GT GreenbergTraurig

Memorandum

TO: Securities Industry and Financial Markets Association

FROM: James D. Masterman

DATE: March 21, 2013

RE: Brockton Eminent Domain Takings of Mortgage Debt

I. Introduction

The City of Brockton and the Brockton Eminent Domain Working Group ("Working Group") has inquired whether the City's eminent domain power may be used to acquire certain mortgage debt of some 2,300 properties characterized as being "underwater" (of the roughly 7,000 Brockton homeowners allegedly underwater), and then convey the mortgage debt of which promissory notes and/or mortgages have been pooled and "securitized" through investment trusts to private third parties. Our understanding of the proposal is taken from notes of the Working Group meeting dated February 20, 2012, the white paper by Grace Ross and to a lesser extent an undated vote by the City Council.

It is axiomatic that all takings must be for a *bona fide* public purpose. From the City Council vote, it is our understanding that the public purpose of this potential taking is for "the purpose of removing blight and restoring family home ownership within the City." It appears that the proponents suggest that the public purpose is achieved by taking the "mortgage debt" and allowing that debt to be refinanced and by so doing theoretically relieving the homeowner from the threat of imminent foreclosure. The proposed taking itself is not land, therefore, but of debt. The homeowner's ownership, in Ms. Ross's view, remains "untouched."

Insofar as the payment of constitutional just compensation, the taken mortgage debt is valued at current fair market value, which one estimate is places at 80% to 95% of the fair market value of the real property itself, but no appraisal has been offered to substantiate that claim. The debt after the taking would be owned by the City of Brockton but then conveyed, pursuant to some yet-to-be drafted, disposition agreement to a new, privately owned financing group or local bank(s).

This Firm has been requested by the Securities Industry and Financing Markets Association to addresses the authority of the City of Brockton under Massachusetts statutory law and the Massachusetts Declaration of Rights to Brockton's to use the power of eminent domain as proposed. We do not address the Federal constitutional issues, which are addressed in the O'Melveny & Myers Memorandum of July 16, 2012, attached hereto, which has been circulated to the City Council.

II. Issue Presented

Whether an acquisition by the City of Brockton may be made by an eminent domain pursuant to Massachusetts General Laws chapter 79 of the mortgage debt with the express purpose of the selling the "property" taken to private, third parties.

III. Short Answer

A. Brockton's plan is wholly incompatible with the lawful and constitutional exercise of the eminent domain power delegated by the Legislature to Brockton under the governing statute and the Massachusetts Declaration of Rights. The statutory scheme governing the use of eminent domain is limited to takings of land within the municipality's territorial limits, pursuant to Chapter 79, and for a public purpose. There is no precedent in Massachusetts law

that would allow Brockton to take by eminent domain mortgage debt in the form of promissory notes while leaving the underlying land in the possession of the original landowner.

B. This is especially so where the promissory notes have been pooled in investment trusts and are not located within the territorial jurisdiction of Brockton. Brockton's eminent domain authority, under the governing statutory delegation and constitutional restraints, begins and ends within its city limits.

C. A mortgage separated from the promissory note does not carry with it the mortgage debt. Thus, a taking of the mortgage only, even if legally permissible, which it is not, would not cancel the promissory note.

D. Brockton's plan does not comply with the required public purpose for takings. Here, no matter how disguised, the plan's predominant benefits flow exclusively to private landowners and not the public.

IV. Analysis

A. Brockton's Right to Take Is Limited by the Declaration of Rights

Any analysis of the right to take under Massachusetts law, as it does in every jurisdiction, starts with the constitution and in particular, with the Massachusetts Declaration of Rights which imposes constitutional limitations on the taking of property. The eminent domain power is an inherent attribute of sovereignty which resides in the Legislature and as the Legislature may rightfully delegate. Article 10 of the Declaration of Rights limits that power and states, in pertinent part, that each person "has a right to be protected" in his "property, according to standing laws," and that

> no part of the property of any individual can, with justice, be taken from him, or applied to public uses, without his own consent, or that of the representative body

> of the people. In [sum], the people of this commonwealth are not controllable by any other laws than those to which their constitutional representative body have given their consent. And whenever the public exigencies require that the property of any individual should be appropriated to public uses, he shall receive a reasonable compensation therefore.

Article 10 thus reaffirms that the eminent domain power rests solely with the Legislature (the constitutional representative body of the people), is to be exercised under "standing laws" and not by fiat, and may only be exercised for a *bona fide* public purpose.

B. <u>Brockton's Right to Take Is A Legislatively Delegated Authority</u>

The underlying assumption in Brockton's proposed takings plan is that the City has the authority to take by eminent domain the debt evidenced by promissory notes and secured by mortgages thus relieving the homeowner of the debt and eliminating the right of the note holder right of foreclosure set forth in the mortgage instrument. It is our conclusion that the City of Brockton is without the legislatively delegated eminent domain power to take the mortgage debt.

"The power of eminent domain 'exists only in cases the Legislature has delegated that power in express terms or by necessary implication; it is not to be inferred from vague and doubtful phrases.' " *Providence and Worcester Railroad Company v. Energy Facilities Siting Board*, 453 Mass. 135, 141 (2009) *quoting Trustees of Reservations v. Stockbridge*, 348 Mass. 511. Cities and towns "are separate units, possessing only the authority thus entrusted." *Id. See also Burnham v. Mayor and Aldermen of Beverly*, 309 Mass. 388, 389 (1941) ("Cities and towns are political subdivisions created for the convenient administration of government, and they possess only such powers as are conferred upon them either in terms of by necessary implication of enabling statutes."); *Lichoulas v. City of Lowell*, 78 Mass. App. Ct. 271, 276 (2010) (eminent domain power resides in Legislature and passes to municipalities only by explicit delegation)

(*citing Burnham, supra, Newton v. Trustees of State Colleges*, 359 Mass. 668, 669-670 (1971) and *Providence and Worcester*, *supra* 453 Mass. at 141). Thus, Brockton's eminent domain power in this case is constrained by the terms of the Legislative delegation of eminent domain.

Moreover, a statutory grant of eminent domain power is strictly and not expansively construed. "It is well established that eminent domain statutes must be strictly construed because they concern the power to condemn land in derogation of private property rights." *Providence and Worcester*, 453 Mass. at 141 *citing Devine v. Nantucket*, 449 Mass. 499, 506 (2007) (citing *Lajoie v. Lowell*, 214 Mass. 8, 9 (1913)).[1] *See also Burnham, supra* at 389 (eminent domain statutes "must be construed with reasonable strictness, so that no citizen shall be deprived of the use and enjoyment of his land except by a valid exercise of the appropriating power subject to which all private property is held"); *Walker v. City of Medford*, 272 Mass. 161, 164 (1930) (strict compliance required with statute by which eminent domain is exercised).

With these principles in mind, there are two general enabling statutes enacted by the Legislature delegating eminent domain power to cities and towns. First, the specific statutory grant of eminent domain power to Brockton as a Plan B city is contained in General Laws Chapter 43, § 30. In pertinent part, Section 30 delegates the power to "purchase, or take by eminent domain, under chapter seventy-nine, any land within its limits for any municipal purpose." *See also City of Springfield v. Dreison Investments, Inc*., 11 Mass. L. Rptr. 379 (Mass. Super. Feb. 25, 2000) (addressing eminent domain issues with respect to c. 43, § 30) (cited

[1] The SJC in *Providence and Worcester* rejected the argument made by Mobil that the required strict construction of eminent domain statutes (which the Court termed a "well-settled proposition") was abrogated by *Kelo v. New London*, 545 U.S. 469 (2005). 453 Mass. at 578 n.11. "The question here, however, is not constitutional in nature, but one of statutory interpretation. *Kelo* dos not mandate that we construe the statutory power to authorize a taking that the Legislature has delegated to the board to be coextensive with the scope of eminent domain under the United States Constitution." *Id*.

herein as "Dreison"). Second, the other enabling statute delegating eminent domain power to cities (other than Boston and the charter cities under c. 43) and towns is Chapter 40 § 14, which in pertinent part states that "[t]he aldermen of any city, except Boston, or the selectmen of a town may purchase, or take by eminent domain under Chapter seventy-nine, any land, easement or right therein within the city or town not already appropriated to public use, for any municipal purpose for which the purchase or taking of land, easement or right therein is not otherwise authorized or directed by statute." The statutes are virtual mirror images and reflect the Legislature's intent that in delegating the eminent domain authority to cities and towns it does so in unequivocal terms and with specific limitations.

C. Brockton's Eminent Domain Authority is Constrained and Limited

By the express language of the enabling statute applicable to Brockton, c. 43 § 30 – the only source of Brockton's eminent domain authority – and mirrored in c. 40 § 14, four limitations have been placed on the exercise of eminent domain power by Brockton (and the other cities and towns). The eminent domain power is restricted (1) to taking land, (2) under the procedures of Chapter 79, (3) for land within the City limits, and (4) for a municipal purpose.

Brockton's intended plan to take securitized mortgage debt exceeds its delegated eminent domain power fails to adhere to, and therefore, violates the express legislative limitations.

The Supreme Judicial Court noted in *Weeks v. Grace*, 194 Mass. 296 (1907) that eminent domain is "strictly a proceeding in rem" and "[t]he power when exercised acts upon the land itself, not upon title, or the sum of the titles if there are diversified interests." *Id*. at 299-300. The Court continued, "Upon appropriation all inconsistent proprietary rights are divested, and not only privies but strangers are concluded. [internal citations omitted]. Thereafter whoever may

have been the owner, or whatever may have been the quality of his estate he is entitled to full compensation according to his interest and the extent of the taking, but the paramount title is in the public, not as claiming under him by a statutory grant, but by independent title." *Id*. at 300. The distinction made by the Court between eminent domain acting upon the land itself and not merely affecting title is important because, as the Court pointed out, if the public obtained mere title through eminent domain and title was defective for some reason the public could be ousted by the true owner. The point is that the nature of eminent domain acts upon the land either in fee or in a lesser estate in the land. In Massachusetts, no city or town can use its eminent domain power to other than an estate in the land.

D. Chapter 79 Does Not Provide For Takings Of Mortgage Debt

That the Legislature's grant of eminent domain authority to Brockton is limited to land is confirmed by the structure and language of Chapter 79, the eminent domain statute. The Legislative purpose of Chapter 79 is to establish throughout the Commonwealth uniformity in the method of taking real estate for public purposes and in assessing damages for such takings. *Walker v. City of Medford*, 272 Mass. at 163. The procedures and requirements of Chapter 79 are mandatory and "prescribes the only way in which the taking of land now can legally be made." *Malinoski v. D.S. McGrath, Inc.,* 283 Mass. 1, 7 (1933).

The statute is replete with language denominating the takings power in terms of land and contains specific provisions for the taking of land subject to mortgages, which codified the common law. For example, Section 1, which requires an order of taking, speaks of the "taking of real estate." Section 2 lists the officials authorized to undertake "a taking of land by eminent domain." Section 3 provides the procedure to acquire possession where the person occupying

the property "which has been taken in fee, or in which an easement has been taken, by eminent domain under this chapter refuses to permit" the municipality to enter and take possession. Sections 22 to 26, 29 regulate the apportionment of damages when there are several persons holding joint or several interests in the real property taken, such as joint tenants or tenants in common, a tenant for life or years. With respect to mortgaged land, sections 32 and 33 establish the procedure "[i]f the property which is taken in whole or part by eminent domain or receives injury, for which damages are recoverable under [Chapter 79], is mortgaged" and for the apportionment of damages between mortgagors and mortgagees. Chapter 79 envisions the taking of the real property, i.e., the land, and not the mortgage. Section 33, damages to the entire mortgaged property are determined, then each mortgagee is paid in order of the mortgages in an amount equal to the unpaid amount of the mortgage debt, and after the debt is satisfied the remainder of the proceeds is paid to the mortgagor. This codifies the common law. *See Bates v. Boston Elevated R. Co*., 187 Mass. 328 (1905). As explained in *Bates*, when land taken by eminent domain is under a mortgage, the compensation due is the property of the mortgagor at law, but in equity the mortgagee can follow the land taken and subject the compensation fund or proceeds of the taking to a lien for payment of the mortgage debt. When land is taken by eminent domain it is no longer subject to the mortgage but has been withdrawn from the operation of the mortgage by paramount title in the public. *Id*. at 337-38.

What is clear from the statutory scheme is that damages for takings are valued and assessed for the entire land taken and not merely for the value of the mortgage or mortgages isolated from the land, as contemplated by Brockton's plan. There simply is no mechanism in

Chapter 79 to exempt the landowner/mortgagor from a public taking of the land where paramount title vests in the municipality. *See Malinoski v. D.S. McGrath, Inc.*, *supra*.

Even if a taking may be made of a mortgage itself without a taking of the land, in Massachusetts, as the Supreme Judicial Court recently observed, a mortgage and promissory note can be separated. *Eaton v. Federal National Mortgage Association*, 462 Mass. 569, 576 (2012). Unlike other jurisdictions, in Massachusetts the transfer of a promissory note does not carry with it the mortgage. *Id*. A mortgage separated from the underlying debt that it is intended to secure is a mere technical interest: a mortgage unconnected to the debt has no determinate value as property. *Id*. at 577 *citing Sangor v. Bancroft*, 78 Mass. 365 (1859) and 1 F. Hilliard, Mortgages at 216 n. (c) and at 217. The result in *Eaton* was that a mortgagee possessing only the mortgage without the debt is without authority to foreclose the mortgage. Conversely, where mortgage loans are pooled together in a trust and converted to mortgage-backed securities, with the promissory notes serving as financial instruments generating an income stream for investors, an attempted foreclosure by a party holding the promissory note but lacking an assignment of the mortgage is similarly not valid. *U.S. Bank National Association v. Ibanez*, 458 Mass. 637 (2011).

Here, the mortgage debts sought to be taken by Brockton are part of pooled, securitized trusts separate from the mortgages on Brockton property. Therefore, if the eminent domain power were to act against the mortgage only, it would not discharge the existing promissory notes evidencing the mortgage debt. Even if the mortgage could be taken by a lawful exercise of the eminent domain power, it would not achieve the articulated goal. The debt remains intact as

evidenced by the promissory note. The City would have successfully taken the mortgage, but the homeowner still owes the money.

In sum, for the above reasons, the statutory authority for Brockton's use of eminent domain does not allow for the taking and valuation of a mortgage interest alone, without taking the land, and even if it did, it would not take the debt evidenced by the promissory notes executed by the homeowners.

E. Brockton's Taking Authority Is Limited To Land Within Its Territory

Even if it were arguable that Brockton could subject mere mortgages to its statutory eminent domain authority without taking the land, and somehow that the exercise of this power of eminent domain also acquired the underlying debt notwithstanding *Eaton*, the City does not have the right or power to take this mortgage debt because it resides outside its territorial limits.

The eminent domain authority granted by the Legislature to Brockton is expressly limited to the taking of land within its territorial limits. The extent of Brockton's power to take is the city limits. The debt Brockton seeks to take by eminent domain has been separated from their mortgages, pooled and securitized in investment trusts located outside of Brockton's city limits. These mortgage debts are expressly not reachable by Brockton through its eminent domain power. In this regard, the analysis in the O'Melvany & Myers Memorandum (pages 11-12) with respect to the territorial limit of eminent domain law in California and the unlawfulness of any attempted extraterritorial seizure of promissory notes in securitized transactions is equally applicable to Massachusetts. *See* G.L. c. 40, § 14; G. L. c. 43, § 30; Massachusetts Constitution, Article 10.

F. Brockton's Plan Is A Bad Faith Taking Because Private And Not Public Benefits Predominate

As noted, Brockton seems to assert that the public purpose for its plan is to remove blight or to restore family ownership in the City. There has been no evidence presented (of which this Firm is aware) with respect to blight, certainly none of that which is commonly presented in the context of urban renewal. Further, there is no evidence presented that the to be acquired mortgage debt attaches to properties that are either themselves in a blighted condition or are located in a blighted area. It is beyond the purpose of this memorandum to address eminent domain takings to remove blighted areas, other than to note that there is a dedicated statutory scheme under Massachusetts law (see e.g., G.L. c. 121B) and regulations promulgated thereunder, dealing with urban renewal plans for rehabilitation and redevelopment of decadent, substandard or blighted areas (complete with appropriate standards and safeguards) based on predicate findings adhering to strict statutory definitions which if approved after exhaustive analysis may authorize the use of eminent domain should that be part of a comprehensive plan. See Chapter 121B § 47. Use of the term "blight" is not without legal definition. It is of questionable legal authority, therefore, for Brockton to circumvent the procedures and safeguards incident to urban renewal plans for redevelopment of blighted areas, yet cite blight or the amorphous allegedly public purpose to "restore family ownership" to justify a taking by eminent domain in derogation of private property rights.

Even if there were some public good, the predominant benefit of Brockton's plan is private. A few private wealthy investors, who appear to be Brockton's partners in this scheme, will profit; a true private to private transaction using the city's power of eminent domain. A taking is valid where the benefit to private parties is *incidental* to a legitimate public purpose. It

may be that only a small portion of the public benefit from a taking, "but the use or service must be of such nature that in essence it affects them as a community and not merely as individuals. . . . Land cannot be taken by eminent domain with the intent to transfer it to private individuals for their own use." *Machado v. Board of Public Works of Arlington*, 321 Mass. 101, 103 (1947).

This is not the first time in Massachusetts a distressed city has attempted to alleviate an urban problem with a novel, yet targeted, series of eminent domain takings, theoretically for the public good but the essence of which is unlawful private, gain. The Superior Court addressed this question in *City of Springfield v. Dreison Investments, Inc.,* 11 Mass. L. Rptr. 379 (Mass. Super. Feb. 25, 2000). Dreison involved the effort by the City of Springfield to bring minor league baseball to the city. A taking of land was needed to build the stadium. Because the team was privately owned, the court rejected the scheme.

In its decision, the *Dreison* Court restated the axiomatic bedrock of eminent domain, that it "is a fundamental principle of law that the government can only exercise its eminent domain powers for a public purpose." *Id*. at § 36. *See also Benevolent & Protective Order of Elks, Lodge No. 65 v. Planning Board of Lawrence*, 403 Mass. 531, 539 (1988) (exercising power of eminent domain is improper unless the taking is for a public purpose); *Flower v. Town of Billerica*, 324 Mass. 519, 523 (1949) ("The right to take private property for a public use is found upon and limited by public necessity. Where the necessity stops there stops the right to take, both as to the amount of land and the nature of the interest therein."). There are cases where there is a private benefit incidental to a public use, but in those cases, the legislative safeguards, procedures and public oversight (e.g., the urban renewal statutes) protect against private interests superseding the interests of the public. *Dreison* at *41. However, where the

dominant reason for a taking is to benefit private interests or to use the power of eminent domain for improper reasons, the taking is in bad faith and is invalid. *Dreison* at *46 *citing Pheasant Ridge Associates Limited Partnership v. Burlington*, 399 Mass. 771, 776 (1987) (pretextual taking made in bad faith).

Much may be made of the differences between the Brockton scheme to take mortgages and that of Springfield to take land for a stadium. These factual differences are inconsequential with respect to the constitutional issues at stake. At the heart of both lies the failure of public officials to respect the constitutional limitations that property may not be taken from one private owner if it ends up in the hands of another private owner in a transparent transfer of wealth pretextually clothed in an ill-defined purported public purpose of general economic benefit. In Massachusetts, it is *per se* bad faith. *Dreison* at *45. The *Dreison* decision should serve as a fair warning to Brockton of the consequences of cavalier regard for private property and misuse of eminent domain.