Federal Forfeiture of Real Estate in Practice: A New Form of Eminent Domain?

BY PATRICIA S. WALL, J.D.; CPA, M.B.A., Ed.D.; AND LEE SARVER, PH.D.

INTRODUCTION

In 2009, the United States Department of Justice filed a complaint in federal court in Massachusetts asserting that Motel Caswell should be forfeited under federal law on the ground that it had been used in connection with recent drug activities. The property has been in the family of the owner, Russell Caswell, since the 1950s.[1] He has not been convicted of any crime, and the Department of Justice lists only eight convictions of hotel patrons for drug-related crimes between 2001 and 2008.[2]

The local Tewksbury Police Department provided the Department of Justice with evidence for the forfeiture filing. If the seizure is successful, the local police department could receive as much as 80 percent of the proceeds from the sale of the motel under a federal forfeiture program called "equitable sharing."[3] Last year, $500 million was collected under this program, representing a 75 percent increase over the past ten years.[4]

Mr. Caswell is fighting the forfeiture, and his attorneys argue that the federal government's "equitable sharing program" exceeds the powers given to the federal government by the Tenth Amendment ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people").

Since there is no mortgage or any money owed on his property, Mr. Caswell believes the seizure of his motel is more about money than about drugs.[5]

If innocent people can lose their property in a procedure such as this, is forfeiture law overly broad? Is equitable sharing being abused by government bureaucrats similarly to eminent domain laws? Will Mr. Caswell's court challenge lead to a revision of forfeiture statutes similar to the revision of eminent domain statutes after *Kelo v. City of New London?*[6] This article considers the purpose and constitutionality of forfeiture laws and their impact on property owners. Further, it presents an overview of the law in the majority of jurisdictions, illustrating with the law of Tennessee (the authors' home state).

About the Authors

Patricia S. Wall *is an attorney and a CPA. She received her juris doctor degree in 1979 from the University of Tennessee College of Law, her master's degree in business administration from the University of Tennessee (Chattanooga) in 1987, and her doctor of education degree from Tennessee State University in 2004. She is presently an associate professor of business law at Middle Tennessee State University, and has also has taught accounting and business law at the University of Alabama in Huntsville, St. John's University (St. Vincent's College) and Hofstra University.*

Licensed to practice law in Tennessee and New York, Wall has worked in private practice as an assistant district attorney, and for the Tennessee departments of Commerce and Insurance (Securities Division), Employment Security (in several capacities, including general counsel), Labor (as general counsel), and Safety.

Lee Sarver, Ph.D., *is an associate professor of finance in the Economics and Finance Department at Middle Tennessee State University. He received his doctorate in economics in 1987 from the University of Tennessee.*

BACKGROUND

In 2000, Congress passed the Civil Asset Forfeiture Reform Act of 2000 (CAFRA), which reformed the federal forfeiture system. It enacted two new statutes, 18 U.S.C. 983 (which establishes the procedures and deadlines) and 985 (which sets forth the procedures for judicial forfeiture of real property).[7]

State asset forfeiture law is a creature of statutory construction, with most states modeling their statutes after federal civil forfeiture laws such as 21 U.S.C. 881, which says in part which types of property may be subject to government forfeiture. In addition to facing criminal prosecution, drug dealers and drunken drivers may have their property taken by the government. This is intended to provide a further deterrent to crime and also helps fund law enforcement. Seizing agencies keep the majority of revenue generated.[8]

Some argue that this law creates a conflict of interest for law enforcement. For this very reason, Tennessee has a statute creating a cause of action against an officer seizing in bad faith. In Tennessee (T.C.A. 40-33-215) "bad faith" exists when an officer acts intentionally, dishonestly or willfully, and/or such officer's actions have no reasonable basis in law or fact in regard to the seizure or failure to return seized property. A party prevailing in such an action is entitled to recover reasonable attorney fees and court costs incurred in bringing such an action. Additionally, monetary damages are available but are limited to the rental value[9] of property similar to that seized for the period of time the property was seized, but cannot exceed the value of the property.

Courts generally have attached a classification of "civil *in rem*"[10] to forfeiture cases and determined that a civil proceeding does not depend upon a criminal prosecution.[11] Thus, it is often practical for seizing agencies to bring a civil forfeiture case even when a criminal prosecution is not pursued, because the burden of proof in a civil case ("a preponderance of the evidence") is less than that in a criminal case ("beyond a reasonable doubt"). In *U.S. v. Dusenbury*,[12] the Northern District Court of Ohio found that wholly circumstantial evidence may serve as proof that property is subject to forfeiture. Further, in *U.S. v. $67,220.00 in United States Currency*,[13] the 6th U.S. Circuit Court of Appeals found:

> The aggregation of facts, each one insufficient standing alone, may suffice to meet the government's burden. To determine whether the information is sufficient, a court must "weigh not the individual layers but the 'laminated' total." *United States v. Nigro*, 727 F.2d 100, 104 (6th Cir.1984) (citation omitted).

While not dependent on a criminal prosecution, civil forfeiture proceedings still have a resemblance to criminal proceedings. Many questions have been raised concerning civil liberties and abuses of civil forfeiture statutes. Forfeiture statutes have been challenged for violating due process, equal protection, double jeopardy and the excessive fines clause under the Eighth Amendment. Legislators at the state and federal levels must draft forfeiture legislation to withstand these constitutional challenges, still focusing on the primary goal to deter criminals while providing funding for law enforcement.

Despite a nationwide trend to mediate and settle cases whenever possible, settlement is particularly desirable for both parties in the majority of asset forfeiture cases. Many state statutes and ethical considerations keep the officer(s) directly involved in a seizure from negotiating a settlement. Thus, most seizing agencies have designated a settlement officer.

TENTH AMENDMENT CHALLENGES

The United States has a federal form of government, which means the federal and state governments *share* sovereign power. The Constitution specifically lists powers of the federal government and gives it implied authority to implement these enumerated powers. The Tenth Amendment states:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

The power of state governments to regulate their states in the best interests of the health, safety and welfare of their citizens is known as the state police powers (state regulatory powers). The "Commerce Clause" of the Constitution (Article I, Section 8) allows Congress "to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." Thus, when a state law or regulation interferes with interstate commerce, the federal government often uses this clause to strike it down. Areas of concurrent regulation by the federal government and the states include taxation, spending and police powers. The latter includes regulation of public health, safety and welfare.

In *Watters v. Wachovia,*[14] the 6th Circuit found the Tenth Amendment inapplicable to a state challenge of federal preemption concerning mortgage activities, because the National Bank Act was a valid use of power under the Commerce Clause. The court stressed that the Tenth Amendment only protects powers not specifically given to the federal government. This case was closely watched because of its implications for other areas (e.g., food and drug regulation and consumer law).[15] The U.S. Supreme Court granted *certiorari* because the national bank operated in many states, including Michigan and Connecticut, where there was litigation. The U.S. Supreme Court upheld the decision of the 6th Circuit, finding that Wachovia's mortgage business had to comply only with federal law.

Could the federal government make a similar argument asserting that CAFRA is a valid use of federal power under the Commerce Clause? In a recent case, the U.S. Supreme Court found unanimously that public citizens may invoke the protections of the Tenth Amendment against an assertion of the federal government.[16] Prior to this, only states could do so. In Mr. Caswell's case, he had always cooperated with the state and local law enforcement.

CONFLICT OF INTEREST

Forfeiture is not favored by law, and statutes authorizing it are strictly construed, justifying forfeiture only when the facts fall within both the letter and the spirit of the law.[17] The majority of state statutes, such as Tennessee's, offer an exemption for innocent owners and lien holders. When a Tennessee officer swears out a forfeiture warrant, the statute specifically requires the judge to question the officer concerning: (1) the probable cause that the owner, co-owner or secured party of the property knew that it was of a nature making its possession illegal or was being used in a manner making it subject to forfeiture; (2) the probable cause that the owner, co-owner or secured parties who are not in possession of the property at the time of seizure were co-conspirators to the activity, making it subject to forfeiture; and (3) any other question deemed necessary to determine the legal and factual basis for forfeiture of such owner, co-owner or secured party's interest.[18]

Many states have amended their forfeiture statutes to increase the burden of proof required for forfeiture and/or prohibiting proceeds from going directly to fund law enforcement agencies.[19] Thus, the Department of Justice is entering into "equitable sharing" agreements with local law enforcement and bypassing the state agencies.[20] In Tennessee and most other states (e.g., Massachusetts), there must be a criminal conviction before land or real estate can be seized. In the Caswell case, the federal agents chose to cooperate with the local Tewksbury police department and bypass the state forfeiture agents in gathering evidence for the federal forfeiture. Under the equitable sharing program, the federal agency could share the proceeds with the local government instead of the state agents. It appears that the federal agency chose to do so because Massachusetts state law does not allow such forfeitures without a criminal conviction. Mr. Caswell's attorneys allege that this use of the equitable sharing agreement of the federal government is an unlawful overruling of state power (i.e., the state forfeiture program).

OTHER CONSTITUTIONAL CHALLENGES

The Fourth Amendment provides protection against unreasonable searches and seizures:

> The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue, but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

Some advocates of civil liberties have characterized forfeiture programs as "policing for profit" and in violation of the Fourth Amendment.[21]

In some jurisdictions—for example in Tennessee—the forfeiture statutes do not require the government to trace the seized property to a specific illegal transaction.[22] Still, the government must show some connection between the seized property and criminal activity.[23] A Louisiana appellate court held that funds intended to be used to further illicit drug transactions are subject to forfeiture, even if substantial amounts of drugs are not present.[24] The eastern district court of New York held that the presence of drugs, scales, drug manufacturing materials and residue, together with the seized property, is probative of its connection to illicit drug trade.[25] Further, in *U.S. v. $67,220.00 in United States Currency*,[26] the 6th Circuit found that even carrying great amounts of cash shows some relationship to illegal drugs for forfeiture purposes.

Mr. Caswell's attorneys assert that the federal government's equitable sharing agreement violates the Eighth Amendment, which prohibits excessive bail and fines, and cruel and unusual punishment. In *United States v. Bajakajian* (118 S. Ct. 2028 (1998)), the U.S. Supreme Court found that the amount of the forfeiture must bear some relationship to the gravity of the offense it is designed to punish. To forfeit a million-dollar motel without a criminal conviction of the owner seems excessive in Mr. Caswell's case.

The Tennessee Supreme Court held in *Stuart v. Dept. of Safety* that civil *in rem* forfeiture proceedings were subject to excessive fines analysis and adopted a proportionality test. The *Stuart* court found that the following factors should be considered:

- the harshness of the penalty compared to the gravity of the offense;
- the harshness of the penalty compared to the culpability of the claimant; and
- the relationship between the property and the offense, including whether use of the property was (a) important to the crime, (b) deliberate and planned or merely incidental and fortuitous, and (c) extensive in terms of time and spatial use.[27 28]

The Caswell forfeiture does not appear to meet the proportionality test under Tennessee and other states' laws.

VALUING RISK AND TIME

Settlement is always an alternative to trial. Two inputs to this decision are (obviously) the probability of winning at trial and (less obviously) the time value of money. The greater the likelihood of winning, the less desirable it is to settle. Conversely, the lower the probability of winning, the more benefit can be salvaged by settling. Hence, the choice is, in actuality, not one between a settlement offer and a full-value forfeit awarded by the court, but between the settlement offer and the *expected* award, which must be *less* than the full value whenever victory is less than certain. The expected value for any period is the average of all possible outcomes for that period, each weighted by its probability:

$$\hat{D} = \sum_{i=1}^{n} P_i D_i = P_1 D_1 + P_2 D_2 + \cdots + P_n D_n$$

where D_i is a possible dollar award, P_i is its probability (from zero to one, inclusive) and i indexes outcomes. In legal matters these probabilities are normally subjective (e.g., based on previous experience with a particular judge or hearing officer). A risk-averse individual (using his own money) will accept less than the expected settlement—the certainty equivalent—in order to avoid the uncertainty. However, an agent with nothing to lose personally is more likely to resist settlement and "go for broke." Settlement negotiations that result in receipts greater than or equal to the expected award should be considered successful. The process may be illustrated simply. Suppose that $1,000,000 is at stake and the odds are thought to be even. Thus, winning means receiving a forfeiture award of $1,000,000, while losing means receiving nothing. The expected award is $500,000, as calculated in the following table:

Figure 1

OUTCOME	AWARD	PROBABILITY	PRODUCT
Win	1,000,000	50%	$500,000
Lose	0	50%	0
Sum			$500,000

Source: Lee Sarver

The risk-averse individual described above would refuse to invest as much as $500,000 in this suit, since that would reduce his expected net payoff to zero, which he can achieve simply by doing nothing and without having to endure any uncertainty. For a risk-averter, breaking even is not good enough.

The second factor, the time value of money, is important because it is always better to receive money sooner rather than later (and, naturally, to pay later rather than sooner). For example, it is less desirable to receive $1,000 a year from now than to receive the same amount now. Any future cash flow is always worth less than the same cash flow received earlier, for the simple reason that if it were available earlier, it could be invested to earn a return and generate income. The rate of return foregone by waiting for later receipt is an "opportunity cost" and is used as the (penalty) rate charged against future cash flows, in order to discount them back to a present value:

$$PV = \sum_{t=1}^{n} \frac{\hat{D}_t}{(1+r)^t} = \frac{\hat{D}_1}{1+r} + \frac{\hat{D}_2}{(1+r)^2} + \cdots + \frac{\hat{D}_n}{(1+r)^n}$$

where D_t is the cash flow expected to be received in period t (discussed above) and r is the periodic discount rate (here assumed constant). The riskier the cash flows (the more uncertain their eventual actual values), the higher should be the discount rate. Settlement negotiations that result in receipts greater than or equal to the present value should be considered successful. Although the details of time value are frequently overlooked in law (e.g., structured settlements, simple interest), it becomes more important the larger are the dollar amounts involved, the more time is likely to elapse before any award, the higher the prevailing interest rate (discount rate) and the more frequently interest is compounded.

An example will illustrate. Recall the $500,000 expected award derived above. Suppose that for various reasons, a hearing cannot take place for a year. Suppose further that the discount rate is 10 percent, compounded annually. Under these circumstances, the litigants should be indifferent about receiving the $500,000 in one year or $454,545.45 now:

$$PV \text{ (of \$500,000 to be received in 1 year at 10 percent)} = \frac{\$500{,}000}{1.10} = \$454{,}545{,}45$$

If it is necessary to wait two years for the $500,000, it is worth only $413,223.14 today:

$$PV \text{ (of \$500,000 to be received in 2 years at 10 percent)} = \frac{\$500{,}000}{(1.10)^2} = \$413{,}223.14$$

Although seized cash is used in these examples, these techniques apply equally well to any property: jewelry, boats, automobiles, aircraft or real estate. For automobiles, resale values can be derived from the NADA *Official Used Car Guide*, with allowance for depreciation. Other property might require an appraisal.

To summarize, the decision to settle and the size of the settlement should be informed by the chance of success at trial and the likely delay before trial. Settlement is more desirable when trial victory is less likely. Even given the likelihood of winning at trial, an expected long delay and high discount rate may make early settlement more desirable than going to trial. Finally, any settlement negotiation resulting in receipts at least as large as the discounted present value of the property at stake should be considered successful.

KNOW WHEN TO FOLD 'EM

Normally, the central issue in finance is valuation: How much is something worth? However, in the case of forfeiture, there is no voluntary exchange of property for consideration. Instead, the value of the property becomes a parameter and the central issue is the determination, incumbent on both sides, of how much time and effort to invest in pursuing or resisting the forfeiture. Naturally, the value parameter influences the decisions: Other things being equal, the greater the value, the more time and effort will be expended by both sides—in the limit, taking the matter all the way to the U.S. Supreme Court. Each side faces considerations in addition to the object's value—notably, costs—which will also influence their decisions. These are all amenable to cost-benefit analysis.

The prosecution's decision is simple. On the initial assumption that the state's marginal cost is zero—because the staff is already on the payroll and the case at hand will not divert them from any other remunerative projects (i.e., its opportunity cost is zero)—the prosecution will never stop short of final victory or defeat, as long as the object being forfeited has any value. Any positive marginal benefit—however small or improbable—will always exceed a zero marginal cost. However, in the more likely case that the marginal cost of prosecution is positive, a more familiar decision emerges: stop (settle) when (if) the marginal cost equals the marginal revenue, which may occur before a final judicial decision is reached.

This is illustrated in Figure 2, below. A zero marginal cost is indicated by a heavy blue line running along the horizontal axis. If the marginal benefit of prosecution is positive and constant—because the value of the asset being forfeited is unaffected by the proceedings or passage of time—there is no intersection and the state will continue until a final decision is reached. If the marginal benefit is positive but diminishing (represented by the heavy black line descending from the left)—perhaps due to neglect of the asset under forfeiture—the state will pursue its goal until a point such as ***A*** is reached, unless the proceedings end earlier, in a final court decision or refusal of appeal or larger settlement offered by the defense. If the marginal cost is positive (rising heavy blue line), the state will end its effort at a point such as ***B*** or ***C***, which may occur before a court renders a final verdict.

The defendants' decision may be explored in a parallel fashion. If they are more interested in principle than in money, or have unlimited resources—perhaps the support of a foundation or interest group—they will behave as if their marginal cost were zero, and pursue the matter until it ends in a final court decision or a point like ***A***. Otherwise, with limited resources, an interior solution, such as points ***B*** or ***C***, is likely.

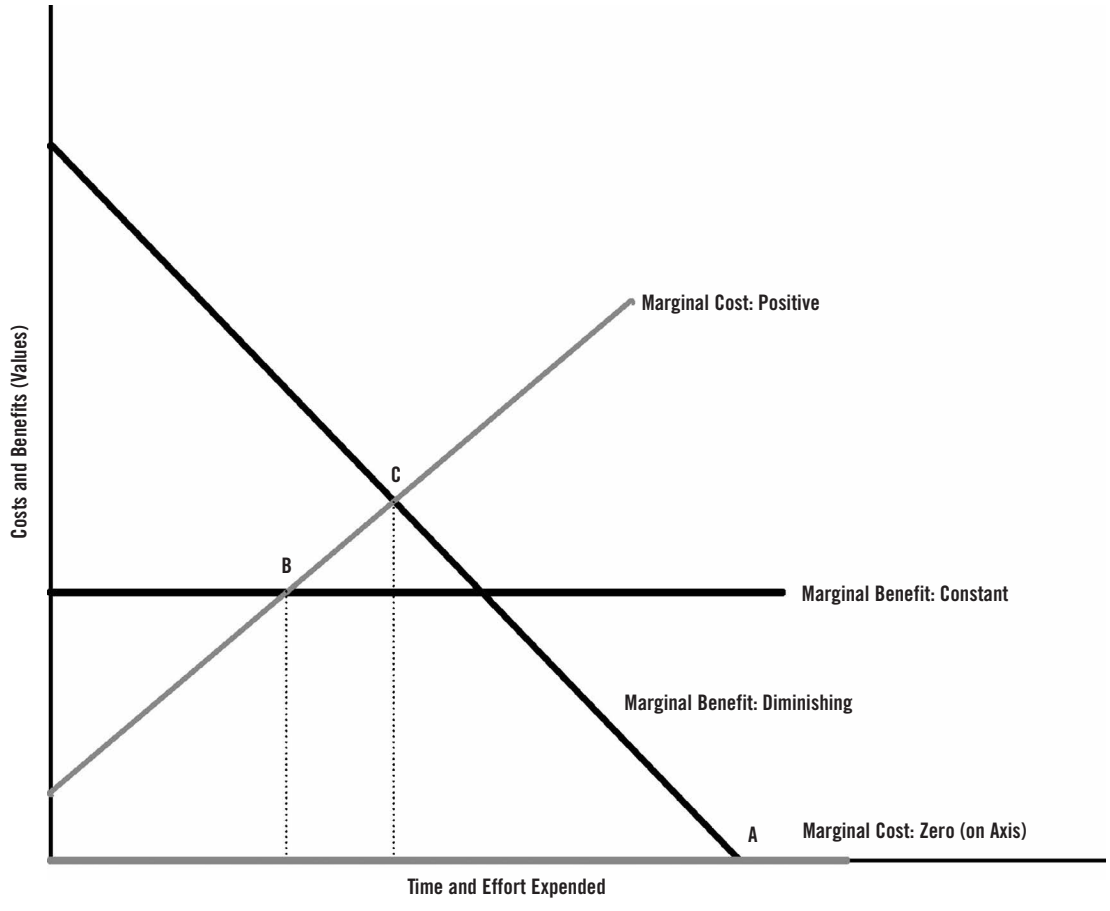
Combining these considerations, one may conclude—rather obviously—that a forfeiture case is most likely to make a complete trip through the court system only if both parties have sufficient resources. If the parties' resources are mismatched, the one with the deeper pockets will be able to persevere longest and is most likely to prevail. However, as noted previously, the majority of asset forfeiture cases are settled at some point during the proceedings.

CONCLUSIONS

What does all this mean for owners of real estate? Naturally, they should be as aware as possible of what is occurring on their property. However, this is not always possible in rental situations, where it is necessary to respect tenants' privacy. If one does suspect illegal drug activity, one should immediately contact and cooperate with local law enforcement. This is necessary in order to maintain the innocent owner defense (as Mr. Caswell alleges he did). If a good innocent owner defense is impossible, one should consider settling the case. Property owners in real estate forfeiture cases are arguably worse off than property owners in eminent domain cases, in which the owners are paid at least a certain amount for their property. As for the objective, legal question raised initially: It cannot be answered until the courts have finished their work. ■

Figure 2

Continue to Litigate—or Settle?



Source: Lee Sarver

ENDNOTES

1. See "Motel is Latest Stopover in Federal Forfeiture Battle," *The Wall Street Journal*, pp. 1, 14, Oct. 18, 2011.
2. Ibid.
3. Ibid.
4. Ibid.
5. Ibid.
6. 545 U.S. 469 (2005).
7. Some of the key provisions of CAFRA are as follows: (1) The seizing agency has 60 days from the date of seizure to send notice of the administrative forfeiture to all persons with an interest in the property. (2) A "supervisory official in the headquarters office of the seizing agency" can grant a one-time 30-day extension for sending notice. Any further extensions must be granted by the court, and for no more than 60 days. (3) Claimants must file a claim within 30 days and identify the specific property and their interest in the property. (4) The U.S. Attorney has 90 days from the date the claim is filed to file a civil complaint and/or to include the property in a criminal indictment. (5) Admiralty Rules will still govern the filing of civil forfeitures and lack of probable cause at the time of filing is no longer a valid basis for a motion to dismiss. (6) In criminal forfeitures, the government must re-seize the property under Section 853(f), although it is already in government custody. (7) Under Section 985 (post and walk policy), all civil forfeitures of real property must be judicial. (8) If the government seeks possession of the property before trial, then a hearing is required. If this hearing is *ex-parte* because of exigent circumstances, there must be a prompt post-seizure hearing where the claimants can be heard. (See Patricia S. Wall & Lee Sarver, "Asset Forfeiture in Practice: Legislative Reform and Financial Considerations," *Tennessee Bar Journal*, April 2001, for a more complete discussion).
8. Ibid..
9. " … consideration paid under the lease for the right to occupy, or the royalties or return received by a lessor (landlord) under a license to real property." *Ballantine's Law Dictionary*, p. 450.
10. Jurisdiction over property as opposed to a person.
11. *Stuart v. State,* 963 S.W. 2d 28 (Tenn. Supreme Ct., 1998.) See also *Calero-Toledo*, 416 U.S. at 683-86.
12. 80 F. Supp. 2d 744 (N.D. Ohio 1988).
13. 957 F.2d 280 (6th Cir. 1992).
14. 127 S. Ct. 1559, 2007.
15. See *Wyeth v. Levine*, 555 U.S. 555, March 2009. The Food and Drug Administration's approval of products and warnings does not pre-empt product liability suits in state court.
16. *Bond v. U.S.*, 564 U.S., 2011.
17. *Williams v. City of Knoxville*, 220 Tenn. 257, 416 S.W. 2d 758, 1967; *Biggs v. State,* 207 Tenn. 603, 341 S.W. 2d 737, 1960; *Blackman v. Norris*, 775 S.W. 2d 367 (Tenn. App. 1989).
18. Tennessee Code Annotated, 40-33-204 (b)(2).
19. See "Fighting Civil Forfeiture Abuse," *http://www.ij.org/about/4059.*
20. Ibid.
21. Op. cit. at 16.
22. *Lettner v. Plummer*, 559 S.W. 2d 785, 1977.
23. *Goldsmith v. Dept. of Safety*, 622 S.W. 2d 438, 1981.
24. *Louisiana v. Douglas*, 541 So.2d 285 (La. App. 1989).
25. *U.S. v. U.S. Currency Amounting to Sum of $20,294.00 More or Less*, 495 F. Supp. (E.D.N.Y. 1980).
26. Op. cit. at 10.
27. *Stuart v. State,* 963 S.W. 2d 28 (Tenn. Supreme Ct., 1998). See also *Calero-Toledo*, 416 U.S. at 683-86.
28. Op. cit. at 7.