The Sixth Circuit's Lingering Mystery of **Fifth Amendment Practical Undercompensation**

By Neal Nusholtz

The eminent domain power of government to take property for public use dates back at least to Rome in the fifth century C.E.[1] Recently, British medieval historian Susan Reynolds wrote a book looking at various countries trying to find the source of this power.[2] One explanation for eminent domain given by Dutch natural rights judicial philosopher Hugo Grotius (1583–1645) is that the community establishes property rights and, therefore, has a higher right over the property of its members.[3] The United States Supreme Court has said that eminent domain is justified because the purposes of government might not be accomplished "if the obstinacy of a private person, or if any other authority, can prevent the acquisition of the means or instruments by which alone governmental functions can be performed."[4]

In the 1983 case *United States v Rodgers*,[5] a man and his wife shared one-half ownership of a Texas home; only the man owed federal taxes. The Supreme Court decided that under the eminent domain power[6] and 26 USC 7403,[7] the government could have a district court order the sale of the home to pay the husband's taxes with the wife receiving the value of her interest. Valuing the wife's homestead interest would be difficult, the Court opined. She might not receive enough money to replace what she had before the sale.

Practical undercompensation

The Court referred to the wife's shortfall as "practical undercompensation" and said it is one of four factors that should be balanced by district courts before ordering the sale of a home.[8] The occurrence of practical undercompensation was a reason not to order the sale of the home. The *Rodgers* case was remanded for the four-factor analysis on whether the sale should occur. A four-justice minority agreed that § 7403 permitted the forced sale of property not owned by a delinquent taxpayer, but disagreed on whether the wife's property could be sold if the husband could not have sold it himself.

The Court's discussion about valuing the wife's interest began with a warning: "[I]n practical terms, financial compensation may not always be a completely adequate substitute for a roof over one's head."[9] The Court noted for comparison the case *United States v 564.54 Acres of Land*,[10] which was decided four years before *Rodgers* and addressed whether a church could receive replacement cost as just compensation for the condemnation of its summer camps. The summer camps had a fair market value of $740,000 but would cost $5.8 million to replace because of recent regulations that applied only to new camps. Under the Fifth Amendment, just compensation does not require replacement cost for condemnees who are not states or their subdivisions.

The *Rodgers* Court gave two reasons for why the calculation of the wife's life estate in the home might fall short of the amount needed to make an innocent spouse whole:

> First, the nature of the market for life estates or the market for rental property may be such that the value of a homestead interest, calculated as some fraction of the total value of a home, would be less than the price demanded by the market for a lifetime's interest in an equivalent home. Second, any calculation of the cash value of a homestead interest must of necessity be based on actuarial statistics, and will unavoidably undercompensate persons who end up living longer than the average.[11]

The Supreme Court gave an example of how valuation of a wife's life estate in the home could be calculated:

> [If] a standard statutory or commercial table [at] an 8% discount rate is appropriate in calculating the value of that estate, then three nondelinquent surviving or remaining spouses, aged 30, 50, and 70 years, each holding a homestead estate, would be entitled to

> approximately 97%, 89%, and 64%, respectively, of the proceeds of the sale of their homes as compensation for that estate.[12]

Section 7403 does not require district courts to order the sale of property. The *Rodgers* Court said, however, that district courts have only limited discretion not to order a sale based on balancing four factors: (1) whether the government will be prejudiced by nonsale; (2) whether the innocent spouse has a legally recognized expectation of nonsale; (3) "the likely prejudice to the third party, both in personal dislocation costs and in the sort of practical undercompensation described *supra*"; and (4) the relative character and value of the interests.[13]

Inadequate just compensation

To date, no other case has held that replacement cost is a precondition to the exercise of the eminent domain power. In cases involving the taking of property, the government compensates only for what it acquires and not for what is lost by the condemnee.[14] Compensation for a taking does not include lost business profits, moving expenses, loss of goodwill, out-of-pocket expenses or consequential damages, or other financial losses.[15] Under the Fifth Amendment, the "principle of indemnity has not been given its full and literal force."[16] The Supreme Court has said that the term "just" is a limitation on the amount paid by "the public that must pay the bill[.]"[17] One theory for the limitation on damages is that to promote growth, courts had fashioned a rule to distinguish between direct damages and consequential damages, and only allowed the former as just compensation.[18]

In *Kelo v City of New London*,[19] the Court decided 5–4 that a city could use its eminent domain power to buy land under the just-compensation rules and turn the land over to Pfizer for economic development. (Pfizer is a biopharmaceutical company that recently

fast facts

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The Sixth Circuit dodged the critical question of the meaning of practical undercompensation while affirming a lower court decision that had addressed the issue.

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attempted to avoid U.S. taxes with a corporate inversion.) During oral argument, three of the justices noted the inadequacy of just compensation, particularly when the property is being sold to a private party in the absence of public use.

> JUSTICE KENNEDY: Let me ask you this, and it's a little opposite of the particular question presented. Are there any writings or scholarship that indicates that when you have property being taken from one private person ultimately to go to another private person, that what we ought to do is to adjust the measure of compensation....[20]
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> JUSTICE BREYER: That's true. But now, put yourself in the position of the homeowner. I take it, if it's a forced sale, it's at the market value, the individual, let's say it's someone who has lived in his house his whole life. He bought the house for $50,000. It's worth half a million. He has $450,000 profit. He pays 30 percent to the Government and the state in taxes, and then he has to live somewhere. Well, I mean, what's he supposed to do? He now has probably $350,000 to pay for a house. He gets half a house because that's all he is going to do, all he is going to get for that money after he paid the taxes, or whatever. And I mean, there are a lot of -- and he has to move and so forth. So going back to Justice Kennedy's point, is there some way of assuring that the just compensation actually puts the person in the position he would be in if he didn't have to sell his house? Or is he inevitably worse off?[21]
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> JUSTICE SOUTER: I mean, what bothered Justice Breyer I guess bothers a lot of us. And that is, is there a problem of making the homeowner or the property owner whole? But I suppose the answer to that is that goes to the measure of compensation which is not the issue here.[22]

The above statements by the justices in *Kelo* help explain the significance of the third balancing factor in *Rodgers* where there was a sale of a home to a private party without public use.[23] Expanding eminent domain power to the private sale of a home to help pay someone else's taxes is harmless as long as the innocent spouse is made whole. If the spouse is not made whole, then that is a reason under *Rodgers* not to order a forced sale.

Sixth Circuit law

The Sixth Circuit has decided that a wife's homestead interest is valued at one-half of the net selling price of the home.[24] An actuarial calculation, like the one supplied by the Supreme Court in *Rodgers*, was rejected in *United States v Barr*:[25]

> The Supreme Court thus based its choice of valuation method on the fact that "any calculation of the cash value of a homestead interest must of necessity be based on actuarial statistics." No such necessity exists here, and Mrs. Barr presents no compelling reason why this court should not apply the presumption of equal spousal life expectancy implicit in Michigan law.[26]

Under *Barr*, a wife is only entitled to one-half of the net sale proceeds, regardless of her age and her likelihood of inheriting a Michigan entireties home free and clear of the tax lien.[27]

If under *Barr* a spouse is only entitled to 50 percent, then what happens under *Rodgers* if "the nature of the market for life estates or the market for rental property may be such that the value of a homestead interest, calculated as some fraction of the total value of a home, would be less than the price demanded by the market for a lifetime's interest in an equivalent home"? More importantly, how can we determine the "market for a lifetime's interest in an equivalent home" when there is no market for life estates in homes?

That issue was addressed in *United States v Davis*,[28] where the cost of a life estate in an equivalent home was determined by uncontradicted affidavits supplying two specific numbers: the monthly rental cost of the home (as obtained from a real estate agent) and the cost of a lifetime annuity to pay the rent based on the age of the spouse and for the spouse's lifetime (as obtained from a life insurance agent). The cost of that annuity is a commercially available market value of a lifetime's interest in an equivalent home. Specifically, the home in the *Davis* case was projected to sell for $400,000 and the cost of an annuity to pay the rent on the home over the lifetime of the spouse was $299,193.36—far more than half the selling price. The other three *Rodgers* factors were deadlocked in a tie. If practical undercompensation existed, then the *Rodgers* balancing factors would weigh against a sale.

The district court in *Davis* rejected the annuity valuation as practical undercompensation and ordered a forced sale, saying:

> This [practical undercompensation] would be true for every non-liable spouse in every tax foreclosure case, because the spouse's one-half share of the sale price of the couple's home would never be sufficient to purchase a new home of the same kind, or to generate

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> enough income to pay the rent for such a home for one's lifetime. Something more prejudicial than this must be shown....[29]

On appeal, the Sixth Circuit affirmed the lower court. The Sixth Circuit restated the replacement cost issue[30] as follows, and said the issue as stated had already been decided in the *Barr* case.

> Diane Davis argues that she will suffer practical undercompensation from the sale of the entire property because she has a longer life expectancy, and thus a greater interest in the property, than her husband.[31]

The Sixth Circuit dodged the question while affirming a lower court decision that had addressed the issue.

Takings compensation in the colonies

The power of eminent domain has expanded over time, both widening the circumstances when it can be asserted and narrowing the compensation that need be paid. An application of the practical undercompensation rule by the Sixth Circuit would have brought us closer to what existed at the time the Fifth Amendment was drafted when compensation for colonial takings was in the form of traditional damages that would make a claimant whole.[32] Here are examples of condemnation law in the colonies:

- The 1648 General Lawes and Libertyes of Massachusetts Statute authorized roads, but required that "if any man be thereby damaged in his improved ground the town shall make him reasonable satisfaction."[33]

- The 1669 Fundamental Constitutions of Carolina provide that buildings or highways could be constructed, but "[t]he damage the owner of such lands (on or through which any such public things shall be made) shall receive thereby shall be valued, and satisfaction made by such ways as the grand council shall appoint."[34]

- In 1715, North Carolina law provided for roads and the payment of "[d]amages which shall be sustained by any private Person in laying out such Road."[35]

- A 1715 South Carolina statute provided that people who had property taken for the Yamassee War "may have just satisfaction for all damage which may accrue to them while made use of by the publick."[36]

- A 1785 Virginia road statute required a jury "to view the lands through which the said road is proposed to be conducted, and say to what damages it will be to the several and respective proprietors and tenants."[37]

- Another 1785 Virginia statute provided for a bridge and payment of "the damages which the persons holding lands may sustain by means of building the said bridge."[38]

Except for Massachusetts, no colony appears to have paid compensation when it built a state-owned road across unimproved land. Legislatures provided compensation only for enclosed or improved land.[39] Even the failure to pay for roads on unimproved land implies that traditional damages were at issue in condemnation proceedings because putting a road on unimproved land probably makes the land worth more. In fact, in Massachusetts, which had allowed damages for roads on unimproved land, one man wrote an angry pamphlet complaining about how a jury assessing damages had decided he would get nothing because his property increased in value by more than his loss from the taking of his land for the road.[40]

Conclusion

Given that damages were already available for public takings at the time of the American Revolution, the Fifth Amendment Just Compensation Clause did nothing more than eliminate sovereign immunity from damage claims for takings of private property. Assuming the

Fifth Amendment was not crafted to reduce existing property rights, the *Rodgers* practical undercompensation test is much closer to what was intended by the framers of the Fifth Amendment than the Sixth Circuit rule, which permits the forced sale of someone's homestead to help pay someone else's tax liability with compensation of only one-half the net selling price. ■

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ENDNOTES

1. Reynolds, *Before Eminent Domain: Toward a History of Expropriation of Land for The Common Good* (Chapel Hill: University of North Carolina Press, 2010), p 16.
2. *Id.*
3. *Id.* at 95.
4. *Kohl v United States*, 91 US 367, 368; 23 L Ed 449 (1875).
5. *United States v Rodgers*, 461 US 677; 103 S Ct 2132; 76 L Ed 2d 236 (1983).
6. The forced sale is "the exercise of a sovereign prerogative...." *Id.* at 697. "§ 7403 makes no further *use* of third-party property interests than to facilitate the extraction of value from those concurrent property interests that *are* properly liable for the taxpayer's debt." *Id.* at 697 (emphasis added).
7. Section 7403 allows the forced sale of any property in which a delinquent taxpayer has an interest.
8. *Rodgers*, 461 US at 710–711.
9. *Id.* at 704.
10. *United States v 564.54 Acres of Land*, 441 US 506; 99 S Ct 1854; 60 L Ed 2d 435 (1979).
11. *Rodgers*, 461 US at 704.
12. *Id.* at 698–699.
13. *Id.* at 710–711.
14. *Monongahela Nav Co v United States*, 148 US 312; 13 S Ct 622; 37 L Ed 463 (1893).
15. *United States v Gen Motors Corp*, 323 US 373, 379; 65 S Ct 357; 89 L Ed 311 (1945).
16. *564.54 Acres of Land*, 441 US at 510–511.
17. *United States v Commodities Trading Corp*, 339 US 121, 123; 70 S Ct 547; 94 L Ed 707 (1950).
18. Treanor, *The Origins and Original Significance of the Just Compensation Clause of the Fifth Amendment*, 94 Yale L J 694, 716 n 124 (1985).
19. *Kelo v City of New London*, 545 US 469; 125 S Ct 2655; 162 L Ed 2d 439 (2005).
20. Oral Argument Tr, 22:6–12, February 22, 2005 <http://www.supremecourtus.gov/oral_arguments/argument_transcripts/04-108.pdf> (accessed July 10, 2017).
21. *Id.* at 48:5–24.
22. *Id.* at 49:13–18.
23. Unless there is a statutory provision, just compensation does not include personal dislocation costs. *Norfolk Redevelopment & Housing Auth v Chesapeake & Potomac Tel Co of Virginia*, 464 US 30, 36–37; 104 S Ct 304; 78 L Ed 2d 29 (1983).
24. *United States v Barr*, 617 F3d 370 (CA 6, 2010).
25. *Id.*
26. *Id.* at 374 (citation omitted).
27. "[D]ifferences in life expectancy do not result in different survivorship interests." *Id.* The Third Circuit has disagreed with using 50 percent to value a spouse's interest. *United States v Cardaci*, 856 F3d 267 (CA 3, 2017). The Third Circuit requires the use of joint actuarial tables when valuing a spousal interest. Ironically, in reaching its 50 percent valuation, the Sixth Circuit in *Barr* relied on the Third Circuit's *Popky v United States*, 419 F3d 242 (CA 3, 2005). The *Popky* case involved splitting marital property after it had been sold and turned into cash. The Third Circuit distinguished *Popky*, saying "there can be no life estate in cash as there can in real property." *Cardaci*, 856 F3d at 278. That quoted statement from *Cardaci* can be explained by borrowing the economic terminology of "rivalrous goods." Rivalrous goods are ones for which use by one party diminishes use by another. When two people have an equal interest in cash, their interest is worth one-half of the cash. A dollar more for one means a dollar less for the other, and the addition of both valuations cannot exceed 100 percent. But when a married couple has an equal interest in a home, use by one rarely diminishes use by the other. Suppose the value of the use of the home by each spouse is 75 percent of the selling price of the home. If that is a reasonable valuation of their respective interests, the sum of their interests will exceed 100 percent, and that can happen when the use of the home valued is a nonrivalrous use. When the *Popky* property was turned into cash by sale, the cash economically became a rivalrous good, and this explains why "there can be no life estate in cash as there can in real property."
28. *United States v Davis*, unpublished opinion of the US District Court for the ED Michigan, issued April 29, 2015 (Docket No. 13-11245).
29. *Id.* at 2.
30. In *United States v Winsper*, 680 F3d 482 (CA 6, 2012), a spouse alleged but could not prove that her share of the sale proceeds would "not permit [her] to relocate to other reasonable housing." The quality of housing someone can afford is not the measure of undercompensation which is "a lifetime interest in an equivalent home." *Id.* at 491.
31. *United States v Davis*, 815 F3d 253, 258 (CA 6, 2016).
32. "Unless there is some artificial rule of law which has taken the place of natural justice in relation to the measure of damages, it would seem to be quite clear that the claimant ought at least to be made whole for his losses and expenditures." *United States v Behan*, 110 US 338, 344; 4 S Ct 81; 28 L Ed 168 (1884).
33. Ely Jr., *That due satisfaction may be made: the Fifth Amendment and the Origins of the Compensation Principle*, 36 American J of Legal History 1 (1992).
34. *Id.* at 4.
35. *Id.* at 8.
36. *Id.* at 13.
37. *Id.* at 5.
38. *Id.* at 14.
39. *The Origins and Original Significance*, 94 Yale L J 694.
40. Parsons, *A Consideration of Some Unconstitutional Measures, Adopted and Practiced in this State* (Newbury-Port: John Mycall, 1784).