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Robbing Peter and Blaming Paul: A Comment Explaining How Professor Robert Hockett Incorrectly Assess the Cause of the Underwater Mortgage Crisis and an Aquinian Explanation of how His Eminent Domain Solution is Neither Ethically Correct Nor Appropriate

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ROBBING PETER AND BLAMING PAUL: A COMMENT EXPLAINING HOW PROFESSOR ROBERT HOCKETT INCORRECTLY ASSESSES THE CAUSE OF THE UNDERWATER MORTGAGE CRISIS AND AN AQUINIAN EXPLANATION OF HOW HIS EMINENT DOMAIN SOLUTION IS NEITHER ETHICALLY CORRECT NOR APPROPRIATE

By Cooper Morgan Walker†

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I. INTRODUCTION

After many years of a booming, highly profitable housing market, in late 2008 the United States experienced the largest price drop in homes in the nation's history.¹ U.S. home values plummeted by almost 30% in October of 2008.² This drop was almost double the number registered in the United States during the Great Depression.³ Many experts believe that the bursting of the housing bubble was the catalyst for the recession that originated at the same time.⁴ Since the housing crisis, many proposals have been set forth attempting to provide a solution for the crisis the United States faces. However, no proposal has created such a buzz, or has been so well received, as that of Robert Hockett.⁵ Hockett is a Professor of Law at Cornell Law School whose principal teaching, research, and writing interests lie in the fields of organizational, financial, and monetary law and economics.⁶

Hockett's solution to the underwater mortgage crisis contains many complexities. One of the purposes of this Comment is to adequately explain those complexities. However, this will be done with a bigger purpose in mind—to prove that Hockett's solution is not an ethically correct or appropriate solution for the current crisis. A more detailed explanation of Hockett's proposal is contained in part II of this Comment, but the fundamental idea that Hockett puts forth is as follows.

First, Hockett suggests that local municipalities use their eminent domain power to take underwater mortgages from banks at a price

1. Alan Libel, *Home Price Index Posts Largest Drop in 17-Year History*, USA TODAY, http://usatoday30.usatoday.com/money/economy/housing/2008-05-22-home-prices-drop_N.htm (last updated May 22, 2008).

2. Carmen M. Reinhart & Kenneth S. Rogoff, *The Aftermath of Financial Crises* 4 (Nat'l Bureau of Econ. Research, Working Paper No. 14656, 2009), http://www.nber.org/papers/w14656.pdf?new_window=1.

3. *Id.*

4. Jeff Holt, *A Summary of the Primary Causes of the Housing Bubble and the Resulting Credit Crisis: A Non-Technical Paper*, 8 THE JOURNAL OF BUSINESS INQUIRY 120 (2009), <http://www.uvu.edu/woodbury/docs/summaryoftheprimarycauseofthehousingbubble.pdf>.

5. The Century Foundation, *Robert C. Hockett-Fellow*, <http://tcf.org/experts/detail/robert-c.-hockett> (last visited Aug. 21, 2014) (explaining Professor Hockett's biography to those unfamiliar with his work).

6. *Id.*

that would “justly compensate” the banks.⁷ “Just compensation” would equal the fair market value of the home in the current housing market.⁸ These mortgages would then be bought by private investors who would in turn begin receiving the homeowner’s mortgage payment.⁹ These private investors are incentivized by a profit that is “created” as a result of the deal.¹⁰ Then, in the end, those with underwater mortgages are provided with a new mortgage that is equal to the value of their home in the present market.¹¹

Hockett’s proposal has produced much debate. There are schools of people eager to either defend or devour his solution.¹² Whether the proposal will be productive in an economic sense and whether the proposal is constitutional has been of much debate in recent months.¹³ While both of these issues should be determining factors in deciding whether to implement the solution, the two issues are both beyond the scope of this Comment. The purpose of this Comment is to address Hockett’s proposal from an ethical perspective. Although the economic and constitutional consequences of Hockett’s proposal are still highly in debate, there seems to be a lack of ethical reflection on the issue. As a prospective attorney, the Author understands that legal issues are based on the law rather than on what is “ethical” or what is “right.” However, when determining what the law should be or what the current law is meant to express, it is important to look at the matter from an ethical perspective.

The Author’s purpose is to show the American community—and specifically the legal community—how and why Hockett’s proposal is not an ethically correct or appropriate solution for the underwater mortgage crisis. To achieve this end, the Author will give a detailed explanation of Professor Hockett’s proposal in Part II. Next, the Author will set forth Hockett’s explanation of what caused the underwater mortgage crisis in Part III. In Part IV the Author will provide his

7. Robert Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, 18 STAN. J.L. BUS. & FIN. 121, 150–51 (2013).

8. *Id.*

9. *Id.*

10. See generally Robert Hockett, *Paying Paul and Robbing No One: An Eminent Domain Solution for Underwater Mortgage Debt*, Fed. Reserve Bank of N.Y., 19 Current Issues in Econ. and Fin. No. 5, 2013, http://www.newyorkfed.org/research/current_issues/cil9-5.pdf.

11. Hockett, *supra* note 7, at 151.

12. See generally Rachel D. Godsil & David V. Simunovich, *Protecting Status: The Mortgage Crisis, Eminent Domain, and the Ethic of the Homeownership*, 77 FORDHAM L. REV. 949 (2008); David A. Dana, *The Foreclosure Crisis and the Anti-Fragmentation Principle in State Property Law* (Nw. Univ. Sch. of Law Scholarly Commons, Working Paper No. 186, 2009); Andrew Peace, *Coming Up for Air: The Constitutionality of Using Eminent Domain to Condemn Underwater Mortgages*, 54 B. C. L. REV. 2167 (2013).

13. A quick Google search will provide numerous articles on whether Hockett’s plan is economically sound or constitutional.

own belief on what the cause of the underwater mortgage crisis is. Then, after showing how Hockett does not assess the cause of the underwater mortgage crisis correctly, the Author will then show the reader how Hockett's solution is not ethically appropriate in Part V. This Comment will evaluate the ethical resolve of Hockett's solution using the legal philosophy of St. Thomas Aquinas. However, the Author is confident that if the reader is willing to inspect Hockett's solution against the facts of what created the underwater mortgage crisis, the reader will then develop an intuitive sense for why Hockett's solution is neither ethically correct nor appropriate.

II. ROBERT HOCKETT'S EMINENT DOMAIN SOLUTION

Robert Hockett's eminent domain solution contains many detailed complexities that are beyond the scope of this Comment. However, to understand the overall message of this Comment, the fundamental idea of Hockett's solution must be understood. This Section will explain Hockett's proposal only to the extent needed to lay a foundation for the ultimate purpose of this Comment—to show both how and why Hockett's proposal is not an ethically correct or appropriate solution to the underwater mortgage crisis. Also, it must be remembered that Hockett's solution requires action at the municipal level. Therefore, this general overview cannot and does not attempt to explain nuances between what one municipality may choose to do in comparison to another municipality. Rather, this Section is intended to explain the general similarities that will be carried out by any municipality that chooses to implement Professor Hockett's proposal.

As explained, the first step in Hockett's proposal asks local municipalities to use their eminent domain power to take the underwater mortgages from banks that own the underwater mortgages.¹⁴ The banks must then be "justly compensated." In other words, the banks must be given the fair market value of the homes under the current housing market.¹⁵ On a related note, Hockett views this issue as being locally based in that certain areas of the United States have been and are being affected by this crisis much more than other areas.¹⁶ Therefore, Hockett believes that local municipalities are much better qualified to address the problem than the federal government is, and he believes that these municipalities should implement Hockett's solu-

14. Hockett, *supra* note 7, at 150–51.

15. See Robert Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, 18 STAN. J.L. BUS. & FIN. 121, 151–52 (2013).

16. *Id.* at 152.

tion.¹⁷ One benefit of a local solution is that it would allow for municipalities to tailor their plans to their local circumstances.¹⁸

In order to purchase these mortgages, municipalities deposit investor-supplied funds in state-administered escrow accounts maintained only for this purpose.¹⁹ The amount deposited, as mandated by law, equals the probable just compensation ultimately to be paid for the condemned mortgages.²⁰ Probable just compensation is determined via municipality-procured appraisals.²¹ Once the underwater mortgages are acquired, each municipality, in cooperation with the private investors, comes to an agreement on the amount the homeowners pay the private investors for the mortgage.²² This agreement is made pursuant to criteria commonly employed by ordinary market lenders like the Federal Housing Administration.²³

In the end, this process results in providing those with underwater mortgages with a new mortgage rate that is much closer to the value of their mortgage in today's market as opposed to what their mortgage was worth at the time when the individual purchased the home.²⁴ In theory, this is a great idea. However, the Author proposes that while Hockett's solution may be theoretically sound, it lacks the ability to be practically sound or ethically appropriate.

III. ROBERT HOCKETT'S EXPLANATION OF WHAT CAUSED THE CRISES AND THE REASONING FOR HIS SOLUTION

In order for a person to make an educated decision that Hockett's proposal is not the ethically correct or appropriate solution for the underwater mortgage crisis, two issues must be understood. First, the fundamentals of Hockett's solution must be understood. This has been discussed in Part II of this Comment. The second issue that must be understood is Professor Hockett's perception of the problem and the reasoning he employs to account for his solution. Once this has been explained, the framework will have been laid to show how Hockett's proposal is neither an ethically correct nor appropriate solution to the underwater mortgage crisis.

Professor Hockett believes that the current underwater mortgage crisis was created by individuals who were acting rationally.²⁵ Hockett claims that because these individuals were acting in a rational manner,

17. *Id.*

18. Robert Hockett & John Vlahoplus, *A Federalist Blessing in Disguise: From National Inaction to Local Action on Underwater Mortgages*, 7 HARV. L. & POL'Y REV. 253, 268 (2013).

19. Hockett, *supra* note 7, at 154.

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.* at 151.

25. Hockett, *supra* note 7, at 138.

the housing crisis was unavoidable absent major Federal intervention.²⁶ While Federal intervention certainly could have helped the current underwater mortgage crisis, the crisis should not have been preventable only through Federal intervention. Hockett also asserts that when looking at all the concerned parties of the underwater mortgage crisis, each party made blameless decisions with the possible exception of the central bank.²⁷ Hockett further explains that the act of parties acting in a financially defensible manner is what enabled the bubble to form.²⁸ As expressed by him, Professor Hockett holds that to attempt to identify and hold accountable the responsible parties is a frivolous pursuit.²⁹

Finally, Hockett states that rather than wasting time pointing the finger at anybody—home buyer, lender, or market investor—what the country should really focus on is the need to clean up the present wreckage.³⁰ Professor Hockett believes that the individuals who created the problem are no better positioned collectively to fix the problem than they were to create it.³¹ To best show how Professor Hockett views the current crisis and how he proposes solving it, the Author provides the following quote from Hockett.

It should be kept in mind in considering the foregoing [solution] that the purpose of the [solution] is not to bail out the borrower; the policy analysis does not depend on the morality of the borrower's or the lender's prior actions in taking or making a toxic mortgage loan. The purpose is to save the neighbor, the community, and the city itself³²

While what Hockett is attempting to accomplish is admirable, the Author believes that Hockett's perception of the underwater mortgage crisis does not fully explain the causation of the crisis. The following Section will be devoted to explaining that there is actually a specific reason for the collapse of the housing market. This should bring light to how and why Hockett's solution is not an ethically correct or appropriate solution to the underwater mortgage crisis.

IV. THE AUTHOR'S EXPLANATION OF WHAT CAUSED THE CURRENT UNDERWATER MORTGAGE CRISIS

During the significant period of time devoted to reading Professor Hockett's writings concerning his solution to the underwater mortgage crisis, the Author became troubled by what he could not find. Specifically, the Author was never able to find a full and adequate

26. *Id.*

27. *Id.* at 132.

28. *Id.*

29. *Id.* at 130.

30. Hockett, *supra* note 7, at 130.

31. *Id.*

32. Hockett, *supra* note 18, at 267.

description of the underwater mortgage crisis—one that fully explains both the causes and reveals the culprits of the crisis. As clarified above, Hockett has expressed that the mortgage crisis was inevitable and based on people making financially rational decisions.³³ The Author must disagree. In fact, the Author strongly disagrees. Therefore, the Author will now attempt to show the true catalyst of the underwater mortgage crisis.

Unfortunately, there is still much debate over what exactly caused the mortgage crisis of 2008. However, this outside debate does not shake the Author's belief that he can show, at the very least, the chief component that created the crisis. Furthermore, the Author also believes that Hockett's solution becomes clearly inappropriate from an ethical standpoint once the chief cause of the underwater mortgage crisis becomes apparent. Thus, the Author will now show that the crisis is largely attributable to the deregulation of the financial market that began in the early 1970s and the many horrific consequences that followed as a direct result of this deregulation.³⁴

A. *A Brief History of What Led to the Crisis*

In the aftermath of the Great Depression, it was nearly universally believed that unregulated financial markets were inherently unstable, subject to fraud and manipulation by insiders, and capable of causing great economic crisis and political and social unrest.³⁵ Therefore, in order to protect the country from these dangers, in the mid-1930s the United States government created a strict financial regulatory system that was largely kept in place through the 1960s.³⁶ This new model was based on the economic philosophies of Maynard Keynes and Hyman Minsky.³⁷ Their ideas generated a change in the American policy perspective of financial markets that was supportive of tight financial market regulation.³⁸

Then, the financial turbulence felt in the 1970s and early 1980s led to another policy regime shift concerning financial market regulation.³⁹ Efficient financial market theory and new classical macro theory began to replace the conservative Keynesian and Minskian views.⁴⁰ The existing system of tight financial market regulation was

33. See Robert Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, 18 STAN. J.L. BUS. & FIN. 121, 138 (2013).

34. James Crotty, *Structural Causes of the Global Financial Crisis: A Critical Assessment of the 'New Financial Architecture'*, 33 CAMBRIDGE JOURNAL OF ECONOMICS 563 (2009), <http://cje.oxfordjournals.org/content/33/4/563.full.pdfhtml>.

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.* at 563–64.

39. Crotty, *supra* note 34, at 564.

40. *Id.*

thus deconstructed through radical deregulation that was pushed by financial institutions that were justifying this new and efficient market theory.⁴¹ These developments then led to the current globally-integrated, deregulated financial market.⁴²

B. *The Creation of the Crisis*

By the time George W. Bush took office in 2001, the United States financial sector was more powerful than ever before due to the creation of derivatives⁴³ and the inability to regulate these derivatives because of the shift in American financial market theory.⁴⁴ During this time there were five investment banks (Goldman Sachs, Morgan Stanley, Lehman Brothers, Merrill Lynch, and Bear Stearns), two financial conglomerates (Citigroup and JP Morgan) and three credit rating agencies (Moody's, Standards & Poor's, and Fitch) were dominating the financial industry.⁴⁵

The driving force behind these companies was a newly created derivative named a Collateralized Debt Obligation, or "CDO."⁴⁶ These CDOs are a collection of mortgage-backed securities and other loans including car loans, corporate debt, credit-card debt, etc.⁴⁷ Once the CDOs are created, they are then sold to investors so that banks can quickly recover the money they just distributed for the loans.⁴⁸

In the old system of Keynes and Minsky, when a homeowner made his or her mortgage payment every month, this payment went back to whomever the homeowner borrowed the money from—usually the bank.⁴⁹ These lenders were in turn very careful about whom they loaned money to.⁵⁰ This caution was only exacerbated by the fact that mortgages take decades to pay back.⁵¹

41. *Id.*

42. *Id.*

43. Tomáš Křížek, Legal Nature and Definition of Financial Derivatives (Oct. 24, 2011) (unpublished manuscript), available at <http://ssrn.com/abstract=1948686>.

44. Vania Stavlakeva, *Derivative Regulation—Why Does It Matter?*, FORBES (Sept. 24, 2013), available at <http://www.forbes.com/sites/lbsbusinessstrategyreview/2013/09/24/derivative-regulation-why-does-it-matter/>.

45. INSIDE JOB (Sony Pictures Classics 2010) (a paginated copy of the transcript to this Academy Award winning documentary can be found at http://www.sonyclassics.com/awards-information/insidejob_screenplay.pdf) (the following citation can be found on page 22 of the transcript).

46. *Id.* at 23.

47. Kay Giesecke & Baeho Kim, *Risk Analysis of Collateralized Debt Obligations*, 59 OPERATIONS RESEARCH 32 (2011), <http://biz.korea.ac.kr/~baehokim/research/riskanalysis.pdf>.

48. Ernest N. Biktimirov & Don Cyr, *Using Inside Job to Teach Business Ethics*, 117 J. BUS. ETHICS 209, 210 (2013).

49. INSIDE JOB, *supra* note 45, at 23.

50. *Id.*

51. *Id.*

However, in the new system, lenders sell mortgages to investment banks such as those listed above.⁵² Then, these investment banks pay the rating agencies to evaluate the CDOs and determine whether buying a particular CDO would be a good investment.⁵³ After receiving a grade, these CDOs are then sold by the investment banks to private investors.⁵⁴ Thus, in today's system, when homeowners pay their mortgages the money travels to investors across the globe.⁵⁵ This, in turn, means that money cannot be followed and monitored like it was in days past.

It is easy to see why this new deregulated financial market system quickly became a ticking time bomb. The new system created a structure that allows the lenders, grading agencies, and investment banks to work exclusively and symbiotically toward their own financial advantage without any regulation of, or consequences for, poor lending, poor grading, or poor investing.⁵⁶ Lenders no longer have to worry about whether borrowers can or will repay them because the lenders know that the mortgage will be bought by an investment bank.⁵⁷ The lenders know that the mortgage will be purchased by an investment bank because the more CDOs the investment banks sell to private investors the higher the investment bank's profits will be.⁵⁸ The investment bank knows that they will be able to sell their CDOs to investors because the investment bank pays the rating agency, and if the investment bank is not getting AAA ratings (the highest rating possible) for their CDOs then the investment banks can simply choose another grading agency to work with. This practice is possible because grading agencies have no liability if their ratings of a CDO prove incorrect.⁵⁹ Therefore, again, the United States financial market has eventually become so unregulated that it now allows lenders, grading agencies, and investment banks to act in their own self-interest, without consequence, and at the expense of our society. This deregulation created what the media calls "the bubble," or, what should really be

52. *Id.*

53. William Alden, *Rating Agencies Repeatedly Caved to Banks' Demands and Helped Cause Crisis, Report Finds*, HUFFINGTON POST, http://www.huffingtonpost.com/2011/04/14/rating-agencies-financial-crisis_n_849410.html (last updated June 14, 2011).

54. Biktimirov, *supra* note 48, at 210.

55. INSIDE JOB, *supra* note 45, at 23.

56. Alissa Brunetti, *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse 2*, http://www.trustinorganizations.com/Resources/Documents/Wall_Street_and_the_Financial_Crisis_Anatomy_of_a_Financial_Collapse_-_Alissa_Brunetti_upload.pdf.

57. INSIDE JOB, *supra* note 45, at 23.

58. *Id.*

59. *Id.*

known as: the complete and total fabrication of the price of a group of assets (CDOs) that is not justified by the actual price of those assets.⁶⁰

Martin Wolf, Chief Economics Commentator of *The Financial Times*, described the current financial market system as not creating real profits or real income.⁶¹ Wolf further stated that money is simply being created by the system, and that in retrospect the system is a global Ponzi scheme.⁶²

C. *The Consequences of the Crisis, Including Those Going Without Consequence*

Once the country realized there was not as much money in the system as alleged by those who created the underwater mortgage crisis, on October 4th, 2008, President Bush signed a \$700 billion dollar bailout bill that would in essence put real currency into the financial market made of fraudulent monetary reports.⁶³ In other words, hundreds of billions of dollars were given to the various companies listed at the beginning of this Section—the same companies that not only crippled the American housing market but also the global economy.⁶⁴ And, in what seems to be an adding insult to injury fashion, the top five executives at Lehman Brothers made over a billion dollars between 2000 and 2007.⁶⁵ Then, once the firm went bankrupt, the executives were somehow allowed to keep all of this money.⁶⁶ In like fashion, Stan O'Neil, the CEO of Merrill Lynch, received \$90 million in 2006 and 2007 alone.⁶⁷ Then, after driving the firm into the ground, Merrill Lynch's board of directors allowed O'Neil to resign and collect \$161 million in severance.⁶⁸

In the five years following the financial collapse, not one executive from any of these financial institutions have been criminally charged.⁶⁹ Not one. There is no denying that those who created the financial crisis that began in late 2008 have had little to no consequences for driving the economy into the ground.⁷⁰ It should be noted that over the last decade the financial services industry has made roughly \$5 billion dollars' worth of political contributions to the

60. NASDAQ, <http://www.nasdaq.com/investing/glossary/e/economic-bubble> (last visited Feb. 28, 2014).

61. INSIDE JOB, *supra* note 45, at 25.

62. *Id.* at 26.

63. Dina Temple-Raston, *Bush Signs \$700 Billion Financial Bailout Bill*, NPR, <http://www.npr.org/templates/story/story.php?storyId=95336601> (last updated Oct. 8, 2008).

64. INSIDE JOB, *supra* note 45, at 53.

65. *Id.* at 56.

66. *Id.*

67. *Id.*

68. *Id.*

69. Biktimirov, *supra* note 48, at 212.

70. *Id.*

United States.⁷¹ The Author has no proof that these contributions play a factor in why these executives have had no criminal charges brought against them, but one may speculate that a \$5 billion contribution could be the cause.

D. *Why Robert Hockett's Explanation of the Crisis is Inadequate*

After this explanation of what the deregulation of the American financial market has done to cause the underwater mortgage crisis, there should now be a clear distinction between how Professor Hockett describes the collapse of the housing market as opposed to the Author's explanation of the collapse. Professor Hockett *barely* acknowledges the deregulation of the American financial market and how deregulation was a major, if not the complete, catalyst for the current underwater mortgage crisis.⁷² Furthermore, while only devoting two paragraphs to the deregulation of the American financial market, Hockett spends approximately ten pages attempting to explain that the underwater mortgage crisis is the result of "rational thinking."⁷³

That Hockett did not adequately address the cause of the current underwater mortgage crisis is the primary reason why the Author chose to address this topic. The Author can find no reason why Hockett would purposely withhold this information from the public—a public who looks to experts such as Professor Hockett to provide them with the information necessary to make an informed decision about the current underwater mortgage crisis.

Unfortunately, the average person is not equipped with the information required to decipher whether Professor Hockett has fully addressed the causes that crippled the housing market. This is why the Author finds it so important to pass the correct information along to the general public. The Author would like to assume that Professor Hockett did not think it necessary to address this issue in more detail. Alternatively, maybe Hockett did not think that an explanation such as that just given would be important when deciding the best route to take in rescuing the country from the underwater mortgage crisis. However, this does not seem to be the case. Whether due to oversight or ulterior motives, Professor Hockett egregiously omits information that is paramount to understanding the crisis and in determining an ethical and proper solution. When the full cause of the crisis is disclosed, Professor Hockett's solution cannot and will not be born by an informed public. If the government chooses to deal with the current underwater mortgage crisis by placing the blame where it belongs,

71. INSIDE JOB, *supra* note 45, at 60.

72. See Robert Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, 18 STAN. J.L. BUS. & FIN. 121, 126 (2013).

73. *Id.* at 126–136.

forcing those individuals to be liable for their actions, then Professor Hockett's solution will no longer be viable.

E. *How Robert Hockett's Explanation of the Crisis is Inadequate*

As explained earlier, Professor Hockett asserts that the underwater mortgage crisis was created by unavoidable, financially rational decision-making.⁷⁴ It should now be clear that this is untrue.⁷⁵ In fact, Hockett's statement is in direct opposition to the real cause of the current underwater mortgage crisis. The executives at these financial institutions clearly knew what they were doing⁷⁶, and the situation certainly could have been avoided if there was any practical regulation of the American financial markets.⁷⁷ More than that, the underwater mortgage crisis could have been avoided if these executives at the lending institutions, grading agencies, and investment banks did not knowingly decide to act in their own financial self-interest with no concern for the economic well-being of the rest of the nation.⁷⁸

Another issue that becomes clear after learning how and why the financial market collapsed is the fact that one logical solution to the problem—to hold the lending institutions, grading agencies, investment banks, and their executives responsible for the problem that they created—has not been implemented.⁷⁹ Within Bank of America, Wells Fargo, Bear Stearns, Citigroup, Goldman Sachs, and J.P. Morgan, just to name a few, not one senior officer has been sued to date.⁸⁰ One of the many reasons why Professor Hockett's solution is not an ethically correct or appropriate solution to the underwater mortgage crisis is because it does not hold accountable the people who created the underwater mortgage crisis. However, this is certainly not the only reason.

F. *The Financial Crisis Inquiry Commission's Opinion*

The Financial Crisis Inquiry Commission was created under the Fraud Enforcement and Recovery Act that was passed by the United States Congress and signed by President Obama in May of 2009.⁸¹ This ten-member panel was composed of private citizens with experience in the areas of housing, economics, finance, market regulation,

74. *Id.* at 126–138.

75. Reference the sub-section “*Creation of the Crisis.*”

76. THE FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT xxii (2011) <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf> [hereinafter *Crisis Report*].

77. *Id.* at xviii.

78. *Id.* at xxii.

79. See generally Ernest N. Biktimirov & Don Cyr, *Using Inside Job to Teach Business Ethics*, 117 J. BUS. ETHICS 209, 212 (2013).

80. *Id.*

81. *History of the Commission*, FINANCIAL CRISIS INQUIRY COMMISSION, <http://fcic.law.stanford.edu/about/history> (last visited Feb. 7, 2014).

banking, and consumer protection.⁸² Six of the Commission's members were appointed by the Democratic leadership of Congress and four by the Republican leadership.⁸³ The Commission's statutory instructions contained twenty-two specific issues that should be investigated, and it asked the commission to examine the collapse of the major financial institutions that failed or would have failed if not for the \$700 billion bail-out bill.⁸⁴

In their final report published in January of 2011, the Financial Crisis Inquiry Commission used variations of the "fraud" at least 157 times when describing what caused the crisis.⁸⁵ The Commission concluded that there was a "systemic breakdown," not just in accountability, but also in ethical behavior.⁸⁶ Furthermore, the Commission found the signs of fraud everywhere, and the number of reports of suspected mortgage fraud rose twenty-fold between 1998 and 2005 and then doubled again the next four years.⁸⁷ The Commission reached nine main conclusions that it published in *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States*,⁸⁸ some of which will now be quoted:

We conclude this financial crisis was avoidable . . . We conclude a combination of excessive borrowing, risky investments, and lack of transparency put the financial system on a collision course with crisis . . . We conclude there was a systematic breakdown in accountability and ethics . . . We conclude collapsing mortgage-lending standards and the mortgage securitization pipeline lit and spread the flame of contagion and crisis . . . We conclude the failures of credit rating agencies were essential cogs in the wheel of financial destruction.⁸⁹

Another reason why Hockett's solution is troublesome is that while the Financial Crisis Inquiry Commission—a commission elected by the United States Congress for the purpose of determining the cause of the financial collapse—is quoted as saying that the underwater mortgage crisis was avoidable⁹⁰, Professor Hockett claims the complete opposite.⁹¹ Hockett specifically states that it was "rational and

82. *Id.*

83. *Id.*

84. *Id.*

85. Jed S. Rakoff, *The Financial Crisis: Why Have No High Level Executives Been Prosecuted?*, N.Y. REV. OF BOOKS (Jan. 9, 2014), <http://www.nybooks.com/articles/archives/2014/jan/09/financial-crisis-why-no-executive-prosecutions/>.

86. *Id.*

87. *Id.*

88. CRISIS REPORT, *supra* note 76, at xvii-xxv.

89. *Id.*

90. *Id.* at xvii.

91. See Robert Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, 18 STAN. J.L. BUS. & FIN. 121, 138 (2013).

indeed unavoidable . . . for individual market actors to enter into transactions that ultimately aggregated into the bubble.”⁹² Yet, the Commission explains that mortgages were being falsely attributed creditworthiness that then became the sole collateral for highly leveraged securities.⁹³ These securities were then marked to have the highest credit rating possible given by the credit rating agencies.⁹⁴ Therefore, after the Committee explained that mortgages were given completely fabricated creditworthiness, Professor Hockett attempts to convince the general public that the crisis was unavoidable and was created by rational decision-making.

V. HOW ROBERT HOCKETT’S SOLUTION IS NOT AN ETHICALLY CORRECT SOLUTION ACCORDING TO THE LEGAL PHILOSOPHY OF ST. THOMAS AQUINAS

A significant portion of this Comment has been devoted to explaining the lack of ethical decision-making that created the current underwater mortgage crisis and to explaining the solution Professor Hockett poses to fix the problem. Moreover, as explained early in this Comment, this was done in order to set up the main purpose of this Comment—to show how and why Professor Hockett’s solution is not an ethically correct or appropriate solution to the underwater mortgage crisis. While it is important that a problem of this magnitude be solved quickly and efficiently, it is most important that the *correct* solution be applied to the problem. The Author argues that for a solution to be *correct*, it must also be ethical. This is not the only characteristic of a correct solution; however, it is an important characteristic in determining a solution. Thus, this ethical characteristic is the focus of this Comment. The purpose of this Section is to adequately explain why Professor Hockett’s solution is not an ethically correct solution to the underwater mortgage crisis. To achieve this end, the Author will utilize the legal philosophy of St. Thomas Aquinas.

The legal philosophy of St. Thomas Aquinas, while complex, is grounded in basic principles that can be universally understood and applied to any situation. This, in large part, is what motivated the Author to use Aquinas’s legal philosophy to demonstrate how and why Hockett’s solution is not ethically sound. Specifically, the Author will be utilizing Aquinas’s definition of justice. The simplicity of Aquinas’s definition of justice is helpful in that it can be applied to any situation. The Author’s purpose in this Section is to explain Aquinas’s definition of justice, to practically apply this definition of justice to the underwater mortgage crisis, and, through the application of

92. *Id.*

93. Rakoff, *supra* note 85, at 4.

94. *Id.*

Aquinas's definition of justice, to prove that Professor Hockett's solution is not ethically sound.

A. *An Explanation of St. Thomas Aquinas's Definition of Justice*

For Aquinas, justice is one of the four Cardinal Virtues, or moral virtues, of which the other three are prudence, temperance, and courage.⁹⁵ Aquinas claims that the virtue of justice governs a person's relationship with others.⁹⁶ Specifically, justice entails a constant willingness to extend to each person what he or she deserves.⁹⁷ While Aquinas's description of justice contains much complexity that is beyond what is necessary for this Comment, it should be acknowledged that Aquinas alludes to a bifurcated explanation of justice—justice in relation to the individual and justice in relation to the community.⁹⁸

Justice in relation to the community is what Aquinas defines as legal justice.⁹⁹ In short, Aquinas states that the purpose of legal justice is to govern a person's actions according to the common good of the community.¹⁰⁰ Interpreted this way, legal justice is a virtue that concerns not individual benefits but the welfare of the community.¹⁰¹ Furthermore, each member of the community relates to that community as a part relates to a whole—the part being the individual and the whole being the community.¹⁰² Thus, it logically follows that anything that affects an individual in a community also affects the community as a whole. Likewise, the actions of the individual in the community can and will effect the community as a whole. Thus, again, that which is focused on the common good of the community is defined as being legally just according to Aquinas.¹⁰³ The Author will now show that Hockett's solution is not ethically correct nor appropriate because it is not in the best interest of the American community.

B. *Robert Hockett's Solution Does Not Treat the Cause of the Underwater Mortgage Crisis at its Source*

Every solution is created in order to repair a problem. In order for the problem to be repaired, the problem must be properly assessed. If a problem is not properly assessed, then the solution created from this

95. 2 St. Thomas Aquinas, *Summa Theologica*, Q. 61 Art. 2, at 846–47 (Fathers of the English Dominican Province trans., rev. ed. 1920, reprt. Christian Classics 1981) (c. 1274).

96. 3 St. Thomas Aquinas, *Summa Theologica*, Q. 57 Art. 1, at 1425 (Fathers of the English Dominican Province trans., rev. ed. 1920, reprt. Christian Classics 1981) (c. 1274).

97. *Id.*, Q. 58 Art. 1, at 1429.

98. *Id.*, Q. 58 Art. 5, at 1431–32.

99. *Id.*

100. *Id.*, Q. 58 Art. 6, at 1432–33.

101. *Id.*

102. Aquinas, *supra* note 96, Q. 58 Art. 5 at 1431–32.

103. *Id.*, Q. 58 Art. 5 at 1432–33.

assessment will not be very useful, nor will it solve the problem. Additionally, every problem seeks a permanent solution. If a problem is to be permanently solved, the solution must attack the problem at the problem's source. Therefore, if a solution does not attack a problem at its source, then the problem always has the chance of resurfacing and is not a true, permanent solution. A solution that is incapable of eliminating a crisis due to a lack of understanding the root cause of the crisis is unlikely to prevent the recurrence of that same crisis. This sort of "solution" is clearly not in the best interest of the American community.

Therefore, since it has been shown that Professor Hockett's assessment of how the mortgage crisis was created is incorrect,¹⁰⁴ and if it can now be shown that his solution does not seek a permanent solution, then it will quickly become clear that Hockett's solution is incapable of ensuring that the crisis disappears; and a solution that is incapable of ensuring that the crisis disappears cannot be what is in the best interest of the community.

If a permanent solution to a problem is desired, then the most logical approach to solving the problem is to fix the problem where it originated. While it might take less time and/or resources to simply clean up the mess that the problem created, this will not create a permanent solution. The common good of the community might temporarily benefit from a "quick fix," but the common good of the community will benefit much more from a permanent solution. There may be certain situations where a community may decide that it would be more economically advantageous for the community to opt for the quick fix rather than the permanent solution; however, the Author does not find it to be a stretch to say that a permanent solution is what is needed for the underwater mortgage crisis.

Imagine a community of homeowners. Since moving in, each homeowner has noticed that his or her pipe underneath their master bathroom sink leaks in the middle of the night for an unknown reason. One solution is for each community member to hire Sam's Water Clean Up to come to his or her house every afternoon to clean up the water from the leaking pipes. While inefficient, this is a solution insofar as each homeowner will come home from work each evening to find a bathroom floor that is free of water. However, the better, permanent solution is to treat the problem at its source by fixing or repairing the pipe so that the leaking no longer occurs. While the former option is a temporary solution that must be applied over and over again, the latter is capable of resolving the problem permanently. Furthermore, by completely removing the problem the community will no longer have to continuously deal with the problem, will not have to spend unnecessary money on Sam's Water Clean Up, and will

104. Refer to pages 8–20 of this note.

not risk any further damage that could be created from the bathroom sink and floor being consistently wet.

Professor Hockett's solution to the underwater mortgage crisis is similar to hiring Sam's Water Clean Up rather than assessing and fixing the root cause of the problem and eliminating the recurrence of the leak. Hockett's solution does not provide a permanent solution to the underwater mortgage crisis; in fact, it clearly leaves the American people at risk for another crisis to occur. For example, Professor Hockett's solution does not call for any of the criminal or civil measures against these financial institutions.¹⁰⁵ Why would these individuals change their behavior if they know they will face no consequences for their actions? The good of a community is not served when people are able to freely commit crimes without consequence.

Furthermore, Hockett suggests that it is unimportant to try and find the cause of the current underwater mortgage crisis.¹⁰⁶ This theory is problematic because the good of a community is not served when that community does not attempt to uncover the origin of its mistakes. It is difficult to prevent a leak from repeatedly occurring without first accurately determining the root cause of the leak and then making repairs to ensure the initial cause of the leak does not return. To benefit the entire United States community, actions must be taken to eliminate the root cause of the underwater mortgage crisis in order to drastically decrease the likelihood of a recurrence. The fact that Professor Hockett's solution does not address the issue in a way that would prevent the crisis from happening again is one of the many reasons why it is unethical and not in the best interest of the American community. What is in the best interest of the United States community is to implement a solution to the underwater mortgage crisis that addresses the crisis at its origin and ensures that it can never occur again.

C. *Robert Hockett's Solution Does Not Hold Those Who Created the Underwater Mortgage Crisis Accountable*

The fact that no executives have been held criminally or civilly liable for their actions, coupled with the fact that Hockett does not find this to be an issue, is further reason why Professor Hockett's solution is not in the best interest of the American community. As suggested, this issue will be dealt with in two prongs. First, the issue of why there is currently no incentive for the executives of these financial institutions to change their behavior will be addressed. Second, the issue of why there is a lack of civil suits being filed against the executives of

105. See generally Robert Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, 18 STAN. J.L. BUS. & FIN. 121 (2013).

106. Hockett, *supra* note 7, at 130.

these companies will be addressed. And, again, the fact that both of these issues are not issues for Hockett provides more reason why his solution is not in America's best interest.

1. Criminal Liability

If a permanent solution to the underwater mortgage crisis is really desired, then it logically follows that one of the goals of the solution must be to prevent the crisis from occurring again. However, there is currently no reason for the executives who caused the underwater mortgage crisis to exhibit behavior different than the behavior that caused the current crisis. As explained, not one executive to date is facing criminal charges for his or her actions.¹⁰⁷ This poses a significant problem. If there is no reason for these individuals to act differently, then there is nothing preventing history from repeating itself. Frankly, there is little reason to attempt to solve the crisis if it is practically inevitable that the crisis will occur again.

Hockett's solution is not in the best interest of the community because it specifically avoids punishing the culprits.¹⁰⁸ In fact, Hockett says that assessing blame is a waste of time.¹⁰⁹ This could not be further from the truth about what is needed to solve the crisis. It is obviously in the best interest of the American community to implement a solution that will permanently solve the problem, and to do this the culprits must be identified and sufficiently punished. It is a futile exercise to clean up a mess that will almost certainly be created again, and if these executives are not held accountable then they have no reason not to continue exhibiting the same behavior. Furthermore, this can lead others to view this as acceptable behavior because they see it going unpunished. The ethically correct course of action to take is to ensure that something like this never happens again. Professor Hockett's solution does not provide this assurance.

2. Civil Liability

Another logical method of dealing with this crisis is to hold these executives civilly liable. Our civil justice system is based on the principle that when person or entity X harms person or entity Y, X should be responsible for compensating for the damages incurred by Y. Yet, somehow this method of justice has not been applied to the culprits of the current underwater mortgage crisis. Furthermore, Hockett does not mention this type of solution anywhere in his writings. As explained, Hockett says that the focus should not be placed on pointing fingers but rather focusing on cleaning up the current wreckage.¹¹⁰

107. Biktimirov, *supra* note 48, at 212.

108. Hockett, *supra* note 7, at 130.

109. *Id.*

110. *Id.*

As if the lack of criminal charges facing corporate executives was not enough, the top five executives at Lehman Brothers made over a billion dollars between 2000 and 2007, and these individuals were able to keep all of this money.¹¹¹ Stan O'Neil, the former CEO of Merrill Lynch, was able to walk away from a company that was driven into the ground with a severance package valued at \$161 million.¹¹² Again, one of the most baffling aspects of the underwater mortgage crisis is the fact that these executives were able to walk away from the damage they caused without any criminal consequence and without being required to put the money that they earned unethically back into the housing market.

The Author will not attempt to determine a hypothetical dollar amount for which these executives might have been charged in a civil suit; and even if a civil suit had taken place and the judgment had been in the billions of dollars, there is no way to know if this would have been able to save the country from the underwater mortgage crisis and the economic collapse that followed. What is highly probable is that if such a suit had taken place and the culprits were charged according to the damage caused, the likelihood of a recurrence would be greatly diminished. Instead, there has been no case, no judgment, and no repercussion of any magnitude for the culpable parties. There has clearly been a lack of adherence to the principle of when person or entity X has harmed person or entity Y, X should be responsible for compensating for the damages incurred by Y in relation to this crisis.

Just as Professor Hockett's solution mentions nothing about holding these executives criminally liable, his solution also mentions nothing about holding these executives civilly liable. This is not in the best interest of the American community. One of the primary duties of our judicial system is to punish and prevent crime. To not utilize the purpose of our judicial system concerning the current underwater mortgage crisis is not in the best interest of the community. Therefore, a solution, like Hockett's, that lacks any use of the American judicial system cannot be in the best interest of the community.

D. *Robert Hockett's Solution Requires Valid Contracts to be Broken*

Another reason why Professor Hockett's solution to the underwater mortgage crisis is not tailored to the common good of the community is that it requires valid, legal contracts to be broken.¹¹³ The breaking of these contracts would require banks to take a *forced* loss.¹¹⁴ This would be the equivalent of A lending money to B so B could make a

111. INSIDE JOB, *supra* note 45, at 25.

112. *Id.* at 57.

113. Hockett, *supra* note 10, at 3.

114. *Id.*

large purchase and then the government stepping in and telling A that it no longer has a right to get its money back. What is even more of a problem is the fact that Professor Hockett has defined this loss as a “raise in value.”¹¹⁵ In a recent paper, Professor Hockett falsely states that write-downs have the important advantage of raising value.¹¹⁶ Hockett’s explanation for how write-downs raise or create value in mortgages is as follows: “Bank officers know that underwater loans foreclose at high rates, with the result that expected values fall needlessly short of face values; hence, they find it financially rational to write down these loans.”¹¹⁷ In other words, it would be better for these banks to receive a “guaranteed” smaller amount than an “un-guaranteed” larger amount.

In an e-mail the Author received from Professor Hockett, Hockett explained that there is surplus generated by write-downs because write-downs lower default risk.¹¹⁸ In other words, if there is a home mortgage note worth \$400,000 that is underwater and is therefore worth only \$300,000 at market value, the lending banks would rather write down the mortgage to market value and have a greater chance of collecting \$300,000 and avoiding foreclosure than a lesser chance of collecting \$400,000. This higher chance of receiving less money is what Hockett has coined a “raise in value.”

However, the problem with Hockett’s explanation is that even if these lending institutions do find it in their best interest to write-down mortgages, this still does not *create* value. What write-downs do is make it statistically more likely that the lending institutions will receive a dollar amount that is *smaller* than the larger amount the bank is owed and is statistically less likely to receive. This is not a creation in value. On the contrary, this is an undeniable loss. If any bank agrees to only receive \$300,000 on a \$400,000 mortgage, the Author guarantees that the bank accounts for a \$100,000 loss.

Furthermore, it does not benefit the American community for local governments to use their eminent domain powers to force the severance of contracts that both parties agreed to and signed. At the time both parties signed the contract, the parties should have recognized that there are always certain risks that come with contractual agreements. If a party does not want to bear the threat of that risk, then the party should not enter into the contract. It is not in the best interest of the community to not force those who freely entered into a contract to not be accountable for that contract.

115. *Id.* at 2.

116. *Id.*

117. *Id.* at 3.

118. E-mail from Robert C. Hockett, Professor of Law, Cornell University Law School, to Cooper M. Walker, J.D. Candidate, 2015, Texas A&M University School of Law (Dec. 13, 2013, 08:51 PM CST) (on file with the author).

E. *Robert Hockett's Solution has no Likelihood of Being Any More Efficient than Leaving the Housing Market Alone*

Another reason why Professor Hockett's solution to the underwater mortgage crisis is not tailored to what is in the best interest of the American community is that the solution does not have a strong likelihood of getting mortgages out of an underwater status any more quickly or efficiently than letting the housing market balance itself out.¹¹⁹ In the last quarter of 2011 there were 12.1 million residential properties with underwater mortgages.¹²⁰ In September of 2013 there were only 6.4 million residential properties with underwater mortgages.¹²¹ Thus, in the past two years, with no plan or solution being implemented, the number of residential properties with underwater mortgages has nearly been cut in half.¹²²

Professor Hockett explains that only certain homes will be eligible for his eminent domain solution. The reason for this is to provide security for the parties involved.¹²³ Thus, only mortgages that have a high likelihood of being brought out of underwater status will qualify for the plan.¹²⁴ Under these rules, Professor Hockett says that in California just fewer than 1.5 million homes will qualify for the plan.¹²⁵ However, Professor Hockett is not able to back this number up with any empirical evidence—after stating the number of homes that will be eligible in California no citation is provided that shows where this information is coming from.¹²⁶ Even if it is assumed that Professor Hockett's numbers are accurate, this means that roughly 75% of homes in California with underwater mortgages will qualify. Therefore, with no solution or plan in place there has been a 50% drop in underwater mortgages,¹²⁷ and if Professor Hockett's plan has a 100% success rate, then 75% of mortgages in California will no longer be underwater. However, there is no way to know how many mortgages will be taken out of underwater status. Furthermore, the threat of severe unintended consequences negatively affecting the housing mar-

119. See generally Les Christie, *2.5 Million Mortgage Borrowers No Longer Underwater*, CNNMONEY, (Sept. 10, 2013, 11:27 AM), http://money.cnn.com/2013/09/10/real_estate/underwater-borrowers/.

120. Bill Campbell, *CoreLogic Reports Negative Equity Decreases in First Quarter of 2012*, CORELOGIC (July 12, 2012), <http://www.corelogic.com/about-us/news/core-logic-reports-negative-equity-decreases-in-first-quarter-of-2012.aspx>.

121. Ricardo Lopez, *Nearly 6.4-Million Homeowners Still Underwater on Their Mortgages*, LOS ANGELES TIMES, (Dec. 17, 2013, 9:53 AM), <http://www.latimes.com/business/money/la-fi-mo-corelogic-underwater-mortgage-report-20131217,0,6001540.story#axzz2nrwpSJmK>.

122. *Id.*

123. Hockett, *supra* note 7, at 154.

124. *Id.*

125. *Id.* at 155.

126. *Id.*

127. Campbell, *supra* note 120; Lopez, *supra* note 121.

ket and the economy is significant with a plan that has never been implemented.

The Author finds no reason to, more than five years since the beginning of the underwater mortgage crisis, try and implement Professor Hockett's plan if the underwater mortgage crisis is already being solved. It is not in the best interest in the American community to implement a plan that would significantly affect the financial market—with potential catastrophic unintended consequences—in order to solve a problem that is already solving itself.

VI. CONCLUSION

The Author has now shown the American community—specifically the legal community who is in charge of deciding how to handle the current underwater mortgage crisis—that Professor Hockett's solution is not in the best interest of the community. The Author is confident that an unbiased, open-minded reader will naturally develop an intuitive sense for why Hockett's solution is not in the best interest of the community from reading the first four Sections of this Comment. However, in order to solidify the fact that Hockett's solution is not appropriate, the Author has implemented the legal philosophy of St. Thomas Aquinas. Specifically, the Author utilized Aquinas's idea of what is legally just to provide numerous factual and logical reasons why Hockett's solution is neither ethically correct nor appropriate.

First, it was shown that Professor Hockett's solution does not treat the cause of the underwater mortgage crisis at its source. Then, it was shown that Hockett's solution does not hold those who created the underwater mortgage crisis accountable either criminally or civilly. It was then shown that Hockett's solution requires valid contracts to be broken. Lastly, it was shown that Hockett's solution has no likelihood of being any more efficient than leaving the housing market alone.

The Author hopes that those who will soon be deciding whether to implement Professor Hockett's solution will take the time to read this Comment.