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"We Buy Houses": Market Heroes or Criminals?

*Cori Harvey**

INTRODUCTION

The residential sale/leaseback/buyback ("RSLB") transaction is a socially beneficial foreclosure rescue transaction that is being regulated increasingly by the criminal courts to the detriment of the homeowners, investors, and society at large. Because the transaction is being regulated more aggressively with the criminal law, peculiar outcomes arise, which include investors being sentenced, in some cases, to draconian sentences – a trend that will eviscerate the transactions rather than improving them.

A standard RSLB transaction is a privately arranged alternative to foreclosure. The RSLB transaction allows a homeowner in foreclosure to sell his property to an investor, lease the property back from the investor, and retain the right to repurchase the property at a set price on a set date in the future (a call option).¹ Although it is not perfect, this arrangement provides numerous

* Associate Professor of Law, Florida A&M College of Law. Special thanks to Peter Carstensen. An additional thank you to Oren Bar-Gill, Donald Joseph, Heinz Klug, Stewart Macaulay, and Lua Yuille for their thoughtful and insightful comments, and to the participants of the 2013 International Conference on Contracting, the 2014 University of Wisconsin Junior Faculty Workshop, the 2014 University of Wisconsin Graduate Student Seminar, and the Missouri Law Review Editorial Board for their comments on the ideas presented here.

1. This Article is the second of a series of articles about residential pre-foreclosure investing. Specifically, these articles introduce the *We Buy Houses* transaction and other residential sale/leaseback/buyback (RSLB) transactions into the legal literature from the previously unheard perspective of the oft-demonized investors. To a large extent, the RSLB transaction is inside the purview of a select group of investors and homeowners in certain neighborhoods, and is widely misunderstood outside of those circles. Indeed many people see "We Buy Houses" signs, yet few understand the actual transaction. To understand this transaction and how it is executed in practice, the Author conducted primary research, including interviews with several real estate investors. This article and the one preceding it are the culmination of over one hundred hours of interviews with RSLB investors. The bulk of these interviews occurred in Fall 2012 and Spring 2013, including exclusive interviews and written correspondence with the first-ever white-collar defendant, an RSLB investor, sentenced under a three-strikes law to a potential life sentence for this transaction.

As explained in the previous Article in this series, the description of the RSLB transaction presented in this series of articles is a composite of their descriptions, theorized and converted into the language of lawyers and academics by the Author. To the extent that the investors' versions or observations differ from the composite, or especially illuminate a point, individual investors' explanations or interpretations are highlighted as warranted.

benefits for the homeowners, including several which would be lost in the traditional foreclosure process,² and, therefore, should be preserved and supported. Instead, the transaction finds itself besieged by consumer protectionists, academics, behavioral economists, the criminal courts, and the public alike.³ For this reason, the transactions are often called “foreclosure rescue scam[s]” and “equity-skimming scheme[s].”⁴

The group of investors who agreed to be interviewed anonymously for this project was comprised of eleven investors and three family members or office staff members of investors. The interviewees have completed transactions in six different states and have each done between “8 or 9” and “well over a hundred or two” similar transactions. To fund the RSLB transactions, some use their own or family funds; others use outside funds entirely. Over half of the investors complete RSLB or similar real estate transactions or do construction full-time. The longest tenured investors of the group have been in the business for over thirty years; the shortest real estate career has been seven years. Three of the investors are related to each other. Another two are a father and daughter duo. Three of the investors were known to the Author prior to the Project.

Each investor was asked to describe the process of executing the RSLB transaction from start to finish, explaining the “how’s” and “why’s” of each step of the transaction. The investors were also asked what they thought were the beneficial and problematic aspects of the transaction and the marketplace altogether. They were asked to describe their interactions with homeowners, other investors, and lenders. Finally, they were asked how they felt about recent prosecutions of investors and whether they were optimistic about this Article. Each interviewee believed the RSLB marketplace is misunderstood by outsiders. This Article seeks to remedy that problem.

In addition to interviews, the Author also relied on investor and homeowner training materials for the RSLB transaction, court documents, and personal experiences in the real estate market. The Author was able to interview Mr. Timothy Barnett, his family, and associates. Mr. Barnett is an RSLB investor sentenced in 2012 to 33.3 years in prison under California’s three-strikes law. A case study of Mr. Barnett is introduced briefly in Part I and detailed in Part V.

2. See generally JOHN RAO & GEOFF WALSH, NAT’L CONSUMER LAW CTR., INC., FORECLOSING A DREAM: STATE LAWS DEPRIVE HOMEOWNERS OF BASIC PROTECTIONS (2009), available at <http://www.nclc.org/images/pdf/pr-reports/report-foreclosing-dream.pdf> (describing how state foreclosure law facilitates the loss of homes and equity to big lenders during the foreclosure process because of weak civil procedural protections, excessive fee schedules, and other means).

3. See CAL. CIV. CODE § 1695(a) (West 2014). California’s statutes regarding home equity sales contracts and governing RSLB transactions reflect the built-in biases and assumptions underlying these transactions. The statute states, “The Legislature finds and declares that homeowners whose residences are in foreclosure have been subjected to fraud, deception, and unfair dealing by home equity purchasers.” *Id.* This declaration reflects the legal and social atmosphere in which RSLB investors operate.

4. Prentiss Cox, *Foreclosure Equity Stripping: Legal Theories and Strategies to Attack a Growing Problem*, 39 CLEARINGHOUSE REV. 607 (2006), available at <http://heinonline.org/HOL/LandingPage?handle=hein.journals/clear39&div=72&id=&page=> (offering numerous ways to go after alleged “acquirers” and their “confeder-

In calling for a retreat from that position, this Article makes both descriptive and prescriptive claims. The first descriptive claim is that the transaction is a beneficial one and that it has valid, non-fraud *raisons d'être*. The second descriptive claim is that the level of persecution of this transaction is escalating for several reasons. Those reasons emerge from a perfect storm of social, political, and economic factors, the desire to criminalize unconscionability, which largely has been obliterated as a civil contract doctrine, and the triumph of behavioral economics over rational choice economics in homeowner advocacy jurisprudence.

The first prescriptive claim is that criminal regulation creates more harm than it cures by eroding the institution of contracting and by exacerbating the very market failure that gives rise to the transaction. The second prescriptive claim is that, where there are problems with the transaction, there are several better alternatives to criminal regulation. Specifically, minor licensing and regulation and remedial civil dispositions create better outcomes than criminal dispositions.

Part I will explain the transaction briefly and introduce the generic homeowner and investor.⁵ It will then examine a couple of key cases to demonstrate the escalation of RSLB charges from quasi-criminal loan sharking, including the popular 1L Contracts textbook case from 1988, *Browner v. District of Columbia*,⁶ to a more recent case in which the first-ever white collar defendant, Timothy Barnett, an RSLB investor, was sentenced to 33.33 years-to-life for residential burglary under California's Three-Strikes Law.⁷

ates," whom the author accuses of "kicking someone who is down"); Nathaniel C. Nichols, *Home Alone: Home Mortgage Foreclosure Rescue Scams and the Theft of Equity*, 11 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 280 (2002) (arguing that foreclosure rescue scams target vulnerable homeowners and failing to acknowledge the benefits the transactions bring to homeowners); see also NAT'L CONSUMER LAW CTR., FORECLOSURES: DEFENSES, WORKOUTS, AND MORTGAGE SERVICING 375-418 §§ 15.1-15.5.4.4 (John Rao et al. eds., 2d ed. 2007) [hereinafter FORECLOSURES]; Steve Tripoli & Elizabeth Renuart, NAT'L CONSUMER LAW CTR., DREAMS FORECLOSED: THE RAMPANT THEFT OF AMERICANS' HOMES THROUGH EQUITY-STRIPPING FORECLOSURE "RESCUE" SCAMS (2005), available at http://nw.org/network/neighborworksProgs/foreclosuresolutions/pdf_docs/foreclosureReport061605.pdf.

5. For an in-depth explanation of the RSLB transaction, see generally Cori Harvey, *"We Buy Houses": A Foreclosure Rescue as the Solution to the Trapped Homeowner Equity Problem*, 79 MO. L. REV. 371 (2014).

6. 549 A.2d 1107 (D.C. 1988). In *Browner v. District of Columbia*, the defendants unsuccessfully appealed their conviction for loansharking under a statute that prohibited the lending of money at a rate above 6% without a license. *Id.* at 1109, 1116. Loansharking in the District of Columbia carries a maximum sentence of "imprisonment for thirty days, or a \$200.00 fine, or both." *Id.* at 1111. The defendants received "suspended jail sentences and were placed on probation and ordered to make restitution, pay fines, and perform community service." *Id.*

7. Stuart Pfeifer, *Housing Scam Brings up to Life Sentence Under Three-Strikes Law*, L.A. TIMES (Apr. 29, 2012), <http://articles.latimes.com/2012/apr/28/business/la->

Finally, Part I will spell out the benefits to homeowners in these transactions to highlight the importance of preserving these transactions as viable options for certain homeowners.

Part II will explore the means of and justifications for criminal regulation of this transaction. Part II will provide a brief overview of the statutes that are being used to prosecute these investors – traditionally fraud and its subspecies, and now residential burglary. This Part will include a brief discussion of the evidentiary problems inherent in criminal regulation of contract disputes and the problems with using burglary and other street-crime statutes to prosecute white-collar offenses. Rejecting both the justifications and the means described, Part II will suggest instead that a perfect storm of social, political, and economic exogeneities – coupled with both a goal to revive the dormant unconscionability doctrine in the criminal courts and a triumph of behavioralism over rational choice economics – actually explains the escalation of criminal regulation of these transactions. The result is an environment that criminalizes unconscionability and finds fraud and misrepresentation in too many contracts.

Part III will outline several problems with criminal regulation of ordinary economic behaviors, concluding that criminal regulation of foreclosure rescue transactions erodes the institution of contracting and exacerbates the market failure that typifies this already precarious market.

Part IV will suggest several alternatives to criminal regulation, including some that have been outlined by consumer protection advocates. Although it may over-sell the size and scope of the problem, consumer protection jurisprudence has proposed many good remedial measures and has made great strides in combatting such problems in non-criminal ways. Finally, Part IV will conclude that socially-beneficial conduct must enjoy clear legal boundaries or it will cease to exist, thereby harming the most vulnerable homeowners who need the options most.

Part V will detail the peculiar case of Timothy Barnett, which is introduced briefly in Part I. This case is important because it represents a conflation of white-collar and three-strikes jurisprudence, a blurring of the contract-crime divide, and, potentially, the scapegoating of a small accessible investor as the “fall guy” in a nation-wide foreclosure crisis in which large lenders are outside the reach of the criminal enforcement authorities. Mr. Barnett’s case

fi-0428-three-strikes-fraud-20120428. Timothy Barnett was sentenced under California’s three-strikes law, also known as California Proposition 184, for his third of three cases, which all stemmed from foreclosure rescue transactions. *Id.* This sentence stands as the first time a white-collar defendant was ever sentenced to a possible life sentence under a three-strikes law. *Id.* Mr. Barnett’s first two strikes stemmed from real estate transactions in the 1990’s, which were prosecuted simultaneously using California’s residential burglary statute, an enumerated felony under California’s three-strikes law. *Id.*

also may have tremendous precedential value in California and his prosecution may serve as a guideline for prosecutors in other jurisdictions.⁸

PART I: THE RSLB MARKET, TRANSACTION, & BENEFITS⁹

To execute an RSLB transaction, in effect, a homeowner in foreclosure contracts with a small, non-bank investor to sell the home to the investor, and to rent the home back for a negotiated period of time, usually between two and five years,¹⁰ called the "leaseback period," at a negotiated rent, while retaining the right to repurchase the property at a negotiated price on a negotiated date.¹¹ This solution averts the foreclosure by liberating the homeowner's trapped equity.¹² However, the transaction is not without risk for the investor and homeowner. While some of these transactions result in the homeowner eventually losing the home, the potential is there for the home-

8. This Article relies primarily on California law because California investors, including Mr. Barnett, have been on the forefront of the RSLB transaction. The transaction is prevalent in many states, however. California also has long-established statutes that govern home equity sale contracts, including RSLB transactions, which, although not perfect, may serve as a guide for other jurisdictions. CAL. CIV. CODE § 1695.1-17. Many other states also have such statutes already.

9. Unless otherwise noted, the information in this Part comes from the interviews conducted by the Author. *See supra* note 1.

10. The leaseback period is usually set to be longer than the homeowner's right of rescission, which in California, for example, is two years. CAL. CIV. CODE § 1695.14(a). During this period after the sale to the investor, the homeowner can rescind and recover his property under certain conditions. *See* CAL. CIV. CODE § 1695.14. Because the title is tentative, the investor has an added incentive not to resell the property. *See* CALIFORNIA RESIDENTIAL FORECLOSURES: THE COMPLETE GUIDE TO EQUITY PURCHASES AND THE LAWS GOVERNING DISTRESS SALES (Fred Crane ed., 5th ed. 2008). The homeowner's right of rescission can be waived in some states, but not in others. *Compare* TENN. CODE ANN. § 66-8-101 (West 2014) (allowing homeowners to waive right of rescission), *with* CAL. CIV. CODE §§ 1695.10, 1695.14 (prohibiting homeowners from waiving their right of rescission).

11. *See* BLACK'S LAW DICTIONARY 972, 1419 (9th ed. 2009) (defining "leaseback" and "repurchase," respectively); BARRON'S DICTIONARY OF FINANCIAL AND INVESTMENT TERMS 293 (4th ed. 1995) (defining "leaseback"); FORECLOSURES, *supra* note 4; *see generally* Harvey, *supra* note 5.

12. In its purest form, the sale to the investor pays off the homeowner's foreclosure and other existing liens at the closing table. Specifically, the sale before the leaseback is what liberates the equity. Kyle S. Wells & Ryan J. Whitby, *Evidence of Motives and Market Reactions to Sale and Leasebacks*, 22 J. APPLIED FIN. 56 (2011), available at http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CB8QFjAA&url=http%3A%2F%2Fhuntsman.usu.edu%2Feconomicsandfinance%2Ffiles%2Fuploads%2FWhitby%2FWells%2520and%2520Whitby.pdf&ei=8VXQU-DrLs-byAS3nIGADg&usq=AFQjCNE3Bm4VYOAy6RhrPfWScJumZZkVkQ&sig2=u4iWZwQNhZkr_MqjVuTduw&bvm=bv.71667212,d.aWw ("Thus, a sale and leaseback provides a means of raising money based on an asset while continuing to use the asset.").

owner to salvage his home, which some homeowners indeed do. Even for those homeowners who do not end up salvaging their homes, they will end up no worse off, and possibly better off, for having had the chance to save their home.

A. The Market Failure

Foreclosure rescue transactions arise from a specific set of market failures. The RSLB rescue transaction arises because certain homeowners lack access to or the ability to qualify for traditional mortgage refinancing¹³ and do not trust mainstream banks.¹⁴ Because these homeowners cannot access traditional sources of capital, which would allow them to access the equity stored in their homes, they seek opportunities in non-traditional marketplaces, often using services provided by small entrepreneurial firms who operate outside of the traditional banking system.¹⁵ These smaller firms can often help homeowners access their stored equity in ways the larger banks cannot or are unwilling to do.¹⁶ Home equity is the difference between the market value of a home and all encumbrances upon it.¹⁷ Equity, once extracted as cash, can be used to meet any cash needs the homeowners might have.¹⁸ These homeowners face the “trapped equity paradox.”¹⁹

The trapped equity paradox refers to the simultaneous conditions of having equity in one’s home, needing cash, and not being able to access the equity to convert it to cash.²⁰ The trapped equity paradox can cause high-equity homeowners to find themselves defaulting on their short-term debt payments

13. MICHAEL S. BARR, NO SLACK: THE LIVES OF LOW-INCOME AMERICANS 10, 15, 133-78 (2012).

14. See Ronald J. Mann, *After the Great Recession: Regulating Financial Services for Low- and Middle-Income Communities*, 69 WASH. & LEE L. REV. 729, 731-48 (2012) (describing the dearth of financial services for low-income people and their preferences for local, non-bank solutions).

15. See *id.* at 740-43.

16. See *id.* at 729.

17. *Home Equity*, THE LAW DICTIONARY, <http://thelawdictionary.org/home-equity/> (last visited Apr. 19, 2014).

18. See *Home Equity Conversion Mortgage*, THE LAW DICTIONARY, <http://thelawdictionary.org/home-equity-conversion-mortgage-hecm/> (last visited Apr. 19, 2014).

19. The Author coined this term in the first article in this series of articles about RSLB transactions. Harvey, *supra* note 5.

20. All homeowners, to some extent, have trapped equity, unless they have access to 100% loan-to-value financing. However, the trapped equity paradox arises when the homeowner has a critical cash need that cannot be met. See generally *Home Equity Terms*, NATIONWIDE, <http://www.nationwide.com/what-is-home-equity.jsp> (last visited Apr. 19, 2014). The paradox is akin to the situation in Coleridge’s “The Rime of the Ancient Mariner.” SAMUEL TAYLOR COLERIDGE, THE RIME OF THE ANCIENT MARINER (1798), available at <http://www.poetryfoundation.org/poem/173253> (“Water, water, every where, / Nor any drop to drink.”).

and, in the case of RSLB homeowners, facing foreclosure because they cannot meet the monthly mortgage payments on the very home with the equity trapped inside of it.²¹ It is while in the midst of the trapped equity paradox that a homeowner would pursue an RSLB transaction.

Although accessible under normal market conditions using ordinary banking and credit functions, in the trapped equity paradox, a homeowner's equity cannot be released, or put to work, for lack of access to credit.²² Homeowners who suffer the trapped equity paradox are primarily asset-rich and cash-poor.²³ The only asset they have is the equity in their homes. However, their equity is inaccessible because, when these homeowners cannot show both a means and a willingness to pay loans, either with current cash flow or other liquid assets, they cannot qualify for financing or refinancing to extract this equity.²⁴

When homeowners approach the final stages of non-payment before a foreclosure sale of their properties and eviction, they have a couple of options to bring their loans current to avoid foreclosure – all of them problematic.²⁵ Homeowners can try to refinance their loans using their own credit, or the credit of friends or loved ones; they can make a lump-sum payment; they can lease the property out; or, they can sell their homes quickly.²⁶ Unfortunately,

21. RealtyTrac demonstrated in its most recent report, *US Home Equity & Underwater Report*, that nationally 31% of homes in foreclosure had positive equity in them (defined as loan to value of 100% or less). *9.3 Million U.S. Residential Properties Deeply Underwater in December 2013, Down from 10.7 Million in September 2013*, REALTYTRAC (Jan. 7, 2014), <http://www.realtytrac.com/content/foreclosure-market-report/us-home-equity-and-underwater-report-december-2013-7959>. That number is significantly higher in some states and metro areas. For example, in Oklahoma, 62% of homes in foreclosure have positive equity (led by Oklahoma City with 63%), in Colorado 54% (led by Denver with 64%), in New York 52% (led by Buffalo with 74%). *Id.*

22. A lack of access to credit may be due to little to no income, or a poor credit score. See FIN. CRIMES INTELLIGENCE UNIT, FED. BUREAU OF INVESTIGATION 2010 MORTGAGE FRAUD REPORT: YEAR IN REVIEW 6 (2011), available at <http://www.fbi.gov/stats-services/publications/mortgage-fraud-2010/mortgage-fraud-report-2010> (citing the Federal Reserve Bank of Philadelphia report, which argues that "low-income households still struggle to access credit . . . [and] . . . [t]he top three factors contributing to a lack of access to credit include lack of financial knowledge, underwriting standards/credit ratings, and lack of cash flow").

23. See *id.*

24. See Jon Prior, *Low-Income Households Struggle to Access Credit*, HOUSINGWIRE (May 17, 2011), <http://www.housingwire.com/articles/print/low-income-households-struggle-access-credit>.

25. For a more thorough explanation of these four options, see Harvey, *supra* note 5.

26. See *id.* As described in the previous Article in this series, there is a foreclosure rescue market for the outright sale of high-equity homes facing foreclosure. This can be a good option for people with homes in saleable condition, who want to leave their homes and take some cash with them, while avoiding further harm to their credit and the humiliation of a foreclosure. An outright sale requires finding a quick-

many homeowners lose a lot of time in the refinance loan application process, only to be disappointed when rejected in the eleventh hour.²⁷ Finally, many homeowners lose time because they are in denial about what is happening to them.²⁸

The trapped equity paradox exists due to a void of supply in the distressed end of the traditional lending market. Although there is high demand among these homeowners for loans, even at high rates, such rescue financing is extremely difficult to find.²⁹ Because they have defaulted on other com-

moving buyer and the ability to vacate the premises rapidly. Conversely, RSLB transactions with high-equity homeowners are different than sales of no-equity or negative-equity homes during foreclosure. These no-equity or negative-equity home sales are most often seen during market slumps and are more complicated, as they can require negotiations with a third party, the lending bank. No-equity and negative-equity transactions are not the focus of this Article.

27. The new Consumer Financial Protection Bureau (“CFPB”) procedural mandates of the Dodd-Frank Wall Street Reform and Consumer Protection Act have been implemented to strengthen homeowner protections. Unfortunately, banks can and will continue to decline a certain percentage of modification and refinance requests, leaving those homeowners in the situation described here: without options. See CONSUMER FIN. PROTECTION BUREAU, CFPB BULLETIN 2012-04 (FAIR LENDING) 1 (2012), available at http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf (citing 12 C.F.R. § 1024-26 (2013)); see generally Patricia A. McCoy, *Barriers to Foreclosure Prevention During the Financial Crisis*, 55 ARIZ. L. REV. 723 (2013) (describing myriad obstacles to successful loan modifications).

28. See Karen M. Kroll, *Foreclosure Counseling for Homeowners*, BANKRATE, <http://www.bankrate.com/finance/mortgages/foreclosure-counseling-for-homeowners-1.aspx> (last visited Apr. 22, 2014).

29. See McCoy, *supra* note 27 at 725, 752. Rescue lending is designed to save distressed homeowners from foreclosure. Rescue lending may include traditional or non-bank refinance loans, modifications of existing loans, or newly originated loans. See *id.* at 725. It might also include various state and federal government programs designed to prevent foreclosure. See, e.g., *id.* Rescue transactions may be offered by a variety of sources, such as investors, traditional banks, family, friends, or government bodies. See *Avoiding Foreclosure*, U.S. DEP’T OF HOUSING & URBAN DEV., http://portal.hud.gov/hudportal/HUD?src=/topics/avoiding_foreclosure (last visited Apr. 22, 2014). Examples of state rescue programs are Michigan’s Rescue Refinance Program and Pennsylvania’s Refinance to an Affordable Loan Program. MICH. STATE HOUS. DEV. AUTH., MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY HOMEOWNERSHIP REFINANCE PROGRAMS, available at http://mich.gov/documents/mshda/ProgramOverview_230188_7.pdf (last visited Apr. 22, 2014); *Loan Programs for Those in Danger of Foreclosure*, U.S. ATT’Y’S OFFICE, E. DIST. OF PENN., <http://www.justice.gov/usao/pae/mortgagefraudtaskforce/loanprograms.html> (last visited Apr. 22, 2014). An example of a federal rescue program is the Making Home Affordable Program. *Making Home Affordable*, DEP’T OF THE TREASURY & DEP’T OF HOUS. AND URBAN DEV., <http://www.makinghomeaffordable.gov/pages/default.aspx> (last visited June 13, 2014). However, all of these programs have strict income and credit qualification guidelines. See, e.g., *Home Affordable Refinance Program*, DEP’T OF THE TREASURY & DEP’T OF HOUS. AND URBAN DEV., <http://www.makinghomeaffordable.gov/programs/lower-rates/Pages/harp.aspx> (last visited June 13, 2014).

mercially available original and backup loans, and are already facing the foreclosure process, these homeowners are seen as high-risk borrowers and, therefore, cannot obtain new financing through traditional or sub-prime channels. Sometimes, lenders simply do not want to lend more money on homes which they feel are likely to end up in the banks' inventories, especially if the equity of the home will be consumed by the expenses of foreclosure.³⁰ Many banks have an overarching rule to not lend to homeowners already facing foreclosure, regardless of the potentially mitigating variables.³¹

Banks also may avoid this segment of the borrowing population because these borrowers' risk-profiles require a large amount of individualized monitoring, which the big banks are not equipped to do.³² They prefer sectors that reward size, volume, expediency, and market power which can be commoditized easily.³³ Rescue transactions, even where there is trapped equity, require small, nimble, and adept lenders who are on the ground and capable of managing individual transactions.³⁴ Therefore, banks have abandoned this piece of the borrowing market, creating a void.³⁵

The market failure persists because banks have another profit-maximizing, redistributive motivation not to provide new financing. Banks have no incentive to refinance these homeowners because, where there are great stores of equity, the banks are able to recoup their full costs of foreclosure from the equity in the home without suffering cash losses. Therefore,

30. The costs incurred by the foreclosing bank during the foreclosure process are charged to the homeowner and deducted from the equity in the home. CAL. CIV. CODE § 2924(c)-(d) (West 2014). The average foreclosure is estimated to cost \$78,000 and to take two years to complete. Associated Press, *Bank of America Starts Foreclosure Rental Program*, CHI. SUN-TIMES (Mar. 23, 2012, 2:24 PM), www.suntimes.com/business/11489245-420/bank-of-america-starts-foreclosure-rental-program; see also MORTGAGE BANKERS ASS'N, *LENDERS' COST OF FORECLOSURE 2* (2008), available at <http://dcwintonlaw.com/wp-content/uploads/2010/06/Lenders-Cost-of-Foreclosure.pdf> (putting the cost of foreclosure at 30-60% of the outstanding loan balance); NAT'L CONSUMER LAW CENTER, INC., *WHY SERVICERS FORECLOSE WHEN THEY SHOULD MODIFY AND OTHER PUZZLES OF SERVICER BEHAVIOR 12* (2009), available at <http://www.nclc.org/images/pdf/pr-reports/report-servicers-modify.pdf> (arguing that loan servicers generally do not lose money on a foreclosure, whereas, they lose money on modifications).

31. Investors said that this void has traditionally been the reason that their marketplace existed. This may be less of a problem with the recent proliferation of government-backed refinance programs. See McCoy, *supra* note 27, at 730-41.

32. NAT'L CONSUMER LAW CENTER, INC., *supra* note 30, at v-viii.

33. See Mann, *supra* note 14, at 735 (describing the credit lending preferences of large banks).

34. See *id.*; see also BARR, *supra* note 13, at 10, 15.

35. See Mann, *supra* note 14, at 735.

the value of that equity is redistributed from the homeowners to the bank itself.³⁶

B. RSLB as a Market Solution

The market has developed its own responses to the trapped equity market failure – the RSLB transaction.³⁷ There is a group of small, informal investors willing to provide solutions of last resort to these otherwise-abandoned homeowners. Small investors are in an ideal position, from a risk-tolerance and operational-efficiency standpoint, to serve this particular market.³⁸ In fact, small investors have responded and designed a solution to fill this lending void. One market solution is the RSLB transaction – a transaction which mobilizes dormant equity.³⁹

36. JOSEPH W. SINGER, PROPERTY LAW: RULES, POLICIES AND PRACTICES 893 n.7 (5th ed. 2010); MORTGAGE BANKERS ASS'N, *supra* note 30, at 6; *see generally* NAT'L CONSUMER LAW CENTER, INC., *supra* note 30.

37. There have been a number of responses to the market failure that exists in the real estate rescue lending market where there is demand for high interest rate rescue loans, but no supply. *See* Harvey, *supra* note 5 (discussing various responses to the market failure that exist in the real estate rescue lending market). Similar to credit card rates, something keeps the commercial rates from going up to their legal limits. Instead of allowing commercial rates to increase, traditional banks just stop lending. Essentially, there seems to be a magical point at which banks just stop lending in both weak markets (perhaps due to equity risk) and strong markets (perhaps due to a particular borrower's default risk or the bank's own profit-maximizing motives), unless the government intervenes.

38. In this Section of the Article, as well as occasionally elsewhere, the Author builds on basic explanatory information about the RSLB transaction that she presented in her previous Article of this series: "*We Buy Houses*": *A Foreclosure Rescue as the Solution to the Trapped Homeowner Equity Problem*, 79 Mo. L. Rev. 371 (2014). To that end, the language here periodically references the explanatory language of the first article.

39. *Id.* These transactions should be distinguished from transactions in which a company charges homeowners a fee to negotiate a short sale or modification with the homeowner's lender. *See FTC Will Not Enforce Provisions of MARS Rule Against Real Estate Professionals Helping Consumers Obtain Short Sales*, FED. TRADE COMM'N (July 15, 2011), <http://www.ftc.gov/news-events/press-releases/2011/07/ftc-will-not-enforce-provisions-mars-rule-against-real-estate>. Such fee-based services are addressed by the FTC's 2010 Mortgage Assistance Relief Services Rule ("MARS Rule") and are not the subject of this Article. *See FTC Issues Final Rule to Protect Struggling Homeowners from Mortgage Relief Scams: Rule Outlaws Advance Fees and False Claims, Requires Clear Disclosures*, FED. TRADE COMM'N (Nov. 19, 2010), <http://www.ftc.gov/news-events/press-releases/2010/11/ftc-issues-final-rule-protect-struggling-homeowners-mortgage>. It should be noted that the FTC has already retreated from its enforcement of key sections of the MARS Rule per its own press release dated July 15, 2011. This is because the FTC realized that sections of the MARS Rule had unintended negative effects on real estate brokers' ability to provide truly beneficial services to certain homeowners. *FTC Enforcement Policy: Real Es-*

The RSLB is a non-bank financial transaction, and it is popular among credit consumers who either do not have access to or do not trust the established banking community.⁴⁰ At this time, through the RSLB transaction, the market solution to the supply and demand misalignment in the trapped equity paradox exists outside of conventional mortgage finance.⁴¹ Non-bank investors come into this arena to reconfigure the marketplace. These investors realign the relationships between owners and lenders and extend or avoid the foreclosure process by liberating trapped equity.⁴²

Commonly, the average RSLB investor⁴³ operates outside of the traditional banking structure, although she may have several ties to and relationships with larger banks in order to help her provide rescue solutions for troubled homeowners.⁴⁴ The RSLB investors describe specialized property niches, such as waterfront properties, inner city fixer-uppers, suburban homes with pools, or homes with store fronts. They also approach their investment strategies and activities like most financial investors, depending on their individual levels of sophistication and financial positioning. These investors share some similarities with traditional mortgage lenders but are also distinct in many ways. For example, while they face similar general and specific risks as their larger counterparts, RSLB investors can take a broader range of factors into consideration when they are making their assessments and decisions – such as familiarity and comfort with a particular neighborhood or other possible sources of income in the home, such as financial support from

tate Professionals and the Mortgage Assistance Relief Services Rule, FED. TRADE COMM'N (July 15, 2011), http://www.ftc.gov/system/files/documents/public_statements/308651/110714marsrealestatepolicy.pdf.

40. See Mann, *supra* note 14, at 743-44; see also BARR, *supra* note 13, at 84.

41. Harvey, *supra* note 5. As described in the previous Article in this series, RSLB transactions are a type of "equity purchase transaction." In an equity purchase transaction, an investor, called an "equity purchaser," purchases the home of an "equity seller," a homeowner in foreclosure. That value is negotiated between the investor and the homeowner. Sometimes, an equity purchase transaction involves a repurchase option, as in the sale/leaseback/buyback transactions described in this Article, where the homeowner has the ability to buy the property back later. California and New York, for example, are states that have statutes describing and regulating these types of transactions. CAL. CIV. CODE §§ 1695-1695.17 (West 2014); N.Y. REAL PROP. LAW §§ 265-a to 267 (McKinney 2014).

42. Harvey, *supra* note 5. *But see* FORECLOSURES, *supra* note 4, at 505 (arguing that investors come into the market to steal the equity, which often hastens the foreclosure).

43. The investor referred to in this Article is just the average investor based on the Author's research, which included hundreds of hours of conversations with real estate investors and extensive research. This composite investor is not synonymous with Timothy Barnett, the case study in Part V of this Article.

44. Harvey, *supra* note 5. In their interviews, several of the investors described previous careers as real estate agents, mortgage brokers, bank tellers, landlords, building superintendents, and one financial advisor.

children, parents, and significant others of the property owner – because they are creating a lease as opposed to a long-term mortgage.⁴⁵

As an RSLB homeowner approaches foreclosure and cannot obtain any more financing to save his property from foreclosure due to income and/or credit restrictions, he finds himself in the precarious trapped equity paradox.⁴⁶ Once a homeowner is far enough in arrears, his lender must publish the homeowner's name as well as the lender's intent to sell the property in a foreclosure sale in the near future in newspapers or other public fora.⁴⁷ The information is then picked up by various listing companies, which aggregate the information for their subscribers.⁴⁸ This publication initiates the foreclosure sale process, which would culminate in the disposition of the property.⁴⁹ As he loses his home in the foreclosure sale process, the homeowner also loses a large chunk,⁵⁰ or all, of the equity trapped in the property – unless something stops the process, such as an RSLB. Once the names of homeowners who potentially need this transaction are published, investors can easily make contact with them, which serves as this market's efficient, least-expensive search and matching function.⁵¹

After the publication, several investors are likely to contact a homeowner and offer an RSLB opportunity.⁵² Usually, these investors then visit the

45. *Id.* Investors explain that their proximity to properties, their personal knowledge of the homeowners, their familiarity with the neighborhoods, and their ability to respond to problems quickly make them better at avoiding costly problems than distant banks.

46. *Id.*

47. *See, e.g.*, 12 U.S.C. § 3708(2) (2012); CAL. CIV. CODE § 2924f (West 2014); MICH. COMP. LAWS § 600.3208 (2014); MO. REV. STAT. § 443.320 (2012); TENN. CODE ANN. § 35-5-101 (2014).

48. As detailed in the previous Article in this series, listing companies are companies that aggregate foreclosure data from dockets in various courts and jurisdictions. Harvey, *supra* note 5. A listing company offers its services in one or more specific jurisdictions because the process of gathering this data requires that the listing company have an employee physically standing at either a county courthouse or other location, where the data is first released to the public. The listed proceedings could be Foreclosure Sales, Notices of Default, Trustees' Sales of Deeds of Trust, State and/or Federal Tax Liens, Mechanics Liens, or Sales of Bank-Owned Real Estate, etc. *Id.* (citing CALIFORNIA RESIDENTIAL FORECLOSURES, *supra* note 10, at 45).

49. *Id.* In the case of a mortgage default, the listing is a Notice of Default, or something similar. *See id.*

50. Associated Press, *supra* note 30; *see also* MORTGAGE BANKERS ASS'N, *supra* note 30.

51. Harvey, *supra* note 5. With this system, investors say it is easier for them to find homeowners than it is for homeowners to find them. Prior to such publication, homeowners have limited opportunity to find investors and would have to rely on word of mouth or respond to signs that say, "We Buy Houses" – neither option of which is particularly efficient.

52. The RSLB market is competitive and the number of competing offers may feel overwhelming to a homeowner. The reason for this onslaught of offers and in-

property in order to make a personal assessment of the homeowner and to assess the property, including an attempt to identify any problems with the property or the homeowner that cannot be identified on paper.⁵³ This is one reason small investors are better able to execute these transactions than their larger counterparts. It also allows the homeowners a chance to meet the investors to make interpersonal decisions and increase their comfort levels with the investors by asking questions.

By the end of the day, the homeowner may have several tentative RSLB proposals, which they would spend the next day or two considering privately before selecting one of the investors.⁵⁴ The homeowner controls the process and would use his own selection criteria in choosing to work with any particular investor.⁵⁵

Once the homeowner has selected the investor he wishes to work with, they negotiate and agree on the terms, usually including an additional cash payment to the homeowner.⁵⁶ The three main terms in an RSLB transaction are the purchase price, the duration and rate of the lease, the buyback price and the date.⁵⁷ It is through the negotiable combinations of these three varia-

formation is that all of the corporate subscribers receive the information at the same exact time and many will then contact the homeowner. The day before the publication, none of them knew that the homeowner existed, so the investors do not trickle in over time. *Id.* (citing FORECLOSURES, *supra* note 4, at 512 ("In some cases, homeowners can receive more than fifty offers for assistance within weeks of the initial public foreclosure notice.")).

53. Some of the investors said that they do not go to the properties personally. Rather, their agents or scouts go to the properties. However, some investors go to the homes themselves.

54. Harvey, *supra* note 5. Homeowners also often have several competing offers from multiple investors to choose among for the best offer. *Id.* Many of the investors describe being asked to meet a competing offer from another investor. They also describe arriving at properties and seeing several notices already in the homeowner's mailbox. They also describe other investors removing their notices from properties. Each of the investors recalls "being played" at least once by homeowners who commit to and string along two or more investors until the very last minute, often after the investors had made significant cash outlays.

55. *Id.* As described in the previous Article in this series, critics argue that homeowners do not have meaningful opportunities to negotiate the terms of the contracts. They also argue that, while the RSLB investors may not be significantly larger in market power, the investors are more sophisticated in education and experiential power. Yet, it should be noted that these are not adhesion contracts. And indeed, the investors are often small investors who are closer in size and market power to the homeowners than either of them is to the large lenders. Accordingly, the argument that it is impossible to negotiate with these small neighborhood investors is unfounded.

56. *Id.* This payment is in addition to the payments made at the closing table to the homeowner's creditors. The amount of this payment is negotiated between the parties. The homeowner may then use the cash payment to pay other delinquent bills.

57. For example, in California, the terms of a rental agreement must be included in the original agreement – a copy of which the homeowner must have prior to the

bles that the investor's premium is outlined and secured. The parties then sign the contracts and suspend their communications for the duration of the statutory waiting period, which corresponds with the homeowner's statutory right to cancel, also called a waiting period.⁵⁸ During the statutory waiting period, both parties must have the fully negotiated contract in hand and cannot take any action on the contract during that time,⁵⁹ which is intended to eliminate the influence of one party over the other,⁶⁰ although it does cut into the short timeframe leading up to the lender's foreclosure sale date. During this waiting period, the homeowner has the time and opportunity to carefully look over the contract and to have it reviewed by an advisor. After the waiting period, if both parties are committed to the contract, they will move forward with the transaction.⁶¹

Shortly after the waiting period, the investor will purchase the home from the homeowner in order to stop the foreclosure procedure; this often occurs within the lender's statutory timeframe of mere days.⁶² At the closing, title transfers to the investor and the homeowner's underlying debts are paid off, including the defaulted mortgage and the other liens attached to the property.⁶³ To buy the homeowner's property, the investor will have used his own investment funds or will have borrowed funds, generally at "hard money loan" rates,⁶⁴ which are used for short-term, high-risk loans.

waiting and attorney review period. CAL. CIV. CODE § 1695.3(f) (West 2014). The rent is usually set at the amount the homeowner agrees that he can pay for the duration of the leaseback period. Harvey, *supra* note 5. The homeowner often sets this rent at a number that is below her current monthly payment, which she clearly cannot meet as she is in foreclosure already. If the negotiated rent is below the investor's holding costs, it will be subsidized by some of the mobilized equity. A more detailed discussion of the rent-setting process follows later in this Article. If any material terms of the agreement are changed, the statutory waiting period would be reinitiated.

58. The length of the statutory cooling-off period varies by state and exists so that the seller has time to think about the transaction and to consult a lawyer. For example, in California, the statutory waiting period for this type of transaction, called an "Equity Purchase Agreement," is five days, which is longer than the statutory waiting period for a refinance transaction (three days), and the statutory waiting period for a standard home purchase mortgage (zero days). CAL. CIV. CODE § 1695.4(a) (West 2014).

59. CAL. CIV. CODE § 1695.6(a)-(b)(4) (West 2014). During this period, the investor and the homeowner cannot have any contact with one another, exchange funds, sign or execute any further documents, or escrow any funds. *See id.* The investor uses this period to complete due diligence and title research on the property.

60. *See* Harvey, *supra* note 5.

61. *See* CALIFORNIA RESIDENTIAL FORECLOSURES, *supra* note 10, at 5.

62. Harvey, *supra* note 5.

63. *Id.* Attached liens may include, for example, tax or other municipal liens, mechanic's liens, or homeowners' association dues. Often homeowners negotiate with the investor to include the payment of other debt into the transaction.

64. *Id.* A "hard money loan" is a short-term, high rate loan most often provided by a non-banking institution or private investor. These loans are not based on the

Once the investor has bought the home from the homeowner thus halting the foreclosure process, the leaseback period begins.⁶⁵ After the homeowner has settled into his lease, the investor then resells the property to a secondary investor in order to bring down the interest rate. A secondary investor is a person or entity with access to more traditional funding sources at widely available commercial or investment rates.⁶⁶ Despite the sale, the homeowner retains the right to buy the property back and must give written permission to the initial investor to transfer the property.⁶⁷ During the leaseback period, because the secondary investor is a silent investor, the initial investor often assumes a landlord and property management function, incurring the costs of property maintenance, repairs, taxes, and insurance.⁶⁸

At the end of the leaseback period, the homeowner may exercise her call-option and repurchase the home, if she gets new financing.⁶⁹ This buy-back right may also be assignable depending on the negotiated terms and the jurisdiction.⁷⁰ The homeowner can also renegotiate her leaseback duration, possibly getting more time to contemplate her decision or to better organize her affairs.⁷¹ It is also possible that the homeowner may finally decide to leave her home. Indeed, the homeowner can, at this point in time, decide under less-frenzied and less-stressful circumstances that she wishes to transition into a new phase, which does not include owning the home, and, therefore,

borrower's credit-worthiness; rather, they are based on the value of the home. Investors use hard money loans as quick-bridge financing. This allows them to complete some short goal, such as a construction project or a refinance application. Because of the high-rate on the loan, hard money is expected to be short-term. Some investors report hard money rates over 20%.

65. *Id.*

66. *Id.* As described more fully in the previous Article of this series, a secondary investor is someone with investable capital. For example, a secondary investor could be a small investment group, a doctor, a businessperson, or a lawyer who is looking for rental income, mortgage interest deductions, and capital gains. This group or person is usually looking for a two-to-five-year opportunity, which is a perfect time-horizon for an RSLB investment.

67. *See, e.g.*, CAL. CIV. CODE § 1695.6(e) (West 2014) (providing that a homeowner with any repurchase rights to a property must approve in writing the transfer of the property from the first investor to the secondary investor); *see also* Segura v. McBride, 5 Cal. App. 4th 1028, 1038 (1992). Most often, this permission will be a part of the original contract. Harvey, *supra* note 5. In fact, it would be better to require that the call option be recorded at the county offices. The call option should be properly recorded in order to encumber the title so that the burden of the option runs with the land to any subsequent buyers. However, California does not require such recording.

68. Harvey, *supra* note 5.

69. *Id.*

70. T.P. Gallanis, *The Future of Future Interests*, 60 WASH. & LEE L. REV. 513, 516-20 (2003) (demonstrating that although options historically have been inalienable, the majority of jurisdictions now permit alienation).

71. Harvey, *supra* note 5.

she will let her repurchase option lapse.⁷² If she lets the option lapse, she must either move out or negotiate a new leasehold without the repurchase option.⁷³

C. Benefits of the RSLB for a Homeowner?

When a homeowner's circumstances suggest that his home is no longer able to provide the traditional benefits of owning property – storage of capital, reliable shelter, and income generation – owning the home in fee simple becomes less valuable to that homeowner.⁷⁴ In that case, a sale/leaseback can provide a superior bundle of benefits for the homeowner, such as liberating the stored value in his property by not owning it while continuing to use the property, the two most important factors to an owner facing foreclosure and wanting to remain in his homestead.⁷⁵

Effectively, the RSLB transaction changes the homeowner's status from owner in fee simple to leaseholder.⁷⁶ The RSLB transaction, with its convenient search and matching function, saves the homeowner the cost of finding a fast-moving buyer.⁷⁷ This transaction allows the homeowner his only chance to convert his equity to usable cash that can be extracted for the homeowner's purposes, most importantly the foreclosure, but also any other current debts that he negotiates for. By paying off his bills, the homeowner is spared the ordeal of eviction, foreclosure and possibly bankruptcy. He also gets his name out of the newspapers and off of the negative public records. In fact, by having done the RSLB transaction, regardless of whether he ever repurchases his home, the homeowner has forever avoided that foreclosure on his credit report and will be able to spare whatever is left of his credit rating.⁷⁸

72. *Id.*

73. *Id.*

74. HERNANDO DE SOTO, *THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE* 7 (2000) (describing the traditional benefits of home ownership).

75. Wells & Whitby, *supra* note 12, at 57.

76. However, in California, for example, such a transaction carries the dubious presumption of being a mortgage loan. See CAL. CIV. CODE § 1695.12 (West 2014). This presumption places the burden on the investor to establish that it is not a loan in disguise. *Id.*

77. See *supra* notes 41-42, 45 and accompanying text.

78. Bob Tedeschi, *Homeowners Walking Away*, N.Y. TIMES, Oct. 25, 2009, at RE11, available at <http://www.nytimes.com/2009/10/25/realestate/25mort.html?module=Search&mabReward=relbias%3Ar&r=0> (“A foreclosure will drop the borrower's credit score by at least 100 points, and will remain on a credit report for seven years.”); see also Robert Celaschi, *Wait For the Market to Rebound, or Cut Your Losses?* SACRAMENTO BUS. JOURNAL (Oct. 14, 2010), <http://www.bizjournals.com/sacramento/stories/2010/10/18/focus1.html?page=all> (stating that a foreclosure will lower a borrower's credit rating 140-150 points).

The RSLB transaction also gives the homeowner a reprieve from the costs of ownership, including insurance, property tax, maintenance, and certain utilities.⁷⁹ These costs are shifted to the investor.⁸⁰ In fact, the transaction frees the homeowner of any incentive to make improvements, repairs, or to take special care of the property.⁸¹ This is heightened as a homeowner becomes more certain that he will not exercise his option to repurchase.⁸² Indeed, a homeowner will often hold off on his efforts to improve the property until he knows whether he will be willing and able to buy the property back.⁸³

An RSLB transaction very effectively allows a homeowner to hedge herself against real estate price risk and to limit her downside, if she anticipates that the market is going to contract.⁸⁴ In such a case, a property owner's goal would be to not own the property when it tumbles in value, but to extract any value out of it and then sell it to someone else before it tumbles. The RSLB transaction gives her the ability to shift that risk by selling the property to the two investors, while having her bills and debts paid off by the mobilized equity.⁸⁵ This makes the RSLB transaction superior to refinancing her mortgage to avoid the foreclosure because, in the latter case, the homeowner would still bear the risks of a declining market or home value.⁸⁶

While the RSLB transaction provides some very apparent financial benefits for rational homeowners facing foreclosure with trapped equity, it also

79. What the homeowner gives up in exchange – her mortgage and property tax deductions – were likely quite small as she likely did not have significant income to offset, and because the amount of equity in a home is often related to length of ownership, her mortgage may be largely amortized already. See Harvey, *supra* note 5; Douglas Hsiao, *Tax Benefits of Owning Rental Properties*, WASH. POST REAL EST. BLOG (Sept. 4, 2012, 5:30 AM), http://www.washingtonpost.com/blogs/where-we-live/post/tax-benefits-of-owning-rental-properties/2012/09/02/90acdf2-f53a-11e1-aab7-f199a16396cf_blog.html; Vivian Marino, *Reaping the Tax Benefits from Rental Property*, N.Y. TIMES (Feb. 4, 2007), <http://www.nytimes.com/2007/02/04/realestate/commercial/04sqft.html?pagewanted=all>.

80. Harvey, *supra* note 5.

81. See Robert J. Shiller & Allan N. Weiss, *Moral Hazard in Home Equity Conversion* 6-9 (Nat'l Bureau of Econ. Research, Working Paper No. 6552, 1998), available at <http://www.nber.org/papers/w6552>. Instead, the investor alone bears the risk of the homeowner's moral hazard. See *id.*

82. See *id.* at 9-11.

83. Harvey, *supra* note 5. As a matter of fact, homeowners who anticipate a market decline or know of some hidden defect in their homes have the largest incentive to enter into RSLB transactions because it may be their last chance to pull any capital out before the market declines, before someone discovers the home's defect, or before they lose the house to foreclosure. These risks are reduced if the homeowner wants her home back and believes she is able to buy the property back. However, even in that case, she still has incentive to push costs onto the investor.

84. *Id.*

85. *Id.*

86. *Id.*

serves some of the emotional and mental needs of homeowners as well. It allows the homeowner to stay in her home, which keeps her kids in their schools, and allows the homeowner to remain a part of her community. She is also spared the shame and humiliation within her community of a foreclosure, eviction, and possibly bankruptcy. By avoiding the foreclosure, the RSLB preserves what remains of the homeowner's credit and gives the homeowner a much-needed emotional reprieve.⁸⁷

The homeowner also benefits from the sale of the property to the secondary investor. The role of the sale to the secondary investor is integral to the success of an RSLB transaction yet is very much misunderstood. It is often held out as dispositive of fraud, implying that it is a shell game or an attempt to confuse the title and the homeowner's rights.⁸⁸ The secondary investor is an investor who sees real estate as a portfolio opportunity and is able to provide cash and credit to the deal in exchange for capital gains (escalation of property value during the leaseback), income (rent as dividends), and tax advantages and deductions, specifically the ones that the homeowner was unable to maximize as the owner of the home.⁸⁹

Another benefit to the homeowner is that the secondary investor is able to get low, market-rate financing, or may have his own pools of capital. Because the homeowner's credit rating makes this type of money unavailable to her, the secondary investor is able to bring the cost of the deal down significantly, including the homeowner's rental price, which drives this transaction. If the homeowner is not able to afford market rent or to cover the investors'

87. Bob LaMendola, *Stress of Foreclosure Can Make Homeowners Ill*, SUN SENTINEL (Dec. 30, 2011), http://articles.sun-sentinel.com/2011-12-30/health/fl-hk-foreclosure-illness-20111230_1_foreclosure-proceedings-foreclosure-counselors-foreclosure-situation (citing study linking the rise of illnesses in certain regions to high foreclosure rates).

88. FORECLOSURES, *supra* note 4, at 389 § 15.4.1.3. *See also* Harvey, *supra* note 5. As described in the previous Article in this series, some courts mistakenly refer to the secondary investor as a "straw buyer." A straw buyer is a buyer who purchases something for someone else because that person cannot qualify to buy the thing for himself. Straw buying is used in real estate when a person cannot afford to buy a home so the straw buyer purchases it for the person, using the straw buyer's own credit, much like when a parent buys a home for a child. Purchasing for someone else is not illegal unless it involves fraud of some sort. A fraudulent straw purchase might be one in which the straw buyer knowingly and falsely represents to the lender that he would be the owner-occupant. Conversely, in the RSLB scenario, the secondary investor is not a straw buyer. The secondary investor does not obtain financing under the guise that it is for himself. In the RSLB transaction, the secondary investor does not deceive the homeowner or the bank that gives the secondary investor the mortgage. All parties are aware that the secondary investor is buying the property for investment purposes.

89. *See* Wells & Whitby, *supra* note 12, at 2 (arguing that under the U.S. tax code, a lessee with a lower marginal tax rate can shift her tax allowances to a higher rate lessor through a sale and leaseback of an asset and that a property owner can negotiate a lower lease rate in exchange for the tax deductions).

costs, the investors may subsidize the homeowner's monthly payments by using some of the newly mobilized equity.⁹⁰

The secondary investor also will have an investment horizon that allows him to delay his gains long enough to facilitate the leaseback period, which must be longer than the statutory redemption period in the jurisdiction.⁹¹ The secondary investor's capacity allows the primary investor to reallocate the funds he had committed to the transaction. The secondary investor frees the primary investor's capital from the prohibitively expensive hard money rates, which allows him to pursue other deals, to perform maintenance on the property as needed, or to pay taxes and insurance.

With the buyback option, a homeowner retains her ability to regain the American Dream of homeownership.⁹² Although certain jurisdictions allow a homeowner to retain a statutory right of redemption,⁹³ the sale/leaseback and

90. Harvey, *supra* note 5. In extreme situations, the investors say that a homeowner may not be able to pay anything for the duration of the leaseback. In this situation, the entire rent would come out of the mobilized equity, thus resembling a reverse mortgage. Another iteration of the transaction occurs when the homeowner is sometimes able to make the current payment, or even a higher payment, but cannot afford to catch up on the lump sum arrearages quickly enough to prevent the foreclosure.

91. *Id.* In most jurisdictions, there is a statutory redemption or rescission period during which a homeowner can change her mind and buy back her home after a foreclosure or foreclosure-related sale, such as an RSLB transaction. *Id.*; *see, e.g.*, CAL. CIV. CODE § 1695.14(a) (West 2014). Certainly, it would be imprudent to structure this deal so that the homeowner must leave before her statutory right of redemption has expired because the homeowner could then come back at any point during the period and say she wants the house back – in which case, the investors would be prohibited from reselling the home and might have to vacate another tenant. Harvey, *supra* note 5. Even if the homeowner is evicted during the leaseback period, her statutory right of redemption remains unaffected.

92. *Id.*

93. As detailed in the previous Article in this series, a "statutory right of redemption" exists only in certain jurisdictions and allows a homeowner who has been foreclosed upon to repurchase her home for a set period after the foreclosure sale. This period is usually one year and the homeowner can re-purchase for the sale price plus foreclosure expenses – expenses which can be excessive and may consume all of the equity in the property. *See* BLACK'S LAW DICTIONARY 1548 (9th ed. 2009). Twenty-two states have statutes providing an absolute right of redemption as of Summer 2014. ALA. CODE § 6-5-248 (LexisNexis 2014); FLA. STAT. ANN. § 45.0315 (West 2014); 735 ILL. COMP. STAT. ANN. 5/15-1603 (West 2014); IND. CODE ANN. § 32-30-10-11 (West 2014); KAN. STAT. ANN. § 60-2414 (West 2014); KY. REV. STAT. ANN. § 426.220 (West 2014); ME. REV. STAT. ANN. tit. 14, § 6313 (West 2014); MICH. COMP. LAWS ANN. § 600.3140 (West 2014); MINN. STAT. ANN. § 580.23 (West 2014); MO. REV. STAT. § 443.410 (2012); N.J. STAT. ANN. § 2A:50-4 (West 2014); N.M. STAT. ANN. § 48-10-16 (West 2014); N.C. GEN. STAT. ANN. § 45-21.27 (West 2014) (providing the shortest redemption period at ten days); N.D. CENT. CODE ANN. § 32-19-18 (West 2013); OHIO REV. CODE ANN. § 5721.38 (West 2014); OKLA. STAT. ANN. tit. 46, § 43 (West 2014); R.I. GEN. LAWS ANN. §§ 34-23-2 to -3 (West 2013) (providing the longest redemption period at three years); S.D. CODIFIED LAWS § 21-

repurchase option often can be the superior option for the homeowner, who plans to regain her property. The negotiated RSLB transaction allows the homeowner greater certainty about the timing of her homeownership and possible relocation in the future. The foreclosure process is messy and strips the homeowner of any control she might have over when she must relocate, when the house will actually be sold at foreclosure, to whom, or at what price.⁹⁴

The repurchase price is another highly-scrutinized aspect of these transactions.⁹⁵ RSLB transactions are generally initiated when home prices are rising.⁹⁶ Therefore, the future purchase price will be set higher than the cur-

47-23 (2013); TENN. CODE ANN. § 66-8-101 (West 2014); VT. STAT. ANN. tit. 12, §§ 4941, 4949 (West 2014); WIS. STAT. ANN. § 846.13 (West 2013); WYO. STAT. ANN. § 1-18-103 (West 2013). As of Summer 2014, nine states have laws providing a hybrid/conditional statutory right of redemption. ALASKA STAT. ANN. § 34.20.090 (West 2014); ARIZ. REV. STAT. § 12-1281 (LexisNexis 2014); CAL. CIV. CODE § 1931 (West 2014); CONN. GEN. STAT. ANN. § 49-20 (West 2014); IOWA CODE ANN. § 654.20 (West 2014); MASS. GEN. LAWS ANN. ch. 244, § 18 (West 2014); MONT. CODE ANN. § 71-1-228 (West 2013); UTAH CODE ANN. § 78B-6-906 (West 2013); WASH. REV. CODE ANN. § 61.24.050 (West 2014). The remaining states – Arkansas, Colorado, Delaware, Georgia, Hawaii, Idaho, Louisiana, Maryland, Mississippi, Nebraska, Nevada, New Hampshire, New York, Oregon, Pennsylvania, South Carolina, Texas, Virginia, and West Virginia, and the District of Columbia – do not provide a statutory right of redemption. See *The Right of Redemption*, ALLLAW.COM, <http://www.alllaw.com/articles/nolo/foreclosure/right-of-redemption.html> (last visited Apr. 23, 2014). To be sure, this right of redemption is problematic because it binds title for the entire period, discouraging the new owner from making any improvements to the land or property for the duration of the right because the new owner does not know when or if she will ever actually own the property. Some jurisdictions also prohibit the buyer from moving into the home during the redemption period. See, e.g., MINN. STAT. ANN. § 580.041 (West 2014) (allowing the owner of a foreclosed property to remain on the property until the end of the redemption period). This right of redemption should not be confused with “equity of redemption,” which is a homeowner’s right to make the lump sum payment needed to buy herself out of foreclosure by making her loan current at any point leading up to the actual foreclosure sale. BLACK’S LAW DICTIONARY 620 (9th ed. 2009).

94. Harvey, *supra* note 5. Part of why the foreclosure process is so unorganized, when compared to a negotiated rescue transaction, is because the homeowner’s status in the property is unclear during foreclosure proceedings. Varying, of course, by jurisdiction, the homeowner may be considered a trespasser, an occupant in adverse possession, or a lessee after the foreclosure proceedings. Additionally, she has no idea how or when the next step in the legal process will commence.

95. See sources cited *supra* note 4.

96. See Harvey, *supra* note 5. If the investors believed the market was falling, they would have no incentive to do the transaction, which requires a commitment to hold the property for two or more years. See *id.* They would only do it if they thought the value of the home was going to increase during their period of ownership. See *id.*

rent market price.⁹⁷ This transaction depends on both parties believing the property value is rising.⁹⁸ However, there may be an exception to this expectation for the homeowner who knows that, even if the market declines, she is still no worse off by doing the RSLB than had she lost the home to foreclosure. She just will not exercise his repurchase option and will walk away. If she were able to extract one dollar over what she would have received through the foreclosure, she is better off having done the transaction. There is no reason for the investors to do this deal if they anticipate a decline in the market, as they would be forced to carry a home that is losing value during the leaseback period.⁹⁹ In fact, the failure of an investor to recognize the early signs of a market downturn can be his most costly mistake.¹⁰⁰

If the home is worth \$100 today, and the 4-year repurchase price is \$110, then the homeowner expects the value of the home to increase to more than \$110 over the next four years. If the market rises as expected, the homeowner may repurchase her home and has captured any equity over the \$110 repurchase price. The primary and secondary investors are able to liquidate the investment, having captured their share of the equity up to the \$110 repurchase price.

The other benefit to the homeowner of the buyback option is that the homeowner can sell it for cash.¹⁰¹ If the option is assignable in the homeowner's jurisdiction, it becomes a thing of value for the homeowner.¹⁰² If the property value goes up as expected, yet the homeowner still cannot repur-

97. Even in an increasingly good market, the investors say that the future buyback price sometimes can be equal to or lower than the current value of the home. The buyback price may even be identical to the amount owed on the foreclosure, depending on the transaction terms negotiated by the homeowner. In such cases, what the investor gets is access to the equity for the time of the leaseback period, which he may invest during the leaseback period.

98. The exception is when the homeowner expects the property to decrease in value during the leaseback and sees the RSLB transaction as her last chance to extract her equity from the home before shifting that risk to the investor. The investors say they make no exceptions; if the property value is falling and the investor does this transaction, he has made a mistake.

99. See Harvey, *supra* note 5.

100. Robert J. Shiller, *Historic Turning Points in Real Estate* 3, Cowles Foundation Discussion Paper No. 1610 (2007), <http://cowles.econ.yale.edu/P/cd/d16a/d1610.pdf> ("By some accounts, the greatest challenge for economic forecasters is to predict turning points" in the real estate and housing markets, which are "populated mainly [by] ordinary folk who do not react with the speed of professionals").

101. See Gallanis, *supra* note 70, at 517 n.16.

102. See *id.* Yet, as explained in the previous Article in this series, the transferability of the option is a term that does not benefit the secondary investor because it increases the chance that *somebody* will exercise the option when the market value is above the option strike price, thereby cutting off the secondary investor's access to the extra equity over and above the strike price. However, it is a balancing aspect of the transaction and it is a value-creating opportunity in this transaction for the homeowner. Harvey, *supra* note 5.

chase the property, she can sell the option to another buyer for any price up to the difference between the repurchase price and the market price.¹⁰³ For example, in the simple example above, if the property rises to \$120, and the homeowner owns the right to repurchase it at \$110, she could sell the option for up to \$9.99, and make herself and the buyer of the option better off.

The next aspect of these transactions that critics fail to understand is why they are so expensive for homeowners and exactly where the equity and sale proceeds go.¹⁰⁴ As demonstrated by simple example, most of it goes to paying off the foreclosure.¹⁰⁵ Some of it goes to a cash extraction by the homeowner.¹⁰⁶ Some of it goes towards paying off the other encumbrances on the title at the time of closing.¹⁰⁷ Some of it is retained for maintenance and other emergency payments.¹⁰⁸ Some of it is used to subsidize the homeowner's below-market rental payments.¹⁰⁹ Some of it is profit for the investors.¹¹⁰

The profit to the investors is widely-criticized.¹¹¹ However, it is important to note that an analysis of such profit cannot be detached from an analysis of the riskiness of the transaction. Where risk is greatest, reward is greatest.¹¹² The greatest indicator of the risk taken by RSLB investors is the fact that larger lenders will not lend to this group of homeowners at all.¹¹³ The risk is that the investors face a likelihood of getting stuck with the property if the homeowners cannot buy back the property. That the lenders avoid this risk is the basis of the trapped equity paradox that gives rise to this transaction.¹¹⁴ Additionally, the benefits of the transaction for the investors must be higher than alternative uses of their funds. If the returns were not better on the RSLB transaction, the investors would choose other investment vehicles instead. If this transaction were priced at market value, the investors would be indifferent, at best, between this transaction and all other market-priced opportunities, which would be of no help to distressed homeowners. In fact, the investors might even disfavor the RSLB transaction because it would come with extra compliance requirements due to legislation regulating the sale of homes in foreclosure.¹¹⁵ In order for the important secondary investor to become involved, he must make a profit, meaning he must be able to buy

103. Harvey, *supra* note 5.

104. *Id.*

105. *Id.*

106. *Id.*

107. *See id.*

108. *Id.*

109. *Id.*

110. *See id.*

111. *See* sources cited *supra* note 4.

112. Harvey, *supra* note 5.

113. *Id.*

114. *Id.*

115. *See, e.g.*, CAL. CIV. CODE § 1695 (West 2014); N.Y. REAL PROP. LAW § 265-a (McKinney 2014).

the property at a below market price. In order for him to make a profit in the second sale, the first sale must be priced even below that. This means that the original purchase from the homeowner must be priced low enough that it can be sold again, and still be below market.¹¹⁶ In effect, this creates a three-way split of the homeowner's equity: one split for the homeowner, one for the primary investor, and one for the secondary investor. However, even if those splits are known in advance, the investors' shares are still uncertain due to unknown carrying costs; whereas, the homeowner's split is known upfront and not subject to depletion. The homeowner's split should be increased by the value of the intangible benefits, such as foreclosure avoidance, credit maintenance, subsidized rent, tax benefits, insurance, and other carrying costs, which are detailed above.¹¹⁷ Therefore, the criticism of investor profits may be overstated because it fails to consider the benefits also achieved by homeowners in lieu of some of their equity.

PART II: CRIMINAL REGULATION

This Article has so far summarized the anatomy of the generic RSLB transaction, which represents the market's organic solution to its own problems. These transactions have been criminalized recently as the law works to eviscerate them as a solution.¹¹⁸ Instead of seeing RSLB investors as the market heroes they could be, and working to facilitate their filling of this market void, the legislative and judiciary reactions demonize RSLB investors and subject them to criminal charges – including criminal mail and wire fraud, identity theft, and now burglary – and often extensive jail sentences.¹¹⁹

Traditionally, real estate cases have been tried in civil courts.¹²⁰ Increasingly, however, foreclosure rescue investors are being criminalized and

116. The primary investor borrows from a hard money lender just enough money to cover the closing expenditures (the defaulted mortgage, liens, closing costs and fees, and cash to the homeowner). He does not borrow the full amount of the equity at the hard money rate. He then resells the property to the secondary investor for a slightly higher price, which gives the original investor his profit after paying off the hard money loan. The secondary investor does not make his profit until he resells the property after the leaseback period. It is for this reason that he bears the greatest risk.

117. See *supra* notes 77-79 and accompanying text.

118. See Harold Brubaker, *25-Year Prison Term for Foreclosure-Rescue Scammer*, PHILA. INQUIRER (Oct. 3, 2012), http://articles.philly.com/2012-10-03/business/34219118_1_prison-term-demarco-rei-massive-mortgage-fraud; Pfeifer, *supra* note 7.

119. See *infra* Part V (introducing Timothy Barnett, a California RSLB investor, who received a 33.33-years-to-life sentence).

120. See Harvey, *supra* note 5. In fact, none of the existing scholarship on foreclosure rescue transactions addresses criminal sanctions. Much of the scholarship comes out of consumer protection jurisprudence and correctly identifies that homeowners need to be protected. Those scholars make some "very good suggestions" about how to "curtail harmful conduct" in this arena, and none of the proffered solutions is to criminalize. See *id.* However, consumer protectionists tend to overestimate the size of the problem and the percentage of these transactions that is problem-

sentenced to severe criminal sentences.¹²¹ Because these transactions are contract-based, they raise the question of when to regulate contractual behaviors with the criminal law. Given the current culture of rampant white-collar allegations,¹²² the inquiry is especially timely. This Article turns a lens on the question of where and why we draw the line between ordinary contracting behaviors, which are best handled by the civil courts, and criminal behaviors, which require the intervention of the criminal courts. This Article concludes that the line is moving dangerously close to over-criminalization and that the civil courts and contract theory are being underutilized in favor of less-efficient, more expensive criminal dispositions.

Regulating ordinary bargaining behaviors with the criminal law usurps the ability of contract theory and the civil courts to resolve their own problems.¹²³ It also imposes on contracting parties unpredictable and unquantifiable outcomes, thus chilling the willingness of one party to enter into potentially socially-beneficial contracts and increasing the cost of such contracts for the other party.¹²⁴

This Article seeks to understand one type of contracting behavior – the buying and selling of distressed homes – which may serve as a proxy for certain other types of contracting behaviors, but not for all. Alleged white-collar activities come in two forms: contract-based activities,¹²⁵ whether oral or written; and non-contract-based activities, such as embezzlement, check fraud, insider trading, etc., which can arise without formal contract relationships.¹²⁶ Further, contract-based activities fall into two categories: those where the contract is performed as written – the focus of this Article – and

atic. Also, consumer protectionists have not addressed the issue that the foreclosure rescue investors describe, which is that the investors are just as vulnerable to unscrupulous or disgruntled homeowners as the homeowners are to the unscrupulous investors.

121. See sources cited *supra* note 118; see also *infra* Part V.

122. FED. BUREAU OF INVESTIGATION, FINANCIAL CRIMES REPORT TO THE PUBLIC: FISCAL YEARS 2010-2011 (2011), available at <http://www.fbi.gov/stats-services/publications/financial-crimes-report-2010-2011> (listing public corruption as a national priority of the FBI's White Collar Crime Program ("WCCP")).

123. See Andrea M. Matwyshyn, *The Law of the Zebra*, 28 BERKELEY TECH. L.J. 155, 177-79 (2013).

124. See Monu Bedi, *Contract Breaches and the Criminal/Civil Divide: An Inter-Common Law Analysis*, 28 GA. ST. U. L. REV. 559, 588-89 (2012).

125. Cf. Stuart P. Green, *The Concept of White Collar Crime in Law and Legal Theory*, 8 BUFF. CRIM. L. REV. 1, 4-6 (2004) (arguing that what is typically termed "white collar crime" may often be characterized as a crime, a non-criminal violation of law, or merely "deviant" behavior).

126. Cf. *id.* This Article does not seek to engage the debate as to whether these charges should be handled as contract breaches or torts. It simply uses them as examples of activities and relationships that can arise without contracts.

those where the contract is not performed as written, such as Ponzi schemes.¹²⁷

In those instances where the contract is *not* performed as written, where the allegation of wrongdoing more closely resembles a breach, there may be a stronger case for criminal regulation based on criminal performance of the contract.¹²⁸ However, in other instances, like RSLB transactions, the contract *is* performed as written and the prosecutor alleges instead some type of criminal formation of the contract,¹²⁹ either in procedure or in substance. In these cases, claims can be brought under traditional contract theories of misrepresentation, fraudulent inducement, unconscionability, misunderstanding, promissory fraud, and other theories that attack the formation.¹³⁰ In such cases, even where these claims have been fully supported or where there has been a finding of a bad act, there are several traditional contract remedies available to the civil courts, namely specific performance, injunctive relief, modification of terms, contract avoidance or rescission, severability, equitable mortgages,¹³¹ and cash remedies.¹³²

The criminal regulation response of the judiciary and legislature to alleged real estate fraud and other white-collar cases amounts to no more than a frenzied mis-response, which creates more problems than it cures. The resulting deluge of prosecutions and statutes is an attempt to triage, which has resulted in casting too-wide a net, which ensnares too many false positives, scapegoating small investors because they are the lowest-hanging fruit, and over-compensating some homeowners, while leaving other homeowners undercompensated.¹³³ For these reasons, this Article argues that a strengthened contract law, not criminal law, is best equipped to handle these types of cases.

127. BLACK'S LAW DICTIONARY 1278 (9th ed. 2009); "Ponzi" Schemes, U.S. SEC. AND EXCH. COMM'N, <http://www.sec.gov/answers/ponzi.htm> (last visited Apr. 18, 2014). The nature of the fraud in an alleged Ponzi scheme is that the investors are told that one thing is being done with their money, while something else is being done with it. *See id.*

128. This Article uses "criminal performance" of a contract to refer to those instances in which the allegations describe a malicious breach or intentional misconduct within the performance of the contract terms. *See* Mark Pennington, *Punitive Damages for Breach of Contract: A Core Sample from the Decisions of the Last Ten Years*, 42 ARK. L. REV. 31, 72 (1989). This Article distinguishes those instances from instances of "criminal formation" of a contract, in which the allegation is that something in the formation of the contract itself was untoward. 8 WILLISTON ON CONTRACTS § 19:43 (4th ed.). This Article focuses on the latter.

129. *See supra* notes 118-122, 125-127 and accompanying text.

130. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 152, 153, 164, 177, 208 (1981).

131. *See* CAL. CIV. CODE § 1695.12 (West 2014) (creating a presumption of a mortgage loan).

132. *See* discussion *infra* Part IV (suggesting several more solutions, including tracking investors and strengthening contract doctrine to facilitate homeowner recovery where warranted).

133. *See* FIN. CRIMES INTELLIGENCE UNIT, *supra* note 22, at 4, 23.

This Article defines criminalization as the process by which acts are placed on a linear spectrum that starts with totally benign and welfare-maximizing conduct on the left, journeys through neutral conduct and questionable conduct, and ends with totally malevolent and destructive conduct on the right. Every point on that spectrum carries with it a commensurate level of punishment for the act. At some point, as acts move from left to right on that line, they shift from just being undesirable, through a gray area, then cross the line into being clearly undesirable and requiring a state reaction. Criminalization is the act of assigning conduct to that gray area or further to the right of the gray area. In this analogy, criminalization represents an escalation of the penalties to which an actor is subject for an act. *Over-criminalization*, therefore, is the *mis*-assignment of acts along that spectrum by placing them farther to the right than the conduct actually warrants. Similarly, over-criminalization can be viewed as an over-escalation of punishment. The spectrum of criminalization is analogous to one that would exist for civil conduct, with the corresponding civil monetary penalties related to the degree of undesirability. While the civil and criminal spectra should and could exist as two separate spectra, criminal regulation of contracts collapses them into one, or creates a bridge at some point between the two spectra. Why?

Where does a civilized, yet capitalistic, society draw the proverbial line in the sand between ordinary business conduct and criminal conduct?¹³⁴ Where there is gray area, prudence and efficiency dictate that civil courts ought to resolve these issues.¹³⁵ Nonetheless, the criminal law is expanding

In June 2010, the DOJ, to include the FBI, announced a mortgage fraud [which, according to the DOJ, includes ‘equity-skimming schemes’] takedown referred to as Operation Stolen Dreams. The takedown targeted mortgage fraudsters throughout the country and was the largest collective enforcement effort ever brought to bear in combating mortgage fraud. . . . The FBI continues to enhance liaison partnerships within the mortgage industry and law enforcement. . . . The FBI employs sophisticated investigative techniques, such as undercover operations and wiretaps, which result in the collection of valuable evidence and provide an opportunity to apprehend criminals in the commission of their crimes.

Id.

134. See generally Ellen Podgor, *Laws Have Overcriminalized Business Behavior*, N.Y. TIMES (Nov. 10, 2013, 7:01 PM), <http://www.nytimes.com/roomfordebate/2013/11/10/prosecuting-executives-not-companies-for-wall-street-crime/laws-have-overcriminalized-business-behavior> (“Attributing criminality to business-related activities is not always so easy. The line between criminal activities and acceptable business judgments can be fuzzy.”).

135. See *United States v. Goyal*, 629 F.3d 912, 922 (9th Cir. 2010) (Kozinski, C.J., concurring) (“Civil law often covers conduct that falls in a gray area of arguable legality. But criminal law should clearly separate conduct that is criminal from conduct that is legal.”).

to envelop ordinary business conduct,¹³⁶ such as RSLB transactions, thereby collapsing the two spectra. In the case of RSLB rescue transactions, the sentiment that gives rise to criminal regulation starts with the popular opinion that homeowners are duped out of their equity and homesteads through affirmative fraudulent misrepresentations or omissions by investors.¹³⁷ While there may be fraud in some cases, as there is in any industry, it is incorrect to call RSLB transactions fraudulent transactions broadly.

To a large extent, the question of where we draw this line becomes a matter of interpretation. What factors do we use? Do we allow prosecutors and the criminal courts to take what they want and leave the rest for the civil courts?¹³⁸ Should the criminal court have this power to decide which conduct falls outside of reasonable business practices? Or, should we rely on business specialists and experts to make those determinations in civil fora?

There are many well-developed theories of criminalization,¹³⁹ however, none fully explains why RSLB transactions are being criminalized.¹⁴⁰ This

136. *See id.* ("This is just one of a string of recent cases in which courts have found that federal prosecutors overreached by trying to stretch criminal law beyond its proper bounds.").

137. *See* sources cited *supra* note 4. RSLB transactions are perceived as unsavory, as is evidenced by headlines that read like tabloids. *See, e.g.,* Michelle Hoffman, *It's Scam Season*, L.A. TIMES (Sept. 9, 2007), <http://articles.latimes.com/2007/sep/09/realestate/re-foreclose9>.

138. While legislatures create or codify statutory schemes, prosecutors decide which of the available charges to lob at a defendant, which means prosecutors can be very creative – like using burglary to prosecute real estate fraud, or using burglary to prosecute domestic violence, or using a carjacking statute to prosecute someone for failing to return a dealership's car after a test drive. *Cf., e.g.,* Mara H. Gottfried, *St. Paul's 'Outside-the-Box' Charges Nail Organized Retail Thieves*, TWINCITIES.COM (Mar. 29, 2014, 1:33 PM), http://www.twincities.com/news/ci_25441031/st-pauls-outsidethebox-charges-nail-organized-retail-thieves (describing how prosecutors charged thieves with burglary because the value of the stolen goods did not meet the statutory felony amount). This allows prosecutors to get unusual sentences for actions that may be outside of the spirit of the statute in question, including actions that may really be civil in nature, especially if the governing civil statute does not provide for the sanctions and sentences that the public or the prosecutor feels are appropriate at the time. *See A Fewer Felonies Rule*, WALL ST. J., Dec. 18, 2010, at A16.

139. Utilitarian theories of punishment include the economic goals of efficiency and deterrence. *See* Louis M. Seidman, *Soldiers, Martyrs, and Criminals: Utilitarian Theory and the Problem of Crime Control*, 94 YALE L.J. 315, 319-20 (1984); *see also* Bedi, *supra* note 124, at 582-83. The deterrence theory of criminalization argues that sanctions must be high enough to deter undesirable conduct. *See* Bedi, *supra* note 124, at 582-84. It posits that, when harms are difficult to detect and prosecute, they must carry proportionally higher sanctions to counter the added security the actor might feel due to his low probability of detection and conviction. The efficiency theory of criminalization posits that sanctions must be high enough to bring the level of undesirable conduct down to the level which maximizes social welfare. *See id.* at 582-83. The hybrid distributive theory of criminalization argues that sanctions for harmful activities should be set at a level that metes out to the wrongdoer the same

Article introduces another explanation: criminalizing perceived unconscionability,¹⁴¹ which suddenly is possible after a perfect storm of social, political, and economic forces materialized in the real estate and securities markets and led to the criminalization and over-criminalization of RSLB contracts. Specifically, a groundswell of public sentiment fueled, in part, by the otherwise innocuous American ideal of homeownership, driven by media sensationalism against anything that smacks of white-collar activity in the wake of large, unremedied corporate and banking fraud, coupled with a downturn in the real estate and securities markets. Prosecutions of alleged RSLB and similar crimes usually peak just after a mortgage correction, based on earlier conduct that occurred during the preceding market boom¹⁴² and a mob mentality set

pain suffered by the victim. *See* Aya Gruber, *A Distributive Theory of Criminal Law*, 52 WM. & MARY L. REV. 1, 5 (2010). Retributive theories of punishment argue that wrongdoers should be punished because morally they deserve to be punished, which does not make a case for either civil or criminal regulation over the other. *See* *Tison v. Arizona*, 481 U.S. 137, 149 (1987).

140. *See* Bedi, *supra* note 124, at 559. Deterrence and efficiency theories of criminalization fail to explain criminalizing these contracts because they are very public transactions due to real estate reporting laws in every jurisdiction and because the harsh sentences will have the effect of eliminating the transaction totally. *See* Harvey, *supra* note 5. Distributive theories fail because they attempt to assign a level of physical pain, caused by incarceration, to the financial pain caused by being a victim of equity. *See* Gruber, *supra* note 139, at 5. Again, retributive theories of punishment argue that wrongdoers should be punished because morally they deserve to be punished, which does not make a case for either civil or criminal regulation over the other. *See* *Tison*, 481 U.S. at 149.

141. These contracts may be perceived as unconscionable because they are risky and expensive for homeowners. However, what the public and the courts have not accepted is that the transactions are equally as risky and expensive for the investors and secondary investors. Indeed, for the reasons presented in this Article, the cost of the transactions to the homeowners reflects the actual risk involved, not an exploitative or oppressive arbitrary figure.

142. *See, e.g.*, FIN. CRIMES INTELLIGENCE UNIT, *supra* note 22, at 23-24. FBI real estate and mortgage prosecutions follow a wave-like pattern. Its peaks often fall just after a real estate market correction, and its troughs are generally seen as a real estate market is climbing. *See id.* This is for two reasons. First, there is a lag time between the time of the alleged behavior and the time when the behavior comes into question. *See* interviews cited *supra* note 1. In RSLB, specifically, regardless of how the real estate market is performing, the time the behavior comes into question is usually as homeowners reach their buyback dates or later, which may be 2-4 years after the transaction. *See id.* Second, downturns in the market complicate or prevent the RSLB buyback for the homeowner and the secondary investor. *See id.* If the market is rising, everyone is benefiting. However, when the market corrects itself, especially unexpectedly, either the homeowner or secondary investor will be unsatisfied, which may cause the transaction to unravel. *See id.* This leads to accusations, which lead to prosecutions on the tail end of a market correction. This also coincides with the investors' accounts that they would only initiate this transaction if they thought the market was still rising. *See id.*

on punishing somebody for the losses in these markets in an era of weak contract remedies, is the best explanation that can be developed for criminalizing small RSLB investors. This perfect storm leads to scapegoating the low-hanging fruit and the casting of an overly-wide net, which produces too many false positives.

A. Fraud and Misrepresentation

Once prosecutors and opponents make the decision to criminalize, they have a basket of charges to use to prosecute investors. The traditional contract doctrines of misrepresentation and fraudulent inducement,¹⁴³ which can be difficult to prove, and the doctrine of mistake¹⁴⁴ give way to criminal fraud doctrines, including promissory fraud¹⁴⁵ and theft by false pretenses,¹⁴⁶ which is one criminal theft charge that can be used to prosecute real property transactions.¹⁴⁷ In some cases, prosecutors will include forgery and identity theft charges as well.¹⁴⁸ They can also prosecute under an equity sales act, if their jurisdiction has one.¹⁴⁹ Additionally, there are often various statutes allowing for enhancements of the charges and sentences for equity or theft transactions involving a certain dollar amount,¹⁵⁰ or for crimes involving the elderly.¹⁵¹

143. RESTATEMENT (SECOND) OF CONTRACTS § 162 (1981).

144. *Id.* at §§ 153-54.

145. Promissory fraud is a promise made without any intention of performing it. *See, e.g.*, CAL. CIV. CODE § 1572(4) (West 2014). This charge has its roots in tort law, but may carry criminal penalties also. *See, e.g.*, Ian Ayres & Gregory Klass, *Promissory Fraud*, 78 N.Y. ST. B.J. 26, 26 (2006).

146. MODEL PENAL CODE § 223.3 (1985). Theft by false pretenses – referred to as “theft by deception” in the Model Penal Code – can be found where a consensual transfer of title was made based on a misrepresentation of a material past or present fact which was known to the investor and which was intended to, and does, cause the homeowner to transfer title to the investor. *Id.*

147. Traditional theft charges, which derive from larceny jurisprudence, often cannot be applied to real and immovable property because at common law those crimes required moving – taking – the property. *See, e.g.*, *State v. Jackson*, 11 S.E.2d 149, 150 (N.C. 1940). Theft by false pretenses does not address the moving question but instead requires transfer of title of the property. *See, e.g.*, *Commonwealth v. Barry*, 124 Mass. 325, 327 (1878).

148. *See* interviews cited *supra* note 1; *see also* MODEL PENAL CODE § 224.1. These cases usually involve allegations that someone else signed the homeowner’s name or that a notary public was asked to back date a homeowner’s signature. *See* interviews cited *supra* note 1.

149. Such acts may govern the sales of homes in foreclosure and provide remedies and sanctions for violators. *See, e.g.*, The Home Equity Sales Contract Act (“HESCA”), CAL. CIV. CODE §§ 1695-1695.17 (West 2014); The Home Equity Theft Prevention Act (“HETPA”), N.Y. REAL PROP. L. § 265-a (McKinney 2014).

150. Some states have an enhancement in their criminal codes that provides for extra sentencing or additional charges for transactions over a certain dollar amount.

In tough economic times, contracting parties are especially susceptible to allegations of fraud and misrepresentation by their contracting counterparts.¹⁵² Because real estate fraud allegations spike just after market corrections,¹⁵³ in RSLB cases and other cases alleging fraud, there should be two important potential gatekeepers to avoid over-prosecution and over-conviction of investors under fraud statutes. The first gatekeeper exists at the indictment or preliminary hearing stage.¹⁵⁴ To provide the best protections for defendants at the indictment stage, criminal fraud cases should look to recent civil cases, such as *Iqbal* and *Twombly*, to import those heightened pleading standards to criminal contracts cases.¹⁵⁵

See, e.g., CAL. PENAL CODE § 186.11(a)(2) (West 2014) (enhancing sentence when losses exceed a \$500,000 threshold).

151. *See, e.g.,* CAL. PENAL CODE § 368(d) (enhancing the sentence when the alleged theft is from an elderly or dependent adult).

152. *See, e.g.,* Bank of Am. Nat'l Trust & Sav. Ass'n v. Pendergrass, 48 P.2d 659, 659-62 (Cal. 1935) (precluding evidence of institutional lender's oral promise that contradicted terms of written agreement in late 1920s), *overruled by* Riverisland Cold Storage, Inc. v. Fresno-Madera Prod. Credit Ass'n, 291 P.3d 316 (Cal. 2013).

153. *See supra* note 142 and accompanying text.

154. *See* Robert L. Rothman, *Twombly and Iqbal: A License to Dismiss*, 35 LITIG., no. 3, 2009, at 1-2.

155. *See* Robert L. Weinberg, *Iqbal for the Accused?*, 34-JUL CHAMPION 28, 30 (2010) (arguing that the standards should be at least as high at the indictment and preliminary hearing stage as the newly-heightened pleading standards given to civil defendants in *Twombly* and *Iqbal* because at the indictment and preliminary hearing stage criminal defendants' liberty, rather than monetary assets, is at stake). The burden that heightened standards at this early stage place on civil plaintiffs is not a concern in criminal cases because the government brings the claim. *See* Ion Meyn, *The Unbearable Lightness of Criminal Procedure* 14-15 (U. of Wis. Legal Studies, Research Paper No. 1239, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2350953## ("In [both civil and criminal fora], the motion to dismiss standard should be the same. The standard, however, has been interpreted to favor the civil defendant (inviting judicial scrutiny, leading to a higher likelihood of dismissal), and to disfavor a criminal defendant (judicial review is lenient, leading to a higher likelihood that the prosecutor's claims are preserved)."). Additionally, "[t]he *Iqbal* decision invites a civil court to join defendant in closely scrutinizing plaintiff's claims." *Id.* at 14. "In drafting a complaint, a plaintiff 'cannot merely track the language of the statute without alleging accompanying facts in his pleading.'" *Id.* (quoting *Sembler v. Attention Funding Trust*, No. 07 CV 2493, 2009 U.S. Dist. LEXIS 79323, at *9 (E.D.N.Y. Sept. 3, 2009)). Yet, a prosecutor can do exactly that: "[a]n indictment that tracks the words of the statute violated is generally sufficient." *United States v. Jackson*, 72 F.3d 1370, 1380 (9th Cir. 1995). Indeed, prosecutors need make only conclusory allegations due to lenient judicial review standards. *See* Meyn, *supra*, at 14-15.

To survive judicial review, a civil plaintiff must, in contrast to a prosecutor, present "plausible" facts that have a reasonable chance of proving the claims asserted. The plausibility standard requires the court to consider not whether plaintiff might possibly prevail, but actually prevail. Where a prosecution's allegations can be highly conclusory, a civil court would first *set aside* conclu-

The second gatekeeper should sit at the testimonial stage, but perhaps does not. Promissory fraud¹⁵⁶ requires evidence that the investor affirmatively promised something different than what was actually written in the contract, and which the investor never intended to happen, such as, "*He told me I would still own my home!*" or, the omission, "*He never told me I was selling him my home!*" Homeowners may say, for example, that they were led to believe that the investors were helping them make restructured payments.¹⁵⁷ This is perhaps the most common form of complaint in an RSLB transaction.¹⁵⁸ A homeowner may offer testimony about conversations that he had with the investor in which the investor allegedly made false statements to the homeowner about the investor's intent, which contradict the written contract.

Under normal civil contract circumstances, such conversations would be inadmissible under the Parol Evidence Rule,¹⁵⁹ in part, because it creates an opportunity for a frustrated party to use the courts to try to amend or to get out of undesirable contracts.¹⁶⁰ However, under the fraud exception to the Parol Evidence Rule,¹⁶¹ such statements are admissible to prove fraud and to rebut the validity of the signed contract; yet, the same opportunities for de-

sory statements and only then determine whether the factual remainder plausibly stated a claim. Inviting judicial engagement, *Iqbal* stated the "context-specific task" requires it to "draw on its judicial experience and common sense" in determining whether plaintiff states a plausible claim for relief. If civil fraud is alleged, pleading requirements are even more stringent; facts showing a nexus between a misrepresentation and the benefit received must be pleaded with particularity. Despite wielding police powers to develop significantly more precomplaint evidence than a civil plaintiff, a prosecutor ironically [need not] articulate anything more than conclusory facts in the complaint. One possible justification for this difference is that a prosecutor "need not specify the theories or evidence upon which it will rely to prove those facts . . ."

Id. (emphasis in original) (citations omitted).

156. Promissory fraud is an extra-contractual, or para-contractual, promise to do a thing so as to induce assent to the contract, with no intent to actually do that thing. It may provide for criminal sanctions. See Ayres & Klass, *supra* note 145, at 26.

157. See interviews cited *supra* note 1.

158. See interviews cited *supra* note 1.

159. The Parol Evidence Rule is a substantive legal rule, which excludes evidence of prior negotiations to contradict an integrated (final) and binding agreement. RESTATEMENT (SECOND) OF CONTRACTS §§ 209, 213 (1981).

160. See, e.g., *Trident Ctr. v. Conn. Gen. Life Ins. Co.*, 847 F.2d 564, 568-69 (9th Cir. 1988) (criticizing precedent allowing extrinsic evidence to divulge original intention of parties in action by borrower to truncate the bargained-for protection of lender).

161. The fraud exception to the Parol Evidence Rule allows evidence of prior or contemporaneous negotiations to contradict an integrated and binding agreement, if intended to prove "illegality, fraud, duress, mistake, lack of consideration, or other invalidating cause." RESTATEMENT (SECOND) OF CONTRACTS § 214(d) (1981).

ception are still there.¹⁶² However, the Parol Evidence Rule only applies to contract law and does not have a reliable counterpart in criminal law. RSLB cases highlight one problem with criminalizing contracts and bring into question how to handle issues during criminal prosecutions, which would normally arise under the civil Parol Evidence Rule. Although the evidentiary standard in criminal cases is the higher “beyond a reasonable doubt” standard,¹⁶³ do the higher stakes in criminal court not warrant something analogous to, but even tougher than, the civil Parol Evidence Rule? Where criminal fraud is found simply by combining homeowner testimony of misrepresentations with unfavorable contract terms, which erroneously appear dispositive of malintent, a dangerous inferential leap has occurred.¹⁶⁴

Foreclosure rescue cases are often initiated by a legal services-type organization, not by individual plaintiffs.¹⁶⁵ Often those legal services attorneys seek out the homeowners after thorough public records searches, telling the homeowners that they may have been defrauded.¹⁶⁶ Consequently, even if unwittingly, legal services attorneys may present both the *opportunity* and the *incentive* for homeowners to falsely allege fraud, by suggesting or promising that the homeowners could get their homes back, if the judge decides that they actually did not understand the transactions or believes that the investor misrepresented his intentions. Given the American worship of homeownership, the incentive is too great, and the stakes are too high, to allow false inferences in criminal courts.

B. Residential Burglary Statute

Prosecutors have long used burglary statutes as a catchall charge for crimes occurring inside of a home; they are now applying burglary statutes to

162. See, e.g., *Bank of Am. Nat'l Trust & Sav. Ass'n v. Pendergrass*, 48 P.2d 659, 659-62 (Cal. 1935) (precluding evidence of institutional lender's oral promise that contradicted terms of written agreement in late 1920s and allowing only evidence that indicated fraudulent procurement of the contract), *overruled by* *Riverisland Cold Storage, Inc. v. Fresno-Madera Prod. Credit Ass'n*, 291 P.3d 316 (Cal. 2013).

163. See, e.g., *In re Winship*, 397 U.S. 358, 361, 363 (1970).

164. See, e.g., Peter J. Henning, *The Difficulty of Proving Financial Crimes*, N.Y. TIMES (Dec. 13, 2010), <http://dealbook.nytimes.com/2010/12/13/the-difficulty-of-proving-financial-crimes/> (“Despite the public's desire to see some corporate executives sent to jail for their role in the financial meltdown, the courts will hold the government to the requirement of proof beyond a reasonable doubt and not simply allow the cry for retribution to lead to convictions based on high compensation.”).

165. Cf. GEOFF WALSH, NAT'L CONSUMER LAW CTR., INC., STATE AND LOCAL FORECLOSURE MEDIATION PROGRAMS (2009), available at http://www.nclc.org/images/pdf/foreclosure_mortgage/mediation/report-state-mediation-programs.pdf (discussing the growing popularity and attractiveness of mediation programs supported by legislatures and courts).

166. See interviews cited *supra* note 1.

RSLB transactions.¹⁶⁷ Residential burglary alleges that a defendant entered another's premises with the intent to commit *a* crime therein.¹⁶⁸ Therefore, a prosecutor can attach a burglary charge to many crimes that occur inside of homes, if they can establish that the actor had the intent to commit *a* crime when he entered the premises, even if it is not *the* crime with which he is ultimately charged.¹⁶⁹ Applying this charge to white collar allegations is an unusual application. What makes this recent development so dangerous is that convictions on certain street-crime statutes subject white-collar defendants to strikes in three-strike jurisdictions.¹⁷⁰

There are four problems with using street crime statutes, specifically the burglary statutes. First, real estate deals *normally* occur inside of somebody's premises and contracts for and discussions about the sale of real estate can be expected to happen there, whereas, other investments do not require entry into another's premises.¹⁷¹ This type of permissible entry violates the spirit of the burglary statute and has unique implications for and disproportionate impact on real-estate professionals. Because a part of the nature of real estate transactions is the unique fact that parts of the negotiations and transaction would logically occur at the home, real estate investors are open to a type of

167. See *infra* Part V (discussing the recent California case involving Timothy Barnett).

168. See generally 3 CHARLES E. TORCIA, WHARTON'S CRIMINAL LAW § 316 (15th ed. 1995) (discussing how common law burglary evolved into broader statute-based burglary).

169. 12A PAUL M. COLTOFF & ELIZABETH WILLIAMS, C.J.S. BURGLARY § 45 (indicating that some jurisdictions require the intended crime be related to theft or stealing but that many jurisdictions do not restrict the intended crime); see also *id.* at § 2 (indicating that burglary is a separate charge from the underlying intended crime and each must be pleaded and proven separately as neither is a lesser included offense).

170. See Pfeifer, *supra* note 7. Burglary can be an enumerated offense in three-strikes jurisdictions, especially burglary of an occupied dwelling. There are twenty-eight states with three-strikes, also known as habitual offender, statutes. ARIZ. REV. STAT. ANN. § 13-703 (2014); ARK. CODE ANN. § 5-4-501 (West 2014); CAL. PENAL CODE § 667 (West 2014); COLO. REV. STAT. ANN. § 18-1.3-801 (West 2014); CONN. GEN. STAT. ANN. § 53a-40 (West 2014); FLA. STAT. ANN. § 775.084 (West 2014); GA. CODE ANN. § 40-5-58 (West 2014); IND. CODE ANN. § 35-50-2-8 (West 2014); KAN. STAT. ANN. § 21-6706 (West 2014); LA. REV. STAT. ANN. § 15:529.1 (2013); MD. CODE ANN., CRIM. LAW § 14-101 (West 2014); MASS. GEN. LAWS ANN. ch. 279, § 25 (West 2014); MONT. CODE ANN. § 46-18-501 (West 2013); NEV. REV. STAT. ANN. § 207.010 (West 2013); N.H. REV. STAT. ANN. § 651:6 (LexisNexis 2014); N.J. STAT. ANN. § 2C:44-3 (West 2014); N.M. STAT. ANN. § 31-18-17 (West 2014); N.C. GEN. STAT. ANN. § 14-7.1 (West 2014); N.D. CENT. CODE ANN. § 12.1-32-09 (West 2013); 42 PA. CONS. STAT. ANN. § 9714 (West 2014); S.C. CODE ANN. § 17-25-45 (2013); TENN. CODE ANN. § 40-35-108 (West 2014); TEX. PENAL CODE ANN. § 12.425 (West 2013); UTAH CODE ANN. § 76-3-203.5 (West 2013); VT. STAT. ANN. tit. 13, § 11 (West 2014); VA. CODE ANN. § 19.2-297.1 (West 2013); WASH. REV. CODE ANN. § 9.92.090 (West 2014); WIS. STAT. ANN. § 939.62 (West 2013).

171. See interviews cited *supra* note 1.

risk, including potential criminal strikes, to which other defendants are not subject, unless they are actually in the traditional burglary business.

Second, burglary statutes may be used over real estate fraud statutes because burglary reserves for the prosecutor the option to invoke three-strikes, allowing for prosecutorial and judicial abuse of discretion.¹⁷² Third, because burglary only requires a finding of intent to commit *some* crime,¹⁷³ it may be easier for a jury to understand and convict on burglary than the actual underlying economic behaviors. Conceivably, a jury could find a burglary even where it finds no actual fraud or theft, which sounds like criminalizing inchoate fraud.¹⁷⁴

Finally, the use of street-crime statutes to prosecute white-collar crimes unjustifiably blurs the deeply entrenched divide between white-collar and street offenses. One of the primary distinctions between white-collar activities, such as RSLB, and street crime activities, such as burglary, is the absence of violence or even the potential for violence in white-collar offenses.¹⁷⁵ Because it can be argued that violent and potentially violent crimes are worse than similar, non-violent crimes, to use the burglary statute and potential strikes for white-collar offenses under-compensates victims of actual violent crimes while over-prosecuting non-violent offenders.

C. A Perfect Storm

Making the case for fraud and burglary in signed-contract cases requires certain evidentiary and inferential leaps and highlights the problems with substituting the logic of criminal jurisprudence for the logic of civil jurisprudence. In fact, a better case can be made that what is actually happening is the criminal regulation of perceived procedural and substantive unconsciona-

172. George Blum et al., *Discretion of Prosecutor; Plea Bargaining*, 22A CAL. JUR. 3d CRIM. L.: POST-TRIAL PROC. § 299 (2014) (“Sentencing a defendant . . . under the three-strikes law does not violate the defendant’s right to equal protection, even though a [similar] nonviolent, nonserious felony . . . would not have been prosecuted under the three-strikes law in another county. The three-strikes law attempts to limit the exercise of prosecutorial discretion, and it may be likely that the district attorney’s office in another county is failing to carry out its duties. Prosecutors in one county are not required to operate under another county’s policies.”).

173. See *supra* note 169 and accompanying text.

174. An inchoate crime is an incomplete or under-developed plan. See, e.g., MO. REV. STAT. § 564.011 (2012). To criminalize the intent, through the burglary statute, does not require proving the charge, or even the attempt. See, e.g., MO. REV. STAT. § 569.160 (2012).

175. Edwin H. Sutherland, *White Collar Criminality*, 5 AM. SOC. REV. 1, 1-12 (1940) (“White-collar criminality in business is expressed most frequently in the form of misrepresentation in financial statements of corporations, manipulation in the stock exchange, commercial bribery, bribery of public officials directly or indirectly in order to secure favorable contracts and legislation, misrepresentation in advertising and salesmanship, [and] embezzlement and misapplication of funds, short weights and measures.”).

bility, and that fraud and burglary charges are just the means to that end. None of the RSLB allegations, such as onerous pricing or excessive investor profit, challenge the performance of the contract; nor do they allege a breach of contract or any problems with the performance of the written contract. For that reason, criminalizing contracts closely resembles using fraud and burglary to criminalize unconscionability, not criminalizing affirmative breaches of contract. Of particular concern is the precedential value of cases, which arise during the perfect storm. Bad decisions lead to bad case law, which gets memorialized as bad law and leads to bad plea-bargaining by weary subsequent defendants.¹⁷⁶

A perfect storm of social, political, and economic forces in the real estate and securities markets converged and created an environment that blurs the line between normal contracting behaviors and criminal conduct.¹⁷⁷ The perfect storm starts with a uniquely American, deeply-entrenched ideal of homeownership.¹⁷⁸ Homeownership is a part of the American ethos, the crux of the American Dream. Therefore, to take someone's home is considered among the worst things a person can do.¹⁷⁹ The storm is intensified by a cul-

176. *Regulatory Crimes: Solutions: Hearing Before House Committee on the Judiciary, Overcriminalization Task Force*, 113th Cong. (2013) (statement of Professor Lucien E. Dervan) ("As the . . . breadth, and sentencing severity . . . increased . . . because of overcriminalization, prosecutors gained increased ability to create overwhelming incentives for defendants to waive their constitutional right to a trial by jury and plead guilty. . . . At the same time, the financial and emotional costs to the defendants and their families of proceeding to trial have grown into often insurmountable obstacles. . . . It is occurring in all manner of criminal cases throughout the country."); see also Lucien E. Dervan, *Overcriminalization 2.0: The Symbiotic Relationship Between Plea Bargaining and Overcriminalization*, 7 J.L. ECON. & POL'Y 645, 646 (2011) ("[P]lea bargaining and overcriminalization perpetuate each other, as plea bargaining shields overcriminalization from scrutiny and overcriminalization creates the incentives that make plea bargaining so pervasive.").

177. See Dick Thornburgh, Former Att'y Gen. of the United States, Remarks at the Luncheon Meeting of the Pittsburgh Legal Administrators Association: Developments in the Law: Past, Present and Future: The Challenge of Over-Criminalization (March 23, 2011) ("The line has become blurred, however, on what conduct constitutes a crime, particularly in corporate criminal cases, and this line needs to be re-drawn and re-clarified. Over-breadth in corporate criminal law, for example, can lead to a near paranoid corporate culture that is constantly looking over its shoulder for the 'long arm of the law' and wondering whether good faith business decisions will be interpreted by an ambitious prosecutor as a crime.").

178. DAVID L. KIRP ET AL., *OUR TOWN: RACE, HOUSING, AND THE SOUL OF SUBURBIA*, 83-84 (1997) (quoting James Madison at the 1787 Constitutional Convention as stating, "The United States have a precious advantage . . . in the actual distribution of property . . . and in the universal hope of acquiring property" and quoting Herbert Hoover at the President's Conference on Building and Home Ownership, "That [Americans] should live in their own homes is a sentiment deep in the heart of our race and of American life").

179. Pfeifer, *supra* note 7 (quoting L.A. Cnty. Superior Court Judge Stephen A. Marcus during sentencing of Mr. Barnett as stating, "The worst thing you can do is

ture of systemic white-collar allegations.¹⁸⁰ Public sentiment is enflamed by the media and has created a groundswell of animosity towards white-collar defendants in the wake of Enron in 2001, WorldCom in 2002, and Bernie Madoff in 2010 – animosity increasingly reflected in white-collar defendants’ sentences.¹⁸¹ While there appears to be significant public sentiment *against* most forms of over-criminalization in non-economic areas, that sentiment does not extend to the over-criminalization of economic behaviors.¹⁸² Therefore, such sweeping criminal legislation by Congress, prosecutorial overreach, and expansive judicial interpretation goes largely unchecked because the public has been mobilized against anything that looks even close to fraud due to recent news-making cases.¹⁸³

Finally, when the American ethos of homeownership and the culture of white-collar activity are coupled with large foreclosures and plummeting home values, which result from a downturn in the real estate and securities markets, the perfect storm erupts. Within the eye of this storm are RSLB investors, who are easier to identify and prosecute than the large banks which

take somebody’s home. . . . Even Bernie Madoff didn’t take people’s homes”). A case study of Mr. Barnett is presented later in this Article. *See infra* Part V.

180. *See* sources cited *supra* note 177.

181. Peter J. Henning, *Sentences Get Harsher in White-Collar Cases*, N.Y. TIMES (April 12, 2010), http://dealbook.nytimes.com/2010/04/12/sentences-get-harsher-in-white-collar-cases/?_php=true&_type=blogs&_r=0. Henning writes:

The 50-year prison term . . . is the latest in a string of harsh punishments imposed on defendants convicted of orchestrating frauds. Twenty years ago, a sentence of more than five years for a white-collar offender was rare, and most sentences were measured in months, not years. The sentence meted out . . . last week is similar in severity to the 150 years given to Bernard L. Madoff . . . and it is the latest signal that many defendants, at least in high-profile cases, are looking at prison terms that will amount to life behind bars. Even in less notorious cases, the prison terms for financial crimes have been moving higher, raising questions whether sentences once reserved for violent criminals are appropriate for white-collar defendants. . . . As more financial frauds come to the surface, do not be surprised to see more white-collar defendants receive long prison sentences. This does not appear to be a trend that will abate any time soon.

Id.

182. Ellen S. Podgor, *Criminal Law: The Challenge of White Collar Sentencing*, 97 J. CRIM. L. & CRIMINOLOGY 731, 731-32 (2007).

183. *See id.* at 740; WILLIAM R. MAURER & DAVID MALMSTROM, THE FEDERALIST SOC’Y, THE EXPLOSION OF THE CRIMINAL LAW AND ITS COST TO INDIVIDUALS, ECONOMIC OPPORTUNITY, AND SOCIETY 4 (2010), *available at* http://www.fed-soc.org/doclib/20100125_CriminalLawCosts.pdf (“Today’s legislature uses the criminal code not just to prevent or punish wrongdoing, but to regulate a wide range of personal, economic, and social conduct. This overcriminalization occurs at both the state and federal level. By the most recent count, there are at least 4,450 federal crimes on the books, an average of 57 crimes added to the federal law per year. . . . There is a similar trend in state law to criminalize personal, economic, and social conduct.”).

many believe caused the most recent financial crisis.¹⁸⁴ RSLB and other small investors become the scapegoats.¹⁸⁵

Public sentiment exists prior to the commission of any acts and is the fertile ground from which over-criminalization sprouts.¹⁸⁶ The surge in animosity towards large corporate and high-dollar actors has created legislation and judicial outcomes that are impacting smaller, individual defendants whose offenses involve significantly smaller and less socially-harmful situations.¹⁸⁷ Although certain scholars of over-criminalization argue that the swelling of sentences has been limited to large, high-profile defendants and has not trickled down to average defendants,¹⁸⁸ recent sentences challenge this wisdom.¹⁸⁹

D. Criminalizing Unconscionability?

The doctrine of unconscionability is most closely associated with Justice Skelly Wright's decision in the *Williams v. Walker-Thomas Furniture Company* case and UCC § 2-302's earlier codification of the doctrine.¹⁹⁰ Advancing the reasoning in Wright's decision, scholars further developed the doctrine into what is commonly known as unconscionability doctrine today – a

184. *Justice Department Oversight* (C-SPAN 3 television broadcast Mar. 6, 2013), available at www.c-spanvideo.org/program/311311-1, at 02:19:25 (showing Attorney General Eric Holder: "I am concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute them when we are hit with indications that if you do prosecute – if you do bring a criminal charge – it will have a negative impact on the national economy, perhaps even the world economy. And, I think that is a function of the fact that some of these institutions have become too large").

185. *See Financial Regulations Law Implementation* (C-SPAN 3 television broadcast Feb. 14, 2013), available at www.c-spanvideo.org/program/310990-1, at 01:39:21 (showing Senator Elizabeth Warren: "There are district attorneys and U.S. attorneys who are out there every day squeezing ordinary citizens – on sometimes very thin grounds – and taking them to trial in order to make an example, as they put it. I'm really concerned that 'too big to fail' has become 'too big for trial'").

186. *See* Podgor, *supra* note 182, at 740.

187. *See* sources cited *supra* note 177; *see also* Podgor, *supra* note 182, at 732-33.

188. *See* Podgor, *supra* note 182, at 731-33.

189. *See infra* Part V (discussing the California case of Mr. Barnett, who was sentenced to 33.33-years-to-life under the state's three-strikes law and became a high-profile defendant only as a result of his sentence); *see also* sources cited *supra* note 177.

190. 350 F.2d 445, 449 (D.C. Cir. 1965); UNIF. COMMERCIAL CODE § 2-302 (1952); UNIF. COMMERCIAL CODE § 2A-108 (1974) (regarding leases). However, the classic description of an unconscionable contract is still this: a contract "such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other . . ." *Hume v. United States*, 132 U.S. 406, 411 (1889) (quoting *Earl of Chesterfield v. Janssen*, 28 Eng. Rep. 82, 100 (Ch. 1750)).

two-pronged doctrine, which includes substantive and procedural elements.¹⁹¹ As the contract doctrine of unconscionability becomes less available for the aggrieved,¹⁹² have the criminal courts stepped in to fill that gap?¹⁹³ The unconscionability defense to contract enforcement can be found in one of two ways: procedural unconscionability and substantive unconscionability.¹⁹⁴ A procedurally unconscionable contract is one where the circumstances surrounding the formation of the contract are unfair, exploitative, or likely to bring about an unfair contract result.¹⁹⁵ A substantively unconscionable contract is one where the terms of the contract are significantly weighted in the favor of the stronger party and onerous to the other party.¹⁹⁶

Several of the major criticisms of the RSLB transaction sound a lot like civil unconscionability. First, there is the criticism that these investors target poor, minority, and elderly homeowners and exploit demographic affinities.¹⁹⁷ Second, there is the criticism that the homeowners are forced to make their decisions under very tense time pressures.¹⁹⁸ Third, there is the criticism that the homeowners do not understand the transactions because the

191. See generally Arthur A. Leff, *Unconscionability and the Code – The Emperor’s New Clause*, 115 U. PA. L. REV. 485 (1967) [hereinafter *Emperor’s New Clause*] (discussing the evolution of Uniform Commercial Code Section 2-302, including substantive and procedural elements); Arthur A. Leff, *Unconscionability and the Crowd – Consumers and the Common Law Tradition*, 31 U. PITT. L. REV. 349 (1970) (discussing procedural and substantive differences in the doctrine of unconscionability as defined by Uniform Commercial Code section 2-302 and case law).

192. See Larry A. DiMatteo & Bruce L. Rich, *A Consent Theory of Unconscionability: An Empirical Study of Law in Action*, 33 FLA. ST. U. L. REV. 1067, 1097 (2006) (“Data revealed that in only 37.8% (56 out of 148) of the cases sampled unconscionability was found”); see generally Anne Fleming, *The Rise and Fall of Unconscionability as the “Law of the Poor”*, 102 GEO. L.J. 1383 (2014) (arguing that although unconscionability was once the law of the poor and was prevalent in consumer protection jurisprudence, today it largely has been supplanted by ex ante legislative efforts). Now the only whispers of unconscionability appear to be in arbitration clause cases.

193. Unconscionability is usually an affirmative defense to contract enforcement. See, e.g., *Repair Masters Constr., Inc. v. Gary*, 277 S.W.3d 854, 856 (Mo. Ct. App. 2009). As such, it emerges procedurally after Party A attempts to enforce a contract right against Party B (say an eviction, repossession, or mandatory arbitration) and Party B raises the defense that the contract or term was unconscionable and should not be enforced. Rarely, a statute will allow unconscionability as an affirmative claim.

194. See *Emperor’s New Clause*, *supra* note 191, at 489.

195. See RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. d (1981).

196. *Id.* at § 208, cmts. c, d.

197. See Nichols, *supra* note 4, at 280-81.

198. See *id.* at 282.

contract documents are too complicated.¹⁹⁹ Finally, there is the criticism that the terms are too onerous for the homeowners to manage.²⁰⁰

In order to criminalize unconscionability, prosecutors must allege actual fraud and misrepresentation. Where there is actual fraud or misrepresentation, no one would argue legitimately in defense of those contracts; the real problem, however, occurs when over-zealous prosecutors lay their allegations before a less skeptical or more sympathetic judiciary or jury, leading to findings of fraud and misrepresentation when there is just the perception of unconscionability. A careful analysis of this market suggests that the latter phenomenon is occurring.

E. Procedural Unconscionability: Targeting Vulnerable Groups

Procedural unconscionability can be found when the circumstances surrounding the formation of a contract would likely lead to an unfair contract.²⁰¹ Critics of the RSLB transaction often accuse investors of seeking out elderly, minority, or poor homeowners. They allege that investors seek out these groups because these groups are vulnerable.²⁰² This is a mistaken conclusion. Critics mistake a causal relationship for what is more likely a corollary relationship. For example, if an investor sees herself as a substitute for traditional financing, she will be a good match for those homeowners who cannot get traditional financing, often due to poor credit. Further, because this transaction is a response to the pre-foreclosure problem, the investors' contracting partners will be facing foreclosure, meaning they are more likely to be poor or working class. Finally, small investors often have a limited pool of capital, which they seek to diversify with as many deals as possible, meaning more, but smaller, deals. Smaller deals are done on lower-cost homes, which likely belong to poorer people. If an investor is a minority, who has relationships in minority neighborhoods and feels more at home in minority neighborhoods, she may use these areas as her place of business, and, therefore, her "targets" will be from those areas. Finally, if an investor seeks to enable homeowners to mobilize their own equity to fund some of her transactions, she will contract with homeowners who have the most equity to mobilize. Such homeowners will tend to have owned their homes the longest, which will correlate with their being older than an average homeowner.²⁰³

199. *See id.* at 281.

200. *See id.*; *see generally* Dan Immergluck & Philip Schaeffing, Responsible Lease-Purchase: A Review of the Practice and Research Literature on Nonprofit Programs (October 12, 2010) (unpublished manuscript), *available at* <http://ssrn.com/abstract=1691194> (reviewing nonprofit lease-purchase programs).

201. *See* RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. d (1981).

202. Nichols, *supra* note 4, at 280-81.

203. JAMES POTERBA, ET AL., NAT'L BUREAU OF ECON. RESEARCH, DEMOGRAPHIC TRENDS, HOUSING EQUITY, AND THE FINANCIAL SECURITY OF FUTURE RETIREES 3 (2007), *available at* <http://www.nber.org/aging/rrc/papers/onb07-06.pdf>.

Another common accusation in these cases is that investors exploit religious, ethnic, or racial affinity.²⁰⁴ Affinity is shared between two people with a mutual affiliation, such as common heritage, race, or religion.²⁰⁵ The allegation is that investors seek out those homeowners with whom the investors have shared attributes, using that shared attribute as a means of gaining trust, which enables the alleged fraud.²⁰⁶ Again, that an investor and a homeowner share some attribute may reflect a corollary, not a causal, relationship. For example, people of a particular demographic may have more access to others of the same demographic than they have to members of other demographics. Additionally, it is not clear that the investors even know of the perception of exploitation. Indeed, investors may just have comfort and familiarity in their own neighborhoods or church communities.

F. Procedural Unconscionability: Time Pressure

Investors are accused of forcing homeowners to make these decisions and to negotiate these contracts under very tight time constraints.²⁰⁷ There is no question that, when a person is facing foreclosure, there are time constraints.²⁰⁸ However, what these critics fail to recognize are two important factors that are outside of investors' control. First, investors do not set the timeline.²⁰⁹ From the moment the foreclosing lender publishes its list of homeowners in foreclosure, the clock begins to tick. After seeing this list, investors contact the homeowners. Because investors do not know about the homeowners until the time of the list's publication, there is no way for investors to lengthen that time frame.²¹⁰ That notification will specify that home-

204. See Cox, *supra* note 4, at 611 (“Acquirers have also used affinity marketing techniques – appeals to racial, religious, or ethnic solidarity – to build a false sense of trust.”); Nichols, *supra* note 4, at 280.

205. MERRIAM WEBSTER’S COLLEGIATE DICTIONARY (11th ed. 2005), available at <http://www.merriam-webster.com/dictionary/affinity> (defining “affinity” as “2a: sympathy marked by community of interest . . . 3a: likeness based on relationship or causal connection”).

206. See Cox, *supra* note 4, at 611, 620-21; Nichols, *supra* note 4, at 282-84.

207. See Cox, *supra* note 4, at 611 (“Acquirers also rely on creating a sense of urgency.”); Nichols, *supra* note 4, at 282-83.

208. Cox, *supra* note 4, at 611 (“Some foreclosed homeowners face loss of the home in weeks or days as the foreclosure redemption period comes to an end, and thus the urgency is real.”). *But see id.* (“In most cases, however, homeowners have sufficient time to sell the home, complete a loan restructuring, or evaluate other options.”).

209. The timelines are statutory and vary by state. See *Foreclosure Laws and Procedures by State*, REALTYTRAC.COM, <http://www.realtytrac.com/real-estate-guides/foreclosure-laws/> (last visited June 28, 2014) (indicating that Minnesota offers homeowners a timeline of seven days – the shortest of all states, Missouri offers a ten-day period, California offers twenty-one days, and Colorado offers sixty days).

210. If there were a way for an investor to negotiate with a lender to extend the timing of the foreclosure initiation procedure, the benefit of that time would accrue to

owners have a set number of days, say thirty days, to bring their loans current before foreclosure proceedings will begin.²¹¹ Those time constraints are statutory and vary by jurisdiction.²¹² Investors must complete their transactions and avert the foreclosures within the statutory timeframe.²¹³ Second, within that limited timeframe, the contracts between homeowners and investors are subject to a statutory waiting period of up to five days.²¹⁴ The purpose of this period, also known as a "cooling off period," is to give homeowners the time they need to objectively and thoroughly review the contracts. Unfortunately, the days dedicated to the waiting period eat into the pre-foreclosure clock. Once the official foreclosure is complete, the cost of this transaction can go up precipitously because the investor must negotiate with the bank instead of the homeowner as the homeowner will have already lost the home. Additionally, the transaction between the bank and the investor will be subject to the homeowners' post-foreclosure rights,²¹⁵ which are governed by a different post-foreclosure statutory scheme because that sale would no longer be considered an open-market transaction and the bank will likely have initiated eviction proceedings.²¹⁶ Finally, after that timeframe runs out, the homeowners' rights are limited with respect to the property and its disposition.²¹⁷

G. Procedural Unconscionability: Confusing Contracts = No Consent

The second way investors are accused of stealing money from homeowners is through contracts drafted in ways that are too complicated for homeowners to understand, even if read. Critics allege that these complicated contracts lead to potentially invalid consent. This argument has three strands. One strand of the argument is that it cannot be assumed that the homeowner

the homeowner. However, it is not always relevant because, in order for an investor to negotiate with a lender, the homeowner would already have committed to work with that particular investor and would have signed documents granting the right to negotiation with the lender to the investor.

211. *See, e.g.*, CAL. CIV. CODE § 2924 (West 2014). For example, in California, once a lender publishes his intent, the homeowner has fifteen days to avoid the foreclosure sale. *See id.* The lender can then sell the property legally on the twenty-first day after the notice; however, the lender may take longer than that. CAL. CIV. CODE § 2924.8.

212. *See supra* note 209 and accompanying text.

213. *See generally* Cox, *supra* note 4, at 610-13 (offering an overview of the RSLB transaction).

214. *See, e.g.*, CAL. CIV. CODE § 1695.4(a); WIS. STAT. ANN. § 846.40(4) (West 2014).

215. *See, e.g.*, N.J. STAT. ANN. §§ 2A:50-3 to 2A:50-4 (West 2014) (outlining homeowners' post-foreclosure rights).

216. *See id.*

217. *See id.*; *supra* note 94 and accompanying text; *see, e.g.*, MINN. STAT. ANN. § 561.10 (West 2014) (conferring rights to foreclosed property purchaser against "tenant in possession").

will read the contract. Indeed, much attention has been paid to the ever-decreasing duty to read.²¹⁸

The second strand of this argument is that, even if homeowners read the contracts, they cannot be expected to understand the nature of their commitments or the likelihood of being able to buy back their homes because they cannot understand the contract and, therefore, ultimately cannot understand the transaction itself.²¹⁹ The first two strands do not account for two important considerations. First, the contracts in this transaction are no more difficult to understand than the corresponding documents of the homeowners' original mortgage loans and other documents they might have, such as a myriad of refinance documents and home equity loan documents.²²⁰ Second, the argument does not take into consideration the important role of community knowledge and collective wisdom within communities where these transactions are common. RSLB transactions are often prevalent, well-known, and oft-discussed in these communities. In fact, the very accusation that investors target these communities implies greater prevalence of the transaction in these communities and supports the inference that these residents are familiar with and knowledgeable about the transactions.

Community understanding surrounding these transactions develops through a social process called "interpersonal learning," which is described as information-sharing that occurs in local communities, both real and virtual.²²¹ In fact, the formal and informal networks that exist within these communities may serve as hubs of information. These networks would include family and

218. See generally Charles L. Knapp, *Is There a "Duty to Read"?* (U. of Cal. Hastings Coll. of the Law Legal Studies Research Paper Series, Research Paper No. 63, 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2330632 (discussing the current state of the duty to read).

219. See *id.* at 323.

220. In fact, the content and degree of readability of RSLB documents are often explicitly governed by a jurisdiction's equity purchase statutes. See, e.g., CAL. CIV. CODE §§ 2945.1-11, 1695.1-17 (West 2014) (outlining equity purchase procedures, including required language and content of documents used in the process); MD. CODE ANN., REAL PROP. §§ 7-105 to -113, 7-301 to -325 (West 2014); MO. REV. STAT. §§ 407.935-.943; WASH. REV. CODE ANN. §§ 19.134.010-.900. Even in those jurisdictions where there is not an equity purchase statute, these transactions would be governed by the same statutes as ordinary land transfers, which would have governed the homeowner's original purchase or acquisition of the property.

221. See Richard A. Epstein, *Behavioral Economics: Human Errors and Market Corrections*, 73 U. CHI. L. REV. 111, 118-120 (2006) (arguing that consumers learn from their own mistakes and the mistakes of others with whom they come in contact, collectively consumers learn faster, and mistakes will cease to exist within marketplaces, especially when the products about which the original errors were made are standardized products). But see Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749, 756 (2008) (arguing that when products or their usage are not standardized, interpersonal learning is slower).

friends,²²² perhaps in churches, community centers, grocery stores, parks, workplaces, and other common meeting areas within a community. Because of these sources of extra-contractual knowledge development, it is not legitimate to say that homeowners cannot have understood the transaction, while also saying that these transactions are concentrated in homeowners' neighborhoods. In fact, a related twist is the possibility that there is actual sophistication in certain communities about RSLB transactions, which would lead to homeowners acting in their own best interests, exploiting the weaknesses of the contracts and conferring with one another about what the investors call "the best methods to beat the system." Indeed, these community resources, coupled with homeowners' conversations with the investors and lenders, and the written contract itself, combine to suggest full understanding.

The third precarious prong in this "could not consent" argument is that due to the homeowners' failure to read or understand the contracts the homeowners' consent can be neither knowing nor voluntary. For the aforementioned reasons, the "could not consent" argument becomes less reliable. However, a more insidious strand of this argument emerges and can be called the "would not consent" argument. Supporters of the "would not consent" argument assert that where the harm is this great – meaning where the risk of losing one's home is high – any consent could not be meaningful consent because no homeowner would consent to such a possibility.²²³ The extension of the "would not consent" argument is that, if losing one's home were foreseeable and discernible, no homeowner would have agreed to it.²²⁴ This mistaken conclusion equates consent with confusion. The "could not consent" argument says that, because a homeowner could not understand the contract, he *could* not have consented.²²⁵ The "would not consent" argument says that, given the possible negative outcome, the homeowner *would* not have consented.²²⁶ The basis of the "would not consent" argument stems from the idea in American society that the homestead is sacred²²⁷ – more sacred, perhaps, than any other possession. The "would not consent" conclusion fails to take into consideration the factors outlined in the next section about the scope of the homeowner's options when choosing the RSLB solution, including the benefits that are only available to the homeowner with the RSLB transaction.

222. OREN BAR-GILL, *SEDUCTION BY CONTRACT: LAW, ECONOMICS, AND PSYCHOLOGY IN CONSUMER MARKETS* 126-30 (2012).

223. *See* SINGER, *supra* note 36, at 808 (5th ed. 2010).

224. *Id.* This argument is most appealing when coupled with the American ideal of homeownership, which holds homeownership in what is, perhaps, an irrationally exalted position. *See supra* note 178 and accompanying text.

225. *See* SINGER, *supra* note 36, at 811.

226. *See supra* notes 223-224 and accompanying text.

227. *See supra* note 178 and accompanying text.

H. Substantive Unconscionability: Unbearable Terms

Investors are often accused of offering terms that are overly burdensome to homeowners – terms that will ensure the investor ends up with the property or underlying equity in the end.²²⁸ The core of this criticism is likely the general discomfort that critics have with investors taking what the critics perceive to be too large of a share of the trapped equity. It is impossible to quantify a fair price in a market like this, in which the risk to the investors varies by transaction, in which payments made on each homeowner's behalf can vary widely, and in which there are both short-term purchase elements and longer-term maintenance elements. However, it is undisputed that investors receive a large portion of equity in these transactions.²²⁹ If it can be accepted that these are high-risk transactions and high-risk homeowners, then it should be understandable that investors will engage in these socially-beneficial, yet high-risk transactions only if the reward premium matches the risk.

Because the only currency available in the transaction is the trapped equity, that equity becomes the currency with which the premium would be paid. The three primary variables in an RSLB transaction are the purchase price, the duration and rate of the lease, and the buyback price and date. It is through the numerous, negotiable combinations of these three variables that the investors' premium is outlined and secured. Homeowners have a chance to negotiate these varying terms and to have a range of advisors review the terms of the transaction – advisors who range from family members to friends to attorneys.²³⁰ They also often have several competing offers from multiple investors to choose among for the best offer. It should be noted that these are not adhesion contracts. These contracts are drafted by small investors who are closer in size and market power to the homeowners than they are to large

228. See sources cited *supra* note 4.

229. See interviews cited *supra* note 1.

230. Some scholars and critics contend that the opportunity to have a transaction document reviewed by legal counsel is irrelevant to the discussion because certain homeowners, in practice, do not have the means to get legal counsel. See Gene R. Nichol, *Judicial Abdication and Equal Access to the Civil Justice System*, 60 CASE W. RES. L. REV. 325 (2010) (discussing the overall lack of access to attorneys and the civil justice system). Indeed, President Jimmy Carter once said: "Ninety percent of our lawyers serve ten percent of our people. We are overlawyered and underrepresented." Deborah Rhode, *Access to Justice: Connecting Principles to Practice*, 17 GEO. J. LEGAL ETHICS 369, 371 (2004). The fact that a homeowner may not or cannot take advantage of legal counsel reflects a larger societal problem and is not unique to RSLB transactions. The lack of legal counsel and the issues that accompany it exist during the precarious foreclosure process as well. Indeed, perhaps legal services organizations should consider dedicating resources to providing contract review sessions to these homeowners during the foreclosure process – such as during the statutory attorney review period before the sale – instead of dedicating those same resources to suing the RSLB investors after the fact.

lenders. The allegation that it is impossible to negotiate with these small neighborhood investors is baseless.²³¹

Finally, proponents of criminal regulation fail to take into account that, in a distressed bargaining situation, such as in rescue transactions, a contracting party may have limited options to begin with. Indeed, in the world of contracts, only *rarely* is a party contracting for “no harm” versus “some harm.” Given the realities of facing foreclosure, the only two possible outcomes for these homeowners are “harm” and “massive harm.” Because these homeowners are choosing between the not-ideal RSLB transaction and the even worse foreclosure option, the “no harm” outcome is not an option. Without RSLB investors, the homeowners would have lost their homes instantly and certainly – most likely without retaining any of their equity. With the pre-foreclosure investor, the homeowner at least has a chance to save his home and to pull out some of his equity. It is this chance a homeowner bargains for and for which a homeowner pays. RSLB gave the homeowner access to at least some of his equity, and possibly a great deal more; whereas, the foreclosure scenario leaves him with nothing. Something is not onerous when compared to nothing.

I. The Triumph of Behavioralism

A third explanation for the recent and steep increase in demonization, criminal regulation, and sentencing that RSLB investors face is the triumph of behavioral economics over rational choice economics in homeowner advocacy jurisprudence.²³² The problem emerges because the pace at which civil judges are re-empowered by the legislature and case law to provide the civil remedies of the 1960s and 1970s trails the pace at which the behavioralists and consumer protectionists are bringing homeowner advocacy suits against

231. It has been argued that though the RSLB investors may not be significantly larger in market power, they are more sophisticated and have other advantages, such as education and experience. *But see* Shiller & Weiss, *supra* note 81, at 11, 29 (arguing that, in home equity conversion product transactions, clever homeowners have incentives to game the transactions and extract value from the homes in ways that are hard to detect and which can become costly for the investors who bear the risk).

232. *See* Mann, *supra* note 14, at 739-40 (describing academic literature’s focus on “paternalistic intervention” theories that influence people’s behavior to “correct market imperfections”). The most recent cycle of rational choice economics began in the late 1970s and early 1980s and was a reaction to sweeping consumer-protection legislation passed in the 1960s and 1970s – the era of *Williams v. Walker-Thomas Furniture Company*. However, beginning somewhere around the middle of the first decade of the 2000s, the pendulum began to shift back. Today, in 2014, the behavioralists and the rational choice theorists still are locked in a battle for the judiciary and the academy. The recent passage and current implementation of the Dodd-Frank CFPB legislation is considered a victory for behavioralists, including some of its original drafters, Senator Elizabeth Warren and Professor Oren Bar-Gill, and indicates that sweeping consumer protectionism may be back in favor.

the investors;²³³ therefore, these advocates turn to the criminal courts instead. Not only are criminal dispositions more expensive,²³⁴ but they also do not provide homeowners with meaningful remedies or recovery from investors who might otherwise be able to generate the funds to pay remedies if they are not in jail. They also fail to create a useful body of common law.

While there has always been consumer protectionist opposition to foreclosure rescue transactions, over the last three decades that opposition existed within and was bounded by the dominant free-market, rational choice framework, and the limits of civil remedies.²³⁵ Rational choice theory and the Coasian rational-actor model theorize that the activities of consumers in the marketplace reflect their actual preferences and personal utility calculations.²³⁶ Rational choice stands on the premise of autonomy, arguing that, if a consumer did something, it must be because the consumer wanted to do it and because it maximized his utility by having done it.²³⁷ It makes no attempt to decipher *why* the consumer may have done it, choosing instead to defer to the consumer's own analysis of his needs and wants. As a result of the dominance of rational choice theory, contract terms became largely deregulated, and prominent corporate defendants have been able to avoid liability for harsh terms and one-sided contracts.²³⁸ During the reign of rational choice, many contract doctrines, under which plaintiffs could traditionally recover or burdened defendants could avoid contract enforcement, were dramatically weakened and effectively ceased to be available to those parties.²³⁹

Behavioralists, however, reject the notion that consumer actions only reflect consumer preferences.²⁴⁰ Instead, behavioralism reveals that consumer actions are rife with error and critical miscalculations, which sellers exploit.²⁴¹ Replacing the mere theorizing of rational-choice economics with data and empirics,²⁴² behavioral law and economics scholars reject the notion that consumers behave in the ways that rational choice economists theorize they would and have called for a wholesale reexamination of the validity of

233. Alan M. White, *Behavior and Contract*, 27 LAW & INEQ. 135, 145 (2009) (“Beginning around 1980, Congress progressively preempted most state usury laws. . . . [T]he initial deregulation of first mortgage rates . . . was the leading edge of a wave.”).

234. A. Mitchell Polinsky & Steven Shavell, *The Optimal Use of Fines and Imprisonment* 2-3 (Nat'l Bureau of Econ. Research, Working Paper No. 932 1982), available at <http://www.nber.org/papers/w0932>.

235. See White, *supra* note 233, at 138-49.

236. See generally R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937) (laying the foundation for the concept of the rational actor in much of neoliberal law and economics).

237. See *id.* at 387.

238. White, *supra* note 233, at 138-41.

239. *Id.*

240. *Id.* at 149-50.

241. *Id.* at 150-51.

242. Mann, *supra* note 14, at 735-36.

rational choice theory as the underpinning of American contract law.²⁴³ Recently, behavioral economics has developed a stronghold in the courts and the academy, and consumer protectionists now find themselves swimming with the current and not against it.²⁴⁴ Much of the opposition to and criticism of transactions like RSLB have come from the consumer protectionist and homeowner advocacy camps, which argue that the transactions are just a means to swindle desperate homeowners out of their home equity.²⁴⁵ Behavioralists echo this sentiment when they claim that sellers of certain products and services, in this case the RSLB investors, exploit what they have learned are the cognitive weaknesses of the consumers, in this case the homeowners.²⁴⁶

Behavioralists would reject the notion that homeowners' acceptance of RSLB and other rescue transactions reflects the actual preferences of the homeowners or is the utility-maximizing option for the homeowners.²⁴⁷ Instead, they would argue that homeowners' decisions are distorted by informational asymmetry, various biases, and manipulation by contracting partners.²⁴⁸

There are problems with the new fervor of the behavioralists and protectionists. The first problem is that such arguments assess what is utility-maximizing behavior for one group – poor homeowners – through an Anglo-normative, middle-class paradigm.²⁴⁹ In doing so, they fail to appreciate that what is of value to a homeowner who is trying to stave off his own personal financial apocalypse in just days may differ from what is valuable to a middle-class homeowner whose financial horizon may be considerably longer.²⁵⁰ Such biased arguments groundlessly strip homeowners of sophistication, savvy, and agency.²⁵¹

These advocates fail to take into account that, in a distressed bargaining situation, such as in rescue transactions, a contracting party may have limited options to begin with and actually may be choosing logically, rationally, and correctly between two bad options. Behavioralists also fail to appreciate the preference and familiarity certain communities have for non-bank solutions

243. White, *supra* note 233, at 136 (calling for a “[rethinking of] the norms to be pursued by consumer contract law,” including reexamination of rational choice theory in several consumer contract-based financial industries).

244. See Mann, *supra* note 14, at 735-36.

245. See *supra* note 4 and accompanying text.

246. See White, *supra* note 233, at 150-51.

247. See generally Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998) (arguing that people actually act differently from how rationale-choice theorists posit).

248. See White, *supra* note 233, at 158-61.

249. See Mann, *supra* note 14, at 739-40.

250. *Id.* at 738, 744, 746.

251. See generally *id.* (arguing that academics effectively ignore lower-income households in their analyses).

and the deep-seated distrust they have for banks.²⁵² Many of the homeowners feel that the banks have abandoned them in their times of greatest need.²⁵³ That a homeowner chooses between evils is not synonymous with the fact that the homeowner could not or did not understand his options or the contracts, or that he lacks sophistication.²⁵⁴

The second, and perhaps larger, problem with the renewed fervor of the behavioralist and consumer protectionist approach is that, as the trend picks up momentum, it targets investors without the availability of the civil courts and contract doctrine to dispose of these cases adequately. In effect, the rise of behavioral economics has outpaced the return of the traditional civil doctrines, which leaves nothing but the criminal law to regulate these transactions with its punitive sword. Regulating these transactions criminally is an attempt to substitute the logic of one institution for the logic of another institution. This incongruity creates a regime of draconian criminal sanctions for contract disputes, removes the availability of the viable RSLB transaction – a last resort for many homeowners – and creates instability in a marketplace that may benefit disproportionately from stability. It also provides no real redress for the homeowners.

PART III: THE PROBLEM WITH CRIMINAL REGULATION

The current criminal regulation response to RSLB investing behaviors weakens the institution of contracting, exacerbates the market failure that RSLB seeks to address, sets up disproportionate outcomes for RSLB investors, and is a poor institutional choice to combat what may be valid state concerns.

Presently, the market solution to the supply and demand misalignment in the trapped equity paradox exists outside conventional mortgage finance through the RSLB transaction. As described in Part I, non-bank investors enter this arena to reconfigure the marketplace. These investors realign the relationships between owners and lenders, extending or avoiding the foreclosure process by liberating trapped equity. At some point, however, some participants of a market become dissatisfied with the results they are getting in the marketplace and those participants pull in the prosecutorial, judicial and/or legislative authorities to intervene and to redistribute market outcomes,²⁵⁵ often with steep civil and criminal sanctions for their opposing

252. *Id.* at 743.

253. One investor, D.A., said during his interview that when he posts “We Buy Houses” signs, he gets the best results from the crooked, handwritten signs because the homeowners believe that there is a real person and not a bank or finance company. See interviews cited *supra* note 1.

254. See Mann, *supra* note 14, at 745-47.

255. Recent headline-making cases demonstrate the trend of government criminal enforcement authorities intervening in what should be private civil matters thereby externalizing to tax-payers costs that private parties alone should incur. For example, Jaguar-Land Rover, a luxury American manufacturer, enlisted federal prosecutors to

parties.²⁵⁶ Criminal regulation of contractual behaviors weakens the institution of contracting, in part, because it blurs the doctrinal line between civil contract disputes and criminal conduct. Indeed, criminal regulation usurps the power of contracting and the civil courts to handle disputes arising therein. As the criminal law then works to eviscerate the market's RSLB solution, including the portions of the solution that are working, it implements instead a worse solution.

A. Erodes Contracting

Regulating ordinary bargaining behaviors with the criminal law erodes the institution of contracting for several reasons. The purpose of contracting is to encourage private ordering of affairs without the intervention of the courts except in an enforcement capacity.²⁵⁷ One reason that erosion of contracting occurs is because of the introduction of unforeseeable outcomes that are difficult and expensive to hedge against in negotiated relationships. They increase the risk inherent in the contracts, thereby increasing the cost and

stop exporters from buying luxury cars in America and shipping them to foreign countries, where the vehicles otherwise could cost three times as much. Matthew Goldstein, *U.S. Ordered to Return Assets Held in Crackdown of Luxury Cars Exported to China*, N.Y. TIMES, Apr. 4, 2014, at B3. Coming to the rescue of the corporate giant, the U.S. Secret Service and the Departments of Homeland Security seized cars and froze assets of the exporting companies. *Id.* One particular exporter of the luxury cars claimed that it was simply exploiting an arbitrage opportunity and that, even if done using straw buyers, this is a civil matter that the car manufacturer should pursue privately – not a federal criminal matter. *Id.* The presiding judge ordered the assets returned and unfroze the exporter's bank accounts. *Id.* In another headline-making example, the debt-collection industry has enlisted state and local prosecutors to help it collect on its bad debts, thereby avoiding the cost of civil litigation and likely increasing the odds of redress. See Jessica Silver-Greenberg, *In Prosecutors, Debt Collectors Find a Partner*, N.Y. TIMES (Sept. 15, 2012), http://www.nytimes.com/2012/09/16/business/in-prosecutors-debt-collectors-find-a-partner.html?pagewanted=all&_r=0&pagewanted=print. District attorneys in more than 300 jurisdictions have partnered with private creditors, such as Walmart, and other debt-collection firms, to issue criminal warnings and sanctions, thereby forcing the public to pay for enforcing contracts that Walmart should pursue privately and putting into the criminal arena what should be civil matters. *Id.*

256. See *supra* note 255. We do not know what percentage of RSLB transactions leave both parties satisfied because those transactions are rarely if ever exposed. Therefore, we only know about the few problematic transactions that surface and appear to represent the norm. See Hoffman, *supra* note 137 (citing an estimate from 2007 in which a supervising investigator for the Los Angeles County Department of Consumer Affairs said that her office had seen approximately fifty cases involving some type of foreclosure scam at a time when 4000 notices of default were published monthly).

257. Barak D. Richman, *Firms, Courts, and Reputation Mechanisms: Towards a Positive Theory of Private Ordering*, 104 COLUM. L. REV. 2328, 2338-40 (2004).

decreasing the stability of contracting.²⁵⁸ The inability to price those outcomes into the contracts accurately robs the contracting partners of the opportunity to allocate risk between themselves as they see fit and to order their affairs in a predictable manner. Criminal regulation leads to expensive over-deterrence through over-compliance,²⁵⁹ which ultimately raises the costs of these transactions to desperate homeowners, destabilizes contracting, and externalizes costs to third parties.

Criminal regulation gives one party an opt-out clause for which he did not have to bargain and which was not, therefore, priced into the contract. In effect, if one party is not satisfied with how the contract turned out, that party can then seek criminal action against the other party.²⁶⁰ For example, the unsatisfied party has two choices: he can bring in criminal authorities to relieve him of having to uphold his end of the bargain, or he can bring in criminal authorities to introduce secondary penalties against his contracting partner that were not originally built into the contract.²⁶¹ This potential for instability, which carries very high stakes, would make the average contracting partner indifferent between having a contract and not having a contract, thus eroding the sanctity of contracting.²⁶²

Criminal regulation creates undesirable externalities. Contracting is further destabilized because these criminalized contracts distribute the costs of the contracts not just to certain outside parties, but to society as a whole, which defeats the purpose of contracting.²⁶³ One socially-beneficial aspect of contracting without criminal regulation is that it allows an allocation of risk and a distribution of costs between the parties involved and to willing insurers. In that case, if the transaction requires a reallocation of resources between the parties, the civil courts alone are the best positioned to do it. If, however, one party is made to bear the costs of the contract in a civil action while also being rendered impotent to pay those costs by a simultaneous criminal action and incarceration, some entity or some group outside of the contract must now absorb costs arising from the contract. The group absorb-

258. Even if an investor pondered that he might be subject to civil or criminal sanctions, it is difficult to predict the impact and scope of a criminal sanction. Moreover, unlike civil judgments, criminal sanctions cannot be insured against.

259. See Part V for a discussion of the exceptional and costly measures taken by investor Timothy Barnett to comply with the requirements of his state's equity purchase statutes.

260. See *supra* note 255.

261. In addition to the RSLB consumer protection example described in this Article, see *supra* note 255.

262. The phenomenon of parties being indifferent between having and not having written contracts could be compounded in criminal fraud cases when the very substance of the contract is being called dispositive of fraud – a second incentive to disfavor contracts.

263. See Steven L. Schwarcz, *Private Ordering*, 97 NW. U. L. REV. 319, 321 (2002) (“[T]he sole motivation for commercial private ordering is to reduce the cost of regulation.”).

ing the costs will be either the title company, which insures the title, or society at large, especially as the public often pays for incarceration costs and judicial and prosecutorial resources. In addition to the widespread distribution of one party's costs, the homeowner is now unable to recover some, if not all, of his appropriate remedy because the payor party is in prison.

B. Exacerbates Market Failure

The judicial and legislative response exacerbates market failure. As a result, this already underserved group of high-equity, pre-foreclosure homeowners becomes even more underserved. The criminal regulation of this type of real estate investment behavior is anti-competitive. Imposing sanctions on small investors to which large investors are not subject is anti-competitive at best, discriminatory at worst.²⁶⁴ The legislative and judicial responses show a clear preference for larger players,²⁶⁵ despite the fact that smaller players are better positioned to fill the void.²⁶⁶

Criminal regulation increases the costs of these contracts in two ways. Investors must increase their compliance efforts, potentially to the point of over-compliance.²⁶⁷ Additionally, while they always had to factor in the probability of a civil violation and the potential size of a civil sanction, investors now also must attempt to calculate the probability of criminal charges and the length of a prison sentence. That cost will be added to the cost of the transactions, some of which will be borne by the investors, some by the homeowners.²⁶⁸ The increased cost of these contracts serves as a barrier to entry for small investors. Indeed, some small investors will decide not to enter the market at all, as the cost of even a first strike in a three-strikes jurisdiction is too great.²⁶⁹ Criminalizing small investors also will require forcing large lenders, who are not burdened by the likelihood of criminal sanctions, to clumsily enter a market they prefer to avoid.²⁷⁰ Or, more likely, the large

264. See *supra* notes 184-185 and accompanying text.

265. See *supra* notes 184-185.

266. See *supra* Part I.

267. See *infra* Part V for examples implemented by Mr. Barnett's firm.

268. How much each party will bear relative to the other is a function of elasticity and other factors which are outside of the scope of this Article.

269. Joanna M. Shepherd, *Fear of the First Strike: The Full Deterrent Effect of California's Two- and Three- Strikes Legislation*, 31 J. LEGAL STUD. 159, 200-01 (2002) (finding that three-strikes laws do, in fact, deter behaviors that may lead to even first strikes).

270. In a recent response to the latest foreclosure crisis, large lenders have begun attempting to provide leaseback solutions similar to those provided by RSLB investors. See FANNIE MAE, SERVICING GUIDE ANNOUNCEMENT SVC-2012-25 (2012), available at <https://www.fanniemae.com/content/announcement/svc1225.pdf> (describing Fannie Mae's Mortgage Release program); see also Lisa Prevost, *Mortgages: The Rental Alternative to Foreclosure*, N.Y. TIMES (Sept. 27, 2012), www.nytimes.com/2012/09/30/realestate/mortgages-the-rental-alternative-to-foreclosure.html (de-

lenders simply will not enter the market and the market will cease to exist. These heightened barriers to entry will exclude otherwise willing investors, making this market even further underserved. The investors who still wish to enter the market would have to raise their costs to compensate them for the added risk. It also drives existing small investors out of the marketplace.²⁷¹ This increased cost of capital would make already-expensive loans even more expensive to the homeowners.²⁷²

Second, criminal regulation decisions are actually distributive decisions, answering the question of who gets to profit from distressed real estate dispositions, and who does not get to profit but goes to jail instead. There is equity in the homes in question. That equity will be divided and distributed at the time of disposition.²⁷³ The foreclosure process distributes most, if not all, of that equity from the homeowner to the large lending bank.²⁷⁴ The RSLB creates a wider distribution of that equity between the homeowner and the investors and gives the homeowner some power in the distributive decision. Criminal regulation of the RSLB transaction, simply, is making the choice that the former distribution has more merit than the latter distribution, which may not be legitimate as it is the latter distribution which provides the best opportunity for the homeowner to salvage any of his equity.

Third, criminal regulation dampens a desirable form of alienation for homeowners who may be most in need of options. Decreasing the access of small investors to the RSLB marketplace eliminates willing contracting partners for these homeowners, essentially eliminating this form of property disposition. Moreover, by artificially dampening the RSLB as a form of alienation of property owned or controlled by homeowners in foreclosure, criminal regulation makes a decision about which types of dispositions of distressed property are more valid than others.

Finally, the use of residential burglary and any other street-crime statutes has a disproportionate impact on real estate investors versus other types of investors, as many real estate negotiations and transactions normally occur inside the properties due to the nature of that industry. Investors in most other fields would not be subject to the residential burglary statute and the accompanying strikes in three-strikes jurisdictions because their choice of investment vehicle conducts its required business in other places. Additionally,

scribing efforts by Bank of America and Citibank to become landlords of their foreclosed homeowners). However, this misguided response is a part of the problem. For example, Fannie Mae has launched its Deed for Lease program, allowing lenders to become landlords of individual foreclosed homeowners, but the program – similarly to other programs like it – does not include a buyback option and requires the homeowner to be employed. *See* Prevost, *supra*.

271. *See* interviews cited *supra* note 1.

272. It is unlikely that, on average and across the population, large banks can serve this market at a lower cost than small investors can. That would require a larger market study than just the few problematic foreclosure rescue cases.

273. *See supra* note 30.

274. *See supra* note 30.

small investors are disproportionately subject to this statute as compared to large lending banks, for whom it is not economically efficient to visit homeowners at their homes. The ability to visit the homes, meet the homeowners, and monitor the negotiations and transactions is a large part of why small investors can do these transactions more efficiently than large lending banks.

Burglary and the strikes which may result are an added risk that will go beyond exacerbating market failure and will virtually eviscerate this transaction from existence as investors, who may have been able to help these homeowners, will flee this market in favor of other investment vehicles.

PART IV: ALTERNATIVES TO CRIMINAL REGULATION

A valid goal of the judicial and legislative response is to fill the trapped equity market void in the least destructive way possible. Filling the trapped equity void would likely protect homeowners from the devastating effects of foreclosure and unscrupulous investors. It would also encourage decent RSLB investors to continue to serve the marketplace. Indeed, filling the void in the least destructive way possible would protect big banks, who are the mortgage holders in this market, without forcing them to contort themselves to fit into this market space. For all of the reasons outlined in this Article, criminal regulation is a poor institutional choice as it really is a means of criminalizing unconscionability and certain other deteriorating contract doctrines.²⁷⁵ With that end in mind, this Article suggests non-criminal alternatives to meet those goals.

Indeed, criminalizing these transactions is an attempt to substitute the logic of one institution for the logic of another institution. The void in the market exists because it is inefficient for large banks to fill it.²⁷⁶ Presently, there is no efficient way to fill the void other than by using small, informal investors. Essentially, the market has responded with the RSLB transaction. To fill the void any other way, including the ways contemplated by the judicial and legislative responses, requires either big, clumsy banks to act nimbly on small scales or requires small informal investors to formalize and increase in size at great financial cost. Currently, big banks operate in the space that rewards scale, volume, and mass-production.²⁷⁷ Small investors operate in the space that rewards quick, nimble, individualized activities that are rela-

275. In asking "Who decides?", Professor Neil Komesar's Comparative Institutional Analysis ("CIA") gets the closest to a working analysis. See NEIL KOMESAR, *LAW'S LIMITS: RULE OF LAW AND THE SUPPLY AND DEMAND OF RIGHTS* (2001) (explaining how the CIA analyzes whether the judiciary, the legislature, or the free-market is best-equipped – or, rather, least poorly-equipped – to resolve various issues).

276. See *supra* Part I (discussing such market void).

277. Mann, *supra* note 14, at 735.

tionship- and contacts-based.²⁷⁸ The criminal regulation response blurs and confounds those niches.²⁷⁹

There are several better solutions to problematic contracts than criminalizing them. These suggestions attempt, in a balanced way, to protect both homeowners from harmful transactions and investors from disgruntled homeowners. These solutions, or some combination of these solutions, would be a more suitable, less expensive, and therefore more efficient means of addressing disputes arising in this marketplace than criminal regulation, while satisfying the state's goal. Additionally, the following proposed solutions spread the burden to both sides of the contracts in that some place an easy burden on the homeowners and others place easy burdens on the investors and banks. These solutions fall into two categories: preemptive and remedial.

Preemptive solutions can be implemented before the transactions take place to ensure that the homeowners and investors are able to minimize undesirable outcomes. Preemptive solutions are most valuable given the goal to protect homeowners who may not have the resources to bring cases to court without the assistance of legal services organizations.

Homeowner education is a viable and inexpensive consumer protection. The homeowners themselves are the first line of defense. Many states and consumer protection agencies publish pamphlets on topics related to consumer protection issues including alleged foreclosure rescue scams.²⁸⁰ However, investor education may also be warranted. To the extent that investors are getting into trouble by making mistakes like poor disclosures, everyone would benefit from increasing access to educative resources.

To combat the allegation that investors are capturing too much of homeowners' equity, the legislature could limit an investor's equity capture in these transactions to, say, 50% or 75% of the total equity. Limits on equity capture would have several beneficial effects. First, limits would keep many honest investors in the marketplace by continuing to allow risk-related premium returns on this investment while driving out the unscrupulous ones. Limits would ensure that homeowners retain a fair portion of their own equity. Limits would also encourage investors to present a fair market value of the property to ensure their own capture of the equity split and maintain good accounting standards.

Additionally, minor licensing and registration requirements of investors who do more than one or two deals would increase accountability and ensure that these investors are known to some supervisory authority. This registering body would be a good way to disseminate educational materials to inves-

278. *See supra* Part I.

279. *See* discussion and sources cited *supra* note 270.

280. *See, e.g.*, FED. DEPOSIT INS. CORP., BEWARE OF FORECLOSURE RESCUE AND LOAN MODIFICATION SCAMS (2009), available at <http://www.fdic.gov/consumers/loans/prevention/rescue/images/rescue.pdf>; THE STATE BAR OF TEXAS, LOAN MODIFICATION SCAM PAMPHLET (2011), available at http://www.texasbar.com/Content/NavigationMenu/ForThePublic/FreeLegalInformation1/Consumer_and_Tenant_Rights1/LoanModificationScam.pdf.

tors. Misconduct could also lead to suspensions and revocations of an investor's registration. Registration would also create a centralized area for complaints.

Although this marketplace is fairly transparent now, to increase the transparency of this marketplace and these transactions even further, changes to the disclosure and recording processes could easily be implemented. For example, a state could require homeowners to handwrite key portions of a required disclosure, as opposed to just putting their signatures on a line. It would be harder for a homeowner to not understand that he is selling his home if he is asked to write out by hand: *I understand that I am selling my home to an investor*. Alternatively, investors could be required to sign sworn certifications that they have clearly made all disclosures to homeowners.²⁸¹ In that instance, investors have an incentive to be very diligent about documenting and proving that they made the appropriate disclosures. The increased accountability would encourage investors to come up with the best solutions to documenting and creating industry norms; however, it still would not change the plaintiff's burden at trial.

Another means of increasing the transparency of the RSLB marketplace would be to require that equity purchase transactions are somehow flagged at the time of recording. Because there can be specific statutes governing the sale of certain properties out of foreclosure,²⁸² it would be easy to require that these transfers be flagged at the time of recording as having arisen out of such regulated transactions. This would expose the transactions to third-party scrutiny from the moment they are recorded right after the original sale instead of years later when the homeowner cannot repurchase the home at the buyback date. At the time of original recording, even a file clerk could make sure the homeowner has received certain informational materials. Or, more intrusively, personnel could be required to look to the terms of the contract and make early determinations about the fairness of the contract. Earlier scrutiny means the contracts could be rectified or renegotiated earlier in the process. It would also be beneficial to require that the repurchase options be recorded along with the recorded conveyance.²⁸³

281. For those who would argue that this creates another possible area of liability for investors, it is important to recall that the investors already bear this burden especially if they go to trial and bear the burden of proving that they made the statutory disclosures. This suggestion simply formalizes the burden up front and is likely to make investors take it very seriously. It also has the very real benefit of creating a set of best practices in the industry as well as establishing market-wide standards of reasonableness with which to compare any one investor's behaviors.

282. See, e.g., MO. REV. STAT. §§ 443.209, .325, .410 (2012).

283. Currently, California does not require the recording of the repurchase option. See CAL. CIV. CODE § 1695.6(e) (forbidding the RSLB investor from encumbering the property without written consent if the homeowner has a repurchase option, but not requiring the investor to record the option so as to encumber the title with the option). In fact, the statutory requirement creates a burden on the option holder to keep informed of the recorded transfers of the property and to then notify subsequent pur-

Additionally, and borrowing from tort theory, it makes sense to put the most responsibility with the entities that have the best and lowest-cost ability to avoid these harms.²⁸⁴ In this instance, the big banks have the best knowledge of the age of the homeowners, whether or not the homeowners are behind on their mortgages, the neighborhood demographics, and the homeowners' incomes. The banks have the most data about these homeowners. They also know before the homeowners which homeowners are likely to be refinanced and which will have no traditional financing alternatives. If a homeowner is going into foreclosure, banks could do several simple things to avoid certain harms. First, the bank could send the homeowner educational information about the sale of his home during the foreclosure process, including information about the statute that governs such sales in that jurisdiction.²⁸⁵ Additionally, for elderly homeowners, the bank could be made to create a special department that deals specifically with the loans of elderly borrowers. That department could easily be trained to look for signs of dementia, undue influence, and other issues affecting the elderly.²⁸⁶ Certainly, the cost of this department and these measures would be distributed across all of the banks' customers; however, at some point, most Americans would be serviced by that department and all could benefit from the added protections. If the bank has a homeowner it knows falls into several of the high-risk categories, the bank has that data long before the investors do. Therefore, the banks should shoulder some of the burden of protecting these homeowners.

There are also several remedial civil solutions. Remedial solutions are those remedies and defenses that would be available to homeowner plaintiffs and investor defendants after a claim has been made.²⁸⁷ They allow judges to provide appropriate remedies to aggrieved parties without having to resort to

chasers that she holds that option. *See id.* This burden is directly at odds with protecting homeowners.

284. *See City of Flagstaff v. Atchison, Topeka & Santa Fe Ry. Co.*, 719 F.2d 322, 323 (9th Cir. 1983) (citing GUIDO CALABRESI, *THE COST OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* (1970); R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960)).

285. Legislation requiring banks to keep homeowners informed about their foreclosure process is already in effect. *Cf.* 12 C.F.R. §§ 1024.1-1026.5 (2013) (requiring disclosures from lenders for many transactions involving credit). The Dodd-Frank Wall Street Reform and Consumer Protection Act has been implemented to strengthen homeowner procedural protections, including transparency of the process. *See* Pub. L. No. 111-203, 124 Stat. 1376-2223 (2010).

286. Nathaniel Nichols argues that some of the duty to identify homeowners in RSLB transactions who have dementia falls on the public notaries who sign off on the transfers. Nichols, *supra* note 4, at 290-92. Even though it is possible that homeowners with dementia make up a small percentage of RSLB transfers, such a discussion is outside of the scope of this Article.

287. *See* Susan P. Sturm, *A Normative Theory of Public Law Remedies*, 79 GEO. L.J. 1357, 1360 (1991). However, remedial solutions are less desirable as they may arise too late in the process because they are not available to the plaintiffs who could not afford to initiate litigation.

criminal sanctions and imprisonment.²⁸⁸ Remedial solutions must also be balanced to protect both homeowners and investors. There are issues that could be addressed at the pleading, testimonial, and sanctioning stages.

Perhaps the most obvious of these solutions would be to strengthen the contract doctrines that have been eroded to the point that criminal regulation is viewed as the only way to punish wrongdoers. For example, if unconscionability and contract fraud have been chipped away,²⁸⁹ the best goal is to strengthen them. While weak contract doctrines have traditionally benefited civil defendants, strengthening those doctrines would likely be preferable to defendants than criminal sanctions.

If criminal regulation has gained favor because evidentiary standards to prove civil unconscionability and contract fraud have become so high that few plaintiffs can meet them, the standards need to be adjusted. If the pendulum has swung too far in favor of defendants, it makes more sense to swing it back slightly rather than to criminalize the activities. The evidentiary questions and the Parol Evidence Rule weakened by the fraud exception can be preempted by the measures suggested above. For example, handwritten statements by homeowners, such as "*I understand that I am now the tenant, not the owner, of this house,*" or "*I understand that the only way to get my house back is to give a new mortgage and buy the house back,*" would go far in preempting evidentiary questions arising under the Parol Evidence Rule at trial.

By strengthening contract doctrines, judges would be re-empowered to use contract avoidance, severance and modifications of contracts, and accompanying damages in ways that punish wrongdoers and protect innocent parties without the cost to society of imprisoning RSLB investors. One tool that judges already have in their arsenal that could be used more broadly is the

288. Some proponents of the deterrence theory of criminalization argue that judgment-proof defendants may only be deterred from certain acts if there is a risk of imprisonment for engaging in the act. See Maurice E. Stucke, *Morality and Antitrust*, 2006 COLUM. BUS. L. REV. 443, 448 (2006). This theory may have merit in certain instances; however, this theory fails to explain criminalizing RSLB investors. Defendants may be considered judgment-proof if they lack financial resources to satisfy cash judgments against them or if their conduct is hard to detect and convict on. See Stephen G. Gilles, *The Judgment Proof Society*, 63 WASH. & LEE L. REV. 603, 606 (2006). However, both theories fail in the case of RSLB investors. Specifically, the theory fails to take into account the social and human capital that these investors have and can bring to bear in generating the funds to pay remedies. *But see id.* at 623-24. In fact, the larger the alleged wrongful scheme of activities, the more valuable is the human and social capital the investor has given the entrepreneurialism, relationship-building and maintenance, and skill required to execute these transactions. That they would be unable to earn enough to pay off their civil judgments is not legitimate as a blanket statement. *See id.* However, this would require that the judgments be deemed non-dischargeable in bankruptcy.

289. *See discussion supra* Part II.

equitable mortgage.²⁹⁰ An equitable mortgage allows a transaction to be re-characterized as a mortgage on equitable grounds if the judge finds that a mortgage instrument is more reflective of the parties' actual intent.²⁹¹ Generally, this is considered a win for the homeowner as it reverses the investors' interests in the homeowner's property; however, it also allows the righting of a wrong, without the investor going to jail.

Another area that could be examined to avoid certain harms is insurance. Currently, title insurance may be used in these cases to undo the title transfers to reinstate the homeowner back into the property.²⁹² Title insurance is purchased by buyers of property to ensure that title is not defective or encumbered in any way.²⁹³ This is important insurance for a buyer, especially if the buyer has outside financing on the property. If that transfer is deemed invalid, title insurance will pay off the buyer's mortgage once the transaction is reversed and title reinstated with the last verified owner.²⁹⁴ Original and secondary RSLB investors can be required to purchase added title insurance coverage to cover RSLB transactions specifically.²⁹⁵ While increased insurance requirements may create moral hazard for the investors, it also puts some of the burden on the insurer to make sure the transactions are

290. See Lawrence R. Ahern, III, *Types of Real Estate Security Devices: The Equitable Mortgage*, in 1 THE LAW OF DEBTORS AND CREDITORS § 8:5 (2014).

291. See *id.* Often courts will find an equitable mortgage in the case of a sale and repurchase option. See, e.g., *Patterson v. Grace*, 661 N.E.2d 580 (Ind. Ct. App. 1996). If the judge finds that the homeowner had no intent to sell his property, but rather intended to get a loan from the investor secured by a lien on the property, the judge can find an equitable mortgage. See, e.g., *Lednum v. Barnes*, 103 A.2d 865 (Md. 1954). In fact, in California, judges are empowered by statute to presume an equitable mortgage in RSLB transactions. See CAL. CIV. CODE § 1965.12 (West 2014). Some scholars overstate the size and scope of the problem by equating rescue transactions with fraud. See Cox, *supra* note 4, at 607; Harold C. Barnett, *Foreclosure Rescue Fraud and Net Benefit Analysis: Making the Case for an Equitable Mortgage* 1 (Nov. 10, 2010) (unpublished manuscript), available at <http://ssrn.com/abstract=1907843>. However, they offer an acceptable solution where there actually is a wrongful act. Again, hand-written disclosures would go a long way in memorializing exactly what a homeowner's intent was at the time of the signing. See FORECLOSURES, *supra* note 4, at § 15.4.1.2.

292. See Noel D. Uri, *The Title Insurance Industry: A Reexamination*, 17 REAL EST. L.J. 313, 314 (1989).

293. See *id.*

294. See generally Harry M Johnson, *The Nature of Title Insurance*, 33 J. RISK & INS. 393 (1966) (providing an overview of title insurance and explaining its operation).

295. This insurance could easily be designed to cover the specific risks and elements of RSLB transactions, which are clearly greater than those of the average transfer. It seems certain that this would be expensive insurance given the difficulty in quantifying this risk. However, the risk being insured against is not the full risk of imprisonment; rather, it is the cost of the property that would be required to pay off the investor's or secondary investor's financing in the event that the home reverts back to the homeowner after litigation.

legitimate, thus focusing an extra set of eyes on the transactions. However, these added costs would most likely be priced into the deals, which get paid for out of the mobilized equity.

Finally, the civil courts should be empowered to remove an investor's right to engage in certain types of real estate transactions going forward if the judge finds a pattern of undesirable behaviors. This would be especially relevant after the implementation of the registration requirement suggested above. Lawyers, doctors, and teachers are all subject to loss or suspension of their professional licenses, which likely affects their professional and personal conduct. Investors who do a certain number of these transactions per year could be required to both register and maintain their good standing or risk loss of privileges.²⁹⁶

Criminalizing wrongful formation, or even breach, of a business contract is an unusual outcome. Specifically, contract law provides remedies for fraudulent inducement, unconscionability, misrepresentation, misunderstanding, mistake and coercion, any of which would be a better framework to assess these cases.²⁹⁷ Where those doctrines have been eroded, the best choice would be to strengthen them, not to cross the bridge into criminal sanctions.

PART V: CALIFORNIA V. BARNETT (2012)

The account below was gleaned from California real estate investor Timothy Barnett, who recently became the first-ever white-collar defendant sentenced to a potential life sentence under a three-strikes law. He was convicted in cases arising from his RSLB transactions. This Author was granted exclusive access to Mr. Barnett and his wife, Kimberly. Over the course of several interviews and written communications, with the Barnetts, they shared their version of what happened in Mr. Barnett's case. During the course of these interviews and communications, Mr. Barnett was, and still is, in a maximum-security California prison. It is the intention here to present what Mr. Barnett would have explained had he testified in his own trial. This account is the only publicly available account of his story.

A. Introduction

In 2012, RSLB investor, Timothy Barnett was sentenced to 33.33 years-to-life, under California's controversial three-strikes law. He was prosecuted for his RSLB transactions using California's residential burglary statute, an enumerated offense in the three-strikes statute. Mr. Barnett's story highlights many of the issues outlined elsewhere in this Article and parallels many, but

296. The constitutionality of this particular taking is outside of the scope of this Article. However, even if it is a taking, it is certainly less of a taking than imprisonment.

297. *See supra* note 130 and accompanying text.

not all, aspects of the generic transaction.²⁹⁸ *California v. Timothy Barnett* (2012) happened in the shadows of the Enron (2001), WorldCom (2002), and Bernie Madoff (2009) cases and went unnoticed by academics. Indeed, while nobody was looking, three-strikes laws turned towards white-collar defendants for the first time in Mr. Barnett's case. A thorough analysis of this case and this type of contracting will help to draw some broader conclusions and will present an example of criminal regulation of contracts gone too far. Mr. Barnett's case may also be the case that starts the evisceration of the RSLB transaction. Indeed, innocent California defendants, who might otherwise have sought their days in court, may plead guilty in a post-Timothy Barnett world.

B. Background

At the time of his arrest, Mr. Barnett had been involved in the Los Angeles real estate community in various capacities for more than thirty years and owned and operated a small real estate investment firm, which did pre-foreclosure investing, traditional loan refinancing, and several other types of real estate investing. This Article and his prosecution deal specifically with his RSLB activities. Mr. Barnett's case is the culmination of events that began in 1991 and ended in 2007, including two early, non-strike prosecutions and a third prosecution that brought him three strikes simultaneously.

Mr. Barnett's first job was as a mortgage broker. On his first day of that job, he was assigned a territory that comprised both the South and West Los Angeles areas. Mr. Barnett was assigned to work in those areas because he knew them well. He grew up in the West L.A. area and his high school sweetheart and now-wife, Kim, grew up in the South L.A. area; so, the couple had spent a lot of time in these communities.

As a mortgage broker, he learned the nuances of the South and West L.A. real estate markets and formed relationships with the major realty and brokerage firms that served those areas. Because of his role as a mortgage broker, he also knew the specific lending requirements and undisclosed red line lending restrictions in these neighborhoods. This is ultimately where he did the bulk of his entrepreneurial investments, starting in his early twenties.

The prosecution would later accuse Mr. Barnett of picking his target areas because the people were poor and unsophisticated. Mr. Barnett rejects the prosecutor's and media's accusation that he preyed with people in order to exploit religious affinity and then dupe them out of their homes. He also rejects the prosecutor's accusation that he chose homeowners in certain

298. Because this is primary research, the account of Timothy Barnett's prosecution is largely the words and versions of Mr. Barnett and his wife, Kim. Interviews of the couple and their children were conducted between September 2012 and Spring 2014 via phone and in-person. In some instances, some facts have been taken from public court records and media accounts. To the extent that this version does not align with the public records, that is because Mr. and Mrs. Barnett never testified.

neighborhoods because the homeowners were poor, minority, or elderly.²⁹⁹ In fact, Mr. Barnett and his wife spent thirty-five years living, working, and socializing in these very communities. Mr. Barnett was active in community groups, and received several awards for his activism in and contributions to these communities. These were neighborhoods to which he felt strong social and community ties and with which he had a personal familiarity and history.

After he married and started his family, Mr. Barnett launched his own company and eventually started doing an early, primitive version of the RSLB transaction as his connections and sources of investment capital grew. He was a good fit for this type of cutting-edge, entrepreneurial transaction because he had the full range of real estate experiences, creativity, and aggressiveness that are required to execute these transactions from acquisition through the leaseback period to the disposition period. Mr. Barnett also had the requisite deep knowledge of particular neighborhoods, broad relationships, access to pools of capital, and what his wife calls "a heart to help people in bad situations." His reward for his entrepreneurial drive and business acumen was a nice home, an office building with his company name on the side, and a comfortable life for his wife and children.

C. The First Prosecution

What Mr. Barnett did not have in those early years was a legal education or adequate counsel. Mr. Barnett concedes that, at the time of his first two cases, he was unaware that there was a California statute, California Civil Code Section 1695, which governed certain aspects of his transactions. This is an example of how an investor's ignorance of the law can get him into significant trouble.³⁰⁰ He would eventually be charged and prosecuted for various violations of that statutory scheme, specifically the Equity Purchase Statute, and, ultimately, burglary, which likely was required to get the jail time for which the Equity Purchase Statute did not provide. Mr. Barnett believes he was guilty of not being organized and formal enough to defend himself. Specifically, he was accused of failing to make required disclosures to homeowners, yet he maintains that he made appropriate disclosures and that the homeowners understood the transactions. However, he was unable to show an orderly set of paperwork as proof because he had done many of his earliest transactions on handshakes and trust. Mr. Barnett's wife says that there was never an opportunity to put on a proper defense due to the quantity and chaos of simultaneous civil cases, Mr. Barnett's incarceration, and the couple's lack of financial resources. She says that the criminal trial did not commence until

299. However, the prevalence of elder homeowners in these transactions may be overstated. In Mr. Barnett's case, despite seventeen potential homeowners solicited by Public Counsel, only one of his convictions involved an elderly adult.

300. The foreclosure rescue industry has advanced since then. Now, there are a couple of memberships and associations for these investors to educate them on the law and to provide services to the investors.

three years after his arrest and that the case had five different district attorneys and four different judges. Fearing that he would bear the brunt of the public outrage over the O.J. Simpson “Not Guilty” verdict, especially since one of his lawyers had been a part of the O.J. trial, Mr. Barnett pleaded guilty in 1997 to the charges. The couple also says that, through it all, the prosecutor never mentioned the second case until thirty days after the plea in the first case, which was contingent upon Mr. Barnett waiving his right to change the plea in the future. Mr. Barnett likely would not have waived the right or accepted the plea had they known the prosecutor was holding the second case. Blindsided by the existence of the second case, Mr. Barnett pleaded guilty to the second set of charges and got a combined sentence for the two cases, which he served.

D. Starting Over

After his sentence and parole were over, and with hard lessons learned, Mr. Barnett re-established his investment business and relationships on what he believed was a sturdier foundation. He had never worked outside of the real estate business, so it was a good place for him to re-establish himself. He stayed in the same market niche, where he had been developing proprietary knowledge and expertise for several years; however, he completely revamped and formalized his operation. At this time, his transaction evolved into something closer to the RSLB transaction described in this Article.

This time, to avoid running afoul of the statutes over which he had stumbled the previous time, he sought to hire experts, at tremendous cost – bringing many of them in-house on salary and retaining others. As a precautionary first step, he hired one of the best law firms in Los Angeles.³⁰¹ Mr. Barnett hired this firm to help him create his Compliance Department, to draft his contracts, and to ensure his company’s compliance with California law. In addition to his in-house counsel, his Head of Compliance, and his Processing Manager, Mr. Barnett brought in, on salary, a Foreclosure Specialist, an Accounting Manager and Chief Financial Officer, and a Sales Assistant. These controls reflect the cost of increased risk and unpredictability in contracts. However, they still were not enough to protect Mr. Barnett from a subsequent prosecution by an aggressive prosecutor.

E. Trouble in Paradise

Mr. Barnett believes his problems arose when one of his tenants, Mr. E.B., was approaching the buyback date. Usually, to complete his transac-

301. The Author is aware of the name of this law firm, but chooses not to include it here. It is, indeed, a very well-known firm with over 1,000 attorneys practicing in over twenty domestic and international offices. It has been ranked at or near the top of various US News & World Reports rankings and specializes in real estate transactions.

tions, Mr. Barnett used some combination of his own funds or those of secondary investors whom he knew well or had worked with before. It was not protocol for a secondary investor to have contact with the homeowner at all; instead, the secondary investors were solely financial partners, leaving the management functions to Mr. Barnett and his staff. However, in Mr. E.B.'s case, Mr. Barnett had not worked previously with this secondary investor. The secondary investor began to contact the homeowner, Mr. E.B., asking the homeowner what his intentions were regarding the buyback and when the homeowner could vacate the property, *if* that was his plan. Mr. Barnett was supposed to be the liaison for all parties because he was the one with the relationships. However, in this case, the secondary investor was becoming uncomfortable with the long-term investment, given the wild swings in real estate market valuations in the mid-2000s. In his panic, he circumvented Mr. Barnett, and all of Mr. Barnett's company controls, to gain direct access to the homeowner. Consequently, the homeowner also began to panic, largely because he did not really know the secondary investor and was not going to be able to repurchase the home, but had not yet made plans to vacate.

F. The Second Prosecution

Feeling pressure from the unknown secondary investor, and rather than contacting and negotiating with Mr. Barnett, Mr. E.B. went to Public Counsel instead to figure out how to avoid having to leave his home at the end of his leaseback period even though he couldn't repurchase the home per the RSLB agreement. In effect, he was asking how to get out of his end of the contract because he either did not like the result or had overestimated his ability to get new financing in what turned out to be an increasingly tough borrowing market.

After being approached by Mr. E.B., Public Counsel found all of the other homeowners through public records searches and contacted all of the homeowners. Because real estate transactions are very open and transparent, due to reporting laws in every jurisdiction, a simple property search would reveal all transactions completed by an investor. Public Counsel sought every homeowner with whom Mr. Barnett had done a similar transaction, including some transactions which had long been closed and completed. Public Counsel then contacted the prosecutor, which set in motion the criminal case that led to Mr. Barnett's ultimate three-strikes conviction. Additionally, several of those homeowners were sought out and offered assistance in filing civil suits against Mr. Barnett. Seventeen of those who were offered assistance filed simultaneous lawsuits against Mr. Barnett personally. Public Counsel again sought the involvement of the District Attorney's Office.

As the civil suits were being filed, Mr. Barnett was arrested on the criminal charges. Despite the larger number of homeowners contacted and/or filing civil suits, only five became involved in the criminal case. There are several possible explanations for this: (1) because only five of them seemed like they would make sympathetic complaining witnesses; (2) because the

statute of limitations had run on others; (3) because the prosecutor could find no wrong-doing to allege in the other cases; or (4) because the other homeowners, whether or not they had repurchased their homes, were satisfied with the results they'd gotten, especially given the risks that they took and the limited options they originally had.

While he was charged in just five of the homeowners' cases, the criminal cases impaired his defense ability in the civil cases. At the time of his arrest, his home and office were raided and searched and all of his documents were seized. Because of his lack of access to his funds and his paperwork, the civil cases all ended up with default judgments, which will likely never be paid. In effect, the legal avalanche overwhelmed Mr. Barnett, and his incarceration made him unable to respond to and defend against any of it. His incarceration also made him unable to pay any of the seventeen default judgments, so the homeowners remain without meaningful remedy. Further complicating the situation were the IRS and the bankruptcy court. Additionally, this series of events started what would result in the collapse of his company, leaving his employees without jobs, and devastating his own family, several of whom worked for the company.

Included in the five criminal cases was Mr. E.B., the original homeowner, who avoided his foreclosure, extracted cash payments out of the transaction, immediately ceased paying taxes and insurance, and paid a monthly rent that was lower than his mortgage payment had been. Also included was Mrs. B.I., whose contract included no rent for the duration of the leaseback period and a future repurchase price that was exactly equal to the market value of the home at the time of the original contract, which means that there was absolutely no escalation of her purchase price nor an exorbitant leaseback rent – two common allegations against RSLB investors. However, after her rent-free period, Mrs. B.I. was contacted by Public Counsel and joined the case anyway. Her entire rent came out of the mobilized equity – resembling a reverse mortgage. Without this option, this particular homeowner would not have been able to save her home at all. Additionally, Mr. Barnett says that, sometimes, the future buyback price can be equal to or lower than the current value of the home. The future buyback price may even be identical to the lesser amount owed on the foreclosure, depending on the negotiations with the homeowner. Mr. Barnett says that, in these cases, what the investor gets is access to the equity to make other investments for the time of the leaseback period, making this a win-win for the parties.

G. The Three-Strikes Sentence

At the conclusion of his final case, Mr. Barnett was convicted by a jury for the theft of, and made to pay restitution equal to, the entire amount of equity present in the homes at the time of the transactions. The prosecutor's calculation, which was wholly accepted by the judge, did not deduct from that amount the cash that was paid to the homeowners at the closing table – like the payment to Mr. E.B., the back real estate taxes that were paid for the

homeowners, the multi-year rental subsidies like Mrs. B.I.'s, or various other liens that those homeowners had accrued and which were paid off from the proceeds of the transactions.

Additionally, Mr. Barnett was given an unprecedented three-strikes sentence of 33.33-years-to-life. Mr. Barnett's first two strikes arose out of one of the earlier cases, in which he was convicted of two counts of burglary because he permissibly entered the homes of two separate homeowners to discuss their real estate deals. Each burglary conviction ended up being a separate strike. There is no indication in the record from the third case, which would arise over a decade after the first cases, that Mr. Barnett had or would have known that he was pleading to strikes in the first cases. Therefore, a third-strike sentence may not have been foreseeable to him. In fact, in the sentencing memorandum from the third-strike case,³⁰² there is argument to the sentencing judge from the prosecutor that the third case should be a third strike, not a second-strike, nor a first-strike. The prosecutor spells out the judge's sentencing options in the third case, including sentencing options for a no-strike sentence, a first strike sentence, a second strike sentence, and a third strike sentence. As urged by the prosecutor, the judge used his discretion to treat the third case as a third-strike case, which permitted the third-strike sentence of 33.33 years-to-life.

H. Other Possible Explanations for Mr. Barnett's Extreme and Unusual Outcome

Mr. Barnett and other observers, who were interviewed for this Article, believe that Mr. Barnett was partly a victim of his own success and that he was targeted because he was a successful investor and colorful character. His case became the subject of extreme media attention.³⁰³ Another argument is that he was a good target for an aggressive prosecutor to build his reputation on. Some have suggested that that Mr. Barnett was merely a scapegoat for an angry public and a frustrated prosecutor in the wake of some very large public fraud and corruption cases and a plummeting real estate market.

Perhaps, there is another economic and mathematical explanation. Both of Mr. Barnett's prosecutions coincided with a market boom, which was followed by a market bust. Specifically, his cases arose between 1991-1995 and 2005-2007. Both periods coincided with a decline in the rate of home price increases that quietly foretold the end of a market boom. During such periods, the first derivative of the home price graph was still increasing, yet the second derivative was declining, which shows that, although the market was still rising, the rate of that increase was slowing down. This, unbeknownst to Mr. Barnett, predicted the market correction that would cause his deals to fall

302. On file with Author.

303. Inflammatory real estate headlines read like tabloids. *See, e.g.,* Hoffman, *supra* note 137; Pfeifer, *supra* note 7.

apart.³⁰⁴ This may also be what precipitated the nervousness of the secondary investor in Mr. E.B.'s case. Although the decreased rate of home price increases is imperceptible to individual investors like Mr. Barnett, banks may be the first to notice it with their algorithms and stop lending. This means the homeowners cannot refinance as they anticipated, cannot repurchase their homes at the buyback date, and suddenly feel duped. This can be exacerbated by the fact that, by the time the cases arise – usually at the time of the failed buyback – potentially two to four years after the original contract and lease-back period, the market correction has happened and the market prices in the old contracts look exorbitant compared to the new market.

*** As of December 2014, Mr. Barnett's case has been reversed and remanded for a new trial. The trial court denied Mr. Barnett's pre-trial request for appointed counsel to replace the retained counsel he could no longer pay. The Court of Appeal of the State of California found this denial to be a violation of Mr. Barnett's Sixth Amendment right to counsel, which amounted to structural error requiring reversal. The Attorney General's Office has yet to indicate how it will proceed.*

304. See generally Shiller, *supra* note 100 (finding almost imperceptible turning points in housing prices starting in 1991 and 2004).