of Minnesota passed a law permitting mortgagors to obtain judicial relief to postpone foreclosure proceedings.[65] Minnesota did not purport to use the power of eminent domain to effect the resulting contract modification,[66] but the Supreme Court's consideration of the limits of the Contracts Clause in that context informs the present analysis. In that case, the Supreme Court found that "where constitutional grants and limitations of power are set forth in general clauses, which afford a broad outline, the process of construction is essential to fill in the details. That is true of the contract clause."[67] When the Supreme Court evaluates the Contracts Clause, it "examine[s] the course of judicial decisions in its application. These put it beyond question that the prohibition [that states not impair the obligation of contracts] is not an absolute one and is not to be read with literal exactness like a mathematical formula."[68]

The Contracts Clause is

> qualified by the measure of control which the state retains over remedial processes, but the state also continues to possess

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61. *Id.*
62. *Id.* at 431.
63. MRP Solution, *supra* note 25, at 4.
64. *See generally* MRP Solution, *supra* note 25; JPA Agreement, *supra* note 19.
65. *Blaisdell*, 290 U.S. at 416.
66. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 596 (1935).
67. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 426 (1934).
68. *Id.* at 428.

> authority to safeguard the vital interests of its people. It does not matter that legislation appropriate to that end has the result of modifying or abrogating contracts already in effect.[69]

Importantly, "the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order."[70] To determine the scope of the condemning authority's power, "[t]he question is not whether the legislative action affects contracts incidentally, or directly or indirectly, but whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end."[71]

The balance of the inherent powers of sovereignty against the limitation imposed by the Contracts Clause was described by the Supreme Court:

> Undoubtedly, whatever is reserved of state power must be consistent with the fair intent of the constitutional limitation of that power. The reserved power cannot be construed so as to destroy the limitation, nor is the limitation to be construed to destroy the reserved power in its essential aspects. They must be construed in harmony with each other.[72]

Specifically, "that power [to modify contracts under an attribute of sovereignty] cannot be said to be nonexistent when the urgent public need demanding such relief is produced by . . . economic causes."[73] Furthermore, the Supreme Court looks only to see whether the state's legislation is within the scope of its power, not "[w]hether the legislation is wise or unwise as a matter of policy."[74]

The existence of an "emergency" does not affect the analysis of the Contracts Clause, because an "[e]mergency does not create power. Emergency does not increase granted power or remove or diminish the restrictions imposed upon power granted or reserved . . . . While emergency does not create power, emergency may furnish the occasion for the exercise of power."[75] The presence of an

69. *Id.* at 434–35 (internal quotation marks omitted).
70. *Id.* at 435.
71. *Id.* at 438.
72. *Id.* at 439.
73. *Id.* at 439–40.
74. *Id.* at 447–48.
75. *Id.* at 425–26.

"emergency" or other exigency is relevant as to whether the exercise of eminent domain is appropriate within the meaning of "public use" in the Fifth Amendment,[76] but it does not affect the analysis of the Program under the Contracts Clause.

Generally, the Supreme Court employs a three-part test to determine whether the Contracts Clause permits particular legislation: (1) whether the state law operates as a "substantial impairment of a contractual relationship," (2) whether the law or regulation was passed pursuant to a "substantial or legitimate public purpose," and (3) whether the legislature's "adjustment of the rights and responsibilities of the contracting parties is based upon reasonable conditions and is of a character appropriate to the public purpose justifying the legislation's adoption."[77]

The Supreme Court in *Midkiff* stated that "the Contract Clause has never been thought to protect against the exercise of the power of eminent domain."[78] The Court in *Blaisdell* was more explicit—"all contracts are subject to the right of eminent domain. The reservation of this necessary authority of the state is deemed to be a part of the contract."[79]

The question is not definitively settled, however, because the Supreme Court in *Louisville Joint Stock* qualified the power of states to use eminent domain to impair contracts: "[t]he bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment. Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, *unlike the states*, it is not prohibited from impairing the obligations of contracts."[80] In that context, the Court found:

> If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of

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76. *See supra* Part III.B.

77. Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400, 411–12 (1983); *see also* O'Melveny Memo., *supra* note 59, at 8–9.

78. Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 243 (1984); *see also* W. River Bridge Co. v. Dix, 47 U.S. 507, 523 (1848) ("It is not to be supposed, that the purpose of this restriction [the prohibition contained within the Contracts Clause] was to extinguish a power [specifically, the power of eminent domain] in the several State sovereignties so essential to the exercise of their functions.").

79. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 435 (1934).

80. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 589 (1935) (emphasis added).

> individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public.[81]

Where the fair market value of a contract and the face value of a contract are the same, or very nearly the same, a state or municipality would likely be able to exercise the power of eminent domain to buy out the rights of one of the contracting parties. However, where, as here, a state or local government seeks to use its power of eminent domain to buy the rights of one party to a contract *because* the face value and the market value of the contract could be quite different, the interplay of the Fifth Amendment and the Contracts Clause is less certain. In such a case, the "just compensation" provision in the Fifth Amendment could potentially require the governmental entity to pay at or near face value, regardless of the current market value of the contract.[82] Otherwise, the party being bought out loses the benefit of the bargain—the right to collect the contract sum without regard to any fluctuation in the value of the underlying property.

In essence, where a governmental entity condemns a performing underwater mortgage it takes the interest in the underlying property and any excess value of the contract beyond the value of that property.

III. THE POWER OF EMINENT DOMAIN

A state can vest a municipality or other local government with the power of eminent domain.[83] The Constitution does not confer the power of eminent domain upon the states. The states, as sovereigns, possess this power independent from any federal grant, because "[t]he power to take private property for public uses, generally termed the right of eminent domain, belongs to every independent government. It is an incident of sovereignty, and . . . requires no constitutional recognition."[84]

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81. *Id.* at 602.

82. *See infra* Part III.B.

83. *See, e.g.*, City of Cincinnati v. Vester, 281 U.S. 439, 448 (1930). For purposes of simplicity, this Comment will refer to "State" power whenever the condemning authority is a state or local, rather than federal, entity.

84. United States v. Jones, 109 U.S. 513, 518 (1883) (holding that while the sovereign's power of eminent domain cannot be delegated to another authority, the determination of just compensation can be delegated).

The United States Supreme Court has explained the necessity of the power of eminent domain:

> The power of eminent domain is essential to a sovereign government. If the [Government] has determined its need for certain land for a public use that is within its . . . sovereign powers, it must have the right to appropriate that land. Otherwise, the owner of the land, by refusing to sell it or by consenting to do so only at an unreasonably high price, is enabled to subordinate the constitutional powers of [that government] to his personal will. The Fifth Amendment, in turn, provides him with important protection against abuse of the power of eminent domain by the . . . Government.[85]

Here the Court set out the two policy reasons that require that sovereign governments retain the power of eminent domain: (1) the power to force a sale to occur at all, and (2) the power to prevent the seller from demanding an unreasonably high price. The Fifth Amendment limits that inherent power:

> The provision found in the fifth amendment to the federal constitution, and in the constitutions of the several states, for just compensation for the property taken, is merely a limitation upon the use of the power [of eminent domain]. It is no part of the power itself, but a condition upon which the power may be exercised.[86]

"While it confirms the State's authority to confiscate private property, the text of the Fifth Amendment imposes two conditions on the exercise of such authority: the taking must be for a 'public use' and 'just compensation' must be paid to the owner."[87] Those two limitations, taken together, "ensure stable property ownership by providing safeguards against excessive, unpredictable, or unfair use of the government's eminent domain power — particularly against those owners who, for whatever reasons, may be unable to protect themselves in the political process against the majority's will."[88]

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85. United States v. Carmack, 329 U.S. 230, 236–37 (1946).

86. *Jones*, 109 U.S. at 518.

87. Brown v. Legal Found. of Wash., 538 U.S. 216, 231–32 (2003).

88. Kelo v. City of New London, Conn., 545 U.S. 469, 496 (2005) (O'Connor, J., dissenting).

The Fifth Amendment does not define the particular property or property interests that it protects; instead, because "the Constitution protects rather than creates property interests, the existence of a property interest is determined by reference to 'existing rules or understandings that stem from an independent source such as state law.'"[89] It is clear, however, that, as a general proposition of law, contracts are property subject to the power of eminent domain.[90]

The owner of property subject to condemnation is entitled to procedural due process: "Due process of law, as applied to judicial proceedings instituted for the taking of private property for public use means, therefore, such process as recognizes the right of the owner to be compensated if his property be wrested from him and transferred to the public."[91] Thus, the Fourteenth Amendment requires the states to employ particular processes, rather than commanding a particular result.

A. The "Public Purpose" Requirement

When the Supreme Court "began applying the Fifth Amendment to the States at the close of the 19th century, it embraced the . . . interpretation of public use as 'public purpose.'"[92] Thus, the public does not actually have to use or have access to the property, but only obtain some benefit from it.[93] Further, "[i]t is not essential that the entire community, nor even any considerable portion, should directly enjoy or participate in an improvement in order to constitute a public use."[94]

The fact that the Program proposed by MRP will most directly benefit the homeowners whose mortgages are rewritten does not necessarily mean that the Program is not a "public use" under the

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89. Phillips v. Wash. Leg. Found., 524 U.S. 156, 163–64 (1998) (quoting Board of Regents of State Colleges v. Roth, 408 U.S. 564, 577 (1972)).

90. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 435 (1934); Long Island Water-Supply Co. v. City of Brooklyn, 166 U.S. 685, 690 (1897) ("A contract is property, and, like any other property, may be taken under condemnation proceedings for public use.").

91. Chicago, B. & Q.R. Co. v. City of Chicago, 166 U.S. 226, 236–37 (1897).

92. *Kelo*, 545 U.S. at 480.

93. Fallbrook Irrigation Dist. v. Bradley, 164 U.S. 112, 161 (1896) ("To irrigate, and thus to bring into possible cultivation, these large masses of otherwise worthless lands, would seem to be a public purpose, and a matter of public interest, not confined to the landowners, or even to any one section of the state."); Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 243–44 (1984).

94. Rindge Co. v. Los Angeles Cnty., 262 U.S. 700, 707 (1923).

Fifth Amendment. A use does not "fail to be public upon the ground that the immediate enjoyment of it is limited to a small group or even to a single person."[95] In fact, it is axiomatic that "the government's pursuit of a public purpose will often benefit individual private parties."[96]

MRP's plan to sell the rewritten mortgages to private investors also will not necessarily defeat the Program because "[t]he mere fact that property taken outright by eminent domain is transferred in the first instance to private beneficiaries does not condemn that taking as having only a private purpose."[97]

That is not to say that courts will assume that the proposed transactions confer a public benefit. "[T]he Court's cases have repeatedly stated that 'one person's property may not be taken for the benefit of another private person without a justifying public purpose, even though compensation be paid.'"[98] If a court did find that the Program conveyed a solely private benefit, the Program "could not withstand the scrutiny of the public use requirement; it would serve no legitimate purpose of government and would thus be void."[99]

There are a multitude of public purposes that MRP can assert the prevention of foreclosures will serve. Some of the economic consequences of foreclosures include "'deadweight losses,' or costs that do not benefit anyone, including the neglect and deterioration of properties that often sit vacant for months (or even years) and the associated negative effects on neighborhoods."[100] Reduction in foreclosure rates in a particular area may reduce the number of vacant properties in that area.[101] Furthermore, at least one study found that "higher neighborhood foreclosure rates lead to higher levels of violent crime at appreciable levels."[102] This finding suggests that "foreclosures may have important social and economic consequences on neighborhoods beyond effects on the finances of households

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95. United States v. Boyle, 52 F. Supp. 906, 908 (N.D. Ohio 1943), *aff'd sub nom.* City of Cleveland v. United States, 323 U.S. 329 (1945).

96. Kelo v. City of New London, Conn., 545 U.S. 469, 485 (2005).

97. *Midkiff*, 467 U.S. at 243–44.

98. *Id.* at 241 (quoting Thompson v. Consol. Gas Corp., 300 U.S. 55, 80 (1937)).

99. *Id.* at 245.

100. FEDERAL RESERVE WHITE PAPER, *supra* note 1, at 2.

101. Dan Immergluck & Geoff Smith, *The Impact of Single-family Mortgage Foreclosures on Neighborhood Crime*, 21 HOUSING STUDIES 851, 854 (2006).

102. *Id.* at 863.

directly affected by the foreclosure."[103] Any challenger to the "public use" prong of the Fifth Amendment should consider that "where the exercise of the eminent domain power is rationally related to a conceivable public purpose, the Court has never held a compensated taking to be proscribed by the Public Use Clause."[104]

Where the power of eminent domain is exercised by a state or local government, rather than by the federal government, the Fourteenth Amendment does not add any additional "public use" requirement beyond what the Fifth Amendment requires. Thus, the construction of "public use" as "public purpose" applies as much to the states as it does to the federal government.[105] The extent of "the 'public use' requirement is . . . coterminous with the scope of a sovereign's police powers."[106]

Courts are extremely deferential to a legislative body's determination about whether a particular use of land furthers the public purpose: where the states legislate concerning local affairs, "[s]ubject to specific constitutional limitations, when the legislature has spoken, the public interest has been declared in terms well-nigh conclusive. In such cases the legislature, not the judiciary, is the main guardian of the public needs to be served by social legislation."[107] This deferential standard has important implications for any challenger to a state's use of eminent domain on the ground that the use does not qualify as a "public purpose," because the "public use" limitation is liberally construed by the courts: "[w]hen the legislature's purpose is legitimate and its means are not irrational, our cases make clear that empirical debates over the wisdom of takings—no less than debates over the wisdom of other kinds of socioeconomic legislation—are not to be carried out in the federal courts."[108] The Supreme Court has explained that:

> Two polar propositions are perfectly clear. On the one hand, it has long been accepted that the sovereign may not take the property of

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103. *Id.*

104. Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 241 (1984).

105. *Id.* at 244.

106. *Id.* at 240.

107. Berman v. Parker, 348 U.S. 26, 32 (1954); *see also* Thomas W. Merrill, *The Economics of Public Use*, 72 CORNELL L. REV. 61, 63 (1986) (arguing that eminent domain "cases suggest that courts have no theory or conceptual foundation from which meaningful standards for judicial review of public use issues might originate").

108. *Midkiff*, 467 U.S. at 242–43.

> A for the sole purpose of transferring it to another private party B, even though A is paid just compensation. On the other hand, it is equally clear that a State may transfer property from one private party to another if future "use by the public" is the purpose of the taking.[109]

Although the Fifth Amendment imposes a "public use" limitation on the exercise of eminent domain, judicial deference to the legislature's determination of the public interest "admits of no exception merely because the power of eminent domain is involved. The role of the judiciary in determining whether that power is being exercised for a public purpose is an extremely narrow one."[110] The standard of review for whether a legislative body has properly determined that a public use exists is the deferential "arbitrary and capricious" standard.[111] It is true that,

> The nature of a use, whether public or private, is ultimately a judicial question. However the determination of this question is influenced by local conditions; and this court, while enforcing the Fourteenth Amendment, should keep in view the diversity of such conditions and regard with great respect the judgments of state courts upon what should be deemed public uses in any state.[112]

With respect to what legislatures may deem to be a public purpose, the Supreme Court has declared that "[t]he concept of the public welfare is broad and inclusive."[113] Under the Fifth Amendment, "[o]nce the object is within the authority of Congress [or

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109. Kelo v. City of New London, Conn., 545 U.S. 469, 477 (2005); *see also* Mills v. St. Clair Cnty., 49 U.S. 569, 585 (1850) ("That the power [of eminent domain] may be abused, no one can deny; and that it is abused, when private property is taken, not for public use, but to be leased out to private occupants to the end of raising money, is too plain for reasoning to make it more so.").

110. *Berman*, 348 U.S. at 32.

111. *See* United States v. Carmack, 329 U.S., 230, 248 (1946); *see also* United States v. 43,355 Square Feet of Land in King Cnty., Wash., 51 F. Supp. 905, 907 (W.D. Wash. 1943) (When the government condemns land, "it is required that the Government proceed in good faith, constructive good faith as well as good faith in fact, and that the proceeding be not arbitrary or capricious.").

112. Rindge, Co. v. Los Angeles Cnty., 262 U.S. 700, 705–06 (1923); *see also Kelo*, 545 U.S. at 482 ("Viewed as a whole, our jurisprudence has recognized that the needs of society have varied between different parts of the Nation, just as they have evolved over time in response to changed circumstances.").

113. Berman v. Parker, 348 U.S. 26, 33 (1954).

the States], the right to realize it through the exercise of eminent domain is clear. For the power of eminent domain is merely the means to the end."[114]

Attempts to effect beneficial economic outcomes can qualify as a public use because "[p]romoting economic development is a traditional and long-accepted function of government."[115] Where the "public purpose" is to encourage economic development, the Supreme Court has declined to require that the condemning authority establish that there is a "reasonable certainty" that the expected public benefits will occur.[116]

It is a substantial question whether a transfer of wealth to obtain purely economic gains can satisfy the requirements of the Fifth Amendment. Where the Supreme Court has permitted the use of eminent domain to achieve economic ends, it has always done so in the context of some concurrent justification for the exercise of the power, such as regulating oligopolies[117] or pursuant to an integrated and comprehensive physical development plan.[118] In MRP's proposed Program, the justifications propounded by the condemning authority can certainly be cast as less comprehensive or articulable than in *Midkiff* and *Kelo*. A substantial justification for the exercise of eminent domain here is to affect the market for mortgages by changing the relative positions of power between the parties.

Opponents of the Program will emphasize that there are persuasive policy reasons to prohibit a government from using eminent domain where the government's justification is that the current market value of collateral has fallen substantially below the face value of the contract. A government could virtually always justify the acquisition of investment instruments in a down market on "public use" grounds; after all, if the market later recovers, the government will be able to sell its securities at a much higher price than what it paid, to the benefit of the public coffers. To permit state and local governments to employ eminent domain for such purposes would inject considerable uncertainty into investment markets, deprive investors of the benefit of the risks that they take, and work a

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114. *Id.*

115. Kelo v. City of New London, Conn., 545 U.S. 469, 484 (2005).

116. *Id.* at 487–88.

117. *See* Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 241–42 (1984) ("Regulating oligopoly and the evils associated with it is a classic exercise of a State's police powers.").

118. *See Kelo*, 545 U.S. at 478, 486–87.

considerable change upon the United States economy.

Although the Supreme Court has rejected a "heightened review" for takings justified by economic benefits,[119] it is questionable whether the United States Constitution permits local governments to condemn investment instruments without also condemning the assets that secure those instruments, particularly where the goal is to secure a benefit to one party to the contract at the expense of the other. Such a program seems to contravene the Fifth Amendment's requirement that "through taxation, the burden of the relief afforded in the public interest may be borne by the public."[120]

Despite these policy concerns, the deference accorded to legislative determinations about what constitutes a "public use," indicates that the MRP Program will survive the first prong of the Fifth Amendment Takings Clause because the prevention of foreclosures (the end) is certainly legitimate, thus indicating that employing eminent domain (the means) is permitted by the Constitution.

B. The "Just Compensation" Requirement

"The Fifth Amendment does not proscribe the taking of property; it proscribes taking without just compensation."[121] The just compensation prong of the Fifth Amendment Takings Clause "is designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."[122]

The just compensation requirement is not conditional or equivocal. "When the government physically takes possession of an interest in property for some public purpose, it has a categorical duty to compensate the former owner, regardless of whether the interest that is taken constitutes an entire parcel or merely a part thereof."[123] The just compensation required by the Constitution "means the full and perfect equivalent in money of the property taken. The owner is

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119. *Id.* at 487–488.

120. Louisville Joint Stock Land Back v. Radford, 295 U.S. 555, 601 (1935).

121. Williamson Cnty. Reg'l Planning Comm'n v. Hamilton Bank of Johnson City, 473 U.S. 172, 194 (1985).

122. First English Evangelical Lutheran Church of Glendale v. Los Angeles Cnty., Cal., 482 U.S. 304, 318–19 (1987) (internal quotation marks omitted).

123. Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 535 U.S. 302, 322 (2002) (internal citation omitted).

to be put in as good position pecuniarily as he would have occupied if his property had not been taken."[124] Although there are common measures employed to determine just compensation, each measure should be evaluated against the particulars of the case in order to ensure that the compensation is "full" and "perfect."

Just compensation normally is measured by fair market value.[125] To arrive at fair market value, the Supreme Court "has repeatedly held that just compensation normally is to be measured by the market value of the property at the time of the taking contemporaneously paid in money."[126] This means that "the valuation of property which has been taken must be calculated as of the time of the taking."[127] The rationale for using market value as the measure of just compensation is that market value "achieves a fair 'balance between the public's need and the claimant's loss.'"[128]

The fair market value requirement does not guarantee the property owner will recover all of the money that he has spent on his property; the fair market value "may be more or less than the owner's investment. [The owner] may have acquired the property for less than its worth or . . . may have paid a speculative and exorbitant price. Its value may have changed substantially while held by [the owner]."[129] The underlying principle of the market value rule is that "[the owner] must be made whole but is not entitled to more. It is the property and not the cost of it that is safeguarded by state and Federal Constitutions."[130]

The U.S. Constitution guarantees to the owners of property the right to a fair *process* with respect to the determination of just compensation. The process established by the States

> is merely an inquisition to establish a particular fact as a preliminary to the actual taking; and it may be prosecuted before commissioners or special boards or the courts, with or without the intervention of a jury, as the legislative power may designate. All that is required is that it shall be conducted in some fair and just

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124. United States v. Miller, 317 U.S. 369, 373 (1943).

125. *See, e.g.*, United States v. 50 Acres of Land, 469 U.S. 24, 25–26 (1984).

126. *Id.* at 29 (internal quotation marks omitted).

127. *First English*, 482 U.S. at 320.

128. *50 Acres of Land*, 469 U.S. at 33 (citing United States v. Toronto, Hamilton & Buffalo Navigation Co., 338 U.S. 396, 402 (1949)).

129. Olson v. United States, 292 U.S. 246, 255 (1934).

130. *Id.*

> manner, with opportunity to the owners of the property to present evidence as to its value, and to be heard thereon.[131]

This standard defers to a state's determination of just compensation. The United States Supreme Court, then, will not necessarily engage in the fact-bound inquiry of determining whether the compensation paid to the owners of mortgages is "just," but instead will look merely to see if the property owner was afforded notice and an opportunity to offer evidence of value. Although the amount of compensation is a question of fact, the method by which value is determined is a question of law,[132] and because of the potential national economic ramifications of multiple jurisdictions condemning mortgages, the Supreme Court could take up the question of which valuation methods are permissible. At least in the context of regulatory takings, the Supreme Court has recognized that "investment-backed expectations" are protected by the Fifth Amendment differently than other interests.[133]

Deviation from the market value measure of just compensation "has been required only when market value has been too difficult to find, or when its application would result in manifest injustice to owner or public."[134] The "manifest injustice" standard is a stringent one: the fact that, for example, the cost to acquire or build a substitute facility would greatly exceed the market value of the condemned facility does not inflict the kind of "manifest injustice" that justifies departure from the market value method.[135] To determine the appropriate valuation method for the property at issue, "the dominant consideration always remains the same: What compensation is 'just' both to an owner whose property is taken and to the public that must pay the bill?"[136]

Where a government entity seeks to condemn contracts that

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131. United States v. Jones, 109 U.S. 513, 519 (1883).

132. *Cf.* United States v. Miller, 317 U.S. 369, 380 (1943) ("questions of substantive right—such as the measure of compensation—[are] grounded upon the Constitution of the United States").

133. *See* Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978); Palazzolo v. R.I., 533 U.S. 606, 617 (2001).

134. United States v. 50 Acres of Land, 469 U.S. 24, 29 (1984).

135. *Id.*

136. United States v. Commodities Trading Corp., 339 U.S. 121, 123 (1950) (holding that "just compensation" does not include compensation based on the "retention value" of goods when prices are fixed by the government in a time of war).

arguably have lower market values than face values, it is unclear whether it would work a "manifest injustice" to require the state to pay only the market value. At least one commentator has argued that the losses mortgagees would realize if forced to sell at current market value are "not relevant for purposes of evaluating the constitutionality of the use of eminent domain . . . ."[137] This issue will likely be the primary focus of any litigation, given the extreme deference that the courts give to a legislative body's determination that a taking effects a "public purpose."[138]

Whether the lending institutions who currently hold the mortgages or mortgage-backed securities at issue bear fault for the current state of the real estate market is irrelevant to the computation of "just compensation," because "[c]onsiderations that may not reasonably be held to affect market value [of the subject property] are excluded."[139] MRP will not be able to argue, then, that it is "fair" for the mortgage owners to bear losses associated with the market downturn—that is not the kind of "fairness" with which the Fifth Amendment is concerned.[140]

Furthermore, under the Fifth Amendment, "just compensation must be measured by an objective standard that disregards subjective values which are only of significance to an individual owner."[141] Thus, the value of a particular set of mortgages to a bank's portfolio or reputation should not be considered when determining "just compensation" for those mortgages.

While the government will not be required to compensate the institutions that own the mortgages for any subjective value that the institution places on them, the government is not permitted to pay less than the full value of the property taken on the grounds that the public project is particularly desirable or necessary.[142] The Supreme Court has held that "a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change."[143]

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137. David J. Reiss, *Comment on the Use of Eminent Domain to Restructure Performing Loans*, BROOKLYN L. SCH. LEGAL STUD. RES. PAPERS WORKING PAPER SERIES, Sept. 2012, No. 292, at 3.

138. *See supra* Part III.A.

139. Olson v. United States, 292 U.S. 246, 256 (1934).

140. *Id.*

141. United States v. 50 Acres of Land, 469 U.S. 24, 35 (1984).

142. Pa. Coal Co. v. Mahon, 260 U.S. 393, 416 (1922).

143. *Id.*

MRP must rely on the requirement that property must be valued at the time of condemnation if, as it promises, the mortgages can be rewritten for a lower value than their original face value, permit MRP to collect a fee, and result in a return for the investors who finance the project, all without the use of tax payer funds.[144] If the condemning authority must pay face value for condemned contracts, then tax payer funds will be necessary to reduce the principal amount of the loan and to pay MRP's fee.

One alternative to the MRP Program would be for the condemning authority to target only high interest rate mortgages, purchase those mortgages at the face value of the principal, and then rewrite the loans for a lower interest rate, all without invading tax revenues. To what extent such a plan would duplicate the effects of the MRP Program is unclear, because we do not know the interest rates on the mortgages that MRP will target. Revising interest rates also would not reduce the principal owed under the mortgage. While interest rate reductions would therefore help families stay in their homes, it would not help families who sell their homes pay off the additional balance owed. Whether private investors would have any incentive to fund such a program is another question. However, such a program would not only be relatively tax-neutral and still reduce the mortgage payments owed by homeowners, but would also provide face value compensation to the mortgagees, discounted to present value, which should survive any challenge under the just compensation prong of the Fifth Amendment.

IV. THE DORMANT COMMERCE CLAUSE

Even if the Program satisfies the public purpose and just compensation requirements of the Fifth Amendment, the Dormant Commerce Clause of the U.S. Constitution may prohibit the use of eminent domain to condemn mortgage contracts. The Commerce Clause of the Constitution provides that "Congress shall have

144. MRP Solution, *supra* note 25, at 4. MRP assumes that the market value of an underwater mortgage contract is approximately eighty percent of the value of the home. *See* Tad Friend, *Letter from California, Home Economics: Can an Entrepreneur's Audacious Plan Fix the Mortgage Mess?*, THE NEW YORKER, Feb. 4, 2013, at 26, 28 ("[U]nder Gluckstern's proposal[,] the bondholders would be paid off at eighty per cent of the current value" of the home.).

Power . . . [t]o regulate Commerce . . . among the several States."[145] Since at least 1852, the United States Supreme Court has also held that, even where Congress has not legislated on a particular matter, the Commerce Clause acts as a "limitation upon the power of the states."[146]

The general rule is "that 'a state may not promote its own economic advantage by the curtailment or burdening of interstate commerce,' [and] the Court has often used the dormant commerce clause to invalidate local protectionist measures."[147] For example, the Supreme Court struck down a New York statute on the grounds that, as applied, it violated the Dormant Commerce Clause, where the state refused to issue a milk processing license to an applicant because the additional plant would "tend to a destructive competition in a market already adequately served, and would not be in the public interest."[148] A North Carolina statute that prohibited closed containers of apples from containing any grade other than those endorsed by the USDA also violated the Dormant Commerce Clause, even though the statute was facially neutral with respect to interstate commerce.[149]

The Dormant Commerce Clause reflects the fact that "our economic unit is the Nation, which alone has the gamut of powers necessary to control of the economy, [and which] has as its corollary that the states are not separable economic units."[150] Congress has "plenary authority" to regulate interstate commerce, and that power was granted out of the Framers' "conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation."[151]

The Supreme Court "has repeatedly held that the grant of power to Congress by the Commerce Clause did not wholly withdraw from

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145. U.S. CONST., art. I, § 8, cl. 3.

146. Edgar v. MITE Corp., 457 U.S. 624, 640 (1982) (citing Cooley v. Board of Wardens, 53 U.S. (12 How.) 299 (1852)); *see also* Or. Waste Sys., Inc. v. Dep't of Envtl. Quality of Or., 511 U.S. 93, 98 (1994).

147. Edward P. Lazarus, *The Commerce Clause Limitation on the Power to Condemn a Relocation*, 96 YALE L.J. 1343, 1347 (1987).

148. H. P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 529 (1949).

149. Hunt v. Wash. Apple Adver. Comm'n, 432 U.S. 333, 352–53 (1977).

150. *Or. Waste Sys., Inc.*, 511 U.S. at 98–99 (quoting *H.P. Hood & Sons, Inc.*, 336 U.S. at 537–38).

151. *Or. Waste Sys., Inc.*, 511 U.S. at 98 (quoting Hughes v. Okla., 441 U.S. 322, 325 (1979)).

the states the authority to regulate the commerce with respect to matters of local concern, on which Congress has not spoken."[152] To determine whether the Dormant Commerce Clause prohibits a state from acting, the "first step in analyzing any law subject to judicial scrutiny under the negative Commerce Clause is to determine whether it regulates evenhandedly with only incidental effects on interstate commerce, or discriminates against interstate commerce."[153] In the context of the Dormant Commerce Clause, "'discrimination' simply means differential treatment of in- and out-of-state economic interests that benefits the former and burdens the latter."[154] "If a restriction on commerce is discriminatory, it is virtually *per se* invalid."[155] However, "nondiscriminatory regulations that have only incidental effects on interstate commerce are valid unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[156] Additionally, "the purpose of, or justification for, a law has no bearing on whether it is facially discriminatory."[157]

The Program contains no indication that MRP intends for governments to utilize the power of eminent domain in a manner that facially discriminates against out-of-state interests, for example by excluding mortgages held by in-state entities.[158] Thus, the *Pike* balancing test will be used to evaluate the "burden imposed" on interstate commerce against the "putative local benefits" of the Program.[159]

However, before the *Pike* test is reached, there may also be a Dormant Commerce Clause problem where the mortgage contract itself is no longer held in the condemning jurisdiction. The Supreme Court has used the Commerce Clause to strike down a state law where the "practical effect of such regulation is to control [conduct] beyond the boundaries of the state."[160] It is unclear to what extent the

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152. Parker v. Brown, 317 U.S. 341, 359–60 (1943).

153. Or. Waste Sys., Inc. v. Dep't of Envtl. Quality of Or., 511 U.S. 93, 99 (1994) (internal quotation marks omitted).

154. *Id.*

155. *Id.*

156. *Id.* (quoting Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970)).

157. *Or. Waste Sys., Inc.*, 511 U.S. at 100.

158. *See generally* JPA Agreement, *supra* note 19.

159. *See Pike,* 397 U.S. at 142; Catherine Gage O'Grady, *Targeting State Protectionism Instead of Interstate Discrimination Under the Dormant Commerce Clause*, 34 SAN DIEGO L. REV. 571, 573–74 (1997) (analyzing the *Pike* balancing test).

160. S. Pac. Co. v. Ariz. *ex rel.* Sullivan, 325 U.S. 761, 775 (1945) (quoted with approval in Edgar v. MITE Corp., 457 U.S.624, 643 (1982)).

condemnation of the mortgage contracts will be held to control out-of-state conduct where one party to the contract is located out of state, especially if payments also are sent out of state and the contract generally is administered out of state. On the one hand, states have a strong sovereign interest in the lands within their borders.[161] On the other hand, the MRP does not contemplate that governments will condemn the real property, but only the mortgage contract, including the mortgagee's right to collect payments under it.[162]

"When discrimination against commerce . . . is demonstrated, the burden falls on the State to justify it both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake."[163] If the Program is challenged and the court finds that the Program discriminates against interstate commerce, the condemning authority will bear the burden of establishing that the local benefits justify the measure, and that there is no nondiscriminatory means of accomplishing those benefits. If the condemning authority sustains that burden, the court will then evaluate the Program under the *Pike* balancing test.

If the Program satisfies the *Pike* test, it "must be upheld if it 'regulates even-handedly to effectuate legitimate local public interest.'"[164] The Supreme Court has "recognized the legitimate interest of a State in maximizing the financial return to an industry within it."[165] The prevention of foreclosures therefore almost certainly constitutes a legitimate public interest.

To determine whether a state statue satisfies the *Pike* test,

> When Congress has not exerted its power under the Commerce Clause, and state regulation of matters of local concern is so related to interstate commerce that it also operates as a regulation of that commerce, the reconciliation of the power thus granted with that reserved to the state is to be attained by the accommodation of the competing demands of the state and national interests involved.[166]

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161. *See, e.g.*, Green v. Biddle, 21 U.S. 1, 12 (1823).

162. *See generally* JPA Agreement, *supra* note 19; MRP Solution, *supra* note 25.

163. Hunt v. Wash. Apple Adver. Comm'n., 432 U.S. 333, 353 (1977).

164. *MITE Corp.*, 457 U.S. at 640 (quoting Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970)).

165. Pike v. Bruce Church, Inc., 397 U.S. 137, 143 (1970).

166. Parker v Brown, 317 U.S. 341, 362 (1943).

Although the effects on interstate commerce are merely "incidental," which is to say facially non-discriminatory, the burdens on interstate commerce may be "clearly excessive" relative to the local benefits. Mortgage contracts are regularly securitized and traded in national markets—in fact, they are regularly purchased by federal institutions.[167] To subject these national contracts to local determinations of "just compensation" will inject uncertainty into the national market for the contracts. Moreover, although condemnations in a single state, even one as large as California, might not significantly alter the value of trusts that hold the securities, if every state were to authorize and implement the use of eminent domain to condemn underwater mortgages the national market would be dramatically affected—the very "balkanization" of commerce in the securitized mortgage market that the Framers feared would come to pass.

V. CONCLUSION

The MRP Program is designed to force mortgagees to accept less than the face value of certain mortgage contracts because the value of the real property that secures those contracts has fallen. It is at this time unknown, of course, how long it might take for the real estate market to recover its pre-2007 prices. By fixing a particular point in time to value a mortgage contract, specifically the moment when a government authority condemns a mortgage, that authority could acquire mortgages priced at what is likely the bottom of an economic cycle. Under the proposed Program, the mortgagees will face a worst-case investment scenario—the forced sale of investments when their value is at their lowest—while the condemning authority will obtain an economic advantage by purchasing investments at their lowest value.

Whether the Constitution permits such an endeavor is an open question. On the one hand, courts traditionally have permitted the states to condemn contracts despite the Contracts Clause. Under the Fifth Amendment, Courts traditionally defer to states' declarations of "public purpose," and permit the states to determine compensation in any proceeding that is fair and provides the party whose property is condemned with notice and an opportunity to be heard. On the other

167. *See supra* Part I.C.

hand, the Supreme Court in other contexts has accorded investment-backed expectations special consideration in the realm of governmental "takings." To permit state and local governments to use the power of eminent domain to condemn securitized investments *because* the market for those investments has fallen (forcing investment owners to realize their losses and effectively eliminating the chance to benefit if the market recovers), would more directly contravene the purpose of the Contracts Clause than any case the Supreme Court has previously considered. The effects on interstate commerce may also outweigh the local benefits of the Program, especially if implemented on a wide scale, in violation of the Dormant Commerce Clause.

There is no doubt that states have the right to exercise the power of eminent domain to benefit the public as a whole; it is also clear that neither the Contracts Clause nor the Dormant Commerce Clause will generally prohibit the use of eminent domain. However, because the purpose of the MRP Program is to force investors to realize their losses by selling at the bottom of the market, the purposes of the Contracts Clause are implicated to their fullest. Therefore, states may not condemn a mortgage contract without either paying the face value of the contract, or also condemning the property that secures that contract. To hold otherwise would permit the state to favor one class of citizens (primarily in-state homeowners) over another (primarily out-of-state mortgage holders)—the very outcome that the Contracts Clause seeks to avoid.

Condemning mortgages will likely qualify as a "public use" under the Fifth Amendment to the Constitution. However, if the only reason to condemn mortgage contracts for less than face value without condemning the property is to convey a *private* benefit upon the homeowners, then it violates the Fifth Amendment. Because the Program proposed by MRP promises that the fair market value of the mortgages is less than the face value, and also that no public funds will be needed to implement the Program, the Program explicitly anticipates that the cost of the public benefit (reduced foreclosure rates) will be born exclusively by private parties (the mortgagees). The fact that the public will not be asked to share in the cost of achieving the benefits of the Program strengthens the argument that the benefit is not truly a "public" one. However, the undisputed costs that high foreclosure rates inflict upon neighborhoods should prevent the Program from achieving a merely "private" benefit, regardless of who bears the costs. The ends (reduced foreclosure rates) almost

certainly qualify as a public purpose; it is the means (use of eminent domain to pay fair market value for the mortgage contracts) that the courts are more likely to prevent.

Finally, valuing underwater mortgage contracts at "current market value" arguably would not result in the payment of "just compensation" as the Fifth Amendment requires. Payment of "market value" would not only result in an inequitable windfall for the condemning authority, but it would also constitute a private burden on the investment institutions that would be forced to realize their losses and forgo the benefit they otherwise would obtain when the market recovers. Theoretically, "just compensation" would accurately reflect the likelihood that a particular mortgage will be paid in full under the terms of the contract. To arrive at "current market value" for each property, courts may have to delve into the likelihood that a particular homeowner will be able to make payments under the contract terms as well as the probability that a particular property will recover its value and when that might happen. Such considerations would no doubt consume considerable judicial or administrative resources, but to provide less than an individualized assessment would deprive the mortgage owners of their rights under the Fourteenth Amendment. Because the MRP program contemplates condemning individual mortgages, the courts would have no alternative but to value each mortgage contract individually.

Additionally, permitting a condemning authority to condemn a contract for less than face value for no reason other than that the market value of the contract has fallen below that value violates public policy. To allow states to exercise the power of eminent domain in this manner would permit states to increase the public coffers at the expense of private investors any time that the market is down, a proposition that seems, frankly, un-American.

The Contracts Clause, the Takings Clause of the Fifth Amendment, and the Dormant Commerce Clause should prevent state and local governments from exercising the power of eminent domain to force a party to a contract to realize losses solely attributable to market fluctuation. In such cases, the Constitution should be read either to prohibit the taking entirely under the Contracts Clause or the Dormant Commerce Clause, or to require payment of face value of the contract discounted to present market value under the Takings Clause of the Fifth Amendment. Any other result would work a fundamental change to the United States economy and dramatically change the property rights that currently inhere to the benefit of the

American people.

The just compensation prong of the Fifth Amendment Takings Clause provides the strongest argument against the Program. States are sovereigns in our federal system, and the courts are generally loath to find that they may not use the power of eminent domain to effect local benefits. The *power* to take property inheres in sovereignty; the *conditions* upon which that power may be exercised are subject to Constitutional limitations. If the Contracts Clause, the Dormant Commerce Clause, or the "public use" prong of the Takings Clause were found to prohibit states from using the power of eminent domain to condemn mortgage contracts, states' hands would be tied in times of crisis. They would be unable to use their sovereign power to keep local properties in the hands of homeowners, a goal that seems well within the permissible scope of *Midkiff*. This problem might also affect the ability of states to condemn real property that is subject to a mortgage, or at least to condemn a mortgage that is traded in interstate commerce.

A better solution than outright prohibiting a taking of such contracts would be to require additional process when a contract is condemned for the purpose of benefitting one class of parties to the contract, and where the subject matter of the contract (in the case of mortgages, the real property securing the loan) is not also condemned. This is particularly so given that the dual purposes that necessitate the available power of eminent domain, the need for the sovereign to have the power to compel sale of property and to prevent extortion of unreasonably high prices when it does so, would not be thwarted by requiring payment at or near the face value of a mortgage contract. A mortgage contract does have a face value; therefore there is an objective basis for establishing its value when separated from the underlying property, and the risk that the face value is "unreasonable" is considerably less where the government seeks to condemn the right to collect payments under the contract. Additionally, a mortgage contract is not unique in the same sense as real property, which the state may require to build a school or complete a roadway. A mortgagee would not have the same power as a landowner to frustrate a state's development project, and thus would have less control over the price the state must pay during negotiations.

To hold that the states may not condemn home mortgages would cripple the ability of states to manage property within their borders. To permit states to purchase mortgage contracts at current market value *because* the market value has fallen would interject

considerable uncertainty into the national mortgage market, and would allow states to receive an inequitable windfall at the expense of one (often out-of-state) class of parties to those contracts. To permit states to condemn mortgage contracts without also condemning the underlying property only if the state pays at or near face value of the contract would reserve to the states their sovereign power to control property within their jurisdiction, secure to the affected parties "just compensation" as required by the Constitution, and ensure that the public pays for public benefits, rather than disfavored private parties.