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FORCED SALE RISK: CLASS, RACE, AND THE "DOUBLE DISCOUNT"

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ABSTRACT

What impact does a forced sale have upon a property owner's wealth? And do certain characteristics of a property owner—such as whether they are rich or poor or whether they are black or white—tend to affect the price yielded at a forced sale? This Article addresses arguments made by some courts and legal scholars who have claimed that certain types of forced sales result in wealth-maximizing, economic efficiencies. The Article addresses such economic arguments by returning to first principles and reviewing the distinction between sales conducted under fair market value conditions and sales conducted under forced sale conditions. This analysis makes it clear that forced sales of real or personal property are conducted under conditions that are rarely likely to yield market value prices. In addition, the Article addresses the fact that judges and legal scholars often have utilized a flawed economic analysis in assessing the economic impact of forced sales in cases involving property owned by low- to middle-class property owners. In contrast, those who are wealthier are much more likely to own their property under more stable ownership structures or to utilize private ordering to avoid the chance that a court might order a forced sale under the default rules of certain common ownership structures. The Article also raises the possibility that the sales price for property sold at a forced sale may be affected by a property owner's race or ethnicity, resulting in a "double discount," i.e. a discount from market value for the forced sale and a further discount attributable to the race of the property owner. If minorities are more susceptible to forced sales of their property than white property owners or if there exists a phenomenon in which minorities suffer a double discount upon the sale of their property at a forced sale, then forced sales of minority-owned property could be contributing to persistent and yawning racial wealth gaps.

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I. INTRODUCTION

The United States is in the midst of one of the worst foreclosure crises in the country's history resulting in thousands of people losing their homes each week due to foreclosure.[1] Not only are many people losing their homes, but homeowners across the country have already lost billions of dollars in housing wealth. One study projected that homeowners with subprime loans originating between 1998 and 2006 that have been or will end up being foreclosed upon may ultimately lose a total of 164 billion dollars in housing wealth.[2] Most of this lost wealth consists of equity that has been or will be stripped away. Not surprisingly, many minority homeowners appear to be particularly hard hit by this crisis as subprime mortgages have been disproportionately made in minority communities and these minority homeowners have lost a tremendous amount of wealth due to foreclosure.[3]

Well before the current wave of foreclosures became so intense and before there was any substantial national attention focused on this particular type of forced sale and its impact on property owners' wealth, we began work on a research project designed to evaluate, in

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1. *See* Les Christie, *Foreclosure Filings Up 120%*, CNNMONEY.COM, July 25, 2008, http://money.cnn.com/2008/07/25/real_estate/foreclosure_figures_up_again/index.htm. RealtyTrac, a firm which is often cited for its measures of foreclosure rates reported nearly four million foreclosure filings in 2009. Press Release, RealtyTrac, RealtyTrac Year-End Report Shows Record 2.8 Million U.S. Properties with Foreclosure Filings in 2009 (Jan. 14, 2010), *available at* http://www.realtytrac.com/contentmanagement/pressrelease.aspx?channelid=9&itemid=8333. In 2009, foreclosure filings were reported on over 2.8 million properties which represented "a 21% increase in total properties from 2008 and a 120 percent increase in total properties from 2007." *Id.*

2. ELLEN SCHLOEMER ET AL., CTR. FOR RESPONSIBLE LENDING, LOSING GROUND: FORECLOSURES IN THE SUBPRIME MARKET AND THEIR COST TO HOMEOWNERS 15-16 (2006).

3. *Id.* at 23; *see also* Charles Scott, Letter to the Editor, *Subprime Loan Crisis Impacts Us All*, CONN. POST, (Bridgeport, CT) Apr. 11, 2008, *available at* http://infoweb.newsbank.com/iw-search/we/InfoWeb?p_product=AWNB&p_theme=aggregated5&p_action=doc&p_docid=120024812794D7D0&p_docnum=2&p_queryname=5 ("Because of the current wave of foreclosures the minority community nationally has suffered the greatest loss of wealth due to the loss of value in their real estate since the Depression.").

part, the economic impacts of forced sales of rural property owned by both white Americans and African Americans in the rural South. Our study was motivated by the fact that very few legal scholars or judges have considered the economic impacts that forced sales of real property might have upon groups of people who may be particularly vulnerable to losing their property at a forced sale. Even more surprising, a number of legal scholars and judges have analyzed forced sales of property owned by low- to middle-class people, including many low- to middle-class minorities, as if these sales should be expected to yield fair market value prices. In litigation, such a judicial failure to consider the economic impact of a forced sale upon the economically vulnerable often occurs even when a court has the discretion to order an alternative remedy to a forced sale that would likely preserve more of a litigant's wealth or to structure a forced sale to minimize the potential adverse economic impacts. This oversight is surprising given that legal scholars and judges often employ very sophisticated economic analysis in considering or deciding what the law should be in many different contexts.

This Article seeks to reframe the economic analysis of forced sales of real property in order to recalibrate expectations about the economic impact that forced sales may have upon property owners. Instead of assuming all property owners will fare equally well in economic terms when their property is sold against their will at a forced sale of one type or another, it may be important to consider how the owner's age, economic status, gender, and race, among other characteristics, may impact a forced sales price. Such an inquiry is consistent with the approach that some law and economics scholars in the field of contracts have utilized in considering how people with different characteristics fare in different types of contractual transactions.[4] Specifically, this Article addresses certain overly optimistic expectations about the economic impact of forced sales on low- to middle-income property owners who have few if any resources to protect their real property-based wealth in legal proceedings of one type or another that may culminate in a forced sale. This Article also raises the possibility that the race of a property owner may impact the ability of such an owner to obtain even a forced sale price when his or her property is sold at a forced sale.

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4. For example, legal scholars in the area of contracts law explored the impact that a person's race or gender may have upon their ability to negotiate a fair bargain. *See, e.g.*, Ian Ayres, *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations*, 104 HARV. L. REV. 817 (1991) (presenting an empirical case for discrimination). Further, scholars in the field of real estate economics have published a large number of theoretical and applied articles and books that consider how someone's particular characteristics such as their race may impact their participation in the real estate market.

Two recent eminent domain disputes that both came to a head at the same time in Madison, Wisconsin provide some evidence that class or racial discounts may occur when property is sold under a forced sale. In one of these eminent domain cases, the University of Wisconsin–Madison exercised its eminent domain power to condemn a popular bar frequented by many students that was located within a block of the campus in order to build a new school of music school on the location.[5] The parties settled the case the day before trial was to have begun for $2.1 million. In terms of the valuation of the property, the City of Madison had appraised the property in 2008 at $682,000[6] and an independent appraiser in the condemnation action had valued the property at $1.1 million.[7] The assessment and independent appraisal suggest that the owners of the bar received significant and perhaps unjustified benefits during the time they owned the property and at the point they settled the case. Assuming the independent appraisal was reasonably accurate, it appears the city had under-assessed the bar by more than $400,000 in at least one year (and probably all years) the condemnees owned it which meant that the bar owners paid significantly less property taxes than they would have paid if their property had been properly assessed.[8] In contrast, the owners of the bar settled their eminent domain lawsuit by agreeing to accept the university's $2.1 million dollar offer which represented one million dollars more that the property's fair market value as determined by an independent appraiser.

In their effort to maximize the compensation they would receive, the owners of the bar mounted an expensive public relations campaign targeting, among others, students and also hired lobbyists in an effort to change state law to limit the university's power to use eminent domain.[9] In addition, the case was covered widely by the

5. Deborah Ziff, *Brothers, UW Settle Dispute; $2.1 Million Payout Sets Stage for Music Facility*, WISCONSIN STATE JOURNAL, Apr. 7, 2010, at A3.

6. *See* City of Madison Assessor's Office Website, Property Search results for 704 University Avenue, http://www.cityofmadison.com/assessor/property/PropertyData.cfm?ParcelN=070923204146 (last visited July 30, 2010) (real estate taxes must be paid in an "assessment year" which is the calendar year after the city appraises property for the purposes of real estate taxes). At the time the case was settled, the city had appraised the property at $627,000.

7. Matt Marx, *Brothers Wants Student Support: Local Bar Begins Campaign to Garner More Assistance in Lawsuit Against UW Regents*, BADGER HERALD, Dec. 11, 2009, *available at* http://badgerherald.com/news/2009/12/11/brothers_wants_stude.php.

8. There is evidence that higher income property owners in central cities often have their properties under-assessed and that lower-income property owners bear an unfair real property tax burden because their properties are over-assessed. *See* Robert P. Inman & Daniel L. Rubinfeld, *The Judicial Pursuit of Local Fiscal Equity*, 92 HARV. L. REV. 1662, 1680 (1979). One empirical study has concluded that property in majority-minority neighborhoods is often over-assessed for property tax purposes as compared to property in majority-white neighborhoods. *See* Lee Harris, *"Assessing" Discrimination: The Influence of Race in Residential Property Tax Assessments*, 20 J. LAND USE & ENVTL. L. 1, 4, 12 (2004).

9. Deborah Ziff, *Lack of Harmony Over Music School Plan; Bar Owners Are Going to Court This Week to Fight UW's Move to Expand*, WIS. ST. J., Apr. 4, 2010, at A1.

media. For example, several newspapers in Wisconsin, at least one newspaper outside the state of Wisconsin,[10] and at least one company in India that specializes in disseminating information about public procurement opportunities reported the story.[11]

At the very same time the University of Wisconsin-Madison's condemnation case was ongoing, the City of Madison sought to acquire seven apartment buildings owned by four minority landlords in a neighborhood located less than three miles from the university called the Burr Oaks neighborhood, which has significant concentrations of low-income people of color.[12] The city sought to acquire the properties in order to construct a senior housing development. In negotiations with the apartment building owners, the city made it clear that it would use eminent domain if the owners did not agree to sell their properties.

In sharp contrast to the university's condemnation case, the City of Madison first offered these landlords as a group $1.37 million despite the fact that the seven properties had a combined assessed value of $2.27 million and despite the fact that the city had budgeted $3 million for acquisition of the properties, demolition and tenant relocation costs.[13] The city assessor who was not involved in the effort to acquire the properties noted that the city's initial offers were based upon an appraisal that included foreclosure sales and other distressed sales as comparables.[14] Though his statement was offered to explain how the city's offer to the landlords could properly be below the assessed value of the properties, his statement is actually strong evidence that the city's initial offer was a lowball offer given that a foreclosure sale is almost always inadmissible as evidence of a sale of comparable property to the property that is condemned in an eminent domain case.[15]

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10. Daily Briefing, *UW-Madison: Owners Will Yield Bar Site for $2.1 M*, ST. PAUL PIONEER PRESS, Apr. 6, 2010, at B2.

11. *United States: Developer Eyes Student Housing Where UW Building Might Stand*, TENDERSINFO, Apr. 9, 2010.

12. Dean Mosiman, *South Side Apartment Owners Given Third Buyout Offer: The City Wants to Put Senior Housing on the South Side Site*, WIS. ST. J., Jan. 23, 2010, at A5.

13. Dean Mosiman, *Losing Offer for Landlords: With Real Estate Prices Hurting, Owners Fear They'll Lose Money in Madison's Plan to Buy and Redevelop Their Properties*, WIS. ST. J., Nov. 10, 2009, at A1.

14. *Id.*

15. *See* 4 NICHOLS ON EMINENT DOMAIN § 12B.07, at 12B-36 to -37 (Julius L. Sackman et al. eds., 3d ed. 2009) ("Even in jurisdictions where evidence of sales of neighboring land is admitted, it is almost universally held that a sale is not competent unless voluntary on both sides; in other words, unless it was the result of the uncontrolled bargaining of a vendor willing but not obliged to sell with a purchaser willing but not obliged to buy. Forced sales, such as a sale of real estate by an administrator, a sale under a deed of trust or execution, a sheriff's sale, or a sale on the foreclosure of a mortgage, are not admissible, because they do not show market value."); 27 AM. JUR. 2D *Eminent Domain* § 595 (2010). *See also* Potter v. Hartzell Propeller, Inc., 189 N.W.2d 499, 503 (Minn. 1971); Tremblay v. State Highway Comm'r, 183 S.E.2d 141, 144 (Va. 1971).

After the landlords protested, the city raised its offers substantially but still did not offer any of the landlords the assessed value of their property. Two of the landlords ended up accepting offers that were more than $60,000 below the assessed value of their respective properties.[16] By mid-February, the city indicated that it would not pay the only landlord to hold out the assessed value for her property and that it would take her property by eminent domain if she did not accept the city's final offer which was $28,000 below the assessed value.[17] To be fair to the city, it is possible that the city's final offers to the landlords reflected the fair market value of the properties given the fact that real estate prices in Madison like real estate prices in most other cities have been in some decline the past few years and that assessments based upon data from the prior year may not accurately reflect the market value of a particular property in the assessed year due to the lag in sales data and changes in the market.

Nevertheless, it is striking that in Madison, the eminent domain case that captured nearly all of the media attention and that had Madison residents debating whether the property owners in question received the fair market value for their property as just compensation was the case in which the property owners were ultimately compensated at a level that was three times the assessed value of their property. In contrast, in the much less publicized case in which the city threatened to use eminent domain against four minority landlords, and ultimately did so against one of these owners, the city ended up compensating each of these minority property owners in an amount that was less than the assessed value of their properties. Nevertheless, there was no real public debate about the fairness of the compensation paid to any of these landlords.

Part II of this Article distinguishes between fair market value and forced sale value. Establishing an asset's fair market value can involve a healthy amount of indeterminacy. As a result, in high stakes litigation involving valuable assets, litigants frequently spend substantial amounts of money in proceedings that often devolve into a battle of highly compensated experts. Homeowners who cannot pay to play the valuation game find themselves at a distinct, if not crippling, disadvantage which is a phenomenon that may contribute to widening the wealth gap between low- to middle-class people—a group that is disproportionately minority—and the wealthy. Notwithstanding the fact that establishing an asset's fair market value involves as much art as science, it is well established that an asset's fair market value is not that same asset's forced sale value.

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16. *See* Dean Mosiman, *Two of Four Apartment Owners Agree to City Buyout*, WIS. ST. J., Jan. 29, 2010, at A5.

17. *See* Paul Snyder, *Madison Landlord Might Sue City*, DAILY REP., Feb. 15, 2010, News Section.

Part III of this Article reviews the manner in which courts and legal scholars have analyzed forced partition sales of property owned under the default rules governing tenancies in common or joint tenancies. We discuss partition sales early on for several different reasons. First, it is likely that many property owners who own real property under the default rules governing the tenancy in common or joint tenancy form of ownership are low- to middle-income people. Second, the judicial decisions and legal scholarship on partition sales demonstrates that legal scholars for the most part have not addressed important economic valuation and wealth impact issues arising in the context of forced sales of property owned by low- and middle-income people. Third, we single out partition sales for separate discussion because the partition sale scholarship is the most fully developed body of scholarship addressing forced sales of black-owned land and, therefore, the body of scholarship one might expect some detailed analysis of the economic impact forced sales have had upon African-American property owners.

Part IV of this Article undertakes a comparative approach of certain other selected substantive areas of law in order to highlight the manner in which the valuation issues that are almost completely overlooked in the partition sale scholarship are hotly contested in legal scholarship, case law, and policy debates in these other areas of law. These debates underscore the fact that forced sales frequently yield prices below market value, making clear how the scholarship on partition sales has been significantly under-developed and under-theorized.

Part V of this Article reviews legal and economic empirical scholarship with respect to eminent domain and foreclosure as well as subsequent sales of properties initially acquired at foreclosure sales. First, a review of this scholarship highlights the fact that little empirical scholarship has been published in law reviews analyzing the prices at which real property is sold under different types of forced sales. Second, this scholarship, as a whole, has also yielded mixed findings. Although many of the sales evaluated in these studies proved to yield prices below fair market value, other properties were sold at or near fair market value and, even in some circumstances, at prices above market value. Those forced sales that yielded prices above market value almost exclusively involve high-value real estate, reinforcing the point that forced sales in the aggregate can be regressive.

Part VI of this Article reviews scholarship and legal cases addressing the role race may play in real estate transactions and real estate finance. This review demonstrates there is clear evidence of discrimination in some real estate contexts but not as clear evidence of discrimination in others. This mixed record underscores the potential value of exploring whether minority property owners who lose their land as a result of forced sales may lose more wealth than similarly situated whites who lose their real property as a result of forced sales due to a "double discount," i.e. a discount as a result of the race or ethnicity of the property owner in addition to the normal forced sale discount.

II. DISTINGUISHING FAIR MARKET VALUE FROM FORCED SALE VALUE

Comparative analysis of cases arising in different areas of private law in which a party requests a court to order a forced sale of real or personal property demonstrates it is quite important to distinguish between forced sale value and fair market value. Because this Article focuses in part upon how sales of real property for prices below fair market value can strip wealth from a property owner, the concept of fair market value must first be defined.

A. *Fair Market Value Defined*

One standard definition of fair market value is the "price that a seller is willing to accept and a buyer is willing to pay on the open market and in an arm's-length transaction."[18] This definition is fairly standard across many substantive areas of both law and economics and is built upon the willing seller-willing buyer paradigm that has been well entrenched in American law for quite some time.[19] For example, in the area of estate and gift taxation, the Supreme Court in *United States v. Cartwright* stated that "[t]he willing buyer-willing seller test of fair market value is nearly as old as the federal income, estate, and gifts taxes themselves . . . ."[20] Reliance upon the willing seller-willing buyer test of fair market value is ubiquitous in those circumstances in which real or personal property must be valued. For example, taxpayers in this country who itemize their deductions on their tax returns are required to make an assessment of the fair market value—under the willing seller-willing buyer test—of non-cash property they donate to charities of one sort or another.[21]

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18. BLACK'S LAW DICTIONARY 1587 (8th ed. 2004); *see also* Dep't of Transp. v. M.M. Fowler Inc., 637 S.E.2d 885, 890 (N.C. 2006) (using BLACK'S LAW DICTIONARY to define fair market value).

19. In fact, the willing seller-willing buyer test is a widely accepted test of fair market value in most market economies. In England, the Land Compensation Act of 1961, 9 Eliz. 2, c. 33, § 5(2), holds that "[t]he value of land shall . . . be taken to be the amount which the land if sold in the open market by a willing seller might be expected to realise." Case law in England also supports the willing seller-willing buyer paradigm. *See, e.g.*, Railtrack Plc. v. Guiness Ltd., [2003] EWCA Civ 188, C2002/1122 (appeal from Lands Tribunal) (holding that section 5(2) of the 1961 Act "requires the assumption of an open market sale [and] the concept of an open market [sale] 'automatically implies a willing seller and a willing buyer' ").

20. 411 U.S. 546, 551 (1973).

21. The definition for purposes of determining value of donated property is as follows: "Fair market value (FMV) is the price that property would sell for on the open market. It is the price that would be agreed on between a willing buyer and willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts." DEPT.

In order for market prices to reflect the true value of an asset,[22] the market must function efficiently. Professors Robert Lawless and Stephen Ferris have identified conditions necessary for market prices to be deemed a reasonable approximation of an asset's market value.[23] First, an adequate number of participants must be present for the market to be deemed competitive so no one participant can unduly influence the pricing of the asset.[24] Second, financial resources must be able to move freely and without "regulatory or institutional impediments."[25] Third, efficient markets must be characterized by widespread dissemination of relevant information so that information asymmetries between buyers and sellers can be eliminated or otherwise mitigated.[26] A fourth requirement identified by Lawless and Ferris which incorporates some of the preceding requirements with respect to the numbers of market participants and dispersal of information is the notion that an asset must be exposed to the mar-

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OF THE TREASURY, DETERMINING THE VALUE OF DONATED PROPERTY, PUBLICATION 561, CAT. NO. 15109Q, INT. REV. SERV. 2 (Oct. 2005).

22. Economists and legal scholars have drawn the distinction between the market prices that may be associated with a particular asset and the market value of that asset. Robert M. Lawless & Stephen P. Ferris, *Economics and the Rhetoric of Valuation*, 5 J. BANKR. L. & PRAC. 3, 11 (1995). Value is defined as "the present value of its future cash flows." *Id.* at 11. Market price is defined as "the amount negotiated between a buyer and a seller in a less-than-perfect market" and is "an historical fact." JAMES D. SHILLING, REAL ESTATE 199 (13th ed. 2002). In efficient markets, there ultimately will be "a convergence between the market price and the value estimated by investors." Lawless & Ferris, *supra*, at 12.

23. Other commentators have also defined market value in a way that adds detail to the willing seller-willing buyer framework. For example, market value has been defined as follows:

> The most probable price in terms of money which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus.
>
> Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:
> 1. buyer and seller are typically motivated.
> 2. both parties are well informed or well advised, and each acting in what they consider their own best interest.
> 3. a reasonable time is allowed for exposure in the open market.
> 4. payment is made in cash or its equivalent.
> 5. financing, if any, is on terms generally available in the community at the specified date and typical for the property type in its locale.
> 6. the price represents a normal consideration for the property sold unaffected by special financing amounts and/or terms, services, fees, costs, or credits incurred in the transaction.

AM. INST. OF REAL ESTATE APPRAISERS & SOC'Y OF REAL ESTATE APPRAISERS, REAL ESTATE APPRAISAL TERMINOLOGY 160-61 (Byrl N. Boyce ed., rev. ed. 1981).

24. Lawless & Ferris, *supra* note 22, at 13-14.

25. *Id.* at 14.

26. *Id.*

ketplace for a sufficient period of time for the proper equilibrium to be reached.[27]

Those who work on estimating the fair market value of a given commodity that has not been placed on the market often make judgments about valuation relying in part upon objective facts and in part upon speculation.[28] The ultimate valuation estimate depends heavily upon the context in which the valuation is made,[29] and also upon the hypotheses and assumptions that the person conducting the valuation makes.[30] As one commentator has stated, valuation assessments "are designed to have normative purchase in the ethical marketplace, and this requires that they be plausible."[31] Therefore, instead of focusing energy upon generating a precise valuation figure that can withstand all criticism, an individual with expertise in valuing particular types of assets or commodities generates a valuation estimate in a particular case that he or she believes falls within a range of reasonable values.[32]

Since valuation can involve a substantial amount of indeterminacy, legal proceedings in which valuation must be determined often provide litigants who have sufficient resources with substantial incentives to hire legal counsel who will engage in aggressive advocacy.[33] Moreover, the incentive to make aggressive valuation assessments is not limited to litigation. It is also present in many other contexts such as the valuing of conservation easement donations for the purpose of claiming these donations as charitable contributions

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27. *Id.* at 14-15.

28. *See, e.g.*, David Gray Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 AM. U. L. REV. 63, 70 (1991) (observing that "[s]ince a bankruptcy judge will determine value without the benefit of an historical exchange, the judge is required to hypothesize one"); *see also In re* Crowthers McCall Pattern Inc., 120 B.R. 279, 297 (Bankr. S.D.N.Y. 1990) (describing valuation as "an imprecise tool, perhaps the best we currently have, designed to reach a calculated decision on the basis of the hypotheses and assumptions in light of a set of facts").

29. Douglas K. Moll, *Shareholder Oppression and "Fair Value": Of Discounts, Dates, and Dastardly Deeds in the Close Corporation*, 54 DUKE L.J. 293, 319 (2004).

30. *See* TIM KOLLER, MARC GOEDHART & DAVID WESSELS, VALUATION: MEASURING AND MANAGING THE VALUE OF COMPANIES 349-50 (4th ed. 2005).

31. Carlson, *supra* note 28, at 71.

32. *See* Keith Sharfman, *Valuation Averaging: A New Procedure for Resolving Valuation Disputes*, 88 MINN. L. REV. 357, 367 n.35 (2003) ("There is what one might call a 'zone of plausibility' in financial valuations, ranging anywhere from plus or minus fifteen to plus or minus thirty percent."); *see also* KOLLER, GOEDHART & WESSELS, *supra* note 30, at 355 ("We typically aim for a valuation range of plus or minus 15 percent, which is similar to the range used by many investment bankers. Even valuation professionals cannot always generate exact estimates. In other words, keep your aspirations for precision in check.").

33. *See, e.g.*, John H. Buonocore, Jr., *Novel Issues Involved in Direct and Cross Examination of Witnesses in an Eminent Domain Trial*, SJ051 ALI-ABA 323, 325 (2004) (LEXIS, Secondary Legal, Combined ALI-ABA Course of Study Materials) ("Contested eminent domain cases, i.e., the ones that go to trial, typically involve 'aggressive' valuation positions and an aggressive defense to those positions.").

deductible from a taxpayer's adjusted gross income[34] under section 170 of the Internal Revenue Code (I.R.C.).[35]

When valuation is contested, it is common for proceedings in which valuation is to be determined to "degenerate into a 'battle of experts,' pitting one appraiser against another."[36] Such battles among experts over valuation occur in many legal contexts including in charitable contribution tax cases,[37] disputes about stock buyouts in corporate mergers and consolidation cases,[38] eminent domain,[39] marital dissolution cases involving marital property disputes,[40] estate tax cases,[41] and ad valorem property tax cases.[42] Oftentimes, these experts utilize such technical and complex methodologies in their valuation analyses that judges and juries feel largely incapable of evaluating the soundness of expert testimony.[43]

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34. John H.A. Griesedieck, Note, *Conservation Easements: Tax Shields with Philanthropic Means*, 14 MO. ENVTL. L. & POL'Y REV. 501, 509-511 (2007). A few years ago, it came to light that there had been some abuse in this area by appraisers who had given inflated appraisals of the value of the donated easements in order to lower the tax burden of the easement donor. *See* Nancy A. McLaughlin, *Questionable Conservation Easement Donations*, PROB. & PROP., Sept.-Oct. 2004, 40, 41, 44-45. As McLaughlin notes, in 2003 the Washington Post published an article that documented several instances in which particular conservation easements had been appraised in questionable ways that ended up generating substantial charitable tax deductions that the easement donor claimed. *See* Joe Stephens & David B. Ottoway, *Developers Find Payoff in Preservation: Donors Reap Tax Incentive by Giving to Land Trusts, but Critics Fear Abuse of System*, WASH. POST, Dec. 21, 2003, at A01.

35. I.R.C. § 170(a)(1) (2006).

36. Lawless & Ferris, *supra* note 22, at 10 n.31.

37. *See, e.g.*, Hearst Corp. v. United States, 28 Fed. Cl. 202, 215 (1993) (discussing a case involving valuation of charitable contribution of film materials to the University of California at Los Angeles, the plaintiff's expert claimed that the gift the plaintiff made had a fair market value of $62 million, but the Internal Revenue Service's valuation expert calculated the value of the gift to be $1.4 million) *vacated and remanded on other grounds*, 1994 U.S. App. LEXIS 25788 (Fed. Cir. Sept. 15, 1994).

38. *See, e.g.*, Cede & Co. v. Technicolor, Inc., 884 A.2d 26, 35, 42 n.69 (Del. 2005) (stating that "[i]t is often the case in statutory appraisal proceedings [under Del. Code Ann. tit. 8, § 262] that a valuation dispute becomes a battle of experts").

39. *See, e.g.*, Miss. Transp. Comm'n v. Highland Dev., L.L.C., 836 So. 2d 731, 735 n.1 (Miss. 2002). The expert for the Mississippi Transportation Commission estimated the just compensation required for the condemnation at $197,775 in contrast to the $2.3 million just compensation estimate made by the property owner's expert. *Id.*

40. *See, e.g.*, Zasler v. Zasler, No. 0564-02-2, 2003 Va. App. LEXIS 470, at *4-10 (Va. Ct. App. Sept. 9, 2003).

41. *See, e.g.*, Estate of Hillebrandt v. Comm'r, 52 T.C.M. (CCH) 1059, 1063 (T.C. 1986) (stating that a case in which the Internal Revenue Service issued a deficiency notice for the alleged insufficient payment of estate taxes based upon the disputed value of certain farmland owned by the decedent "presents the usual inexactitude of property valuations, and . . . is yet another 'battle of the experts' ").

42. *See, e.g.*, Bd. of Supervisors v. HCA Health Servs. of Va., Inc., 535 S.E.2d 163, 171 (Va. 2000) (concluding "the issue of the proper valuations of the hospital property presented a 'battle of the experts' ").

43. One Delaware court has stated the following:

> Experience in the adversarial, battle of the experts' appraisal process under Delaware law teaches one lesson very clearly: valuation decisions are impossible to

Furthermore, the expense of utilizing expert appraisers in various legal matters reinforces one of the realities of our legal system: law is not free.[44] For example, according to two leading practitioners in Montana and Wisconsin, simply hiring an appraiser to estimate the value of a conservation easement often can cost a landowner between $2000 and $40,000 depending upon the complexity of the case and the geographic region of the country involved.[45] In extreme situations in litigation, a person's financial inability to hire an expert can be fatal to one's case.[46] Those who do not hire valuation experts of their own in many other legal disputes or transactions involving assets of significant value, for whatever reason, can risk losing significant amounts of money or substantial asset value.

In seeking to estimate a commodity's fair market value, there are a number of valuation models that can be employed. For example, three well-accepted methodologies used in valuing various business enterprises and in valuing real estate holdings include the comparable sales approach, the replacement cost approach, and the income flow or income capitalization approach.[47] Even if valuation is determined using an agreed-upon technique, substantially different values for the same

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> make with anything approaching complete confidence. Valuing an entity is a difficult intellectual exercise, especially when business and financial experts are able to organize data in support of wildly divergent valuations for the same entity. For a judge who is not an expert in corporate finance, one can do little more than try to detect gross distortions in the experts' opinions. This effort should, therefore, not be understood, as a matter of intellectual honesty, as resulting in *the* fair value of a corporation on a given date. The value of a corporation is not a point on a line, but a range of reasonable values, and the judge's task is to assign one particular value within this range as the most reasonable value in light of all of the relevant evidence and based on considerations of fairness.

Cede & Co. v. Technicolor, Inc., No. 7129, 2003 Del. Ch. LEXIS 146, at *5-6 (Del. Ch. Dec. 31, 2003) (footnote omitted), *rev'd on other grounds*, 884 A.2d 26 (Del. 2005).

44. *See* DEBORAH L. RHODE, ACCESS TO JUSTICE 103 (2004) ("Bar studies consistently find that about four-fifths of the civil legal needs of low-income Americans remain unmet. The nation's poor, who most need legal assistance, are least likely to obtain it."); *see also* Deborah J. Cantrell, *Justice for Interests of the Poor: The Problem of Navigating the System Without Counsel,* 70 FORDHAM L. REV. 1573, 1582 (2002).

45. E-mail from Johanna Allex, Partner, Law Offices of Christenson and Allex, L.L.C., to Thomas Mitchell, Associate Professor, Univ. of Wisconsin Law School (Aug. 6, 2008, 14:57 CST) (on file with authors) (leading practitioner in Wisconsin providing a range of between $2000 and $3000 for cases arising in southern Wisconsin); E-mail from David J. Dietrich, Partner, Dietrich & Assoc. to Thomas Mitchell, Associate Professor, Univ. of Wisconsin Law School (Aug. 5, 2008, 17:19 CST) (on file with authors) (leading practitioner in Montana providing a range of between $15,000 and $40,000).

46. *See* David Medine, *The Constitutional Right to Expert Assistance for Indigents in Civil Cases,* 41 HASTINGS L.J. 281, 286, 288-89 (1990).

47. ROBIN PAUL MALLOY & JAMES CHARLES SMITH, REAL ESTATE TRANSACTIONS: PROBLEMS, CASES AND MATERIALS 240 (2nd ed. 2002); *see also* Snowbank Enters., Inc. v. United States, 6 Cl. Ct. 476, 486 (1984) ("A trial court is not restricted to any of these methods in arriving at its determination of fair market value. Its valuation analysis may be based upon the comparable sales, the replacement cost, the income capitalization or upon any combination of these three appraisal methods.").

asset or commodity can be generated to the extent the parties make different assumptions in their respective valuation analyses.[48] Similarly, competing experts in personal injury or wrongful death litigation who use very similar valuation methods often generate dramatically different valuation assessments because they make different assumptions about what the plaintiff's projected work-life expectancy or salary raises, for example, would have been had they not been injured or killed.[49] To make matters more complicated, opposing parties often use different valuation methodologies and then make very different economic assumptions resulting in the generation of highball/lowball numbers.[50] Given that courts have broad leeway under different substantive laws to determine a property's fair market value,[51] litigation involving asset valuation can turn into a high-stakes contest because courts often adopt a winner-take-all approach.[52]

B. *Fair Market Value is the Antithesis of Forced Sale Value*

1. *The Law and Economics of Forced Sales*

Despite the wide range of estimates of an asset's fair market value that can be generated depending upon which valuation methodology

48. *See, e.g.*, Neptune, L.L.C. v. Town of Madison, No. CV030478100, 2005 WL 1524916, at *1, *5 (Conn. Super. Ct. June 2, 2005) (stating that the appraisers both used the comparable sales approach; however, the appraiser for the defendant appraised the property at $2,589,200 and the plaintiff's appraiser appraised the property at $1,496,000 which meant that there was a difference of over a million dollars between the appraisals).

49. *See, e.g.*, Pierce v. Am. Family Mut. Ins. Co., 736 N.W.2d 247, 254 n.11 (Wis. Ct. App. 2007) (showing that the expert for the plaintiff in a personal injury case valued the pecuniary damages at $316,000, but the expert for the defendant insurance company valued the loss at $125,000).

50. *See* MALLOY & SMITH, *supra* note 47, at 240; *see also* Bassett, New Mexico L.L.C. v. United States, 55 Fed. Cl. 63, 67, 76-78 (Fed. Cl. 2002) (comparing plaintiff's $92,806,000 just compensation estimate calculated by using a combination of the income flow and comparable sales methodologies with defendant's $1,550 just compensation estimate that was derived by utilizing comparable sales analysis alone); Rakow v. Comm'r, T.C. Memo. 1999-177, 1999 WL 335970, at *1, *9 (U.S. Tax Ct. May 27, 1999) (stating that the petitioner used an asset-based valuation to value the stock at $354.89 per share and respondent used a discounted cash flow approach to value the stock at $606.59, and holding that valuations were incorrect, but that the discounted cash flow approach was the correct methodology to value the stock).

51. *See* Christopher Serkin, *The Meaning of Value: Assessing Just Compensation for Regulatory Takings*, 99 NW. U. L. REV. 677, 687-704 (2005) (noting that compensation in takings cases can vary greatly depending upon the manner in which a court utilizes one or more various "valuation mechanisms" at its disposal).

52. *See* Alex E. Sadler, Note, *The Inherent Ambiguity of Commercial Real Estate Values*, 13 VA. TAX REV. 787, 808 (1994) (noting that in litigation between taxpayers and the I.R.S. that courts sometimes base their decision on one party's appraisal either due to the strength of the analysis of that party's expert appraiser or due to the weakness of the analysis of the opposing party's expert); *see also* Denny's Realty, Inc. v. Town of Wethersfield, No. 550064, 1996 Conn. Super LEXIS 1970, at *2-4 (Conn. Super. Ct. Aug. 1, 1996) (determining a property in question should be valued at $1,262,000, the precise figure generated by the valuation expert for the Town of Wethersfield, and thereby rejected the $840,000 valuation estimate of the plaintiff's valuation expert).

is used and which assumptions are made, fair market valuation analysis is not unbounded. In many areas of the law it is well accepted that an asset sold at a forced sale will likely sell for a price significantly below the asset's fair market value.[53] Treasury Regulation 20.2031-1 addresses estate and gift taxes, and quite clearly distinguishes between a price satisfying the fair market value standard and a forced sale price. Under this regulation, fair market value is defined as follows:

> The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. *The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price.*[54]

In deciding a seminal bankruptcy case in 1994, Justice Scalia proclaimed that "market value, as it is commonly understood, has no applicability in the forced-sale context; indeed, it is the very *antithesis* of forced-sale value."[55]

Comparing the conditions of a forced sale with the conditions viewed as necessary for markets to function efficiently helps one understand why a forced-sale price is likely to represent a significant discount from an asset's fair market value. First, unlike a voluntary sale, under a forced sale the seller and/or buyer is not a willing participant in the transaction, so he or she cannot be described as "typically motivated."[56] Second, the buyer at a forced sale is often not very informed about the property being sold. In many instances, prospective buyers have insufficient time to gather quality information about the property being sold. In other instances, the sale procedures those conducting the sale must follow by court order or by statute effectively prevent prospective buyers from gathering the type of information

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53. A forced sale has been defined as follows:

> The phrase "forced sale" is used in the law of condemnation to describe a sale of property which is inadmissible as evidence of value because elements of compulsion so affected the seller that the sale could not be said to be fairly representative of market value at the time made. The conception of a forced or compulsive sale includes force or compulsion as a result of some kind of legal process. Thus sales on foreclosure or execution are treated as forced sales. But the compulsion may also be that created by business circumstances. For example, a property taken in discharge of a debt may be considered a forced sale, where the creditor had little choice in the matter.

Hickey v. United States, 208 F.2d 269, 275 (3d Cir. 1953) (citations omitted).

54. Treas. Reg. § 20.2031-1(b) (2008) (emphasis added).

55. BFP v. Resolution Trust Corp., 511 U.S. 531, 537 (1994).

56. REAL ESTATE APPRAISAL TERMINOLOGY, *supra* note 23, at 161.

one would gather if the property were being sold on the open market.[57]

For example, many states mandate partition sales be conducted at public auctions after notice of the sale is given in the manner required by state law for sales of real property on execution.[58] Real property ordered sold under state execution statutes can almost always be sold by the sheriff at a public auction within thirty days—and often sooner—after notice of the sale has been published or posted for the first time. This leaves prospective buyers little time to evaluate the property.[59] In terms of sale procedures, under forced sales such as foreclosure sales, prospective buyers are rarely able to conduct any on-site inspection of the interior or exterior of the property beyond what they can observe from outside the property boundaries.[60] Further, unlike arms-length negotiations, bidders at foreclosure auctions typically purchase the property "as is, where is," and the foreclosing lender typically does not provide bidders any title re-

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57. *In re* Robbins, 119 B.R. 1, 5 (Bankr. D. Mass 1990); *see also* Lynn M. LoPucki, *A General Theory of the Dynamics of the State Remedies/Bankruptcy System*, 1982 WIS. L. REV. 311, 317-18 (1982).

58. *See, e.g.*, IDAHO CODE ANN. § 6-524 (2007). This statute reads as follows:

> All sales of real property made by referees under this chapter [that addresses partition of real estate] must be made at public auction to the highest bidder, upon notice published in the manner required for the sale of real property on execution. The notice must state the terms of sale, and if the property or any part of it is to be subject to a prior estate, charge or lien, that must be stated in the notice.

Id.

59. *See, e.g.*, ALASKA STAT. § 09.35.140(2) (2007) (requiring that notice of the sale be given at least thirty days before the day of sale); ARIZ. REV. STAT. ANN. § 12-1621.A.3 (2007) (requiring that notice of the sale be given at least fifteen days before the day of sale); MONT. CODE ANN. § 25-13-701(1)(c) (2005) (requiring that notice of the sale must given twenty days before the day of sale). Some of these statutes merely require that the notice of the sale be published during the relevant time period on two or three separate occasions. *See, e.g.*, LA. CODE CIV. PROC. ANN. art. 2331 (2007); N.D. CENT. CODE § 28-23-04 (2007).

60. Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L.J. 1399, 1421 (2004); *see also* WIS. STAT. § 846.17 (2006) (providing that a purchaser may only be let into possession after obtaining a sheriff's deed to the property upon the sale of the property and after the foreclosure sale has been confirmed). The issue of presale inspections can also arise in the context of personal property that has been possessed by a sheriff under a writ of execution prior to a sheriff's sale. To this end, Professor LoPucki has stated as follows:

> Prospective purchasers would be unwise to bid on the assumption that the automobile is operative and not in need of major repair, without at least test driving the automobile. The sheriff, on the other hand, would he [sic] equally unwise to permit test drives with the concomitant problems of possible theft, accidental destruction of the automobile, injury to third parties for which the sheriff might have liability, and mechanical problems, in addition to paying for gas, oil and other routine maintenance. The author is unaware of any sheriff's office which permits the test drive.

LoPucki, *supra* note 57, at 318 n.30.

port or title insurance for the property.[61] The fact that prospective buyers often lack sufficient information needed for them to be fully informed about the property often results in buyers submitting offers factoring in some uncertainty.[62]

Third, as these examples illustrate, property sold at a forced sale on a particular date after being sparsely marketed for two to four weeks is often not exposed to the market for a sufficient period of time to attract a robust number of prospective purchasers.[63] Such a truncated marketing time stands in sharp contrast to the typical marketing time for property sold in the ordinary retail market. There, property is normally listed on the market for several weeks or months,[64] exposing the property "to more potential buyers, and thus to a higher probable price" than property sold in the forced sale context.[65]

Forced sales are often also poorly advertised, compounding these informational and exposure problems.[66] Professor LoPucki has noted that when personal or real property is sold at forced execution sales the property is typically advertised as follows:

> The advertising is . . . done in a very perfunctory manner, usually in the legal notices column of a newspaper. The manner of advertising is calculated not to attract bidders but to satisfy formal requirements. Property to be sold at execution sale need only be "described with reasonable certainty, so as to enable prospective purchasers in the exercise of ordinary diligence, to identify it." Thus, descriptions which fail to give the typical reader sufficient information to know whether he is interested in the property are nevertheless legally sufficient.[67]

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61. Nelson & Whitman, *supra* note 60, at 1422. Furthermore, especially in the context of foreclosures of commercial property, the foreclosing lender may possess additional information about the property that can include environmental audits, engineering reports, and appraisals. *Id.* at 1421. However, these foreclosing lenders are not duty-bound to share this information with prospective bidders and often choose not to share this information. *Id.* Because replicating this type of information requires gaining access to the property, prospective bidders often are not able to get this information, which can impact not only the amount they may elect to bid but also their ability to bid in the first instance as many lenders require this type of information in their loan approval process.

62. *In re* Robbins, 119 B.R. 1, 5 (Bankr. D. Mass 1990).

63. *Id.* The fact that properties sold at forced sales are exposed to the market for a shorter period of time than comparable properties sold under normal market conditions has particular significance given that "the pool of buyers is relatively thin for distressed properties to begin with" as compared to the pool of buyers for properties for nondistressed properties. Kerry D. Vandell & Timothy J. Riddiough, *On the Use of Auctions as a Disposition Strategy for RTC Real Estate Assets: A Policy Perspective*, 3 HOUSING POL'Y DEBATE 117, 118 (1992).

64. *See* NATIONAL ASSOCIATION OF REALTORS, PROFILE OF HOME BUYERS AND SELLERS 83 (2008).

65. Nelson & Whitman, *supra* note 60, at 1417.

66. LoPucki, *supra* note 57, at 317.

67. *Id.* (footnotes omitted).

In one Alaska case, for example, the more than 562 acres of real property sold on execution was described merely by its legal description.[68] This is typical in many if not most states. The type of marketing of the real property sold upon a writ of execution in *Mallonee* is typical of the type of marketing utilized in foreclosure auctions as well.[69]

Further, there are many forced sale procedures that make it difficult for a bidder without sufficient cash on hand to participate effectively in the bidding process. For example, in foreclosure auctions, seller financing is rarely available and the high bidder is usually required to make a substantial deposit on the auction date with the balance of the purchase price due within a short period of time.[70] Most state statutes governing execution sales require the winning bidder to make immediate cash payment.[71] This precludes bidders from making bids contingent upon securing financing within a commercially reasonable period of time or from making their payments by any form of negotiable instrument, including personal checks.[72]

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68. Mallonee v. Grow, 502 P.2d 432, 434 (Alaska 1972). In these notices, including the notice that was published five times in the Anchorage Daily Times, the property was described as follows:

> Seward Meridian, Alaska
> T. 16 N, R. 2W.
> Sec. 1, SE 1/4 SW 1/4, Lot 7
> Sec. 2, Lot 5
> Sec. 11, Lots 1, 3, 4, 5 and 6, N 1/2 NE 1/4
> Sec. 12, N 1/2 NW 1/4, Lots 2 and 3

Id. at 434 n.5.

69. Dale Whitman has described the type of marketing utilized in mortgage foreclosures:

> In foreclosure auctions . . . the only "marketing" is typically a classified advertisement in the local newspaper that gives the legal description of the land and perhaps a little additional information, such as its street address and the type of improvements located on it. A notice may also be recorded in the public records and posted on the land itself, containing the same data. It is up to the individual bidders to accumulate the additional information they need to formulate intelligent bids. The foreclosing mortgagee may or may not have this information, and may or may not be cooperative in passing it to prospective bidders.

Dale A. Whitman, *Chinese Mortgage Law: An American Perspective*, 15 COLUM. J. ASIAN L. 35, 73 (2001).

70. Nelson & Whitman, *supra* note 60, at 1420. Because "bidders must come to the auction armed with letters of credit, cashiers' checks, or the like, and must have prearranged financing for the rest of the price . . . only professional bidders or dedicated and knowledgeable amateurs are likely to bid." *Id.* at 1420. Further, even bidders who may be prepared to make otherwise competitive cash bids often must compete against a mortgagee who has the right to make a credit bid up to the level of the unpaid debt. *See* Alex M. Johnson, Jr., *Critiquing the Foreclosure Process: An Economic Approach Based on the Paradigmatic Norms of Bankruptcy*, 79 VA. L. REV. 959, 995-97, 1007-12 (1993).

71. 30 AM. JUR. 2D *Executions and Enforcement of Judgments* § 423 (2009).

72. *See, e.g.*, Proto v. Missoula County, 749 P.2d 1094, 1096 (Mont. 1988) ("While some courts have recognized a limited exception in which the judgment creditor consents to a bid paid by check, the general rule is that the execution officer is bound to accept only cash for the bid, as our statute requires."). Many courts have indicated that in a forced sale

Further, in nearly all states, the winning bidder at a partition sale must make an immediate cash payment to the sheriff and is prohibited from making payment on credit.[73]

Because prospective buyers in arms-length transactions routinely make offers that are contingent upon securing financing within thirty to sixty days,[74] such restrictions in the forced-sale context amount to a special financing term likely to produce fewer bids and ultimately a lower sales price. In fact, some courts that have approved a cash sale requirement at a forced sale have done so despite tacitly accepting the premise that such a cash sale requirement can chill the bidding in a manner potentially resulting in a sale below market value.[75]

2. *"Vulture Buyers" Target Owners of Distressed Properties Worried About Potential Forced Sales*

The economic ramifications of a forced sale of real property have become increasingly significant to more and more Americans as a result of the current foreclosure crisis that has only gotten worse during the writing of this Article. The mortgage foreclosure filings in July 2008 were up 121% as compared to the foreclosure filings in July 2007.[76] By March 2008, 2.47% of the more than 50 million mortgages in the United States,[77] representing approximately 1.2 million households, were in foreclosure.[78] By the late summer and fall of 2008, the number of mortgage foreclosures across the United States was still surging[79] and the rate of mortgage default was occurring "at a faster pace than at any point in recent decades."[80] Observers who initially

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that is required to be conducted *for cash*, hard currency, certified checks, or cashier's checks may be tendered because these forms of payment represent funds that are immediately available. In contrast, these courts hold that personal checks, drafts, or any negotiable instruments are not acceptable forms of payment. *See, e.g.*, Upchurch v. Chaney, 635 S.E.2d 124, 125 (Ga. 2006).

73. *See, e.g.*, Overton v. Porterfield, 177 S.W.2d 735, 738 (Ark. 1944) (holding that the trial court that ordered a partition sale did not abuse its discretion in ordering a sale for cash instead of on credit).

74. *See, e.g.*, Tracie R. Porter, *The Anatomy of Real Estate Contract Forms for New Real Estate Attorneys*, 17 CHICAGO BAR ASSOC. REC. 34 (2003).

75. *See Proto*, 749 P.2d at 1097; *see also id.* (Sheehy, J., dissenting) ("[T]he officer could take a check and hold the property until the check cleared the bank. In these days of checks and balances in business as in government, checks have become an accepted medium of exchange. The result here may have been a higher bid of [sic] checks were accepted.").

76. *Id.*

77. Frank Langfitt, *Morning Edition: Bad Mortgages Taking Down Good Loans, Too*, (National Public Radio broadcast Sept. 23, 2008), *available at* http://www.npr.org/templates/story/story.php?storyId=94921465 (citing Jay Brinkmann, chief economist at the Mortgage Bankers Association).

78. Press Release, Mortgage Bankers Ass'n, Delinquencies and Foreclosures Increase in Latest MBA National Delinquency Survey (June 5, 2008), http://www.mortgagebankers.org/NewsandMedia/PressCenter/62936.htm.

79. *See, e.g.*, Christie, *supra* note 1.

80. *The Hammer Drops; America's Property Crisis*, ECONOMIST, Oct. 4, 2007, at 31.

expected foreclosures to total 2 million for 2008 revised projections upward to reflect the higher than anticipated 1.4 million foreclosures that occurred by the end of the second quarter of the year.[81]

An additional 6.35% of those with mortgages—roughly 3.2 million households—were delinquent on their mortgage payments.[82] The picture is even more troubling if one focuses exclusively upon the delinquency rate of those with subprime mortgages. In the first quarter of 2008, delinquencies on subprime mortgages increased to 18.79% of all the outstanding subprime mortgages, representing an increase from a 17.31% delinquency rate in the fourth quarter of 2007.[83]

The problem has only increased as the foreclosure crisis continued into 2009. In August of 2009, foreclosure filings were up an additional 18% from August of 2008.[84] In July of 2009, a record number of properties entered default or sold at foreclosure auctions.[85] The number of homeowners impacted by the crisis has also grown, with 1 in 357 households nation-wide receiving foreclosure notices in August 2009.[86] In Nevada, one in sixty-two households received notices.[87] Overall, by August 2009, 9.24% of all mortgages on one to four unit properties fell delinquent,[88] and by the end of 2009, 2.8 million households faced foreclosure.[89]

Perhaps unsurprisingly, there is a growing niche in the real estate business sector built upon the age-old maxim that one person's misfortune can be another person's opportunity. One of the leading businesses in this sector, Foreclosure.com, claims that its "[w]eb site is loaded with amazing bargains that are below market value," sometimes as much as 50% below market value.[90] Some refer to those willing to take economic advantage of distressed owners as investors who "[p]lay the [v]ulture."[91] Other businesses dispassionately describe their

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81. *E.g.*, Christie, *supra* note 1.

82. *See* Press Release, Mortgage Bankers Association, *supra* note 78.

83. *Id.*

84. Press Release, Realtytrac.com, Foreclosure Activity Remains Near Record Level in August (Sept. 10, 2009), http://www.realtytrac.com/contentmanagement/pressrelease.aspx?channelid=9&accnt=0&itemid=7381.

85. *Id.*

86. *Id.*

87. *Id.*

88. Press Release, Mortgage Brokers Ass'n, Delinquencies Continue to Climb, Foreclosures Flat in Latest MBA National Delinquency Survey (Aug. 20, 2009), http://www.mbaa.org/NewsandMedia/PressCenter/70050.htm.

89. *Record Year for Foreclosures as Unemployment Rises; 2.8M Households Threatened with Foreclosure,* N.Y. DAILY NEWS (Jan. 14, 2010), *available at* http://www.nydailynews.com/real_estate/2010/01/14/2010-01-14_record_year_for_foreclosures_as_unemployment_rises_28m_households_threatened_wit.html.

90. Foreclosure.com, http://www.foreclosure.com/top_foreclosure_web_site.html (last visited July 30, 2010).

91. Stephanie Fitch, *Prospering in the Housing Bust*, FORBES, June 5, 2006, *available at* www.forbes.com/forbes/2006/0605/142_print.html. This article identifies metropolitan areas with high foreclosure rates as the "Predators' Delight." *Id.* Another article refers to

participation in this niche sector as "making money off a negative situation."[92]

Distressed owners find themselves in a very vulnerable state as opposed to the willing seller in a fair market value transaction. For example, property owners who have fallen behind on their loan payments know a foreclosure action may destroy or severely damage their credit rating. This makes owners of so-called preforeclosure properties a target for real estate investors who seek to acquire these properties in order to make a quick profit.[93] Aggressive buyers who are prepared to engage in "wheedling distressed owners"[94] can often reap handsome profits by purchasing the property directly from the distressed owner either prior to or after a foreclosure action has been initiated but before a foreclosure sale occurs. These buyers tend to target distressed properties in which the owner's have built up a substantial amount of equity; they are often able to purchase these properties from the distressed owners for prices far below the property's market value. In fact, those in the "vulture sector" of the real estate sector often target distressed sellers who are not typically motivated because they feel compelled to sell in the shadow of an impending forced sale. Such sales conditions almost guarantee a sale below market value, as made explicit in the following article:

> "[V]ulture" buyers are zeroing in on the desperate investors, many of whom face foreclosure.
>
> Condo Vultures Realty, in Bal Harbour, Fla., organized two years ago to represent buyers seeking deeply discounted property. It compiles a monthly database of Florida "soft sellers"—those who've listed their condos and homes at least 100 days, or cut prices 10% or $100,000.
>
> By June, the database had grown to 1,361 condos and 810 town houses and single-family homes. The average discount: 21%, or $227,619.
>
> "We're creating the idea that we're going to buy cheap. And wouldn't you (as a soft seller) rather get out now than face repercussions later?" said Peter Zalewski, a former condo speculator

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this same phenomenon as "Heading Into Vulture Mode" and advises those interested in making money in this niche business to be "well versed in your state's real estate laws and prepared for tasks like evicting a family." Barbara Kiviat, *The Bust Hits Home*, TIME, Sept. 24, 2007, at 52.

92. Renee Montagne, *Morning Edition: Foreclosure Agents Profit from Housing Crisis* (National Public Radio broadcast Sept. 6, 2007), *available at* http://www.npr.org/templates/story/story.php?storyId=14204632 (quoting Glen Daniels, a director at Foreclosure.com who was interviewed by Renee Montagne).

93. *Foreclosure.com to Feature National Real Estate Expert Lance Young During Special "Preforeclosure Deals" Webinar; Online 90-Minute Presentation to Provide Current and Future Investors with Simple Strategies to Find, Negotiate and Resell Preforeclosure Properties for Big Profits*, PR NEWSWIRE, Aug. 27, 2007, http://sev.prnewswire.com/multimedia-online-internet/20070827/CLM09227082007-1.html.

94. Fitch, *supra* note 91.

> who got out of the market in 2004 and then founded Condo Vultures. "We swoop in and try to feast."[95]

Authors of a growing number of popular guidebooks coach potential investors through the process of negotiating with such distressed sellers who are described by these authors as often being "in a state of heightened emotion, which can include some combination of embarrassment, frustration, anger, fear, and panic."[96] Some authors even provide vulture buyers with tips on how to use deceitful practices to increase a distressed seller's anxiety and lower his or her expectations about obtaining a good sales price.[97] In the end, authors of some of these guidebooks advise vulture buyers to offer distressed sellers facing foreclosure anywhere from $2,000 to just walk away from the property to a price that is "below sixty five [sic] percent of the fair market value" of the property.[98] Though many people may consider these preforeclosure "vulture-buying" practices to be ruthless and repugnant, the increasing number of vulture buyers successfully bargaining in the shadow of forced foreclosure sales clearly illustrates that a property's forced sale value often represents just a fraction of its fair market value.

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95. Joe Gose, *Auction Buyers Pursue Condo Minimums; Discounts Aplenty, Amid Glut; Developers Who Overbuilt and Must Cut Carrying Costs Head for the Bidding Block*, INVESTOR'S BUS. DAILY, June 29, 2007, at A8.

96. HOWARD A. SMALL, THE COMPLETE GUIDE TO PREFORECLOSURES AND FORECLOSURES: HOW TO MAKE $10,000, $20,000 AND MORE IN REAL ESTATE USING THE REAL DATA SYSTEM 89 (2nd ed. 2006).

97. To be fair, there are a number of investors who are uncomfortable with making profits in the real estate market at the expense of families in economic distress. In describing the downside of acquiring preforeclosure property, two real estate experts detail the human element of using this technique:

> [Y]ou will likely be dealing with a family in a downward spiral. Their life will probably be falling apart, and even if you deal with them honorably and respect their dignity, most families will view you as an "opportunist" or "parasite". The challenge of dealing with this "human element" will prove too much to deal with for many investors.
>
> . . . .
>
> When we started, we were those investors fresh out of seminars and reading books who sought to make a fortune purchasing pre-foreclosures. Preforeclosures were supposed to be our primary sourcing mechanism. The "human element" we describe above was too much for us to deal with. Others are able to deal with this easier, and this can be a wonderful sourcing mechanism if you are able to disconnect yourself from the troubles of the families you will be profiting from. Simply put, we were not able to do this and after two or three months of trying we abandoned this method of purchasing discount residential real estate.

SCOTT FRANK & ANDY HELLER, TEN WAYS TO BUY LOW 11 (2007).

98. LANCE YOUNG, MAKE BIG PROFITS WITH PREFORECLOSURES AND PROPERTY LIENS: 59 (2006) (on file with authors).

III. COURTS AND LEGAL SCHOLARS ALIKE OFTEN FAIL TO RECOGNIZE THAT A PARTITION SALE IS A FORCED SALE

Tenancy in common is a form of concurrent ownership in which legal rights among the common owners are governed under what scholars in the field of business organizations refer to as an aggregate theory (as opposed to an entity theory) of ownership.[99] In tenancy in common ownership, each of the common owners holds an undivided interest in the whole of the property no matter how small their individual interest. Also, each cotenant has the right to use the whole property provided such use does not operate to oust any other cotenant.[100] In terms of exit, any single cotenant, no matter how small his or her ownership interest may be, may terminate his or her interest in the tenancy in common by initiating a legal proceeding called a partition action.[101]

Most state partition statutes provide that judges should first consider the feasibility of ordering a partition in kind—a division of the property into physically distinct and separately titled parcels—that would give the person seeking partition his or her pro rata share of the property leaving the other nonpetitioning cotenants as tenants in common with respect to the remaining land.[102] Under these state statutes, the judge should order a partition sale only if he or she determines in an equitable proceeding that a physical division of the property would be impracticable or inequitable. However, many scholars and advocates claim that judges throughout the country normally order a partition sale irrespective of whether the jurisdiction has a statute indicating partition in kind should be the preferred remedy.[103]

A. *Conflating Market Value with Forced Sale Value*

In deciding whether to order a partition in kind or a partition sale as a threshold matter, state courts throughout the country have increasingly utilized an economic analysis which either completely or largely discounts any noneconomic values claimed by those who seek to resist a partition sale and instead request the court order a parti-

99. *See infra* note 147.

100. Thomas W. Mitchell, *From Reconstruction to Deconstruction: Undermining Black Landownership, Political Independence, and Community Through Partition Sales of Tenancies in Common*, 95 NW. U. L. REV. 505, 512 (2001).

101. *Id.* at 513.

102. *Id.*

103. *See, e.g.*, Phyliss Craig-Taylor, *Through a Colored Looking Glass: A View of Judicial Partition, Family Land Loss, and Rule Setting*, 78 WASH. U. L.Q. 737, 753-54 (2000) (noting "the burden is so easy to meet that partition sales are the rule rather than the exception"); John G. Casagrande, Jr., Note, *Acquiring Property Through Forced Partitioning Sales: Abuses and Remedies*, 27 B.C. L. REV. 755, 771-72 (1986) (observing the "trend away from partitioning by division in kind and towards judicial sales is generally acknowledged to be universal").

tion in kind so they can retain possession of their property. For example, though the North Carolina partition statute maintains the traditional preference for a partition in kind, the statute indicates a partition sale may be ordered if "an actual partition of the lands cannot be made without substantial injury to any of the interested parties."[104] The North Carolina statute requires a court to determine "substantial injury" as follows:

> (1) Whether the fair market value of each cotenant's share in an actual partition of the property would be materially less than the amount each cotenant would receive from the sale of the whole.
> (2) Whether an actual partition would result in material impairment of any cotenant's rights.[105]

Courts in many other states throughout the country with partition statutes indicating that a partition sale may be ordered only if a partition in kind would result in "great prejudice"—or among other formulations of the test would result in "manifest prejudice" or would not be "fair and equitable"—to the common owners have also developed, through case law, a predominately economics-only test to determine whether to order a partition in kind or a partition sale.[106] One frequently applied common law test courts have utilized to determine whether a partition in kind would result in great prejudice is "[w]hether the value of the share of each in case of a partition would be materially less than his share of the money equivalent that could probably be obtained for the whole."[107] Those who advocate for courts to use a "totality of the circumstances" test, which requires a court to balance a range of economic and noneconomic factors before deciding whether to order a partition in kind or a partition sale, argue that utilization of the economics-only test undermines very important property rights that are upheld in many other areas of property law. Though it is a minority approach, certain states have adopted such a "totality of the circumstances" test.[108]

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104. N.C. GEN. STAT. § 46-22(a) (2009).

105. *Id.* § 46-22(b).

106. *See, e.g.*, Anderson v. Anderson, 108 S.E. 907, 908 (Ga. Ct. App. 1921); Schnell v. Schnell, 346 N.W.2d 713, 716 (N.D. 1984) ("Sentimental reasons, particularly in the preservation of a home, may also be considered, although they are subordinate to the pecuniary interests of the parties."); Fike v. Sharer, 571 P.2d 1252, 1254 (Or. 1977) ("Oregon case law indicates that the financial interests of the owners is the primary factor to be considered for purposes of a determination of prejudice in the event of partition or sale."); Zimmerman v. Marsh, 618 S.E.2d 898, 901 (S.C. 2005).

107. Idema v. Comstock, 110 N.W. 786, 787 (Wis. 1907).

108. *See, e.g.*, Eli v. Eli, 557 N.W.2d 405, 410 (S.D. 1997) (courts must consider the "totality of the circumstances," including the ability of one or more of the parties to purchase the land at a partition sale, the parties' sentimental attachment to the land, the location and size of the land, and the present and likely future uses of the land); Ark Land Co. v. Harper, 599 S.E.2d 754, 761 (W. Va. 2004) ("[T]he economic value of the property is not the exclusive test . . . Evidence of longstanding ownership, coupled with sentimental or emo-

Irrespective of whether it is good policy for courts to utilize an economics-only test in partition cases, if such a test is to be utilized, courts should conduct a proper economic analysis of the comparative economic benefits to the common owners of a partition in kind as opposed to a partition sale. However, many courts that have principally utilized economic analysis in deciding which remedy to order in a partition action have not been properly attentive to the different manner in which property should be valued if partitioned in kind versus sold at a partition sale. In estimating the value of the separate parcels that would result from a partition in kind, it is appropriate to consider the fair market value of these parcels as the prospective owners of these properties would then be able to later sell these parcels under market value conditions. However, in order to estimate the value of the property if sold as a whole, one must take into account the type of sale conditions under which the property would be sold. As indicated in the previous part of this Article, partition sales are almost never conducted under fair market value conditions.

In fact, in many partition actions, one or more of the common owners often seek to acquire the property at the public auction specifically because they recognize a partition sale is a forced sale and the property will likely be sold below, often well below, its fair market value. To this end, in one Delaware case, two of the common owners of a family farm sought to halt a partition sale because the other common owners had disseminated information about the sale in a manner that exceeded the limited advertising required by state statute and court order.[109] Such enhanced advertising jeopardized the plans the two common owners had of acquiring the family farm at a significant discount from its full market value.[110] In other cases, real estate speculators have purchased small interests in tenancy in common property with the specific motive of seeking a forced partition sale so they can purchase the property at a significant discount from market value and in some cases at fire sale prices.[111]

Although some courts do appear to understand a partition sale is a forced sale,[112] many other courts in partition actions seem to simply

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tional interests in the property, may also be considered in deciding whether the interests of the party opposing the sale will be prejudiced by the property's sale.").

109. Plouffe v. Hastings, No. C.M. 3069 G-198, 2000 WL 1521471, at *2 (Del. Ch. Aug. 29, 2000). Although the court did permit advertising in excess of the minimum required by the statute and court order, it appears that the partition sale that was to be conducted in this case still lacked the attributes of a market value sale. Despite this fact, the court indicated that increased advertising could attract more bidders which would "increase the possibility that the full market value for the property will be paid." *Id.* at *3.

110. *Id.* at *2.

111. *See* Mitchell, *supra* note 100, at 579.

112. Schwartz v. Shapiro, 40 Cal. Rptr. 189, 202 (Ct. App. 1964) ("The [partition] sale is a 'forced sale' in the same sense as would be a mortgage foreclosure, a trustee's sale or a sale under execution."). *See also* Orgain v. Butler, 496 S.E.2d 433, 435 (Va. 1998) (reversing chan-

assume "the estate in common is assumed to realize fair market value. . . ."[113] In one recent New York partition case that applied the "great prejudice" standard to determine whether a partition sale should be ordered despite New York's statutory preference for a partition in kind, the court utilized an economics-only test to decide whether it would order a partition in kind or a partition sale of commercial property in Brooklyn.[114] The court analyzed "whether the aggregate value of the several parts when held by different individuals in severalty would be materially less than the whole value of the property if owned by one person."[115] According to the party who sought to resist a partition sale, the value of the parcel in its undivided state was $77 million and the aggregate value of the parcels resulting from a division in kind was $75.8 million.[116] Though the court ended up ordering a partition sale, there was no indication the court evaluated the value of the whole property based upon its forced sale value. Similarly, in a North Carolina partition case, the court also used an economics-only test in which it compared the fair market value of the entire property with the fair market value of the two parcels resulting from a division in kind.[117] Although in this case the court determined the $2100 diminution in value resulting from a division in kind was insufficient for the court to order a partition sale, the court seemed to assume, without a basis for doing so, that the property would sell for the fair market value of $280,000 at a forced partition sale.[118]

The overly optimistic economic analysis many courts utilize in deciding whether to order a partition in kind or a partition sale is strikingly different from the type of economic analysis often used when a partition sale has been challenged ex post on the basis of a low sales price. Although many courts appear to assume a partition sale should yield a market value price when they are deciding whether to order a partition sale in the first instance, many other courts quite clearly realize a partition sale is a forced sale when they consider arguments one or more of the parties make to nullify a partition sale after it has been conducted. To this end, one court has stated the following:

> A partition sale is a forced sale, and for that reason courts have been hesitant to find that a bid substantially below an appraised value or an arm's length transaction value is so grossly inadequate

cellor's order that property be sold at a public auction because the property would yield a much better price if it were offered for sale on the open market by a real estate broker).

113. Drachenberg v. Drachenberg, 58 A.2d 861, 865 (N.J. 1948).

114. Snyder Fulton St., L.L.C. v. Fulton Interest, L.L.C., 868 N.Y.S.2d 715, 717 (N.Y. App. Div. 2008).

115. *Id.* (quoting Partrick v. Preiser, 341 N.Y.S.2d 806, 808 (N.Y. 1972)).

116. *Id.*

117. Phillips v. Phillips, 246 S.E.2d 41, 44 (N.C. Ct. App. 1978).

118. *Id.* at 43-44.

> to shock the conscience. Bids often amounting to only 50% or less of the appraised or arm's length value have been upheld.[119]

Other courts have indicated that to test for adequacy of the sales price of a partition sale, one must compare the price the property sold for at the partition sale with the price one could expect at a fairly conducted forced sale and not with the price one might expect at a sale conducted under market value conditions.[120] Some courts have even scolded parties who challenge the confirmation of a partition sale in which the property is sold at a public auction based upon the claim that the sales price was unreasonably low. For example, one court has stated that "[t]hose who stand by and permit a partition proceeding to culminate in a public sale of the property can reasonably expect the property to be sold, in many cases, for less than its maximum market value."[121] In fact, many tenants in common in partition actions do not merely stand by passively while a court orders a partition sale but instead vigorously fight to prevent a court from ordering a partition sale because they are very aware that such a sale could have devastating economic consequences.

B. Legal Scholars Have Overlooked the Wealth Impacts of Partition Sales

Hardly any legal scholars have considered the economic valuation issues involved in a partition sale in any depth. Some of those who support a preference for the partition sale believe wealth is maximized under a partition sale but not under a partition in kind because the property in its undivided state often has scale economies the market values.[122] Thomas J. Miceli and C.F. Sirmans, for example, assume the fundamental trade-off "is between the benefits of preserving the optimal scale of the parcel under forced sale and the protection of subjective value under partition in kind."[123] Further, they claim a partition sale "subjects nonconsenting owners to a forced sale, thereby depriving them of any value that they attach to the land *in excess of its market*

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119. Smith v. Rusmisell, 517 S.E.2d 494, 498 (W. Va. 1999) (quoting Koay v. Koay, 359 S.E.2d 113, 116 (W. Va. 1987)). Some courts that have decided whether a partition sale should be set aside based upon the claimed inadequacy of the sales price have specifically identified some of the reasons that a partition sale fails to meet the test for a sale under fair market value conditions. For example, one court in Delaware noted that the property sold at the partition sale in question is typically purchased by people who finance their purchase of real property over some extended term as opposed to on the basis of a cash sale that the court mandated in that case. Gray v. Gray, No. G-49-77, 1977 WL 176257, at *1 (Del. Ch. Sept. 23, 1977).

120. Koester v. Koester, 543 S.W.2d 51, 55 (Mo. Ct. App. 1976).

121. *Gray*, 1977 WL 176257 at *1.

122. Thomas J. Miceli & C. F. Sirmans, *Partition of Real Estate; Or Breaking Up Is (Not) Hard To Do*, 29 J. LEGAL STUD. 783, 789 (2000).

123. *Id.* at 784.

value."[124] This type of economic analysis is incorrect because it fails to take into account that a partition sale is a forced sale that could leave the cotenants stripped of significant wealth. Other commentators who have also utilized law and economics analysis to argue partition sales should be ordered more frequently have also incorrectly assumed that partition sales are typically conducted under open market conditions that yield fair market value prices.[125]

In contrast, legal scholars primarily concerned with land loss in poor and minority communities have published law review articles arguing quite vigorously that courts should maintain the property rule protection traditionally afforded tenants in common with respect to the remedy of partition. These scholars believe by upholding the traditional preference for the partition in kind remedy, courts can vindicate a property owner's noneconomic interests in his or her property. These noneconomic interests include liberty, dignity, citizenship, security, psychological well-being, and political participation.[126] However, most of those who argue tenants in common should be granted greater legal protections and greater stability of ownership over time either have failed to address or challenge the assumption made by certain law-and-economics scholars that partition sales are wealth-maximizing, or they have addressed such wealth-maximizing claims in a tentative way by claiming that *some* partition sales *may* yield prices below market value.[127]

Although most scholarship to date has failed to consider the likely negative wealth impacts resulting from partition sales, the likelihood of such wealth impacts comes into sharper relief when one considers

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124. *Id.* (emphasis added).

125. *See, e.g.*, Candace Reid, Note, *Partitions in Kind: A Preference Without Favor*, 7 CARDOZO L. REV. 855, 878-79 (1986):

> [A] rule favoring sales in partition actions would promote efficiency by placing the property on the open market where co-owners opposing a sale or having a particular emotional attachment to the property would have an opportunity to retain possession by outbidding all comers. Therefore, the market price would reflect both the objective and subjective values of the property . . . .
>
> Under the principle of wealth maximization, when property is placed on the open market, courts are assured that the property will fetch the highest price possible and will end up in the hands of the party who values it the most.

126. *See, e.g.*, Craig-Taylor, *supra* note 103, at 766-69, 773-75; Chris Kelley, *Stemming the Loss of Black Owned Farmland Through Partition Action—A Partial Solution*, 1985 ARK. L. NOTES 35, 36; Mitchell, *supra* note 100, at 535-42.

127. *See* Craig-Taylor, *supra* note 103, at 773 (stating that in partition sale cases, African Americans "receive compensation that not only may fail to reflect the nonmarket value of the property lost but also may fail to accurately reflect fair market value"). A couple of authors do address the economic efficiency arguments more squarely. *See* Faith Rivers, *Inequity in Equity: The Tragedy of Tenancy in Common for Heirs' Property Owners Facing Partition in Equity*, 17 TEMP. POL. & CIV. RTS. L. REV. 1, 58 (2007) (claiming, inter alia, that the typical partition sale "draws less than optimal market value because of the forced, timed conditions of the court sale"); Thomas W. Mitchell, *Destabilizing the Normalization of Rural Black Land Loss: A Critical Role for Legal Empiricism*, 2005 WIS. L. REV. 557, 585-97 (2005).

that financial and estate planning practitioners are well aware that partition sales are not "likely to command a fair market value price."[128] Therefore, these professionals typically advise their clients to structure their real property ownership in a way that contracts around the default rules governing exit from tenancies in common. For example, transactional attorneys play a key role in helping real estate investors who are interested in taking advantage of the tax-deferred benefits provided by the rules set forth in I.R.C. § 1031[129] governing "like-kind exchanges," structure the ownership of their tenancy in common (TIC) property.

These transactional attorneys know full well that "permitting any TIC Owner to exercise its right of partition could be devastating to everyone's investment."[130] To address this serious risk as well as other issues in a proactive way, leading practitioners consider a tenancy in common agreement (TIC agreement) to be the most important document for investors interested in this ownership structure.[131] These TIC agreements can mitigate the potential economic harshness of a partition sale in many ways,[132] including by requiring the investors to waive their right to partition. The Internal Revenue Service permits these types of waiver agreements in certain circumstances.[133]

TIC agreements that include provisions limiting the unfettered rights of a tenant in common to seek a partition sale provide an example of how, through private ordering, wealthier people with more social capital own their property under highly stable ownership structures or under a set of privately negotiated rules restricting the liquidation rights that a common owner might otherwise have under another ownership structure that may have default rules that make it quite unstable. Such restricted liquidation rights limit the likelihood that wealthier people who own real property in common with others will suffer significant negative wealth impacts upon one of the

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128. TERENCE MYERS, DORINDA DESCHERER & SIDNEY KESS, CCH FINANCIAL AND ESTATE PLANNING GUIDE 89 (2008).

129. I.R.C. § 1031 (2009).

130. ALVIN L. ARNOLD, REAL ESTATE TRANSACTIONS—STRUCTURE AND ANALYSIS WITH FORMS § 2:103 (2006).

131. Ken Swenson & Mary L. Dickson, *Common Ground: The Recent Trend Toward Financing Tenancies in Common Poses Substantial Challenges to Lenders*, LOS ANGELES LAWYER, September 2005, at 40, 43. Others have noted that "it is difficult to imagine a TIC arrangement that does not have such a co-ownership agreement." Bradley T. Borden & W. Richey Wyatt, *Syndicated Tenancy-in-Common Arrangements: How Tax-Motivated Real Estate Transactions Raise Serious Nontax Issues*, PROB. & PROP., Sept./Oct. 2004, at 18, 20.

132. *See generally* Bradford Updike, *Exploring the Frontier of Non-Traditional Real Estate Investments: A Closer Look at 1031 Tenancy-in-Common Arrangements*, 40 CREIGHTON L. REV. 271, 340 (2007) (observing "a number of protections" are available to "help mitigate the harshness of this risk").

133. Cheryl P. Armata, *Financing Tenant in Common Projects: Tenant in Common Commercial Projects Have Risks for Lenders. But with Some Planning, Those Risks Can Be Managed*, 22 NO. 5 PRAC. REAL EST. L. 17 (Sept. 2006).

common owner's exit from the common ownership arrangement. In contrast, those whose human or economic capital is insufficient to engage in private ordering remain subject to the default rules that make tenancy in common ownership highly unstable and increase the likelihood the owners will lose wealth—perhaps substantial wealth—if a court orders a partition sale.

C. Partition Sales May Be Contributing to the Racial Wealth Gap

Just as many courts and legal scholars have overlooked the possible negative wealth impacts partition sales may generate, the existing scholarship on partition sales has not explored whether the race of the landowner is an important independent variable that may affect sales price. In fact, the current legal regime governing partition actions may be contributing in a number of ways to the racial wealth gap between African Americans and white Americans. This wealth gap is substantial as the average black family possesses approximately just one-tenth the wealth or assets of the average white family.[134] The partition rules may have a disparate impact upon African Americans to the extent a disproportionate percentage of African Americans own land under the default rules governing tenancies in common, which seems likely.[135] If this is the case, African Americans would be more at risk of having their tenancy in common property sold at partition sales than white Americans who may tend to own their property under more stable ownership structures such as limited liability companies, land trusts, or under TIC agreements which ensure stable ownership.[136] In sum, if African Americans are overrepresented in the group of property owners who own tenancy in common property under the inherently unstable default rules, such a

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134. *See, e.g.*, LAWRENCE MISHEL, JARED BERNSTEIN & SYLVIA ALLEGRETTO, THE STATE OF WORKING AMERICA 2006/2007 258 (10th ed. 2007); *see generally* MELVIN L. OLIVER & THOMAS M. SHAPIRO, BLACK WEALTH/WHITE WEALTH: A NEW PERSPECTIVE ON RACIAL INEQUALITY (10th ed. 2006) (analyzing the many different facets of the wealth gap between black Americans and white Americans).

135. *See* THE EMERGENCY LAND FUND, INC., THE IMPACT OF HEIR PROPERTY ON BLACK RURAL LAND TENURE IN THE SOUTHEASTERN REGION OF THE UNITED STATES 64, 475 (1984) (estimating that 41% of black-owned land in the southeastern states is owned under the default rules governing tenancies in common as ownership of this land has been transferred by intestacy).

136. In this way, a racialized pattern of tenancy in common ownership under the default rules would mirror the current foreclosure crisis in which African Americans and Latinos hold a disproportionate percentage of subprime mortgages, which are the mortgages that are being foreclosed upon at the highest rate. *See* SCHLOEMER ET AL., *supra* note 2, at 23 (showing that 52% of African Americans receive higher-cost mortgages; 40% of Latinos receive higher-cost mortgages; and 19% of non-Latino whites receive higher-cost mortgages). The lack of comparative data on white-owned rural property owned under the tenancy in common form of ownership makes it difficult to assess whether black landowners own more of their landholdings under the default rules governing tenancies in common than white landowners.

pattern of tenancy in common ownership could be contributing to the perpetuation of the racial wealth gap given that partition sales are often wealth-depleting.

It is also possible that of all the property owners who own property under the default rules governing the partition of tenancy in common and joint tenancy property, African Americans and other minorities may be targeted for forced partition sales in one way or another. For example, it is possible judges order partition sales in a higher percentage of partition cases involving African Americans than they do in partition cases involving whites. This would be consistent with the claims that many have made that eminent domain has been utilized more heavily in minority neighborhoods than in white neighborhoods under programs such as urban renewal.[137] In addition, the media, including the *Associated Press*, has uncovered many shocking instances in which real estate speculators utilizing very sharp practices purchased very small interests in black-owned tenancy in common properties located in states throughout the South, properties that in many instances had been owned by certain African-American families for generations, and then were able to convince various state courts to order the property sold under a partition sale.[138] There is no similar evidence in the media or otherwise of white landowners in any region of the country who own tenancy in common property being systematically targeted by real estate speculators seeking to force the sale of their property.

Race may be a causal factor in diminishing the sales price at a partition sale to the extent partition sales of black-owned property are conducted differently than partition sales of white-owned property. For example, if public officials sell black-owned property subject to a partition sale under certain rigged conditions of one type or another that are likely to suppress the sales price, but sell white-owned property at partition sales in compliance with the law, it is likely that black landowners would often receive even less than the normal forced sales price. Although there is no study that has evaluated whether public officials tend to sell black-owned property under illegally rigged conditions more frequently than they sell white-owned

137. *See* Kelo v. City of New London, 545 U.S. 469, 522 (2005) (Thomas, J., dissenting); *see also* BERNARD J. FRIEDEN & LYNNE B. SAGALYN, DOWNTOWN, INC: HOW AMERICA REBUILDS CITIES 28 (1989) ("Of all the families displaced by urban renewal from 1949 through 1963, 63 percent of those whose race was known were nonwhite."). In addition, it would be consistent with claims that minority farmers have made that the U.S. Department of Agriculture has been more willing to restructure loans for white farmers who fell behind in making loan payments as result of economic shocks than similarly-situated minority farmers who fell behind in making loan payments. *See infra* notes 348-55 and accompanying text.

138. *See, e.g.*, Todd Lewan & Dolores Barclay, *Quirk in Law Strips Blacks of Land*, TENNESSEAN, Dec. 11, 2001, at 8A.

property under such conditions, there is evidence in some places that officials have sold property subject to a forced sale under rigged conditions.[139]

Even if the same partition sale procedures are used irrespective of the race of the property owners, it may be the case that African Americans and other minorities are particularly susceptible to receiving prices below forced-sale value at partition sales. For example, the typical black property owner may not be as capable as the typical white property owner of bidding effectively at a partition sale in a thin market due to the fact that the average black family has much less wealth than the average white family[140] and due to lending discrimination. If black property owners are not as able to bid competitively as white property owners when their property is subject to a partition sale, black-owned property may be selling for lower than expected prices at partition sales given the fact that one or more of the common owners are often among the small group of people who make bids at partition sales.

IV. COURTS IN OTHER CONTEXTS UNDERSTAND THE IMPORTANT DISTINCTION BETWEEN FORCED SALE VALUE AND MARKET VALUE

Though largely overlooked in the context of partition sales of real property, valuation is crucial in many areas of the law, like business organizations and partnership law,[141] bankruptcy law,[142] tax law,[143]

139. For example, property has been sold under rigged condition in Bolivar County, Mississippi—at least according to the Bolivar County official we spoke to a few years back. Instead of selling property that was subject to a tax sale at a public auction, the property was offered to a limited number of real estate investment firms according to the county official we interviewed. According to this official, these real estate firms were offered the property on a rotating basis under which they made noncompetitive bids. Such an arrangement would have violated Mississippi law that requires property subject to a tax sale to be sold at an auction. *See* MISS. CODE ANN. § 27-41-59 (West 2008). This statute states in relevant part that

> the tax collector shall proceed to sell, for the payment of taxes then remaining due and unpaid, together with all fees, penalties and damages provided by law, the land or so much and such parts of the land of each delinquent taxpayer *to the highest and best bidder for cash* as will pay the amount of taxes due by him and all costs and charges.

Id. (emphasis added); *see also* Harold A. McDougall, *Black Landowners Beware: A Proposal for Statutory Reform*, 9 N.Y.U. REV. L. & SOC. CHANGE 127, 134 n.37 (1979-1980) (claiming that public officials have conspired with private parties to force the sale of black-owned, tenancy in common property).

140. *See* MISHEL ET AL., *supra* note 134, at 258.

141. *See* Susan Kalinka, *Dissociation of a Member from a Louisiana Limited Liability Company: The Need for Reform*, 66 LA. L. REV. 365, 388 (2006).

142. *See, e.g.*, Harvey R. Miller & Ronit J. Berkovich, *The Implications of the Third Circuit's* Armstrong *Decision on Creative Corporate Restructuring: Will Strict Construction of the Absolute Priority Rule Make Chapter 11 Consensus Less Likely?*, 55 AM. U. L. REV. 1345, 1350 (2006) ("Taking into account that bankruptcy reorganization is a zero-sum game, valuation is a critical factor for participation in the reorganization.").

eminent domain,[144] and foreclosure,[145] for example. In these areas of law, there is often vigorous litigation about whether the property in question should be valued at its fair market value or its forced or liquidation value, or whether property to be sold at a forced sale should be sold under conditions more likely to yield prices that may approach fair market value prices. Litigants, judges, scholars, and others recognize that the manner in which these valuation issues are resolved is critical and that the manner in which value is determined can give rise to significant wealth transfers between the parties.[146]

The legal scholarship and case law in many areas of law in which valuation is crucial has been dynamic and contested, reflecting an underlying disagreement about which factors and norms should be taken into account when determining value. We survey partnership dissolution cases and two specific areas of bankruptcy law to highlight the critical distinction between valuing an asset at its fair market value as opposed to valuing the same asset at its forced sale or liquidation value. This review makes it clear that it is highly unlikely forced sales—including partition sales—of property owned by low- to middle-income and minority property owners yield market value prices. In other words, forced sales of property owned by low- to middle-income and minority property owners are highly unlikely to constitute a wealth-maximizing, sui generis category of forced sales.

A. *Partnership Dissolution Cases: The Concern About "Fire Sales"*

Partnership dissolution cases provide a particularly good comparative framework for evaluating the law of partition in the context

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143. JOHN A. BOGDANSKI, FEDERAL TAX VALUATION ¶ 1.01[1] (2006). One court has stated:

> Disputes over valuation fill our dockets, and for good reason. We approximate that 243 sections of the Code require fair market value estimates in order to assess tax liability, and that 15 million tax returns are filed each year on which taxpayers report an event involving a valuation-related issue. It is no mystery, therefore, why valuation cases are ubiquitous. Today, valuation is a highly sophisticated process.

Estate of Auker v. Comm'r, No. 13150-96, 1998 WL 248923, at *11 (T.C.M. (RIA) May 19, 1998).

144. Serkin, *supra* note 51, at 686 n.41.

145. *See, e.g.*, Nelson & Whitman, *supra* note 60, at 1415-26.

146. *See, e.g.*, Advanced Commc'n Design, Inc. v. Follett, 615 N.W.2d 285, 293 (Minn. 2000). In *Follett*, the court stated as follows:

> [W]e conclude that a valuation of $475,381 for respondent's one-third interest in ACD represents an unfair wealth transfer from the remaining shareholders to respondent because it places unrealistic financial demands on the corporation given the financial data presented in the majority report, and in all probability strips ACD of necessary cash flow and earnings for future growth.

Id.

of disputes involving real property owned under different concurrent ownership structures. A partnership and a tenancy in common are both undivided ownership structures under which two or more people own some asset collectively, whether the asset is in the form of personal or real property.[147] Like other common ownership structures, the law provides individual owners with the unilateral right to exit both a partnership and a tenancy in common. In dealing with exit in both the context of partnerships and tenancies in common, courts must decide how to balance the interests of the individual who seeks to exit the ownership group and the interests of the remaining common owners.

In the context of partnership dissolution cases governed under either the Uniform Partnership Act (UPA)[148] or the Revised Uniform Partnership Act (RUPA),[149] courts have faced a very similar issue to the one judges in partition cases confront in deciding whether to order a partition sale, a partition in kind, or some other remedy such as a buyout. In the partnership context, in cases in which certain events trigger a mandatory dissolution and winding up of the partnership,[150] judges must decide between ordering a judicial sale of partnership assets, normally at a public auction, or ordering some other remedy such as an in-kind distribution of the physical assets of the partnership or a mechanism permitting the remaining partners to buy out the interests of an exiting partner.[151] In contrast to most state partition statutes containing an explicit preference for a partition in kind,[152] most courts have resolved partnership dissolution cases under the UPA based upon a plain language interpretation of the UPA,

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147. In fact, prior to the promulgation of the Revised Uniform Partnership Act, which explicitly adopted an entity theory of a partnership, the Uniform Partnership Act utilized the "tenancy-in-partnership" concept. Rebecca S. Rudnick, *Enforcing the Fundamental Premises of Partnership Taxation*, 22 HOFSTRA L. REV. 229, 249-50 (1993). Some have described the tenancy in partnership as a modified form of the tenancy in common. *See, e.g.*, ROGER A. CUNNINGHAM, WILLIAM B. STOEBUCK & DALE A. WHITMAN, THE LAW OF PROPERTY § 5.1 (2d ed. 1993).

148. UNIF. P'SHIP ACT (1914).

149. REV. UNIF. P'SHIP ACT (1997).

150. Under the default rules of the UPA, the partnership constitutes a very unstable ownership structure as there are a number of events that can trigger an automatic dissolution of the partnership. Some of these events have been referred to as technical dissolutions, and they include the death of any partner or the retirement of a partner. *See* WILLIAM A. GREGORY, THE LAW OF AGENCY AND PARTNERSHIP 372 (West Group 2001); Alan R. Bromberg, *Partnership Dissolution–Causes, Consequences, and Cures* 43 TEX. L. REV. 631, 636 (1965). For a comprehensive listing of the events that will cause the dissolution of a partnership under the UPA, see *id.* at 633-37. In contrast, the drafters of RUPA sought to move partnership law closer to the entity model of business organizations under which the stability and continuity of the business enterprise is favored as opposed to the aggregate theory that more strongly influenced the drafters of the UPA and under which the partnership is viewed as being indistinguishable from the partners. *See* Rudnick, *supra* note 147, at 250, 258.

151. *See generally* Creel v. Lilly, 729 A.2d 385, 391-402 (Md. 1999) (discussing remedies).

152. Mitchell, *supra* note 100, at 513 n.40.

which has resulted in a rule tending to favor liquidation of the partnership assets and cash distribution of the sale proceeds absent some agreement to the contrary.[153]

Under RUPA, almost all of the technical dissolutions that may occur under the UPA cannot occur. For example, RUPA now requires a majority of the partners in a partnership for a definite term or for a particular undertaking to consent to dissolution and the partnership to buy out the interest of the dissociated partner in other circumstances such as the death of a partner.[154] Nevertheless, RUPA still permits an individual partner in a partnership at will to force a liquidation of the partnership in some circumstances.[155]

Just as financial and estate planners counsel their clients that a partition sale of property owned under a tenancy in common is likely to yield prices below market value under the tenancy in common default rules,[156] business counselors typically advise their clients that a dissolution of a partnership and the liquidation of the partnership assets at a public auction will often result in economic loss that in some cases can be ruinous.[157] Due to this concern, clients who are well-advised often enter into agreements contracting around the default provisions of the UPA and RUPA,[158] provisions that may otherwise be deemed to require dissolution of the partnership and a winding up of the business in a manner that ends with a sale of the assets of the partnership at a public auction.[159]

Leading business organizations scholars have claimed liquidation by public auction rarely occurs due to the prevalence of partnership agreements that, among other things, restrict the rights of any partner to compel dissolution and winding up and the rights of partners during the winding up process to have distributions paid to them in cash under the default rules set forth in UPA section 38(1) or RUPA section 807(a).[160] Through such private ordering, property owners

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153. *See* Disotell v. Stiltner, 100 P.3d 890, 894 (Alaska 2004) (recognizing the general rule but noting the statute does not "absolutely compel liquidation"). Most leading business organizations scholars conceptualize winding up either under the UPA or under RUPA as also requiring liquidation. According to one leading business organizations scholar "[winding up] of a partnership is the practice of liquidating assets and discharging liabilities following dissolution or disassociation if the partnership is to be terminated." ROBERT W. HAMILTON, BUSINESS ORGANIZATIONS: UNINCORPORATED BUSINESSES AND CLOSELY HELD CORPORATIONS ESSENTIAL TERMS AND CONCEPTS 452 (1996).

154. GREGORY, *supra* note 150, at 372.

155. *Id.*; *see also* RUPA § 801(1).

156. *See* MYERS, DESCHERER & KESS, *supra* note 128, at 89.

157. Bromberg, *supra* note 150, §§ 8.801, 807.

158. These agreements are commonly referred to as business-continuation agreements or simply as continuation agreements. MELVIN ARON EISENBERG, AN INTRODUCTION TO AGENCY, PARTNERSHIPS, AND LLCS 91 (4th ed. 2005).

159. Bromberg, *supra* note 150, at 668; *see also* GREGORY, *supra* note 150, at 369.

160. *See* Gregory, *supra* note 150, at 369-70; *see also* ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON LIMITED LIABILITY PARTNERSHIPS, THE REVISED

with sufficient economic resources and human capital own their property under more stable arrangements and are better positioned to fend off a request that one of their co-owners may make for a forced sale than otherwise similarly situated low- to middle-income and less wealthy property owners who often are not able to privately order their asset ownership for financial and other reasons.

In partnership dissolution cases governed under the default rules, disputes may arise if a partner seeks to liquidate a partnership based upon a claim that he or she possesses liquidation rights under certain provisions of either the UPA or RUPA. Two separate lines of cases have developed to resolve these types of partnership disputes. The dominant approach is exemplified by the Supreme Court of Montana's decision in *Pankratz Farms Inc. v. Pankratz*.[161] The court utilized a plain language interpretation method which resulted in a rule making liquidation of partnership assets through a forced sale the only option upon dissolution.[162] Under this approach, a court will order a partnership liquidated at a public sale irrespective of whether there might be a substantially more wealth-maximizing way in which to dissolve and wind up the partnership.

However, courts in a number of other jurisdictions have expressed concern about "the unfairness and harshness of a compelled liquidation."[163] Courts willing to seek alternatives to liquidating partnership assets through a forced sale have framed their concerns in primarily economic and wealth impact terms. One court referred to the forced sale option as a "fire sale."[164] Another court claimed that under the facts of the case it was deciding, "a forced sale of the partnership will destroy a great part of the value of the business"[165] while another claimed more broadly that a "forced sale often results in economic waste" because such sales often end up dissipating the wealth of the common owners as a whole.[166]

These forced sales can result in economic waste if the property is sold for a price below market value or, if the property is sold for market value, as a result of transaction costs that may be higher in a forced sale than they would be if some other alternative to a liquida-

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UNIFORM PARTNERSHIP ACT, AND THE UNIFORM LIMITED PARTNERSHIP ACT (2001) 351, 359 (2008 ed.) (referring to the "standard practice of drafting around the [liquidation] right").

161. 95 P.3d 671 (Mont. 2004).

162. *Id.* at 681.

163. Creel v. Lilly, 729 A.2d 385, 393 (Md. 1999). For this reason, courts in a number of states have been willing to consider alternatives to liquidation through forced sales in partnership dissolution cases.

164. *Id.*

165. Fortugno v. Hudson Manure Co., 144 A.2d 207, 219 (N.J. Super. Ct. App. Div. 1958); *see also* HAROLD GILL REUSCHLEIN & WILLIAM A. GREGORY, HANDBOOK ON THE LAW OF AGENCY AND PARTNERSHIP §§227-29 (1979).

166. Horne v. Aune, 121 P.3d 1227, 1233 (Wash. Ct. App. 2005).

tion sale were ordered. In *Disotell v. Stiltner*,[167] the Supreme Court of Alaska decided it was more appropriate to permit one partner to buy out the other partner's partnership interest at fair market value upon dissolution than to order a forced sale of the partnership's assets. The court indicated a forced sale would likely result in an unnecessary dissipation of the partners' wealth and detailed the benefits of the buyout option:

> The superior court reasoned that a buyout would reduce economic waste by avoiding the cost of appointing a receiver and conducting a sale. Even though there was no ongoing business, the superior court noted that the expense of a sale could total as much as twelve percent of the property's value. This was a valid reason and potentially benefited both partners. The potential savings were significant. The court's effort to avoid further loss to both partners justifies its decision to offer Stiltner the buyout option. Further, properly conducted, a buyout guaranteed Disotell a fair value for his partnership interest. Liquidation exposed Disotell to the risk that no buyer would offer to pay fair market value for the property.[168]

In *Creel v. Lilly*,[169] Maryland's highest court decided whether the partnership assets of Joe's Racing, a partnership, were required to be liquidated upon winding up of the partnership after one of the partners died, as the estate of the deceased partner insisted.[170] Although Maryland adopted RUPA on June 1, 1998, during a five-year phase-in period, the UPA was still in effect for partnerships like Joe's Racing that were formed before Maryland adopted RUPA.[171] The *Creel* court held that the lower court's determination that the partnership agreement did not require liquidation was in conformity with the UPA.[172] Moreover, the *Creel* court noted liquidation for many small businesses such as Joe's Racing can be a "harmful and destructive measure."[173] Based upon this concern, the court held neither the UPA nor RUPA required a forced sale of the partnership assets upon dissolution in order to ascertain the true value of the business even if the partnership agreement is silent on the manner of dissolution and winding up of the partnership.[174]

The same economic issues that have encouraged many courts in partnership dissolution cases to seek judicial alternatives to the forced sale of partnership assets are present in the context of partition sale cases. In other words, it is the forced sale remedy and not

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167. 100 P.3d 890 (Alaska 2004).
168. *Id.* at 894.
169. 729 A.2d 385.
170. *Id.* at 387.
171. *Id.* at 393.
172. *Id.* at 388.
173. *Id.* at 400.
174. *Id.* at 399.

the form of ownership that can be the source of economic waste. For example, in a recent case, Steven Aune and Cecilia Horne purchased property together in 2002 in Gig Harbor, Washington, as tenants in common.[175] A few months later they converted their ownership of the property from a tenancy in common into a partnership governed under RUPA, as Washington adopted RUPA in 1998.[176] Both parties ended up agreeing the partnership should be dissolved and wound up,[177] but disagreed on whether the court was obligated to order a public sale of the partnership property.[178] As a case of first impression in Washington, the court chose to follow *Creel* and affirmed the trial court's decision to permit Horne to buy out Aune's partnership interest for $50,000, representing 50% of the equity the partnership had built up in the property.[179]

The very same concerns about economic waste and adverse wealth impacts would have been present had the litigants in *Horne* opted to maintain their ownership under a tenancy in common and had one of them later initiated a partition action requesting a partition sale. Despite significant differences in the rules governing these ownership forms, a tenancy in common and a partnership have many similar features, including the type of remedies that are theoretically available to a common owner upon exit. Therefore, it is striking that the economic waste issues many legal commentators and judges squarely address in the context of partnership dissolution cases—albeit in ways that reach different conclusions—have only rarely been addressed head on in scholarship or judicial opinions addressing the partition remedy in the real property context.

B. *Bankruptcy: Pitched Battles over Establishing the Valuation Standard*

In bankruptcy law, asset valuation is pervasive in any number of contexts, and it plays an important and oftentimes dispositive role.[180] Bankruptcy courts have developed and utilized a large number of asset valuation theories, perhaps because the Bankruptcy Code contains provisions that invite case-by-case valuation analysis.[181] For example, 11 U.S.C. § 506(a),[182] a very important provision in many bankruptcy proceedings, addresses the valuation of a creditor's collateral for purposes of determining the extent to which the creditor's

175. Horne v. Aune, 121 P.3d 1227, 1228 (Wash. Ct. App. 2005).
176. *Id.* at 1228-31.
177. *Id.* at 1229-30.
178. *Id.* at 1231.
179. *Id.* at 1230, 1233-34.
180. Lawless & Ferris, *supra* note 22, at 3, 7-11.
181. *See, e.g.*, Carlson, *supra* note 28, at 64 (1991) (noting that bankruptcy courts have developed an "extremely diverse and contradictory set of valuation theories").
182. 11 U.S.C. § 506(a)(1) (2006).

claim is secured as opposed to unsecured. This section states "value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest."[183]

As a threshold matter, bankruptcy courts often decide the legal standard that will be used to measure value and these legal standards include liquidation value, going-concern value, and replacement value.[184] There is a dramatic difference between valuing an asset according to its liquidation value and valuing the same asset according to its replacement value. One commentator has described the meaning of liquidation value in the bankruptcy context as follows:

> Liquidation value is usually taken to imply what the creditor could realize in a forced sale under the rules of U.C.C. article 9, real estate mortgage provisions, or, even worse, under the rules of judicial execution. Such sales are notoriously poor in producing cash proceeds, and, if hypothetical liquidation is the standard, a court could easily justify a low figure by way of value.[185]

Going-concern value has been defined "as the price a buyer would pay for an asset when sold as part of the business as a whole."[186] The Supreme Court has defined replacement value in the context of bankruptcy essentially as fair market value. In *Associates Commercial Corp. v. Rash*,[187] the Supreme Court defined replacement value as "the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller."[188] After the legal standard is determined in many bankruptcy proceedings, the evidence about the specific characteristics of the asset in question is considered in the light of the applicable legal valuation standard to arrive at a valuation figure.[189]

Bankruptcy law incentivizes debtors and creditors to stake out very different and sometimes shifting positions with respect to valuation.[190] Oftentimes, the debtor attempts to convince the bankruptcy court to establish a low value for a particular asset and the creditor asks the court to establish a much higher value for the same asset. In

183. *Id.*

184. Lawless & Ferris, *supra* note 22, at 1, 11.

185. Carlson, *supra* note 28, at 75.

186. Chaim J. Fortgang & Thomas Moers Mayer, *Valuation in Bankruptcy*, 32 UCLA L. REV. 1061, 1092 (1985).

187. 520 U.S. 953 (1997).

188. *Id.* at 960.

189. *See, e.g.*, *In re* De Anda-Ramirez, 359 B.R. 794, 797 (B.A.P. 10th Cir. 2007) (describing a case in which the parties valuing an automobile in a Chapter 13 cramdown proceeding under the replacement value standard disagreed about whether the Kelly Blue Book retail value estimate or the Kelly Blue Book private party value estimate was most germane).

190. Carlson, *supra* note 28, at 85.

other instances, for example in a proceeding in which the creditor seeks to lift an automatic stay of all creditor actions against the debtor outside of the bankruptcy court, it is the creditor who often argues its interest is not adequately secured because the collateral in question has a relatively low value based upon the asset's liquidation value.[191] Sometimes a debtor or a creditor will argue for different valuations of some asset in the course of the very same bankruptcy proceeding, for example arguing for the liquidation value of a particular asset in one context and the going-concern value for the very same asset in another context.[192]

The fierce contest by parties in bankruptcy proceedings over establishing the proper valuation standard in the first instance reinforces the point that there is a substantial difference between an asset's fair market value and its liquidation or forced sale value. Chapter 13 "cram down" proceedings and cases that implicate Section 548 of the Bankruptcy Code provide two good examples of how important it can be whether an asset is valued at its fair market value or its forced sale value.

1. *Chapter 13 "Cram Down" Proceedings*

Valuation battles in bankruptcy proceedings, like valuation battles in other contexts, are not just academic. Their resolution can significantly shift economic burdens between debtors and creditors. A Chapter 13 "cram down" proceeding provides one good example of the central role valuation can play in bankruptcy proceedings. In a "cram down" proceeding, the debtor may keep the collateral at issue over the objection of the creditor, while the creditor retains the lien over the collateral to secure payment. The creditor is also entitled to be paid the present value of the collateral over the term of the reorganization plan.[193] The manner in which courts resolve the valuation issues arising in Chapter 13 "cram down" proceedings can mean the difference between a debtor staying in business under a court-

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191. *See, e.g., In re* Robbins, 119 B.R. 1, 2 (Bankr. D. Mass 1990) (involving creditor who sought to remove automatic stay under 11 U.S.C. §362(d)(1) in order to foreclose his second mortgage interest on the debtor's investment property).

192. Carlson, *supra* note 28, at 85-86. However, some courts resist the attempts of either a debtor or a creditor to argue for a different valuation standard at some later point in a bankruptcy proceeding. In a well known case, one court stated the following:

> Having declared itself a fish to be reorganized, it would be inconsistent for the court now to permit the Debtor to declare itself a fowl to be liquidated for purposes of "cramming down" a lower "appraised" value upon the secured Creditors. Therefore, a liquidation value, i.e., a foreclosure value, is a procedure totally foreign to this matter and not a proper standard for valuation.

In re Pine Gate Assocs., No. B75-4345A, 1976 U.S. Dist. LEXIS 17366 (N.D. Ga. Oct. 14, 1977).

193. *See, e.g.,* Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 957 (1997).

approved reorganization plan under which debt schedules are restructured or the debtor being immediately forced to liquidate his or her assets.

In *Associates Commercial Corp. v. Rash*, the debtors who filed for reorganization under Chapter 13 sought to keep a truck for use in generating a future stream of income in their freight-hauling business.[194] Associates Commercial Corp., the creditor, argued the truck should be valued at $41,000 based upon a replacement-value standard, while the debtors argued the truck should be valued at $31,875 based upon a foreclosure-value standard.[195] Obviously, a higher valuation amount would benefit a creditor in a cram down proceeding—including a creditor who might be under-secured—and a lower valuation amount would minimize the amount of money the debtor would be required to pay the creditor during the reorganization term thereby helping the debtor generate more unencumbered income while under reorganization.[196] In evaluating which legal standard to employ, the court noted the use of the foreclosure-value standard typically yields values lower than the replacement-value or fair-market-value standard as was the case in *Rash*.[197] Ultimately, the *Rash* Court held the replacement-value standard was the appropriate standard to use when valuing an asset the debtor seeks to use during reorganization in a Chapter 13 cram down case.[198]

2. *Section 548 of the Bankruptcy Code*

In 1994, in *BFP v. Resolution Trust Corp.*,[199] the Supreme Court decided a bankruptcy case in which the debtor in possession sought to set aside the conveyance of property sold for $433,000 at a noncollusive real estate foreclosure sale that occurred a few months before the debtor filed for bankruptcy under Chapter 11.[200] The debtor in possession claimed the property had a fair market value of $725,000 at the time of the foreclosure sale and that the sales price constituted a fraudulent conveyance under Section 548 of the Bankruptcy Code.[201] Under Section 548, not only may property transfers be set aside if there is evidence of actual fraud, but transfers in which con-

194. *Id.* at 956-57.

195. In *Rash*, the Supreme Court defined replacement value as "the price a willing buyer in the debtor's trade, business, or situation would pay a willing seller to obtain property of like age and condition" and indicated that its definition of replacement value was consistent with the definition of fair market value that the Ninth Circuit articulated in *In re* Taffi, 96 F.3d 1190, 1192 (9th Cir. 1996). *Rash*, 520 U.S. at 959 n.2.

196. *See id.* at 953.

197. *Id.* at 960.

198. *Id.*

199. 511 U.S. 531 (1994).

200. *Id.* at 534.

201. *Id.*

structive fraud is established may also be set aside.[202] The debtor's claim for constructive fraud hinged upon whether the foreclosure sale price, a price allegedly constituting 60% of the fair market value of the property at the time of the foreclosure sale, represented "less than a reasonably equivalent value" for the property.[203]

In affirming the Ninth Circuit's opinion and resolving a split in the federal courts of appeals,[204] the Supreme Court in *BFP* indicated that the term "fair market value" is not found in Section 548, in contrast to its inclusion in other provisions of the Bankruptcy Code.[205] More broadly, the Court considered the "reasonable equivalent value" standard in the light of the economic conditions under which property is sold at a typical foreclosure sale, concluding " 'fair market value' presumes market conditions that, by definition, simply do not obtain in the context of a forced sale."[206] The Court then made clear some of the ways in which a sale under a willing seller-willing buyer paradigm differs from a sale under foreclosure sale conditions. Writing for the Court, Justice Scalia stated as follows:

> An appraiser's reconstruction of "fair market value" could show what similar property would be worth if it did not have to be sold within the time and manner strictures of state-prescribed foreclosure. But property that *must* be sold within those strictures is simply *worth less*. No one would pay as much to own such property as he would pay to own real estate that could be sold at leisure and pursuant to normal marketing techniques. And it is no more realistic to ignore that characteristic of the property (the fact that state foreclosure law permits the mortgagee to sell it at forced sale) than it is to ignore other price-affecting characteristics (such as the fact that state zoning law permits the owner of the neighboring lot to open a gas station). Absent a clear statutory requirement to the contrary, we must assume the validity of this state-

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202. *Id.* at 535.

203. *Id.*

204. To this end, in 1980, the Fifth Circuit held in *Durrett v. Washington Nat'l Ins. Co.* that a debtor in possession was entitled to set aside as a fraudulent conveyance—under a provision of the prior Bankruptcy Act that was analogous to Section 548—a real estate transfer in which the property in question was sold for 58% of its fair market value at a foreclosure sale conducted nine days before the Chapter 11 bankruptcy petition was filed. 621 F.2d 201, 202-03 (5th Cir. 1980). In dicta, the court in *Durrett* further indicated that any sale for less than 70% of fair market value should be set aside as not satisfying the reasonable equivalent value standard, provided that all of the other elements of the fraudulent conveyance provision were satisfied. *See id.* at 203. In contrast to *Durrett* and its progeny, courts of appeal in the Sixth and Ninth Circuits had held that the consideration received in a noncollusive foreclosure sale conducted in accordance with a state's foreclosure laws constitutes a reasonable equivalent value under Section 548 irrespective of whether the consideration represents an amount substantially below the fair market value of the property. *BFP*, 511 U.S. at 536.

205. *BFP*, 511 U.S. at 537.

206. *Id.* at 538.

law regulatory background and take due account of its effect.[207]

Though Justice Scalia's assertion that property sold under foreclosure sale conditions is "worth less"[208] may be technically inaccurate in economic terms,[209] one can expect a higher sales price to be fetched for an asset if it is marketed under fair market value conditions as opposed to forced sale conditions.

Overall, the partnership dissolution examples and bankruptcy examples make it clear that, in many areas of the law, judges, academics, and practicing attorneys fully understand that an asset's forced sale value is quite different from the asset's fair market value. Property sold under forced sale conditions should normally sell for less than the property's fair market value, thereby reducing a property owner's wealth upon finalization of the sale, sometimes substantially. As a result, valuation disputes generate a great deal of litigation in many different legal contexts. Serious concerns about the wealth-depleting impact of forced sales also motivates many people who have sufficient means and who are well-advised by transactional attorneys to structure their property ownership ex ante in such a way as to minimize the chances that a forced sale of their property could occur down the road.

V. EMPIRICAL STUDIES OF FORCED SALES AND RESALES OF "FORECLOSURE-STATUS" PROPERTY

Very few law review articles in the area of property law have undertaken an empirical analysis of any of the types of legal processes that permit the forced sale of real property to test whether such sales have any impact on the wealth of the property owner. For example, empirical scholarship on many types of forced sales of real property, such as partition sales and tax sales, is practically nonexistent whether in law reviews or in other scholarly publications.[210] The ensuing discussion reviews empirical literature assessing the compensation paid for properties obtained in the context of eminent domain and the prices paid for foreclosed and "foreclosure-status" properties.

A. *Just Compensation in Eminent Domain*

More so than in almost any other forced-sale context, one could reasonably expect property owners in eminent domain cases to be

207. *Id.* at 539.
208. *Id.*
209. Lawless & Ferris, *supra* note 22, at 5, 19-22.
210. Few empirical articles have been published in law reviews that address any of the myriad of issues involved in the field of real estate transactions and real estate finance. One of these published empirical articles, an article published by a practitioner, has addressed racial discrimination in residential property tax assessments. *See* Harris, *supra* note 8, at 1.

paid the market value for their property upon its condemnation. In fact, it appears many property owners and legal scholars have simply assumed fair market value is paid when property is taken under eminent domain. As a result, legal scholars have paid far more attention to other aspects of an eminent domain proceeding, such as whether those vested with eminent domain power use it properly by, among other requirements, only condemning property for a valid public use.

1. *Property Owners Entitled to Fair Market Value Compensation*

Compared to the default rules of almost every other legal process authorizing real property to be sold against the wishes of the property owner, the law of eminent domain provides a property owner with very strong legal rights with respect to the minimum compensation that must be paid to the property owner upon the extinguishment of his or her property rights. The Fifth Amendment to the U.S. Constitution provides that private property may not be taken for public use without the payment of just compensation to the property owner.[211] Further, in almost every instance, the Supreme Court has determined "just compensation" entitles the property owner to receive the fair market value for his or her property upon its being taken.[212]

The Supreme Court has stated that the fair market valuation compensation standard represents an objective standard.[213] Nevertheless, under the Supreme Court's interpretation, property owners are not required to be compensated for a range of economic and noneconomic losses they may likely experience.[214] These losses can include consequential damages such as relocation costs and loss of goodwill, as well as noneconomic damages that may result from the taking due to the property owner's subjective emotional attachment to his or her property or community.[215]

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211. U.S. CONST. amend. V ("[N]or shall private property be taken for public use, without just compensation.").

212. United States v. 50 Acres of Land, 469 U.S. 24, 25 (1984). Courts have deviated from the fair market value standard of compensation in two discrete circumstances: when it is too difficult to determine market value or when it has been determined that applying the market value standard would result in manifest injustice to the condemnee or to the public. United States v. Commodities Trading Corp., 339 U.S. 121, 123 (1950).

213. *See* United States v. 564.54 Acres of Land, 441 U.S. 506, 511 (1979).

214. *See* Kimball Laundry Co. v. United States, 338 U.S. 1, 5 (1949) ("[L]oss to the owner of non-transferable values deriving from his unique need for property or idiosyncratic attachment to it, like loss due to an exercise of police power is properly treated as part of the burden of common citizenship.").

215. *See* John Fee, *Reforming Eminent Domain*, *in* EMINENT DOMAIN USE AND ABUSE: *KELO* IN CONTEXT 125, 133 (Dwight H. Merriam & Mary Massaron Ross eds., 2006). Though not required under Supreme Court precedent to compensate for economic or noneconomic losses in excess of the fair market value of the condemned property, some jurisdic-

There are many commentators who argue the law of eminent domain should be reformed in such a way that property owners would not be restricted to receiving the fair market value for their property if these property owners have suffered additional economic or non-economic losses.[216] Some of these commentators have argued property owners should be able to receive full compensation for all of their losses in an eminent domain case, as opposed to the incomplete compensation many property owners now receive under the current law.[217] Other scholars are concerned that minorities have often lost both their homes and their status as homeowners when their property has been taken under eminent domain because the compensation these property owners have received has often proven insufficient for these owners to purchase comparable housing nearby as their neighborhoods undergo gentrification. To remedy this problem, these scholars have argued that property homeowners should receive "status preserving compensation" that may exceed the fair market value of their condemned property in order that these condemnees may be able to actually purchase comparable housing within the vicinity of their former homes.[218] All these calls for reform assume property owners in eminent domain cases are in fact paid the fair market value for their property consistent with the Supreme Court's articulation of the just compensation requirement, but that such fair market value compensation often fails in predictable ways to make the property owner whole. As a threshold matter, however, one must question whether property owners in eminent domain actions do in fact tend to receive fair market value compensation when their property is taken for a public use as the law mandates and as many have assumed does occur in most cases.

2. *Many Condemnees Receive Less than Fair Market Value*

Very few academics or researchers have conducted empirical studies to assess whether property owners have received fair market value compensation when their property has been taken under eminent domain. Even fewer law professors have conducted such empirical studies. The most substantial of the studies conducted by law professors was conducted by Curtis Berger and Patrick Rohan, who ana-

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tions do provide that a property owner may be entitled to compensation in excess of the fair market value of his or her property that is taken. *See, e.g.*, GA. CODE ANN. § 22-1-13 (2010) (entitling condemnee to recover, *inter alia*, reasonable relocation expenses and payment for economic losses of tangible personal property).

216. *See* Michael DeBow, *Unjust Compensation: The Continuing Need for Reform*, 46 S.C. L. REV. 579, 580 nn.7-8 (1995); Fee, *supra* note 215, at 134.

217. *See* Fee, *supra* note 215, at 134.

218. Rachel D. Godsil & David Simunovich, *Just Compensation in an Ownership Society*, *in* PRIVATE PROPERTY, COMMUNITY DEVELOPMENT AND EMINENT DOMAIN 133, 135, 147 (2008).

lyzed the condemnation practices of county officials in Nassau County, New York during the early 1960s.[219]

An overwhelming percentage of the cases in Berger and Rohan's study ended in a settlement agreement as opposed to an award at the end of a trial.[220] The settlement agreements, viewed in the aggregate, reveal that the County negotiated with individual property owners—the majority of whom were not represented by an attorney—in a way that resulted in most of the property owners receiving less than fair market value for their property.[221] In fact, just 15.7% of the condemnees who settled received compensation equal to or better than the lowest County appraisal figure, and 56.9% received compensation under 90% of the County's low appraisal.[222] The fact that 8.6% of condemnees settled for less than 50% of the County's lowest appraisal and that 16.9% received compensation between 50% and 69% of the County's lowest appraisal provides evidence of the shocking, lowball negotiating tactics that some of the County negotiators employed.[223] More broadly, in 29.3% of the settled cases, the condemnees received 69% or less of the mean appraised value of the properties in those cases in which more than one appraisal was prepared.[224]

Berger and Rohan posit that so many claims were settled below the County's lowest appraisal based upon a combination of the County's deceptively hardnosed negotiating strategy and the fact that many property owners either lacked knowledge about their property's value or were under emotional and financial duress as a result of the eminent domain process.[225] Negotiations would begin between the

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219. Curtis J. Berger & Patrick J. Rohan, *The Nassau County Study: An Empirical Look Into the Practices of Condemnation*, 67 COLUM. L. REV. 430 (1967).

220. *Id.* at 440-41. In fact, trials only approached settlement agreements as the most frequent method of disposition for the properties in the data set that ended up yielding the highest compensation amounts. *Id.* This suggests that wealthier property owners not only better understood the relative value of settlement versus litigation in terms of just compensation valuation, but also that wealthier property owners were better able to afford the costs of litigating such cases through trial.

221. *Id.* at 451. A number of the condemnees who did hire attorneys did so only after an agreement on the sales price already had been negotiated, thereby limiting the attorney to working on matters related to the closing and to satisfying any objections to the state of the title. *Id.* at 454.

222. *Id.* at 442-43.

223. *Id.* at 443.

224. *Id.* at 442.

225. *Id.* at 444-47; *see also* Gideon Kanner, *"[Un]equal Justice Under Law": The Invidiously Disparate Treatment of American Property Owners in Takings Cases*, 40 LOY. L.A. L. REV. 1065, 1104-05 (2007). Berger and Rohan note some of the practices the County used that may have had the impact of partially disarming the condemnee when price negotiations began. For example, the first interaction between the condemnee and the negotiator often occurred when the condemnee contacted the negotiator after receiving a pamphlet from the County entitled "How Your County Acquires Land for Public Purposes," a pamphlet that did not advise the condemnee to obtain his or her own appraisal. Berger & Rohan, *supra* note 219, at 444, 445 n.35. The negotiator would then seek to assist the condemnee in completing the proof of title form completed before any negotiation on price be-

County and the condemnee some time after the first appraisal had been conducted. The County utilized low-paid county negotiators in all the proceedings, and these negotiators were given strict constraints on the amount of compensation they were authorized to offer the condemnee.[226] The authors were told the ceiling on the amount the negotiators could offer was between 60% and 85% of the appraised value; in contrast, there was no minimum amount set on how much the negotiator had to offer a condemnee.[227]

Berger and Rohan's study revealed that a condemnee's likelihood of receiving fair market value as established by the County's appraisal alone—a determination of market value those who practice in the area of eminent domain on behalf of condemnees would reject forcefully—depended heavily upon whether the cases were settled or whether a judge or jury established compensation at the conclusion of litigation. In cases that were settled, the condemnee received an amount that was below the lowest appraisal in 84.4% of the settlements; in 88.8% of the settlements, the condemnee received less than the mean appraisal in those cases in which two appraisals were conducted.[228] In cases that were fully litigated, the condemnee received an amount that reflected the low appraisal amount or more in 84.7% of the cases.[229] The differences in outcomes between the settled cases and the fully litigated cases are evidence of a class divide in takings cases in which those property owners with less social and financial capital are much more likely to receive below market value compensation in eminent domain proceedings than wealthier and more knowledgeable property owners who are often able to obtain compensation in excess of market value.

The overwhelming percentage of property owners who received compensation below market value in eminent domain settlement cases in Nassau County during the early 1960s is consistent with more

gan. Further, the negotiator would try to accommodate the condemnee by making a visit to the condemnee's home to demonstrate goodwill. *Id.* at 444-45.

In terms of lack of knowledge of value, Berger and Rohan note that there were significant information asymmetries between the County officials and the claimants. The claimants were not shown the County appraisal and usually did not have their own appraisal. Further, the claimants often had very dated information about the value of their property that did not capture the true value of properties in an area that had experienced rapid appreciation. The claimants also lacked the ability to value partial takings of their property. *Id.* at 445. Berger and Rohan also note that the eminent domain process placed some condemnees under emotional and financial stress. In terms of emotional stress, eminent domain is a forced sale process after all, and many claimants found the process to be mystifying. *Id.* at 446. In terms of financial hardship, many claimants who were forced to relocate had trouble financing the purchase of a new property before they had been paid for the taking of their old property. *Id.*

226. Berger & Rohan, *supra* note 219, at 433, 445.

227. *Id.* at 445.

228. *Id.* at 442-43. The tables reporting these figures round the data.

229. *Id.* at 450.

recent findings from California and Utah, which also indicate that the "practice of making lowball offers and of undercompensating condemnees is prevalent."[230] In California, the Institute for Legislative Practice at the McGeorge School of Law evaluated, inter alia, the difference between final settlement offers made by the government to condemnees in eminent domain litigation and the judgments condemnees obtained at trial in eminent domain litigation in California over a twelve-year period.[231] This study was done in the late 1990s to assist the California Law Revision Commission while it considered proposed changes to the manner in which litigation expenses may be awarded in eminent domain cases. The Institute for Legislative Practice's data set consisted of 237 eminent domain cases in California identified on Westlaw and Lexis between 1985 and 1999.[232] Unlike the Berger and Rohan study, no comparison was made between eminent domain cases settled in a nonlitigation context and those that were litigated. The Institute for Legislative Practice found the average jury verdict was 41% higher than the condemnor's final offer, and the average bench verdict was 33% higher than the condemnor's final offer.[233]

In 1999, the *Salt Lake Tribune* conducted an investigative report of more than 200 properties acquired by the Utah Department of Transportation (UDOT) between 1994 and 1999.[234] The reporters discovered more than 80% of the property owners who contested UDOT's appraisal in court received substantially higher compensation than UDOT had offered them.[235] The mean increase over UDOT's

230. Memorandum from Gideon Kanner, Consultant to the Cal. Law Revision Comm'n, to the Cal. Law Revision Comm'n, 9 (Nov. 10, 1999), *available at* http://www.clrc.ca.gov/pub/1999/M99-66s1.pdf.

231. Todd A. Schaffer & J. Clark Kelso, Inst. for Legislative Practice, *Jury Verdicts in California Eminent Domain Cases: Some Descriptive Statistics*, 1 (submitted to the California Law Revision Commission on Nov. 11, 1999), *available at* http://www.clrc.ca.gov/pub/1999/M99-66s1.pdf.

232. *Id.*

233. Memorandum from Nathaniel Sterling, Executive Secretary, Cal. Law Revision Comm'n to the Cal. Law Revision Comm'n (Nov. 16, 1999), *available at* http://www.clrc.ca.gov/pub/1999/M99-66s1.pdf.

234. Ray Rivera, *UDOT: Fair Deals or Land Grabs?: Buy-Ups Often Leave Trail of Bitterness and Mistrust*, SALT LAKE TRIB., Oct. 24, 1999, at A1.

235. Of the more than 200 cases that the *Salt Lake Tribune* examined, there had been a settlement or a jury had returned a verdict in ninety-seven of the cases at the time the research for the article had been completed. Of these ninety-seven cases, property owners had favorable outcomes in eighty. *Id.* There is an issue of how representative these cases were given that a majority of property owners did not challenge UDOT's final offer. *Id.* Perhaps UDOT made fair offers to most property owners, and any claims to the contrary were "just a bunch of baloney," as one satisfied condemnee stated. *Id.* On the other, maybe a large percentage of those who did not challenge UDOT's final offer were particularly vulnerable to hard bargaining tactics on the part of UDOT or were otherwise more susceptible to receiving lowball offers than those property owners who challenged UDOT's offer in court.

final offer for this group of owners was 41%.[236] In the only four cases decided by jury trial, the net gain for the property owners over UDOT's offer ranged from 43% to 115%, and from $190,000 to $1,600,000 in terms of absolute dollars.[237]

The Tribune reporter found the disparity between the appraisals, which formed the basis of UDOT's offer to condemnees, and the recoveries condemnees were able to obtain at trial could be explained by the quality of UDOT's property appraisals.[238] The article reported UDOT relied exclusively upon a very small number of outside appraisers and suggested these appraisers may have felt some pressure to lowball the appraisals in order to stay in the good graces of UDOT.[239] Unsurprisingly, the appraisers and UDOT denied UDOT had pressured any appraiser to submit a lowball appraisal.[240] In fact, UDOT countered that attorneys for property owners utilized a select group of appraisers who were expected to generate inflated appraisals.[241] Just as Berger and Rohan had postulated that many property owners in Nassau County probably settled for compensation below market value due to their emotional and financial stress, several of the property owners *The Tribune* interviewed reported the eminent domain process had exacted a high toll on them both emotionally and financially. This caused some of these property owners to settle for a smaller amount of compensation than they believed was justified.[242]

Scholars outside of legal academia have conducted empirical research analyzing the economic relationship between the compensation paid to property owners in eminent domain proceedings and the fair market value of the properties taken. Patricia Munch analyzed data on property acquisitions from three large urban renewal projects in Chicago from 1962 to 1970, a time in which the Chicago Department of Urban Renewal invoked its eminent domain power to acquire property.[243] Munch's regression analysis revealed "high-valued parcels systematically receive more than market value and low-valued parcels receive less than market value."[244]

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236. *Id.*

237. *Id.*

238. *Id.*

239. *Id.* Between 1996 and 1998, UDOT repeatedly contracted with just four appraisers who performed 86% of UDOT's appraisals during this period, with one of these appraisers alone accounting for 46% of the contracts. *Id.* Others have also claimed that appraisers retained by the government tend to submit conservative bids in an effort to secure future business. Kanner, *supra* note 225, at 1107.

240. Rivera, *supra* note 234.

241. *Id.*

242. *Id.*

243. Patricia Munch, *An Economic Analysis of Eminent Domain*, 84 J. OF POL. ECON. 473, 485 (1976).

244. *Id.* at 495.

Terrence Clauretie, William Kuhn, and R. Keith Schwer sought to evaluate whether the appraisers utilized by local officials to value residential property the government sought to take by eminent domain valued the properties differently from how such properties would have been valued in free market transactions.[245] The authors studied sixty properties taken by Clark County, Nevada as part of the expansion of McCarran International airport in Las Vegas, Nevada, and 374 similar properties located nearby that were sold in arms-length, open market transactions.[246] Clauretie, Kuhn, and Schwer found the appraisers utilized by Clark County over-appraised the sixty properties taken by eminent domain in their sample by 17% in the aggregate.[247] Consistent with Patricia Munch's study, however, Clauretie, Kuhn, and Schwer also found the government appraisers valued high and low-value properties differently. Low-value properties were under-appraised and high-value properties were over-appraised.[248]

More recently, Yun-chien Chang conducted an empirical study of the compensation paid to property owners in eminent domain settlements in New York City from 1990 to 2002.[249] Overall, Chang found New York City paid $17,311,176 to eighty-nine condemnees in eminent domain settlements involving residential properties although the aggregate estimated fair market value for those properties was $21,173,198, which meant the settlements as a group represented a 23% discount from market value. Chang further reported that condemnees did not receive equitable settlements as only 7% received a settlement roughly approximating the fair market value of their property.[250] Of the other property owners who settled, 53% received

245. Terrence M. Clauretie, William Kuhn & R. Keith Schwer, *Residential Properties Taken Under Eminent Domain: Do Government Appraisers Track Market Values?*, 26 J. REAL EST. RES. 317, 318 (2004).

246. *Id.*

247. *Id.* at 326.

248. *Id.* One other study conducted by Krisandra Guidry and A. Quang Do compared properties acquired by the California Department of Transportation ("Caltrans") under eminent domain with similar properties sold in comparable neighborhoods under free market conditions. Krisandra Guidry & A. Quang Do, *Eminent Domain and Just Compensation for Single-Family Homes*, 66 APPRAISAL J. 231 (1998). Guidry and Do conclude that the condemnees in their study received a sales price that was *on the average* 4.71% higher than the sales prices that the sample of property owners in their study who sold their property on the free market received. *Id.* at 235. They suggest that this premium results from the fact that government bodies seek to avoid lengthy and costly litigation that could be generated by owners dissatisfied with the amount of compensation condemning agencies would offer them. *Id.* at 231. Unlike the Munch study or the Clauretie, Kuhn, and Schwer study, Guidry and Do do not evaluate whether there was any vertical inequity in the manner in which property owners in their sample who owned low-value properties and property owners who owned high-value properties were compensated by Caltrans. This oversight renders suspect their sweeping conclusion that "[s]ingle-family homeowners are more than fairly compensated under eminent domain acquisitions." *Id.* at 235.

249. Yun-chien Chang, *An Empirical Study of Compensation Paid in Eminent Domain Settlements: New York City 1990-2002*, 39 J. LEGAL. STUD. 201 (2010).

250. *Id.* at 204.

compensation below fair market value, and 40% received more than fair market value.[251] Interestingly, he notes that 40% of the residential condemnees who settled with New York City received compensation he describes as "extreme compensation payment," which he defines as compensation that is either higher than 150% or lower than 50% of fair market value.[252]

B. Foreclosure Sales and Resales of "Foreclosure-Status" Property

This Section will review several empirical studies of either foreclosure sales or resales on the open market of property initially purchased by the resale seller through the foreclosure process, a type of property some refer to as "foreclosure-status" property. Given that a foreclosure sale is a type of forced sale lacking many of the attributes of a sale under fair market value conditions as discussed previously, many courts and legal scholars believe "properties sold at foreclosure sales often [are sold] below fair market value."[253] In contrast, one might expect the winning bidder at a foreclosure sale, whether such a bidder is the mortgagee or a third party, to resell the property for its fair market value in an effort to maximize his or her investment in the property given such a seller is not legally compelled in most instances to sell the previously foreclosed property in question. Nevertheless, just because a sale is not a forced sale in some technical sense does not mean the sale constitutes a sale conducted under conditions likely to yield fair market value.

1. Empirical Studies of Foreclosure Sales

A number of law professors have examined the fairness of foreclosure sales in terms of whether the current laws governing real property foreclosure sales adequately protect any equity a mortgagor may have built up in his or her property. Very few law professors, however, have published law review articles compiling and analyzing data on the foreclosure process.[254] Yet, it appears that more law reviews have published empirical studies of the foreclosure process than empirical studies of eminent domain or any other legal process involving the forced sale of real property. This Section will review two empirical studies of foreclosure sales published by law professors, focusing upon the conclusions each author draws about the fair-

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251. *Id.*

252. *Id.* Chang does warn those who read his study that his findings on settled compensations in eminent domain cases may not be generalizable to nonsettled condemnation cases and that the sales prices in the New York City real estate market may not represent the fair market value of the properties assuming a valuation based upon "the highest and best use" of the property in all circumstances, as his statistical study assumes. *Id.* at 231-33.

253. *See, e.g.*, Kooloian v. Suburban Land Co., 873 A.2d 95, 100 (R.I. 2005).

254. Nelson & Whitman, *supra* note 60, at 1426.

ness of the prices paid for properties sold at foreclosure sales.[255] In order to assess the fairness of the foreclosure sale process, both authors gathered data on the foreclosure sale itself and on subsequent resales of properties purchased at foreclosed sales.

Steven Wechsler evaluated all mortgage foreclosure actions beginning in Onondaga County, New York during 1979 and culminating in a foreclosure sale in either 1979 or 1980.[256] The data set consisted of 118 such transactions.[257] The mortgagee was the successful bidder in 77% of the cases, and a third party was the successful bidder in 23% of the cases.[258] According to Wechsler, in the cases where the resale price could be calculated, mortgagees made profits in thirty-five of the cases, with a median profit of $5080 on these resales.[259] However, mortgagees suffered losses in thirty-seven cases with a median loss of $6900 on these resales.[260] To put this data in perspective, the median original loan amount for all of the properties in Wechsler's study amounted to $20,400,[261] and the median amount that mortgagees had invested in the property as of the foreclosure date amounted to approximately $23,000.[262] Though his data showed the median loss was $1820 more than the median profit on resale, Wechsler concluded that when profits and losses were netted from all of the resales, the average mortgagee sustained a loss of more than $13,000 on each resale.[263] In contrast, the third-party purchasers made a profit upon resale in fourteen of the fifteen cases, with profits ranging from $7000 to $54,000.[264]

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255. The studies reviewed are: Debra Pogrund Stark, *Facing the Facts: An Empirical Study of the Fairness and Efficiency of Foreclosures and a Proposal for Reform*, 30 U. MICH. J.L. REFORM 639 (1997); Steven Wechsler, *Through the Looking Glass: Foreclosure by Sale as* De Facto *Strict Foreclosure—An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 CORNELL L. REV. 850 (1985).

256. Wechsler, *supra* note 255, at 865.

257. *Id.* at 865-66.

258. *Id.* at 875. Properties that a lender acquires at a foreclosure sale are referred to as "real estate owned" (REO) within the lending business. Nelson & Whitman, *supra* note 60, at 1423.

259. Wechsler, *supra* note 255, at 880. Wechsler did not take account of the mortgagee's foreclosure costs, carrying costs, or marketing costs upon resale. Nelson & Whitman, *supra* note 60, at 1427. If Wechsler had taken these transaction costs into account, it is likely that he would have reported that mortgagees made a profit in a number of the resales but not in roughly half of the resales. *Id.*

260. Wechsler, *supra* note 255, at 880, 882.

261. *Id.* at 872.

262. *Id.* at 874. Wechsler defines a lender's total investment in the property as being comprised of "[t]he sum of the debt balance, accrued interest, and additional amounts due the mortgagee, added to any surplus amount paid to the mortgagor or junior lienors." *Id.*

263. *Id.* at 882-83. A similar pattern emerged in Wechsler's data analysis of foreclosed properties that a government agency acquired from mortgagees under an insurance contract and then later resold. *Id.* at 883-84.

264. *Id.* at 883 n.182.

Debra Pogrund Stark conducted an ambitious empirical study of mortgage foreclosures in Cook County, Illinois in which she collected data on all real estate foreclosures commenced between July 1993 and July 1994.[265] Her study resulted in a number of interesting findings. Like the Wechsler study, the Stark study found third parties were the successful bidders in a very small percentage of foreclosure cases. They acquired the property as a result of being the high bidder in 11.2% of the 1993 judicial sales and in 9.6% of the 1994 judicial sales.[266] In contrast, "the mortgagee was the successful bidder in more than 80% of the cases" in her study.[267]

Stark claims that one way to assess how fairly mortgagors are treated at foreclosure sales is to evaluate "the extent to which lenders and third-party bidders bid less than the fair market value of the property and then resell the property within one year after the foreclosure sale."[268] Though Stark indicates a borrower may have been treated unfairly if property is sold below market value at a foreclosure sale and then resold within one year at a profit, her study lacks actual data on the fair market value of the properties sold at the foreclosure sale or the fair market value of the subset of these properties that were later resold within a year.[269] Instead, Stark implies that if a resale takes place within one year of the foreclosure sale and the winning bidder at the foreclosure sale makes a profit on the resale, the purchase price at the foreclosure sale may be deemed to have been below market value because the resale price presumably represented the fair market value for the property.[270] Conversely, she assumes if the winning bidder at the foreclosure sale did not make a profit upon a resale that took place within one year of the foreclosure sale that the foreclosure sale constituted a sale at fair market value.[271]

Overall, Stark's conclusions about the extent to which the winning bidder at a foreclosure sale makes a profit upon reselling the property within one year are quite consistent with Wechsler's conclusions. Mortgagees who resold within one year of acquiring property at a foreclosure sale resold the property for a nominal profit in 28.3% of the cases and incurred a loss 71.8% of the time.[272] When Stark takes into account in the fact that carrying and resale costs can equal 10% of

265. Stark, *supra* note 255, at 656-57.
266. *Id.* at 663.
267. *Id.* at 673.
268. *Id.* at 665.
269. Although the resales are not forced sales themselves in any technical sense, one cannot assume that all of the properties that were resold by lenders or third parties were resold under fair market value conditions. In many of these instances, one could postulate that the lenders, at the least, were not typically motivated and that they were not attempting primarily to maximize the sales price. *See infra* Part V.B.2.
270. Stark, *supra* note 255, at 666-67.
271. *Id.*
272. *Id.* at 666.

the resale price based upon what many bank officials she interviewed told her,[273] she indicates lenders only made a true profit in 20% of their resales.[274] Third parties who resold properties within a year after they acquired them at foreclosure sales made true profits at a much higher rate than the mortgagees who resold.[275] Further, the successful third-party bidders in the 1993 cases made much more substantial profits upon resale than the profits successful mortgagee bidders were able to make upon resale.[276]

Based upon the studies conducted by Wechsler and Stark, one can only draw limited inferences about whether foreclosure sales yield fair market value prices. It appears clear that most of the third parties in the two studies who purchased properties at foreclosure sales and then resold these properties within a few years had purchased many of the properties for prices below market value given the rather substantial profits that many of these third parties were able to make upon resale. Nevertheless, in both studies, the mortgagees were the most successful bidders at the foreclosure sales in a substantial majority of the cases and were also the most frequent sellers of previously foreclosed property. In considering the findings from Wechsler's and Stark's studies together, a large percentage of mortgagees failed to make a nominal profit upon resale. When one factors in carrying and resale costs, an even larger percentage of mortgagees failed to make a true profit upon resale.

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273. *Id.* at 661. Elsewhere, she calculates that total carrying and resale costs for a "typical" sale can constitute up to 14% of the selling price. *Id.* at 676. Nelson and Whitman also report that the Department of Veterans Affairs (VA) has published data that reveals that the carrying and resale costs for residential properties that the VA has foreclosed upon throughout the country has ranged between 10%and 14%in recent years. Nelson & Whitman, *supra* note 60, at 1425.

274. Stark, *supra* note 255, at 667. As indicated, Wechsler likely would have concluded that fewer mortgagees made a profit upon resale than he reported if he had taken into account the type of transaction costs that Stark accounted for in her study.

275. *Id.* at 666-67. The fact that successful third-party bidders at foreclosures sales made profits in the overwhelming number of resale cases suggests that third parties bidders targeted properties in which the value of the property substantially exceeds the mortgage debt. Nelson & Whitman, *supra* note 60, at 1428. In addition, most lenders do not act as real estate speculators who flip properties for short-term gain; instead they are primarily interested in recovering as much of their investment in the foreclosed property as possible and are normally content to allow third parties to purchase those properties offered at foreclosure sales that have the potential of returning substantial profits from a short-term resale if the third parties bid more than the lender's full credit bid. *Id.* at 1423-24, 1428.

276. Stark, *supra* note 255, at 667. The profits that nine successful third-party bidders in the 1993 foreclosure sale cases made upon resale ranged from 32% to 326%. In contrast, eight of the lenders who were the winning bidders at the 1993 foreclosure sales made a true profit upon resale within a year. *Id.* In these eight cases, if one assumes carrying and resale costs of 10%, lenders barely made a true profit in five of the cases as they resold the properties in these cases for slightly more than 10% of the foreclosure sales price. *Id.* at 667 n.120. Of the remaining three cases, the lenders involved made a profit of 37% in one case, approximately 50% in another case, and of more than 100% in the remaining case. *Id.*

Though this comparison of foreclosure sales prices and resale prices may help one form an impression about the fairness of the foreclosure sale and the extent to which mortgagees or third-party purchasers at foreclosure sales act as speculators or vulture buyers, it alone does not prove whether the foreclosure sale or the resale yields a fair market value price. Therefore, as the studies in the next Section make clear, the assumption that the failure to make a profit upon resale proves the foreclosure sale yielded a fair market value price is not sound.[277] Theoretically, it is equally plausible that in many instances neither the foreclosure sale nor the subsequent resale of the previously foreclosed property were conducted under fair market value conditions. To this end, the fact that Wechsler and Stark each find nearly all third-party purchasers made a profit on resale and a large percentage of mortgagees failed to make a profit on sales of foreclosed property may suggest third-party purchasers were much more selective than mortgagees in the type of properties they purchased at foreclosure sales and were much more *typically motivated sellers* with respect to resales of previously foreclosed properties than the mortgagees who resold foreclosed properties.

2. *Empirical Studies of Resales of "Foreclosure-Status" Property*

As indicated previously, the mortgagee usually ends up being the entity that acquires real estate through the foreclosure process.[278] Theoretically, lenders who acquire foreclosed property, whether a bank or some other financial institution, should be in a position to sell these real estate owned (REO) properties under fair market value conditions. Under ideal conditions, the department at a bank or other financial institution with responsibility for reselling REO property acquired through the foreclosure process should act as an "efficient salvor" and seek to maximize the sales price obtained for any given piece of real estate.[279]

Nevertheless, the approach an efficient salvor would take to marketing real estate is inconsistent with the approach an institution would take if it had goals other than selling certain real estate hold-

277. To be fair to Stark, who was primarily interested in evaluating the fairness and efficiency of the foreclosure process, fairness is often judged by how lenders and mortgagors emerge from the foreclosure process from a comparative economic perspective. Based upon this criterion, foreclosure sales may be relatively fair in a large percentage of cases even though many foreclosure sales may not yield a fair market value price.

278. Stark, *supra* note 255, at 663; Wechsler, *supra* note 255, at 875.

279. Edward J. Kane, *Principal-Agent Problems in S&L Salvage*, 45 J. FIN. 755, 757 (1990). Kane indicates than an efficient salvor preserves an asset's value, appraises the asset's value, and seeks to broaden the pool of potential buyers for the asset by identifying and communicating with parties that otherwise would not have considered purchasing the salvaged asset. *Id.*

ings to maximize the present value of the real estate. To this end, William Hardin and Marvin Wolverton stated as follows:

> Because institutional owners of foreclosed properties appear to be subject to atypical motivations that cause them to value some degree of reduction in time on market, and marketing time can be compressed by acceptance of a below-market price, it is reasonable to expect market prices for foreclosed properties to be systematically less than market prices for non-foreclosed properties.[280]

In fact, a small number of empirical studies conducted mostly by business school scholars in the fields of finance and real estate confirm banks and other lenders have employed more aggressive marketing strategies than an efficient salvor would use in order to speed up the liquidation of certain real estate assets.[281]

James Shilling, John Benjamin, and C. F. Sirmans sought to estimate the net realizable value for distressed real estate lenders acquired through the foreclosure process.[282] In contrast to the fair market value of a particular property, the net realizable value is the value of a "property to a particular investor or enterprise, a value that is based on the amount realized from its sale, adjusted for selling expenses."[283] Although the expected gross selling price of real estate can be expected to increase the longer the property is exposed to the market,[284] most lenders that acquire distressed real estate through the foreclosure process prefer to sell these properties sometime shortly after they acquire them.[285] Assuming the fair market value of a property is more than the net realizable value, the difference between the fair market value and the net realizable value can be referred to as the liquidating discount.[286]

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280. William G. Hardin, III & Marvin L. Wolverton, *The Relationship Between Foreclosure Status and Apartment Price*, 12 J. REAL EST. RES. 101, 101 (1996) (citation omitted). Certain commentators have identified some of the reasons banks and other financial institutions have opted to pursue aggressive liquidating strategies with respect to their real estate assets that are inconsistent with the goal of maximizing the sales price for these assets. These include the need to meet stringent equity capital requirements mandated by certain governmental regulations and the fact that the stock market places a comparatively lower value on banks that hold a relatively high proportion of their assets in real estate. *Id.* at 102.

281. *Id.*

282. James D. Shilling, John D. Benjamin & C. F. Sirmans, *Estimating Net Realizable Value for Distressed Real Estate*, 5 J. REAL EST. RES. 129, 130, 136 (1990).

283. *Id.* at 130; *see also* AMERICAN INST. OF REAL ESTATE APPRAISERS, DICTIONARY OF REAL ESTATE APPRAISAL 208 (2d ed. 1989) (defining net realizable value as "[m]arket value minus the cost of disposition").

284. Shilling et al., *supra* note 282, at 133; *see also* John D. Benjamin , G. Donald Jud & G. Stacy Sirmans, *What Do We Know About Real Estate Brokerage?*, 20 J. REAL EST. RES. 5, 14, 16 (2000) (observing "time on the market (TOM) is positively related to selling price").

285. Shilling et al., *supra* note 282, at 138.

286. *Id.* at 129.

To estimate the net realizable value of distressed properties, the authors used a sample of sixty-two residential condominiums sold in Baton Rouge, Louisiana in 1985.[287] The sample included both condominiums sold under fair market value conditions and comparable condominiums liquidated by a local financial institution.[288] To measure the extent of the liquidating discount, if any, the authors utilize a multiple regression analysis. Their regression analysis determined there was a 24% liquidating discount for the distressed properties in the sample as compared to the properties sold under fair market value conditions.[289]

Fred Forgey, Ronald Rutherford, and Michael VanBuskirk followed up on the Shilling, Benjamin, and Sirmans study by evaluating sales of previously foreclosed single-family homes sold by individuals or financial institutions.[290] These authors collected data on residential properties sold and closed upon in Arlington, Texas between July 1991 and January 1993.[291] Of the 2482 sales in the data set, 11.28% had a foreclosure status, meaning the homes had previously been acquired by the seller at a foreclosure sale.[292]

The findings of the Forgey et al. study are strikingly similar to the results of the Shilling et al. study as the nearly 300 foreclosure-status, single-family homes in the former sold for an average of $15,038.40 less in absolute dollars than the other houses in the data set.[293] In percentage terms, this meant the previously foreclosed homes sold at a 23% liquidating discount as compared to the other single-family homes in the sample.[294]

William Hardin and Marvin Wolverton extended the findings of Shilling et al. and Forgey et al. by evaluating resales of income-producing real estate initially acquired at a foreclosure sale.[295] Hardin and Wolverton collected data on ninety sales of income-producing apartment buildings in Phoenix, Arizona to noninstitutional buyers in which the real estate closing took place between January 1993 and November 1994.[296] Ten percent of the sales in their sample consisted of foreclosure-status properties.[297]

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287. *Id.* at 135.
288. *Id.*
289. *Id.* at 136.
290. Fred A. Forgey, Ronald C. Rutherford & Michael L. VanBuskirk, *Effect of Foreclosure Status on Residential Selling Price*, 9 J. REAL EST. RES. 313, 314 (1994).
291. *Id.*
292. *Id.* at 315.
293. *Id.* at 316.
294. *Id.* at 318.
295. Hardin & Wolverton, *supra* note 280, at 102.
296. *Id.* at 105.
297. *Id.*

Though Hardin and Wolverton evaluated sales of income-producing as opposed to residential property and collected data in a different geographical location than the locations utilized in earlier studies, their findings are nearly identical to the findings of both Shilling et al. and Forgey et al. Results of the Hardin and Wolverton study indicate the foreclosure-status apartment buildings in their sample sold for 22.2% less than the nonforeclosure-status apartment properties.[298] Taken together, the empirical studies on resales of foreclosure-status property indicate these sales are not conducted under fair market value conditions. It is likely that the sellers in this context are often not typically motivated for one reason or another and are willing to sell the property for a liquidating discount.

Overall, the empirical studies reviewed in this Section make it clear that one cannot simply assume real property is sold for fair market value without evaluating whether the conditions necessary for a sale to occur under fair market value conditions are present. Property that is offered for sale to the public under a forced sale by definition is not offered for sale under fair market value conditions. Unbeknownst to most lay people and law professors alike, the empirical studies on eminent domain compensation reveal that one cannot even assume that most condemnees in eminent domain cases are paid fair market value for their property even though the U.S. Constitution requires fair market value be paid to condemnees in almost all cases. Further, the empirical studies on resales of foreclosure-status property make clear that it is important to evaluate whether all market value conditions exist in any given sale, including whether the seller and the buyer are typically motivated, even with respect to a nonforced sale in which one might reasonably assume that fair market value conditions would prevail. Finally, the empirical studies on eminent domain reveal that when property owners with different socioeconomic backgrounds have their property forcibly sold, such sales can produce regressive vertical inequities. As a result, wealthier people often benefit economically from such forced sales and the less wealthy often lose significant wealth when such sales are finalized and, sometimes, their ability to maintain their status as property owners at all after such sales.

298. *Id.* at 108. In comparing their findings with the findings of Shilling et al. and Forgery et al., Hardin and Wolverton adjusted the reported discounts in the earlier studies using a methodology called the Halvorsen and Palmquist methodology that was used in their study to ensure consistency. However, the adjusted discounts were slight. As applied to the Forgery et al. study, the adjusted discount rate is reported as 20.4%; the adjusted discount rate for the Shilling et al. study is reported as 21.3%. *Id.* at n.2.

VI. DOES RACE MATTER IN REAL ESTATE TRANSACTIONS AND REAL ESTATE FINANCE

Do people with certain characteristics face obstacles in their efforts to accumulate and maintain assets that other people do not? Is the market colorblind? Are the rich and poor treated evenhandedly in the markets for real estate and other capital? We focus particularly on whether someone's race may present a barrier to acquiring or maintaining land and other real estate assets or to realizing the potential economic value of land and other real estate holdings.

To this end, we address two overarching issues relevant to assessing whether the racial wealth gap exists in part due to discrimination in the real estate and real estate lending markets. First, we focus specifically on previous research on aspects of possible price discrimination in real estate sales as well as discrimination by real estate brokers and salespersons in the manner in which they market properties to people of different races and ethnicities.[299] Second, we consider the extent to which discrimination may exist in real estate finance by reviewing research in this area and considering cases filed by African-American farmers against the U.S. Department of Agriculture (USDA) that are based upon claims the USDA violated the Equal Credit Opportunity Act[300] in such a way that it has driven many African-American farmers into foreclosure over the course of the past few decades.

A. *Studies of Racial Discrimination in Real Estate Pricing and Marketing*

For purposes of our discussion, the most relevant literature on price discrimination addresses whether different kinds of consumers

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299. The ensuing discussion focuses upon literature that has examined whether African Americans pay more for housing than whites despite the fact that the focus of our Article is on the prices that a property owner receives upon the forced sale of their property. However, unlike the studies that show that wealthier property owners fare better than low- to middle-class property owners in eminent domain proceedings, we are not aware of any studies that evaluate whether there are differences in the prices that African Americans and whites are paid when their property is sold under different types of forced sales. Nevertheless, it is worth considering whether such racial differences in forced sale prices exist because, among other reasons, there are studies that indicate that racial valuation differences do exist in such areas as tort law. For example, some scholars have found evidence that minority plaintiffs have had their tort injuries valued by civil juries at a lower level than white plaintiffs who have suffered similar injuries. *See generally* AUDREY CHIN & MARK A. PETERSON, DEEP POCKETS, EMPTY POCKETS: WHO WINS IN COOK COUNTY JURY TRIALS (1985); Jennifer B. Wriggins, *Torts, Race, and the Value of Injury, 1900-1949*, 49 HOW. L.J. 99 (2005).

300. Equal Credit Opportunity Act of 1974, 15 U.S.C. § 1691(a)-(f) (2008) (prohibiting discrimination in lending on the basis of race, color, religion, national origin, sex, marital status, or age).

pay different prices for the same commodities.[301] In this vein, David Caplovitz published an early and influential study that found the poor may indeed pay higher prices for many goods and services.[302] His study has stimulated much additional research. Price discrimination has been intensively studied for a number of commodities, including groceries and other foods, automobiles, and even Broadway tickets.[303] We focus our review on selected literature on racial price discrimination in real estate markets.

Before reviewing literature on racial price discrimination for real estate, we offer a few observations about the nature of the price of complex commodities such as land and real estate. To a first approximation, there are many goods and services that we can reasonably treat as being standardized. Commodities such as wheat, oil, or milk are fairly homogeneous, or nearly so, because there are well-known systems for grading such commodities. But for many complex goods such as automobiles, high-tech computers, and land and real estate, analysis is complicated because the goods themselves are more complicated and standardization is much more difficult. In particular, no two real estate parcels, whether these parcels are farmland, commercial buildings, or residential structures, are truly identical in all respects. In conducting economic analyses on issues involving complex goods such as real estate, it is important to attempt to control as clearly as possible for differences in the characteristics of such goods.

Economists and other social scientists have used regression analysis in order to control for many such characteristics simultaneously.[304] These regressions produce hedonic price indexes, which focus

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301. For an excellent review of the theoretical literature on price discrimination, including a review of literature addressing topics such as price discrimination over different periods of time and geographical location, see generally LOUIS PHLIPS, THE ECONOMICS OF PRICE DISCRIMINATION (1983).

302. DAVID CAPLOVITZ, THE POOR PAY MORE: CONSUMER PRACTICES OF LOW-INCOME FAMILIES (1967). It should be noted that price discrimination by income, if effective, may disadvantage higher-income as well as lower-income consumers, depending on the context. For example, much airline price discrimination is presumably aimed at extracting higher fares from business and other consumers with a greater purchasing power.

303. *See, e.g.*, Ian Ayres & Peter Siegelman, *Race and Gender Discrimination in Bargaining for a New Car*, 85 AM. ECON. REV. 304 (1995); Chanjin Chung & Samuel L. Myers, Jr., *Do the Poor Pay More for Food? An Analysis of Grocery Store Availability and Food Price Disparities*, 33 J. CONSUMER AFF. 276 (1999); Charles S. Goodman, *Do the Poor Pay More?*, 32 J. MARKETING 18 (1968); Kathryn Graddy, *Do Fast-Food Chains Price Discriminate on the Race and Income Characteristics of an Area?*, 15 J. BUS. & ECON. STATS. 391 (1997); Lashawn Richburg Hayes, *Are Prices Higher for the Poor in New York City?*, 23 J. CONSUMER POL'Y 127 (2000); Howard Kunreuther, *Why the Poor May Pay More for Food: Theoretical and Empirical Evidence*, 46 J. BUS. 368 (1973); Phillip Leslie, *Price Discrimination in Broadway Theater*, 35 RAND J. ECON. 520 (2004).

304. Regression analysis is a statistical technique applied to a set of data for finding the best fitting relationship between a dependent variable (e.g., property selling price) and a set of independent or explanatory variables (e.g., size of the unit, measures of its quality,

on housing characteristics that give utility or satisfaction, hence "hedonic."[305] Typically, a regression of sales price against land and structural characteristics, for example, is used to standardize transactions. Now, if *X* paid $3000 per acre for land that the hedonic regression estimates was worth $3500, but *Y* paid $2000 for land that the hedonic predicts a selling price of $1500, we would surmise that *Y* paid a higher price per unit of real estate services. Studies of racial price discrimination carry out such calculations for a sample of many consumers, and then examine whether, for example, African Americans or other minorities are systematically treated like consumer *X* (i.e., they regularly pay less or receive a discount to estimated market price) or consumer *Y* (i.e., they regularly pay more than the model predicts which is often referred to as paying a premium).

In real estate, other complications can arise that social scientists attempt to take into account in conducting their regression analysis. For example, many purchases involve simultaneous financing decisions. Therefore, in these cases, not only do characteristics of complex goods like real estate or automobiles come into play, but adjustments for risks and transactions costs do as well.[306] How does a borrower's credit rating impact the type of loan they can get to purchase a specific parcel of property? Will future prices for this kind of real estate or this neighborhood rise or fall relative to prices for other commodities? How easily can a lender foreclose on a defaulted transaction if necessary? How readily might we expect this real estate collateral to be sold and for how much if it is foreclosed upon, in good markets and in bad?

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and neighborhood characteristics). The hedonic regressions we consider often have one or more variables representing a buyer's race or ethnicity. Some variables have natural measures (e.g., dollars or square feet), but other variables that represent categories (e.g., single-family houses, compared to other structure types; or black buyers, compared to other races) are measured with so-called dummy variables, which take on the value one if a condition is true or present, and zero otherwise. Standard regression models ("ordinary least squares") also assume the dependent variable is the only "endogenous" variable, i.e. determined by the process under study, and that the independent variables are "exogenous," or determined independently of the process we study.

305. Early on in the development of hedonic pricing analysis, Andrew Court and Zvi Griliches applied the method to study automobile and housing markets respectively. *See* A.T. Court, *Hedonic Price Indexes with Automotive Examples*, *in* THE DYNAMICS OF AUTOMOBILE DEMAND 99 (1939); Irma Adelman & Zvi Griliches, *On an Index of Quality Change*, 56 J. AM. STAT. ASS'N 535 (1961). These early studies along with some others were precursors of a large literature that followed theoretical underpinnings provided by Kelvin Lancaster and Sherwin Rosen. *See* Kelvin J. Lancaster, *A New Approach to Consumer Theory*, 74 J. POL. ECON. 132 (1966); Sherwin Rosen, *Hedonic Prices and Implicit Markets: Product Differentiation in Pure Competition*, 82 J. POL. ECON. 34 (1974).

306. According to a famous model that underlies much of finance, the Modigliani-Miller Theorem, financing per se should not affect the price investors pay for an asset. Optimal decisions require first choosing the best (risk-adjusted) return, then the best way of financing that investment. *See* Franco Modigliani & Merton H. Miller, *The Cost of Capital, Corporation Finance and the Theory of Investment*, 48 AM. ECON. REV. 261 (1958). However, the assumptions are quite stringent for the Modigliani-Miller Theorem to hold strictly.

Do regression studies demonstrate African Americans and other minorities pay more for housing? Economists and other social scientists have not completely settled whether such differential pricing exists. As economists, two of the authors of this Article believe there is more evidence on one side of the debate than on the other. Early literature, such as John Kain and John Quigley's classic study, tended to find blacks paid more for housing than whites once controls were put in place for characteristics of the housing unit.[307] Later research, such as a study by James Follain and Stephen Malpezzi, tended to find discounts for African Americans.[308] In an effort to reconcile the earlier and later studies, some scholars suggested some of the differences between the earlier and later studies may have been attributable to changing market conditions and the effects of fair housing and other public policies since, unsurprisingly, the earlier studies tended to rely on older data.[309] However, it seems unlikely these explanations could account for all the differences between the earlier and later studies. Instead, much of the difference is more likely ascribed to differences in data sources and methods.

One particularly important issue in determining whether minorities pay more for housing is the difference of the effect of an individual's race from the effect of neighborhood racial composition in the hedonic specification. Data that permit this are difficult to obtain, in no small part because of the confidentiality requirements of census and other household survey data that limit public information about the location of individual survey households. One of the first studies to obtain such data and carefully analyze it was Daniel Chambers' Chicago study from the early 1990s.[310] He found discounts tended to exist in Chicago's black neighborhoods relative to prices in white neighborhoods once a wide variety of structural and other neighborhood characteristics were taken into account.[311] The discounts tended to fall as neighborhoods became more integrated.[312] More to the point,

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307. *See, e.g.*, JOHN F. KAIN & JOHN M. QUIGLEY, HOUSING MARKETS AND RACIAL DISCRIMINATION: A MICROECONOMIC ANALYSIS 294 (1975).

308. *See, e.g.*, James R. Follain Jr. & Stephen Malpezzi, *Another Look at Racial Differences in Housing Prices*, 18 URB. STUD. 195 (1981).

309. *See, e.g.*, Ann B. Schnare & Raymond J. Struyk, *Segmentation in Urban Housing Markets*, 3 J. URB. ECON. 146, 147-48 (1976). If a given housing market is racially segregated, prices for housing in black and white neighborhoods could rise or fall at different rates over time. Amongst other reasons, such a different pattern in price changes could arise as a result of economic gentrification (irrespective of the race of the gentrifiers) or different rates of growth in white and black populations or incomes. *See generally* John Yinger, *Prejudice and Discrimination in the Urban Housing Market*, *in* CURRENT ISSUES IN URBAN ECONOMICS 430 (Peter Mieszkowski & Mahlon Straszheim eds., 1979) (providing a more complete discussion of these issues).

310. Daniel N. Chambers, *The Racial Housing Price Differential and Racially Transitional Neighborhoods*, 32 J. URB. ECON. 214 (1992).

311. *Id.* at 219.

312. *Id.* at 225.

when he examined prices paid by black households in largely white neighborhoods, he found no statistically significant difference between the prices blacks paid for houses and the prices whites paid.[313] Later research by Katherine Kiel and Jeffrey Zabel with generally similar data from Denver and Philadelphia, as well as Chicago, tended to confirm Chamber's broad conclusions.[314]

While many studies of price discrimination in housing rely on the hedonic regression method, there have been several important studies mostly addressing other aspects of housing discrimination based on the alternate approach of paired testing. This approach involves more direct tests of discrimination in the market, although these tests tend to yield less direct empirical evidence on possible sizes in price differentials consumers may experience. The method revolves around data collected from interviews with paired testers who are trained individuals sent to search for housing units or to obtain a mortgage who dress and otherwise act as similarly as possible as they utilize similar scripts addressing their desire to rent or purchase a home.

There have been three related major studies of housing markets with paired testers, about a decade apart, all supported by the U.S. Department of Housing and Urban Development (HUD). The earliest of these studies, published in 1979, focused primarily on blacks and whites and tended to find that real estate brokers treated whites and blacks substantially differently.[315] The study found, among other things, real estate brokers tended to show whites looking for housing more units and units in better neighborhoods than blacks. One of the biggest differences tended to be in the number of initial units offered for review by the broker or salesperson before any actual units were shown.[316]

The follow-up study, published in the early 1990s, revisited the issue and also expanded the types of households studied; in particular, Hispanics as well as blacks and whites were analyzed.[317] Broadly, the second round of paired testing found somewhat reduced, but still quite substantial, discriminatory practices by real estate brokers and salespersons in many markets. The latest study, published by HUD in 2002, further expanded the markets studied and also examined American Indians and Asians, as well as blacks and Hispanics rela-

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313. *Id.* at 224.

314. Katherine A. Kiel & Jeffrey E. Zabel, *House Price Differentials in U.S. Cities: Household and Neighborhood Racial Effects*, 5 J. HOUSING ECON. 143 (1996).

315. *See* RONALD E. WIENK ET AL., U.S. DEP'T OF HOUS. AND URBAN DEV., MEASURING DISCRIMINATION IN AMERICAN HOUSING MARKETS: THE HOUSING MARKET PRACTICES SURVEY 96 (1979).

316. *Id.* at 106.

317. MARGERY AUSTIN TURNER ET AL., U.S. DEP'T HOUS. & URBAN DEV., HOUSING DISCRIMINATION STUDY: SYNTHESIS 42 (1991).

tive to whites.[318] There was yet again evidence of some progress, but substantial discriminatory biases remained.

To summarize the literature on racial discrimination in real estate markets—(1) most studies to date have focused on urban housing and few have examined racial issues in commercial or rural real estate; (2) while not unanimous, the most recent studies to explore the issue of price discrimination found housing units owned by blacks mostly in black or integrated neighborhoods trade at a discount relative to similar housing in white neighborhoods; and (3) while there is evidence of some progress, in urban housing transactions, blacks are still often treated differentially, e.g., they are shown smaller numbers of units than similarly qualified whites and are often steered to black neighborhoods and away from white ones.

B. Is There Evidence of Racial Discrimination in Real Estate Finance?

Recently, civil rights organizations have pointed out African-American borrowers are much more likely to have high-interest, subprime loans than white borrowers. These allegations have now gained national attention. On March 13, 2009, the NAACP sued a number of subsidiaries of two major banks claiming these institutions unlawfully steered African-American borrowers into high-interest, subprime loans although many of these borrowers were eligible, based upon their income, assets, and credit scores, for the less costly loans whites were much more likely to receive.[319]

The issue of racial discrimination in mortgage markets first exploded in the public consciousness in the late 1980s and early 1990s when the *Atlanta Journal-Constitution* and the *Wall Street Journal* published articles reporting the results of simple tabulations of differences in mortgage approvals from Home Mortgage Disclosure Act (HMDA) data.[320] In one widely cited HMDA tabulation, in 1990 blacks were rejected for mortgages 34% of the time; Hispanics, 22% of the time; and whites 14% of the time.[321]

Both early and all subsequent HMDA data have shown blacks are rejected much more often than whites for mortgages. By itself this

318. MARGERY AUSTIN TURNER ET AL., U.S. DEP'T OF HOUS. & URBAN DEV., DISCRIMINATION IN METROPOLITAN HOUSING MARKETS: NATIONAL RESULTS FROM PHASE I HDS 2000, iii (2002).

319. E. Scott Reckard, *Housing; NAACP Suits Claim Mortgage Bias*, L.A. TIMES, Mar. 14, 2009, at B1.

320. Bill Dedman, *The Color of Money*, ATLANTA J.-CONST., May 1-4, 1988, *available at* http://powerreporting.com/color/color_of_money.pdf; Paulette Thomas & Raquel Santiago, *Mortgage Rejection Rate for Minorities is Quadruple That of Whites, Study Finds*, WALL ST. J., Oct. 21, 1991, at A2.

321. Glenn B. Canner & Dolores S. Smith, *Home Mortgage Disclosure Act: Expanded Data on Residential Lending*, 77 FED. RES. BULL. 859, 868-81 (1991).

tells us little about discrimination. The most obvious issue, and the one first addressed by researchers, is that there are many reasons to expect a correlation between race/ethnicity and other characteristics reasonably affecting mortgage approvals, such as credit score, borrower ability to pay, other mortgage terms, and possibly other variables like expected property appreciation in a given neighborhood.

It turns out to be extremely difficult to control for all the possible relevant variables in such a regression. The first serious attempt was by Alicia Munnell and others at the Federal Reserve Bank of Boston.[322] They required Boston area banks to supplement their HMDA submissions with additional data on characteristics of the borrowers, including information on an applicant's total debt and net worth, rudimentary information the banks had on their applicants' credit scores, and some additional information about the characteristics of the financial transaction.[323] In their widely-cited paper (the Boston Fed study), they found when they added the set of collected variables, measures of disparate treatment fell, but were by no means eliminated.[324] Black and Hispanic applicants were still 60% more likely to be denied mortgage loans than white applicants with similar characteristics.[325] Given the fact that the simple unadjusted measure suggested minorities were 2.7 times as likely as whites to be denied mortgage loans, it is clear these additional variables mattered, but 60% remained a seemingly substantial measure of disparate treatment.

Munnell et al.'s initial efforts were roundly criticized by several other researchers. Mark Zandi[326] and Glenn Harrison[327] found the Boston Fed study results to be fairly fragile in that there was no significant evidence of disparate treatment when additional explanatory variables were added to the regression equation. Theodore Day, Stanley Lebovitz,[328] and Zandi[329] examined outliers and inconsistencies in the data. Once these researchers removed a substantial number of suspect observations from the Boston Fed study, they found no significant differences in treatment.[330] Other researchers claim the sam-

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322. *See* Alicia H. Munnell et al., *Mortgage Lending in Boston: Interpreting HMDA Data* 1 (Fed. Reserve Bank of Boston, Working Paper No. 92-7, 1992).

323. *Id.* at 18.

324. *Id.* at 2.

325. *Id.*

326. Mark Zandi, *Boston Fed's Bias Study Was Deeply Flawed*, AM. BANKER, Aug. 19, 1993, at 13.

327. Glenn W. Harrison, *Mortgage Lending in Boston: A Reconsideration of the Evidence*, 36 ECON. INQUIRY 29, 30 (1998).

328. Theodore E. Day & S. J. Liebowitz, *Mortgage Lending to Minorities: Where's the Bias?*, 36 ECON. INQUIRY 3, 4 (1998).

329. Zandi, *supra* note 326.

330. Another review also found many technical problems with the Boston Fed study but was more supportive of some of Munnell et al.'s qualitative conclusions. James H. Carr & Isaac F. Megbolugbe, *The Federal Reserve Bank of Boston Study on Mortgage Lending Revisited*, 4 J. HOUSING RES. 277 (1993).

ple of loan applicants in studies such as the Boston Fed study are unrepresentative and the type of methodology utilized in such studies can generate misleading results.[331]

Another issue addressed by Yezer, Phillips, and Trost[332] and others is that many of the independent variables are endogenous.[333] For example, the loan-to-value (LTV) ratio is a key underwriting variable, and a higher LTV ratio should increase the probability of rejection. But the regression model assumes the LTV ratio is predetermined by the applicant and not itself part of the underwriting process. An applicant who may be close to acceptance, but with some red flags such as a marginal credit score, may be counseled by a mortgage broker or bank employee to increase his or her down payment. Since the down payment is now determined as part of the same process as determining acceptance or rejection of the loan, it becomes difficult to interpret the coefficient of LTV as the effect of LTV on acceptance or rejection. Furthermore, if white lending officers, for example, wittingly or unwittingly, offer more informal guidance on "proper" LTV ratios to white borrowers than to blacks, the effects of race on the mortgage decision is now confounded with LTV ratio.[334]

Recently the Department of Housing and Urban Development sponsored a paired testing study of the mortgage preapplication

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331. The Boston Fed Study and many of the studies evaluating it rely on single equation regression estimates that relate accept-reject decisions to a set of characteristics of households and the potential transaction. But only households who have successfully negotiated to the point of making a formal application are included in HMDA data. Households must initially decide whether to apply for such a loan, whether to apply to an institution regulated that is required to submit HMDA data, and then typically undergo some initial two-sided screening in an initial meeting with a bank or mortgage origination employee before deciding whether to submit an application. Some studies have shown that single equation estimation methods that do not account for these early stages in the process can give misleading results. *See, e.g.*, Anthony M.J. Yezer, Robert F. Phillips & Robert P. Trost, *Bias in Estimates of Discrimination and Default in Mortgage Lending: The Effects of Simultaneity and Self-Selection*, 9 J. REAL EST. FIN. & ECON. 197 (1994). According to at least one researcher, they will most likely lead to false positives, i.e., evidence of racially disparate treatment when the underlying simulation model data contains no such discriminatory behavior by construction. Michael LaCour-Little, Identification of Discrimination in Mortgage Lending Markets 177 (July 26, 1996) (unpublished Ph.D. dissertation, University of Wisconsin-Madison) (on file with Memorial Library, University of Wisconsin-Madison). Theoretically, of course, single equation estimation methods could yield false negatives as well.

332. Yezer, Phillips & Trost, *supra* note 331, at 202.

333. If some of the independent or explanatory variables in the regression relationship are in fact endogenous, i.e. also determined by the same process as the dependent variable, then it becomes difficult to interpret the estimated coefficient as the effect of the independent variable on the dependent variable. A.H. STUDEMUND, USING ECONOMETRICS: A PRACTICAL GUIDE 531-55 (3rd ed. 1997).

334. *See* Raphel W. Bostic, *A Test of Cultural Affinity in Home Mortgage Lending*, 23 J. FIN. SERVICES RES. 89, 109 (2003) (finding "some evidence consistent with the notion of taste-based cultural affinity" which implies a "shying away from opposite race pairings rather than a seeking out of same-race pairings"); William C. Hunter & Mary Beth Walker, *The Cultural Affinity Hypothesis and Mortgage Lending Decisions*, 13 J. REAL EST. FIN. & ECON. 57 (1996).

process conceptually similar to paired testing of real estate brokerage discussed above.[335] The study was carried out in Los Angeles and Chicago and compared the experiences of Asian and Hispanic testers as well as blacks and whites. We focus on the black-white differential. The testers were again pairs of black and white individuals provided with identical scripts regarding their financial position and credit histories. They presented themselves to loan officers in a range of mortgage lending institutions and inquired about availability and terms of home mortgages.

Ross et al. presented unconditional fractions of occurrences when whites were favored at a given institution and of occurrences when blacks were favored, for each of several measures.[336] They also presented multivariate results that controlled for lender characteristics (e.g., size of lender and whether the loan officer was white or black) and for tester "fixed effects" which are designed to remove results that might be systematically related to a particular tester (e.g., if a particular tester was less able to follow the script accurately).[337]

Results were mixed. In the unconditional measures of Ross et al.'s Table 3, Chicago blacks were statistically disadvantaged in the original information provided, the range of products discussed, the coaching received to help complete a successful application, and in follow up after the meeting.[338] There were no statistically significant differences between whites and blacks in the maximum loan amount suggested or whether lenders encouraged the borrower to apply for a Federal Housing Authority loan.[339] In Los Angeles, the null hypothesis of no difference in treatment could not be rejected, except for one measure, the coaching and related assistance received by the borrower.[340]

The multivariate results of Tables 6 and 7 generally exhibited fewer statistically significant differences between white and black treatment in both cities, although some remain.[341] Blacks were less likely to be advised about alternatives for down-payment assistance in Chicago and more likely to be steered towards FHA lending in both cities.[342] The multivariate results also provide a richer set of findings regarding interaction of borrower and lender characteristics. And it bears noting the results are very different in many respects across the two cities,

335. Stephen L. Ross, Margery Austin Turner, Erin Godfrey & Robin R. Smith, *Mortgage Lending in Chicago and Los Angeles: A Paired Testing Study of the Pre-Application Process*, 63 J. URBAN ECON. 902 (2008).

336. *Id.* at 911-12.

337. *Id.* at 913-17 (especially Tables 6 and 7).

338. *Id.* at 911.

339. *Id.*

340. *Id.*

341. *Id.* at 915-16.

342. *Id.*

which of course have different racial and ethnic compositions, homeownership rates, and so forth.[343]

This paired testing study is suggestive and important but, as the authors are careful to point out, does not answer all the important questions about possible mortgage discrimination. It is important to note that this study is a study of the preapplication process. Paired testing cannot be used in any robust way to assess the mortgage approval process because federal law prohibits submitting false credit applications,[344] and paired testing by its very nature requires the testers to utilize false information because the scripts that paired testers utilize are fictional.

The most recent concern about discrimination in lending concerns "steering" into subprime loans. There is no dispute that African Americans received a disproportionate share of subprime, or "high-cost" loans.[345] But the relevant question is whether African Americans who qualified for prime mortgages were steered into subprime mortgages. Consistent with past studies, it is difficult to arrive at a dispositive answer to this question. However, we do have evidence consistent with steering: after controlling for income and, importantly, lender type, African Americans are more likely to obtain high-cost loans than other borrowers.[346] Unfortunately, the analysis to this point does not include a complete set of underwriting variables typically used to make loan decisions. Going forward, moreover, analysis will be difficult because many high-cost loans had no documentation of income and assets, thus making it impossible to know whether the borrower might have qualified for a prime loan had they provided documentation.

Although almost all of the studies addressing possible discrimination in real estate finance we have reviewed focus upon urban real estate markets, we conclude our discussion with an unambiguous case of lending discrimination arising in a rural context and leading to substantial minority land loss through foreclosure and other distress sales. After claiming for decades that discrimination claims made by black farmers were unfounded,[347] the USDA published a report in 1997 written by its Civil Rights Action Team (CRAT) that

343. According to tabulations of the 2000 U.S. Census, metropolitan Chicago was 19% black and 10% Hispanic, and that 68% of households owned. Los Angeles was 17% black and 44% Hispanic, and 49% of households owned. Data from U.S. Census Bureau, 2000 Census of Population and Housing, Summary File 3: Technical Documentation 2000, *available at* www.census.gov/prod/cen2000/doc/sf3.pdf.

344. *Id.* at 903 n.3.

345. *See, e.g.*, WILHELMINA A. LEIGH & DANIELLE HUFF, JOINT CTR. FOR POLITICAL AND ECON. STUDIES, AFRICAN AMERICANS AND HOMEOWNERSHIP: THE SUBPRIME LENDING EXPERIENCE, 1995-2007 4-6 (2007).

346. *See* Robert B. Avery, Kennth P. Brevoort & Glenn B. Canner, *The 2007 HMDA Data*, FED. RESERVE BULL., A107, A139 (Dec. 2008).

347. *See* Mitchell, *From Reconstruction to Deconstruction*, *supra* note 100, at 529 n.146.

largely acknowledged the USDA had committed systemic discrimination against black and other minority farmers, including the very lending discrimination black farmers had long claimed.[348] In 1999, the U.S. government settled a landmark class action lawsuit filed by African-American farmers against the USDA mostly based upon the claim that the USDA for decades had violated the Equal Credit Opportunity Act by administering its credit and benefit programs in a discriminatory way and by failing to investigate and resolve the farmers' discrimination claims in a proper way.[349]

We include this well-documented case of governmental lending discrimination as a case of discrimination in real estate finance because many of the black farmers in *Pigford* have claimed that the USDA required black farmers to use their real estate as collateral to secure non-real estate operating loans[350] but did not require white farmers to do the same. Further, the lending discrimination alleged in *Pigford* included the claim that the USDA improperly delayed processing of loan applications to black farmers, which resulted in the loan funds arriving either very late in the planting season or even after the planting season was over, rendering these loans of limited benefit to black farmers and increasing the risk that these farmers would face foreclosure.[351] Other black farmers have claimed, for example, that the USDA forced them into foreclosure by refusing to adjust loan repayment terms for black farmers experiencing temporary financial difficulty as a result of catastrophic weather conditions but the USDA did adjust repayment terms for similarly situated white farmers who faced the same weather conditions.[352]

The CRAT report concluded that minority farmers "have lost significant amounts of land and potential farm income as a result of [USDA] discrimination."[353] Despite the fact that under the nearly completed claims process established under the *Pigford* settlement black farmers have received slightly over $1 billion in compensa-

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348. CIVIL RIGHTS ACTION TEAM, U.S. DEP'T OF AGRIC., CIVIL RIGHTS AT THE UNITED STATES DEPARTMENT OF AGRICULTURE 21 (Feb. 1997) [hereinafter CRAT REPORT].

349. Pigford v. Glickman, 185 F.R.D. 82, 86 (D. D.C. 1999).

350. E-mail from Stephen Carpenter, Senior Counsel, Office of the Monitor for *Pigford v. Vilsack* and *Brewington v. Vilsack* to Thomas Mitchell, Associate Professor, Univ. of Wisconsin Law School (Oct. 7, 2009, 20:39 CST) (on file with authors).

351. *Pigford*, 185 F.R.D. at 87.

352. Darryl Fears, *Protesters Take Over USDA Office in Tennessee; Black Farmers Say Promised Loans Were Mishandled*, WASH. POST, July 2, 2002, at A3. Other minority farmers have also claimed that the USDA has refused to restructure their loans but has restructured loans of similarly-situated white farmers. *See, e.g.*, Jim Henderson, *Hispanic Farmers Protest Practice—Discrimination Suit Against USDA Cites Widespread Inequity*, THE HOUS. CHRON., Oct. 13, 2002, at A37; David Schaper, *All Things Considered: Native American Farmers Allege Loan Bias*, National Public Radio broadcast Nov. 22, 2006, *available at* http://www.npr.org/templates/story/story.php?storyId=6524797.

353. CRAT REPORT, *supra* note 348, at 30.

tion,[354] a recent report published by the Government Accountability Office has indicated the USDA has largely failed to establish management systems necessary to respond effectively to ongoing and serious discrimination claims.[355]

To summarize the scholarly literature on racial discrimination in real estate finance—(1) most studies to date have focused on urban residential mortgages; (2) simple tabulations of data (e.g., mortgage approvals from HMDA) always find large unconditional racial disparities; but (3) when other characteristics of the transaction, especially borrower credit histories, are included, the racial effect is mitigated and sometimes—but not always—disappears (in the sense of statistical significance). Even the best studies to date have yet to deal successfully with important issues of sample selection and endogenous, "independent" variables, so this literature remains unsettled.

Our review of discrimination in real estate transactions and real estate finance does raise the possibility that when property is sold at a forced sale, whether the forced sale involved is a taking, a partition sale, a tax sale, or some other type of forced sale, the race of the property owner may affect the sale price. At a minimum, further study should be conducted to follow up on the case studies on partition sales presented by the *Associated Press* in its *Torn from the Land* series on black land loss. These case studies suggest, but do not prove, black-owned property was sold for prices well below the forced sale prices that white property owners can expect to receive when their properties are sold at forced partition sales. Subsequent research could help determine whether the case studies the *Associated Press* utilized or the case studies of eminent domain in Madison, Wisconsin we highlighted earlier on this Article signal the existence of a more general racial pattern in which minorities suffer a "double discount" at forced sales of one type or another, which in turn would be one factor that could be contributing to maintaining the seemingly intractable racial wealth gap.

VII. CONCLUSION

Our Article has demonstrated that the scholarship and case law on forced sales of property owned by many low- to middle-class property owners under regimes such as the default rules governing tenancy in common ownership often has failed to consider the negative economic impact of such forced sales. A comparative-law perspective

354. OFFICE OF THE MONITOR, STATISTICS REGARDING *PIGFORD V. VILSACK*; TRACK A IMPLEMENTATION AS OF OCT. 13, 2009 (2009), *available at* http://www.pigfordmonitor.org/stats/stat_nat.pdf.

355. U.S. GOV'T ACCOUNTABILITY OFFICE, RECOMMENDATIONS AND OPTIONS TO ADDRESS MANAGEMENT DEFICIENCIES IN THE OFFICE OF THE ASSISTANT SECRETARY FOR CIVIL RIGHTS, GAO-09-62, at 31-32 (2008).

on forced sales in different substantive areas of the law renders visible the possible adverse economic impact of forced sales that has remained unseen and largely unaddressed when low- to middle-class property owners have their real property forcibly sold, whether under eminent domain or under partition sales. Therefore, though it may be reasonable for judges to order a forced sale in one context or another to promote certain policy objectives, such sales should not be ordered based upon an unjustifiably optimistic notion that the sales are likely to be wealth-maximizing in most instances.

This Article also highlights the manner in which the economic status of a property owner may determine the extent to which his or her real property holdings are shielded from possibly wealth-depleting forced sales. For example, as the discussion of Section 1031 like-kind exchanges involving tenancies in common revealed, those who have greater financial resources and human capital often, through private ordering, structure their property ownership in such a way as to avoid potentially economically-devastating forced sales. In addition to retaining transactional attorneys and other business professionals to help them structure ownership in the first instance, wealthier property owners also vigorously seek to protect—or even enhance—their wealth in those instances in which their property becomes subject to a forced sale. In contrast, less wealthy property owners often are not well positioned to structure their property ownership to ensure its stability or to litigate the issue of valuation in a vigorous manner to protect their wealth when their property is subjected to a forced sale.

Finally, our Article has at least raised the possibility that the race of a property owner may affect the price they can expect to receive in forced sales of real property of one type or another. Although many have studied the role that race may play in various real estate and housing markets, we raise the possibility for the first time that racial price discrimination may exist in the context of forced sales of real property. If minorities are either more at risk of having their property sold at a forced sale as a result of owning property under more unstable conditions than white property owners or if minorities suffer a "double discount" when their property is sold at a forced sale, then it would be necessary to address these issues as part of a comprehensive and concerted campaign to close the racial wealth gap.